

# Examiner's report

F6 Taxation (UK)

June 2012

The ACCA logo consists of the letters 'ACCA' in a bold, white, sans-serif font, centered within a solid black square.

## 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.

The vast majority of candidates attempted all five questions, and there was little evidence of time pressure. Where questions were left unanswered by candidates, this appeared to be due to a lack of knowledge or poor exam technique, as opposed to time pressure.

Question 4 was the most difficult of the three 15-mark questions, so it was a sensible strategy to leave this question until last. If time was running out, it would have been much easier and quicker to score marks on question 5.

Candidates performed particularly well on questions 1a, 1b, 1d(i), 2a, 3a, 3b, 3c(i), 4a, 5a and 5b. The questions candidates found most challenging were questions 1c, 1d(ii), 1d(iii) 2b, 3c(ii), 4b and 5c – approximately one-third of the paper. This is mainly due to candidates not covering the entire syllabus as part of their studies

A number of common issues arose in candidate's answers:

- Failing to read the question requirement clearly. For example, calculating the income tax in question 1(a) despite being told that only the taxable income figure was required.
- Poor time management. For example, the 1 mark questions should have been answered with a brief sentence rather than a long paragraph.
- Not learning lessons from earlier examiner's reports and hence making the same mistakes. For example, the necessity of learning basic rules (such as where there is a long corporation tax period of account) has previously been highlighted several times.
- Poor layout of answers. For example, the two sections of question 2 were sometimes combined into one long very confusing answer. The same with question 3(b) where it was often not clear which of the two sections was being answered.

## Specific Comments

### Question One

This 30-mark question was based on Flick Pick, who was employed throughout 2011-12 as a film critic, but also commenced in partnership on 1 January 2012 running a small cinema. The question also included property income and national insurance contributions (NIC), together with the valued added tax (VAT) marks for this paper.

Part (a) for 12 marks required candidates to calculate Flick's taxable income for 2011-12.

There were many very good answers to this section. The aspects that caused problems were not appreciating that:

- When calculating Flick's share of the partnership profits, the capital allowances had to be deducted before allocating the profit.
- When calculating the property business profit, no deduction is given for the cost of replacement furniture when the wear and tear allowance is claimed.

Part (b) for 4 marks required candidates to state what classes of NIC would be paid in respect of Flick's income for 2011-12, and in each case who would be responsible for paying them. No actual calculations were required.

There were many very good answers to this section, but some candidates missed some very easy marks by explaining NIC in detail, but not actually answering the requirements of the question.

Part (c) for 4 marks required a list of the advantages and disadvantages for the partnership of choosing 30 April as its accounting date rather than 5 April.

Quite a few candidates appreciated that an accounting date of 30 April would result in overlap profits and that the basis period rules would be more complicated. Very few knew that the interval between earning profits and paying the related tax liability would be longer or that it would be easier to implement tax planning.

Part (d) for a total of 10 marks dealt with various VAT issues. The first requirement for 3 marks required an explanation as to whether or not it would have been beneficial for the partnership to have used the VAT flat rate scheme for the quarter ended 31 March 2012. The second requirement for 3 marks required an explanation as to whether or not it would have been financially beneficial for the partnership to have voluntarily registered for VAT from 1 January 2012. The final requirement for 4 marks required advice as to when the partnership should be accounting for output VAT on the renting out of private boxes in its cinema.

Although it was disappointing to see a number of candidates deduct inputs when calculating VAT using the flat rate basis, the first requirement was otherwise generally answered very well. The second requirement caused a lot of confusion, with quite a few candidates discussing VAT registration – the correct answer was simply that voluntary VAT registration reduced the partnership's profits by the amount of VAT payable calculated in the first requirement. For the final requirement, quite a few candidates just explained the time of supply rules, without relating them to the information given in the question. It was clearly stated that an invoice was issued on the date of a film being screened – so the 14-day rule for issuing an invoice was irrelevant.

## **Question Two**

This 25-mark corporation tax question involved two companies, Heavy Ltd and Soft Ltd, with Heavy Ltd having acquired 100% of the ordinary share capital of Soft Ltd on 1 September 2010. Heavy Ltd prepared accounts for the year ended 31 December 2011, whilst Soft Ltd prepared accounts for the 16-month period ended 31 December 2011 so as to make its accounting date coterminous with that of Heavy Ltd.

Part (a) for 18 marks required a calculation of Heavy Ltd's corporation tax liability for the year ended 31 December 2011. This involved the calculation of the deduction for a lease premium, a detailed capital allowances computation, an appreciation of which dividends are included as franked investment income, and the ability to calculate a corporation tax liability where an accounting period spans 31 March and there has been a change in the rates of tax.

There were many very good answers to this section. The aspects that caused problems were not appreciating that:

- There was no chargeable gain on a disposal of an office building to Soft Ltd because of the 75% group relationship.
- As the accounting period spanned 31 March 2011 it was necessary to apportion the taxable total profits between the financial years 2010 and 2011.
- The balance on main capital allowances pool could be fully written off as it was less than £1,000.

- There was no balancing allowance on the special rate pool despite all the items included therein having been sold.

Part (b) for 7 marks required a calculation of Soft Ltd's corporation tax liabilities in respect of the 16-month period ended 31 December 2011. This required an appreciation that the long period of account was split on a 12 month - 4 month basis, and again involved an accounting period spanning 31 March with a change in the rates of tax.

