

Tax Professional Knowledge Competency Assessment

June 2014

Paper 1: Solution

Suggested Solution

Question	Topic	Marks
1	Company Tax Calculation and Advisory	40
2	Analysis of Financial Statements	45
3	Value-Added Tax	40
4	Tax Administration Act	35

Total marks: 160

The marks specified are an indication of the expected length and detail of your Response.

Question 1

40 Marks

Item / Calculation	Amount	
Net Profit before tax	3 984 314	(½)
Income from providing administration services	-	(½)
Sales of sporting equipment	-	(½)
Cost of Sales		
No deductions for trading stock purchases but not received at year-end (s 23F (1)).	78 000	(1)
Note: s 23H, deduction for pre-paid expenses, is not applicable to trading stock.		
Sporting equipment (trading stock) received for no consideration	(500 000)	(1)
An amount equal to market value should have been deducted during the 2013 y.o.a. (s 22(4))		
Adjustment to opening stock at market value.		
Donation – Accounting entry. Add back.	400 000	(½)
Recoupment of trading stock (s 22(8)(b)(i))	400 000	(1)
Closing stock: Sporting equipment (20% xR500 000)	100 000	(1)
Interest received – cancel the actual interest received	(99 000)	(½)
Deemed accrual of interest in terms of s 24J		
AP1:		
R1.8 million x 6.438293455%		
= R115 889 (1)	115 889	(1)
AP2:		
(R1.8 million (½) + R115 889 ((½)MT) – R99 000(½) x 6.438293455%(½)		
= R116 977 x 150/181 days (1)		
= R96 942	96 942	(3)

Alternative: Financial calculator

PV = (R1 800 000)

FV = (R1 800 00 x 103%) = R1 845 000

n = 3 (1½ years)

PMT = R1 800 000 x 5.5% per year = R99 000

Comp i = 6.438293455% = yield to maturity

AP1: R115 889 (full period) (1)

AP2: R116 977 x 150/181 days = R96 942 (2)

Total = R212 831

Section 10(1)(i) exemption claimed: (-½)

Dividends received

ABC REIT and Admin Wizz = R100 000 (1) + (R80 000) (1) 164 000 (2)

Only 80% of the amount paid by Admin Wizz represents a dividend as 20% of the amount is a reduction in contributed tax capital and therefore a return of capital. The amount of R16 000 (20% x R80 000) has CGT-implications. Refer to CGT calculation.

Dividend exemption – s 10(1)(k)(i) (amount from REIT not exempt) 0 (1)

(64 000) (1)

Lease income – land and factory

Add back accounting entry (80 000) (½)

Land: From 1 October 2013 – 31 May 2014

8 months x R10 000 = R80 000 (1)

Factory: From 1 January 2014 – 31 May 2014 155 000 (2)

5 months x R15 000 = R75 000 (1)

Lease improvements		
Paragraph (h) inclusion of lease improvements	950 000	(1)
Section 11(h) deduction i.r.o. lease improvements		
R950 000 / (1+6%) ^2.75 = R809 343	(140 657)	
(33 months / 12 = 2.75 years)		
Allowance: R950 000 – R809 343		
Note: Principal market should be awarded (for determining the NPV		
and deducting it from the R950 000)		(1)
Recoupment of section 11(h) allowance on disposal of factory (s		
8(4)(a))		
Cost less than proceeds	140 657	(1)
Salaries and wages: Alternative 1		
Medical lump sum – deductible in terms of s12M. No adjustment	0	(1)
Add back restraint of trade payment to Glen Maxwell.	880 000	(½)
Deduct section 11 (cA) deduction: Lesser of (½)		
R880 000 / 4 = R220 000 (½); and		
R880 000 / 3 = R293 333 (½)	-220 000	(1½)
Salaries and wages: Alternative 2		
Staff costs – add back accounting		
	R7 337 500	
Medical lumps sum – deductible		
	(R150 000)(1)	
Restraint of trade payment		
	(R220 000)	
Deduct section 11 (cA) deduction: Lesser of (½)		
R880 000 / 4 = R220 000 (½); and		
R880 000 / 3 = R293 333 (½)		
Salaries and fringe benefits: R5 570 000 – R880 000		
	(R4 870 000) (½)	

