

# Examiner's report

## P6 Advanced Taxation (UK)

June 2012



### Introduction

The performance in the June 2012 exam was an improvement on that in December 2011 but not as strong as that of previous sittings. There were many good, concise scripts with some candidates demonstrating a strong, broad knowledge of the syllabus. The majority of candidates attempted virtually all of the parts of four questions.

Although there were, as always, various areas of technical weakness, the most significant issues related to poor exam technique as set out below.

### General Comments

The exam was divided into section A and section B. Section A consisted of two compulsory questions for a total of 64 marks. In section B candidates were required to answer two of the three questions worth 18 marks each. In section B, question 4 was the most popular and questions 3 and 5 were equally popular.

Candidates' performance in this exam illustrated three common failings as regards exam technique. These failings are referred to in detail below in respect of each question but it is useful to summarise them here.

First, candidates must read the questions carefully and identify all of the relevant information. For example:

|            |   |
|------------|---|
| Question 1 | The importance of the Double Tax Agreement information.                     |
| Question 2 | The acquisition of the subsidiaries part-way through the accounting period. |
| Question 5 | The short accounting period and Mr Quinn's ownership of other companies.    |

Secondly, candidates must address all aspects of the question. This means that candidates must be methodical in their approach. They must think about how they intend to satisfy the requirements and identify the precise tasks involved. For example:

|                   |   |
|-------------------|---|
| Question 1(a)     | Candidates needed to consider the inheritance tax <b>and</b> capital gains tax implications of <b>both</b> a lifetime gift and a gift via a will in respect of <b>both</b> potential gifts.                           |
| Question 2(c)(ii) | Candidates needed to consider the possibility of the shares being sold at a profit <b>and</b> at a loss with the substantial shareholding exemption <b>either</b> applying or not applying in <b>both</b> situations. |
| Question 3(b)     | Candidates needed to consider the cost to Jerome <b>and</b> to Tricycle Ltd of <b>each</b> of the two alternatives.   |

Thirdly, candidates must avoid wasting time on matters that are not part of the requirement or on providing too much detail. The amount of detail provided in a written answer should reflect the number of marks on offer and therefore the number of minutes available. The first marks in any question are likely to be easier to earn than later marks, i.e. candidates will find it easier to increase their mark in a ten mark question from zero to four marks as opposed to from four marks to eight marks. Therefore they must attempt all parts of all four questions and give each part the appropriate amount of time. In particular, many candidates provided too much narrative in their answers to the following questions:

|            |  |
|------------|--|
| Question 1 | The basic mechanics of inheritance tax and capital gains tax.                          |
| Question 2 | The basics of corporate losses and the mechanics of the capital goods scheme.          |
| Question 4 | The conditions and rules relating to venture capital trusts and pension contributions. |
| Question 5 | The conditions and rules relating to scientific research and capital allowances.       |

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 1 that some candidates did not know the conditions regarding the availability of reliefs for the purposes of capital gains tax. Similarly, in question 2, some candidates did not know the definitions of a group for the purposes of group relief and chargeable gains.
  - This knowledge must be up to date. Candidates sitting the exam in December 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 question 1. 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) required candidates to prepare a memorandum with supporting calculations in relation to two proposed gifts of high value assets. Part (b) required candidates to write a letter addressing the implications of the non-declaration of taxable income.

Part (a) concerned a proposed gift by Una to her son of either some farmland situated in the UK or a villa situated overseas. Candidates were required to prepare calculations of the inheritance tax and capital gains tax payable in respect of each of the possible gifts, explanations, particularly in relation to the availability of reliefs and a concise summary of the calculations.

This question was answered reasonably well. In particular, only a minority of candidates confused the rules of inheritance tax and capital gains tax. Also, many candidates demonstrated strong technical knowledge of the mechanics of inheritance tax and agricultural property relief. Now that inheritance tax has been part of Paper F6 for a while, candidates sitting Paper P6 can expect to see more questions in this style, i.e. questions which work at the margin rather than requiring complete tax computations.

The one common error in relation to inheritance tax was a failure to realise that the earlier cash gift had no effect on the nil band in respect of the later gift as it was made more than seven years prior to death. Other, less common, errors included deducting taper relief from the value transferred rather than from the inheritance tax liability and deducting the annual exemptions from the death estate.

