

# Examiner's report

P6 Advanced Tax (ZAF)

December 2014



## General Comments

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

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

Candidates' 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. Of significant concern is the use of out-of-date legislative references (by 2-5 years) and a failure to use the information provided in the tax rates and allowances at the front of the exam paper. Candidates are encouraged to familiarise themselves with these tax rates and allowances which are also published on the website.

Most candidates attempted the necessary questions. However, a number of candidates omitted parts of questions. Whether this was due to time constraints or a lack of knowledge was unclear from the answers supplied.

Candidates are reminded that no part of their answer should contain their own name. A number of candidates signed questions in their own name (including questions other than question 1 which is the only question requiring a particular format).

It is very clear that the jump from the Fundamentals level to the Professional level is significant. Many candidates tried to force answers into numeric form rather than discussion without due regard to the verb used in the requirement. In addition, in some instances the discussion presented tended to be introductory comments on the issue or legislative references which did not address the actual issues within the questions. Therefore, some candidates wrote long answers of little relevance to the requirement set.

## Specific Comments

**Question One** involved a holding company situated in South Africa with a variety of subsidiary and investment holdings offshore. The focus of the question was, in the main, the receipt of foreign dividends.

Candidates are again reminded that the foreign dividend exemptions are supplied in the tax rates and allowances provided in the question paper. A large number of candidates failed to reference even the principles contained in the supplied exemptions in their solutions. There were approximately 5 marks available for the application of the foreign dividend exemptions within part (i) of the question which was worth 18 marks in total. Many candidates failed to achieve these marks despite the information provided in the tax rates and allowances.

There was also evidence of a lack of knowledge concerning the application of withholdings taxes and the rebate provision for foreign taxes.

Many candidates identified potential controlled foreign company (CFC) issues. However, these issues were frequently applied in the wrong context or not applied to the scenario at all. This resulted in lengthy answers of little relevance to the scenario.

Part (iii) of the question involved an inflated rate of interest charged by the South African company to its offshore subsidiary in a high tax jurisdiction. Some candidates managed to identify the issue of the high interest, but



reversed the application and instead treated the South African company as the paying company. Candidates are again reminded of the importance of careful reading of the scenario so they can accurately apply their knowledge to the relevant facts.

Many candidates seemed unaware of the rebate provision for certain South African source income on which foreign withholding taxes have been levied in part (iv) of the question.

The audit fees deductibility issue in part (v) was well considered by many candidates. However, the issue of the training fees expense in part (vi) was generally not identified.

**Professional marks:** Most candidates achieved the available marks for using the required report format (although a minority of candidates instead provided a letter). However, the effectiveness and logical flow of the communication was generally unsatisfactory. Although candidates used some structure in their answers (as guided by the question); many of the supporting calculations carried no descriptions making them difficult to follow.

**Question Two** – This question involved a sole trader with an existing VAT registered trade converting a hobby into an additional trade. In addition, a number of transactions between spouses were considered in the context of these trades. Despite the information provided in the question, some candidates simply stated that the hobby could not be converted to a business.

Tax concepts were frequently confused by candidates. For example, candidates recommended turnover tax for the new trade and immediately followed the recommendation with a discussion of the deduction of expenses for that trade which is irrelevant if the turnover tax regime is applied.

Candidates did, in the main, successfully identify the issue associated with the transactions (interest and rental) between the spouses at higher than market value rates (where there was a clear intention to transfer profits being taxed at a high tax rate to a low tax rate). However, most candidates did not consider that Bronwyn's salary could be increased to bring it up to market value rates– which would achieve the result desired by the taxpayers without triggering the anti-avoidance provisions.

Very few candidates identified the issue of pre-trade expenses.

Many candidates dealt with the issue of the reimbursed travel expenses within the management consulting practice as if Dylan were an employee rather than a sole trader.

Some candidates suggested incorporating the business and continued on this assumption in contradiction to the facts supplied in the scenario. Again, candidates are reminded of the importance of careful reading of the question.

A small minority of candidates applied the personal service provider provisions (often based on old legislation and tax rates) or the small business corporation rates to the scenario. As the business was not incorporated, these provisions did not apply.

Very few candidates addressed the issue of the income from the trust for Bronwyn.



### **Question Three**

It was very evident that candidates were not equipped to answer this question. The majority of candidates who attempted this question could not demonstrate the basics of the capital gains tax calculations, even whilst ignoring the currency translation issues within the question. It was very evident that candidates were not sufficiently familiar with the capital gains tax rules concerning disposals in a foreign currency.

### **Question Four**

This question concerned both VAT and income tax. However many candidates who attempted this question only addressed the VAT implications without considering the income tax implications. This obviously restricted the marks that were available.

Six items were presented for discussion.

For item 1: The majority of candidates failed to consider the requirement for the South African branch to register as an “external company”.

Item 2: Many candidates demonstrated a lack of knowledge of the import issues for VAT. Many candidates also failed to consider the income tax implications.

Item 3: This part of the question was generally well handled from an income tax perspective, but not from a VAT perspective.

Item 4: This transaction concerned the importation and sale of goods and a transaction with a connected non-vendor. Again the import issues were not well handled by the majority of candidates. On the other hand, the export considerations were well handled by most. Again, many candidates failed to consider the income tax implications.

Item 5: This transaction involved the comparison of a finance lease and a purchase on credit. As in previous sittings, candidates continue to confuse the two arrangements. Many candidates took the approach of writing about all of the tax issues without indicating whether these were relevant to the finance lease or the purchase on credit.

Item 6: This transaction was generally well-handled apart from those candidates who failed to consider the income tax aspects.

### **Question Five**

Part (a) involved two client queries. Query 1 concerned a bad debt write off after the business owner had died and the business was bequeathed to a beneficiary. A few candidates made odd assumptions including that the business was incorporated (which removed the issue under examination), or that the child was a minor. Candidates should ensure that they confine their answers to the facts in the scenario.

Query 2 concerned a beneficiary refusing the asset bequeathed and requesting the executor to dispose of the asset and distribute the cash to another party. Again, some strange assumptions were made by some candidates.

Part (b) concerned the distribution / vesting of a capital loss and a revenue loss. This was handled well by some candidates and less well by others.

Part (c) concerned the basic general anti-avoidance rule (GAAR) within the context of a transaction. Many candidates struggled to consider the GAAR in the context of a transaction. In fact, many candidates appeared



unfamiliar with the requirements for the GAAR to apply (knowledge of which would have assisted them greatly to pass this part of the question).