

Examiner's report

P6 Advanced Taxation (UK)

December 2013



General Comments

The overall standard in the December 2013 exam was below that of the last few sittings.

The exam was in its 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 3 was the most popular question and question 4 was the least popular.

In general terms, those candidates who did not perform as well as they could were weak in the following four areas.

- They did not answer the question set, such that they provided irrelevant information, addressed the wrong taxes or wrote about the wrong taxpayers.
- They did not take sufficient time to identify the most efficient way to approach the problem, such that the method they used was inefficient.
- They did not have sufficient, precise knowledge of the tax rules within the syllabus.
- They were unwilling, or lacked the confidence, to engage with the computational aspects of question 1(b)(iii) and question 5(a)(ii), perhaps due to a lack of practise of past exam questions.

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 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.
- Practise past exam questions in order to familiarise yourself with the style of questions that you will have to deal with.
- 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 provide a suitable amount of appropriate narrative, calculations that were clear and logical and sensible analysis in relation to the position of Lauda in an appropriately formatted memorandum. On the whole, the performance of candidates in this area was good with the majority of candidates producing a memorandum in a style that was easy to follow.

Specific Comments

Question One

Question 1 concerned two partners in a partnership who were planning to sell their business to a company in exchange for cash and shares. They were then planning to make disposals of the shares. The question was in two main parts.

Part (a) concerned the information required and action to be taken before becoming tax advisers to the two partners. This should have been straightforward but, on the whole, it was not done particularly well. The main problem was a lack of thought before answering the question.

The question asked for the information required **before** becoming advisers to the partners but a significant number of candidates listed the information they would need in order to be able to give advice to them once they had become clients (including personal details, information in respect of prior years and so on). Candidates will always benefit from reading the requirement carefully and thinking before they begin to write their answers. It is important to think about the specifics of the situation, for example, the fact that the partners required sophisticated and specialised tax planning work, such that the firm needed to be sure that it had staff with sufficient knowledge and competence.

Part (b) of the question was in three parts.

Part (i) concerned the capital allowances on the sale of the business to the company. Again, this was reasonably straightforward and again, on the whole, it was not done well. The question asked for a detailed explanation of the calculation of the capital allowances for the final trading period of the business. Accordingly, the answer should have explained how the balancing adjustment would be calculated and explained why the assets could not be transferred at tax written down value.

However, many answers included detailed calculations of capital allowances over many years (despite the fact that the question did not include the information necessary to prepare such calculations) or tried to explain everything about capital allowances, very little of which was relevant to this particular question. A short

thoughtful answer was able to score three marks whereas many answers covering more than a page only scored a single mark.

Part (ii) concerned the inheritance tax and capital gains tax implications of the transfer of shares to a discretionary (relevant property) trust. The majority of this part of the question required an explanation of the calculation of an inheritance tax liability. This was done very well by most candidates. However, performance in respect of the availability of capital gains tax gift relief was not quite as strong; candidates must learn when the various capital gains tax reliefs are available. Gift relief is available where a transfer is immediately subject to inheritance tax regardless of the nature of the assets disposed of.

Part (iii) was the more demanding part of this question. It required a review of whether or not one of the partners should disclaim incorporation relief for 14 marks. There was guidance in the question as to what the review should encompass. This part of the question was not done well.

It was important that candidates approached the question methodically. There was to be a sale of the business followed by a gift of shares and subsequent sales of shares in the future. The question stated that incorporation relief was available on the sale of the business. Candidates needed to calculate the tax that would be charged in respect of these transactions both with and without incorporation relief and then make some sensible comments regarding their findings.

The first thing to note is that many candidates did not have a thorough attempt at this part of the question. Many answers were very short, despite the number of marks available, and some candidates omitted it altogether. Other candidates avoided producing calculations and simply wrote about the issues in general terms which was never going to be particularly successful.

In addition, most candidates who attempted the question did not give it sufficient thought before starting their answers. As a result, many answers were confused and did not cover sufficient ground to score well. In particular, it was often not obvious which aspect of the question was being addressed and the summary of calculations and statement of key issues required by the question were often missing. Finally, many candidates addressed inheritance tax in this part of the question, which was not required and, therefore, could not score any marks.

In addition to the general problems regarding the approach to the question, there were two specific technical problems.

Firstly, the majority of candidates tried to calculate the gain on the disposal of the business by reference to the total value of the assets sold as opposed to calculating the gain on each individual chargeable asset. There was only one chargeable asset in the question, goodwill, so all that was needed was the gain on the goodwill. Secondly, many candidates then struggled with the calculation of incorporation relief and its effect on the base cost of the shares.