Contributions to Provident Fund – add back actual contributions.	1 437 500	(½)
Section 11 (e): 20% x R5 750 000 (approved remuneration)	(1 150 000)	(1)

Alternative percentage:

10% x R5 750 000 = R575 000 (1)

Alternative 1:

If the R1 437 500 was not added back (½):

Add back: R287 500 / R862 500 (1)

Alternative 2:

Added back total staff cost: R7 337 500 (½)

Deducted correct section 11(l): (R1 150 000) / -R575 000 (1)

Repair and maintenance – add back. (no s 11(d))		(1)
Does not qualify as repairs because the tiles were not replaced because it was broken but only to be in uniform with the new wing.	800 000	

Depreciation – accounting entry.	325 286	(½)
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Add back

Wear-and-tear on the manufacturing equipment

Section 12C: 20% x R555 000 = R111 000	(111 000)	(1)
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Administration Building = Commercial building.

Original administration building:

Section 13 quin building allowance contracted and erected after

1 April 2007 + R4 500 000 x 5% = R225 000	(225 000)	(1)
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New wing + tiles for old wing = improvements (13 quin)

(R2 000 000(½) + R800 000(½) x 5% (1) = R140 000	(140 000)	(2)
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Land (both factory and administration building)

No wear-and-tear on land	-	(1)
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Factory – no section 13(1) allowance as cost was not included by

Sports World, but by lessee.	-	(1)
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Taxable capital gain (s 26A)

Alternative 1:

Land

Proceeds: R3 mil x R1.5 mil / R2.45 mil = R1 836 735 (½)

Base cost: R1 500 000 (½)

Capital gain: R336 734

Factory building

Proceeds: (R3 mil x R950 000 / R2.45 mil) (½) – R140 657

(recoupment) (MT) (½) – R1 022 608

Base cost: R950 000(½) – R140 657 (s11(h)deduction) (MT) (½) =
R809 343

Capital gain: R213 265

Alternative 2:

Land and Factory building

Proceeds: R3 mil (1) – R140 657 (recoupment) (MT) (½)

= R2 859 343

Base cost: R1 500 000(½) + R950 000 (½) – R140 657 (s11(h)
deduction) (MT) (½) =R2 309 343

Capital gain:R550 000

Shares

Proceeds:R70 000(½)

Base cost : 40% (½) x (R220 000 (½) – (R80 000 x 20%)) (1)

= R81 600

In terms of paragraph 76B of the Eighth Schedule the base cost of shares must be reduced by a return of capital received.

Capital loss: (R11 600)

An exempt dividend as per par 19 of the Eighth Schedule to the amount of R 64 000 was received as it is both exempt from normal tax (s (10(1)(k)(i) and dividends tax (s 64F(1)(a)).

Extraordinary exempt dividend + R64 000 (1) – (15% x R70 000) (1)
 = R64 000 - R10 500 = R53 500

Therefore a capital loss to the extent of the extraordinary dividend must be disregarded.

Thus, full R11 600 capital loss must be disregarded. (1) (MT)

Aggregate capital gain: R336 734 + R213 265 + R550 000 (1) (MT)

Taxable capital gain: R550 000 x 66.6% (½)

Refer separate CGT calculation	366 300	(10)
Balance of assessed loss carried forward from 2013	(1 200 000)	(1)
Taxable income/ (assessed loss) before s 18A deduction	1 435 917	

Value of donation: Amount previously deducted in terms of s 22(8), namely the market value:

80% x R500 000 = R400 000 (143 591-70) (1)

R400 000 exceed taxable income before s18A. Only R143 592 deductible

Limited to 10% of R1 435 917 = R143 592 (MT) (1)

