

# Examiner's report

F6 Taxation (UK)

December 2014



## General Comments

The examination consisted of five compulsory questions. Question 1 for 30 marks, question 2 for 25 marks, and three further questions of 15 marks each.

Quite a few candidates found this examination time pressured, with several sections of the paper not being answered. This generally seemed to be because too much time was spent providing unnecessary explanations or on producing detailed workings for items that could easily have been included in the main computations. However, well prepared candidates had little difficulty in achieving a pass mark.

The value added tax (VAT) aspects of question two were generally answered unsatisfactorily, with many candidates not attempting this section at all. Candidates performed particularly well on questions 1 (a), 1 (b)(i), 1 (c), 2 (a)(i), 3 (a), 3 (b), 4 (a), 4 (c)(ii), 4 (c)(iii), 5 (a) and 5 (c). The questions candidates found most challenging were questions 1 (b)(ii), 2 (a)(ii), 2 (b)(i), 2 (b)(ii), 2 (b)(iii), 2 (b)(iv), 4 (b)(i), 4 (b)(ii), 4 (c)(i), 5 (b) and 5 (d).

## Specific Comments

### Question One

This 30-mark question involved Alfred and Edward King, who were trying to calculate their balancing payments for the tax year 2013-14. Alfred was in partnership with Anne Royal and Mary Regal, although Mary resigned as a partner on 1 January 2014. Edward was employed by Stately Ltd as a marketing director.

Part (a) for 23 marks required candidates to calculate Alfred and Edward King's respective balancing payments for the tax year 2013-14. For Alfred, this involved a calculation of his share of the partnership's trading profit (including a detailed capital allowances computation), taking account of dividends received (some of which were from a stocks and shares ISA) and gift aid donations made, and the calculation of class 4 national insurance contributions (NICs). For Edward, this involved the calculation of the taxable benefits arising from the provision of a beneficial loan and the gift of an asset which had previously been provided for private use, taking into account contributions to an occupational pension scheme, charitable payroll deductions, and deductions for a mileage allowance and a professional subscription. The section was generally satisfactorily answered, although many candidates wasted a considerable amount of time by providing detailed explanations and/or using far too many workings. The class 4 NIC calculation for Alfred was sometimes omitted, with a number of candidates conversely providing unnecessary NIC calculations for Edward.

Part (b) was for a total of 4 marks. The first requirement for 2 marks was to advise Alfred and Edward King of the latest dates by which their respective self-assessment tax returns for the tax year 2013-14 should be filed given their stated preferences for filing online or by paper return. The second requirement for 2 marks was to advise Alfred and Edward King as to how long they must retain the records used in preparing their respective tax returns. Although the first requirement was well answered by most candidates, the record retention dates were often not known or were vague. Candidates should appreciate that for two-mark requirements they are not expected to provide detailed explanations – no additional marks are possible, and they should remain conscious of time.

Part (c) was for 3 marks. It concerned the partnership replacing Mary Regal by employing either one full-time employee or two part-time employees, and the requirement was to explain why employing two part-time employees would not be any more expensive than employing one full-time employee, despite the difference in the salary cost. It involved the calculation of employer's class 1 NIC for each alternative. It was pleasing to see that this section was well answered by many candidates.

### Question Two

This 25-mark question was based on Commerce plc. The company had prepared its own corporation tax computations for the year ended 31 March 2014, although there were various outstanding queries.

Part (a) was for a total of 15 marks. The first requirement for 12 marks was to prepare a revised version of E-Commerce plc's corporation tax computation for the year ended 31 March 2014 after making any necessary corrections arising from the queries. It was necessary to adjust for disallowed legal fees, correct the deduction for a lease premium, adjust for incorrectly calculated capital allowances, and make adjustments to the property business profit and to loan interest receivable. The second requirement for 3 marks was to explain why E-Commerce plc would not have been required to make quarterly instalment payments in respect of its corporation tax liability for the year ended 31 March 2014, but would have to do so for the year ended 31 March 2015. This was because E-Commerce plc was not a large company for the year ended 31 March 2013.