The capital gains tax elements of the question were not handled as well as inheritance tax. Many candidates did not know the conditions relating to the availability of capital gains tax reliefs and simply assumed, incorrectly, that gift relief would be available. A substantial minority also forgot the fundamental point that there is no capital gains tax on death and calculated liabilities in respect of both lifetime gifts and gifts via Una's will.

However, the main problems experienced by candidates related to exam technique. There were three particular problems; failing to read the question sufficiently carefully, failing to address all of the requirements and running over time.

When reading the question, many candidates failed to identify the relevance of the exemption clause in the Double Taxation Agreement. The effect of the clause was to exempt the overseas villa from UK inheritance tax. This meant that, when dealing with the villa, candidates needed only to consider the tax suffered overseas. Those candidates who failed to appreciate this did not lose many marks but wasted time calculating UK inheritance tax on the villa.

The question required calculations of the 'possible reduction in the inheritance tax payable as a result of Una's death' in respect of each of the possible lifetime gifts. This required candidates to compare the tax arising on a lifetime gift with that arising if the asset passed via Una's will for both of the assets. There was then the need to consider the capital gains tax on the lifetime gift whilst remembering that there would be no capital gains tax if the assets were retained until death. Finally, candidates were asked to provide a concise summary of their calculations 'in order to assist Una in making her decision'.

The problem was that many candidates were not sufficiently methodical such that they did not carry out all of the necessary tasks and missed out on easy marks. In particular, many candidates did not provide the final summary.

The final problem in relation to exam technique related to time management: it was evident that some candidates did not have a sufficient sense of urgency when answering this question. This resulted in lengthy



explanations of how inheritance tax, and, to a lesser extent, capital gains tax, is calculated together with details of Una's plans.

The question asked for 'explanations where the calculations are not self-explanatory, particularly in relation to the availability of reliefs'. Candidates need to think carefully before providing narrative as writing is very time consuming. They should identify, in advance, the points they are planning to make and should then make each point in as concise a manner as possible. There is likely to be a mark for each relevant point so each one should take no more than two short sentences.

Part (b) required a letter in relation to the non-declaration of income and was done reasonably well. There were two elements to a good answer: the penalties that could be levied on the taxpayer and the professional issues relating to the firm of accountants. The two elements were indicated clearly in the question which stated that 'the letter should explain the implications for Una and our firm'. Those candidates who failed to address both elements struggled to do well.

### **Question Two**

Question 2 concerned the Janus plc group of companies and was in four main parts. It required candidates to have a broad knowledge of corporation tax and VAT together with the ability to move from one technical area to another briskly. The first part of the question concerned losses and was done well. Performance in the remaining parts varied considerably from candidate to candidate.

Part (a) concerned the relief available in respect of a trading loss made by Janus plc, a group holding company. Candidates needed to consider the reliefs available in Janus plc itself, group companies and a consortium company. The group companies were acquired part way through the loss-making period.

The majority of candidates identified most of the relevant information in the question and knew how to relieve the loss in order to maximise the tax saving. Only a minority of candidates identified that there were only four associated companies in the period prior to the loss.

Some candidates spent too long on this question and provided very detailed explanations of group relief and consortium relief; the amount of detail provided must relate to the number of marks on offer. Also, there was a tendency to repeat things, for example stating that Janus plc is in a loss group with Seb Ltd and Viola Ltd followed by a statement that it was not in a loss group with Castor Ltd. Candidates should identify the points they intend to make and then make them as concisely as possible. They will find this more efficient than making it up as they go along.

Part (b) was in three parts.

Part (b)(i) required an explanation of how the chargeable gain on the disposal of a building would be calculated. Those candidates who knew their stuff, slowed down, thought more and wrote less did well.

This question demanded a clear understanding of the conditions necessary for a chargeable gains group to exist. Unfortunately many candidates thought that Janus plc and Pollux Ltd were members of a chargeable gains group; this was not the case because Janus plc does not own at least 75% of Castor Ltd. Other candidates failed to notice that Castor Ltd and Pollux Ltd **were** members of such a group.

