Examiners' report

P6 Advanced Taxation (UK)
December 2007

The December 2007 exam was the first sitting of Paper P6. Candidates appeared to be well prepared for the change in question style from Paper 3.2.

The exam was divided into section A and section B. Section A consisted of two compulsory questions worth a total of 64 marks. In section B candidates were required to answer two of the three questions worth 18 marks each.

It was pleasing to see a good proportion of candidates spending an appropriate period of time on the optional questions. Candidates should be aware that they are more likely to be successful if they manage their time throughout the exam and allow the correct amount of time for each question.

Some candidates started with the shorter, optional questions in Section B. This is an approach that all candidates should at least consider as these questions provide a more gentle introduction to the exam than those in section A.

In section B, question 5 was the most popular question and question 3 the least popular.

General paper comments

If you are preparing to sit Paper P6 in 2008 you should pay particular attention to the following in order to maximise your chances of success.

Know your stuff
- Successful candidates are able to demonstrate sufficient, precise knowledge of the UK tax system.
- Knowledge and understanding of the technical content of Paper F6 is vital if you are to be successful at paper P6.

Address the requirement
- Read the requirement carefully – then read it again; it's important.
- The requirement of each question is carefully worded in order to provide you with guidance as regards the style and content of your answers. You should note the command words within the requirement (calculate, explain etc), any matters which are not to be covered and the precise issues you have been asked to address.
- Pay attention to the number of marks available – this provides you with a clear indication of the amount of time you should spend.

Don't provide general explanations or long introductions.
- There is no need to explain what you are going to do before you do it; just get on with it.
- Think before you write. Then write whatever is necessary to satisfy the requirement.
- Apply your knowledge to the facts by reference to the requirement.

Be brave
- Don't be put off by a situation that you have not seen before.
- Follow the instructions in the question and the requirement and apply your knowledge of the tax system to the facts of the situation.

Manage your time
- Ensure that you allow the correct amount of time for each question.

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 format of the document requested. Further marks were then available for the clarity of the answer, including the ease with which it could be marked and the degree to which the conclusions reached followed logically from the explanations and calculations provided. These latter marks were more likely to be earned by those candidates who thought about the manner in which they intended to satisfy the requirement such that there was a sense of purpose and a coherency to their answers.

Question 1

This question principally concerned a number of issues relating to the establishment of an unincorporated business. It was pleasing that most candidates produced a memorandum as required and structured their answer in an appropriate manner.

In part (a) (i) candidates had to calculate the external finance required by the new business. This calculation had to be done in two stages.

First, it was necessary to calculate the capital gains arising on the sale of shares and loan stock acquired as a result of a paper for paper transaction. Whilst many candidates were aware that particular rules applied in this situation (and many described them, unnecessarily, in great detail) only a well prepared minority were able to calculate the gains correctly.

It was then necessary to use the information regarding the taxpayer's income in order to determine the rate of capital gains tax payable. Candidates performed well when calculating the taxable income but many did not know how to use the information and went on to calculate the income tax due or tried to use the income to fund the establishment of the business.

Part (a) (ii) required candidates to identify a strategy to increase the after tax proceeds from the sale of the loan stock and to suggest a form of external finance more appropriate than a bank overdraft. The first task was not done well as many candidates were of the opinion, incorrectly, that the sale of the loan stock would not give rise to a tax liability and therefore the position could not be improved. The second task was done well.

Part (b) required candidates to address various issues relating to the new business. This was not done particularly well. Candidates were happy to outline the national insurance position of unincorporated traders in general but, unfortunately, were less willing to apply their knowledge to the taxpayer's particular situation. When addressing the income tax relief available in respect of the purchase of the theatre, many candidates were under the misapprehension that a theatre is an industrial building. The VAT implications of renting out the building were not well understood.

The final part of the question concerning the potential inheritance tax liability in respect of a lifetime gift was done well.

Question 2

This question concerned a business venture where losses were anticipated. Candidates were asked to produce three distinct schedules, which should have had appropriate headings taken from the requirement; sadly, many failed to do so.

In part (a) candidates were required to calculate the tax adjusted trading profit/loss of the new business. This required a relatively tricky calculation of industrial buildings allowances which was not done well.

Part (b), representing almost half of the question, required candidates to determine the tax relief available in respect of the anticipated trading losses depending on the legal structure of the venture. This necessitated some clear thinking, ideally communicated to the examiner via the use of subheadings, such that a distinction was drawn between operating as an unincorporated trader and operating as a company. In many cases there was little evidence of such thinking taking place.