The general impression was that many candidates had not practised sufficient past exam questions, such that they were unable to plan their approach to a question of this type and then to carry that plan out.

Question Two

Question 2 concerned a group of companies and various corporation tax and Value Added Tax (VAT) matters. The question was in three main parts.

Part (a) consisted of a corporation tax computation in respect of one of the group companies together with a number of notes. Candidates were required to review the computation, identify any errors and prepare a revised computation with supporting explanations where necessary. This was done well by many candidates.



In relation to the tax adjusted trading income, many candidates thought, incorrectly, that the cost of entertaining overseas customers was allowable. In addition, there was a general, correct, view that the management bonus should be disallowed but very candidates knew that it was because it had not been paid within nine months of the end of the accounting period.

The majority of candidates picked up the point in relation to group relief and arrangements in force in respect of Marussia Ltd. However, candidates did not do so well in relation to the position of Eagle Ltd, which could not be a consortium company as it was a 75% subsidiary of Ligier Ltd.

The majority of candidates handled the degrouping charge and the annual exempt amount correctly.

When calculating the corporation tax liability, most candidates recognised that Eagle Ltd was not an associated company but very few identified the fact that Brawn Ltd was not a close investment holding company, such that the main rate of corporation tax did not apply automatically.

Part (b) of the question was in two parts. The first part required candidates to set out the matters that need to be considered in order to determine whether or not a company is a close company. This was intended to be a relatively straightforward requirement, which then required some thought if a very good mark were to be obtained. However, the majority of candidates simply did not know the rules, such that the performance in this part of the question was poor. On the whole, candidates focussed on the **owners** of the company and knew the rules had something to do with five shareholders and any number of directors. However, the key to the rules is who **controls** the company as opposed to who owns it.

Some candidates tried to make up for their lack of knowledge by writing about the implications of a company being close. As always, regardless of its technical accuracy, such irrelevant information did not score any marks.

The second part of (b) concerned transfer pricing. Many candidates were able to score two out of the three marks but very few addressed the availability or otherwise of the exemption for small and medium-sized enterprises.

Part (c) of the question required candidates to state the conditions and operation of the VAT annual accounting scheme. Candidates' performance in this part of the question was very good. A small minority of candidates confused the annual accounting scheme with group registration, perhaps because there was a group in the question, but the majority produced brief succinct answers that scored well.

Question Three

This question concerned inheritance tax and capital gains tax and was in three main parts.

Part (a) required a calculation of inheritance tax in respect of a potentially exempt transfer following the death of the donor. The majority of candidates performed well and scored high marks. Less well-prepared candidates were unable to value the shares in Sepang plc and/or the amount of the nil rate band to be transferred from the donor's deceased husband. This was because they either did not know the rules or were unable to apply them to the facts in the question. Some candidates failed to identify that the husband's nil rate band was available for transfer.

Part (b) concerned capital gains tax and was in two parts; neither part was done particularly well.

Part (i) required a calculation of the tax due on the sale of shares. The shares had been acquired via gift and had then been the subject of a share for share takeover and a bonus issue. Accordingly, the calculation of the base cost required a certain amount of work.



It was first necessary to realise that, due to the fact that gift relief was not claimed on the original gift (the question stated that gift relief was not available), the base cost of the original shares was their market value at the time of the gift. Following the takeover, this original cost had to be split between the new shares and cash received by reference to the market value of the consideration. Finally, the bonus issue increased the number of shares but had no effect on the total base cost.

A significant number of candidates lost marks here because they side-stepped the first two stages of this calculation by attributing a cost to the new shares equal to their market value at the time of the takeover. The majority of candidates had no problem with the bonus issue.

When calculating the amount subject to capital gains tax it was necessary to deduct EIS deferral relief equal to the whole of the £50,000 invested in EIS shares. Many candidates confused this relief with the relief available in respect of income tax when EIS shares are acquired.

Part (ii) required a statement of the capital gains tax implications of the future sale of the EIS shares. The first problem that some candidates had here was that they answered the question by reference to income tax rather than capital gains tax. Many of those who did address capital gains tax did not score as many marks as they might have done because they were not methodical in their approach. It was important to (briefly) consider four possible situations, i.e. sale of the shares at a profit or a loss both within and after the three-year period.

The final part of the question concerned a particular aspect of a gift with reservation. It was not done particularly well as those candidates who clearly had some knowledge did not pay sufficient attention to the requirement. The question asked how the gift would be treated for the purposes of calculating the inheritance tax due on death. This required consideration of the value to be used, whether or not the reservation was lifted prior to death and the relief available in order to avoid double taxation.

