

Examiner's report

P6 Advanced Taxation (UK)

December 2011



Introduction

The performance in the December 2011 exam was not as strong as that of recent sittings. Having said that, there were many good scripts and the vast majority of candidates attempted all of the parts of four questions. In addition, the majority of scripts were relatively concise.

The most significant issues for weaker candidates were a tendency to address technical areas in general terms as opposed to in relation to the questions' requirements, and a lack of knowledge of certain technical areas.

It continues to be true to say that many candidates would benefit from thinking more and writing less.

General Paper Comments

The exam was divided into section A and section B. Section A consisted of two compulsory questions for a total of 66 marks. In section B candidates were required to answer two of the three questions worth 17 marks each. In section B, question 4 was the most popular and question 3 was the least popular.

Candidates should pay particular attention to the following in order to maximise their chances of success in the exam in the future.

1. Know your stuff
 - Successful candidates are able to demonstrate sufficient, precise knowledge of the UK tax system. For example, it was clear from answers to question 2 that many candidates did not know the closing year rules for an unincorporated trader and that they were confused about certain aspects of the residency rules as they related to income tax and capital gains tax.
 - This knowledge must be up to date. Candidates sitting the exam in 2012 must familiarise themselves with the changes introduced by the recent Finance Acts as summarised in the Finance Act articles published in Student Accountant magazine and on the website.
2. Practise questions from past exams with the aim of adopting the style of the model answers.
3. Address the requirement
 - Read the requirement carefully – in the Section A questions the detailed tasks that you are to perform will be set out in one of the documents. It may be helpful to tick off the tasks as you address them. Marks are awarded for satisfying the requirements and not for other information even if it is technically correct.
 - The requirements of each question are carefully worded in order to provide you with guidance as regards the style and content of your answers. You should note the command words (calculate, explain etc), any matters which are not to be covered, and the precise issues you have been asked to address.
 - You should also note any guidance given in the question or in any notes following the requirement regarding the approach you should take when answering the question.
 - Pay attention to the number of marks available – this provides you with a clear indication of the amount of time you should spend on each question part.
4. Don't provide general explanations or long introductions.
 - If you are asked to calculate, there is no need to explain what you are going to do before you do it; just get on with it – only provide explanations when you are asked to.
 - Think before you write. Then write whatever is necessary to satisfy the requirement.
 - Apply your knowledge to the facts by reference to the requirement.
5. Think before you start and manage your time
 - Ensure that you allow the correct amount of time for each question.
 - Before you start writing, think about the issues and identify all of the points you intend to address and/or any strategy you intend to adopt to solve the problem set.

If you are preparing to resit the exam, think about the number of additional marks you need and identify a strategy to earn them. For example:

- Identify those areas of the syllabus where you are weakest and work to improve your knowledge in those areas.
- Ask yourself whether you could improve the way you manage your time in the exam and whether you address all of the parts of all four questions or whether you waste time addressing issues which have not been asked for.
- Make sure that you earn the professional skills marks and that you are prepared to address the ethical issues that may be examined.

Marks available in respect of professional skills

Marks were available for professional skills in questions 1 and 2. In order to earn these marks candidates had to provide clear explanations and coherent calculations in appropriately formatted documents.

On the whole, the performance of candidates in this area was good with the majority of candidates producing correctly formatted documents in a style that was easy to follow.

Specific Comments

Question One

Question 1 was in two parts. Part (a) was substantial and required candidates to prepare a memorandum with supporting calculations in connection with the purchase of a company and related matters. Part (b) required consideration of the ethical principle of confidentiality.

Part (a) was in two parts for a total of 23 marks.

Part (a)(i) required candidates to address the acquisition of a company (Rain Ltd) by either an individual (Drench) or by a company (Hail Ltd) owned by Drench. Depending on the circumstances, Rain Ltd would be either profitable or loss making such that there were four possibilities to consider.

The question asked for the tax implications to be compared such that numbers should have been produced for each of the four possible situations. The question also stated that Drench was aware of the general implications of forming a group and that the comparison should focus on certain specific issues. It was important for candidates to be clear as to what they had been asked to do and also what they had been asked **not** to do. The answers to this question were not as good as expected.

The following general mistakes were made by many candidates:

- Many candidates did not structure their answers to this part particularly well such that it was not always clear which of the four possible situations was being addressed.
- Despite the question instructing candidates to focus on specific issues, many candidates wasted time by addressing general issues. Accordingly, a considerable amount of unnecessary information was provided in connection with groups generally and the extraction of profits from companies.
- A minority of candidates reached an initial conclusion that Rain Ltd should be acquired by Hail Ltd such that numbers were only prepared for that eventuality.
- When addressing the purchase of Rain Ltd by Drench, a minority of candidates erroneously relieved the company's losses against the income of Drench.

In addition to the general mistakes set out above, many candidates stated that the losses of Rain Ltd would have to be carried forward if the company were purchased by Drench due to the unavailability of group relief. This omitted the possibility of a current year offset against the chargeable gains in Rain Ltd. The other specific common error related to the effect of the acquisition on the accounting periods of Rain Ltd with many candidates



confusing the need to time apportion losses for the purposes of group relief with the need to prepare tax computations for separate accounting periods.