Note: Mark awarded for applying 10% to the correct taxable income (should be the last deduction) taxable income before s18A amount has been deducted:

Taxable income for the 2014 year of assessment	1 292 325-30	(½)
	Available:	45.5
	Maximum	40

Question 2

45 Marks

Part 1

1. Health (Pty) Ltd.'s financial statements are not subject to external audit. (½)
 This increases the risk of misstatements and inappropriate accounting policies which could result in incorrect tax treatment. (1)
2. The full R7 million turnovers was received and should be included in gross income. (½)
 There is a risk that only the net amount (after deducting R250 000) was included in gross income thereby understating taxable income. (½)
 The allowance for returns does not qualify for a deduction (½) since Health did not incur an unconditional legal obligation (½) as required by section 11(a) (Nationale Pers / Edgars Stores cases) (½)
3. The company purchases trading stock from Lombardini SpA (½)
 Lombardini is a non-resident (resident of Italy). (½)
 Lombardini is also a connected person (½) (company that owns more than 20% of shares (½) – par (d) of definition (½)
 The purchases of goods from Lombardini SpA could therefore be an “affected transaction” and invoke the transfer pricing provisions of section 31. (½)

 The decline in the gross profit percentage from 52.5% (2100 / 4000) in 2013 to 18.5% (1250 / 6750) in 2014 could (½)

 Indicate that the prices charged by Lombardidni are not at arm’s length. (½)
 There is a risk that Heath’s taxable income can increase if the excessive expenditure incurred to purchases stock from Lombardini is disallowed (1)

4. Purchases of trading stock from Lombardini were converted using the average exchange rate for the year. (½)

Section 25D(1) requires the company to use the spot rate on the date of the transaction. (½)

There is a risk that Heath claimed a smaller or larger deduction for tax purposes. (½)

There is a risk that VAT will not be paid upon importation as the supplier is not a vendor (non-resident) (½)

5. Lian LLC is a foreign company (½) of which more than 50% of the shares are owned by SA residents (½) (Heath owns 100% of the shares) (½)

Lian LLC is therefore a controlled foreign company. (½)

There is a risk that the “net income” of Lian LLC was not included in the taxable income of Heath unless one of the s 9D(9) exemptions applies. (1)

The net income of the CFC will be deemed to be nil where the aggregate amount of Mauritian tax payable is at least 75% of the normal South African tax payable (Provision (i) to section 9D (2A)). (½)

The interest-free loan granted (½) by Valentino quid pro quo (in exchange for) the consulting services has a money value (½) which would have to be determined (CSARS v Brummeria Renaissance) (½)

There is a risk that Heath did not value and include this determined value of the market-related interest on this loan in its gross income. (1)

6. Since the loan granted by Mrs. Clifford was used to fund deductible operating expenses and has been waived, there is a risk that Heath has not included the reduction amount in its taxable income as a recoupment in terms of section 19. (1)

However, if the waiver of the debt was a donation under s 55(1) then there will be no recoupment (s19 will not apply(s 19(7)) (1)

(1)

No transfer pricing (thin capitalization) risk under s 31 since Mrs. Clifford is not a connected person (only 9% shareholding)

7. The share-based payment made to Mr. Kingsley does not qualify for a deduction in terms of section 11(a) since the issue of a company's own shares does not qualify as expenditure actually incurred (CSARS v Labat) (1½)

The issue also does not qualify for a section 11(A) deduction since it was not made in terms of a broad-based scheme in terms of section 8B. (½)

Shares are unrestricted equity instruments as per section 8C and therefore remuneration subject to employees' tax. (1)

There is a risk that Heath (as the employer) did not withhold the appropriate amount of employees' tax.

