Tax Professional

Knowledge Competency Assessment

November 2014

Paper 2: Question

South African
Institute of
Tax Professionals

South African Institute of Tax Professionals

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	Value-Added Tax	40	Blue
2	Individual	40	White
3	Farming	40	Pink
4	Estate Duty and Donations Tax calculations in a Deceased Estate	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

All-parts (Pty) Ltd ("All-parts"), a registered VAT vendor, is situated in Mafikeng, South Africa and specialises in the supply and installation of motor vehicle parts. More than 95% of All-parts' supplies are taxable supplies. All-parts recently approached you, a tax consultant, regarding the VAT consequences of the following transactions:

Transaction 1

During October 2013 All-parts acquired a second hand electric car jack from a non-vendor situated in South Africa for R7 600. The open market value of the car jack was R7 800 on the day of acquisition. After All-parts used the car jack for a period of three months in its day-to-day operations, the use of the car jack was given to John Brickley, one of All-parts employees, for the purpose of working on his own private vehicle at home. The market value of the car jack on this date was R7 200. John returned the car jack after two months to All-parts, where it was once again used for All-parts' business purposes. The market value on this date was R7 000.

All-parts have not accounted for any VAT consequences of the above information and request your assistance.

Transaction 2

During November 2013 All-parts contracted with Johan Elhers, a South African ("SA") resident, for the installation of a new engine to his truck that is used for farming purposes in Botswana ("BWA"). The engine was bought by Johan from another party and delivered to his farm in Botswana. It was decided that it would be most cost effective for one of All-parts installation specialists to travel to the farm in Botswana to do the installation. For travel purposes the specialist made use of a private airplane and a private driver (both in SA and BWA). After the completed installation, All-parts created a valid invoice for Johan that included the following:

Description	R (excl. VAT)
Reimbursement of airfare (SA – BWA, BWA – SA)	3 550
Reimbursement of other travel cost in SA	150
Reimbursement of other travel cost in BWA	200
Installation of engine	12 000
Subtotal	15 900

All-parts are, however, unsure of the VAT consequences of this transaction.

Transaction 3

During December 2013 All-parts agreed to supply two specialised transmissions to Albert Crisfield, a resident of Zimbabwe. All-parts only had one of these transmissions in stock and were obliged to order an additional transmission from the manufacturer in Germany.

For the transmission that was available in stock, All-parts agreed to deliver the transmission to Louis Trichardt, South Africa, where Albert took possession of the goods. Albert then personally transported the goods to Zimbabwe.

In terms of an arrangement between All-parts and the transmission manufacturer, the ordered transmission was delivered directly from Germany to Zimbabwe. As All-parts normally carry the transportation cost of importing transmissions, the cost of transportation was carried by All-parts and was not included in the invoice to Albert.

A valid tax invoice was created for Albert that included the following:

Description	R (excl. VAT)
2 x Specialised transmission, R80 000 each	160 000
Transportation cost to Louis Trichardt	800
Subtotal	160 800

All-parts are unsure of the VAT consequences of this transaction.

Transaction 4

During January 2014 All-parts was approached by Peter Makelele, a good friend of the owner of All-parts, to build a high powered go-kart for professional racing purposes. All-parts have never before built such a go-kart and they do not have any intention to build one again. The go-kart was built over a period of two days and the activities in building the go-kart was completely different to All-parts normal day to day activities.

For purposes of building the go-kart, All-parts only made use of current trading stock initially acquired for the purposes of making taxable supplies. As Peter is a friend of the owner of All-parts, the parts used in building the go-kart was sold at cost price (excluding VAT paid on acquisition and claimed as input tax) to Peter. A valid invoice was created for Peter that included the following:

Description	R (excl. VAT)
Parts used for go-kart	25 000
Labour costs in building go-kart	4 000
Subtotal	29 000

All-parts are, however, unsure of the VAT consequences of this transaction.

