

OCCUPATIONAL CERTIFICATE: Tax Professional

SAQA ID: 93624

Knowledge Competency Assessment

November 2016

Paper 1

SOLUTIONS

| | | | | | | | | | |
|-------------------------|--|--|--|--|--|--|--|--|--|
| CANDIDATE NUMBER | | | | | | | | | |
|-------------------------|--|--|--|--|--|--|--|--|--|

QUESTION 1: COMPANY

1. Discuss whether or not Retro (Pty) Ltd is a small business corporation as contemplated in section 12E of the Income Tax Act.

MARKS

Section 12E lists the following requirements for a small business corporation

| | | |
|--------------------|--|------------------|
| [1] | Must be a private company, CC or co-operative Retro (Pty) Ltd is a private company | 0.5 |
| Application: | (requirement met) | 1 |
| [2] | All holders of shares must be natural persons Joan is the sole holder of shares (natural person - requirement met) | 0.5 |
| Application: | | 1 |
| [3] | Shareholders may not hold other shares (equity) other than few exceptions Joan does not own any other shares or interests. | 0.5 |
| Application: | | 1 |
| [4] | Gross income must not exceed an amount equal to R20 million Gross income appears to be only R15 million + R2 000 000 = R17 000 000 | 0.5 |
| Application: | (requirement met) | 1 1 |
| [5] | Limit of 20% on investment income and income from personal service. No indication of any personal service income. | 0.5 |
| Application: | The company earned interest of R2 million which is considered investment income. R2 million (investment income) / R17 million (total) = 11.76% 11.76% is less than 20% | 1 1 2 1 |
| | Therefore the requirement has been met (does not exceed 20%) | 1 |
| [6] | Must not be a personal service provider | 0.5 |
| Application: | No indication that Retro is a personal service provider (requirement met) | 1 |
| Conclusion: | Retro is a small business corporation | 1P |

Available
Maximum

| |
|-----------|
| 16 |
| 15 |

2. Retro is a small business corporation

R

| | | |
|--|------------------|-----------|
| Profit before tax | 4 000 000 | 1 |
| Allowance on laptop SBC can use either ss 11(e) or 12E | | 1 |
| Because the asset has a cost less than R7 000 it can be fully written off in the year acquired / qualifies as a small value item | | 1 |
| Therefore use s 11(e) - more beneficial | -6 500 | 1 |
| Allowance on passenger vehicle | | |
| s 11(e) write-off is five years | | 1 |
| (or: $R200\,000 \div 5 \text{ years} \times 1/12$ (or $31/366$) = R3 333 (or R3 388) | | 1 |
| s 12E allows for 50/30/20 write-off without apportionment. | | 1 |
| Therefore use s 12E | | 1 |
| 50% x R200 000 = | -100 000 | 1 |
| Taxable income | 3 893 500 | |
| Tax according to SBC table | | |
| Fixed R59 150 | 59 150 | 1 |
| Variable 28% of (R3 893 500 - R550 000) | <u>936 180</u> | 1 |
| | 995 330 | |
| | | 12 |

3. Retro is NOT a SBC

| | | |
|--|------------------|----------|
| Profit before tax | 4 000 000 | 1 |
| Laptop (must use 11(e)) | -6 500 | 1 |
| Passenger vehicle (must use 11(e)) | | |
| R200 000 / 5 years | | 1 |
| x $31/366$ (or $1/12$) | | 1 |
| Allowance for this year | <u>-3 388</u> | |
| Taxable income | 3 990 112 | |
| Tax at 28% (not a small business corporation) | | |
| R3 990 112 x 28% | 1 117 231 | 1 |
| | | 5 |

4. Dividends tax

The company did not appear to make any distributions during the year.

However, section 64E(4) **deems** the following to be a **dividend in specie** :

Where an amount is **owed to a company** (Joan owes R1 million to Retro)

by a person who is a **resident** (Joan is a resident)

who is **not a company** (Joan is not a company OR Joan is a natural person)

and who is a **connected person** to the company (Joan is a connected person - owns all (100% of) the shares which exceeds the required 20% in terms of the definition of a 'connected person')

if the debt is in respect of **any share held** in the company.

Joan's **shareholding** is the **reason** why the loan was granted.

The deemed dividend is R1 million x **8%** (official rate of interest as provided) x **1/12** (or 31/366) =

6 667

1.5

Alternative: R6 776

The amount above is subject to dividends tax at 15%: **15%** x R6 776 =

1 016

1

Since it is a dividend *in specie* **the company (Retro) is liable** to pay the dividends tax.

