



## ADIT Examiners' Reports from May 2007 examinations

### Paper I

76 candidates sat this examination (as compared with 51 candidates last year). For the first time, the examination paper was divided into two parts. Parts A and B comprised five essay questions and two problem questions respectively. Candidates were required to answer four questions composed of either two questions from each part or three questions from part A and one question from part B.

Most candidates used the time available (3 hours) well and attempted four questions in accordance with the examination rubric; although, in some instances, there was a clearly weaker fourth answer. Interestingly, approximately, half of the candidates attempted questions 6 and 7 (the problem questions), and a very high percentage answered question 7. Each of the questions on the examination paper attracted answers. The most popular question was question 7 and the least popular was question 3.

Overall, the standard of the scripts was disappointing with a highest mark of 69% and only 10 candidates in the 60-69% band. The breakdown of marks was as follows:

70 or over	0
60-69	10
50-59	33
40-49	13
39 or below	20

It is difficult to explain this spread of marks, although it is conceivable that the 'bunching' in the 50-59 band may be attributable to the fact that, in some cases, a candidate's overall mark was brought down by a weaker fourth answer. It might be added that such weaker answers were not necessarily to the problem situations posited in questions 6 and 7.

### Paper IIA

1.

This was one of the least popular questions in the paper, a fact which somewhat surprised the examiner as the first two parts both focussed on tax cases which are both recent and newsworthy. Any candidate who spent any time reading the professional press should have been in a position to comment on the significance of both of these cases.

As it turned out, most of those who tackled the question had some idea about *Gaines-Cooper*, more about its importance on questions of residence than of domicile (although, to be fair, that is what most commentators have concentrated on). *Wood v Holden* seems, however, to be little known and quite a few candidates managed to answer without mentioning it at all.

A veil should be drawn over the third part of the question out of kindness to those who tried it. They were (mostly) aware of the relevant legislation but could not perform any calculations.

2.

If the question says to address “transfer pricing issues”, that is what the examiner is expecting to receive. Controlled foreign company issues may also arise but that is not what he has chosen to address in the question and any candidate who decides to write about irrelevancies is merely wasting his own time as he will receive no credit.

The examiner expected candidates to score quite well and, in general, he was not disappointed. Most candidates were able to recognise the transactions which would be relevant for transfer pricing purposes and to give reasonable guidance as to the application of the various transfer pricing methodologies.

The third part of the question was a veritable disaster. After marking a few woeful attempts, the examiner had to check for himself that he was not imagining the existence of the relevant VAT directives as they went unmentioned by almost every candidate. VAT is part of the syllabus and candidates must be aware that they will be questioned on it.

3.

This was another popular question with quite a lot of straightforward marks to be gained. Most candidates picked up the basic issues and scored reasonable marks although share option matters were outwith the knowledge of the majority. Quite a few candidates either had not heard of tax equalisation or chose to ignore that aspect of the question.

Rather to the examiner’s surprise, most candidates answered the second part of the question well. Inheritance tax does not form a large part of the syllabus but candidates appeared generally aware of the basic international rules.

#### Question 4

This question gave rise to mixed responses although most candidates displayed a good understanding of some of the issues to consider in a relatively straightforward acquisition scenario (withholding tax, deductibility of interest, foreign exchange, thin capitalisation, etc.).

However, a lack of knowledge was shown by most candidates in relation to the UK tax status of UKP. It was generally assumed that UKP would be taxable in the UK, instead of consideration given to whether there was a UK taxable presence and in particular if A Inc was regarded as trading in the UK through a permanent establishment. This is a fundamental aspect of UK international tax and should be understood better.

Also, confusing answers were provided to the withholding tax position on interest payments to UKP, which should have given candidates an opportunity to describe the general treaty situation of payments received by a partnership (uncertain), and the application of the UK arbitrage provisions.

#### Question 5

This was generally answered well although most answers did not contain sufficient depth in relation to the SSE rules and general Treasury consents. Easy marks were also given away by not specifying certain things (eg taxable in the UK at 30%).

#### Question 6

General CFC knowledge was good but specific knowledge on the application of the exempt activities test to service companies that generate income from UK residents and connected persons was poor, so marks were lost in this area.

There were several good attempts at analysing the main business of B taking into account its (potentially) “good” trading business and “bad” investment business. Marks were awarded here for sensible analysis in this area even if the conclusion was not necessarily correct in all cases.

### Question 7

Good general knowledge was displayed eg taxation of dividends, permanent establishments. However, as for question 4, a number of candidates assumed that the UK p.e. was taxable in the UK, whereas in reality it was unlikely to be trading if it only owned intellectual property, and marks were therefore lost for not analysing the position.

Most candidates understood to look to the UK treaty with A to mitigate UK withholding tax, even though a p.e. was earning the income, although few explained that the treaty withholding tax reduction would not apply to royalties paid to the UK p.e., whether it was taxable in the UK or not.

### **OVERALL**

Some good answers and some poor ones, with most in the middle. Easy points were lost by not stating UK tax rates or commenting on straightforward issues, which is something for future candidates to focus on. In most cases not enough depth to answers.

