

# Examiner's report

## P6 Advanced Taxation (UK)

### September 2015



#### General Comments

The overall standard in the September 2015 exam was quite pleasing.

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

- They made no or very little attempt at question 1(a)(i).
- They did not spend sufficient time carefully reading the question and thinking before they started writing. This meant that they failed to address the question from the required angle, or produced an unstructured answer which tended to lead to unnecessary repetition.
- They wasted time providing information that had not been asked for.
- They did not attempt every part of four questions.
- They did not have sufficient, precise knowledge of the tax rules within the syllabus, particularly some of the more fundamental rules contained in the F6 (UK) syllabus.

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 includes knowledge brought forward from the F6 (UK) syllabus.
2. Practise questions from past exams with the aim of adopting the style of the model answers. In particular, candidates should practise the often more intellectually demanding Section A style questions.
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 satisfy the requirement.

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. This should include any technical areas brought forward from F6 (UK) where necessary.
- 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 demonstrate a professionally acceptable style and presentation, provide explanations and calculations that were clear and logical and follow the instructions in the question. On the whole, the performance of candidates in this area was reasonably good with the majority of candidates producing a document in a style that was easy to follow. Part (a)(i) was a notable exception in some cases where a significant number of candidates failed to demonstrate a logical approach to explaining and taking relief for the trading loss.

### **Specific Comments**

#### **Question One**

Question 1 concerned the commencement of an unincorporated business, including consideration of a potential loss in the first accounting period and the employment status of part-time salesmen. There was also a requirement to amend an inheritance tax computation in respect of a death estate.

Part (a), which was in three parts, related to a sole trader business. Part (a)(i) required candidates to calculate an individual's post-tax income for the first two tax years of trading, after considering the optimum relief for a trading loss in the first accounting period. A small number of candidates achieved full, or nearly full marks for this part but a significant minority made no or very little attempt to address this part of this question, suggesting a lack of preparation for this type of question. Unincorporated business are tested in every paper, and questions frequently demand consideration of basis periods and/or relief for trading losses, so question practice on these areas should always form an important part of all candidates' preparation for this exam.

Relief for trading losses is a technically demanding area, which requires accurate knowledge of what reliefs are available in which situations, and the precise rules or conditions in each case. Many candidates confined themselves to discussing just one method of loss relief, whereas careful reading of the question indicated that there were different options available and a decision was to be made regarding the optimum method of relief, thereby suggesting that more than one method of relief was available.

It appeared that many candidates would have benefited from pausing and thinking more before they started to write. It is important in a question dealing with relief for losses that a well-considered and logical approach is taken. Weaker candidates prepared detailed income tax computations for several tax years in the apparent hope that this would eventually lead to being able to determine the rate of tax paid in each year, and an ability to calculate the tax refund suggested by the question. The problem with this approach was that it was very time consuming and tended to produce redundant information as tax years were included for which it was not possible to offset the loss. Candidates should be advised to consider first of all the tax years in which they believe loss relief is available, before launching into a series of detailed computations for which there are no marks available.

Part (a)(ii) concerned the employment status of two part-time salesmen and was done extremely well. The majority of candidates were able to identify which of the specific contractual arrangements given in the question concerning the work to be done by the salesmen indicated self-employment and any changes required to the other arrangements in order to maximise the likelihood of the salesmen being treated as self-employed. Many candidates gave the impression of being very confident with this topic, and happy to write at length about the different arrangements, giving the impression that they may well have exceeded the four marks worth of time which should have been allocated to this part. Candidates should always take note of the number of marks available for each question part and resist the temptation to elaborate unnecessarily on areas with which they are very comfortable.

Part (a)(iii) covered the ethical issue of confidentiality in relation to using knowledge and experience gained from dealing with both current and ex-clients to assist a new client. This part was done very well by the vast majority of candidates, with many scoring full marks. It was pleasing to see that most candidates related well to the specific client and the facts given in the scenario.

Part (b) of this question required candidates to identify errors in an inheritance tax computation on a death estate, and to calculate the amount to be received by the sole beneficiary of the estate, after the correct inheritance tax had been paid.

Performance on this part of the question was mixed, with a disappointing number of candidates believing that the capital gains tax exemption for chattels with a value below £6,000 also applies to inheritance tax, and that inheritance tax annual exemptions are available against assets in the death estate. These are fundamental errors which candidates at P6 should not be making. Candidates should ensure that they are able to identify and apply correctly the different exemptions available for capital gains tax and inheritance tax as these are tested on a very regular basis.

In order to calculate the correct amount of inheritance tax to be paid after correcting the errors found, the majority of candidates rewrote the entire death estate. This succeeded in gaining the relevant marks, but was probably fairly time-consuming, and candidates are encouraged to try and adopt a more efficient approach, focusing on the effect of correcting the error on the value of the chargeable estate as this would save time.

Questions at P6 frequently ask for a calculation of after-tax proceeds – here, the amount receivable by the sole beneficiary of the estate. Candidates need to think more carefully about the starting point for this type of calculation. Here, it wasn't the value of the chargeable estate, as this includes a deduction for the nil rate band. Candidates needed to identify the actual value which would be received prior to making this deduction. Failure to identify the correct starting point is a common error.

