

Examiner's report

P6 Advanced Taxation (UK)

December 2012



General Comments

The overall standard in the December 2012 exam was satisfactory. Most of the scripts were concise and included attempts at virtually all of the parts of four questions.

Poor exam technique was not a significant factor this time. However, there were two general failings as detailed below. In addition, there were, as always, various areas of technical weakness.

The exam was divided into section A and section B and was in its new standard format; section A consisting of the compulsory questions 1 and 2, worth 35 marks and 25 marks respectively, and section B where candidates were required to answer two out of the three questions worth 20 marks each. In section B, question 4 was the most popular question and question 3 was the least popular.

As noted above, there were two general failings in relation to exam technique.

The first concerned the inclusion of irrelevant content by weaker candidates who either did not know the answer to a question, and so wrote about something else, or who side-tracked themselves away from the question and answered a different question. Irrelevant information does not score marks but does, of course, waste time. Candidates are advised to read the requirement carefully and to concentrate whilst writing their answers in order to ensure that they remain within the confines of the requirement.

The second failing concerned a small but noticeable minority of candidates who treated companies as individuals and/or treated individuals as companies. For example, such candidates wrote about entrepreneurs' relief, the annual exempt amount and tax rates of 18% and 28% when dealing with the chargeable gains of companies. Candidates should always begin a question more slowly than the final 'top speed' that they will eventually achieve. They must take the time to understand the facts of the question, the entities that they are dealing with and the particular taxes involved.

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.
 - This knowledge must be up to date. Candidates sitting the exam in 2013 must familiarise themselves with the changes introduced by the recent Finance Act 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 question 1. In order to earn these marks candidates had to use the information provided in the question correctly and then provide specific advice, clear explanations and coherent calculations in an appropriately formatted report. On the whole, the performance of candidates in this area was good with the majority of candidates producing a report in a style that was easy to follow.

Specific Comments

Question 1

Question 1 was in two parts. Part (a) required candidates to prepare a report with supporting calculations in relation to the proposed sale of a company. Part (b) required candidates to summarise the implications of an unexpected refund of tax.

Part (a) was in three parts.

Part (i) required candidates to calculate the tax cost of two alternative transactions. The first involved a company, Flame plc, selling its subsidiary, Inferno Ltd and the second, alternative transaction, involved Inferno Ltd selling its trade and assets. Answers to this part varied in quality quite considerably. There were many candidates who clearly understood the two alternatives and the related tax implications whilst weaker candidates were unsure of the precise nature of the transactions and the related tax implications, such that they produced confused answers. This was also one of the questions referred to in the general comments above where a small minority of candidates treated the companies as individuals

The sale of Inferno Ltd had two main implications; a chargeable gain on the sale of the shares and a degrouping charge. The chargeable gain was worth one mark. However, it took some candidates half a page or more to calculate and write about this gain in order to score that mark. This was most likely because it was the first thing they did in the exam and there were still almost three hours to go, such that the pressure was not yet on. Candidates must approach every mark in the exam in the same way and get on with it. There is no time to dither when there is so much to do.



Frustratingly, it was not uncommon for some candidates to only score half a mark for this gain because they based the indexation allowance on the unindexed gain rather than the cost. I suspect that this was a lack of concentration rather than a lack of knowledge but the half mark was still lost.

It was stated in the question that the substantial shareholding exemption was not available. Many candidates simply included a statement to that effect in their report and earned a mark. However, a small minority of candidates wasted time writing at length about the exemption rather than getting on with the question.

The degrouping charge was done well on the whole. Those candidates who did not do so well were divided into two groups. The first group missed the degrouping charge altogether. This was perhaps due to a lack of knowledge but, in view of the fact that degrouping charges are examined regularly, was more likely due to a lack of thought. Candidates must give themselves time in the exam to think about issues before they start writing; it is difficult to successfully think of one issue whilst writing about a different one.

The second group of candidates knew that there would be a degrouping charge somewhere in the answer and earned most of the marks available for saying why and for calculating it. However, they did not know which of the two possible transactions would give rise to the charge and either put it into the wrong section of the report or put it into both sections. This was not particularly costly, but would have been in a different question which was only concerned with one of these two transactions. Candidates must know their stuff; degrouping charges only occur on the sale of a company, ie on the sale of shares, and not on the sale of assets.

The sale by Inferno Ltd of its trade and assets was not done particularly well. A small minority of candidates treated the disposal as the disposal of a single asset by adding up all of the proceeds and then deducting the total cost. Even those candidates who knew that each asset had to be handled separately failed to apply basic rules concerning capital allowances and chargeable gains.

Capital allowances were handled particularly poorly with very few candidates identifying that where the tax written down value is zero, any sale of machinery must result in a balancing charge. In addition, most candidates calculated capital losses on the sale of the machinery, thus failing to recognise that, due to the claiming of capital allowances, no capital losses would be available. Finally, only a minority of candidates identified that the deferred gain of £8,500 would crystallise on the sale of the milling machine; most candidates thought, incorrectly, that the gain would be deducted from the asset's base cost.

