

# Examiner's report

P6 Advanced Taxation (UK)

June 2015



## General Comments

The overall performance in the June 2015 exam was less satisfactory than might have been hoped.

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 should were weak in the following areas.

- They did not do sufficiently well in question 2.
- They did not spend sufficient time thinking before they started writing. This meant that they did not give themselves the chance to identify the issues that needed to be addressed and they were therefore unable to earn sufficient marks.
- 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.

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 on the website.
2. Practise questions from past exams with the aim of adopting the style of the model answers. In particular, candidates should practise Section A style questions and the exam technique required here.
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.
- 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 satisfactory with the majority of candidates producing a document in a style that was easy to follow.

### **Specific Comments**

#### **Question One**

Question 1 concerned various aspects of personal taxation and VAT in relation to Jodie, an unincorporated trader, and was in four main parts.

Part (a) concerned the individual's residence status and liability to income tax. It was generally answered well, with many candidates demonstrating a strong knowledge of these aspects of the syllabus. In particular, candidates knew how to determine the number of ties that needed to be satisfied and were able to describe the ties and relate them to the facts of the question.

Unfortunately, many candidates failed to consider the automatic UK residence tests and were unable to state clearly the income tax implications of being non-UK resident, i.e. not being subject to UK income tax on overseas income. This latter point was part of an overall lack of clarity among many candidates in relation to the overseas aspects of personal tax. Candidates were vague about the implications or wasted time providing significant amounts of information on the remittance basis.



Part (b) concerned terminal loss relief for an unincorporated sole trader, and was generally answered well. This was a marked change in the performance in this area when compared with that in recent exams.

In particular, many candidates were able to calculate the terminal loss reasonably accurately and to calculate the tax saving at the margin without preparing detailed income tax computations.

Those candidates who performed less strongly had two main problems. Firstly, they did not know the detailed process necessary to calculate a terminal loss, such that they simply used the loss of the final trading period. Secondly, they prepared various detailed income tax computations in the hope that this would eventually lead to the tax saving required by the question. The problem with this approach was that it was very time consuming and, on the whole, it did not produce an acceptable answer.

Well prepared candidates scored well in this part and were able to do so in a sensible amount of time.

Part (c) covered various aspects of capital gains tax. It was perhaps more challenging than part (b), but there were still plenty of very accessible marks, such that a well prepared candidate should have no issue achieving a reasonable number of marks.

This part of the question had two requirements.

The first requirement was for an explanation of the effect of Jodie's departure from the UK on her liability to UK capital gains tax. This was the more challenging aspect of this part of the question and required candidates to state the basic rule in relation to residency and capital gains tax and to highlight the possible issue of temporary non-residence. The temporary non-resident rule was relevant due to the statement in the question that Jodie would return to the UK after four years (i.e. within five years) if her children were not happy overseas. This was only answered well by a minority of candidates.

The main problem related to something which came up throughout this exam which was a lack of clarity as regards the overseas aspects of personal taxation. Some candidates thought that being non-resident was only relevant in relation to assets situated overseas whilst others wrote at length about the remittance basis and the importance of either remitting or not remitting gains made but did so by reference to Jodie's non-resident status as opposed to her domicile status.

The second requirement was for a calculation of Jodie's capital gains tax liability. There were a number of tasks to carry out in order to satisfy this requirement and those candidates who kept moving and tried to address all of the aspects of the question were able to score well.

The gains on the business assets and the availability of entrepreneurs' relief were tackled well by the majority of candidates. The availability of the relief in respect of the principal private residence was identified by most candidates but only a minority considered the relevance of the size of the plot of land on which the property stood.

The more challenging aspect of the question related to the charging of the heldover gain on the Butterfly Ltd shares as a result of Jodie leaving the UK within six years of the gift. This was, perhaps not surprisingly, missed by many candidates although it was picked up by some.



The final part of the question related to other aspects of Jodie leaving the UK and concerned inheritance tax and VAT.

The inheritance tax aspects were not done particularly well with only a minority of candidates stating clearly the implications of Jodie's departure from the point of view of inheritance tax. In particular, candidates should have stated the relevance of domicile to inheritance tax and referred to the relevance of deemed domicile.

The VAT aspects were handled better but still very few candidates were able to pick up all of the available marks here.

## **Question Two**

Question 2 concerned a group of companies and included the sale of a company, loan relationships and aspects of capital gains groups. The question was in four parts.

Part (a) was for 11 marks and was the largest part of the question. It consisted of various aspects of corporation tax with some easy and some more challenging marks. Candidates who did well had a good knowledge of the subject and addressed all of the issues briefly rather than writing about a small number of issues in great detail.

