

## **MAY 2018 EXAMINERS' REPORTS**

### **Chief Examiner Comments**

#### General Comments

After several sessions where the performance on the VAT Advisory papers has been very poor, it was very pleasing to see a dramatic improvement in the quality of answers on both Advisory papers.

In relation to the other papers, the results were generally in line with expectations except for the Taxation of Individuals and Human Capital Taxes Advisory papers. On the Individuals paper, candidates generally fell down on the question on Accelerated Payment Notices, which was surprising as we felt this was highly topical and good marks were anticipated. Candidates should remember that in addition to their training manuals, they should be keeping up to date with current issues in tax through wider reading. The issues on the Human Capital paper seemed to be more fundamental in that there was a general failure to apply knowledge to the scenario rather than just stating technical information, which suggests that candidates sitting this paper may lack practical experience.

#### Application and Professional Skills

The May and November 2018 sessions will be the last for the existing Application & Interaction paper. With this in mind, I thought it would be useful for those who will be sitting the new Application and Professional Skills paper if I focussed on some of the issues identified with the answers this session and how they will be relevant to the new paper.

The new paper represents a substantial shift from the existing paper in that there are no direct technical marks. Instead a number of themes or topics within the answer will be assessed for the demonstration of skills by the candidate. This doesn't mean that producing a technically correct answer doesn't matter, rather that producing a technically correct answer won't in itself be sufficient to result in a pass on this paper. Candidates need to demonstrate the professional skills. The rationale for this shift in focus is that it is the skill of advising that employers require and clients expect: producing something technically correct is a given.

Candidates will be expected to produce a much shorter answer than at present, which should make it a much less time pressured exam. The time save writing will be required to properly plan the answer. This brings me to the first point arising from the answers this session. Both the Company and OMB examiners reported that some candidates were producing very long plans and as a result were losing time that would have been better spent polishing their answer. The crux of the plan is to identify from the question the key issues and to consider their relative importance. This will then allow the plan to be developed around the time/effort which should be devoted to each of those issues. The main arguments and technical points can be identified and importantly, the various elements of the answer can be arranged so as to present a logical flow to the reader. Too many answers still leap from one topic to another with no thought, for example, to the date order of the topics being discussed or to presenting all material on one topic in one place. If there is something relevant to a number of topics, it makes sense to identify this at the outset. For example, if Entrepreneurs' Relief applies to several topics, by explaining the generalities of it first, it will not be necessary to repeat material several times.

The Company Tax examiner commented that it was clear that those candidates who had no plan failed to produce an answer with the right balance across the topics. They often spent too long on material which in the context of the requirement as a whole was a minor element. Whilst at present the inclusion of irrelevant material simply means that the candidate has wasted time, with the new paper the ability to produce an appropriate answer without excessive irrelevant material is tested. It is therefore highly unlikely that candidates who fail to properly plan their answer will pass.

The OMB and Company examiners also reported on that some executive summaries were far too long or introduced new material. It is important that the summary is just that: a summary of the main points arising and recommendations being made with just enough additional information so that the context of them is clear. As such, they are likely to be well under a side long. If they are longer then they are likely to be unnecessarily repeating detailed information from the body of the report, or even introducing new material which should be in the body of the report. Again, on the new paper candidates will be assessed on whether their executive summary is appropriate.

Candidates sitting the new paper are advised to carefully read the document on the CIOT website explaining how the new paper will be marked (<https://www.tax.org.uk/students-and-qualifications/reviced-cta-examination/application-and-professional-skills-examinable>). Whilst those sitting the existing Application and Interaction paper in November 2018 may think that the above points are not relevant to them, this is not the case as a focus on these points, including on the skills referred to in the marking information on the new paper, will help them to secure a pass in the existing paper.

## **AWARENESS**

### **Module A (VAT including Stamp Taxes)**

#### Overall Comments

On the whole the paper seemed to be well received, with most candidates attempting all questions. One general recurring problem is the incorrect reference to certain technical terms, with some confusion between exempt, zero rated and transfers which are outside the scope of VAT. Specific feedback is given only on those questions which were answered poorly in a significant number of cases:

#### Question 1

Many candidates incorrectly discussed the operation of the fuel scale charge, suggesting that this would be used to calculate the amount of VAT to reclaim in relation to business mileage.

#### Question 4

Whilst answered very well by a large number of candidates, those who did not score so well focused on the wrong party to the transaction and discussed the implications for the buyer rather than the seller.

#### Question 11

As expected, the interaction of VAT and SDLT caused the main errors. On occasions, where VAT was considered it was incorrectly added on both properties.

#### Question 12

A surprising number of candidates were unable to correctly calculate the charge at 0.5% and gave an answer based on 5% even where the working showed a 0.5% rate.

### **Module B (IHT, Trusts and Estates)**

#### General Comments

Overall, candidates displayed a reasonable knowledge of most areas tested, with some excellent answers to some of the questions. Where the questions were not quite so well done, the main problem was failure to pay close attention to the information given in the question and/or the requirements of the question.

### Question 1

Generally well done by most candidates, although common errors included working out the lifetime tax on the CLT when it was given in the question, failure to understand the operation of the transfer of the unused nil rate band from husband to wife, deducting annual exemptions from the death estate, including the CLT as part of the death estate and/or deducting the lifetime tax paid on the CLT against the tax due on the death estate.

### Question 2

Although there were a lot of excellent answers given and most candidates had a good understanding of the issues under consideration, in several cases there seemed to be some confusion with Capital Gains Tax and several candidates discussed the CGT implications of the transactions rather than the Inheritance Tax implications as was required.

### Question 3

This was probably the worst answered question on the paper, with very few candidates scoring full marks. Most candidates did not know what to do with Arthur's previous gift of the shares to charity, with several calculating the IHT value of the gift and then simply stating that it was exempt, while several candidates appeared to be completely unaware of the related property rules.

### Question 4

This was generally well answered, with most candidates being comfortable with the issues. However common problems included failure to recognise that the PET was more than seven years prior to James's death and the belief that the election for Dolores to be treated as UK domiciled would be void after 4 years of non UK residence, after which the IHT would become payable.

### Question 5

This question was generally well done, with many candidates scoring full marks. Common errors included not restricting the additional administration expenses on the overseas property, omitting the chattels from the death estate and valuing the unit trust incorrectly. Once again, several candidates deducted annual exemptions from the death estate.

### Question 6

A mixed performance in this question, with a few excellent answers. Despite the question requiring explanations as to where the four assets were located for the purposes of UK IHT, some candidates simply discussed whether or not the assets were liable to UK IHT. The most common error was confusion over the debt owed to Joaquin by his cousin, with several candidates either thinking that Joaquin was the debtor or that Joaquin's asset was the Bubaloo plc shares.

### Question 7

Generally a very good performance on this question. Common errors included deducting annual exemptions from the CLT, despite the gross figure being given in the question, and once again several candidates included the CLT as part of the death estate and/or deducted annual exemptions against the death estate.

### Question 8

This question was generally very well answered, with the majority of candidates understanding and being able to clearly explain the implications of a gift with reservation of benefit, although some candidates thought that the pre-owned asset rules were applicable.

#### Question 9

Generally, the performance in this question was disappointing. Although most candidates were comfortable with the post mortem relief available on the shares, some went on to discuss the restriction if further shares were subsequently purchased by the executors, which was going beyond the scope of the information given in the question and was therefore not relevant. The post mortem relief on the related property was generally not well done, with most candidates treating it in the same way as the shares. The time limits on the sales of the assets for the reliefs to be available were frequently not stated.

#### Question 12

Candidates' performance in this question was frequently disappointing. Several candidates calculated the original cost of the land to be £60,000 (the acquisition cost LESS the legal and professional fees of acquisition), and some wasted time calculating the gain on the first part disposal in 2005. Of those who did this, some went on to roll over this gain against the base cost of the remainder. As for the disposal of the remainder, several candidates missed the point that gift relief was available as there was an immediate charge to Inheritance Tax on the disposal to a discretionary trust. If gift relief was recognised, quite frequently candidates deferred the balance of the gain after deducting the CGT annual exemption.