1

Available

10.5

Maximum

8

QUESTION 2: ANALYSIS OF FINANCIAL STATEMENTS

MARKS

1 Reconciliation of output VAT to turnover

1

Total output tax for the year was

R2 299 000

1

Output tax divided by 0.14 to calculate value of taxable supplies (excluding VAT)

(A)

R16 421 429

1

Turnover reported in the financial statements

(B)

R 41 000 000

1

Difference between A and B

R24 578 571

1

There is a large (significant) difference between the output VAT declared on VAT returns and the turnover reported in the financial statements.

1

| | |
|---|---|
| This could indicate that the supplies on the VAT returns have possibly been understated. | 1 |
| This difference should be investigated further and the reasons should be clarified. | 1 |
| Should it become evident that VAT was understated, the company should apply for the voluntary disclosure programme (VDP) to correct the understatement and to | 1 |
| avoid the imposition of penalties. | 1 |
| 2 the imports of the specialised helmets is subject to VAT levied in terms of s7(1)(b) If a clearing agent is used, then the VAT 201 will not reflect the VAT levied in terms of s7(1)(b) as the clearing agent will pay this over and the VAT is not double counted. However, if a clearing agent is not used, then the VAT would need to be reflected correctly on the VAT 201 and this will further increase the difference between the sales declared for VAT purposes and the turnover of R41 000 000. | 1 |
| There is also the possibility of the VAT levied in terms of s7(1)(b) being incorrectly calculated due to the use of incorrect customs duty values and import duties. | 1 |
| Further, there is also the possibility of the incorrect foreign exchange rates being used. | 1 |
| This could indicate a further possibility of the understatement of VAT. | 1 |
| This should be investigated further and the use of a clearing agent or not should be established. | 1 |
| Examination of invoices to determine if the correct customs duty values and import duties were used to calculate the VAT in terms of s7(1)(b) | 1 |

| | | | |
|---|---|------------|-------------|
| | Recalculation of the goods imported using the foreign exchange rates applicable. | | 1 |
| | Should it become evident that the VAT was understated, then the company should apply for the Voluntary Disclosure Programme(VDP) to avoid imposition of penalties. | | 1 |
| 3 | The financial statements are compiled internally by the company's bookkeeper. The bookkeeper does not appear to have been trained (has no knowledge of financial reporting standards). The company should consider appointing (or contracting) with a trained accountant or bookkeeper. | | 1 1 1 |
| 4 | No recognised accounting framework (standard) is used to prepare the financial statements. One needs to consider the Public Interest Score of the company to determine whether this is allowed: | | 1 1 |
| | Average number of employees 48 + 2 (directors are also counted) | 50 | 1 1 |
| | Each million in turnover (or portion thereof) 41 points for the R41 million in turnover | 41 | 1 1 |
| | Each million in third-party liability (or portion thereof) 20 points for R19.3 million in third party liabilities | 20 | 1 1 |
| | One point for each individual with interest in the shares Three individual holders of shares, therefore 3 points | 3 | 1 1 |
| | TOTAL | 114 | 1 |
| | Since the Public Interest Score is more than 100, the Companies Act requires the entity to compile its financial statements using either IFRS or IFRS for SMEs. | | 1 1 1 |
| 5 | The financial statements are not subject to an audit. | | 1 |

| | | |
|---|--|-----------|
| | An audited enhances the credibility of the information reported in the financial statements. | 1 |
| | However, since the PI score is less than 350, usually no audit is required. | 1 |
| | However, since the company's financial statements are internally compiled AND the PI score is more than 100, the financial statements do require an audit. | 1 |
| | The company should therefore either: Appoint external auditors to perform an audit OR Have the financial statements compiled independently (in which case an independent review will also be required). | 1 |
| 6 | There is no statement of cash flows as part of the financial statements. | 1 |
| | There are no notes presented as part of the financial statements. | 1 |
| | The minimum requirements for financial statements (IFRS/IFRS for SMEs) are: | 1 |
| | Statement of financial position (balance sheet) | 0.5 |
| | Statement of profit or loss and other comprehensive income (income statement) | 0.5 |
| | Statement of changes in equity | 0.5 |
| | Statement of cash flows | 0.5 |
| | Notes to the financial statements | 0.5 |
| | These must all be presented with equal prominence. | 0.5 |
| 7 | The submission of the 2014 tax return was supposed to be made within one year after year-end (31 December 2015) and is therefore late. | 1 |
| | | 1 |
| | AVAILABLE | 50 |
| | MAXIMUM | 40 |

QUESTION 3: VAT and Transfer Duty

**NOVEMBER 2016
TPKCA**

**PAPER 1: COMPANIES
QUESTION3: VAT**

T
Practitioner
PO Box 123
Johannesbu
g
1234

1 Addresses

Mr Sanjeev Pillay
PO Box 456
Johannesburg
1234

Date: XXX

1 Date

Dear Mr Sanjeev Pillay

As requested, herewith the VAT consequences of the proposed transaction:

1 Appropriate
addressee and
introduction

Compulsory registration for VAT

In terms of section 23(1) of the VAT Act, you would be required to register if you:

1 Section 23

Actually made taxable supplies where the value of taxable supplies is exceeding R1 million in a 12 month period

1

OR

If he has a contractual obligation to make taxable supplies in excess

1

It does not appear that either situation is present (actual supplies not yet R1m and no indication of contracts in place).