A final thought on part (i) relates to the narrative provided by candidates in their reports. The question required candidates to include concise explanations of matters where the calculations were not self-explanatory. On the whole this was done well. Most candidates kept their answers brief and very few fell into trap of writing down everything they knew about the broad technical areas relating to the question.

Part (ii) concerned an approved company share option plan. This was a straightforward question that tested candidates' knowledge of a particular share scheme. In order to do well, candidates needed to slow down for a moment and make sure that they were about to write about the correct scheme. They then needed to ensure that they addressed all of the issues set out in the question. The majority of candidates did both of these things and therefore scored well.

Part (iii) concerned the VAT implications of the granting of a lease and was done reasonably well by most candidates.

Part (b) of question 1 concerned a refund of corporation tax. Candidates needed to realise that this refund had been received some time ago and that, if it had been paid in error, it had to be returned to HM Revenue and Customs. Most candidates recognised this situation and were able to list the actions that the firm needed to take and the matters that needed to be drawn to the attention of Bon Ltd.

Question 2

Question 2 concerned an individual, Dana, and was in two parts. Part (a) involved the relief of losses in the opening years of an unincorporated business. Part (b) concerned capital gains tax and inheritance tax.

Part (a) required candidates to consider all of the ways in which Dana could realise her trading loss and to calculate the total tax relief obtained.

The first task was to determine the trading profit/loss for each of the tax years. This required candidates to deduct the pre-trading expenditure from the profit of the first trading period and then to apply the opening years rules. They also needed to know that losses are only recognised once in the opening years. The treatment of the pre-trading expenditure was done well by only a minority of candidates. Other candidates either missed it out altogether or deducted it from the taxable profit for the tax year 2010/11 rather than the profit of the first trading period. The opening year rules and the treatment of the loss within those rules were done well by the majority of candidates. This was a significant improvement over the performance in recent exams.

Once the profits and losses had been determined, candidates needed to consider the reliefs available in respect of the loss. There were two aspects to this. First, candidates needed to know all of the available reliefs for the losses. This was done very well by the vast majority of candidates. Secondly, candidates needed to compare the different reliefs and then calculate the total tax relief obtained by the most efficient strategy. Performance of this second task was mixed with some candidates calmly and efficiently calculating the tax due before and after claiming relief in order to determine the tax saving, whilst others wrote about how to do it in general terms without actually doing it. This is perhaps a confidence issue; candidates should ensure that they have practised as many questions as possible prior to sitting the exam and, once in the exam, should have the self-belief to address the figures and come up with specific advice.

The second part of this question was in two parts.

Part (i) concerned the availability of gift relief on the transfer of a rental property to a trust and was not done particularly well. The issue here was that gift relief would be available because the transfer was immediately subject to inheritance tax. This is true regardless of the nature of the asset, such that those candidates who focussed on whether or not the property was a business asset had missed the point. This was not too great a problem as there were only two marks available. However, a minority of candidates made things worse by ignoring the fact that this question part needed to be answered in approximately 3.5 minutes and wrote about gift relief at length, thus wasting time.

Part (ii) concerned Dana's inheritance tax position. Those candidates who made a genuine attempt to answer the question here did well. The technical issues in this question were:

- the transfer of the rental property in December 2007 was a chargeable lifetime transfer, such that we needed a value for the property in order to determine the nil band available for the transfer in September 2012.
- the gifts of cash to family members were potentially exempt transfers, such that they would not affect the nil band whilst Dana is alive.
- the cash gifts may be exempt depending on the amount given, the date of the gift and the reason for the gift. Exempt gifts would not use Dana's annual exemptions, such that they may be available for relief against the transfer to the trust.

This question was different from past inheritance tax questions and required some thought before it could be answered. It was not technically difficult but required candidates to address the specific question; the minority of



candidates who wrote about inheritance tax in general terms and ignored the specifics of the question did poorly, as did those who tried to calculate inheritance tax liabilities. Some candidates let themselves down by writing that they needed 'the details of the gifts' without specifying what those details were and why they needed them.

Question 3

This question concerned two close companies; Banger Ltd and Candle Ltd. It was in two parts.

Part (a), Banger Ltd, was in two parts.

Part (i), for three marks, required candidates to explain the taxable income arising out of the use by a minority shareholder of a car owned by the company. Almost all candidates were able to calculate the benefit in respect of the use of the car but not all of them realised that this would be taxed as a distribution rather than employment income. Many of those who knew this point still failed to earn full marks because they did not state the reasons for this treatment; those reasons being that the company is a close company and that the individual is not an employee.