8. Salaries and wages would qualify for deduction if all the requirements of the general deduction formula set out in s 11(a) and read together with s 23 are met. (½)

The performance bonus constitutes "variable remuneration" as contemplated in section 7B ('over-time pay, bonus or commission'). (1)

It will only be deductible once paid in cash (following year of assessment – August 2014) (1)

General administrative expenses would qualify for deduction if all the requirements of the general deduction formula set out in s 11(a) and read together with s 23 are met. (½)

9. The VAT penalty is not allowed as a deduction (section 23(d)). (This penalty indicates past non-compliance (½) with tax legislation.) (1)

10. The payment made to the health and safety official appears to be a bribe. Section 23(o) prohibits the deduction of unlawful expenditure. (1)

Depreciation on the factory building and office buildings is not allowed as a deduction as it is capital in nature (see notes 15 and 16 below)

11. The advertising billboards erected along the N1 are likely to create an enduring benefit. It is therefore capital in nature and not deductible. (1)
- A wear-and-tear allowance could be claimed under s 11(e) for tax while the amount was deducted in full for accounting purposes. (1)
- Tax and accounting treatment therefore differs.
- 11.1 The cost of the billboards has been included in the financial statements inclusive of VAT, which is incorrect? (1)
- Where VAT input was claimed, the cost of the item for income tax purposes should exclude VAT (s 23C). (1)
12. The fair value adjustment on the shares represents a “book loss” (unrealized loss) and is not expenditure actually incurred. It is therefore not deductible for income tax purposes. (1)
13. The cost of R220 000 to fly staff to Cape Town is expenditure actually incurred; however if it appears to be excessive there is risk that the expenditure could be regarded as not expended for purposes of trade and therefore not deductible (s23(g)). (1)
- 13.1 The cost of the year-end function appears to be “entertainment” as defined in the VAT act. (1)
- The deduction of input tax on “entertainment” is prohibited. (1)
- There is a risk that input tax was incorrectly claimed and that the cost was subsequently accounted for incorrectly as the amount excluding VAT. (1)
14. The travel expenses incurred for Mr. Kingsley’s wife is private/domestic expenditure and/or not expended for purposes of trade and is therefore not deductible (s23(a)/(b)/(g)) (1)
15. Accounting and tax treatment of office building differs. The office building (depreciated over 20 years) was acquired on 1 July 2001. The office building does not qualify for a tax allowance as s13quin only came into operation on 1 April 2007. (1)

16. The factory building would qualify for a 5% annual allowance in terms of s 13(1) for tax purposes, which is different from the useful life used to determine depreciation for accounting purposes (i.e. 15% per year). (1)

17. All interest received by or accrued to Heath will be included in gross income and no exemption is available. (1)

The interest-free loan advanced to Ruben Oosthuizen is a deemed dividend in terms of s 64E(4) (1/2)

Ruben is a connected person (relative) of Mr. Oosthuizen; not a company and the loan is granted by virtue of Mr. Oosthuizen's shares in Heath. (1)

Mr. Oosthuizen is a connected person in relation to the company (owns 21% which exceeds 20%) (1)

The dividend is deemed to be paid on the last day of the year of assessment. (1/2)

The amount of the deemed dividend is calculated based on interest at the official rate (6.5% from 1/2/14) for the period that the loan was in existence during the year of assessment (3 months from 1 April to 30 June 2014). (1/2)

Therefore, the dividend tax liability is: $15\% \left(\frac{1}{2}\right) \times (R500\ 000 \times 6.5\% \times \frac{3}{12} \left(\frac{1}{2}\right)) = R1\ 218.75$ (1/2)

Heath is obliged to notify SARS on the DTR (Dividends Tax Return) form that it has paid this dividend.

The DTR form must be submitted to SARS and payment made by no later than the last business day of the month following the month in which the dividend was paid i.e. payment must have been made by 31 July 2014.

If Heath has not submitted the DTR form there is a risk that SARS will levy an understatement penalty in terms of Chapter 16 of the Tax Administration Act (unless the non-submission was due to a bona fide inadvertent error).

Heath could make use of the voluntary disclosure program to submit the outstanding return thereby reducing the % that SARS would use to calculate the understatement penalty.