### **Module C (Corporation Tax)**

#### General Comments

Overall, there was a mixed performance. Most candidates did well on areas such as capital allowances and personal services companies, but struggled on others, such as group aspects and Corporation Tax penalties.

#### Question 1

This was a question where candidates either knew the rules or they didn't, and those candidates who did were able to explain and apply them well, with many achieving maximum marks.

#### Question 3

There was a mixed performance on this question. Despite explicitly stating that the company was required to pay its Corporation Tax by instalments, several candidates tried to prove that it was not, and therefore stated the '9 month and 1 day rule' which did not get any marks. Some candidates calculated the instalments and balance due as 25% of the Corporation Tax liability and others started the instalments at 14 July 2017, despite the period being 10 months to 31 December 2017.

#### Question 4

This was generally not well done, with confusion over the difference in treatment of the lease premium for the lessor and the lessee. Many candidates included the rental income for the Billoo Ltd and then omitted it as rental payments for Toolilly Ltd, or time apportioned it differently despite both companies having the same year end. When faced with a question like this, candidates need to adopt a structured approach in order to make it clear which part of the question they are actually answering.

#### Question 5

The first part of this question was generally well done, with many candidates scoring full marks. The second part was disappointing, with the majority of candidates failing to spot that the pension spreading rules would apply. They assumed that the £1.8m included the £800,000 paid in the previous year and simply stated that pension contributions were allowed on a paid basis and then added back £800,000.

#### Question 6

Some candidates ignored the fact that the company was ceasing to trade (despite this being explicit in the question) and therefore discussed carrying forward the trading losses. Those who tried to apply the cessation rules often failed to realise the importance of the final period only being 10 months long and others ignored the loss in the penultimate period and simply focused on the final period's loss. Another common error was to carry back the trading loss against trading profits only, rather than against total profits.

#### Question 7

Very few candidates understood the effect of the previous intragroup transfer, and even fewer managed to get the indexation correct. Although asked to calculate the after-tax proceeds of the disposal, most candidates thought that this was calculated by deducting the Corporation Tax liability from the gain, rather than from the net sale proceeds.

#### Question 8

This question was generally quite well answered. The main problem was lack of clarity of explanation with regard to the conditions for the SSE to apply to the disposal; candidates need to be very specific in order to gain the marks available.

#### Question 9

Generally, the performance in this question was disappointing. Most candidates seemed to think group relief would be against just trading and property income rather than against TTP. Very few picked up on the fact that the two companies did not have the same year end and therefore time apportioning was required to calculate the maximum group relief, whereas others seemed to think the capital loss needed to be time apportioned.

#### Question 12

This question on penalties was generally not very well done. Although most candidates were fine on late filing penalties, the same could not be said about late payment penalties, with several candidates applying the rules applicable to personal tax.

### **Module D (Taxation of Individuals)**

#### Overall comments

There were some significant gaps in the knowledge of some candidates; for example, with regard to how to determine Scottish taxpayer status and the tax consequences of exercising and selling EMI shares. In many cases, marks were lost /time was wasted by the candidate failing to satisfy/stick to the requirements of the question.

#### Question 1

Most candidates dealt well with this question; however, a common error was to fail to take into account the £5,000 of dividends falling within the dividend allowance when calculating the remaining basic rate band.

## Question 2

Many candidates were unfamiliar with the rules for determining Scottish taxpayer status and instead relied on a simple 'days spent' calculation. There was some confusion with the Statutory Residence Test for determining UK residence status. Candidates should be careful with the terminology they use; many candidates used 'UK resident' to mean that the individual was not a Scottish taxpayer.

## Question 3

A number of candidates lost marks by failing to push on with their answers; for example, they stated that the donation would extend the individual's basic rate band but they did not go on to give the amount of the increased basic rate band or to calculate the income tax saving this would generate.

## Question 4

Candidates were fairly evenly split between those who knew how to deal with the salary foregone and those who did not; in general, those falling in the latter category chose to ignore it. There were a lot of simple errors; for example, failing to calculate the income tax or NICs or using an incorrect rate of tax/NICs.

## Question 6

A number of candidates lost marks in this question because they did not satisfy the requirement and explain their answers.

## Question 7

A significant number of candidates struggled with this question with many choosing not to attempt it.

## Question 8

Overall, candidates performed well in this question. However, many candidates lost valuable time providing detailed explanations of their answers; this was not required.

## Question 9

As for Question 8, a significant number of candidates wasted time providing explanations for their answers; this was not required and did not gain them any marks. A significant minority of candidates forgot to take into account the annual exemption. A surprising number of candidates confused Entrepreneurs' Relief with Business Property Relief.

## Question 11

Many candidates were uncomfortable with the rules in the area and scored low marks as a result.

## **Module E (Taxation of Unincorporated Businesses)**

### Overall comments

In general, candidates performed well in this paper, displaying a good knowledge of the main areas.

## Question 1

Most candidates dealt well with the calculation of Class 4 NICs but few were able to correctly explain the position had the individual reached state pensionable age during the tax year. Although the question asked for Class 4 NICs only, a significant number of candidates also calculated/discussed Class 2 NICs.

#### Question 4

All but a few candidates struggled with this question, showing little if any knowledge of the fixed value requirement.

#### Question 5

Although most candidates showed a good knowledge of the early years' rules, many were unable to correctly calculate the trading loss.

#### Question 6

Most candidates displayed gaps in their knowledge of the cash basis (e.g. unaware of the cap on interest) or of the flat rate expense for use of home.

#### Question 8

In general, candidates who set out the standard capital allowances' pool working did better than candidates who tried a 'shortcut' calculation.

#### Question 9

The question asked for calculations only; however, quite a few candidates wasted time providing explanations of their answer.

#### Question 11

Although most candidates were comfortable with the rules in this area, and scored high marks as a result, many were not familiar with the rules and chose not to answer this question.

#### Question 12

A common error was to include stock as a chargeable asset.

### **Module F (Environmental Taxes, Excise Duties and Stamp Duties)**

#### General Comments

As was the case on the previous sitting, generally the performance in this paper was fairly disappointing, given that many of the questions were not difficult, and the syllabus is not large. Unfortunately, there seemed to be quite a number of candidates that were not prepared, and the number of passes reflect that.

Some candidates simply failed to read the question properly and so provided answers to questions that had not been set or provided a great deal of irrelevant information that had not been requested, and so wasted time.

Also, when a question states "Explain", a one word answer setting out what the liability is does not constitute an explanation.

#### Questions 1-4

These questions were on the whole answered quite well except for Question 3 where a number of candidates simply put “30 days” as being the notification period without stating 30 days from when.

#### Question 5

Most candidates were clearly afraid of the calculations and simply did not answer the question. Those that did scored reasonably well though this was largely due to follow through marks being awarded.

#### Question 6

The question was also not answered very well, which was surprising as it was not difficult. A number of candidates set out VAT taxpoints for CCL, which showed a clear lack of understanding.

#### Questions 7-9

These were generally well answered.

#### Questions 10 – 12

None of these questions were answered well, especially Question 11 which very few candidates attempted. It should be recognised that Excise Duties will remain a part of the syllabus going forward and candidates should make themselves better aware of what is a relatively small syllabus. Many candidates simply made up return periods for Question 10, or quoted VAT periods, which was clearly incorrect and wasting their time.

### **Module G (Accounting)**

#### Overall comments

Overall, candidates performed well in this module. Generally, candidates seemed more comfortable setting out accounting entries and completing T accounts than answering written questions.

#### Question 3

Some candidates struggled with part 2 of this question which asked them to work out the cost of goods using a gross profit margin figure.

#### Question 4

Many candidates seemed to be unfamiliar with the concept of a contingent asset. Some candidates misread the question, believing that the company had a liability and not an asset.