The other technical problem that candidates had with this question was that many thought it included a degrouping charge. However, a degrouping charge can only occur when a company leaves a chargeable gains group, i.e. there needs to be a sale of shares, and this question involved the sale of a building. Accordingly, time spent writing about degrouping charges was wasted.



Part (b)(ii) required candidates to apply the capital goods scheme to the purchase, use and subsequent sale of a building. This was done well by those candidates who both knew what to do and had practised applying the rules prior to the exam. Weaker candidates had a vague, confused knowledge of the rules or simply tried to describe them as opposed to apply them to the specific circumstances of the question. Very few candidates knew how to handle the adjustment following the sale of the building.

Part (b)(iii) concerned the sale of an intangible asset and was done reasonably well by the majority of candidates.

Part (c) was in two parts.

Part (c)(i) concerned the purchase of services from overseas to which the reverse charge applied. It was not answered particularly well; very few candidates had a clear understanding of the VAT treatment of the transaction.

Part (c)(ii) concerned the sale of shares in a company and was answered well. It required candidates to recognise that the substantial shareholding exemption might apply to the sale provided the conditions were satisfied. This question illustrated the need for candidates to be methodical as, if maximum marks were to be obtained, candidates needed to consider four situations; sale at a profit and sale at a loss with the substantial shareholding exemption either applying or not applying in each case.

Part (d) concerned the responsibilities of a senior accounting officer. Only a minority of candidates knew the rules, but those who did answer the question well.

### **Question Three**

This question concerned the VAT implications of the sale of a business by Jerome to Tricycle Ltd, the total tax cost of leasing a car and the payment of travel expenses in respect of the family of an employee working overseas. It was in three parts.

Part (a) required an explanation of the VAT implications of the sale of a business to a company. Candidates first needed to recognise that the sale was a transfer of a business as a going concern such that VAT should not be charged. This was done well with the majority of candidates listing the conditions that needed to be satisfied.

Candidates were then expected to realise that the building being sold was a commercial building that was less than three years old. Accordingly, VAT would need to be charged in respect of the building unless the purchaser made an election to tax the building at the time of purchase. Very few candidates identified this point.

Part (b) required calculations of the total tax cost for Tricycle Ltd and Jerome in relation to the lease of car. The car would be leased by Jerome, an employee of the company, or by Tricycle Ltd. This was a practical problem that was not particularly technically difficult but required care and thought in order to score well. It was not done as well as it should have been.

The point here was that Jerome owned Tricycle Ltd such that he was interested in the total tax cost to himself and the company in respect of each of the two options. Candidates needed to recognise that there were tax implications for both the employer, Tricycle Ltd, and the employee, Jerome, in each situation. For example, if Jerome leased the car, the payment of 50 pence per business mile was tax deductible for the company but resulted in taxable income for Jerome. There was also the need to consider national insurance contributions as well as income tax and corporation tax.

The main problem for candidates was a lack of exam technique. In particular, weaker candidates did not spend sufficient time thinking about the different tax implications for both parties in each situation but focussed on Jerome when he leased the car and on Tricycle Ltd when it leased the car.

There was also considerable confusion as to what represented a 'tax cost'. A tax cost (or saving) was either income/expenditure at an appropriate tax rate or a direct tax cost due to the arrangement, for example class 1A national insurance contributions. Many candidates did not multiply income/expenditure by tax rates or simply got lost in the distinction between what is taxable and what is allowable for tax purposes. This led to various errors including, indicating that the benefit in respect of the car was an allowable expense for the company or that the leasing costs paid by Jerome were deductible from taxable income.

The final part of the question concerned the payment of travel expenses in respect of a family of an employee working overseas. This was a minor part of the question for two marks. It rewarded those (few) candidates who had acquired a knowledge of the less frequently examined areas of the syllabus.

#### **Question Four**

This question concerned an individual, Tetra, who had been made redundant and then joined a partnership. It required knowledge of the tax treatment of redundancy payments, opening year rules for the unincorporated business, venture capital trusts and pension contributions.