18. The deposit is treated differently for tax and accounting purposes. (½)

The deposit of R200 000 received from Zara CC was treated as a liability for accounting purposes (not income). (½)

The definition of gross income (s 1) requires an amount to be included in gross income at the earlier of receipt or accrual. (½)

The deposit was received in Heath's current account evidently for its own benefit and on its own behalf and is therefore gross income. (1)

(Refer to Geldenhuys/Pyott cases) (½) (½)

The deposit will only be considered to be "consideration" in accordance with section 1 of the VAT Act once it is applied as such or forfeited. There is therefore a risk that the output tax is accounted for in the incorrect VAT period. (1)

19. Other valid points

Available	49
Maximum	45

Question 3

Marks 15

Part 1

Discussion and Calculation

The importation of the fruit

The charging section of the VAT Act, section 7(1)(b) provides that VAT is charged on the importation of goods into South Africa.

(½)

In terms of section 13(3), goods set forth in Schedule 1 to the VAT Act are exempt from tax charged on the importation of goods.

Paragraph 7(a) of Schedule 1 provides for an exemption of foodstuffs listed in Part A and Part B of Schedule 2 and subject to the condition mentioned in those Parts.

Fruit, not cooked or treated in any manner except for the purpose of preserving such fruit in its natural state are exempt from tax charged on the importation of goods
(Item 13 of Part B to Schedule 2)

(1)

At the time of importation all the fruit is frozen and would therefore fall under item 13 of Part B

The fruit will therefore be, in terms of section 13(3) exempt from the VAT charged in terms of section 7(1)(b).

(1)

As no VAT was paid on the importation of the fruit, no input tax credit will be allowed in terms of section 16(3) read with the definition of 'input tax' in section 1.

R0.00 (1)

The sale of fruit

In terms of the charging section of s 1, GG is required to levy VAT on any supply of goods and services in the course or furtherance of their enterprise. Thus, all supplies should carry VAT at 14% unless a specific exemption or zero-rating provision applies. (1)

The frozen fruit

The supply of frozen fruit will be zero-rated (1) in terms of section 11(1)(j), read together with Schedule 2 of the VAT Act as the fruit has not been cooked or treated in any manner except for the purpose of preserving such fruit in its natural state (1). R0.00 (2)

The clients will be charged for transportation and this is therefore a supply of services on which output tax must be levied at the rate of 14%: no specific exemption or zero-rating provision applies. (1)

The amount of output tax will be $R11\ 350 \times 14/100$ R1 589 (½)

The output tax on the supply of the goods and the transportation service must be accounted for when the invoice is raised (s 9(1)). (½)

No input tax can be claimed on the petrol costs, as fuel subject to the fuel levy is a zero-rated supply to GG in terms of section 11(1)(h). R0.00 (1)

The juiced fruit

The fruit juice is not in its natural state. (1)

The zero-rating in terms of section 11(1)(j) will therefore not apply to the juice and the supply will be a standard rate supply in terms of section 7(1)(a) (1)

The container should not be considered separately as it forms part of the supply of the juice and does not constitute a separate supply. (½)

The amount of output tax charged on the juice will be $3\ 000 / 100$ (½) 21 000.00 (1)
 $\times R5\ 000 \times 14/100$ (½)

The transport is a supply of services will be a standard rated supply. (1)

No input tax is allowed on the petrol as it was a zero-rated supply. (1)

The amount of output tax charged on the transportation will be R12 500 x 14/100. 1 750.00 (½)

As for the supply of the fruit, the output tax on the supply of the juice and the transport services must be accounted for on the date that the invoice is raised. (½)

The pulped juice

The pulped juice represents fruit considered to be in its natural state (1) (item 13 of Schedule 2) and will be zero-rated (1) in terms of section 11(1)(j). R0.00 (2)

There is no supply of transportation to the client and therefore no VAT implications for GG in this regard. (½)

Available 18.5
Maximum 15

Part 2

Marks 15

Deregister as a VAT vendor on 15 February 2013

Output
tax/(input
tax)

Section 8(2) will apply as Auto Zone ceases to be a vendor (½)