The first requirement was not particularly difficult, but the information was presented in a different format to previous questions of this nature. However, candidates would have benefited from knowing the pro-forma layout. The requirement was generally reasonably well answered and there were a few highly satisfactory answers. The deduction for the lease premium caused the most problems, with many candidates not appreciating that there was no need to recalculate the amount assessed on the landlord – thereby spending quite a bit of time unnecessarily. The second requirement was also reasonably well answered, although to score full marks it was necessary for answers to be quite precise – not, for example, just mentioning large companies, without explaining what a large company is.

Part (b) for a total of 10 marks dealt with various VAT issues. E-Commerce plc had been late in submitting its VAT returns and in paying the related VAT liabilities for the previous three VAT quarters. The company had also been careless in incorrectly treating the supply of standard rated services received from VAT registered businesses situated elsewhere within the European Union, and this had resulted in an underpayment of VAT. The first requirement for 3 marks was to advise E-Commerce plc of the default surcharge implications if, during the current default surcharge period, it was late in paying a further VAT liability, and what the company would need to do in order to revert to a clean default surcharge record. The second requirement for 3 marks was to explain when and how a UK VAT registered business should account for VAT in respect of the supply of services received from VAT registered businesses situated elsewhere within the European Union. The third requirement for 2 marks was to explain why E-Commerce plc would be permitted to disclose its underpayment of VAT by entering the amount on its next VAT return, and to state whether or not default interest would be due. The final requirement for 2 marks was to advise E-Commerce plc as to the maximum amount of penalty which was likely to be charged by HM Revenue and Customs in respect of the underpayment of VAT, and by how much this penalty would be reduced as a result of the company's unprompted disclosure. This section as a whole was generally not well answered, with a number of candidates simply ignoring it altogether. For the first requirement, many candidates wasted time by stating everything they knew about the default surcharge rather than confining their answer to the facts of the question – what penalties had been charged in respect of the previous defaults being irrelevant. For the second requirement, candidates often confused the VAT treatment of services received with that for imports or the acquisition of goods. In the fourth requirement, candidates often explained the full range of potential penalties despite being told that the underpayment had arisen due to carelessness.

### Question Three

This 15-mark capital gains tax question involved Patrick and Emily Grant, a married couple. They had both always been resident in the UK, but following Patrick's retirement, the couple decided to move overseas, purchasing an overseas property on 6 April 2013. Patrick and Emily urgently needed to raise £80,000 in order to renovate their overseas property, and had three alternative assets which could be sold in order to raise the funds.



Part (a) for 3 marks required candidates to explain why Patrick and Emily Grant would both be treated as resident in the UK for the tax year 2013-14. This requirement was reasonably well answered, with many candidates appreciating that residence was based on having two UK ties. However, very few candidates knew that the second of these ties was being in the UK for more than 90 days during the previous two tax years.

Part (b) for 12 marks required candidates to advise Patrick and Emily Grant as to which of the three alternative disposals would result in the highest net proceeds after taking account of capital gains tax. The three alternative assets that could be sold were (1) eight acres of land owned by Patrick (he had originally purchased 14 acres of land, having previously sold six acres), (2) 8,000 £1 ordinary shares in Shore Ltd, an unquoted trading company, owned by Emily (the disposal qualified for entrepreneurs' relief), and (3) 32,000 £1 ordinary shares in Beach plc, a quoted trading company, jointly owned by Patrick and Emily (they had originally purchased 54,000 shares in Beach plc, having previously sold 22,000 shares). Although there were many satisfactory attempts at this question, quite a few candidates did not appreciate that it was necessary to consider each disposal separately. The computations themselves were not particularly difficult, with the emphasis of the question being on the correct application of the capital gains tax rates. Many candidates missed some easy marks by not realising that in computing the net of tax proceeds they should have used the disposal proceeds as a starting point rather than the chargeable gains. As regards the disposal of shares in Shore Ltd, the availability of entrepreneurs' relief was often overlooked. The gain on the disposal of shares in Beach plc was often not split between the two taxpayers.

#### **Question Four**

This 15-mark corporate groups question involved three separate scenarios.

Part (a) for 4 marks, involved Accra Ltd, which on 1 April 2013 had set up a 100% owned subsidiary company, Banjul Ltd. Candidates were required to calculate the overall corporation tax saving for the year ended 31 March 2014 if, rather than setting up Banjul Ltd as a subsidiary company, this company's business had instead been run by Accra Ltd as part of its existing business. This section was generally well answered, although many candidates wasted time in giving unnecessary explanations in support of their answers.

