

Tax Professional

Knowledge Competency Assessment

November 2015

Paper 1 Solution

Suggested Solution

Question	Topic	Marks	Answer Book
1	Company Reorganisation	40	Blue
2	Analysis of Financial Statements	40	White
3	VAT and Transfer Duty	40	Pink
4	General Income Tax Principles	40	Green

Total marks: 160 per paper

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

Question 1 – Suggested Solution

40 Marks

PART A

6 marks

Section 8(5) [1] recoupment

R318 000 – R292 000 = R26 000 [1] *limited to:*

Rent paid: R750 x 19	= R14 250 [1]
Lease premium: (R10 000/8) x (19/12)	= <u>R 1 979</u> [2]
	R16 229

Recoupment included in gross income: R16 229. [1 mark for applying principle correctly]

PART B – 34 marks

1. X-treme must pay the following withholding tax iro the purchase of the land from a non resident over to SARS in terms of s 35A:

7,5%x R5 000 000 = R375 000 (1½)

X-treme can claim the following deductions iro the erection of the sales shop and flats:

- Shop: S13quin (R3 990 000 x 100/114) x 5% = R175 000 (2)
- Flats: S13sex R1 710 000 x 10% = R171 000 (2)

X-treme must include the rental of R105 000 (10 x R1 500 x 7) in gross income.(1)

2. X-treme

The cost of the machine is as follows:

	R	
Purchase price €80 000 x 12,75 =	1 020 000	(1)
Freight insurance and import duty	<u>70 000</u>	(1)
	<u>1 090 000</u>	

Sec 12C wear and tear of 40% x R1 090 000 = R436 000 can be claimed. (1)

Foreign exchange differences:

Since the machine was only taken into use in the 2015 year of assessment, the exchange difference that arose on 31 October 2014 was deferred to the 2015 year of assessment in terms of s24I(7). The following exchange differences must be deducted and included in the 2015 year of assessment:

Exchange loss (deferred)		
€80 000 x (12,90 – 12,75)	(12 000)	(2)
Exchange profit on realisation		
€80 000 x (12,10 – 12,90)	64 000	(2)

The exchange differences iro the loan from Mrs. Carter, a connected person, must be deferred till the realisation date iro s24I(10A). An exchange gain of R72 000 (€80 000 x (11,60 – 12,50)) must be included in the 2015 year of assessment. (2)

3. X-treme must include the following deemed interest iro s24J(3):

	R	
R600 000 x 17,50653%	= 105 039	(1)
(R600 000 + R105 039 – R60 000) x 17,50653% x ¹⁰⁶ / ₁₈₄	= <u>65 054</u>	(3)
	<u>170 093</u>	

X-treme can claim the following as a deduction iro s24J(4A)(a):
R600 000 – R710 093 (R600 000 + R170 093 – R60 000) = (R110 093) (2)

Since X-treme is not a dealer in financial instruments, the R50 000 loss (Selling price (R550 000 less cost price (initial amount) (R600 000)) is a capital loss and must be taken into account for CGT purposes. (See point 6 below). (2)

4. X-treme must include the interest accrued ito s24J and can claim a s 24 debtors allowance.

		Capital	VAT	Fin cost	Total
		400 000	56 000		456 000
31/10/2014	Interest	-	-	54 720	54 720
31/10/2014	Installment	(118 539)	(16 596)	(54 720)	(189 855)
		<hr/>			
		281 461	39 404	-	320 865
31/10/2015	Interest			38 504	38 504
31/10/2015	Installment	<u>(132 764)</u>	<u>(18 587)</u>	<u>(38 504)</u>	<u>(189 855)</u>
		148 697	20 817	-	169 514

The 2015 tax implication is therefore:

	<u>R</u>	
Interest accrued (s24J)	38 504	(2)
Add: S24 debtors allowance for 2014 ($\frac{400\,000 - 250\,000}{400\,000} \times R281\,461$)	105 548	(2)
Less: S24 debtors allowance for 2015 37,5% x R148 697	(55 761)	(2)

5. X-treme can claim R15 000 ((R4 - R1) x 5 000)) per employee as a deduction ito s 11(IA). The shares were granted in the 2014 year of assessment and therefore R10 000 per employee were already claimed as deduction in 2014 (the maximum per employee per year).

