



# Examiner's report

## P6 Advanced Taxation (ZAF)

June 2011

### General Comments

The examination consisted of two compulsory questions (Question 1 for 25 marks and Question 2 for 35 marks). Candidates had to then elect any two of the three questions in Section B (each for 20 marks). The examination required mainly discussion and advice with some computation as well.

There were observable gaps in knowledge based on the answers supplied. These are highlighted below.

Candidate answers to discussion questions, in some cases, tended to be repetitive and indicate that those candidates had not fully grasped or considered all of the issues on the topic.

The paper did not appear to cause any time constraint difficulties as most candidates attempted the necessary questions.

### Specific Comments

#### Question One

Question 1 required candidates to provide client advice in the form of a letter.

The letter had to address:

1. Whether or not an associate in a medical practice was an employee or an independent contractor;
2. The gross income implications for the associate and partnership; and
3. The VAT consequences for the associate and the partnership.

Part (a) – Candidates had to address the statutory tests of employee versus independent contractor (as contained in the definition of “remuneration” in the Fourth Schedule to the Income Tax Act) and the common law tests (as contained in an Interpretation Note).

Most candidates recognised the principles of “control” and “supervision”, however many omitted key statutory considerations and the key aspect of earning “remuneration” as a starting point. Many rewrote the facts from the question without applying the facts to the necessary tests. A combination of the above resulted in a loss of marks.

Part (b) – Critical to part (b), and omitted by most candidates, was identifying the key “gross income” principles to be applied to the scenario, namely “accrual”. In addition, many candidates addressed only the partnership and gave no consideration to the associate. Most candidates failed to address the key aspect of partnership (as contained in section 24H) being the split of income between the partners in their profit sharing ratio.

Part (c) – This part was not handled poorly, and key aspects were omitted, especially the consideration of the compulsory registration requirements to be applied to the associate.

#### Question Two

This question, in the form of a memorandum, addressed a number of cross-border transactions, namely:

1. Debt finance from a connected non-resident equity holder
2. Purchase and sale of trading stock cross-border.

Part (1) considered the thin capitalisation and transfer pricing issues arising from the equity holding non-resident supplying large amounts of finance to the SA company. Most candidates addressed the thin capitalisation component but omitted the transfer pricing aspect. In addition, despite not being relevant to the current year of assessment discussion, a few candidates spent time addressing the wrong aspect of the transaction – being the manner in which the loan finance was used.

Part (2) considered, firstly, the acquisition of stock from outside SA. A number of issues had to be addressed, being the VAT consequence of imported stock; the income tax consequences (deductions and value of stock) and lastly the exchange differences. Performance varied dramatically amongst candidates for this part.

Some candidates omitted the sale portion of the transactions. Some also did not address the zero-rating of the exported goods (i.e. the sale outside of SA is an export). In addition, many failed to address the income tax (gross income) implications, concerning themselves only with the exchange differences.

A second part (part (b)) to this question considered, firstly, the “resident” definition as applies to non-natural persons. Most candidates confused their answers to this domestic definition with that of the second requirement to this part, being the determination as to whether or not a joint venture company was a permanent establishment of the SA joint equity holder in the joint venture company. Candidates scored well in this second aspect of part (b), being largely guided by the question.

#### **Question Three**

This question concerned the compulsory application of the intra-group provision (section 45) to an intra-group transaction. Most candidates did not recognise the application of section 45 at all. Instead, candidates presented the connected person implications of the transaction (as would apply in the absence of section 45). It was very evident that this represents a knowledge gap.

#### **Question Four**

This question contrasted the applications on death of a person ordinarily resident in another country but considered resident for the purposes of the income tax act in SA. Most candidates correctly identified the world-wide application of the income tax act on a person deemed resident in terms of the physical presence test. However, all candidates extended the income tax act definition to the estate duty act, which contains no such provision and only carries reference to the concept of “ordinarily resident”. As a result, the estate duty implications were largely incorrect.

The Trust aspect and the application on death was also poorly handled or omitted by most candidates. As a result, this question was not well handled.

#### **Question Five**

Few candidates attempted question 5, which concerned the application of a double tax agreement (DTA) to a person that had emigrated from SA. It was surprising that few candidates attempted this question as many “easy” marks were available for basic discussions on source and the application to non-residents.

The DTA implications could be drawn directly from the question and again were “easy” marks to score. Most candidates attempting this question were rewarded.