

Examiner's report

P6 Advanced Taxation (UK)

June 2011

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

Introduction

Performance in the June 2011 exam continued the positive trends from recent sittings; there were many good scripts and the vast majority of candidates attempted all of the parts of four questions. In addition, the majority of scripts were relatively concise and candidates demonstrated an impressive willingness in question 1 to work right through to the end of a long question.

The most significant issues for weaker candidates were a failure to take account of the guidance given in the questions and a tendency to address technical areas in general terms as opposed to the facts given in the questions.

It is still true to say that many candidates would benefit from thinking more and writing less.

General Paper 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, questions 3 and 5 were equally popular; question 4 was the most popular question. 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 that many weaker candidates did not know the conditions that needed to be satisfied in order for capital gains tax reliefs to be available in question 1 or the precise rules regarding partial exemption and default surcharge in question 2.
 - 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.
 - Think about the issues before you start and identify a strategy 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 questions 1 and 2. In order to earn these marks candidates first had to satisfy the requirement in relation to the style and format of the document requested. Further marks were then available for providing clear explanations and coherent calculations.

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 a substantial question in two parts. Part (a) required candidates to prepare notes and calculations in connection with a number of proposals designed to increase the income of Farfisa, the daughter of a client, Calisia. Part (b) required an explanation of the manner in which Calisia's inheritance tax liability would be calculated on her death.

Part (a) was for 21 marks. With a question part of this size it was important for candidates to be clear as to what they had been asked to do and how they were going to do it. It was very pleasing to see the majority of candidates taking a well-structured approach to this question and addressing all of the alternatives in a consistent manner. There were some very good answers to this question with some candidates scoring full marks.

The question centred on capital gains business reliefs and the taxation of various sources of income. The income tax elements were done well but candidates' knowledge of business reliefs was often not as good as it could have been. However, there was a clear indication that candidates were taking the right approach to capital gains tax in that they were considering the availability of reliefs every time a gain arose. This was very good to see and it now remains for candidates to improve their knowledge of the conditions that must be satisfied for the reliefs to be available.

The first task was to calculate the amount of additional income required by the client's daughter, Farfisa. This was a relatively simple task and many candidates scored full marks. Other candidates failed to identify that the proposed loan was for less than £5,000 such that it was an exempt benefit or were not careful enough in distinguishing taxable income (income less personal allowance) from post-tax income (income less tax).

Under the first alternative the income was to be provided via a transfer of quoted shares. The majority of candidates were happy calculating the number of shares to be transferred but many failed to consider how the dividends would be taxed in the hands of Farfisa. Those who did address this point often considered the rate of tax but not the credit. The point that needed to be identified was that there would be no tax to pay on the dividend income because, as Farfisa would be a basic rate taxpayer, the tax liability would be covered by the tax credit.

Under the first alternative candidates then had to calculate the capital gain on the proposed gift of the shares. This is where some candidates began to have problems as they thought that gift relief would be available.



However, the relief was not available because the shares were quoted and Calisia did not own at least 5% of the voting rights.

Under the second alternative candidates had to calculate the capital gains on the proposed sale of a building that was rented out as qualifying furnished holiday accommodation. Calculating the gain was simple; but again there was the need to consider the availability of business reliefs. Many candidates failed to realise that entrepreneurs' relief would be available such that tax would only be taxed at 10%. A minority of candidates also had the problem here of distinguishing a taxable gain (proceeds less cost) from post-tax proceeds (proceeds less tax). Under the third and fourth alternatives the rental property was to be gifted rather than sold. Candidates had to identify that gift relief would be available under both alternatives. It was then necessary to consider how the rental income received by Farfisa in respect of the property would be taxed. Under the third alternative the income would be simply be taxed at 20%. But under the fourth alternative rent a room relief would be available. These points were identified by the vast majority of candidates.

Candidates were also asked to consider stamp duty and stamp duty land tax and to prepare a summary of the capital gains tax liabilities under each of the alternatives. A minority of candidates did not carry out one or both of these tasks thus sacrificing some fairly easy marks.

Part (b) required candidates to prepare a comprehensive explanation of how Calisia's inheritance tax liability would be calculated; this was done well by many candidates.

This question was fairly unstructured such that candidates had to think and impose their own structure in order to maximise their marks. Candidates who failed to do this often repeated themselves, did not cover sufficient aspects of the question and included material in their answers which was irrelevant. In particular, some candidates wasted time by writing about inheritance tax in general terms, including giving general advice on inheritance tax planning, or by preparing computations when they were told not to.