The first part concerned the tax treatment of statutory redundancy, compensation for loss of office and a payment for agreeing not to work for a competitor. It was a test of knowledge and was done well by the majority of candidates with many scoring full marks. The only problem that some candidates had was a tendency to write too much. There were only three marks available so only three points were required. Some candidates wrote significantly more than this and used time that they should have been using elsewhere.

Part (b) required candidates to calculate the class 4 national insurance contributions in respect of a partner's first year of trading. It required knowledge of the opening year rules, the allocation of profits between partners and the calculation of national insurance. It was done well. Common errors included the treatment of the partner's salary as employment income rather than trading income and the failure to adjust the profit for the partners' salaries before splitting the remainder between the partners.

The final part of the question concerned the tax implications of investing in a venture capital trust and of making pension contributions; it was not done as well as expected. Candidates were required to 'compare the effect of the two alternative investments on Tetra's income tax liability'. This meant that calculations were required. However, many candidates simply treated the question as being about venture capital trusts and pension contributions and explained all the rules they could remember that related to these two areas of the syllabus. Marks are only awarded in the exam for relevant points that address the requirements and much time was wasted here that could have been spent earning marks.

There were, however, many knowledgeable answers to this part of the question. Many candidates successfully identified the effect of making pension contributions on Tetra's personal allowance situation. In addition, the majority of candidates were able to explain the effect on the basic rate band of making pension contributions and the tax relief available in respect of the investment in a venture capital trust.

#### **Question Five**

Question 5 concerned two unrelated companies, Sank Ltd and Kurt Ltd. The question required knowledge of corporation tax payments, enquiries into corporation tax returns, capital allowances and scientific research. The question was in two main parts.

Part (a) concerned the payment of corporation tax by Sank Ltd and enquiries. The payment of corporation tax appeared to be fairly straightforward but care was needed if sufficient marks were to be earned. It was not enough to state that the company would pay corporation tax quarterly because it was paying tax at the main rate. Candidates needed to explain how they knew the rate of tax the company was paying (i.e. by reference to its



profits and the number of associates). There was also a need to point out that the company paid tax at the main rate in the previous accounting period.

Weaker candidates calculated the company's tax liability whilst ignoring the associated companies thus wasting a lot of time. Such candidates would have benefited from slowing down, reading the question carefully and thinking before they began their answers.

The majority of candidates did not realise that interest would be charged on any quarterly payment that was less than a quarter of the company's final tax liability of the period. Weaker candidates confused quarterly accounting with the payments of income tax by individuals and thought that the payments were paid on account by reference to the liability for the previous year.

Part (a)(ii) related to enquiries into a corporation tax return. It required candidates to explain the validity of the compliance check enquiry 'in relation to the date on which (it)..... was raised'. Many candidates simply wrote about compliance check enquiries generally such that this part of the question was not answered well.

Part (b) related to capital allowances and scientific research. Most candidates produced reasonable answers but many would have done better if they had simply read the question more carefully and identified the relevance of all of the information and slowed down. In particular, many candidates wrote about the basic rules at some length rather than thinking about the particular situation of the question.

The owner of the company concerned owned three other companies. This information was intended to elicit a discussion of the need to split the annual investment allowance between the companies. However, many candidates wrote instead about the unavailability of group relief. The question also pointed out that the relevant accounting period was only eight months. This meant that the annual investment allowance and the writing down allowance needed to be multiplied by 8/12. However, this point was missed by many candidates.

A significant number of candidates were of the opinion that, because the company was loss-making, it should not claim all of its capital allowances. It should be remembered that, where the annual investment allowance is concerned, failing to claim allowances in full will considerably slow down the time it takes for a tax deduction to be obtained for the cost incurred as, in the future, there will only be a 20% writing down allowance on a reducing balance basis. Accordingly, there needs to be a strong reason not to claim allowances in full. Such a reason might include the situation where there are insufficient profits in the group to relieve a company's losses in the current year and any losses carried forward are likely to be locked inside the company for a considerable period of time. In such a situation it may be worthwhile claiming reduced capital allowances in the current year in order to have increased capital allowances in future years that can then be group relieved.

The tax treatment of the expenditure on scientific research was explained well by the majority of candidates, many of whom were aware that there was a possibility of claiming a 12.5% repayment. However, very few candidates attempted to evaluate whether or not the repayment should be claimed.