#### Question 11

Quite a few candidates struggled with this question, either choosing not to attempt it or scoring low marks.

## ADVISORY

### Taxation of Owner-Managed Businesses

#### General Comments

In general, performance in this paper was better than in recent sittings, although performance in question 1 was surprisingly poor.

#### Question 1

A significant number of candidates answered this as their final question which suggests that they found it the most difficult on the paper. In general, candidates struggled to attain a pass on the question, principally due to failing to score anything beyond a single mark in relation to the smaller IHT-based requirement. Only one candidate even mentioned the existence of the replacement property rules, and a significant number stated that BPR would be available at 50% on the property, despite having no connection to the partnership going forward.

It was particularly concerning to see a significant number of candidates failing to properly understand the requirements of entrepreneur's relief as it relates to a non-incorporated business. This relief is absolutely key for owner-managed businesses, and it should be second-nature to candidates sitting this paper. Individuals/partnerships are not covered by the intangible fixed assets legislation and entrepreneur's relief is given based on the disposal as a whole, not by reference to the individual assets of the business.

Most candidates failed to correctly treat the investments as not giving rise to a gain or loss and a large number omitted them entirely from their answer.

#### Question 2

Candidates were generally well prepared for this question. In particular most candidates demonstrated knowledge of:

- restricting trading losses on succession where relevant liabilities exceeded relevant assets;
- principles on the value attributed to the disposal of stock;
- succession rules for trading losses and retention of capital losses.

There were a number of recurring errors:

- Omission of proceeds on sale of assets in computing the net liabilities position;
- On the transfer of the property, incorrect references to:
  - a no gain/no loss treatment which applies to a capital gains group (also outside the syllabus);
  - Gift hold-over and/or roll-over reliefs on transfer of the property.
- Implications of a potential change in Quik-Stores's trade: reference to the succession date as the transfer to Warrington, rather than the date of acquisition of Quik-Stores's shares, as the trigger for a change in ownership.

#### Question 3

There seemed to be a fairly sharp divide on this question between the good and not so good answers. The main problems which arose were:

- Confusing the trading test for availability of entrepreneurs' relief and whether it was a trading company for purchase of shares (wholly or mainly test)
- Adult children being associates for the purposes of connection/substantial reduction tests
- Getting the substantial reduction test the wrong way around (ie reduce by 75%)

Part of the question was whether Steve should repay his loan account out of the proceeds of sale or accept a smaller sum and for the loan to be written off. Some candidates considered this in relation to the connection test which of course is not relevant as Steve was indebted to the company, not the other way around.

The question did not ask for calculations of tax payable and so no marks were available for answers which did include such calculations (which a significant number did).

#### Question 4

Candidates performed reasonably well on this question. The best performing candidates made a significant number of notes (as per the requirements), and gained credit for obvious statements such as 'cars are not eligible for the AIA' as well as a few more complex aspects requiring legislative references. Candidates who knew where to find the relevant 'lists' in legislation generally performed very well.

Common errors included treating the disposals of fixtures at the Red site as additions, not including the lift from 2012 in the computation, treating the hoist as a non-qualifying asset, treating the fire doors and/ or mezzanine platform as qualifying assets.

#### Question 5

Candidates obviously felt confident with this question as they often answered it early in the exam, perhaps attracted by the adjustment to profit calculation, but with mixed results.

Profit adjustments due to cessation caused problems. A common error was the failure to disallow the costs of a staff party held on closure and so not for the benefit of the trade. Many also missed the stock adjustment required although several later realised their mistake and gained full credit for stating the correct amount to include. The van balancing charge was often well-handled but many candidates did not take account of plant disposal proceeds, arguably the easier element.

Performance in respect of basis periods was disappointing, with too many candidates omitting this entirely, or missing an element such as not stating the period, not labelling the tax year, or not calculating the profit. Too many answers were just incorrect. However, many candidates did understand the relief for overlap profits.

There were easy marks available for an income tax calculation, although many did not give loss relief. Some candidates forgot the other income and so thought there was no tax. Calculations of capital gains tax were performed well, with entrepreneurs' relief recognised, but the other gain was also forgotten and so the treatment of the annual exempt amount was often incomplete. Candidates would do well to check the facts of the question when moving on to the next requirement to ensure they pick up all relevant information.

#### Question 6

The general quality of answers to this question was very good. Most candidates had a good understanding of several of the individual elements of the question but very few had a broad knowledge of the taxation of each benefit.

Although the general presentation and format was good, a significant proportion of candidates failed to appreciate that a briefing note needs to be drafted in a clear logical manner aimed at the specific reader. Many candidates simply listed a sequence of isolated facts.

A number of candidates struggled with the concept of salary sacrifice, both in terms of how it is taxed and when it applies, including a belief that a deduction from net salary would be treated as a salary sacrifice.

The beneficial loan to the FD caused a number of issues: A loan to pay the tax on the exercise of an EMI option is not itself an “allowable purpose”. The BIK charge does not arise only if the employee fails to reimburse the company within 90 days of receipt of the loan.

The majority of candidates treated the employee contribution for the use of the company car as a capital contribution restricted to a maximum of £5,000 rather than as a deduction from the annual benefit in kind.

The operation of payrolling of benefits was very poorly dealt with by most candidates.

## **Taxation of Individuals**

### General comments

Overall candidates showed a good level of tax knowledge with most candidates making a good attempt at questions three, four and six. However many appeared to struggle with question five which covered accelerated payment notices.

A number of candidates missed out on easier marks in the questions by failing to cover areas such as annual allowances and the basics of calculations.

### Question 1

Only a few candidates provided strong answers to this question. It was surprising how few candidates identified and were able to correctly allocate the personal allowances in the most tax efficient way.

It was pleasing that most candidates identified the need to separate the UK and overseas rental businesses and were able to correctly calculate the overseas loss.

There appears to be poor understanding by candidates of the conditions that need to be met for a loan to be allowed as a deduction against an individual’s income.

A number of candidates failed to complete the calculations in the relevant stages and as a result struggled to correctly calculate the tax liability and payments on account due. Those who followed the suggested format generally achieved higher marks.

### Question 2

Whilst there were some very strong answers on this question, unfortunately the majority of candidates scored poorly.

Very few candidates correctly identified that part of the annual allowance charge would be at higher rate and part at additional rate, with most answers simply stating that the charge is taxed at the individual’s marginal rate.

A lot of candidates who correctly calculated the pension input then went on to add the employer’s contributions to this figure to arrive at the total pension contributions for the year.

Very few candidates calculated the correct amount of adjusted net income, with most adding the £7,000 employer contribution to the threshold income.

### Question 3

On the whole this question was well answered, with most candidates correctly identifying that both Income Tax and Capital Gains Tax reliefs could result from Brian's investment. It was encouraging to see many candidates advising Brian on the potential positive and negative outcomes of his investment proposal rather than just providing him with a list of facts.

Most candidates correctly explained the conditions for a qualifying investor for EIS purposes and were aware of the various events that could trigger a claw back of Income Tax relief or the crystallisation of the deferred gain.

The majority of candidates identified that the sale of the warehouse was a part disposal, although many then went on to apply the  $A/(A+B)$  calculation to the enhancement costs, which should have been allowed in full.

Unfortunately, in many cases candidates wasted time by listing out the qualifying conditions for the company and a surprising number failed to identify that cars are specifically exempt from Capital Gains Tax.

A lot of candidates missed out on the easy marks available for deducting the annual allowance and advising Brian of the due date of the Capital Gains Tax.

#### Question 4

It was pleasing that most candidates discussed the Transfer of Assets Abroad legislation but there were a number who still referred to targeted anti-avoidance legislation or the GAAR.

Very few candidates considered whether there was evidence to demonstrate there was no tax avoidance motive.