Question 1 Required	Marks
Transaction 1 Explain, with reference to applicable legislation, the VAT consequences (including both output tax levied and input tax claimed) for All-parts in respect of this transaction.	7
Transaction 2 Explain, with reference to applicable legislation and case law, the VAT consequences for All-parts in respect of the invoice to Johan.	14
Transaction 3 Explain, with reference to applicable legislation, the VAT consequences for All-parts in respect of the invoice to Albert. Also list the documentary proof that All-parts would have to retain in addition to a valid tax invoice.	10
Transaction 4 Explain, with reference to applicable legislation, the VAT consequences for All-parts in respect of the invoice to Peter.	9
Total	40

Question 2 40 marks

Ignore VAT for this question.

Francine Forbes, 45 years old, is a lecturer in interior decoration at a private college in Johannesburg. She is married to Fabio, an artist, and they have two daughters, 16 and 22 years old. She contacted you as a tax consultant in an accounting practice as she feels she is paying too much tax. You ascertain that she has the following amounts of income and expenditure for the year of assessment ending 28 February 2015:

1. She earns a salary of R480 000 per year at the college and receives a bonus in December of 10% of the above salary. For the 2014 year of assessment the salary and bonus were R450 000 in total.

2. She and her family stay in a house connected to the student hostel and she is responsible for the students in the residence. The college pays all their electricity and other municipal services but she furnished the house herself. She does not pay any rent towards the accommodation.

3. The college also gives lectures at a campus in Braamfontein and they gave Francine the use of a motor vehicle for visiting that campus twice a week. She keeps the vehicle at her house and uses it all the time. The college purchased the vehicle at a cost of R228 000 on 1 December 2011. The vehicle was not bought with a maintenance plan. Francine has had the use of the vehicle since 1 March 2014. She pays for all the maintenance costs (R4 800 for the year) and has to pay fuel costs for private travel. Francine kept a logbook for the entire year noting that her trips to Braamfontein made up 15% of the 21 000 kilometres travelled during the year. She also paid the R420 license fees for the vehicle.

4. Francine has an office at the college which she uses during the week. The college estimates that it costs them approximately R4 000 per month to maintain the office. Francine works in her study at home during the weekends when she has to mark scripts and prepare lectures. She estimates that her expenditure on the study (cleaning, insurance and depreciation of the furniture) is R2 300 per month (determined as a proportion of her total expenditure on these items).

5. The college provides her with a laptop with specialised software for creative projects that she teaches her students. This costs the college R1 200 per month.

6. Francine and her family are also provided with meals from the hostel dining room every day. The college estimates that these meals cost them R1 000 per month for the entire family.

7. As both Francine's daughters are on a diet she spends an additional R1 500 per month on fish and salad ingredients for them.

8. Francine employs an au pair (child minder) to drive her youngest daughter to school, sport and cultural activities. Francine pays the au pair R4 000 per month and compensates her at a rate of R2,50 per kilometre for using her own vehicle for the trips. Francine considers this a valid business expense as she would not be able work if she had to look after her daughter. She is considering employing the au pair through the decorating business (see note 11 below).

9. Francine belongs to the medical aid fund provided by the college and Francine's two daughters are listed as her dependents on the medical aid. The total medical aid contribution is R5 600 per month, of which Francine contributes half and her employer pays the other half. All of Francine's medical expenses were covered by her medical aid during the year of assessment.

10. Francine contributes R2 240 per month to a pension fund and R3 500 per month to a retirement annuity fund.

11. As she is a sought-after interior decorator, Francine started a private practice providing advice and soft furnishings to clients on 1 March 2014. The business, called Francine's Furnishings, is managed by one of her former students but Francine still spends a lot of time there. The business operates from a rented shop and Francine has employed a handy-man and a lady to sew curtains and other soft furnishings. The income and expenses of business for year of assessment ended 28 February 2015 are as follows:

	R
Total fees written for decorating projects	850 000
Sales of furniture and soft furnishings	160 000
Salaries paid to employees	320 000
Purchase of materials	64 000
Closing stock of furniture and fabrics	56 000
Rental of commercial premises	24 000
Purchase of sewing machine SARS allows a five year write-off period on similar machines	67 000
Insurance paid Francine paid R120 000 for insurance of her business premises and contents on 1 January 2014. This is a premium that will cover the business for two years	120 000

Francine feels that she should not be paying tax on her business income and she has asked you whether she should rather inflate the business costs on her tax return so that there would be no taxable income.