When calculating the gain on the sale of the shares in Bar Ltd, the majority of candidates recognised that here would be a degrouping charge and most candidates explained the reasons for the charge arising. However, a minority of candidates were unable to calculate the indexation allowance correctly and so failed to gain some of the available marks.

Candidates who performed less well often confused the sale of shares with the sale of assets and calculated gains on the individual assets owned by the company. Candidates must take the time to ensure that they understand the transactions that have taken place in a scenario.

It was then necessary to consider the availability of the substantial shareholding exemption. Most candidates knew that at least 10% of the company's shares needed to be owned for 12 months in the two years prior to the sale. However, fewer candidates pointed out that the companies needed to be trading companies. The final element, which was only picked up by a small number of candidates, was the fact that the ownership period was satisfied in this particular situation due to the trade of Bar Ltd having been owned by another group company, Aero Ltd, previously.

The stamp duty land tax aspects of the question were not handled well with very few candidates recognising that the inter group exemption that was available when the trade and assets of Aero Ltd were transferred to Bar Ltd would be withdrawn due to the sale of Bar Ltd within three years.

Part (b) concerned the loan relationships rules and produced a great variety of answers. Those candidates with a good knowledge of the rules were able to present a brief, methodical answer that scored very well. Candidates who were less confident in this area did not pursue the question to its



conclusion and therefore did not address the detail of the offset of non-trading loan relationship deficits. This made it difficult to pick up many marks.

Part (c) concerned rollover relief and the offset of capital losses within a capital gains group. Most candidates identified the fact that rollover relief was not available because the building had never been used in the company's trade. The problem was that many candidates described all of the rules relating to rollover relief in addition to making the one relevant point that was worth a mark.

Performance in respect of capital losses was mixed. The majority of candidates knew that, in certain circumstances, capital losses can effectively be transferred between companies in capital gains groups. The problem was that this could not occur in this question because the capital losses concerned were pre-entry capital losses, such that their use was restricted. Many candidates did not identify this point but I suspect that they would have done if they had simply paused and thought before they started writing.

The final part of the question concerned the information required and the actions to be taken before becoming tax advisers to a new client. Many candidates did well here. Those who did not either did not have the necessary knowledge or did not make a sufficient number of points briefly, but instead wrote at length about a small number of matters.

### **Question Three**

This question concerned a partially exempt close company for the purposes of value added tax (VAT). It was in three main parts.

The first part concerned two alternative ways in which a computer was to be provided to a shareholder who was not employed by the company. Despite knowing the relevant rules, candidates did not perform as well as they could have done in this part for two reasons. Firstly, they failed to consider all of the aspects of the situation and secondly, they did not answer the question set.

Most candidates appreciated that the provision of the computer would give rise to a distribution but many failed to address the capital allowances position of the company. This was important because it differed in the two alternative situations. Similarly, many candidates failed to address the tax treatment of the loss on the transfer of the existing computer in the second alternative. Candidates will benefit if they think before they write and identify all the different aspects of the transaction. They should then address each of the aspects in a concise manner.

The failure to answer the question set related to the need to determine the after-tax cost for the company. Most candidates focussed on the tax treatment for the individual, which meant that they missed out on some of the available marks.

Part (b) concerned Siglio, the company's managing director, who was going to borrow money from a bank and then lend it to the company. Many candidates provided unsatisfactory answers to this question part because they wanted the question to deal with a loan from a close company to a participator in that company – but it wasn't. It was also important to deal with the two loans separately.

The loan to the company was a normal commercial loan. The company would obtain a tax deduction for the interest paid and Siglio would pay income tax on the interest income in the normal way. It was no more complicated than that.

The loan from the bank to Siglio was more interesting in that it would be a qualifying loan, such that the interest paid by Siglio would be tax deductible. Some candidates were aware of this point but very few stated the detailed reasons for the tax deduction being available.

The final part of the question concerned VAT and was in two parts.

Part (i) concerned the partial exemption *de minimis* tests. It was a straight forward test of the rules and was done well by those candidates who knew them. As always, it was important to read the question carefully and to address the requirement and nothing more; some candidates wasted time by addressing other aspects of VAT that were not required. Candidates should recognise that VAT is tested at every sitting and that the partial exemption rules are tested regularly.

Part (ii) concerned the annual test for computing recoverable input tax and was not done well. The problem here was that the majority of candidates addressed the annual accounting scheme rather than the subject of the question. This was unfortunate and meant that very few candidates did well on this part of the question. Candidates should always try to be sure as to what the question is about; both parts of part (b) related to partial exemption.