A number of candidates did not correctly identify that the only individual subject to tax was Paul. There were also significant inconsistencies between the explanation as to the amounts liable to tax and the amounts actually included in the calculations.

#### Question 5

Given that Accelerated Payment Notices are so topical, it was disappointing that so many candidates were poorly prepared for this topic. A number of candidates didn't attempt the question at all and many others wrote long answers with little or no bearing on the actual question asked.

#### Question 6

Most candidates made a reasonable attempt at part 1, although many incorrectly thought that either cottage 2 or cottage 4 did not qualify as a furnished holiday let. There is clearly confusion surrounding the new interest rules, with candidates restricting interest relief in the rental calculations. Capital allowances also caused problems, either with candidates not recognising that they were available and disallowing the costs altogether, trying to claim on the renewals basis for furniture or claiming a writing down allowance at 18% rather than an annual investment allowance. Very few candidates stated that the tax payable could be collected via coding in 2019/20.

Part 2 was not so well answered. Many candidates recommended claiming gift relief or rollover relief. Only a few recognised that it was possible to claim relief under the joint interest in land rules.

### **Human Capital Taxes**

#### General comments

Candidates struggled with a number of aspects of this paper. The majority were able to demonstrate good knowledge of core areas such as the statutory residence test and the pool car rules. However, a large number of candidates failed to apply the knowledge to the specific circumstances of the questions: it is important for candidates to appreciate that we expect them to apply their technical knowledge to the situation rather than just write all they know about a subject.

#### Question 1

The majority of candidates dealt with this question well and covered most aspects. Quite a few candidates wasted time covering short term business visitors, which was not in point due to the existence of the permanent establishment. Quite a number also spent a lot of time detailing the remittance basis, which was not relevant as the individuals were treaty non-resident.

#### Question 2

On the whole, it was clear that candidates did not understand the meaning of the pool car rules. Whilst most listed the criteria, they then interpreted the criteria and applied them incorrectly. The question was testing the candidates' ability to use the legislation in real working scenarios and apply the rules to the situation.

Few candidates attempted to make suggestions to solve the Derek conundrum.

#### Question 3

Candidates identified the topics being tested, suggested using a PSA and gave reasons. However, candidates did not understand the details of each exemption and how to calculate the limits. Few candidates correctly calculated the grossed-up tax and Class 1B due.

Candidates muddled the different exemptions up and included random criteria from other aspects of tax legislation not relevant to the topic.

There were a surprising number of candidates who stated that only cash amounts, rather than gifts, qualified as exempt from any Income Tax or National Insurance.

#### Question 4

On the whole candidates answered the question quite well. However, not many correctly calculated the change in monthly take home pay. Most candidates failed to calculate that the share income would push them into the 40% bracket for that month.

The amounts were such that there was no question that there was enough pay in the month, but that employees would be down by over a third of their normal net take home pay, which would be a considerable hardship. Few candidates appreciated the impact this would have and discussed the possible options for the employer.

#### Question 5

On the whole candidates showed they understood the basic principles of the difference between hiring an employee locally as opposed to them going on assignment. There was good reference to the legislation which was applied correctly by most candidates.

Most candidates showed a good understanding of the difference between incidental and substantial workdays and were able to define each with good examples. Several candidates also showed awareness of the difference in treatment for directors of a company. A few candidates clearly showed they knew the

difference between the two but simply did not state the different tax treatment between the two types of day.

Candidates also gave away a lot of marks by stating one point on an area and moving on rather than going into more specific detail. For example, all candidates referred to the 52 week trailing National Insurance period but then did not state that the employer needs to monitor this. In addition, with respect to the 52 week period, candidates seemed unaware of the difference in how this applied between Class 1 Primary and Secondary and Class 1A.

Candidates should bear in mind:

- a) the format required by the question as too many were written as a formal email rather than as a technical note
- b) the question was being asked by the employer and full consideration of the difference in assignment type and how this would affect the company itself was required rather than focusing on Fred's personal position. For example, candidates did not consider what the position would be for any trailing payments that may relate to Fred's previous UK employment and how these should be picked up by the company.

### Question 6

A large part of this question was around the effect of tax equalisation on an employee's UK tax liability and in particular, how tax equalisation settlements should be treated for UK tax purposes. Tax equalisation settlements cannot be ignored when calculating earnings liable to UK tax and may represent positive or negative earnings under s62.

However, despite being invited to source bonus payments or option gains, hardly any candidates considered how tax equalisation settlements might be sourced in a similar way. As a result, many candidates failed to point out the impact of each settlement, with many just assuming it had no impact at all. Where this was the case, it was very difficult to achieve enough marks to pass the question.

The US Tax Equalisation Calculation caused particular difficulty (unsurprisingly), with very few identifying the adjustment to UK taxable income required as a result. It was comforting, however, to see the number of candidates identify that the federal tax withholding and tax advances had been misreported and this needed regularising somehow.

## **Inheritance Tax, Trusts and Estates**

### General Comments

There was a mix of scores throughout the paper with some at the extreme lower end of the spectrum. Candidates appeared to be less prepared with some questions left unanswered or incomplete. In many cases it was evident that the candidates had not read the question correctly thus wasted time giving answers that were not required.

### Question 1

This required a calculation of the estate Inheritance Tax (IHT) liability with consideration of making a charitable gift in line with the testator's wishes and at a level intended to maximise the tax relief available. Overall this question was very poorly answered.

Those candidates who were aware of the need to identify the separate components of the estate scored well but many candidates failed to perform this task. One of the four components was a property in which

the deceased had a clear reservation of benefit (GWR) but many candidates instead wrote a lengthy debate on the arguments for a GWR, the applicable rules and how it could be avoided. This was not a question requirement and valuable time and marks were lost. Similarly, many candidates spent time debating the valuations of the assets given and how these might be adjusted but again, this was not a requirement.

The majority of marks were available for advising on the use of a Deed of Variation, identifying the separate components, calculating the level of the charitable gift required to secure the reduced rate of IHT and detailing the process of the merger election to include time limits and the parties to the election. The majority of candidates identified a need for a Deed of Variation however, very few mentioned merger elections and those that did, dismissed it as not being the responsibility of the executors. No candidates gave details of the time limits.

### Question 2

This question focused on the rules regarding Settlor interested trusts and the impact on the tax liability of the Settlor. In general, it was poorly answered.

It was disappointing that so few candidates identified that any trust created in favour of the settlor's husband, regardless of type, would be settlor interested and therefore lost valuable marks. The majority of candidates wrote several pages comparing the income tax treatment of a Discretionary Trust with that of an Interest in Possession Trust but this was not required, wasted time and lost marks. Some candidates incorrectly concluded that any such trust would be a Qualifying Interest in Possession with no tax implications on transfer in of asset. Very few of those candidates that concluded the trust would be settlor interested, identified that general s.260 Capital Gains Tax (CGT) holdover relief would not be available.

The second part of the question required consideration of alternative options to the use of a settlor-interested trust. Most candidates were able to identify that an outright gift to Philip would qualify for the IHT spousal exemption, result in a no gain/no loss for CGT, and enable him to receive the income thereby utilising his personal allowance and basic rate band.

### Question 3

This question tested candidates' knowledge of the tax treatment of trusts created for disabled persons. Although not mainstream, the subject has been tested in prior exams and now as then it was poorly answered. Candidates lacked sufficient depth in their answers, simply skimming over the main points which resulted in low marks being achieved overall.

Whilst most candidates could give reasons for setting up such a trust and identify who is able to do so, many simply cited the legislation rather than stating the definition as required by the question. Marks were lost for failing to differentiate between the initial vulnerable person's election and the trustees' subsequent choice to annually elect for the special Income Tax and CGT treatment to apply, that the initial election was irrevocable once made and that it ceased on the disabled person ceasing to qualify as such. Most candidates failed to identify that self-settlement automatically resulted in settlor interested trust treatment for Income Tax but that CGT could still be affected by the trustees' election. The majority of candidates were able to set out, albeit in very broad terms, the IHT treatment of such a trust.