### Paper III B

This year's exam scripts provided a spectacular contrast – some absolutely brilliant and some absolutely abysmal.

The worst script scribbled a few paragraphs on each question from Van Raad's book. The best scripts showed that the examination can be easily passed with some thorough preparation and understanding of the subject-matter.

The majority of candidates passed the paper and many scripts were of outstanding quality, a number achieving a "distinction" level result at university.

Clearly, the choice of "hot topics" on the paper this year helped candidates considerably, but all questions on the paper were attempted by many candidates with a considerable spread in results – for example: all questions were answered really well by one or more candidates showing that the questions were not difficult if that area of the syllabus was prepared; that said, each question was also answered very poorly by a number of weaker candidates who clearly did little preparation for this advanced level professional qualification.

Once again. Weaker candidates failed to write sufficient material on each question to demonstrate knowledge of the topic and to thus, score well. Examples were page and a half answers (skipping a line), in reality less than a page of writing on a question compared with the better students who furnished 5-7 pages per answer. Lay-out was often poor, with students throwing away easy marks despite the warning at the start of the paper.

Other examples of poor scores included candidates who cited the name of a case and said no more about it, whereas better candidates cited the same case, gave some facts, said what the ECJ held, sometimes added a key quote or point, and analysed or commented on the case within the context of the question, demonstrating an understanding of the case to the examiner. As all the cases were available in Van Raad's book, little excuse can be made for not picking up easy marks in the discussion of the Court's jurisprudence.

In terms of an overall comment, clearly the standard of preparation of candidates was up on last year. There were some outstanding scripts this year of the highest quality and there were lots of very, very good scripts where two or three questions were answered very well.

As a final reminder to future candidates, I think it is important to point out that familiarity with the entire course helps a lot. For instance, a VAT case can be cited in many answers. Similarly, familiarity with the basic landmark cases helps a lot as these can often be cited in a number of questions and used in a variety of ways to illustrate your answers.

### Paper IIIC

This was the second sitting of the Paper III UK Option with only two candidates sitting the paper. The level of knowledge shown by the candidates was in line with the required level expected and required by one candidate but only at an average level and well below the required level for the other candidate.

The intention with this paper is for a general knowledge of UK taxation as a secondary jurisdiction but from an international perspective.

It is intended that the format, required level of knowledge and mix of UK and International aspects for future sittings will continue to be in line with this paper, the 2006 paper and specimen paper produced the previous year.

Future candidates should again review each of the questions set as a guide for future examinations both in terms of format and technical content.

The seven questions set can be summarised as: -

Q1. A general question requiring an understanding of the definition and factors affecting an individual's domicile and residence and the effect this can have on their liability to tax in the UK. Also to illustrate the benefits of non-domiciled status.

Both candidates attempted this question. Answers were far too vague and did not cover the key points succinctly. Bullet point format with brief expansion of each point would have been better layout. Neither candidate expanded on the benefits of non-domiciled status other than to mention that the remittance basis would apply. This was the key point to part II of the question.

Q2. A straightforward question on the development of the UK tax system and the various sources. The second part asked for a consideration of the problems with the tax re-write project. Required candidates to show some understanding of UK tax law and its nature.

Only one candidate attempted this question. They showed a reasonable knowledge of the UK tax system and the various sources but the comments on the tax re-write project were too vague and barely touched on the key issues.

Q3. A group chargeable gains question also including roll-over, substantial shareholdings and directors CGT and connected party rules. Required a basic knowledge of chargeable gains group definition and of rules for roll-over and substantial shareholding exemption.

Again only one candidate attempted this question. The answer was very poor on parts 1. and 2. and worse on part 3. Candidate showed a very limited knowledge of roll-over relief or substantial shareholding exemption and minimal knowledge of personal CGT or arm's length issues.

Q4. A general question on the setting up of a new business venture in the UK requiring comments on the various structures available to use. Also required knowledge of R&D tax credit reliefs and capital allowances and interest relief plus general comments on new business losses etc.

Again only one candidate attempted this question and made good comments re: various reliefs etc but other than listing the possible structures to use did not comment on the pros and cons of each. Merely stating that company was best. Comments on the various structures was as noted in the question a key part and as a result this lost many marks.

Q5. A question on the taxation of dividends on both individuals and companies both resident and non-resident. Also covered CGT on sale of UK company by same individuals.

No candidates attempted this question.

Q6. A question on the setting up of a new UK venture by non-resident persons. Required knowledge of permanent establishment rules and reliefs available for property. Also transfer pricing issues needed to be considered in part 2.

One candidate attempted this question with below average results with reasonable attempt at part 1 but poor attempt at part 2. Answer was much too vague missing many of the relevant points.

Q7. A question on the taxation of UK source income on non-residents and reliefs available also in part 2 on the reliefs available for foreign tax suffered on foreign income received by UK residents.

Both candidates attempted this question. Good attempts at part 1 of the question showing reasonable understanding of how non-residents are liable to UK tax on UK source income. Second part was not as well answered with lack of understanding of the various methods of relief for foreign tax. Limited mention of Double Tax agreements.

As with all examinations marks were allocated for lay out and presentation