12. Francine's father created a trust for her and her daughters and he donated some of his shares and investments to the trust in 2013. The trust earned the following net income (also the taxable income calculated according to the Income Tax Act) during the year of assessment ended 28 February 2015:

	R
South African dividends	30 000
Interest from ABSA	70 000
Net rentals from student flats let out near the University	66 000

According to the trust deed, each year R28 000 is paid to Francine and each of the daughters (R84 000 in total). Any remaining income may be distributed to Francine and the two daughters at the trustee's discretion.

Thus, the following distributions were made for the year ended 28 February 2015:

To Francine: R28 000 + R42 000 = R70 000

To the elder daughter: R28 000 + R42 000 = R70 000

To the younger daughter: R28 000 only

13. Francine developed a new fuss-free curtain rod and she sold the patent thereon to Sanderson's Limited who pay her a royalty for every meter of rod sold. During the seven months, August 2014 – February 2015, they have been using the patent they paid her royalties of R49 000 in total.

Question 2 Required		Marks
1	Calculate the taxable income of Francine Forbes for the year of assessment ending 28 February 2015. *All deductions, inclusions, exemptions and items not dealt with must be motivated by reference to the Income Tax, or other Act or case law.*	25
2	Write a letter to Francine Forbes informing her on the following and supporting your answer with brief reasons:	
	2.1 The deductibility of the au pair's costs.	2
	2.2 What the tax implications would be if she employed the au pair through her decorating business.	3
	2.3 Whether it would be acceptable for her to reduce her business taxable income to Nil and whether you would be willing to do her tax return if she adjusted the expenses as she has indicated.	3
	2.4 What the tax consequences would be if she donated her patent to the trust.	6
	Layout and presentation	1
	Total	40

Question 3 40 marks

All amounts exclude VAT unless indicated otherwise.

Nkosi Mkele, a resident of the Republic, is 42 years old and married with one child.

Nkosi wanted nothing else in life but to be a farmer. On 12 March 2014 Nkosi received a farm as part of the land restitution process. At that time Nkosi had no start-up capital and could therefore not immediately commence farming.

He had no choice but to let part of the farm to his neighbour in order to earn rental income of R60 000 per annum. The neighbour used the land to graze his livestock. Nkosi had to spent R5 000 on this piece of land and R7 500 on the rest of the farm to prevent soil erosion. The prescribed certificate was received from the Executive Officer (appointed in terms of the Conservation of Agricultural Resources Act).

On 1 August 2014, the Landbank granted Nkosi a loan of R1 000 000 and he commenced farming.

Nkosi Mkele's statement of comprehensive income for the year ended 28 February 2015 is set out below. He earned no other income and incurred no other expenditure during the year of assessment.

Statement of Comprehensive Income

Expenditure:	R	Income:	R
Development expenditure:		Rentals earned from letting farm land to a neighbour	60 000
New irrigation equipment	25 000		
Dams and boreholes	12 360	Fee for letting of harvest machine	9 600
Establishment of orchards	13 600	Grazing fees	21 000
New fencing	3 420	Interest received	1 920
Road-making	15 340	Livestock sales	831 000
Soil erosion works (on farmland let to neighbour)	5 000	Produce sales (wool and fruit)	114 220
Soil erosion works (on farmland used by himself)	7 500		
Fertilizers and manures	5 250		
Food for livestock	9 360		
General farming expenses (all deductible)	3 960		
Interest payable (Landbank)	16 340		
Livestock purchases	34 200		
Repair of damaged fencing	3 900		
Seeds	2 980		
Wages and rations	11 556		
Wear-and-tear (all deductible)	14 800		
(see note 7)			
Net profit	853 174		
	1 037 740		1 037 740

Notes:

The following information also applies to Nkosi's 2015 year of assessment. These transactions were not accounted for in the statement of comprehensive income:

1. Nkosi's uncle, an experienced farmer and Nkosi's mentor, died unexpectedly on 2 April 2014. On 25 August 2014, the executors of the estate of his late uncle handed over to Nkosi 1 800 ewes, 200 rams and 400 lambs. The current market value of these animals at the date of his uncle's death was R650 000 and this was the fair market price on 25 August 2014. The standard value of this livestock would have been R12 800.

