

# Examiner's report

P6 Advanced Taxation (UK)

June 2014



## General Comments

The exam was in its standard format; section A consisting of the compulsory questions 1 and 2, worth 35 marks and 25 marks respectively, and section B where candidates were required to answer two out of the three questions worth 20 marks each. In section B, questions 4 and 5 were equally popular whilst question 3 was less popular.

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

- They did not do well in questions 1 and/or 2 indicating a lack of practise of Section A style questions and, possibly, a lack of knowledge of assumed material from F6.
- 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 did not answer the question set.
- 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 the 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 – 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 a question and manage your time
  - Ensure that you allow the correct amount of time for each question.
  - Before you start writing, think about the issues and identify all of the points you intend to address and/or any strategy you intend to adopt to solve the problem set.

If you are preparing to resit the exam, think about the number of additional marks you need and identify a strategy to earn them. For example:

- Identify those areas of the syllabus where you are weakest and work to improve your knowledge in those areas.
- Practise past exam questions in order to familiarise yourself with the style of questions that you will have to deal with.
- Ask yourself whether you could improve the way you manage your time in the exam and whether you address all of the parts of 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 that they had thought about how to approach the question in terms of their layout and presentation; provide calculations that were clear and logical; and focus their efforts on the needs of the client by providing a useful summary in part (a)(i) and/or part (b). On the whole, the performance of candidates in this area was satisfactory with the majority of candidates producing a document in a style that was easy to follow.

### **Specific Comments**

#### **Question One**

Question 1 concerned an unincorporated trader who intended to either cease trading and sell the assets of the business, or to sell the business as a going concern. The question required sound knowledge of the closing year rules for unincorporated traders, capital gains tax, value added tax (VAT) and the basic mechanics of inheritance tax. The question was in two main parts.

Part (a) concerned the tax implications of the disposal of the business and was split into two sub-requirements. The first part was quite substantial and was worth 17 marks. Candidates were required to compare the financial implications of the two possible methods of disposal of the business. This required consideration of income tax and capital gains tax and a summary of the post-tax cash position.



Stronger candidates structured their answers in such a way that it was very clear which of the possible methods of disposal they were addressing and then dealt with the two methods one at a time. Weaker candidates did not spend sufficient time thinking about the facts of the question and simply dealt with a disposal without making it clear which of the possibilities they were considering.

The income tax aspects of the disposal revolved around the closing year rules for the unincorporated trader. There were two possible dates for the disposal: 31 January 2015 (in the tax year 2014/15) and 30 April 2015 (in the tax year 2015/16). It was important to be able to identify the tax years of the proposed disposal and the basis of assessment for each of the relevant years.

Many candidates did not have a clear understanding of these basic rules, such that they were not able to identify the relevant tax years or to accurately calculate the taxable profits for each of the relevant tax years. The unincorporated trader is an important element of the syllabus and is examined at almost every sitting; candidates must ensure that they are competent at applying the opening years rules, closing years rules and relief for losses.

The trader had purchased equipment, which was then to be sold on the cessation of the business. This required knowledge of the fundamentals of capital allowances including the annual investment allowance (AIA) and the balancing charge on disposal. Most candidates identified the AIA but many then omitted to follow the story through to the disposal, such that the balancing charge was left out. In addition, weaker candidates prepared comprehensive (and time-consuming) calculations of capital allowances in order to arrive at an AIA of £6,000, when all that was required was a statement in the calculation of the trading profit that the AIA was £6,000.

The treatment of overlap profits, the personal allowance and the calculation of income tax was done well by the vast majority of candidates.

The capital gains tax implications of the sale of the business were straightforward and were handled reasonably well. However, one common error was to treat the sale of the business as if it were a sale of a single asset as opposed to a sale of the individual assets of the business. It is important to calculate a chargeable gain on the disposal of each individual asset and not to group assets together as a single disposal.

Many candidates concluded that the capital gains tax implications were the same regardless of which of the methods of disposal took place. However, this was not the case because there was a disposal of goodwill only where the business was sold as a going concern. This affected both the disposal proceeds of the assets and the capital gains tax arising.