### Question 4

The question required candidates to demonstrate their understanding of the tax implications of assets distribution from a relevant property trust, in particular, the effect of the rule in *Crowe v Appleby* regarding property. Far too many candidates failed to read the question and repeated information that was already provided or performed calculations that were not required. This question was not popular, often being left until last and was the most poorly answered of the paper.

Candidates who knew the rule and its effect scored well but too many candidates were unaware of its application and spent time calculating the CGT on the property at the date of the distribution. An exit charge

arose on both distributions but the calculation of that rate was not the main focus of the question as the effective rate at the previous 10-year anniversary rate had been stated in the question. Despite this, most candidates attempted to recreate the calculation of the effective rate with poor results and several candidates tried to calculate the exit charge with a modified 10-year anniversary calculation using values from the creation of the trust. Valuable marks were lost. Of those candidates who did use the effective rate from the question, many did apply it correctly however, there were some who ignored the relevant quarters fraction. The question expressly stated that candidates were not required to calculate the interest and penalties arising and yet several did so.

#### Question 5

This was a question in two parts which required firstly, a calculation of tax on lifetime gifts and on a relatively simple death estate and secondly, consideration of post mortem reliefs. It focused on valuation issues, the availability of both agricultural and business property reliefs and the additional conditions that needed to be satisfied in order for the lifetime gifts to continue to qualify for these reliefs on the death of the transferor. Overall, it was no more than adequately answered.

The first part was answered well by although many candidates failed to recognise the trigger points for the reliefs to be withdrawn on death which led to the incorrect calculation of the tax on the lifetime gifts and the resultant loss of marks. The valuation issues were recognised by most candidates although their ability to correctly calculate the related property values and the appropriate amount of relief on the development land was variable. Many candidates failed to identify that only 50% business property relief applied to the farmland held outside the partnership. There was some evident confusion over the Residence Nil Rate Band which was not in point.

Too many candidates quoted the generic rules of all three post mortem reliefs without focusing on the question facts whilst others wrote at length about the relief for quoted shares of which there were none and therefore wasted time for no marks. This part of the question was either answered very well or very poorly, differentiating those candidates that had revised this area of the syllabus from those that clearly had not.

#### Question 6

This discretionary trust question required the calculation of optimum income distributions and a 10 Year Anniversary charge. Both requirements were generally well answered by the better prepared candidates, and interestingly for most this was the first question of the paper answered. However, some candidates failed very badly showing a lack of preparation and knowledge of basic trust Income Tax.

A few candidates tried to calculate exit charges for the distributions to the two beneficiaries using initial trust asset values, double counting those values and generally displaying evident confusion. The better candidates correctly identified the number of quarters to be used to provide relief for the added property. A few outstanding candidates obtained full marks for this part of the question.

Most candidates identified that the undistributed income would form part of the capital for the 10 Year Anniversary charge and the majority went on to mitigate this by recommending a distribution of the income arising in the years prior to 2013/14. Candidates alternatively advocated fully utilising the tax pool for which they were given due credit. The better candidates considered the timing of the distribution for Charlotte and the possibility of a settlor interested income tax charge arising on Emily if a distribution were made pre 15 September 2017.

### **Taxation of Major Corporates**

#### General Comments

Candidates generally handled this paper well, setting out their answers nicely. Many, however, found questions 3 and 4 particularly difficult, which could indicate a lack of tax knowledge in certain areas of the syllabus, and also an inability to deal with a scenario they might not have seen before.

### Question 1

This computational question was generally handled well. Most candidates appreciated that two calculations were required, laid out their calculations in an easy-to-follow manner and gave clear explanations where necessary. However, the treatment of short life assets was not dealt with well. Many allocated a disposal value to the computers, despite the computers being scrapped for £nil disposal proceeds. Few appreciated that a balancing allowance was due in relation to the scrapped computers, and even fewer calculated it correctly. Candidates were given equal credit for allocating the new computers to the general pool or deeming a new short life asset election to be made. Many misinterpreted s5(5) CAA 2001, which did not apply as the date the payment was due was the same as the date of unconditional obligation. Some also thought that s28 meant that the thermal insulation qualified for the main pool.

There was a clear split between those who knew how deferred tax should be calculated under IFRS and those who didn't. Some lacked even a basic understanding of '(qualifying net book value less tax written down value) \* tax rate'. A surprising number included the non-qualifying assets in the calculation.

### Question 2

Almost all candidates showed a good understanding of SSE principles, although many either forgot to apply the SSE conditions to each disposal, or applied them incorrectly to at least one of the disposals. Many correctly identified the contingent consideration although some failed to appreciate the difference in treatment between ascertainable and unascertainable consideration.

It was disappointing that so few mentioned, and even fewer calculated stamp taxes, despite its applicability to the land and building transfer, the transfer of Soya Ltd shares and the acquisition of Clementine Ltd shares.

### Question 3

This question, which tested candidates' knowledge of the impact of a company ceasing to trade and going into liquidation, was answered poorly. Almost all failed to keep their comments relevant and in line with the requirement of the question. Most explained the tax consequences on Paddle plc (e.g. applicability of SSE to the liquidation and the tax treatment of distributions received from Crawl Ltd) despite the question asking for the tax consequences on Crawl Ltd.

Most correctly stated some of the rules for accounting periods on cessation/liquidation, but then struggled to name any other consequences. Many wrongly stated that plant and machinery could be transferred at tax written down value under the 'transfer of trade' provisions, even though the question stated the transfer would take place after cessation of trade.

Hardly anyone appreciated that the group relief grouping broken on liquidation was between Crawl Ltd and Butterfly Ltd, not between Paddle plc and Crawl Ltd, and hence that it was Butterfly Ltd's losses that could not be group relieved for the period between liquidation and transfer to Splashing Ltd.

### Question 4

This question contained a relatively sophisticated scenario, which candidates may not have come across, but they should have been able to identify the relevant tax technical issues. There was a wide range in the quality of the answers. Those who failed to appreciate that this was essentially a financing arrangement struggled.

It was reassuring that some had a broad understanding that partnerships were treated as transparent but hardly any explained how the taxation of partnerships works. Many went into detail on the rules for investment companies and management expense, without any mention of the loan relationship rules.

On the CFC aspects, most had a reasonable grasp of the rules. However, not everyone identified that the CFC rules only apply to controlled foreign *companies*. Few showed any knowledge of the full and partial exemptions for qualifying loan relationships under the non-trading financial profits gateway.

Many made valid points around the application of the transfer pricing rules and hybrid mismatch rules. But many incorrectly provided detailed explanation of the diverted profit tax rules and failed to note that they do not apply to profits diverted through holding loan relationships. Hardly any mentioned the possible application of the unallowable purpose rule.

#### Question 5

Although candidates performed well overall, a significant number of candidates struggled with the DTR aspects of the question. Some of the common errors were:

- Incorrectly assuming that Faraday plc and Faraday Consulting Ltd had a nine-month period of account;
- Incorrectly treating Faraday plc as a trading company;
- Not identifying the royalty income as taxable as profits from a non-trading intangible fixed asset, and also not commenting that the IP would be ineligible for the Patent Box rules;
- Assuming that Faraday Consulting Ltd had to claim group relief against all of its taxable profits; and
- Claiming expense relief for DTR against taxable profits rather than as credit relief against the company's Corporation Tax liability.

#### Question 6

This was a straightforward question but required in-depth knowledge and so those who could read their legislation performed well. The top candidates applied the rules to the particular scenario, and identified the potential issues that could arise on the takeover. The question asked for details of the Corporation Tax treatment but some focused on the Income Tax position of the employees.