#### Question Four

This question concerned the sale of unquoted shares and the capital gains tax, inheritance tax and income tax implications of the transfer of assets to a trust. It was in three main parts.

Part (a) required candidates to calculate the number of shares that needed to be sold in order to realise post-tax proceeds of £30,000. This was done relatively well by the majority of candidates, although only a minority of candidates managed to arrive at the correct answer.

A minority of candidates did not know how to solve this problem and simply calculated a tax liability based on an assumed number of shares sold. For those candidates who could see what needed to be done, the main mistake that was made in arriving at post-tax proceeds was to deduct the tax liability from the gain as opposed to from the sale proceeds.

Part (b) concerned the transfer of assets to a trust and was in two parts.

Part (i) required candidates to advise on the capital gains tax and inheritance tax implications of the transfer of the assets. This was a straightforward requirement where candidates simply needed to know the basic rules and to be organised and methodical. For example, it was important to deal with the two taxes separately and not at the same time.

The capital gains tax implications were done well with most candidates recognising that gift relief was available because the gift was immediately chargeable to inheritance tax. The only common mistake was a failure to point out that cash is an exempt asset for the purposes of capital gains tax.

The inheritance tax implications were also handled reasonably well although some candidates were unable to follow through the position in relation to the availability of the annual exemptions. Also, many candidates reduced the available nil rate band due to the gift to the daughter on 1 June 2014. This was incorrect because the gift to the daughter was a potentially exempt transfer that will only become subject to inheritance tax if the donor dies within seven years. Therefore it has no effect on the nil rate band whilst the donor is alive.

Part (ii) concerned the income tax position of the life tenant of the trust. This was done well by those candidates who knew the rules. The only difficulty here was to ensure that the answer given was comprehensive and referred to the need to gross up the income, the rate of tax and the availability of the tax credit.

The final part of the question concerned inheritance tax and, in particular, related property and associated operations. This was a challenging part of the question but there were plenty of accessible marks for those candidates who were willing to be brave and to simply apply their knowledge to the facts. It was therefore important that candidates did not simply decide that they had not learnt the rules relating to associated operations, such that they were unable to answer the question. Basic knowledge of inheritance tax, including the need to take account of related property, went a long way towards obtaining reasonable marks here.

### **Question Five**

This question concerned the costs relating to the appointment of a part-time employee, the tax implications of selling items on the Internet and the capital gains tax implications of selling an overseas asset.

Part (a) concerned an individual, Cate, running a successful unincorporated business that required an additional part-time employee. The requirement was to calculate the annual cost of employing the part-time employee.

The first thing candidates had to do was determine all of the costs that were going to be incurred. On the whole this was done reasonably well, although some candidates confused cost with tax deductibility, and some simply prepared tax computations for Cate, which was not what they had been asked to do. In addition, many candidates failed to consider the employer national insurance contributions aspects which were a key part of the question.

Once the costs had been determined, it was simply a case of recognising that Cate was a higher rate tax payer, such that she would save income tax at 40% and class 4 national insurance contributions at 2% as a result of the increased costs. This was not tackled well by the majority of candidates who tried to do before and after calculations rather than working at the margin. In addition, many failed to consider the class 4 national insurance contribution implications altogether.

There was a more subtle point in the question in relation to the income tax personal allowance. The reduction in Cate's taxable trading income due to the costs relating to the part-time employee meant that part of her personal allowance would be reinstated, thus reducing the after-tax cost to her of taking on the new employee.

Part (b) required a discussion of the tax treatment of the profit derived from the sale of books on the internet. This required candidates to consider the badges of trade in relation to the specific transactions taking place. This part of the question was done well by many candidates. However, some candidates did not give themselves sufficient thinking time, such that they failed to realise what the question was testing.

It was important that candidates tried to reach a conclusion based on the information provided and that they thought about the capital gains tax implications as well as the income tax implications. There was no right answer as such, just a need to think about the relevant issues and to express the implications in a clear manner.

The final part of the question was arguably more challenging. It concerned the capital gains tax position of an individual, Ravi, who was resident in the UK but domiciled overseas and focussed principally on the remittance basis.

Although some candidates did reasonably well here, almost all candidates could have scored more marks if they had organised their thoughts before they began writing. There was a mark for making the point that Ravi was liable to UK capital gains tax because he was UK resident and a further mark for recognising that the remittance basis was available because he was domiciled overseas. In order to score these two marks, candidates had to make it clear that the liability to capital gains tax was due to his residence status and the remittance basis was due to his domicile status. Many candidates did not make these two points clearly, such that they only scored one of the two available marks.

Candidates were then expected to address the remittance basis charge and the loss of the annual exempt amount. This was done well by the majority of candidates.