Finally, candidates were required to prepare a summary. From the point of view of the client there are many detailed issues and calculations to consider here so it is important to be able to bring matters together in a manner which is useful and informative. The summary was worth a maximum of three marks and simply required figures from earlier calculations to be brought together in one place. In order to score the maximum marks available, candidates had to include the trading income and the proceeds from the sale of the assets together with both the income tax and the capital gains tax. It was also important to exclude any non-cash items. Very few candidates managed to score all three marks; and many candidates failed to produce any sort of summary.

The second part of part (a) concerned the VAT implications of the disposal. It required candidates to distinguish between the sale of assets and the sale of an ongoing business that might amount to a transfer of a going concern. This was handled well by the majority of candidates with many candidates demonstrating a good knowledge of the various conditions necessary for a sale to be regarded as a transfer of a going concern.

The second part of the question concerned the basic mechanics of inheritance tax; it was done well by many candidates. The question concerned the gift of a business and the subsequent death of the donor.

Almost all candidates identified the gift of the business as a potentially exempt transfer that would become chargeable following the death of the donor within seven years. They were also competent at dealing with the annual exemptions, the nil rate band (with one exception – see below), the tax rate and taper relief.

The one area where a lot of candidates did not perform as well was when it came to business property relief (BPR). To begin with, many candidates omitted BPR altogether. BPR is a significant relief that all candidates should be aware of. It is important to slow down in the exam and make sure that you work through the tax implications of the particular situation in a logical way. So, with inheritance tax, assets need to be valued, then reliefs (including BPR) need to be considered, then exemptions, followed by the nil band, tax rate and taper relief.

Those candidates who did include BPR in their answers often failed to realise that if the business was sold by Ziti (the donee) before the death of his father (the donor), BPR would not be available because the rules require the donee to own the assets gifted at the date of the donor's death.

The point referred to above regarding the nil rate band relates to the relevance of the chargeable lifetime transfer (CLT) made by the donor of the business on 1 May 2006. It was thought by some candidates that this gift would have no effect on the nil rate band available as it was more than seven years prior to the death of the donor. However, because the CLT was made within seven years of the gift of the business on 1 July 2010, the nil rate band available when calculating the tax due in respect of the gift of the business has to be reduced by the amount of the CLT.

## **Question Two**

Question 2 concerned a group of companies and included various aspects of loss relief, the sale of a company and the implications of making an error in a corporation tax return. The question was in three parts.

Part (a) concerned relief for trading losses within the group. As is often the case, some thought was required before starting because the question did not have as its objective the relief of losses in order to maximise the tax saved. Instead, the question stated that all of the companies were paying tax at the main rate and therefore the objective was simply to relieve the losses as soon as possible. However, many candidates ignored this point and focussed on tax rates and tax computations. This was not



necessarily that costly in terms of marks but, as the question did not require tax computations to be prepared, was potentially costly in terms of time.

The question was all about identifying various individual points in respect of each of the companies. That's why the email from the manager suggested 'you should think carefully about the tax position of each company'.

Akia Ltd, the loss-making company, had realised a chargeable gain against which the loss could be offset. There was also the possibility of carrying the loss back 12 months, although very few candidates identified this point.

Once the position of Akia Ltd, the loss-making company, had been considered it was then necessary to consider the group and consortium position. The group position was handled well but many candidates failed to spot that because Venere Ltd was a 75% subsidiary of Jarrah Ltd, it could not be a consortium company.

Ribe Ltd had trading losses brought forward. These could not be group relieved (because only current period losses can be group relieved) and therefore could only be used against that company's trading profits. However, a minority of candidates simply added the losses of Ribe Ltd to those of Akia Ltd and then addressed the total losses together.

Finally, Binni Ltd was not a member of the group for the whole of the period so it was necessary to determine the maximum loss that could be surrendered to it by Akia Ltd. This is a straightforward point but it was missed by many candidates.

There were plenty of relatively straightforward marks to be earned in this part of the question but candidates needed to slow down slightly, think and, in particular, make a real effort to answer the question set as opposed to the question that they might have been expecting.

The second part of the question concerned the sale of shares by one of the group companies and the availability of the substantial shareholding exemption (SSE). This was not done well for two main reasons.

First, many candidates failed to consider the SSE despite it being an important exemption at P6. There were follow through marks available for those who found themselves in this predicament but only if they answered the question set. Unfortunately, many candidates failed to do so.

Two lessons may be learned from what happened here.