### **VAT on UK Domestic Transactions, IPT and SDLT**

#### General comments

The majority of candidates answered all of the questions, suggesting that, for the most part, timing was not an issue. Quite a lot of the answers seemed to reflect a theoretical, rather than practical, approach and this suggests that the candidates were not thinking enough about the intended reader or had insufficient practical experience before sitting this paper. Recommendations were often not forthcoming: it should be remembered that the adviser's role is to advise. However, overall there was a sharp improvement in the quality of answer as compared to recent sittings.

#### Question 1

The vast majority of candidates were aware of the main issues in point in this question and were able to discuss relevant cases. The best candidates were able to use the cases selectively and apply the salient points of the different judgments to the relevant part of their answer. Higher marks were awarded to candidates who provided recommendations with justifications rather than merely stating the problem areas that needed to be addressed.

A number of candidates incorrectly concluded that BigBulldog Holdings Ltd made an exempt sale of shares and then went on to discuss the implications of the *AB SKF* case. The sale of shares was made by Jimmy and not the company so this analysis was largely irrelevant and highlighted that the candidate was not reviewing the question in sufficient detail.

#### Question 2

The VAT aspects of the question were largely answered well but the Stamp Duty Land Tax (SDLT) aspects were not always addressed in full. Higher marks were awarded to candidates who put forward recommendations to mitigate the impact of exempt leases causing a restriction on input tax recovery (such as suggesting a sale to a connected party). The vast majority of candidates flagged the issue but only a few took this a stage further and discussed options to address the problem. Only a couple of candidates provided accurate SDLT calculations. Very few candidates compared a standard SLDT calculation with a calculation including multiple dwellings relief and therefore some relatively straightforward marks were missed.

#### Question 3

In general, candidates were able to accumulate sufficient marks by answering the basic points of the question correctly. Higher marks were awarded to candidates who could expand on some of the complex areas and provide more detailed analysis. For example, more detailed discussion of the insurance intermediary exemption, providing commentary on the sale of the property as a TOGC, some of the implications of being in a receivership situation and greater detail on post deregistration issues were all valid areas that could have gained further marks.

Only a couple of candidates spotted the opportunity to request that the option to tax on 1 Central Drive was revoked. Again, a recommendation that was relatively straightforward as a potential cash saving avenue for the troubled company.

Surprisingly, the VAT return and partial exemption calculations were answered relatively poorly. In particular, the refunds and rebates appeared to confuse a number of candidates.

#### Question 4

Most candidates recognised the likelihood that TOGC treatment would be achieved. A number suggested that the website operation might not form part of the TOGC and suggested that this might mean that the transfer of it was taxable, but did not recognise that it would have little or no value in the final deal. Only a few candidates commented on the extra SDLT cost of failing the TOGC requirements for that land element of the deal.

#### Question 5

No candidates recognised the mis-match between the time limits for claiming bad debt relief and the VAT return cycle. Most recognised the need to exclude credit charges from BDR claims but few picked up on the fact that the time limit for claiming ran from the due date in cases where deferred payment terms were available. The availability of "GMAC claims" was recognised by many candidates but many seemed not to appreciate the details. Quite a few candidates mentioned the possibility of using Regulation 38 adjustments as a means of adjusting for non-payment (and were given credit for this) but almost without exception, this was presented without any mention of the commercial and technical difficulties of establishing that the adjustments or consideration were available.

#### Question 6

Most candidates tackled this question and scored reasonably well on it. A few candidates missed pretty simple points and lost marks accordingly and one wrote about VAT instead of IPT.

## **Cross Border VAT & Customs Duties**

### General comments

The VAT questions in the paper were generally well answered although candidates would benefit from recognising that their answers are for a client and not a tutor/academic, and too many wrote with assumptions using technical phrases where practical/client focused explanations would have scored higher. Questions 2 and 3 required recommendations not to go ahead with proposals that the clients had brought to the adviser. Candidates who gave a clear recommendation against proposals scored more marks than those who were non comital or “hedged their bets” with ambivalent advice.

The Customs questions were better answered than in recent sittings but candidates still need to do more work in this area to really score well. It was pleasing that all candidates attempted both questions at this sitting, albeit some answers were very brief. It was also encouraging that fewer candidates wasted time writing about subjects that were specifically excluded from the question; although quite a few still wrote about valuation and assists for question 4.

### Question 1

Candidates performed well on this question with the majority showing good understanding of the meaning and effect of Business and Fixed establishments and the features that determine from which establishment supplies are made and received. Some candidates incorrectly thought that CPP principles involving “essential character” should apply to determine which of two potential establishments was making a supply, rather than which was more connected with the supply. Approximately 25% of answers explored whether calibration services were land related supplies, some of which believed that French VAT would be incurred and recoverable by cross border refund. It was concerning that a small number of candidates thought that supplies could be accounted for in whichever way caused the least inconvenience by potentially any entity and irrespective of the facts clearly indicating that was the wrong analysis.

### Question 2

Overall this question was adequately answered. The majority of candidates failed to acknowledge that coffee would not ordinarily be subject to VAT and there were even fewer reasons that would make Fiscal warehousing attractive. Many suggested in conclusion that a cost-benefit analysis should be performed, rather than clearly stating that the benefits were minimal. A minority thought the question was about Customs warehousing and sought to keep the goods out of free circulation for as long as possible. The opportunity for growing service income (rents, sorting etc.) was not generally fully explored for coffee or potentially other related eligible products in which the client could trade.

### Question 3

A significant number of candidates did not address the requirement to provide EU case law references and superficially covered the two ECJ principles. Nevertheless, strong recommendations to the client to reject, or at least not to proceed without further clarity from HMRC, were common and demonstrated clarity and conviction in making recommendations. The abusive nature of the arrangements were related to Halifax principles in approximately 25% of answers. Candidates drew the definition of a car from several parts of VAT legislation – NMT, blocking order etc. but all concluded that the vehicles were misdescribed and could be distinguished from vans on fiscal neutrality grounds. Explanations and case law regarding fiscal neutrality and legitimate expectation were surprisingly weak overall given the cross-border nature of the paper.

#### Question 4

Too many candidates are still failing to learn enough about the subject (Customs Duty) to be able to apply it to scenarios and to be able to give advice. Many seem simply to learn some words about a subject and to write these out once they see a key word with no ability to apply it to the question asked.

A good number of candidates explained “wholly obtained” and a lot of these then gave examples. Many then said that if goods were not “wholly obtained” they must be sufficiently worked or processed with no further explanation or examples. They lost simple marks by failing to explain quite simple terms.

On the other hand, quite a few candidates (impossibly) quoted an exact percentage that non-originating components could make up of the (unknown) finished product. Some even going as far as telling (again impossibly) the client that the exported EU component was below this percentage and so the imported goods would qualify for preference.

Nearly all candidates wrote about REX but too many decided that as it is a Registered Exporters Scheme, the client would not be affected as he did not export or that he would have to apply to become a REX. The question asked about the affect of claiming preference on a guarantee. Too many candidates simply wrote words to the effect of, “claiming preference will not affect your guarantee” – this cannot be advice. Reasons why this is the case must be given. Quite a few said that no guarantees were needed for preference goods, which is wrong. Others simply said that the UCC makes guarantees mandatory, which given that the client is asking what affect something will have on his guarantee, is not particularly helpful and does not address the question.

#### Question 5

Candidates answered this question fully and large numbers identified the attractiveness of onward supply relief. Some candidates drifted from the 3 specific questions being asked and lost time describing the liability of goods dispatched to Cyprus, - but not the repackaging service received. Many candidates queried the US sales tax charged and were awarded a bonus, however many failed to pick up an easy mark by offering practical advice on the currency conversion requirement. Tax points on reverse charge supplies were well understood and a small number ventured into error correction procedures. The strongest candidates recognised that the acquisition tax liability upon triangulation would rest with the client’s customer and not the client.

#### Question 6

Candidates did not score as well on this question as on question 4 which is surprising given how important AEO is.

Again candidates failed to score marks by not giving an explanation of terms: “you must meet financial solvency conditions” does not score well. Simply listing the names of the criteria is not giving someone advice.