Matters done well included the identification of the degrouping charge (although many candidates neglected to include it in the company's corporation tax computations), the corporation tax payment dates and the calculations of the maximum possible group relief.

Part (a)(ii) concerned a loan from Hail Ltd to Drench and the VAT cash accounting scheme. This part was done reasonably well with many candidates demonstrating a good knowledge of the technical areas.

The question asked for the tax implications **for Hail Ltd** of the loan. Almost all candidates recognised that Hail Ltd was a close company such that a 25% charge would be payable to H M Revenue and Customs. However, very few candidates identified that Hail Ltd would have to pay class 1A national insurance contributions in respect of the benefit relating to the loan. This is not an obscure point and would have been known to almost all candidates. It may be candidates need to think about the requirement and identify all of the possible issues before commencing writing in order to identify as many relevant points as possible.

The majority of candidates were able to identify the advantages of using the VAT cash accounting scheme and to link the facts in the question to the scheme's limit in respect of annual taxable supplies; this part of the question was answered well.

The final part of the question concerned the ethical considerations relating to confidentiality and was done well by the majority of candidates.

Question Two

Question 2 concerned the personal tax position of an individual, Mirtoon, and was in two main parts.

Part (a) concerned Mirtoon's financial position in view of his plans to sell his house, cease his business and leave the UK. It required a calculation of the total proceeds generated by the proposed transactions.

The sale of the house was handled well with almost all candidates identifying the availability of principal private residence relief and the need to restrict the relief to 80% of the gain arising. The crystallisation of the heldover gain in respect of the agricultural land (due to Mirtoon becoming non-resident and non-ordinarily resident), on the other hand, was spotted by only a small minority of candidates. However, this was an easy point to miss and it was possible to obtain a perfectly good mark without any reference to it.

The treatment of the losses arising on the cessation of the business was not handled well due to a lack of knowledge of the closing year rules. This meant that many candidates struggled to determine the assessment for the final years of trading. There was also a considerable number of candidates who erroneously treated the overlap profits brought forward as taxable profits in the final tax year as opposed to being part of the allowable loss. The unincorporated trader is examined with great regularity and candidates are likely to benefit from knowing, in particular, the opening and closing years rules.

A minority of candidates demonstrated a lack of precision when considering the tax due in respect of the sale of the house and the tax saving in respect of the offset of the trading losses. This lack of precision included a failure to take account of the capital losses brought forward and/or the annual exempt amount and the omission of the personal allowance from the income tax computations. It was important to consider the personal allowance as Mirtoon's income exceeded £100,000 such that the personal allowance was restricted.

Part (b) was in three parts and produced a wide variety of answers.



Part (i) concerned the VAT implications of Mirtoon ceasing to trade. This part was done reasonably well, although, perhaps not as well as expected. Some candidates made it hard for themselves by writing generally rather than addressing the facts of the question. In particular, many candidates wrote at length about the sale of a business as a going concern. However the question made it clear that the business was to cease with the assets then being sold. The vast majority of candidates identified the need to deregister. However, a considerably smaller number pointed out the possible need to account for output tax on business assets owned as at cessation.

Part (ii) concerned Mirtoon's liability to income tax and capital gains tax whilst living overseas. There were some good answers to this part but also two particular areas of confusion.

The first area of confusion related to the taxation of income where an individual is not resident in the UK. It needs to be recognised that where an individual is not resident in the UK, any foreign income will not be subject to UK income tax. Where many candidates went wrong was to imagine that the remittance basis was relevant here (perhaps because Mirtoon was non-ordinarily resident but continued to be domiciled in the UK). This led candidates to write at length about the remittance basis thus wasting time.

The second area of confusion concerned the temporary non-resident rules. These rules relate to capital gains tax and cause gains that would otherwise not be taxable in the UK to be so taxable if the individual returns to the UK within five tax years of leaving. However, a minority of candidates incorrectly treated these rules as an extension of the residency rules as they relate to income tax.

Part (iii) concerned two areas of inheritance tax; associated operations and gifts with reservation. The good news was that the vast majority of candidates knew all about gifts with reservation and answered this part of the question well. Knowledge of associated operations was less common but this was to be expected.

The bad news, however, was that many candidates did not restrict their answers to the above two areas but wrote at length about inheritance tax generally. Candidates must take care in identifying what has been asked and try to avoid addressing other areas.

Question Three

This question concerned a Save As You Earn share option scheme, a medical care scheme and payments to employees for driving their own cars on business journeys. It was in two main parts.

Part (a) required a detailed knowledge of Save As You Earn share option schemes in order to comment on the acceptability or otherwise of a proposed set of rules and to calculate the income tax and national insurance liabilities in respect of shares acquired.

In order to score well it was important for candidates to address each of the detailed rules in the question as opposed to writing generally about share option schemes. Many candidates who attempted this question were knowledgeable about Save As You Earn schemes but only a minority took a sufficiently disciplined approach to score well.