The deduction for the 2015 year of assessment is therefore R5 000 x 10 = R50 000 (2)

X-treme must deduct employees' tax (1) on the profit of R30 000 ((R7 - R1) x 5 000)) which must be included in Employee Vertrek's gross income in terms of s8A. (1)

6. CGT CALCULATION

Capital loss	<u>(50 000)</u> See point 3 above
Net capital loss	<u>(50 000)</u>

The net capital loss must be carried forward to the 2016 year of assessment. (1)

Question 2 – Suggested Solution

40 Marks

Part (a)	MARKS
DCC is a private company (Pty Ltd).	1
One must therefore consider its public interest score (PIS) in order to address the question.	1
<u>Financial reporting framework</u>	
In terms of regulations issued in terms of the Companies Act, a company with a PIS of more than 350	1
must apply either IFRS or IFRS for SMEs .	2
Based on the available information, DCC's PIS appears to exceed 350 due to:	
- It has than 400 employees (this would already result in a PIS of at least 400).	1
- Its annual turnover is R360 million (this would add another 360 PIS points to the score).	1
DCC must therefore apply either IFRS or IFRS for SME's.	1
The company applies an internal financial reporting framework and is therefore non-compliant with statutory provisions.	1
<u>Assurance (audit or review requirement)</u>	
Company's with a PIS of more than 350 are required to be audited.	1
If a company's financial statements are audited, no independent review is necessary.	1
The Companies Act provides for an exemption from audit and review where all shareholders in the company are also	1
directors (section 30(2A)).	

- (b)
- The R20 million advance payment from the customer was not included in revenue for accounting purposes. 1
- Amounts are included in gross income at the earlier of receipt or accrual (Silverglen Investments case principle). 1
- The R20 million must therefore be adjusted for (added to taxable income). 1
- The sale to the customer on 26 December 2015 was included in revenue (accounting) at present value. 1
- Amounts are included in gross income at face value (proviso to definition of gross income). 1
- The difference of R100 000 must therefore be adjusted for (added to taxable income). 1
- 2
- All raw materials are purchased from Banca Ltd, a connected person (holds more than 20% of shares - s1 definition) 2
- There is a risk that prices charged are not at arm's length which could invoke transfer pricing provisions in s31. 1
- 3
- Interest of R1 000 was charged on a R1 million loan to a shareholder. 1
- Rate charged therefore 0.01%. 2
- Since the shareholder is a natural person SA resident and the loan appears to have been granted due to his shareholding, there is a risk that the interest charged below market interest (SARS official rate) is a deemed dividend. 1
- 4

	Share-based payment does not qualify for s11(IA) deduction since it is not a broad-based scheme as contemplated in s8B.	1
	It also does not qualify for the s11(a) deduction since no expenditure was incurred (Labat case).	1
	Therefore the share-based payment must be adjusted for (added back to taxable income).	1
5	A "book loss" of R2 million was recognised on the share investment for accounting purposes.	1
	Losses are only deductible when actually incurred (s11(a)).	1
	The R2 million must therefore be adjusted for (added back to taxable income).	1
	Section 24J allows a deduction for interest when it is incurred in the production of income.	1
	The interest on the loan was incurred to derive dividend income which is exempt (therefore not "income").	1
	In addition, section 23(f) prohibits the deduction of expenditure incurred to produce exempt income.	1
	The R500 000 must be added back (adjusted for).	1
6	The restraint of trade payment was made to a company (therefore not deductible in terms of s11(cA)).	1
	Section 23(l) further prohibits deducting this amount (specifically because it does not qualify for the special deduction).	1
	Traffic fines are unlawful activities and the deduction is prohibited in	1

terms of
s23(o).
Penalty on late submission of VAT return is not tax deductible
(s23(d)).