As with question 4, some candidates felt they knew enough about the business to judge e.g. their compliance record and could tell the business that AEO would be granted. This is impossible from the information given. Most candidates did not know the difference between AEOC and AEOS: either in terms or criteria to gain the status or what benefits come from the status

### **APPLICATION & INTERACTION**

#### **Question 1 – Taxation of Individuals, Trusts & Estates**

This question related to the Inheritance Tax (IHT) exposure of Mr & Mrs Green, partners in a farming partnership, the implications of making lifetime gifts to their two adult children and required future tax planning advice.

It was pleasing to see that nearly all candidates who attempted this question produced a report in the correct format and included an introduction, terms of reference and an executive summary. In addition, the majority stressed the importance to the client of having a Will drawn up although very few went on to explain how the assets would devolve under the intestacy rules and even fewer explained the requirements for a valid Will.

Most candidates showed a good understanding of the basic concepts of IHT and referred to the transferable nil rate band and the residence nil rate band (RNRB), but many were not aware that the £2 million limit on the RNRB applies to the estate before any reliefs, so subsequently included it in their IHT computations in error.

Whilst many candidates were able to provide an adequate definition of agricultural property relief (APR) not all were then able to correctly apply the rules to the assets in the question. The farmhouse and farm cottages were generally correctly treated by most, although not all candidates appeared to be aware of the “*character appropriate*” test and of those who did refer to this, only a handful explained what factors should be considered when determining this. It was however pleasing to see that most candidates were aware that APR is restricted to the agricultural value of the property. In addition, a large number of candidates were not aware that the woodlands would qualify for APR if ancillary to the agricultural land. Credit was given to candidates who referred to woodlands relief instead.

A reasonable explanation of business property relief (BPR) was provided by candidates, but many wasted time explaining the how BPR applies to shareholdings in limited companies, which was not relevant as the business in the question was a partnership. Good explanations were provided of the “*wholly or mainly trading*” rules and the factors that need to be considered. Some candidates also provided a detailed analysis of the accounts, with many reaching the correct conclusion that the business as a whole would qualify for BPR.

Unfortunately, having explained that it was necessary to look at the business as a whole or “*in the round*”, the vast majority of candidates then completely ignored what they had previously said and stated that the six Blue Row Cottages let to non-agricultural tenants and the furnished holiday let, The Lodge would not attract BPR. Some candidates also incorrectly applied BPR to the balance of the Farmhouse value above the agricultural value.

Most candidates were able to explain the basic IHT and Capital Gains Tax (CGT) implications of lifetime gifting but the availability of gift relief on the assets in the question was either dealt with very poorly or in many cases not even considered. As a result, many candidates reached a patchy conclusion, advising the client not to make any lifetime gifts due to the high CGT liability that would arise, even though they had previously stated that no BPR would be available on death once the client had retired from the business. It was also disappointing to see that most candidates failed to take into account the main residence exemption when talking about gifting the farmhouse to Alan.

In this paper candidates were expected not only to explain the current position and the implications of the lifetime gifts suggested by the client, but also to provide appropriate advice for the future. The majority of candidates were able to deal with the current position and the lifetime gifting suggestions, but some candidates did not go any further and provided no advice or suggestions to the client which left their reports unfinished such that it was not possible for any of the marks available for these higher skills to be awarded.

Finally, many candidates suggested that Mr & Mrs Green could create a trust to hold Blue Row Cottages for the benefit of Anne and her children. Whilst this is a good suggestion, candidates need to be aware that they will not gain many marks by merely saying “you should set up a trust” without going on to explain what a trust is, which type of trust would be appropriate for the clients’ circumstances and also explaining not

only the tax issues on creation of the trust but also the ongoing tax implications, all of which is core material for this paper.

## **Question 2 - Taxation of Larger Companies and Groups**

### General Comments

Most candidates addressed all of the requirements of the question and constructed answers that were in an appropriate format and which addressed the majority of issues. The successful candidates distinguished themselves from the unsuccessful ones by methodically identifying all of the issues that were signposted in the question and then addressing each issue succinctly but comprehensively.

Candidates who did not appear to plan their answer gave too much detail on relatively unimportant or irrelevant aspects. Some candidates, however, had plans that ran to several pages, and would have been better off spending more time on the actual answer. Similarly, the length and quality of the Executive Summary varied from being non-existent or too short to running to two or even three pages, which is then not a summary but a repeat of the answer.

In a few instances, the quality of handwriting was extremely poor. Marks cannot be awarded where the examiner cannot read what has been written.

### Corporation Tax aspects

Areas that were generally well dealt with included: corporate residence and liability to Corporation Tax; the availability and nature of various tax reliefs; and other planning opportunities. Some candidates showed a muddled knowledge of UK corporate residence and the taxation of permanent establishments. Other candidates failed to identify the full range of capital allowances and other reliefs potentially available. Most candidates failed to identify the overarching issue, which was that there were significant losses in early years so that enhancing them with further interest deductions, and in consequence giving rise to a likely tax liability in Mulronia, was not a good strategy. This impacted on the quality of advice given in respect of the debt and equity financing, which while generally technically correct, seldom gave appropriate advice on the timing and mix of debt and equity. Some candidates wasted time by writing all they appeared to know about a subject regardless of its relevance. Examples included long passages about the loan relationships legislation, Senior Accounting Officer responsibilities and transfer pricing mechanisms.

### Personal Tax aspects

The requirement to address the personal tax aspects of the relocating employees were not always addressed well. Domicile was almost never mentioned, and knowledge of the taxation of the various potential benefits referred to in the question was frequently superficial or wrong.

### Memo to partner

The majority of candidates dealt well with the two ethical issues (fiancée shares and referral/commission). A couple of candidates failed to identify the need to consider client acceptance procedures and terms of engagement.

## **Question 3 - Owner Managed Businesses**

### General Comments

Candidates were required to draft a report covering the tax implications of the disposal of a limited company, Whitley Precision Tools Ltd (`WPTL`), either as a trade & asset sale or share sale to a third party or a share sale at undervalue to their son. The owners, Andrea and Mungo Whitley (`AW` & `MW`), were also considering selling their UK home and emigrating. The question therefore also required an appreciation on how this may link into their plans regarding disposing of WPTL.

The vast majority of candidates adopted a suitable report structure (ie properly headed and including an introduction and appropriate executive summary, section numbers and appendices). A few, however, did not (particularly omitting a reasonable introduction or referenced appendices) and therefore failed to gain the easy marks available for this. It was also noted on occasion that the executive summary (and sometimes answer plans) were nearly as long as the main body of the report rather than simply being a summary of the main points. This could only be described as poor exam technique and not an efficient use of time in the exam room.

Looking at the question in a bit more detail:

### Trade & Asset Sale

This required some fairly straightforward chargeable gains and (cessation) capital allowance computations followed by a discussion of the most likely route to extract residual cash from WPTL. The chargeable gains computations were generally dealt with well, although many failed to realise that gains would arise on the disposal of the two high value lathes. Capital allowances, however, were generally dealt with poorly. Common errors were (i) claiming an annual investment allowance in the final accounting period; (ii) electing to transfer at tax written down value (WPTL and the buyer were completely unconnected); (iii) giving an additional deduction for balancing charges, and; (iv) failing to restrict the disposal value for the lathes to original cost.

Many realised that the way to proceed in terms of extracting the residual cash was by way of a formal liquidation and discussion surrounding the availability of entrepreneurs' relief was generally good. Quite often, however, this included an extensive discussion of paying additional salary before concluding that this was not the way to proceed and therefore, from the client's perspective, essentially irrelevant. With regards striking off a common belief was that distributions up to £25,000 would be capital in nature with only the excess being treated as an income distribution.

### Share Sale

From WPTL's perspective too few candidates recognised that AIA was now available for the continuing company which yielded a trading loss and hence a corporation tax refund and led into a discussion of the change in company ownership rules.