## **Question Two**

Question 2 concerned the calculation of corporation tax payable by a company which had produced accounts for a long period of account, and consideration of the differences between the share capital of the company being purchased by an individual, or by another company. There was also a short requirement relating to registration for VAT.

Part (a) required a calculation of the corporation tax payable for a company in respect of a 16-month set of accounts, including consideration of two asset disposals where rollover relief had been claimed previously. It was surprising, and indeed disappointing, to see that the majority of candidates calculated the corporation tax payable for the 16-month period as a whole, rather than recognising the need to split this into two separate accounting periods, the first covering the first 12 months and the second covering the remaining four months. This led to the loss of a number of what should have been easy marks. Candidates are reminded that a good level of familiarity with the F6 (UK) syllabus is required for P6; it is not enough to just focus on the new areas, candidates must ensure that they are also confident in dealing with more basic issues.



The majority of candidates recognised that the sale of the two business assets would cause the gain rolled over on the acquisition of these assets to become chargeable. However, the different treatments in respect of the depreciating asset (fixed machinery) and non-depreciating asset (building) was identified by only a small number of candidates.

Part (b) was for 12 marks and was the largest part of the question. It required a comparison of the tax implications of a company being acquired by an individual as opposed to by another company. Candidates who did well had a good knowledge of the subject, adopted a sensible, logical approach and addressed all of the issues briefly, as instructed in the question. Weaker candidates fell down in at least one of these areas.

The adoption of a logical approach in this sort of question requiring a comparison of two alternatives can save considerable confusion and avoid wasting time due to needless repetition. Candidates should pause and think before they start writing. Dealing fully with the implications of one of the alternatives first, and then the other, tended to provide a much clearer answer than those who adopted a less logical approach, apparently writing points as they occurred to them, without making it clear which alternative they were dealing with, constantly swapping between the two, and leading to a confusing answer.

Candidates should avoid repetition, including making the same point from different angles. An example in this case would be where a candidate has stated that if the company is acquired by another company, they would form a group for group relief purposes. Stating separately at a later point that if acquired by an individual there will not be a group for group relief purposes, scored no additional marks.

Part (c) concerned the often-tested area of registration for VAT, an area which the vast majority of candidates are very technically comfortable with. However, all but a handful failed to read the question in sufficient detail, and provided a very detailed account of the tests applied to determine whether compulsory registration is required, but this did not address the question and wasted a good deal of time. Where the subject coverage is very familiar it is particularly important to understand the context in which it is being tested. In this case, the key issue was recognition that monitoring the level of cash receipts is not relevant, it is the level of taxable supplies, i.e. the invoiced value of taxable sales which is relevant.

### **Question Three**

This question concerned the tax treatment of a small company's expenditure on research and development, the tax implications of two asset sales, and the loss relief available in a joint venture situation. It was in three main parts.

The first part required an explanation of the tax relief available for a small company in respect of expenditure on research and development. The majority of students were aware that directly related revenue expenditure qualifies for an additional 125% deduction, but were rather vague in their explanations as to why items were or were not included. A small minority wasted time by discussing the tax credit which could be obtained in respect of a loss created by the enhanced deduction, despite there being no mention of a loss in the question, nor sufficient information to be able to calculate one.

The first of the two assets sold was an intangible asset, which was sold to a wholly-owned subsidiary. Intangible assets are examined fairly frequently at P6, so candidates need to be aware of their tax treatment as trading assets, rather than capital assets, for companies, which will give rise to a balancing charge or allowance on sale, rather than a capital gain or loss. In the case of a transfer between two companies in a 75% group, the asset will be transferred at its written down value, thereby giving rise to neither profit nor loss. Interestingly, the majority of candidates identified one or other of these points, but very few identified both.



The second asset disposal related to shares in an unquoted trading company. This was the sale of an 8% shareholding in a company following a sale of 4% the previous year. In any question regarding the sale of shares in one company by another, candidates should automatically consider the application of the substantial shareholding exemption (SSE). This is an area where it is very important to know the precise conditions, to be able to state definitively whether or not the exemption applies, and the reasons why, or why not. In this case the timing of the disposal was critical; bringing the date of disposal forward would mean that the requirement to hold at least 10% of the shares for a continuous 12 month period in the two years prior to sale would be satisfied, whereas this would not be the case if the disposal was delayed. An ability to advise on the timing of transactions in respect of all taxes is an important skill at P6.

The final part of this question concerned a proposed joint venture between two companies, where two alternative group structures were being considered. The new company to be set up would be lossmaking initially. The key issue here was to be able to differentiate between a group for group relief purposes (which requires one company to have a minimum 75% holding in another) and a consortium (which is formed where two or more companies hold a minimum of 75% between them in a third company, each with at least 5%, but none holding 75% or more on their own). It was disappointing to see that a good number of candidates were unclear on these definitions, thereby producing incorrect answers and scoring few marks. However, well-prepared candidates who were able to make this distinction tended to go on and score well in respect of the way in which the new company's trading losses could be relieved.