Firstly, it is always worth thinking about how to do a calculation in an efficient manner rather than to just immediately start it. Those candidates who thought it was necessary to calculate a chargeable gain on each of the possible disposal dates should have realised that the only difference was an increase in sales proceeds of £20,000. This would, of course, increase the gain by £20,000; there was no need to repeat the whole calculation to determine this.



The second lesson is that you must answer the question set. Candidates were asked to consider on which of the two dates it would be more financially advantageous to sell the shares. This required candidates to consider the post-tax proceeds on each of the potential disposal dates, but the majority of candidates simply focussed on the amount of the chargeable gain.

The final part of the question concerned an error in a corporation tax return and the matters that needed to be considered in relation to the disclosure of the error to HM Revenue and Customs. This was a standard question and an opportunity for all candidates to earn some straightforward marks.

Unfortunately, a minority of candidates decided to address the penalties aspect of the question in great detail without thinking about the other relevant issues. Stronger candidates recognised the need to consider the importance of disclosing the error from the point of view of tax evasion, money laundering and the acceptability of continuing to act for the company. These stronger candidates were able to score well on this part of the question.

### **Question Three**

This question concerned various incentives and benefits to be provided by a company to its employees. It was in three main parts.

Part (a) tested the provision of vouchers to purchase childcare and payments made to employees when they work from home.

The taxation of vouchers to be used for the purchase of childcare was tackled well by the majority of candidates. The majority of candidates were aware that an exemption was available in respect of the provision of such vouchers, with many knowing that the amounts of the exemption depend on the employee's marginal rate of tax.

The rules regarding the ability of an employer to make tax-free payments to employees who work from home were not as well known, such that very few candidates scored well on this aspect of the question.

Part (b) tested various aspects of the enterprise management incentive (EMI) scheme and was split into two sub-requirements.

The first part concerned the ability of the company concerned to establish such a scheme and to make it available to nine key employees. This part of the question was done reasonably well. The majority of candidates knew that there were conditions relating to the number of employees and the gross assets of the company, although not all knew the precise detail of the conditions. Most candidates were also aware that it is acceptable for an EMI scheme to be provided to key employees (rather than to all of a company's employees) but many did not realise that part-time employees are not permitted to be members of such a scheme.

The second part related to the tax implications of the grant and exercise of the share options and the sale of the shares. This was arguably a more difficult requirement and was not done particularly well. As always, those candidates who adopted a methodical approach and dealt with the grant, exercise and sale as three separate issues did better than those who tried to address everything at once.

Candidates will almost always benefit from starting a new paragraph for each new issue that needs to be addressed.

The final part of the question concerned a redundancy package to be received by an employee of the company. The package consisted of a payment of statutory redundancy, an additional payment and the provision of a company car after the employment ceased. All three matters were handled well by many candidates with most candidates demonstrating awareness of the £30,000 exemption.

The one area where almost all candidates could have improved their performance was the additional payment. The question was deliberately silent as to the reason for and the nature of the payment. It was up to candidates to raise the matter as to whether or not the payment was for work carried out or a restriction to be placed on the employee's future working activities, such that it would be taxable in full.

#### **Question Four**

This question concerned income tax and capital gains tax. It was in three parts.

Part (a) required an explanation of the availability and operation of rent-a-room relief together with a calculation of an individual's taxable income.

The basics of rent-a-room relief were reasonably well-known by many candidates. However, a minority thought that the £4,250 could be deducted in addition to expenses incurred as opposed to instead of those expenses. Also, many candidates neglected to divide the £4,250 between the two owners of the property. Very few candidates mentioned the need to make an election for the relief to apply.

The calculation of the individual's taxable income was done well by the majority of candidates in relation to the pension income and the personal allowance, where a restriction was required due to the level of the individual's income. The interest arising in respect of the loan stock was not handled particularly well with the majority of candidates failing to recognise that the accrued income scheme applied, such that 10 months of interest needed to be included.

Following on from a relatively straightforward part (a), part (b) was more challenging. It required candidates to consider the effect of renting out part of the family home on the amount of the taxable capital gain on a future sale of the home. Almost all candidates realised that this required them to consider the principal private residence exemption but many were not sufficiently methodical in their approach.

The main area of difficulty related to thinking about the whole of the period over which the property will have been owned as opposed to just the period during which the property will have been let. The period of ownership should be split into three parts: the period prior to letting (wholly exempt), the last three years of ownership (wholly exempt) and the period in between (70% exempt). Very few candidates addressed these three periods in a clear manner.