Many candidates wrote more broadly about gifts with reservation, explaining the rationale behind the rules and the actions necessary in order for the reservation to be lifted. These generalisations did not score any marks.

Question Four

This question concerned VAT and overseas issues in relation to corporation tax and income tax. It was in three main parts.

Part (a) required a calculation of the VAT partial exemption annual adjustment in respect of a company. This was done reasonably well by those candidates who had a working knowledge of the *de minimis* rules. A minority of candidates had very little awareness of the rules, such that their performance was poor. Candidates who did not have a precise knowledge of the rules were able to score reasonably well provided they satisfied the requirement and attempted to address all *three de minimis* tests.

Part (b) concerned a company incorporated and trading in an overseas country. It was in two parts.

Part (i) required an explanation of how to determine whether or not the company was resident in the UK. This simply required a statement of the rules regarding country of incorporation and place of management and control but the majority of candidates were unable to state these fundamental rules.

Part (ii) required an explanation of the company's corporation tax liability together with the advantages and disadvantages of making an election to exempt the profits of an overseas permanent establishment from UK tax. This was done well. The majority of candidates prepared a short accurate calculation and were able to state the particular disadvantages of making such an election.



Part (c) concerned the travel and subsistence costs of an employee seconded to work overseas. This was relatively tricky but was done reasonably well by those candidates who were methodical in their approach. In particular, candidates who did not necessarily know all of the detailed rules were still able to score an acceptable mark if they applied basic principles to all three elements of the question.

Very few candidates identified that the overseas workplace would be a temporary workplace. In addition, a minority of candidates discussed the tax implications for the company rather than for the employee. Candidates must read the requirement for each question carefully and ensure that their answer is always focussed on satisfying that requirement.

Question Five

This question was in two main parts.

Part (a) concerned various aspects of income tax and capital gains tax in relation to tax planning for a married couple and was in two parts.

Part (i) required a statement of the conditions that must be satisfied for the letting of a UK furnished property to qualify as furnished holiday accommodation. This was answered very well by the majority of candidates. The only difficulty related to confusion over the meaning of 'longer term accommodation' and the maximum number of days of such occupation permitted in a tax year.

Part (ii) was the more difficult part of the question. It required a calculation of the total tax saving on the transfer of a 20% interest in a rental property from one spouse (Monisha) to the other (Asmat) together with the property being let as furnished holiday accommodation in the future. This was done poorly by many candidates who either did not have a thorough attempt at it or worked very hard but did not pause to think about how to approach the problem.

The key was to first calculate the taxable property income in order to identify the amount of taxable income that would be taxed in the hands of Asmat rather than Monisha. It was then necessary to recognise that for the first five years under consideration, Monisha would be a higher rate taxpayer whereas Asmat's income would be covered by his personal allowance, such that no tax would be payable. Accordingly, by working at the margin, it was easy to see that for the first five years the saving would be 40% of the income transferred. In the sixth year, Asmat was expected to be employed, such that the income transferred would be taxed at 20% and the saving would therefore be 20% (40% – 20%) of the income transferred.

The problem was that very few candidates chose to work at the margin. Instead, many chose to prepare income tax computations for the two individuals before and after the transfer of the interest in the property in order to quantify the difference in the total liability. This was very time consuming. Some candidates even prepared calculations for each of the five years despite the fact that the figures were the same in each year.

Calculating tax liabilities can be very time consuming. Candidates should always stop and think about the most efficient way of approaching a set of calculations before they start writing.

The capital gains tax element of this part of the question was not handled particularly well. This was perhaps due to a shortage of time. It required candidates to recognise that an additional annual exempt amount would be available and that tax would be charged at 10%, due to the availability of entrepreneurs' relief, rather than at 28%. Only a minority of candidates were able to quantify the effect of these points.

Part (b) concerned the personal service company (IR35) rules and was in two parts.



Part (i) required an outline of the circumstances in which the rules apply. The majority of candidates struggled to satisfy this requirement despite a reasonable knowledge of the rules. It was generally recognised that the rules were in place in order to prevent the avoidance of tax but there was some confusion as to exactly where tax was being avoided. Very few candidates were able to state the commercial relationship between the taxpayer, the personal service company and the client in a clear manner.

Part (ii) required a calculation of the deemed employment income under the personal service company (IR35) rules. This was done well or very well by the majority of candidates. The only common error was a failure to calculate employer's national insurance contributions in respect of the salary paid.