#### **Question Four**

This question concerned the capital gains tax and inheritance tax implications of two gifts to be made by an individual.

Part (a) related to a gift of loan stock in a company. Despite being told in the question that the loan stock was a qualifying corporate bond for capital gains tax purposes, a lack of technical knowledge or inadequate reading of the question meant that the majority of candidates did not identify this as an exempt asset. This led to a considerable amount of time being wasted in many cases as candidates went on to calculate a gain and consider available reliefs. As stated previously in relation to question 1(b), an ability to recognise exempt transactions, for both capital gains tax and inheritance tax, is something that is frequently tested.

The loan stock had been acquired in exchange for shares on the takeover of an unquoted company. It was pleasing to see that a majority of candidates realised that they needed to calculate the cost of the loan stock by reference to the value of loan stock and shares received in the exchange. However, having done this few realised that this needed to be used to calculate a gain at that date, and that this would then be frozen until the later date of disposal of the loan stock. Admittedly this is a difficult area, but many candidates would have scored higher marks if they had paid more attention to the requirement to 'Explain' the capital gains tax implications, as well as performing the calculations.

Part (b) related to the gift of shares in an unquoted company. The question stated that gift relief was to be claimed, but despite this, several candidates included an unnecessary explanation of the conditions to be satisfied for this claim. If a question indicates that a particular relief is to be claimed, candidates should accept that the conditions must be satisfied, and not waste time discussing them. The purpose of the question here was to focus on the practical implications of taking the relief, and not the conditions required.

It was very disappointing to see that the majority of candidates ignored (or didn't know what to do with) the information given regarding the value of the various assets owned by the company at the date its shares were gifted. These values were required in order to calculate the amount of gift relief available, which was restricted to the proportion of the gain relating to the business assets only, (Chargeable business assets/total chargeable assets). They were also needed to calculate the business property relief available for inheritance tax purposes in



the following part of the question, so there were a good deal of marks at stake here such that well-prepared candidates were able to score highly on these business reliefs.

Part (c) related to the inheritance tax implications in relation to the gift of shares in part (b) on the assumption that the donor died within five years of making the gift. Explanations were required, together with supporting calculations, but a significant minority of candidates produced only calculations, with little, if any written explanation. Marks are specifically awarded for written explanations in these questions, in the absence of which these will be lost or severely restricted. However, the most common issue related to candidates' dealing with the two prior lifetime gifts. These were included in order to ascertain availability of the nil rate band and annual exemptions when discussing availability of reliefs and exemptions for the gift of unquoted shares in the question. No calculations were required in respect of these two earlier gifts, but a good many candidates wasted a considerable amount of time producing these and calculating the tax payable on each. It is very important to take time to read the requirements carefully so as not to waste time providing superfluous calculations.

#### Question Five

This question concerned the income tax implications of receiving overseas income and the definition of and capital gains tax reliefs available for furnished holiday accommodation, and the VAT schemes available for small businesses.

Part (a) required a calculation of the after-tax income from an overseas rented property. There were a good number of easy marks here for producing a respectable-looking income tax computation, which most candidates achieved, but the double tax relief aspect was done rather less well. The majority of candidates were aware that double tax relief is available as a tax credit against the UK tax liability, equal to the lower of the overseas tax deducted and the UK tax attributable to the overseas income, although a minority believed that the absence of a double tax treaty between the UK and the overseas country precluded this. Candidates should recognise that double tax relief is always available as a tax credit against the UK tax liability unless specifically excluded by such a double tax treaty. Candidates are more accustomed to seeing this tested under corporation tax rather than income tax, and only a handful adopted the correct method for calculating the UK tax liability in respect of the overseas income. It is important to be aware of the methods for calculating this for both of these taxes.

Part (b) concerned a furnished holiday letting (FHL). Most candidates were able to state the conditions required for a property to qualify, but didn't achieve full marks as they didn't actually address the precise requirements asking them to consider the information in the question and state what **additional information** was needed from the client in order to determine whether the property would qualify. Once again, it is important to read the question carefully to ensure that marks which could have been gained are not lost due to approaching the answer from the wrong angle.

This part then went on to require an explanation of the capital gains tax advantages ensuing on the sale of a FHL. Despite the question clearly stating that only capital gains tax advantages were required, many candidates included other advantages of a property being treated as a FHL including inclusion in earnings for pension contribution relief purposes, and the availability of business property relief for inheritance tax, which unfortunately weren't relevant and only served to waste time.

Part (c) related to the VAT special schemes which are available for small businesses, the main details of which many candidates clearly know well. However, the slant of this question was a little different as it required candidates to focus on the administrative advantages of the schemes only, and their availability to the sole trader in question. Consequently candidates did not perform as well as they probably could have done on this part, as they included too much irrelevant information. Once again, the message for candidates is to ensure that their answer directly addresses the question set, rather than providing more general discussion on the subject.