# Examiner's report

## P6 Advanced Taxation (ZAF)
## June 2012

**General Comments**
The examination consisted of two compulsory questions (Question 1 for 37 marks and Question 2 for 23 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 answered 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.

The performance of candidates in this sitting was disappointing.

**Specific Comments**

**Question One**
Question 1 required candidates to:
(a) Discuss income tax effects arising from selected transactions
(b) Provide advice in the form of a letter with respect to:
(i) income tax implications of the client becoming non-resident (assuming the sources of income remained constant)
(ii) discussing the disposal of South African immovable property subsequent to change of residence.

For part (a) most candidates only considered the implications for gross income and no further implications. With respect to the royalty, there was an exemption to consider. This would also have provided further discussion material in part (b)(i).

It is evident that candidates are not well grounded with respect to the principles of source as regards pension lump sums and annuities.

While many candidates correctly identified that the purchase of the property by John to place in the name of his spouse was a donation, most did not extend their thinking to the capital gains tax implication. This appears to be a gap in knowledge evident also from question 3 with respect to trusts.

Part (b)(i) required a letter format. Candidates frequently presented memoranda rather than letters. This simple mistake would have caused the loss of a mark. Most candidates focused only on the income streams as supplied in the question ignoring the wider income tax implications inherent in changing residence. This requirement was not overt in the question, however the assumption that the "royalty income, pension annuity and ownership of the [...] flat" would continue should not have been read as implying that these were the only discussion points. The mark allocation should have provided further evidence that something more was required. In addition, some candidates chose to discuss the pension lump sum in the year of emigration. This is clearly incorrect as the tax implications had been considered in part (a) in the prior year of assessment and a lump sum from a fund is a "once-off" event. It should not have been reconsidered in this part.

Part (b)(ii) highlighted a further gap in knowledge. All candidates discussed the capital gains tax effects for the spouse disposing of the property, but (as the spouse was a non-resident) failed to discuss the withholdings tax implications. In particular as this is not a final tax, the determination of the capital gain and the withholdings tax implications had to be considered together.

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It is also of great concern that candidates apply: old legislation; incorrect withholding tax rates and cannot communication the principles required clearly. Answers were frequently repetitive.

The major difficulties in this 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 required candidates to advise a client as to which of two financing options would be best from a tax and cash flow perspective. Errors in candidates' answers included the following:
(a) Not calculating the tax implications of the options, the cash flow effects or, in extreme cases, either the tax effects or the cash flow implications.
(b) Classifying a loan as an instalment credit agreement for VAT purposes. This is evidence of a "learned answer" in that prior examinations have contrasted a finance lease with a suspensive sale arrangement (both of which for VAT purposes are instalment credit agreements). This question contrasted a standard bank loan with a sale and leaseback arrangement. Certainly the lease back component of the second transaction could be classified as a finance lease and therefore an instalment credit agreement, but this did not apply to the loan arrangement.

The question required calculations in support of the explanations to be provided, but candidates often supplied calculations with no explanation or vice versa. In addition the application of a yield-to-maturity to a loan appears to not be understood, with candidates spreading the interest evenly over the periods or calculating simple interest against the initial capital for each period.

It is also evident that candidates still do not understand finance lease arrangements, confusing accounting principles with tax implications. While an asset subject to a finance lease may be capitalised for accounting and depreciating, the same is not true for income tax, where the lease payments are deductible and no capital allowances occur (because of the legal arrangement between the parties). Candidates try to hedge their answers by supplying references to the deductibility of the lease payments and calculating capital allowances. This is not acceptable.

The disappointing results in this question are as a result of gaps in knowledge and a lack of technique in providing comparative answers structured in a manner so as to provide advice.

**Question Three**
This question had three parts.

Part (a) considered a standard planning structure for the sale of a company on interest free loan by the shareholder to a trust in order to retain control. Part (b) considered the basic revenue and capital aspects of trusts (contrasting a vesting with a discretionary trust). Part (c) considered the estate duty and income tax implications of a bequest of the loan account owed by the trust to the trust.

For part (a), most candidates missed the structure completely and supplied an answer and a structure that would result in the loss of control. Most candidates did not appear to understand that control did not mean marginal influence. Some candidates proposed structures that while providing control would result in the assets of the trust being deemed to be those of the "donor". The avoidance of such structures was specifically required and an overt statement in the question requirement. Most study texts on trusts refer to the scheme used in the solution.

For part (b), most candidates mentioned the revenue aspects of trusts and the revenue attribution rules. Others also mentioned that the "donor" would incur capital gains tax on disposal of the assets to the trust. However, no

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candidates addressed the capital gain attribution rules applicable to these circumstances. In particular the inability of the attribution rules to function where the trust is a vesting trust (as regards capital), a key element of the question, was missed. Various erroneous statements were made in this part in a vague attempt by candidates to distinguish vesting from discretionary trusts. This represents a key lack of knowledge.

Part (c) discussed the estate duty and income tax implications of the bequest (by the “donor”) of the balance of the loan account to the trust (the debtor). Most candidates failed to identify that a waiver of debt had occurred for capital gains tax purposes. This carried the bulk of the marks for this part.

**Question Four**
Few candidates attempted this optional question. Question four had three parts. This first required the identification and basic explanation of one of the corporate rules of income tax. Most candidates did not understand or have any knowledge of the corporate rules and addressed entirely irrelevant points. Part (b) considered the VAT implications for the sale of a business. Of those candidates that attempted this optional question, many scored a passing mark. The final component was the disposal of an asset denominated in a foreign currency. Most candidates did not address the “worldwide” concept of taxation for residents and did not identify the key capital gains tax provision that would have supplied the bulk of the marks for this part. Parts (b) and (c) should have been “easy” marks to score in this question with part (a) being the harder marks to score.

A lack of knowledge seems to have again played a factor in the answers supplied for this question.

**Question Five**
Question five should have been a “banker” question. It required a comparison of a travel allowance and company car over a five-year period to advise a client on the better option. Again (like in question two) candidates seem unable to provide a comparison of options over a timeline. In addition (and of greater concern) candidates seemed unable to distinguish the two options and mixing concepts. Common errors included:
(a) confusing employees tax and normal tax
(b) not understanding the timing nature of employees tax
(c) treating an allowance as a fringe benefit
(d) when the allowance is added to taxable income
(e) not considering that more than one option exists for the reduction of the allowance
(f) when amounts may or may not be used to reduce the allowance or the company car fringe benefit
(g) how to perform a cash flow analysis

Candidates need to return to basics and close the various gaps in knowledge in order to be successful.