

Tax Professional

Knowledge Competency Assessment

June 2015

Paper 2: Questions

Instructions to Candidates

1. This competency assessment paper consists of four questions.
2. Answer each question in a separate answer book.

Question	Topic	Marks	Answer Book
1	Business Forms	40	Blue
2	Employee Taxes	40	White
3	Estate Planning	40	Pink
4	Tax Administration	40	Green

Total marks: 160

Time: 4 hours plus ½ hour reading time

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

3. Enter your examination number on the cover of each answer book as well as on all answer sheets.
4. Your name must not appear anywhere in the answer books.
5. Answers may not be written in pencil and correction pens (tipex) may not be used.
6. Answer the questions using effective presentation and pay particular attention to the use of concise language, clarity of explanation and logical argument. Marks will be awarded for these aspects of your response.
7. It is your responsibility to ensure that all answer books are handed in to the invigilator before leaving the examination room, as answer books handed in thereafter will not be marked.

Question 1

40 Marks

Tshego Sebeela is a 26 year old unmarried South African resident. She is a sole proprietor and trades as 'Ethno-Fab Haircare'. Her primary business is the sale of ethnic hair care products, but she also provides consultation services to hair salon owners on best practices in ethnic haircare. She buys her trading stock from registered VAT vendors, but only sells to non-vendors. Tshego believes that "cash is king" and therefore has no creditors or debtors. She started trading on 1 March 2013 when she inherited a substantial amount from her maternal grandmother and has been going strong ever since. She is not currently registered as a VAT vendor.

Tshego is based in East London and owns the following assets:

1. A small store that she uses to display her haircare products and as a distribution centre. The store was bought for R250 000 on 1 March 2013 and was previously used as a general dealer. Tshego immediately started trading from the premises. For her consultation services she travels to the relevant hair salons.
2. A Volkswagen Polo VIVO. She uses this car 70% for business purposes and has a logbook that substantiates the business use. The car was purchased for R140 000 on 1 March 2013 and also immediately brought into use. You may assume that the business use percentage is accurate.
3. Shares in BAS Ltd, a resident company listed on the JSE. Tshego purchased the shares for R15 000 in March 2014.
4. A money market account with BB Bank. Tshego invested R50 000 into the money market account during April 2014.

During the 2015 year of assessment, the following amounts were either received or paid by Tshego:

	R
Sales from hair care products	450 000
Income from consultation services	45 000
Dividends from BAS Ltd (gross dividend received on 25 February 2015)	21 600
Interest from investment in money market account received on 27 February 2015	14 400
Purchases of hair care products	
• Stock on hand on 1 March 2014	70 000
• Actual purchases during the 2015 year of assessment	295 000
• Stock on hand on 28 February 2015	5 000
Fuel and maintenance cost in respect of the Volkswagen Polo VIVO (Tshego's logbook indicated that she had travelled a total of 15 000 km during the 2015 year of assessment)	62 300
Marketing material for haircare products	16 200
Proceeds from sale of Volkswagen Polo VIVO. The motor vehicle was sold by Tshego for an amount of R60 000 in cash on 1 February 2015. She has not yet replaced the vehicle.	60 000

Tshego heard that she can possibly be taxed as a micro business in terms of the turnover tax system and has approached you for advice.

You may assume that the Commissioner will allow a four year write-off period (straight-line) on all qualifying assets in terms of Binding General Ruling: No. 7.

Question 1		Marks
Required		
1	a. Draft a memorandum to Tshego Sebeela in which you explain to her whether or not she can elect to be taxed according to the turnover tax method.	10
	b. Tshego is unsure about whether she should register as a VAT vendor. Advise Tshego on whether she could register as a VAT vendor and, assuming Tshego can register as a VAT vendor, indicate the accounting basis that will apply.	5
	c. Assuming that Tshego qualifies for the turnover tax regime, advise her on whether or not she should elect to be taxed as a micro business for the 2015 year of assessment. <i>Ignore VAT. Support your advice with detailed calculations.</i>	20
	d. If Tshego had traded in a company (i.e. her business and her investments were held in a company of which she was the sole shareholder), how would your answer in (c) above changes?	5
Total		40

Question 2

40 marks

Mike Haasbroek (a 42 year old South African resident), resigned as the Head of Training of Karate Kallie (Pty) Ltd ('Karate Kallie') on 31 December 2014. Mike resigned voluntarily, because he wanted to go on a two-year sabbatical visiting karate clubs across the world. Mike is married out of community of property to Annetjie Kotzé (a 40 year old South African resident) who is unemployed and stays at home. They have no children.