Candidates' knowledge of inheritance tax was often very good. The link between domicile and the taxation of overseas assets, the transfer of the husband's nil rate band, the treatment of the donation to the political party and the taxation of the client's home were identified and understood by the majority of candidates.

Business property relief was often explained well although, as always, there was a small minority of candidates who confused reliefs available in respect of capital gains tax with those available in respect of inheritance tax. It was important to provide some detail here (the requirement was for a comprehensive explanation) so a statement that 'business property relief would be available' was, despite being true, insufficient to score. Candidates needed to address the assets that would qualify for the relief, the qualifying ownership period and the rate of relief; many candidates did not address as much as they could have.

In respect of the property situated overseas, the marks available for explaining the relief in respect of tax suffered overseas were missed by many candidates. Other marks that were often missed included the deduction available for the costs of administering the property situated overseas, the treatment of Calisia's home, the deduction available in respect of funeral costs and the need for the political party to qualify in order for the donation to be exempt.

Question Two

Question 2 concerned the taxation of a company, Glenz Ltd, and was in two parts.

Part (a) concerned value added tax (VAT), corporation tax and national insurance. Candidates' performance was pretty mixed with some very good scripts, some very poor ones and a range in between.



The VAT element required calculations and explanations of the company's VAT liabilities for two quarters. This was done well by those candidates who knew how to do it but, unfortunately, many candidates had little more than an awareness of the rules and did not know how to apply them to the facts. There is always a reasonable number of marks in the exam relating to VAT and changes introduced by the latest Finance Act are often examined so it should not have been surprising to see partial exemption being tested.

The corporation tax element required calculations and explanations of the company's corporation tax liability. This was done well by the majority of candidates. The question required an *explanation* of the number of associated companies (ie by reference to Petzold's control of Glenz Ltd and Clementi Ltd) and the consequent rate of tax payable by reference to the limits. Many candidates took these points for granted such that they did not score as well as they could have.

The information in the question relating to the two three-month periods resulted in a small minority of candidates preparing meaningless calculations of tax for each of the periods. This is something they would never have done in their preparation for the exam or ever seen in a textbook. A small minority of candidates recognised that the company was marginal and proceeded to calculate the tax on the whole of the taxable profits at the marginal rate. This is not the way the marginal rate works; the marginal rate is only relevant in relation to the profits between the limits.

The national insurance element was straight forward and done well by those who attempted it. The problem was that many candidates did not identify the need to carry out the calculations despite the clues in the question. Part (b) concerned the company's cash flow position in relation to VAT, the treatment of a refund of corporation tax and the sale and leaseback of a warehouse.

The VAT element concerned the default surcharge penalty. Just as with the VAT element of part (a), it was done very well by those who knew the rules and (inevitably) considerably less well by those who did not. As noted above, candidates would do well to recognise that VAT features in every exam.

The client was proposing to retain a recently received tax refund despite not knowing what it was for. Candidates were expected to recognise that this was not acceptable behaviour and the vast majority were able to do so. However, a minority of candidates did not do much more than that such that they failed to explain the implications of not returning the money in relation to both the client and its advisers.

The implications of the sale and leaseback were covered well by many candidates. In some ways this element was similar to question 1(b) in that candidates had to slow down and think in order to provide sufficient information. The question asked for a 'detailed explanation' of relief of the gain via rollover relief. This required candidates to consider the nature of potential replacement assets, the period in which the replacement assets needed to be acquired, the implications of reinvesting some, rather than all, of the proceeds and the manner in which the relief would be given. Very few candidates addressed all of these matters but it is likely that the vast majority of candidates knew something about all of them. When asked to write in detail, candidates must plan their answers such that they cover all of the relevant issues.

Question Three

This question concerned a new unincorporated business. It was in two parts.

Part (a) concerned the choice of year end for the new business; it was answered poorly by a majority of candidates but very well by the remainder.

The question was slightly unusual in that it required candidates to explain why something was true; namely that one year end rather than another would be likely to delay the first tax year in which the business makes a taxable profit. This required candidates to apply their technical knowledge to the facts of the question

In order to answer this question, candidates needed to know the opening year rules for an unincorporated business. However, they also had to reach the conclusion set out in the question. The problem here was that many candidates did not pause and think about what they had been asked to do. Instead, they simply wrote about opening years in relation to overlap profits, utilisation of losses or tax payment dates.

Candidates who did well either thought before they began writing, such that they submitted very concise answers that neatly summarised the position, or explored the opening year rules for each of the year ends and reached the required conclusion.

Part (b) required a comparison of employing someone with going into partnership with them. There were lots of marks available, many of which were straightforward and, on the whole, this part was answered reasonably well. However, many candidates could have done considerably better if they had recognised all of the help that was provided to them in the question and had taken the time to consider whether or not they had addressed all of the relevant points.