In terms of section 10(5) the consideration for the supply is the lesser of (½)

The cost (including VAT) or (½)

The open market value (½)

Second hand vehicle (R1 700 000 x 14/114) 208 772 (½)

Vehicles bought from vendors at cost (s16(3) allowed) 1 200 000 (½)

Vehicles bought at cost from non-vendors (s16 (3) allowed, para (b) of input tax def.) (½) 1 300 000 (1)

Excluding s 22(3) output tax (s 8(2)(v)) (½) -800 000 (1)

Consideration for supply of second hand vehicles 1 700 000

Debt older than 12 months – output tax already paid - (½)

Debt bot older than 12 months (300 000 x 14/114) 36 842 (½)

Supply in terms of section 22(3) proviso (ii)(dd) (½)

Debtors account – output on earlier of invoice or payment (s9(1)) - (½)

Taxi's in transport business – input not allowed in terms of input tax def. - (½)

Exempt supply in terms of section 12(g) (½)

Company vehicles – input tax denied in terms of section 17(2) - (½)

Total section 8(2) deemed supply 245 614 (½)

2. Supply business as going concern

Auto Zone VAT consequences

Business mainly (70%) used fir the making of taxable supplies (½)

Entire business deemed to be enterprise supplied (s 11(1)(e)(ii)) (½)

Zero rate entire supply of enterprise –
 excluding 17(2) denied assets (s8(14)(a))
 (R4 000 000 – R750 000) (½) x 0% (½) (s
 11(1)(e) requirements are met) (1) 0 (2)

Input tax deduction in terms of section 16(3)(h)
 allowed (½)

A x B x C -116 667

A = 14/114 (½)

B = 950 000 (cost including VAT) (½)

C = 100% (previously an exempt supply) (½)

Auto One VAT consequences

Input tax limited to invoice – R0 0 (½)

Additional output tax in terms of section 18A 124 035 (½)

Value of going concern 4 000 000 (½)

Value of assets 100% for taxable use (½) – -2 456 140 (1)
 second hand vehicle (2 800 000 x 100/114)
 (½)

Value of assets where input tax denied (½) – -657 895 (1)
 Company vehicles (7 50 000*100/114) (½)

885 965

Multiply non-taxable use of remaining assets – 885 965 (½)
 100% exempt supply

Multiply by 14% (885 965 x 14%) 124 035 (1)

Available 19

Maximum 15

Part 3

Marks 10

Doughnuts sold to Good Foods

All the requirements of section 7(1)(a) are met on the supply of the doughnuts to Good Foods and VAT will therefore be levied on this supply. (1)

Note: Marks also to be awarded if the requirements of section 7(1)(a) were stated.

Good Foods and Deli Doughnuts are connected persons as more than 10% (100%) of the shares in Deli Doughnuts are held by good Foods (1) (definition of “connected person” in section 1 (½)). (1½)

Therefore the supplier and the recipient are connected persons in relation to each other. (½)

In terms of section 10(4) (½) the value of the supply, in the case of connected persons, shall be deemed to be the open market value, if: (½)

(1) The supply is made for no consideration or for a consideration in money that is less than the open market value

The supply is for a consideration in money (R900) that is less than the open market value (R1200) (1)

(2) If a consideration for the supply equal to the open market value of the supply had been paid by the recipient, he would not have been entitled under section 16(3) to make a deduction of the full amount of tax in respect of that supply,

In terms of section 1, “input tax” means tax charged under section 7 and payable in terms of that section by a supplier on the supply of goods or services made by that supplier to the vendor where the goods or services are acquired wholly/partly for the purpose of consumption, use or supply in the course of making taxable supplies. (½)

Taxable supplies (section 1) means any supply of goods or services which is chargeable with tax under the provision of section 7(1)(a)

The full amount of input tax should be claimable by Good Foods (the recipient) (½) in respect of the doughnuts acquired from Deli Doughnuts.