He was unemployed during the months of January and February 2015. Mike had joined Karate Kallie on 1 January 1999. The company (a registered VAT vendor) will continue to exist without him. On his resignation, Kallie was awarded the following:

- R38 900 in lieu of accumulated leave that he had been unable to take because of work commitments.
- A DVD set of the most popular martial arts movies ever made. It had cost Karate Kallie R12 768 (R11 200 plus VAT of R1 568) and was awarded to Mike in appreciation of his long and dedicated service.
- A resignation (withdrawal) lump sum of R142 000 from its provident fund (Mike has been a member of this fund since 1 January 1999). His contributions to the provident fund during his membership were R69 000 as at 31 December 2014. The R69 000 includes contributions of R7 000 made in the 2015 year of assessment.
- Mike used his proceeds from the resignation lump sum to purchase his 'company car' and to settle his loan with Karate Kallie (*refer notes 3 and 4 below*).

Mike's other receipts, accruals, benefits and expenses during the 2015 year of assessment were as follows:

1. A cash salary of R15 000 per month.
2. The free use of a double-cab bakkie that had cost Karate Kallie R193 800 (R170 000 plus VAT of R23 800) on 1 January 2007. Mike had the sole use of this vehicle since that date. The vehicle is subject to a maintenance plan and the company had always paid for all the fuel costs. During the period 1 March 2014 to 31 December 2014, Mike was able to prove that he travelled a total of 30 000km in this vehicle, of which 25 000km were for private purposes. You may assume the logbook is accurate and complete.
3. On his resignation, Mike purchased this vehicle from Karate Kallie at its book value in its accounting records of R60 000. The market value at that stage amounted to R91 000.
4. A loan of R90 000 from Karate Kallie at an interest rate of 3% per year was granted during the 2014 year of assessment. Mike used the loan to purchase a portfolio of local shares for investment purposes. During the 2015 year of assessment, local dividends of R6 500 accrued to him from his share portfolio. On his resignation he repaid his loan, also using the remainder of the proceeds from his provident fund lump sum. You may assume that the repurchase (or repo) rate was 5.75% throughout this period.
5. Karate Kallie owns a 10-day holiday at a timeshare unit in the ATKV Hartenbos holiday resort. When it is not used by its employees, it is let to non-employees at a rate of R200 per person per day. Mike and his wife invited another couple to share this holiday with them. The group stayed in the timeshare unit for the ten days.

6. Mike was a member of Karate Kallie's medical scheme up to the date of Mike's resignation. Karate Kallie paid for the full monthly contribution of R2 100 to have Mike and his wife as members of the medical scheme. Mike did not join a new medical scheme for the months of January and February 2015.
7. Mike incurred and paid for hospital expenses to the amount of R63 100, which resulted from a head injury he suffered during a training session. Of this amount, R23 000 was refunded by the medical scheme.
8. Interest of R21 200 from an investment with a local bank.
9. On 28 February 2015, Mike sold all of his shares (refer note 4) for a capital gain of R29 000.
10. Mike has an assessed capital loss of R2 500 carried over from the 2014 year of assessment.