There was then the need to consider the letting exemption. Most candidates recognised the need to refer to this exemption and their knowledge of it was satisfactory. However, a minority of candidates did not mention the exemption at all. Candidates will always benefit from thinking before they start



writing an answer to a question in order to ensure that they have identified the principal points that need to be made in the time available.

The final part of the question concerned inheritance tax and was done reasonably well. It required an explanation of the implications of electing to be treated as UK domiciled for the purposes of inheritance tax and a calculation of the residue of an estate.

The explanation of the election required two main points to be made: the effect on the spouse exemption and the fact that overseas assets would become subject to UK inheritance tax. Many candidates identified both of these points, although a minority wrote about the remittance basis, which did not have any relevance here.

The calculation aspect of the question was more challenging than the explanations and very few candidates did particularly well. The difficulty was that most candidates wanted to calculate an inheritance tax liability when what was required was a calculation of the residue.

The residue was calculated by deducting the legacy to the daughter and the inheritance tax liability from the estate. So a calculation of the inheritance tax liability was a necessary step on the way but was not an end in itself. The calculation of the inheritance tax liability also required the gift to the daughter to be grossed up because the residue of the estate was exempt. Very few candidates identified this point but it was possible to score a very good mark without it.

#### **Question Five**

This question concerned various aspects of VAT, corporation tax and income tax in relation to a close company. It was in three main parts.

Part (a) concerned the VAT flat rate scheme. Candidates were required to explain whether or not a particular company could join the scheme and the matters that needed to be considered in order to determine whether or not it would be financially beneficial to do so.

Almost all candidates realised that the ability of the company to join the scheme depended on its taxable supplies being below the limit of £150,000. However, a small minority did not apply their knowledge to the facts of the question where there was sufficient information to reach a conclusion in respect of the company concerned.

The matters that needed to be considered in relation to the financial implications of joining the scheme were not handled particularly well with many candidates appearing to be somewhat confused as to the implications of joining the scheme. This was partly due to mixing up the flat rate scheme with other VAT special schemes and also due to a lack of methodical thought. In particular, candidates should have slowed down and tried to explain the payments made to HMRC under the existing arrangements and the payments that would be made under the flat rate scheme so that a comparison could be made.

In part (b), candidates were required to explain 'the tax and financial implications' of proposals to sell a machine and rent a replacement. When candidates read the model answer to this question they will realise that this was not a challenging requirement. However, very few candidates scored well.

The problem here was that candidates started writing before they had identified the issues. As a consequence of this, most candidates addressed the chargeable gain point and very little else. This was unfortunate as the chargeable gain point was not as easy as it appeared, such that many candidates got it wrong. Other points that most candidates should have been well-equipped to tackle if they had thought to do so included: a balancing charge would arise, the inability to offset capital losses against trading profits and the rent representing a cost to the company that would reduce its taxable profits.

The final part of the question concerned the extraction of funds from the company by its owner, Charlotte, and was split into two sub-requirements.

The first part required calculations of the cost to the company of providing Charlotte with post-tax income of £14,000. This was relatively challenging and was not done particularly well.

Candidates needed to identify that Charlotte was a higher rate taxpayer and paying national insurance contributions at the margin at the rate of 2% in order to gross up the amount required at the appropriate rate. They then had to identify that the company would have to pay employer's national insurance contributions and that this would be a tax deductible expense for the purposes of corporation tax.

A minority of candidates did not read the question carefully enough, such that they calculated the cost to Charlotte of being paid a bonus or a dividend of £14,000.

The second part of (c) required an explanation of the immediate tax implications for the company and Charlotte of the company making an interest-free loan to Charlotte. The use of the word 'immediate' was important here as no marks were available for explaining what would happen when the loan was either repaid or written off in the future.

It was important here to identify the implications for **both** the company and Charlotte, otherwise not all of the marks were available to be earned.

Most candidates stated (correctly) that an amount equal to 25% of the loan would have to be paid to HMRC but very few explained that this was because it was a loan by a close company to a participator. Also, quite a few candidates did not state that the loan would be a taxable employment income benefit for Charlotte. This meant that they also failed to identify the class 1A national insurance contributions that would be payable by the company.

In both parts of (c) a little more thought from some candidates would have been of great benefit.