2. On 26 November 2014 Nkosi received, by way of donation from his father, 600 ewes and 100 rams. At the date of donation, the fair market value of these animals was R200 000. The standard value would have been R4 200.

3. At 28 February 2015 the numbers of livestock on hand were as follows:

   Ewes 1 500

   Rams   250

   Lambs   400

	Market value each R	Standard value each R
Ewes	900	6
Rams	1 200	6
Lambs	750	2

Nkosi has elected the standard values fixed by regulation.

4. The estimated cost of production of wool and fruit on hand at 28 February 2015 was R9 100 (market value was R18 200).

5. During the year Nkosi, his wife and his family consumed produce at an estimated cost of R3 500 (the fair market value of the produce was R5 800).

6. 24 ewes and 12 rams were donated to the church and school (not qualifying public benefit organisations) during the year. These animals were acquired at a cost of R6 700, but at the date of donation their fair market value was R10 800.

7. In addition to the wear and tear on office equipment, accounted for in the statement of comprehensive income, Nkosi also acquired a second-hand harvest machine on 1 September 2014 at an auction for R30 000. He used this harvest machine to harvest fruit during the year of assessment. He agreed to let the machine to his neighbour for a fee of R9 600. The harvest machine was used by the neighbour in his trade as farmer and was used for the same length of time as it was used by Nkosi. No capital allowances were accounted for on this machine in the statement of comprehensive income.

Question 3 Required	Marks
Calculate the taxable income of Nkosi Mkele for the year of assessment ended 28 February 2015.	40

Question 4 40 marks

You are a senior tax consultant at TAF Tax Consultants. On 31 August 2014 you received the following electronic mail from a client:

To: TAF Consultants

From: Mr Executor

Date: 31 August 2014

Subject: Estate Duty and donations tax calculations in a deceased estate

To whom it may concern

I am a practising accountant with a number of individual and corporate clients to whom I provide various bookkeeping and accounting services.

On 1 June 2014 one of my clients, Philip Mapfumo (a South African resident for his entire life), died in a motor vehicle accident at the age of 64 years. Philip was married out of community of property to Lilian, without the accrual system. Philip got married to Lilian 5 years ago. He was previously married to Esther, who died 2 years before Philip got married to Lilian. Esther left her entire estate to Philip. I was also the executor in Esther's estate and I still have her complete estate file with me. Philip and Esther have two sons, Tayo and JJ, who were 28 and 30 years old respectively at the date of Philip's death.

Philip nominated me as the executor in his estate and I have formally accepted the appointment. I have performed most of the administrative tasks required to be done in respect of the estate and only need to finalise the estate duty calculation in the estate. I am 100% certain that I have accounted for all of Philip's assets and liabilities, income and expenditure, before and after the date of his death.

I have done a provisional calculation of the estate duty liability in the estate, but I am uncertain as to the correctness thereof. I am sending the calculation in an attachment to this mail (*ED Calculation P Mapfumo.pdf*), which shows my calculation together with a few explanatory notes to clarify some of the amounts in the calculation and to provide further information where necessary.

Furthermore, in terms of Philip's will his net distributable estate must be divided as follows:

- R500 000 cash to Lilian.
- 50% of the rest of the estate after Lilian's legacy to Tayo.
- 50% of the rest of the estate after Lilian's legacy to JJ.

However, after his death, Lilian, Tayo and JJ decided that the estate must be distributed as follows (a formal re-distribution agreement was drawn up and approved and registered with the Master of the High Court):

- R600 000 cash to Lilian.
- 40% of the rest of the estate after Lilian's legacy to Tayo.
- 60% of the rest of the estate after Lilian's legacy to JJ.

Taking into account my calculations and additional notes in the attachment to this e-mail, I would appreciate if you could provide me with a tax opinion with regards to the following three issues:

1. Any corrections that need to be made to my estate duty calculations. I need you to provide me with reasons for any such corrections / adjustments.