1 Application

Voluntary registration for VAT

In terms of section 23(3) you may voluntarily register for VAT if:

1 Section 23

Your actual value of taxable supplies exceed R50 000 in a twelve month period

1

OR

| | | |
|---|---|--------------------------------------|
| Your supplies are reasonably expected to exceed R50 000 in the 12 months after registration | 1 | |
| However, the definition of an "enterprise" in section 1 requires a person to make taxable supplies where the value of taxable supplies is exceeding R120 000 in a 12 month period (from 1 April 2016). Before 1 April 2016 the threshold was R60 000) | 1 | Enterprise/S1 |
| (or reasonably expects to exceed) where commercial accommodation is supplied. | 1 | R120 000 Commercial accommodation |
| Accommodation in the guest house along with services (laundry, cleaning) would constitute commercial accommodation as defined in section 1 | 1 | n |
| Since your supplies are expected to exceed R120 000 in the next 12 months (R300 000), you will likely be permitted to register. | 1 | Application |
| | 1 | Conclusion |

Output tax (requirement to charge VAT)

| | | |
|---|---|---------------|
| If you register for VAT, you will be required to charge output tax on the fees charged to guests in terms of section 7(1)(a). | 1 | |
| Where commercial accommodation is supplied at an all-inclusive rate (with domestic goods and services) for a period exceeding 28 days, then Output tax is only charged on 60% of the all-inclusive charge. Section 10(10). This could be relevant to guests making extended bookings (four weeks at a time as indicated) during December-January. | 1 | all-inclusive |
| | 1 | 28 days |
| | 1 | 60% |
| | 1 | S10(10) |
| | 1 | Application |

Transfer duty

| | |
|---|---|
| Since the property is not purchased from a VAT vendor, the purchase will be subject to transfer duty. This tax is payable by the purchaser (Sanjeev). | 1 |
| | 1 |

Transfer duty payable:

| | | |
|-----------------------|---------------|---|
| R45 000 + | 45 000 | |
| (R2.1m - R1.75m) x 8% | 28 000 | |
| | 73 000 | 1 |

Input tax

The property is being supplied by a non-vendor and is therefore not a taxable supply. 1

However, since the property was previously used (second-hand) and fixed property constitutes "goods" as defined in section 1 you will be entitled to claim notional input tax on the purchase of the property 1

This may be claimed on the lower of the purchase price or open market value 1

| | | |
|---------------------|-----|---|
| | 257 | |
| 14/114 x R2 100 000 | 895 | 1 |

Notional input tax on the purchase of fixed property can only be claimed once the property has been registered in the name of the purchaser (Sanjeev). 1

Once registered, notional input tax can be claimed to the extent that payment has been made for the property. 1

In addition, input tax may only be claimed to the extent that the goods (property) will be used for making taxable supplies. 1

Since you will only use 350 sqm of the 400 sqm for the guest house (the remaining 50 sqm is for private/residential/exempt use), you may only claim to this extent: 1

| | | | | | | | | |
|-----------|------|--|---------|--|--|--|--|---|
| | 350 | | | | | | | |
| 257 895 x | /400 | | 225 658 | | | | | 1 |

Interest incurred on the mortgage bond constitutes a financial service which is an exempt supply. (No input tax to claim). 1

Bank charges incurred on the mortgage are fee-based and therefore not exempt. You will be entitled to claim input tax to the extent of taxable use (350/400 = 87.5%). 1

Yours faithfully

T Practitioner

PR number

AVAILABL
E 44
MAX 40

QUESTION 4: GENERAL INCOME TAX PRINCIPLES

Marks

General deduction formula - section 11(a) and 23(g)

For an amount to be deductible for income tax purposes if it is incurred for the purposes of the taxpayer's trade, it needs to meet all the requirements of the section 11(a), read with section 23(g)

1

For an amount to be deductible it must comply with the above, namely:

The taxpayer must carry on a **trade**
There must be **expenditure or losses actually incurred**
during the year of assessment
incurred in the production of income not of a capital nature

2

To the extent to which the amount was **laid out or expended for the purposes of the taxpayer's trade**

The **onus of proof** is on the taxpayer in terms of **section 102 of the Tax Administration Act, to prove the amount is deductible.**[1]

A From the facts given it is clear that Braai and Barbeque Ltd is carrying on a trade the amounts spent on repairs constitute expenditure as part of their trade

1

It can also be considered to be **in the production of income as the repairs are closely connected to their trade** and ensuring that their products work
[Port Elizabeth Electric Tramway Co]
Or close concomitant of taxpayer's trade - [Joffe]

