

Examiner's report

P6 Advanced Tax (ZAF)

June 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 computational aspects 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. It remains a significant concern that candidates continue to use of out-of-date legislative rules.

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

Candidates are reminded that no part of their answer should contain their own name.

It is very clear that the jump from the Fundamentals level to the Professional level is significant. Some candidates try to force discursive answers into numeric form. In addition, the discussion presented tends to be introductory comments on the issue or an outline of legislative rules with little relevance or application to the scenario in question. This lack of exam technique can lead candidates to write long answers of little relevance.

Some candidates begin their answers by repeating all the facts from the scenario provided. This is not a good use of time. Instead, candidates should focus on applying their knowledge to the presented scenario in line with the requirements set.

Specific Comments

Question One

This question required comment on three separate transactions. The first transaction dealt with the importation of goods. The output VAT payable on importation and its subsequent claim had to be identified. Unfortunately many candidates did not appear to have a sound grasp of the mechanics of the importation and the tax effects for the importer.

In addition, some candidates applied "zero-rating" to the importation of the goods which is incorrect.

Many candidates only addressed the VAT considerations of transactions 1 and 2 despite the question clearly noting that both the VAT and corporate income tax implications required to be considered. This failure to read the question requirement, obviously impacted affected candidates' performance.



Transaction 2 was similar to transaction 1 with the difference that, as the goods were sourced from within the SADC region, the customs tariff was nil. Some candidates mentioned only the customs tariff implications and omitted the VAT and income tax implications.

The income tax implications of both transactions 1 and 2 included foreign exchange gains and losses. Many candidates classified the gains and losses as “capital” in nature and therefore assumed there was no tax effect. This was not correct as the foreign exchange movements were linked to the acquisition of goods for resale (trading inventory). These answers ignored the relevant legislation [section 24I] which requires gains and losses for foreign exchange instruments to be recognised as “revenue” in the taxable income calculation. Many candidates were not comfortable with the mechanisms of calculating the foreign exchange gains and losses and some candidates overlooked the forward exchange instrument entirely.

Transaction 3 carried the most marks for this question and required consideration of the transfer pricing and controlled foreign company rules with respect to loan finance and royalty payments. The interest and royalty payments had distinct directions. The interest was paid by the South African parent company (Baby World Ltd) to overseas subsidiary in Ireland whilst the royalty was received by the Baby World Ltd from a subsidiary in a high tax jurisdiction. However, candidates ignored the transaction flows and often assumed that both transactions were deductions for the SA company. This demonstrates a failure to carefully read the facts of the question.

In addition, when dealing with the transfer pricing aspects, many candidates referred to rules which are out-of-date by a number of years.

Most candidates correctly identified the existence of CFCs in the scenario but failed to correctly address the consequences.

Professional marks: Most candidates scored the marks for the briefing notes format (although a handful provided other or no format). However, the effectiveness and logical flow of the communication of answers was generally unsatisfactory. Candidates could have better structured their answers by using the guidance given in the question.

Question Two

This question was a practical and technical consideration of certain tax issues under dispute affecting a company (CheapSA). Candidates essentially had to consider the facts and the nature of the Commission for the South African Revenue Services (SARs) disallowance and decide whether the assessment had been correctly determined or not. Some candidates appeared to be swayed by the amounts having been assessed and forced conclusions to agree with the assessment of the Commissioner. As assessments can be wrongly decided and appeals processes exist for this reason, candidates should not automatically assume that the assessment is correct.

The first issue concerned the claim by CheapSA that a large one-off payment was a “rental” payment and thus revenue in nature (despite relating to a period of some 30 years). Candidates had to weigh up the facts in light of the nature of the business activity.

There was evidence of confusion here over the fundamental concepts of capital and revenue.

Other answers were more satisfactory with some candidates highlighting factors indicating a capital nature before considering the possibility of any special deductions.

For dispute 2, many candidates failed to understand that the issue was payment for the USE of a trademark and not the acquisition of the trademark.

The quality of answers for dispute 3 were mixed.

Question Three

It was very evident that candidates were not equipped to answer this question. The question concerned dividends *in specie* in anticipation of the liquidation of a company. The final aspect of the question was the liquidation of the company when it had been reduced to its bare components of equity and cash. This should have been relatively straightforward but it appeared to be an area of weakness in the candidates. The dividends *in specie* were made to specifically chosen shareholders. Firstly, a resident company majority shareholder - this was used to demonstrate the prevention of cascading taxes for dividends tax. A dividend *in specie* was also made to a non-resident natural person which resulted in the application of dividends tax but at a reduced rate (despite the tax for a dividend *in specie* being payable by the company and not the shareholder).

Apart from the dividend tax aspects, basic issues concerning the disposal of an asset by way of distribution were ignored, such as the recouplements and capital gains tax implications for the company.

Some candidates only addressed the implications for the natural person shareholder, clearly not in compliance with the requirement of the question.

Question Four

Muso Ltd for 5 marks

Candidates' performance on this question was mixed.

While a pleasing number of candidates identified the R50,000 threshold and that the non-resident company should register for VAT, candidates struggled to give any further advice. A large number of candidates incorrectly applied zero-rating to this question, which either indicates that the question was not read carefully, or that those candidates were unaware of this relatively new requirement for non-resident providers of electronic services.

Goods Ltd for 5 marks

The performance on this question was unsatisfactory.

Candidates were generally unaware of the four-month rule for the receipt of excess consideration. Candidates were also unaware of the 12-month rule where inputs have been claimed but payment has not been settled.

Prop Ltd for 10 marks

Candidates' performance on this question was unsatisfactory.



Change in use adjustments for vendors dealing in mixed supplies should be revised carefully by the candidates. There seems to be a general lack of breadth of knowledge in relation to VAT.

Question Five

This was a popular choice amongst the Section B questions for candidates.

Part (a) for 10 marks

Candidates' performance on this question was unsatisfactory.

While most candidates were able to identify that the transfer by donation would have donations tax consequences and that the transfer of the assets to the trust would remove these assets from the taxpayer's estate for estate duty purposes, the remainder of responses were generally unsatisfactory. Common areas where candidates lost marks were as follows:

- Not including the capital gains tax consequences for the transfer by donation. It appears that many candidates missed the fact that a donation is a disposal for capital gains tax purposes.
- While a pleasing number of candidates mentioned the [section 7] income attribution rules (particularly in respect of the income vested in the minor child although less so in respect of income retained in the trust), very few candidates considered the capital attribution rules. This appears to be a symptom of a general lack of breadth of knowledge [of the Eighth Schedule to the Act].
- Candidates were largely unaware that for the sale on interest free loan account, the attribution would be limited to the market value interest that would have been charged on the loan balance.

Part (b) for 10 marks

Candidates' performance on this part of the question was also unsatisfactory.

Common errors were as follows:

- While most candidates confirmed that the taxpayer was a resident for income tax purposes, a large number of candidates often stated that only South African source assets would be subject to capital gains tax. It appears that candidates are confused between the principles for estate duty and capital gains tax as very few candidates identified that only South African source assets fall to be included for estate duty purposes. Many relatively easy marks were lost because of this.
- It was disappointing to see the number of candidates who did not indicate that assets left to the taxpayer's wife and the PBO would be excluded for capital gains tax and estate duty purposes.