



# Examiner's report

## P6 Advanced Taxation (ZAF)

### December 2013

#### **General Comments**

The examination consisted of two compulsory questions (Question 1 for 35 marks and Question 2 for 25 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** concerning a liquidation was poorly answered.

**Professional marks:** Most candidates scored the marks for the letter format (although a handful provided a memorandum format). Few used an appendix for the calculations required which rendered many answers unreadable or difficult to follow. The effectiveness of the communication was generally poor. Many candidates had no structure to their answers; calculations carried no descriptions rendering them impossible to follow.

#### **Sharedealer's question (i)**

Candidates confused consolidation from an accounting perspective with tax principles. Alternatively some candidates confused tax legislation with accounting profit calculations. Few identified correctly that the subsidiary company had to be liquidated first and others simply "liquidated" the holding company, ignoring the subsidiary company.

Almost no candidates discussed the deductibility of the severance packages or liquidation costs. This would have created a distinction between the determination of the cash (and equity) available for distribution versus the determination of the income tax liability. Many candidates treated the income tax calculation as the determination of the accounting profit to add to retained earnings for the liquidation.

Some candidates omitted the determination of the VAT liability.

Having identified the cash available (by whatever means), many candidates failed to identify the dividend or the exemption from dividends tax for the dividend from the subsidiary company to the holding company.

Candidates did not have a structured approach with respect to the subsidiary to holding company liquidations and the lack of structure liquidating the subsidiary company followed through to the holding company.

Candidates spent some time discussing the corporate rules which had been excluded by virtue of the statement in the question that the companies had agreed in writing to not apply such rules. The benefits or lack thereof did not earn marks.

#### **Sharedealer's question (ii)**

Few candidates identified the application of the Nemojim principle with respect to the acquisition of the group for the purpose of liquidation and the application of sections 11(a) with 23(f). This is a fairly straight-forward principle and should have been considered. Most candidates confused contributed tax capital with the deduction in the hands of the sharedealer.

### **Sharedealer's question (iii)**

Candidates discussed the capital gains consequence for a sharedealer with only a few recognising the revenue aspect of the transaction entered into. This was a major failing in identifying a key principle of income tax.

### **Question Two (*Trusts*):**

The question was poorly answered. The first part required candidates to identify the most tax efficient method for the client to create a trust. Reference in the question to the purpose of the trust being to provide for the wife and children in the event of his death sent many a candidate down the path of a testamentary trust which was not the intention of the entire question. Secondly the first part of the question made it clear that the most tax efficient method to create the trust was to be identified i.e. the creation of an inter-vivos trust. The subsequent parts to the question also imply an inter-vivos trust scenario. Some candidates only compared an inter-vivos trust to a testamentary trust in this part and did not consider the tax efficiency at all.

The second part (sub-item (i)) required consideration of the tax impact of the trust created on the founder and the trust itself. The solution required the consideration of an inter-vivos trust. If candidates had discussion, in error, testamentary trusts in part (a) of the question, it led them down the incorrect path in this part. However, credit was given for appropriate principles identified for such a trust. Most candidates considered the anti-avoidance rules in section 7 but did not include reference to similar rules in the capital gains tax schedule. The implications for the trust were limited by most candidates to the outcome of the section 7 rules and no discussion was generally provided with respect to the trading in shares undertaken by the trust. As a result the discussion with respect to the deemed capital treatment for shares held for 3 years was missed.

Sub-item (ii) of part (b) required discussion of the estate duty implications of the trust created. This was poorly answered and in most cases candidates failed to discuss the entire estate duty liability, in particular the impact of the assets to be left to the surviving spouse.

Part (c) required discussion of the tax impact of changing a vesting trust to a discretionary trust. Most candidates simply discussed the difference between the vesting and discretionary trusts and failed to identify the actual capital disposal of the vested right to income in the trust.

Part (d) sub-item (i) addressed section 3(3)(d) of the Estate Duty Act. Some candidates identified the issue and others did not.

Part (d) sub-item (ii) – most candidates identified that should the founder be a beneficiary of the trust, his estate would increase by the benefits vested, but did not consider the fuller implications to score the remaining marks.

There was significant repetition by candidates throughout this question.

### **Question Three**

This question concerned a capital gains tax transaction. Part (a) considered whether a price below “market value” between connected persons could still be arm’s length. Most candidates did not address the negotiated price aspect of the financial difficulty being relieved by the nephew for the aunt. Rather candidates applied concepts of “fairness” and concluded that the discount is unfair and the price is therefore not arm’s length not considering their previous statement of a price agreed between a willing buyer and willing seller (i.e. did not consider the relative bargaining strengths of the parties). Most did address the donations tax aspect, but did not address the application of a deemed proceeds figure for capital gains tax. Some candidates failed to adhere to the instruction in the paper that calculations for this part were not required.

Part (b) considered the tax implications for Alan’s mother, yet some candidates presented the implications for the aunt as well (which did not earn marks). The calculations generally had no structure and the ordering of some of the calculations was incorrect. The calculations presented demonstrated a lack of knowledge in this area. Many candidates also failed to provide any discussion in addition to the calculations as required by the question.

Part (c) applied the rule for the recipient where the deemed market value has been applied. Some candidates did identify the application of this rule but did not extend it to include the other acquisition costs incurred by Alan (losing the mark in that instance).

### **Question Four**

This question had two parts.

Part (a) considered separate branch registration within the VAT system. In addition the scenario was complicated by the location of the branch being outside South Africa. The part was poorly answered with few candidates even discussing the requirements and application of the conditions needed for branch registration. Candidates also confused the VAT impact of separate registration versus the branch being simply part of the enterprise.

Part (b) considered the disposal of buildings used in the supply of taxable and exempt supplies. Many candidates did not distinguish the supply of the buildings versus the supply of the use of the building. This had the result that many failed to identify that the building providing residential accommodation when sold would be a taxable supply. Furthermore (and partly as a result of the above), fewer candidates identified the need for a VAT input adjustment on disposal of the residential accommodation building. Most candidates did identify the minimisation of VAT being by disposal of a going concern and the conditions that must be met for such a disposal but did not tie this in many instances to the timing of the deregistration from VAT.

### **Question Five**

The question had two main parts, each with sub-parts. Very few candidates elected this optional question.

Part (a) considered a younger individual saving for retirement. Sub-part (i) sought to test whether candidates could separate the saving for retirement from the employment period. Knowledge of the concepts of preservation of retirement savings and the transfer to another fund free of tax consequences did not draw their attention to the separation of the retirement time horizon and the employment period.

Sub-part (ii) addressed the concept of salary sacrifice for contributions to a provident fund. This was generally not well discussed with many key concepts being omitted or irrelevant issues being discussed.

Sub-part (iii) was not well answered. Those that actually considered the fund generally applied old taxation concepts.



Sub-part (iv) was handled better than the previous parts with most candidates able to identify the two forms of exit from the fund and the implications.

Part (b) considered a retiring individual. Most correctly identified the on-going taxation of the annuity, but did not address the transfer into the annuity. Most identified the lump sum option, but the subsequent discussion of the impact was weak. Candidates did not all address the impact of a combination of annuity and lump sum as required in the question.

Sub-item (ii) of part (b) was not well considered, despite marks being available for any relevant consideration. This required practical application of knowledge and was not well handled.