All too often global CGT computations were prepared using combined sales proceeds and cost rather than separate computations for AW and MW. The loan notes caused some problems insofar that there was often very little discussion of the type of loan notes (i.e. QCB or non QCB) and the difference that this might have from a taxation perspective. Many candidates failed to realise that entrepreneurs' relief would not be available to the Whitley's for gains coming into charge upon the redemption of the loan notes. Almost without exception there was also an absence of discussion of the potential bad debt risk (i.e. wider commercial implications) associated with taking consideration in this form.

Generally the possible share sale by the Whitleys at undervalue to their son was well answered, picking up the restrictions for actual proceeds and chargeable non-business assets. It was, however, noted that frequently candidates thought that any gift relief would be clawed back upon their emigration whereas the claw back would happen if their son (i.e. the donee), rather than themselves, emigrated.

### Emigration

This section was generally reasonably well attempted, particularly the identification and application of the temporary non-residence rules. Most candidates were also able to link in a sensible way the implications of becoming non UK resident to the proposed disposal of WPTL and their UK home.

For some candidates, however, there was a temptation to simply list the rules governing an individual's residence status without any real attempt to distil them to the salient points and apply them to the specifics of the question scenario. Additionally statements were often made (e.g. that the Whitley's would `become non UK resident` or that `split year treatment would be available`) without any attempt to justify this position. It was also noted that many incorrectly thought that the effect of becoming non-UK resident from a CGT perspective was that the Whitley's would then only become taxable on their UK chargeable gains.

#### **Question 4 - Human Capital Taxes**

##### Requirement 1

Requirement 1 was for candidates to comment on the UK tax and legal implications of a Canadian national being seconded to the UK to take up a new managing director position in a newly acquired subsidiary company. The director was coming to the UK with his family and candidates were provided with his draft remuneration package and emails between management in the company. He was also to spend time travelling to Austria for 25% of his UK assignment time. The former managing director had left the business quickly following the acquisition.

Almost all candidates presented their answers in the correct formats with clear headings, introductions and executive summaries of the key points and advice.

The majority of candidates were able to accurately identify the residence and domicile status of the individual and the impact on UK taxation including the remittance basis and overseas workday relief, however, only a small proportion of candidates recommended keeping records of days spent travelling in and out of the UK. In some cases, candidates swiftly concluded UK residence but other spent a long period of time going through each of the tests in statutory residence, which although technically correct, did not gain any additional marks.

The UK/Canadian social security position was very well identified by the majority of the candidates, with a large majority scoring full marks on this section, however, only a quarter commented on the Austrian social security impact.

Whilst the principles of tax equalisation and the need to operate PAYE including the use of a modified payroll was included by the majority of candidates, the finer details around extended filing dates for P11Ds and RTI requirements under a modified payroll were included by less than half of candidates.

Also whilst the principles of tax equalisation were explained by most candidates as were the practical aspects of hypothetical taxes, the flow of hypothetical tax to the UK entity by way of a recharge was not mentioned by any candidates.

High income child benefit charge was identified by the majority of candidates and almost all of those applied the charge to the individual in the question, which shows good application of the facts.

Almost all candidates explained the principles of a temporary workplace and recommended where possible to keep the period of assignment below 24 months. However, the detail around this such as the benefit of the relief passing to the employer and the limit of expenditure for the employee compared to his family was identified by under a third of candidates.

One of the options explained in the remuneration package was in relation to a car being leased for the employee. Most candidates identified that a company car benefit would arise but few mentioned low or

zero emission vehicles as an alternative and capital allowances and the corporate tax deduction restrictions for leased or high emission vehicles were ignored by almost all candidates. Similarly, barely any candidates identified any VAT issues relating to a company car with none talking about VAT on private fuel.

Mileage allowances were to be paid in excess of the MAT rates for the employee and whilst the majority of candidates identified that the 45p/25p rates were being exceeded which would result in taxable income, few recommended the mileage rate was restricted to the MAT levels.

The relocation exemption of £8,000 was identified by the majority of candidates as being available but less than half mentioned the conditions for qualifying expenses and under very few talked about the timescale for qualifying payments to be reimbursed.

The question about taxation of stock was identified by all with the majority calculating what the option liability might be as well as understanding that the option gain would be impacted by periods of non-residence over the grant to vest period.

One of the topics included in this section was employment law, but few candidates identified the need to discuss this.

The final element of this requirement was a calculation of the tax equalisation or the likely tax position for the employee. Whilst the majority of candidates attempted a calculation, only about half gained marks for their calculations as often they were rushed and did not include some of the basics such as deduction of hypothetical tax against income or the correct apportionment of bonus for the taxable period. With more care, candidates could have made up a significant number of marks on the calculation section.

Many candidates did a good job referencing the double tax agreement, but similarly to the residence position some candidates went into too much detail which potentially cost them time they could have been spending elsewhere.

## Requirement 2

Requirement 2 was for candidates to comment on any areas where there could be additional risk or opportunity in the UK for the UK company or the Canadian parent company.

Candidates did a good job of identifying the PE risk in Austria and the corporation tax impact thereon as well as the need for transfer pricing.

Regarding the exit of the former MD, whilst a large proportion of candidates identified that there could be a case of unfair dismissal or breach of contract with legal advice being recommended, many did not comment on the tax treatment of any settlement or ordinary resolutions needed to appoint or remove a director.

## **Question 5 - VAT and Other Indirect Taxes**

### General Comments

As expected, candidates scored well on the VAT section of the paper.

In contrast, the marks secured on the corporation tax issues were poor with few even gaining the basic marks for the basic principles of notification of the Club's liability to corporation tax (the Club having acknowledged that it had a liability), the dates for filing returns, the penalty regime, the mitigation of penalties and finally, the principles covering the deduction of expenses.

The Insurance Premium Tax aspects of the paper were dealt with well, but that was not so in the case of Machine Games Duty where many candidates simply summarised the general principles of the tax, rather than addressing the specific matter raised by the client.

Turning to Stamp Duty Land Tax ("SDLT"), it was disappointing that so few candidates identified the charitable exemption. The correspondence from the Club raised various ethical matters - reference solely to the need for a suitably drafted letter of engagement was insufficient; a more detailed answer was expected.

### Specific Comments

The following specific observations arise from candidates' scripts:

1) In relation to the sale of the Club's current site, it was pleasing that candidates identified the impact an option to tax ("OTT") by the Club on the SDLT which would fall on the purchaser. More disturbing was the number of candidates who thought that the OTT would be disappplied on account of the purchaser's (as a developer) construction of dwellings on the site.

2) No candidate identified that the use of the new clubhouse for business purposes did not preclude zero rating on its construction where it was intended for use by a Club as a facility similar to a village hall for the provision of social or recreational facilities by the local community. Consequently, few candidates addressed in depth the relevant principles relating the relief, but instead concluded that VAT was chargeable on the works and then set out in depth a basis for deduction of the tax charged (there were some very full answers based on suggested partial exemption special methods). Candidates who proceeded on this basis were given credit, albeit the suggested answer does not fully reflect this approach.

3) Few candidates identified the scope of extra-statutory concession 3.35, but nevertheless some quite reasonably reached the same conclusion on the basis of UK and EU caselaw. Candidates' approach to the deduction of VAT on the Club's current and future capital costs was generally good, with a number identifying the application of the standard method over-ride.

4) In relation to the Club's proposed sale of its naming rights, many candidates correctly addressed in depth the place of supply and the identity of the recipient of the Club's supply, but few considered whether there was a single composite supply or two or independent supplies to be assessed independently. Some candidates unnecessarily focussed on the use of the clubhouse by Chiyoda Ltd, with very few as requested by the Club addressing the accounting aspects of the sale proceeds.

5) Disappointingly very few candidates seemed aware of the fundamental principle that unless an expense item has been incurred exclusively for the purposes of a trade, strictly it is non-deductible in computing a taxpayer's corporation tax liability.