Question 2		Marks
Required		
a	<p>Calculate the normal income tax liability of Mike Haasbroek in respect of the 2015 year of assessment.</p> <p><i>Indicate, with a reason, if an amount has a R-nil impact on the taxable income calculation.</i></p> <p><i>Presentation mark</i></p>	<p>29</p> <p>1</p>
b	<p>List five employees' tax-related duties imposed on Karate Kallie (Pty) Ltd in terms of the Income Tax Act No. 58 of 1962.</p> <p><i>Do not address any administrative requirements imposed by the Tax Administration Act No. 28 of 2011.</i></p> <p><i>No calculations are required.</i></p>	5
c	<p>Annatjie's brother, Fritz Kotzé, is a 43 year old South African resident (unmarried). During the 2015 year of assessment, he earned a salary of R180 000 and local interest of R43 300. He does not carry on any other trade.</p> <p>Briefly advise Fritz Kotzé whether or not he is exempt from registering as a provisional taxpayer in respect of the 2015 year of assessment. Your answer must be supported by short reasons and calculations.</p>	5
Total		40

Question 3

40 marks

You are a partner in a firm of tax practitioners and regularly deal with queries regarding estate planning and estate administration for deceased estates. The following is an extract from an e-mail which you received from a potential client:

“My client, Gordon Hamsey, was a 49 year old entrepreneur (a South African resident) who died on 1 January 2015. Gordon was always unmarried. He was a qualified cook who started operating a ‘snack truck’ which provided snacks and ‘meals on wheels’ in and around Pretoria. He owned a mini-van which he purchased for this purpose at a cost of R250 000 in November 2008. Gordon converted this mini-van into a snack truck by equipping it with the necessary cooking and catering equipment at a cost of R110 000 during December 2008. He used some of his accumulated savings to start this business when he resigned from his job as head chef at a city restaurant during 2007. He worked at this restaurant ever since he was 19 and has never carried on any other business activities.

Gordon started using the snack truck in his meals on wheels business activities as a sole proprietor on 1 January 2009. After having substantial problems with obtaining quality sauces for his famous hamburgers, he purchased a brand new specialised “*Sauce-o-Matic*” machine for R1 700 000 on 31 January 2013. This machine makes tomato sauce, mustard sauce and mayonnaise. The process of making the sauces is regarded as a manufacturing process by SARS. The market value of the machine was R1 930 000 on 1 January 2015.

Gordon always used the snack truck and the abovementioned machine 100% for business purposes. He was never regarded as a VAT vendor and consequently never registered as such. His business has always been successful and Gordon made sure to pay all his income tax due, which included claiming all the relevant income tax deductions. SARS allows a write-off period of four (4) years in respect of the snack truck in terms of Binding General Ruling: No. 7.

At the date of Gordon's death the market value of the snack truck was R650 000. In terms of Gordon's will, all his assets were to be sold to pay for any outstanding liabilities and costs, including his funeral costs. The vehicle and the machine were sold by the executor of Gordon's estate to Samuel, Gordon's best friend, for R645 000 and R1 980 000 respectively on 17 March 2015.

An insurance policy on Gordon's life paid out an amount of R4.5 million to Samuel on 12 February 2015. Samuel took out this policy during 2013 to enable him to buy the truck and machine upon Gordon's death and to provide start-up cash for him to take over the business. Samuel paid all the premiums on this insurance policy and the total of all the premiums plus interest at 6% per annum until the date of Gordon's death amounted to R60 000.

Gordon owned no other assets at the date of his death and has never sold any assets. Gordon owed SPS Bank (a South African bank) R59 000 in respect of an overdraft account at the date of his death. Estate administration expenses amounted to R35 000 (including Gordon's funeral expenses).

As Gordon was such a close family friend, Samuel decided to pay for all the costs of administration of the estate, Gordon's funeral expenses as well as the bank overdraft.

In terms of Gordon's will, his entire net estate is bequeathed to his illegitimate son, Patrick (19 years old and a South African resident).

The executor of Gordon's estate has asked me to assist with considering and calculating all the tax consequences of Gordon's estate. Could you please advise me on the income tax and estate duty consequences of this case?"

Question 3		Marks
Required		
1.	Write an e-mail response to the potential client in which you address the following tax consequences:	
a.	Discuss and calculate all the income tax (including capital gains tax) consequences of the snack truck and Sauce-o-Matic machine in respect of Gordon's final income tax calculation for the period from 1 March 2014 until the date of his death. <i>Discuss all considerations that the executor should consider in completing the final income tax return of Gordon.</i> <i>Indicate nil effects clearly.</i>	20
b.	Discuss and calculate all the income tax (including capital gains tax) consequences of the given information for the deceased estate of Gordon for the 2016 year of assessment (assuming income tax legislation applicable to 2015 will remain unchanged for 2016).	12
c.	Calculate the estate duty consequences of all of the given information for Gordon's estate.	5
	<i>Presentation mark</i>	3
	Total	40

Question 4

40 marks

You are a postgraduate student in taxation and have received the following four queries from one of your tax lecturers. All the taxpayers below are South African residents.