Part (b) was for a total of 6 marks, and involved Cairo Ltd and its 100% subsidiary company, Dakar Ltd. Cairo Ltd had taxable total profits for the year ended 31 March 2014, whereas Dakar Ltd had made losses for the year ended 30 November 2013 and for the four-month period ended 31 March 2014. The first requirement for 4 marks was to advise Cairo Ltd as to the maximum amount of group relief which could be claimed against its taxable total profits for the year ended 31 March 2014. The second requirement for 2 marks was to explain why it was probably beneficial for Dakar Ltd to group relieve its losses to Cairo Ltd rather than offsetting them against its own profits. This section was not particularly well answered. As regards the first requirement, most candidates did not appreciate that it was necessary to compare profits and losses for each corresponding period. The capital loss was often included, or alternatively just ignored (along with the qualifying charitable donations), without any explanation. For the second requirement, the fact that there was no tax rate advantage to the loss surrender seemed to confuse many candidates, with few appreciating that there would be earlier relief and that qualifying charitable donations would not be wasted.

Part (c) was for a total of 5 marks, and involved Kigali Ltd, the holding company for a group of companies. Kigali Ltd owned 80% of Lome Ltd, which in turn owned 100% of Maputo Ltd, which owned 70% of Niamey Ltd. On 31 May 2013, Kigali Ltd sold a freehold office building, and Lome Ltd, Maputo Ltd and Niamey Ltd had all recently purchased, or were planning to purchase, freehold warehouses. The first requirement for 2 marks was to state whether Maputo Ltd and Niamey Ltd were included in a chargeable gains group with Kigali Ltd. The second requirement for 2 marks was to calculate Kigali Ltd's chargeable gain in respect of the disposal of its freehold office building. The third requirement for 1 mark required candidates to state the period during which reinvestment by a group company would have to take place in order to make a claim to rollover Kigali Ltd's chargeable gain. For the first requirement, it was often not appreciated that the lack of 75% ownership between

Maputo Ltd and Niamey Ltd precluded Niamey Ltd from being part of a chargeable gains group with Kigali Ltd, despite there being an effective interest of more than 50%. The second requirement was generally well answered, although a number of candidates incorrectly based their indexation allowance calculation on the net gain rather than on the cost figure. Some candidates also wasted time by doing two indexation allowance calculations rather than just one based on the total cost figure. The third requirement was generally well answered.

### **Question Five**

This 15-mark question involved Tobias, who had recently inherited the residue of his aunt Mildred's estate. He was going to use some of his inheritance to make an additional personal pension contribution, some to make a gift to his daughter when she got married, and also to invest the maximum possible amounts into ISAs.

Part (a) for 7 marks required a calculation of the amount of inheritance that Tobias would have received from his aunt Mildred's estate, taking into account the inheritance tax that would have been payable. This section was well answered, although quite a few candidates did not appreciate that the claim for a deceased spouse's unused nil rate band is based on the current value rather than the value at the time of death.

Part (b) for 3 marks required candidates to advise Tobias of the maximum amount of additional gross personal pension contribution that he was permitted to make for the tax year 2013-14, and how much of this maximum contribution would qualify for tax relief. Although many candidates correctly identified the amount of available annual allowances, very few appreciated that contributions up to the level of relevant earnings would actually qualify for tax relief, and that there is no maximum limit to the amount of additional personal pension contribution which can actually be made.

Part (c) for 3 marks required candidates to explain the inheritance tax implications if Tobias made a cash gift of £100,000 to his daughter when she got married. This section was generally answered very well, although few candidates appreciated that even though no inheritance tax would be payable in respect of the potentially exempt transfer (PET), the PET would then reduce the amount of nil rate band available against the death estate.

Part (d) for 2 marks required candidates to advise Tobias as to what options he had as regards making full use of his ISA limits for the tax year 2013-14. Tobias had already invested £2,400 into a cash ISA during this tax year, having previously invested £3,200 into a cash ISA during the tax year 2012-13. Given that the investment limits are given in the rates and allowances, this section was not answered as well as might have been expected. The prior year investment was often included in the calculations, and many candidates did not differentiate between the two types of ISA in their answers.