2. Who will be liable for the estate duty, in other words: will Philip's deceased estate need to pay the whole amount of the estate duty or will beneficiaries also be liable for any or all of the estate duty? For this part I would like you to

calculate the correct amount of estate duty payable in the estate and then indicate who is liable for its payment.

3. I would like to know whether there will be any donations tax consequences as a result of the redistribution agreement between the beneficiaries as stated above.

I appreciate your assistance with this matter as soon as possible.

Regards

Mr Executor

Attachment: ED Calculation P Mapfumo.pdf

ESTATE DUTY CALCULATION: PHILIP MAPFUMO

	Notes	R
Property and deemed property		12 798 937
Proceeds at auction: Fixed property: Sandton stand 109 with residence		7 900 000
Proceeds: Kia Sportage motor vehicle, sold to local motor vehicle dealership		200 000
Proceeds: Various items of gold jewelry, sold to a local retail jewelry shop		155 000
Proceeds: Shares in Cool Shades (Pty) Ltd, sold to Ben Baker	1	990 000
Shares in a night club in London, United Kingdom	2	600 000
Fixed property (a flat) in the province of Buenos Aires, Argentina	3	1 550 000
Usufruct: (R1.5m x 12% x 7.79965)	4	1 403 937

Deductions		(4 871 952)
Auctioneer’s commission		315 000
Bank overdraft: London, UK		700 000
Foreign property: flat in Argentina	3	1 550 000
Mortgage loan i.r.o. Sandton property: outstanding capital and interest as at date of death		1 333 000
Section 4(q): accruals to surviving spouse		600 000
South African Revenue Services (Philip’s final income tax liability as per assessment, as well as the deceased estate’s income tax liability)		154 000
Cost of advertisements for the estate		777
Master’s fee		600
Executor’s remuneration (relating to gross assets included in the estate)		218 575
		7 926 985
Section 4A Abatement		(3 500 000)
Dutiable Amount		4 426 985
Estate Duty @ 20%		885 397

Notes

1. Philip owned 50% of the shares in this company that imports and distributes sunglasses. The other 50% of the shares belonged to Ben Baker, Philip's close friend. The entire shareholding in the company was valued at R2.4m by the company's independent auditors at the date of Philip's death. In terms of a buy-and-sell agreement Philip's shares were sold to Ben after Philip's death. Ben took out a life insurance policy on Philip's life with the purpose of providing the funds necessary to buy Philip's shares. The policy paid out R1 million to Ben on 15 June 2014. The total premiums paid in respect of the policy (together with interest thereon at the prescribed rate of 6%) amounted to R67 000. Of this amount, Ben paid R50 000 and Philip paid R17 000.

2. Philip inherited these shares from his grandmother, Ellah, who died 12 years ago. Ellah has always been a resident of England and Philip was her only grandson. No death taxes were payable on these shares in the UK. Since the tax treaty with the UK does not specifically deal with death or inheritance taxes, I reckon that the shares are subject to estate duty in South Africa.

3. Philip purchased this flat in Argentina seven years ago. Inheritance tax (death duties) amounting to R150 000 were paid in Argentina on this property as Buenos Aires is the only province in Argentina that levies death duties on fixed property. As there is no tax treaty in place between South Africa and Argentina, I reckon that the property will be deductible for estate duty purposes in South Africa in order to avoid double taxation.

4. Philip enjoyed the usufruct of an apartment in Green Point, Cape Town (valuation of the apartment at 1 June 2014 was R1 500 000) in respect of which his sister, Olivia was the holder of the bare dominium. The usufruct was donated to Philip by his aunt Cecile on 1 June 2004 when the fair market value of the apartment was R900 000. Cecile donated the bare dominium to Olivia on

the same day. Olivia and Cecile were 42 and 62 years old respectively on the date of the donation.

Question 4 Required		Marks
1	Draft a tax opinion to Mr Executor in which you address his three questions regarding the tax implications of the deceased estate of Philip Mapfumo. *You are not required to include a limitation of liability clause in your tax opinion.* 1. Issue 1 2. Issue 2 3. Issue 3 *Layout and Presentation*	 22 10 3 5
	Total	40