Query 1

Mr X is a tax practitioner, registered both with SARS and with SAIT. Due to the long waiting queues at his local SARS branch, Mr X did not apply for his tax clearance certificate of 'good standing' from SARS, in respect of the 2015 year of assessment.

Query 2

Ms Y has a client who is 'in a lot of trouble with SARS'. She sent you the following e-mail:

'My client has an entire load of penalties for non-submission of income tax returns. He failed to submit his 2013, 2014 and 2015 income tax returns. When I at last submitted his returns via e-filing, he was actually assessed with a refund. However, because of the outstanding admin penalties, it was not refunded. These penalties were indicated in penalty assessments issued by SARS over the past three years.

I requested remittance of penalties in light of the fact that I did remedy the problem and submitted all his outstanding returns. This request was denied and SARS provided no reasons. I appealed, got rejected again. No reasons provided.

What now?'

Query 3

Mr Z is a 35 year old accountant in the full-time employment of a local company. His taxable income from his employment amounted to R410 000 for the 2015 year of assessment. He is not a member of a medical scheme.

Mr Z informed you confidentially that he has been secretly carrying on another trade. His wedding photography started out as a hobby a few years ago, but has since

become a profitable business. However, Mr Z wants to save for his own wedding and has not declared his 2015 profit from his photography trade in his 2015 income tax return (he has declared his photography income in past tax returns, though).

The net income from his photography trade amounted to R209 000 for the 2015 year of assessment. This is after the deduction of a fine of R8 000 for illegally videotaping a wedding ceremony in a mosque.

Mr Z told you that he had received a penalty notice from SARS, but because he was in a rage, he had deleted the document. He could only remember the words 'understatement penalty' and 'Tax Administration Act'.

Query 4

Mr S is a commission earner and keeps a logbook for all his business travels. However, he does not have any records of actual travel expenditure, for example petrol slips. In the past, SARS allowed self-employed taxpayers to claim travel expenses based on the deemed kilometre cost method as available to travel allowance receipts. This was based on Practice Note 24, which has since been withdrawn.

Mr S wants to know whether he would still be able to claim deemed expenditure against his commission income. He does not receive a travel allowance and he uses his own vehicle.

Question 4	Marks
<p>Required</p> <p>Note:</p> <p><i>Show all your calculations and round off to the nearest Rand.</i></p> <p><i>You need not discuss any case law or provide references to any legislation.</i></p> <p><i>The queries below are in the context of (but not limited to) the Tax Administration Act No. 28 of 2011.</i></p>	
<p>a Refer to Query 1.</p> <p>Briefly explain, with short reasons, the consequences arising from Mr X's failure to obtain a tax clearance certificate. You need not address the requirements of a valid tax clearance certificate.</p>	5
<p>b Refer to Query 2.</p> <p>Briefly explain, with short reasons, whether or not SARS was correct in denying the remittance of the penalty. You should identify, with reasons, the type of penalty that was charged, but you need not discuss the workings of the penalty.</p> <p><i>Do not provide any calculations.</i></p> <p><i>Presentation mark.</i></p>	14 1
<p>c Refer to Query 3.</p> <p>Calculate, with short reasons, the likely understatement penalty that SARS has levied in terms of the Tax Administration Act. Also indicate any other possible consequences (if applicable).</p> <p><i>Do not address the remittance of a penalty.</i></p>	15

d	<p>Refer to Query 4.</p> <p>Briefly advise Mr S as to whether or not he would be allowed to claim an income tax deduction based on deemed travel expenses. <i>You must refer to the applicable provision(s) of the Income Tax Act and/or Tax Administration Act.</i></p> <p><i>No calculations are required.</i></p>	5
Total		40