



Examiner's report

P6 Advanced Taxation (ZAF)

December 2012

General Comments

The examination consisted of two compulsory questions (Question 1 for 40 marks and Question 2 for 20 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 advice in the form of a letter. A number of candidates failed to provide the correct format (supplying a memorandum format or none at all). This is a simple aspect to fix and ensure further presentation marks.

The letter had to address various transactions, specifically:

1. Which, if any, corporate rules could apply to a transaction involving a resident company and a formed non-resident company (51% owned);
2. Assuming the corporate rules did not apply, the income tax effects of the transfer of intellectual property to such non-resident company;
3. An assessment of the residence status of the company Patent Co [for the remaining parts the supplied assumption was that Patent Co was non-resident];
4. The South African income tax effects of the royalties received by Patent Co;
5. The South African tax effects for the royalty paid by Green Build to Patent Co (ignoring the transfer pricing aspects)
6. Whether Patent Co was a controlled foreign company for South African tax purposes and, if so, what the consequences of such classification would be for Green Build.

(1) It is very evident that the corporate rules represent a significant gap in the candidates' knowledge. Few candidates even correctly identified any potentially applicable corporate rules [for sake of completeness these rules refer to sections 41-47 of the South African Income Tax Act]. The question fortunately tempered this lack of knowledge through more marks being available than required.

(2) Candidates tended to score fairly well in this aspect of the question (although credit was also given to candidates that placed key information required in this part of the solution elsewhere). Most candidates failed to articulate the clear connected person relationship between Green Build and Patent Co.

(3) It is of concern that some candidates attempting this examination did not have any understanding of the definition of "resident" for non-natural purposes. Some discussed the aspects of the definition pertaining to natural persons. However, most candidates sought to find a definitive answer. Sometimes definitive answers are not possible at this level (as indicated by the solution that further investigation would be required to provide the client with an appropriate answer).

(4) Most candidates scored the bulk of the 3 marks available in this section. However, many only referred to the withholding tax aspect and not the gross income component.

(5) In this section, candidates focused on the wrong taxpayer. The income aspects of the royalty were considered and not the deduction aspect for Green Build as the payer of the royalty. No candidates identified the limitation of deduction caused by the intellectual property being “tainted” by the previous ownership by Green Build. This is an identified gap in knowledge. This gap in knowledge caused the loss of a number of marks in this section.

(6) Most candidates correctly identified that Patent Co would be a controlled foreign company and that this would result in an inclusion in Green Build’s taxable income. However, none discussed the potential minimisation of such inclusion to nil if the foreign taxes incurred were sufficiently significant. This part also tied to the possibility of a full and unlimited deduction for the royalty payment discussed in (5) above.

The major difficulties in the question appeared to be:

- (a) gaps in candidate knowledge – this can be rectified by additional study material and practice questions
- (b) a lack of focus in answering questions – this can be rectified by candidates having test and practice questions marked (having been completed under examination conditions).

Question Two

This question addressed employment and retirement issues, namely:

1. Employees tax arising from employment for only part of a year
2. Taxation of retirement benefits
3. Provisional tax implications as a result of “other” income.

The employee’s tax part required a calculation of the employee’s tax in respect of the Company. While it is true that pension benefits paid by a fund would be subject to employee’s tax, it was not appropriate for candidates to include the pension benefits in this part (being from another employer – the pension fund). Furthermore, many candidates simply performed a standard income tax calculation, including income not related at all to employment, and did not consider the employment tax impact of working for part of a year and receiving amounts considered “recurring” versus “annual”. This section should have provided an “easy” 8 marks. Instead, most candidates did not achieve high scores.

The taxation of retirement benefits for many candidates appeared to be a gap in their learning. Most correctly identified that the lump sums would be subject to separate tables, but were unable to correctly determine the amounts to apply to such tables. Disallowed deductions were double counted. The retirement tables were applied separately instead of cumulatively etc. The end result was poor scores for this section, which accounted for half the required marks. Of greater concern was the clear trend, based on the candidates’ answers, which many candidates were studying from out-of-date materials.

The third part should again have been “easy” marks to score. Few candidates identified the need for provisional tax for this taxpayer after retirement. Alternatively, candidates identified that provisional tax would be paid, but did not provide a reason in support of such an assertion. Most also ignored the aspect of the requirement requesting return and payment due dates.

Question Three

Few candidates attempted question 3. This question concerned the change from a VAT registered partnership to a company. Performance was disappointing in this question. Many focussed on one issue to the exclusion of all others. While their statements were correct, the marks for that aspect had been awarded. In addition, answers supplied were repetitive in the hope to score additional marks for each aspect discussed. Many candidates only considered the partnership and the new company (and some only the VAT aspects of the transaction). Most did not address the offshoot company that was to be created. Future tax implications for the various entities were also not considered.

Question Four

This question addressed the tax implications for the difference between a trading and an investment portfolio where the instruments held are shares. While some candidates correctly identified the deemed capital treatment of qualifying shares after 3 years despite the trading portfolio classification, none discussed what a qualifying share would be. This influenced the marks scored later in the question as well.

Credit was given where possible to incorrect answers derived from earlier aspects of the question. Transaction 3 was marked leniently as it was not clear from the requirement that this shareholding was within the trading portfolio.

For part (c) of the question, candidates had to identify that financial instruments held as trading stock may not, in terms of the Income Tax Act, be held below cost. Few correctly identified this aspect of the trading stock provision.

Question Five

This question was split into three parts.

Part (a) considered an agency relationship and the impact for income tax. In addition, the VAT aspects of the transactions had to also be considered. Many candidates focussed only on the VAT aspects and considered the income tax aspects in a single sentence. The reverse was required. Greater discussion was needed for the income tax aspects as a result of the gross income definition. Furthermore candidates confused the VAT implications for the principle rather than the agent.

Part (b) addressed a situation similar to *CSARS v Brummeria (69 SATC 205)* [name shortened]. Some candidates correctly discussed aspects of the gross income definition but did not reach the correct conclusion. Others did not address the issue correctly at all. Credit was given where possible.

Part (c) concerned donations tax and income tax avoidance. Some candidates addressed the use of a trust to avoid the donations tax for the planned donations by the client. This was not considered in the suggested solution (as it was not, in this instance, the most tax efficient method), however, where correctly discussed, credit was given.

General

Performance in this paper was better than prior years, which may partly be attributed to some questions having more marks available than required. However, performance is still not as good as it could be.

Those candidates that passed the paper did provide better answers than have been presented in the past, and if candidates prepare sufficiently for this exam, hopefully this will continue.