It is therefore required to establish whether Good Foods will levy output tax in terms of section 7(1)(a) on the doughnuts given to the children’s nursery. (1)

The matter that requires consideration is whether or not the supply of the doughnuts is in the course or furtherance of an “enterprise”. (1)

Enterprise is defined as any enterprise or activity which is carried on continuously or regularly by any person in the Republic and in the course or furtherance of which goods or services are supplied to any other person for a consideration.

Note: Marks should be awarded for identifying that the enterprise definition should be considered even where the definition was not stated in full.

The activities surrounding the supply of the doughnuts to the children’s nursery appears to take place regularly (every second day) (½) and in the Republic (½). The question remains whether the goods are supplied for a consideration. (1)

It should also be considered whether or not the supply was made for a consideration. (1)

“Consideration includes any payment made or to be made, whether in money or otherwise, or any act or forbearance, whether or not voluntary, in respect of, in response to, or for the inducement of, the supply of any goods or services”

Option 1:

(3)

It is submitted that the supply for purposes of CSI was made in the furtherance of enterprise as it could effectively increase future taxable supplies (½).

The doughnuts are therefore supplied for a consideration (½) and Good Foods will be entitled on a 100% input tax (½) deduction on the acquisition of the doughnuts.

Therefore the value of the supply by Deli Doughnuts will not be market value (½) (the provisions of section 10(4) do not apply.)

The value of the supply is the actual payment (½) and Deli Doughnuts should levy output tax of $R300 \times 14/114$ (½) = R37

Option 2:

(3)

It is submitted that the supply was not made in the course / furtherance of an enterprise as it cannot be said to induce future taxable supplies (½).

The doughnuts are, therefore, not supplied for a consideration (½) and Good Foods will therefore not be entitled to a 100% input tax (½) deduction on the acquisition of the doughnuts.

Therefore the value of the supply by Deli Doughnuts will be the open market value (½) (the provision of section 10(4) shall apply)

The value of the supply is deemed to be the open market value (½) and Deli Doughnuts should levy output tax of $R1200 \times 14/114$ (½) = R147

Available 15.5

Maximum 10

Part A

Marks 12

Tax Administration

(a) Reportable arrangement

The transaction will be a reportable arrangement as defined if it satisfies the conditions contained in section 35 of the TAA. (1)

Therefore the transaction should be an arrangement that satisfied the criteria in section 35 (1) or (2), and which results in a tax benefit being derived. (1)

A transaction falls within the ambit of an “arrangement” as defined in section 34 of the TAA. (1)

Note: Mark can also be awarded where definition of “ arrangement” were stated (1)

The transaction is not a reportable arrangement as per the public notice issued in accordance with section 35(2) of the TAA.

The group has effectively achieved a deduction for interest incurred in the production of exempt income. (1)

Therefore a “tax benefit” as defined in section 34 of the TAA has been derived (1)

Which also meets ONE of the following five requirements:

Note: One principal mark where all 5 requirements were listed correctly but not applied to the facts

- | | |
|--|---------------------------------|
| <p>1. The interest payable by Newco to the bank is not dependent on assumptions relating to the tax treatment.
Therefore this requirement has not been satisfied.</p> | (1) |
| <p>2. The transaction can be considered to be within the ambit of section 80C(2)(b)
The transaction includes round-trip financing as per section 80D as:</p> <ul style="list-style-type: none"> • Funds are transferred from the bank to Newco and then to TH and then back to the bank <mention parties involved>; • The transfer creates a tax benefit by means of an interest deduction of R1.35 million; and • The business risk for Newco is significantly reduced as TH effectively retains ownership of all the existing buildings <p>Therefore this requirement has been satisfied.</p> | (1)

(1) |
| <p>3. The interest deduction will be disclosed as a deduction and expense for tax and financial accounting purposes respectively</p> <p>The rental income will be disclosed as gross income and revenue for tax and financial accounting purposes respectively.
Therefore this requirement has not been satisfied.</p> | (1)

Ma
x:5

(1) |

4. There is a reasonable expectation that one of the participants will derive a pre-tax profit: (1)
- Newco will show a pre-tax profit of R50 000 per year (R1.4 million – R1.35 million).