The explanation of the tax liabilities in respect of the shares acquired under the scheme was not done particularly well. Many candidates lacked precise knowledge of this area such that they did not know that no tax would be charged until the shares were sold. In addition, it needed to be recognised that the position of each employee would vary depending on whether or not they had made any other capital gains and on the level of their taxable income; very few candidates considered these matters.

Part (b) concerned the medical care scheme and the payments to employees for driving their own cars on business journeys.

The medical care scheme was not handled particularly well in that many candidates incorrectly stated that the provision of health insurance would be an exempt benefit for the employees. However, this was not too important as it was only a minor part of the answer. The provision of an interest free loan was also not dealt with as well as might have been expected. The question stated that the loan would be 'up to £7,500' so it was necessary to point out that loans of no more than £5,000 would be exempt.

The explanation of the implications of the payments to employees for driving their own cars was handled well. The only common error was the failure to recognise that there would be no national insurance implications.

The question asked for the tax implications 'for the employees' as opposed to the tax implications generally. Accordingly, it was necessary to consider the national insurance issues for the employees (but not the employer) and there was no need to address the ability of the employer to obtain tax relief for the costs incurred.

Question Four

This question concerned the tax implications of the creation of a discretionary trust and the inheritance tax liability arising on a death. The question was in two parts.

Part (a) required an outline of the capital gains tax implications of various transactions relating to the trust and the inheritance tax charges that may be payable in the future by the trustees. It was important for candidates to be methodical in their approach to this question. There were three transactions to be addressed in relation to capital gains tax whereas the inheritance aspects of the question were more open ended.

The majority of candidates knew some of the capital gains tax implications of the transactions but very few knew all of them. In particular, there was a lack of understanding that capital gains would arise when the trustees transfer trust assets to the beneficiaries of the trust. As always, when dealing with capital gains tax, it is vital to consider the availability of reliefs; gift relief is available when assets are transferred to a discretionary trust and again when they are transferred to the beneficiaries.

The inheritance aspects of part (a) were not handled as well as the capital gains tax aspects. The majority of candidates failed to mention the ten-yearly charges and exit charges payable out of the trust's assets.

Part (b) required a calculation of the inheritance tax liability arising on the death of an individual who had made a number of lifetime gifts. This was a fairly straightforward question, albeit with a couple of tricky points within it, but it was not handled particularly well.

There was a lack of appropriate structure to candidates' answers that indicated that, perhaps, there had been insufficient practise of this area. Inheritance tax computations should all look the same, starting with the tax on any chargeable lifetime transfers, followed by the consideration of gifts within seven years of death and ending with the death estate. However, many candidates began with the death estate and worked their way backwards towards the lifetime gifts; a method that was never going to be successful.

There was confusion as to which gift benefited from the annual exemptions and in respect of the utilisation of the nil rate band. There was also a general lack of knowledge of the impact of related property on the valuation of a gift. Other technical errors, made by a minority of candidates, included the treatment of cash as an exempt asset and business property relief being given in respect of the shares owned by the taxpayer.

On the positive side, the majority of candidates identified the availability of the husband's nil rate band and the death estate was handled well.

Question Five

This question concerned the minimisation of the corporation tax liability in respect of a chargeable gain in a capital gains group, the tax relief available in respect of loan interest payable by a company and group registration for the purposes of VAT. It was in three parts.

Part (a) required candidates to identify the companies in a group to which a chargeable gain could be transferred and the most advantageous strategy. This was done well by the vast majority of candidates who attempted this question. A small minority of candidates incorrectly included Wahl Ltd, a 60% subsidiary, in the capital gains group. This appeared to be due to confusion over the relevance of the 50% element of the definition of a gains group. A gains group consists of a principal company together with its 75% subsidiaries and their 75% subsidiaries and so on. There is then an additional rule that requires the principal company to have an effective interest of more than 50% in all of the companies in the group. Other candidates failed to exclude Teton Inc from their strategy or failed to explain why it was not included. The question required candidates to 'explain in detail'; the majority of candidates followed this instruction.

Part (b) concerned loan relationships and was not answered as well as part (a). A minority of candidates did not give themselves time to think such that they did not identify the fundamental issues involved and simply stated, incorrectly, that the interest payable would be deducted from the rental income. A minority of those who realised that the appropriate technical area was loan relationships, did not think to address the possible reliefs available in respect of the non-trading loan relationship deficit that would arise due to the circumstances in the question. A minority of candidates produced short, precise answers that scored full marks.

Part (c) required an explanation of the effects of registering two of the companies as a group for the purposes of VAT. Candidates clearly had plenty of knowledge of VAT groups but many did not take sufficient care to address the specifics of the requirement and simply wrote down everything they knew.

The question asked for two specific areas to be addressed; the total input tax recovered by the group and the monthly management charge, but very few candidates addressed these points directly. Instead, many candidates wasted time explaining whether or not the two companies could be registered as a group and discussing the various advantages and disadvantages of so doing. Finally, a minority of candidates confused the treatment of exempt supplies with zero rated supplies in that they described Byrd Ltd as being in a repayment situation as opposed to being unable to register and, therefore, unable to recover any input tax.