The majority of candidates either ignored the opening year rules for the unincorporated trader or failed to apply them to the situation. To be fair this was a relatively tricky situation due to the presence of the losses but it did seem as though many candidates had forgotten the basic rules governing the taxation of an unincorporated trader.

In order to calculate the potential tax relief it was necessary to determine the taxpayer's income tax liability for the years in which loss relief was available. Candidates had no problems calculating the income but were unsure how to proceed from there. In particular there was a lack of thought with many candidates performing calculations for all years rather than recognising that the income was the same in each year such that only one calculation was necessary.

Answers improved when considering the position of a company but there was a lack of precision when describing the loss reliefs available. There was also some confusion as to whether group relief would be available if the two companies were owned personally by the individual taxpayer (it wouldn't). Finally, there was a general unwillingness to satisfy the requirement and calculate the 'tax relief available'.

The final part of the question concerned a loan from a close company to a participator. Candidates did well in identifying the tax implications of the loan but many ignored the ethical considerations inherent within the question.

Question 3
This question required candidates to identify various issues arising out of the acquisition of a subsidiary company. It was the least popular of the optional questions and was not done particularly well by those who attempted it. Part (a) was in two parts. Both parts required candidates to identify the implications of the proposed transactions and to apply their knowledge to the facts.

Part (i) concerned research and development and the use of brought forward losses. Whilst these issues were often successfully identified by candidates, the detail requested in the requirement was missing as was the effect of the issues on the amount of corporation tax payable. Some candidates thought, erroneously, that the restriction on the use of losses brought forward following the change in ownership and the major change in the nature of the trade related to group relief.

Part (ii) concerned the identification of a degrouping charge and the treatment of the profits of a controlled foreign company. Again, the issues were successfully identified by many candidates but there was a lack of precise knowledge of the rules and a tendency to describe the rules in general terms rather than to simply apply them to the facts.

Part (b) required candidates to understand the VAT implications of sales to domestic customers within and outside the European Union (standard rated and zero rated respectively). This was a straightforward test of important VAT rules but the majority of answers were poor and many confused the terms exempt and zero rated.

Question 4
This question and question 5 were the most popular of the section B questions. The question concerned tax efficient contributions to a pension scheme and the taxation of overseas income in the hands of an individual who is resident and ordinarily resident but not domiciled in the UK.

Part (a) required candidates to determine whether pension contributions should be made by the employee or by the employer and the employee together 'with the objective of minimising the total after tax cost'. This requirement was trickier than it appeared and could not be easily satisfied by simply preparing a series of corporation tax and income tax calculations. Instead, it was necessary to focus on the tax savings resulting from the pension contributions.

Many candidates demonstrated poor knowledge of the tax treatment of pension contributions and consequently did not score well. Others took the opportunity to explain the tax aspects of pension contributions in a general manner rather than attempting to satisfy the particular requirements of the question.

Part (b) concerned the resident, ordinarily resident and domicile status of the taxpayer and the taxation of overseas income. This was answered fairly well by many candidates.

Candidates should note the following points in connection with part (b).

1. The following explanation is not incorrect but is not as clear as it could be.

   'The overseas income is taxable on the remittance basis because Coral (the individual in the question) is resident, ordinarily resident but not domiciled in the UK.'

   It is better to explain the situation in the following manner.

   'The overseas income is taxable because Coral is UK resident. However, it will be taxed on the remittance basis because she is not domiciled in the UK.'

2. The rules concerning deemed domicile relate to inheritance tax and not to income tax. They were referred to by many candidates but were not relevant to this question.

Question 5

This question concerned the capital gains tax and inheritance tax position of a recently deceased individual. It was the most accessible of the optional questions and gave rise to the best answers.

Part (a) was done well by many candidates. Those who did not perform well were either not aware of the ability to carry back capital losses arising in the year of death or lacked precision in their application of the rules.

Part (b) required candidates to identify the *immediate tax implications* of a gift of shares. Answers to this part were relatively disappointing given the simplicity of the situation. It was particularly surprising to note how few candidates recognised that there would be no capital gain as the deemed proceeds would be equal to the donor's base cost. In addition, the word 'immediate' in the requirement meant that candidates should only have concerned themselves with what was going to happen now as opposed to what would happen in the future.

Part (c) was the easiest part of the question and rewarded those who got to the end of the question with sufficient time remaining. It was done well by many candidates. Common errors included the treatment of the chargeable lifetime transfer and the availability of business property relief in respect of the unquoted shares.