Part (ii) concerned the treatment of company distributions before and after the appointment of a liquidator. Performance in this part of the question was mixed. Those candidates who did not do well either did not know the rules or were not careful enough in addressing the requirements. A lack of knowledge of the rules was unfortunate and not something that could easily be rectified in the exam room. Failure to address the requirements carefully was a greater shame as potentially easy marks were lost. The requirement asked for the tax implications for 'Banger Ltd, the minority shareholders and Katherine'. Most candidates dealt with the minority shareholders and Katherine but many omitted the implications for Banger Ltd. Candidates should always read the requirement carefully and identify all of the tasks. It would have been helpful then to use sub-headings for each of the three aspects of the requirement to ensure that all of the aspects of the requirement were addressed.

Part (b) required candidates to calculate the corporation tax liability of Candle Ltd. On the whole, this part was done quite well by many candidates.

The two more difficult areas of this part of the question concerned loan relationships and a share for share disposal. The loan relationships issue was not done well. The vast majority of candidates failed to apply the basic rules such that they did not offset the amounts in order to arrive at a deficit on non-trading loan relationships. This was not a difficult or obscure matter; it simply felt as though candidates were not giving themselves the time to think before answering the question.

The share for share disposal was identified by the vast majority of candidates who went on to point out that no chargeable gain would arise in respect of the shares. There was then a further mark for recognising that there would also be no gain in respect of the cash received as it amounted to less than 5% of the total consideration received. This point was picked up by only a small number of candidates.

Question 4

This question concerned various aspects of capital gains tax, VAT and income tax and was in three parts.

Part (a) was in two parts. Part (i) required a statement of the conditions necessary for the disposal of an asset to be an associated disposal for the purposes of entrepreneurs' relief and was not done well. This is not an area of the syllabus that one would expect to see examined regularly and many candidates will have known immediately



on reading the requirement that they did not know the answer. However, the sensible approach would then have been to write a very brief answer with some sensible comments on entrepreneurs' relief. It was pretty likely that this would then score one of the three marks available.

Part (ii) was more straightforward and required candidates to calculate a capital gains tax liability. In order to do so, candidates had to know how to calculate a gain on the assignment of a lease and on the disposal of a remaining piece of land following an earlier part disposal. Entrepreneurs' relief was available in respect of some of the gains and there was also a capital loss and the annual exempt amount that needed to be offset correctly.

In general this question was done well by many candidates. There was no problem in deciding what needed to be done, so those candidates who did poorly simply did not have sufficient knowledge of the rules.

Part (b) concerned registration for the purposes of VAT. The majority of the question was done very well including, in particular, the advantages and disadvantages of registering for VAT. However, some candidates' answers lacked precision when it came to the circumstances where compulsory registration is required in that taxable supplies were not clearly defined and/or the 12-month period was not clearly stated. Other candidates wasted time by writing far too much on the recovery of input tax. The one area where performance was not good was the exceptions to the need to register, which were only referred to by a very small number of candidates.

The final part of the question concerned the matters to consider when making a claim to reduce a payment on account of income tax. This was an area that candidates would have been familiar with but it approached it from a slightly unusual angle: it was not done well. Candidates needed to use their common sense as much as anything else here and to recognise that the claim would need to be made before the end of the tax year. This in turn meant that the tax liability would need to be estimated and that interest would be payable if the final liability turned out to be more than the estimated liability. Making these two points would have scored two of the three marks available for this part of the question

Question 5

This question concerned various aspects of capital gains tax, income tax and inheritance tax and was in three parts.

Part (a) required detailed knowledge of the payment of capital gains tax by instalments. It was the most difficult part of the question and was not done well. The fundamental problem here was that candidates simply did not know the rules, such that they had very little to say. The smart candidates kept their answers brief and moved on to the easier marks in part (b) and, particularly, part (c).

Part (b) concerned the penalty for making a careless error in a tax return. The question stated that the error was careless but many candidates described the full range of penalties available for all error types thus wasting time. Having said that, candidates' performance in this part of the question was good with the exception of the meaning of potentially lost revenue (PLR), the figure on which the penalty would be based. PLR is the additional tax due following the correction of the error and not the amount of the undeclared income.

Part (c) required calculations of inheritance tax and was done well. Almost all candidates understood the relevance of the tax payer being UK domiciled rather than non-UK domiciled and most candidates handled the chargeable lifetime transfer correctly.

There were two common areas where marks were lost. First, many candidates omitted to calculate the original inheritance tax liability that would have been paid before the additional information was discovered. This calculation was necessary in order to calculate the tax underpaid. Secondly, many candidates were not sure of



the due date for inheritance tax or, if they knew the six-month rule, they did not know how to apply the rule to the facts.

A minority of candidates did not know the mechanics of inheritance tax particularly well. As a result, they did not deal with the nil rate band correctly or they included the chargeable lifetime transfer in the death estate. Other errors involved applying capital gains tax exemptions to inheritance tax and failing to calculate an estate rate in order to justify the double tax relief available.