Therefore this requirement has not been satisfied.

5. It can be reasonably expected that the tax benefit of R1.35 million will exceed the expected pre-tax profits of Newco (a participant), estimated to be R50 000. (1)

Note: Prior to the transaction the rental income of R1.4 million would have been taxed, albeit in the hands of TH instead of Newco. Therefore the entire interest deduction creates a tax benefit.

Therefore this requirement has been satisfied.

Therefore, the arrangement is a reportable arrangement in accordance with section 35(1)(b) / 35(1)(e) (1)

Available 14
Maximum 12

Part B

marks 10

Disclosure and penalty

- TH / Nick will be the “promoter” as defined in section 34 (1) of the TAA as they are principally responsible for organizing and managing the arrangement (1) (2)
- TH / Nick (the promoter) must report the following (s 38 of the TAA) (½)
- A detailed description of all the steps are key features (½)
- A Detailed description of the assumed tax benefits for all participants (½)

The names, registration numbers and registered addresses of all participants (½)
 A list of all the agreements, and (½)
 Any financial model that embodies its projected treatment. (½)

If there is no promoter or a non-resident promoter, the other participants are required (1)
 to report (s 37(2)).

The reportable arrangement must be disclosed within 45 business days after any
 amount is received by or accrued to a participant or actually incurred by a participant.

Section 212 of the TAA imposes an administrative non-compliance penalty / (2)
 reportable arrangement / section 212 penalty (1) if the participant fails to disclose (1)
 the reportable arrangement to SARS as required by s 37.

The penalty is:

R50 000 in the case of a participant other than the promoter (1)

R100 000 in the case of the promoter (1)

The penalty is charged for each month that the failure to report continues (up to 12 (1)
 months).

The penalty is doubled if the tax benefit exceeds R5 Million and tripled if the tax (1)
 benefit exceeds R10 million.

Available 13

Maximum 10

Part C

Marks 9

Further dispute resolution mechanisms

Since SARS has disallowed the objection, an appeal must be lodged within 30 days (s107 read together with the rules for dispute resolution) of the notice disallowing the objection. (1)

The appeal may be lodged using one of three options:

1. Alternative dispute resolution (s107(5) and (6)) (1)

This option is less formal, faster and more cost effective and should be selected

If the taxpayer does not want to engage in litigation. (1)

This opinion is available (1)

2. Litigation: Tax Board (s108 - 115) (1)

The Tax Board can only handle disputes where the tax in dispute does not exceed R100 000 / R500 000 (1)

The tax in dispute in this matter is R1.35 million x 28% = R378 000 (1)

This opinion is therefore not available. (1)

3. Litigation: Tax Court (s116 – 132) (1)

Tax Board can only be approached for appeals to the outcome of ADR (½) or on appeal to a Tax Board decision (½) (1)

This option is therefore available (1)

Thereafter, the taxpayer may appeal to the High Court (or directly to the Supreme Court of Appeal) – s133 – 141 (1)

Section 164(1) of the TAA provides that the obligation to pay the assessment is not suspended by any objection or appeal (1)

Available 13
Maximum 9

Part D

Marks 4

Requirements to register as a tax practitioner

Section 240 of the TAA requires natural person to register if they provide advice to another person with respect to the application of a tax Act, or completes or assists in completing a document to be submitted to SARS by another person in terms of a tax Act. (1)

Syltax, TH and StuProps are companies (not natural persons) and are therefore not required to register as tax practitioners (1)

Nick Mollin completes tax returns in respect of the employer by whom he is employed on a full-time basis. He is not therefore required to register (s240 (2)(a)). (1)

Sylvia must register as she is a natural person who provides tax advice and completes returns on behalf of other taxpayers for consideration. (1)

She is required to register with SARS and a recognized controlling body (s240 (1)). (1)

None of the exclusions in s 240(2) are applicable to her. (1)

Available	6
Maximum	4