1

1

1

It is not considered to be of a **capital nature as it does not improve the income-earning structure of the company** **[New State Areas]**

1

1

The question is whether the amounts provided for the guarantee **was actually incurred**. That is, did they have an **unconditional legal liability at the end of the 2016 year of assessment?**

1

1

They do not know how many repairs would be needed and therefore the amount does not form an unconditional legal liability and could not be deducted
[Edgars stores]

1

1

| | | |
|----------|--|-----------------------------------|
| | Section 23(e) also prohibits the deductions of amounts taken to reserve funds. | 0.5,1, |
| | The amounts actually spent on wages in London and actual repairs done here would be deductible. | 1 |
| | Repairs are deductible in terms of section 11(d) and as long as it is <i>restoration by renewal or replacement of a subsidiary part of the asset</i> it would qualify [Flemming] | 0.5 <u>1,1</u> 18 13 max |
| B | The question here is whether the damages and legal costs paid are deductible for tax purposes? The damages: The general deduction formula as given above refers and it is clear that the question is - was it in the production of income? | 1 1 |
| | PE Tramways refer as this is similar circumstances to the case i.e. also a driver/installer getting hurt in the course of his employment. The question is what was the purpose of the expense and how closely is it linked to the business of the taxpayer? | 1 1,1 |
| | Joffe - the expense must be an unavoidable consequence and not due to negligence . | 1 1,1 |
| | The purpose is the transfer and installation of company products. This is closely linked to company business. The risk of gas exploding is part of the business and this was a faulty gas bottle. Therefore there was no negligence. It was thus necessary to pay the compensation and it is not of a capital nature. And the company can deduct the expense in the production of income. | 1 1 1 |
| | The legal expenses Section 11(c) determines that legal expenses actually incurred in respect of any claim or dispute arising in course of ordinary operations undertaken by the taxpayer can be deducted insofar as it is not of a capital nature and incurred in respect of a claim the damages of which would be taxable or deductible. It was determined above that the damages is deductible, therefore they could also deduct the legal expenses. | 0.5,1 1 13.5 12 max |
| C | Can the prize won by Peter be considered taxable? It can only be taxable if it complies with the definition of gross income as defined in section 1 It is an amount received by the taxpayer during the year of assessment But is it considered to be of a capital nature. | 0.5,1 1 1 |
| | Prizes and gambling are normally not taxable unless it relates to services rendered – par (c) of gross income def Peter did not work for Braai & Barbeque Ltd and as such would not be considered to have been rendering services to the company for the prize. | 0.5,1 1 |

| | |
|--|--|
| <p>However, he is a chef and the prize could be connected to his know-how and he could be taxed then on it</p> <p>A court case taxed a journalist winning a competition based on his work know-how. (IBS 976)</p> | <p>1</p> <p>1 Bonus</p> <p>8</p> <p>5 max</p> |
| <p>D Can the company deduct more audit fees than was allowed by the SARS?</p> | |
| <p>The general deduction formula given above relates:</p> <p>Trade carried on</p> <p>They are producing gas barbeques and heaters and earning dividends from investments</p> | <p>1</p> <p>1</p> |
| <p>expenses and losses</p> <p>Audit fees are expense incurred</p> | <p>1</p> |
| <p>actually incurred during the year of assessment</p> <p>Although audit fees are normally paid after the end of the year of assessment it relates to that year and was therefore incurred</p> | <p>1</p> |
| <p>in the production of income</p> <p>Although audit fees do not directly produce income they are necessary and required by law for companies. Therefore it is a close concomitant - PE Tramways</p> <p>"The auditing of financial records is clearly a function which is 'necessarily attached' to the appellant's income earning operations". MTN</p> <p>The expense for exempt income does not fulfil this requirement</p> | <p>1</p> <p>1</p> <p>1 bonus</p> <p>1</p> |
| <p>Not of a capital nature</p> <p>It is a recurring expense</p> | <p>1</p> |
| <p>Section 23(f) specifically prohibits expenditure incurred to produce exempt income. Therefore the portion of the audit fees that relates to the exempt income (dividend income) would not be deductible.</p> | <p>1</p> |
| <p>Court case: C:SARS v MTN and Nemojin Case - similar circumstances applied</p> <p>MTN case - Only 10% of the audit fee was allowed as a deduction, Accordingly, the audit fee expenditure could only be said to be related to the extent of 10% of the total audit fees to the lending of money to earn interest of the business. The 90% related to dividends earned(exempt).</p> <p>Conclusion -</p> <p>Therefore only 20/100 x R880 000 can be deducted for tax purposes = R176 000 and not on time spent</p> | <p>1</p> <p>1</p> <p>2</p> <p>14</p> <p>10 max</p> |
| | <p>40 Total</p> |