



Examiner's report

P6 Advanced Tax (ZAF)
December 2015

General Comments

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

There were observable gaps in knowledge based on the answers supplied. The main issues are highlighted below:

Candidate answers to discussion questions, in some cases, tended to be repetitive and demonstrated a poor application of the theory to the facts of the scenario as supplied. It remains a significant concern that candidates continue to use of out-of-date legislative rules (by 2-5 years).

The paper did not appear to cause any time constraint difficulties as most candidates attempted all of the necessary questions. Few candidates attempted question 5. It is unclear whether this was due to a lack of knowledge of the syllabus areas being tested in this question or an indication that candidates are not actively choosing the best optional questions to answer.

It is very clear that the jump from the Fundamentals level to the Professional level is significant. The discussion answers as presented by candidates tended to be introductory comments on the issue or legislative references having no significance or not addressing the actual issues within the questions. Therefore candidates tended to write long answers of little relevance to the scenario. Many candidates begin their questions by repeating all the facts of the scenario. This both wastes the candidates' time and carries no marks. *Application* of technical knowledge to the facts of the scenario is what is required at the P6 level and this skill was lacking from many candidates' answers.

Specific Comments

Question One

Part (a) of this question was divided into a number of sub-questions to provide greater guidance to candidates and direct their answers. Despite such division, the answers as supplied demonstrated an unsatisfactory understanding of the issues.

The first sub-question concerned the tax residence of a company incorporated in South Africa. The company's majority shareholder was a non-resident individual from a non-treaty country. Most candidates correctly identified the application of the domestic law of incorporation being sufficient for treaty residence.

The second sub-question related to the controlled foreign company (CFC) regime. Unfortunately a number of candidates attempted to apply the law to the South Africa resident company. As the starting point for a CFC is that the company is a foreign company, such answers contradicted the earlier identification of the company's tax residence. Sufficient facts were provided to indicate that the CFC regime was potentially applicable to the foreign subsidiaries of the South Africa company.



Significant confusion appeared in the answers with respect to the identification of a CFC with the basic rule omitted in numerous instances.

The third sub-question concerned transfer pricing. Some candidates confused transfer pricing with corporate rules (which are entirely distinct from transfer pricing). Furthermore, it was evident that candidates struggled to contextualise transfer pricing issues from the scenario with some candidates providing illustrative examples from manufacturing. The broad concept of transfer pricing was understood by some, but poorly applied to the scenario.

The fourth sub-question was on exchange differences and was satisfactorily answered by many candidates. However a number of candidates considered translation of the exchange differences at the average exchange rate in contradiction to the translation rules contained in the legislation.

The fifth sub-question illustrated the gap in candidates' knowledge with respect to ~~foreign tax~~ foreign tax credits and, specifically, unilateral tax relief. Most candidates assumed that, as no treaties existed, no relief could be obtained, or assumed (contrary to the facts) that treaties were in place. Candidates must use the facts as presented in the relevant scenario.

Sub-question six tested value added tax (VAT) and was largely satisfactorily performed.

In part (b) of the question, the headquarter company regime was tested and adjustments to the earlier advice in response to the parent company being classified as a headquarter company was required. There was a clear gap in candidate knowledge with respect to headquarter companies.

Professional marks: Most candidates presented their answers in the required report format (although a handful provided another or no format). The effectiveness and logical flow of the communication was generally unsatisfactory as was the structure of answers. The structure of the question was intended to assist candidates with the logical structuring of their answers

Question Two

This question concerned the comparison (from a tax perspective only) of the use of different legal structures for a new business venture.

A number of fundamental errors were noted in answers to this question with some candidates struggling to perform the basic numeric calculations. Many candidates did not properly identify the correct treatment of a partnership for income tax purposes, and many also failed to identify the implications of dividends tax as part of their calculations of the overall tax burden on the profits.

Part (b) was generally well answered with respect to VAT thresholds and the need for the partnership to register independently of the partners. However, some candidates omitted the critical zero-rating consideration in this part (ie. the fact that the business would be in a repayment position for VAT purposes).

For part (c), most candidates identified that the interest on the loan finance would be deductible in the company. However, very few candidates were able to comment on tax advantage arising as a result of the difference in the



combined corporate and dividends tax saving when compared to the additional income tax assessable on the individual taxpayers in respect of the corresponding interest income.

Part (d) was not well answered. A few candidates correctly identified the small business regime as the critical issue, whereas others only referred to the standard capital allowances as the incentives. Those that did identify that the company would qualify as a small business corporation did not all provide a comparison of the tax and the amount that may be saved as asked for in the requirement.

Question Three

Question 3 mainly concerned VAT issues with those around imports and exports featuring significantly. Furthermore, the question considered the introduction of an exempt supply into a business which had previously been exclusively dealing in taxable supplies and the resultant change in use considerations for its capital goods.

In general, the question was well answered, although candidates' answers could have been structured better. The issue of mixed supplies and the need for a change in use adjustment was often identified but the application of knowledge was often poor. The apportionment chosen for the rental expense was also incorrectly chosen in most instances.

Question Four

This question dealt with the tax implication on the death of a taxpayer and recommended estate planning. This question was divided into three parts with the first considering the existing position at death, the second the liquidity of the estate and the third the potential for tax planning for pre-determined options. As a result of the layout of the question, the answers were appropriately structured. The answers, however, particularly for part (c) demonstrated large regurgitation of theory (not all relevant) without application to the facts. The critical issue in part (c) was the effect of transferring the assets at death; or before death by *inter vivos* trust or at death to a testamentary trust and the implications thereof. Much time was spent by candidates addressing the income aspects of the trusts after formation and transfer of assets instead of focussing on the transfers to the trust in each instance.

Unfortunately, many candidates did not address the roll-over relief applicable for the purposes of both capital gains tax and estate duty in part (a), but subsequently concluded in part (c) that it would apply (contradicting their previous (incorrect) answer).

Part (b) was unsatisfactorily answered in that many candidates simply referred to their erroneous calculations from part (a) leaving it to the marker to assess whether or not sufficient cash assets existed to ensure liquidity rather than performing the cash evaluation required.

Question Five

This question was broken into two parts. Part (a) considered a non-resident with an interest in a South African company. The issues tested included (i) the acquisition of a company with an assessed loss and the anti-avoidance implications; (ii) the residence of the company and the non-resident shareholder (including should a change of residence occur for the shareholder); (iii) the acquisition of equity and loan interests in the company by the shareholder and the tax consequences for structuring the capital in the company.



This part of the question was generally unsatisfactorily answered with very few candidates identifying the anti-avoidance issue in relation to the loss.

Part (b) concerned the venture capital regime. While not a new regime, it was clear that many candidates had insufficient knowledge of this regime.