This section was often not well answered, with the main problem being that candidates simply did not know the long period of account rules. This lack of a basic piece of knowledge cost many candidates several very easy marks. Even those candidates who knew the rules often deducted the capital loss in the second period, when it should have simply been carried forward.

### Question Three

This 15-mark question was based on Winston King and Wiki Ltd. Winston had already made a chargeable gain during 2011-12 as a result of disposing of a painting, but was also considering a further disposal during the tax year - consisting of a business that he had run as a sole trader. Wiki Ltd had sold a freehold warehouse on 3 February 2012 for £312,000, and was going to reinvest the proceeds from the sale during July 2012 by either purchasing a freehold factory for £166,000, or a freehold office building for £296,000.

Part (a) for 2 marks required candidates to state which individuals are subject to capital gains tax (CGT) on the disposal of chargeable assets situated in the UK, and which companies are subject to corporation tax on the disposal of chargeable assets situated in the UK.

There were many correct answers to this section. However, candidates should appreciate that for just two marks a detailed explanation of the residence rules was not required.

Part (b) for a total of 7 marks dealt with Winston's CGT liability. The first requirement for 3 marks required the CGT liability to be calculated on the assumption that the sole trader business was not disposed of during 2011-12. The second requirement for 4 marks also required the CGT liability to be calculated, but this time on the assumption that the sole trader business was disposed of on 25 March 2012. One of the assets disposed of qualified for entrepreneurs' relief, whilst the other asset disposed of resulted in a capital loss.

This section was very well answered, with many candidates achieving maximum marks. However, it was sometimes not appreciated that the disposal of the business would fully utilise the available nil rate band - resulting in the painting being charged at the higher rate of 28%.

Part (c) for a total of 6 marks dealt with Wiki Ltd's chargeable gains. The first requirement for 3 marks required the calculation of the chargeable gain in respect of the disposal of the warehouse. This involved the calculation of an indexation allowance. The second requirement for 3 marks required advice as to the amount of rollover relief that would be available for each of the two alternative reinvestments.

The first requirement was very well answered, although the incidental costs of acquisition were often omitted from the indexation allowance calculation. The final requirement was the only aspect of this question that was consistently not well answered. A number of candidates stated that the amount of proceeds not reinvested would be the chargeable gain, despite this figure being higher than the gain calculated in the initial requirement.

### Question Four

This 15-mark question covered Government tax policies and two self-employed taxpayers, Michael and Sean, who had both made trading losses

Part (a) for 4 marks required an explanation as to how the UK Government's tax policies encourage individuals to save, individuals to support charities, and entrepreneurs to build their own businesses and to invest in plant and machinery.

This section was generally well answered, although candidates should note that where just one or two marks are available for a requirement then just a short sentence is required – not a detailed explanation.

Part (b) for 11 marks required candidates to identify the loss relief claims that were available to Michael and Sean, and to explain which of the available claims would be the most beneficial in each case. There was no requirement to calculate any income tax liabilities. Michael had made a loss in the first four years of trading, and the most beneficial claim was against total income for the three preceding years. This section was worth 5 marks. Sean had ceased trading and had made a terminal loss in the final 12 months of trading. The most beneficial claim was as a terminal loss against trading income for the year of the loss and the three preceding years. This section was worth 6 marks.

Not surprisingly, this was the section of the paper that caused the most problems. For Michael, the claims should have been fairly straightforward given that he only had one source of income for each year. However, some candidates were not even aware that a claim could be made against total income. For Sean, a few candidates suggested that the loss be carried forward despite the trade ceasing. In both cases, it was generally not appreciated that the most advantageous choice of loss relief claims would generally preserve the benefit of personal allowances.

#### **Question Five**

This was a 15-mark inheritance tax (IHT) question involved Ning.

Part (a) for 4 marks required candidates to advise Ning as to how much nil rate band would be available when calculating the IHT payable in respect of her estate were she to die on 20 March 2012. Ning's husband had predeceased her, with 70% of his nil rate band not being used, and she had made two potentially exempt transfers (PETs). The first PET was exempt from IHT as it was made more than seven years before 20 March 2012.

This section was well answered, with candidates being given credit for their treatment of the PETs even if this was included in part (b).

Part (b) for a total of 9 marks dealt with the IHT liability on Ning's estate. The first requirement for 7 marks required a calculation of the IHT that would be payable if Ning were to die on 20 March 2012, and a statement as to who would be responsible for paying the tax. Candidates needed to appreciate the different treatment of repayment mortgages (deductible) and endowment mortgages (not deductible), and the type of debts which can be deducted from the value of an estate. The second requirement for 2 marks required advice as to whether the amount of IHT payable would alter if Ning were to live for either another six or another seven years after 20 March 2012, and if so by how much.

This section was also well answered, although a number of candidates deducted the endowment mortgage (it would have been repaid upon death by the life assurance element of the mortgage) and the promise to pay a nephew's legal fee (not deductible being purely gratuitous). Somewhat surprisingly, there was often little knowledge of who was responsible for paying the tax – many candidates stated that it was the beneficiaries (or even the deceased!), rather than the personal representatives. The effect of living for another six years or another seven years was often not understood – the difference being that after seven years all the PETs would become exempt, thus increasing the available nil rate band. Too many candidates discussed taper relief despite this having no impact on the tax payable in respect of the estate.



Part (c) for 2 marks required candidates to state what conditions would have to be met if Ning wanted to make gifts out of her income to her children so that the gifts were exempt from IHT.

Very few candidates correctly answered this section, with many discussing every available relief – except the one that was relevant.