Candidates' first impression on reading this question may have been favourable in that the technical area was one they were likely to be comfortable with (although the lack of numbers may have worried some). However, in order to maximise their marks candidates needed to follow the instructions given in the notes to the question. Note 1 required candidates' answers to be restricted to losses; this was ignored by many candidates. Note 2 provided a structure to what was otherwise an awkward open ended question; unfortunately, this suggested structure was also ignored by many candidates.

Those candidates who ignored the notes lost marks for two reasons; they wasted time writing about matters that did not score (principally the taxation of profits) and they failed to address all of the relevant issues (as listed in note 2). For example, candidates wrote about how Class 4 national insurance contributions would be calculated when they should have written that no such contributions would be due until the business was profitable.

Question Four

This question concerned inheritance tax and capital gains tax on the transfer of a property to a trust and the sale of shares and qualifying corporate bonds. The question was in three parts.

Part (a) required candidates to consider both the capital gains tax and inheritance tax implications of the transfer of a property to a discretionary trust. The inheritance tax implications were addressed very well by all but a tiny minority of candidates. The only common error was a failure to set out any assumptions made as required by the note to the question.

The capital gains tax element of this part was not answered well. The problem here was that most candidates did not think; instead they simply deducted the cost from the proceeds and addressed rates of tax. Some candidates then realised that gift relief was available and that, per the question, all available claims would be made. As a result, although they had wasted some time, they were still able to score full marks. Other candidates, however, did not address the gift relief point and consequently did not score any marks for the capital gains tax element of the question.

Part (b) concerned the sale of shares in respect of which EIS relief had been claimed. Almost all candidates identified the claw back of the relief if the shares were sold within three years of the acquisition. However, many stated that the whole of the relief obtained would be withdrawn as opposed to a proportion of it.

The implications of delaying the sale were not identified particularly well. Many candidates simply stated the opposite of what they had already written, ie that the relief obtained would not be withdrawn if the shares were held for three years. More thoughtful candidates considered other matters and recognised that delaying the sale



delayed the receipt of the sales proceeds and that the value of the shares might change (for the better or the worse).

The final part of the question concerned the sale of shares and qualifying corporate bonds that had been acquired following a paper for paper exchange. This part was done well by those candidates who knew how to handle this type of transaction.

The first task was to recognise that the cost of the original shares needed to be apportioned between the new shares and the corporate bonds. Many candidates knew what they were doing here and were on the way to doing well in this part of the question.

However, there was often confusion as to the treatment of the sale of the corporate bonds. Many candidates who knew that corporate bonds are exempt from capital gains tax went on to calculate a gain on the sale and include it in the taxable capital gains for the year. Also, many candidates were not able to identify the gain on the original shares that was frozen at the time of the paper for paper exchange and then charged when the corporate bonds were sold.

Question Five

This question concerned the acquisition of an overseas business, double tax relief and transfer pricing. It was in three parts.

Part (a) required candidates to explain the relief available in respect of the expected loss to be made by the business depending on whether it was established as a branch or a subsidiary of the UK company. This was an area where candidates had a certain amount of knowledge but, on the whole, did not score as well as they could have done because they wrote generally about branch versus subsidiary as opposed to addressing the particular facts and requirements of this question.

In particular, despite being asked to address loss relief, many candidates wrote about the taxation of profits. Many of those who did address losses did not address them as precisely as they could have done in the context of the question such that they did not consider the relevance of the tax rates provided.

Part (b) concerned group relief and the preservation of double tax relief. It required technical knowledge that almost all candidates had regarding double tax relief being the lower of the UK tax and the overseas tax on the overseas income. However, it also required candidates to be able to work out how to ensure that sufficient overseas profits remained within the charge to tax such that relief in respect of the overseas tax was not wasted. This task was carried out elegantly by a minority of candidates but the majority struggled with the problem. Credit was available for approaching the question by reference to double tax relief but many candidates simply stated that group relief was restricted to the lower of the losses available and the profits subject to tax. The final part of the question concerned transfer pricing and was done reasonably well by many candidates who had a good knowledge of the transfer pricing rules. However, only a small minority made reference to the relevance of the size of the companies in determining whether or not the rules would apply or to the possibility of reaching an agreement with HM Revenue and Customs.

The question also required candidates to explain how the prices charged between the group companies would affect the total tax paid by the group. In order to do this, candidates had to focus on the difference between the tax rate in the UK and that in Kuwata and the possibility of group profits being taxed at the lower rate. It was important here to address the situation from a group perspective rather than that of a particular company. However, the majority of candidates did not address this element of the question.