1

The abovementioned prohibited deductions must be
reversed

1

(added back to taxable income).

Knowledge components tested in this question:

Analysis & Interpretation of Financial Statements	AVAILABLE	28
	MAX	25

Question 3 – Suggested Solution

40 Marks

	Input VAT	Output VAT	MARKS
QUERY 1 (8 marks)			
The transport of fare-paying passengers to Lesotho (outside SA), by road, is zero-rated (i.e. a taxable supply).			1
Transport of fare-paying passengers in the Mangaung area (in SA) by road is an exempt supply			1
Taxable supplies (540 000/900 000)	60%		1
Exempt supplies (360 000/900 000)	40%		1
Sale of computer (R120 000 x 14/114 x 100%)		14 737	1
s 8(16) of the VAT Act provides that a supply is deemed to be made wholly in the furtherance of Longhaul's enterprise			1
Input tax adjustment - s 16(3)(h)			
Full input tax upon acquisition was denied (R285 000 x 14/114 x 60%)			0.5
14/114 x R120 000 x 40%	(5 895)		1.5
QUERY 2 (15 marks)			
Local sales ((R540 000 + R140 000)*14/114)		83 509	2
Export sales ((R370 000 - R140 000) x 0%) - zero rated		0	1
Interest - exempt supply (financial service)		0	1
Purchase of gold bangles (gold not included as second-hand goods, thus no notional input tax deduction available)			2
	0		
Purchase of used jewel-crafting machine from non-vendor			
- second-hand goods			1
- notional input tax of 14/114 x R96 000	(11 789)		1
Export of used jewel-crafting machine			

-	not zero-rated due to provisions of proviso to s 11(1)		1
-	levy output equal to notional input claimed	11 789	1

Purchase of bakkie

-	Instalment credit agreement		1
-	Not a motor car as defined (thus input not denied)		1
-	Time of supply is 25 September 2015 when deposit is paid		
	Total payments (R10 000 x 60)	600 000	1
	Less: Finance charges	(123 500)	1

Cash value	476 500		
	x 14/114	(58 518)	1

QUERY 3 (12 marks)

	Cost (excl VAT)		
Development costs per townhouse			
- Proportionate share of land (R114 000 x 14/114 x 25)	R100 000	(350 000)	1
- Materials (R570 000 x 14/114 x 25)	R500 000	(1 750 000)	1
- Labour (not part of 'enterprise)	R350 000	0	1
Cost per townhouse	R950 000		

Sale of 19 townhouses (R950 000 x 1.2 x 14%) x 19		3 032 400	3
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Sale of townhouse to shareholder's daughter

- connected person to Marco			
- sale below open market value			
- s 10(4) applicable and output has to be levied out open market value (R950 000 x 1.2 x 14%) x 1			2
		159 600	

Change in use - 2 units to be supplied as dwellings in terms of an agreement for the letting thereof - s 18(1)			1
Open market value (incl VAT) per unit	R1 299 600		1
(R950 000 x 1.2 x 1.14)	x 2		0.5
	x 14/114	319 200	0.5

Change in use - 3 units intended to be sold during 2016			
Temporarily supplied as dwelling - s 18B determines no s 18(1) adjustment			1

QUERY 4 (total of 6 marks limited to 5)

MEMORANDUM

To: Managing Director of Rebel			
From: SAIT Student			1
Date: Nov-15			
Re: Re-opening of VAT assessment			

As per your query on the validity of SARS re-opening your VAT assessment for September 2010, please note the following:

A VAT return is a 'self-assessment' as defined in section 1 of the TAA Act as the taxpayer is responsible for determining the amount of VAT and submitting the return (the VAT 201) which incorporates the determination of the VAT amount. 1

Section 99 of the TAA determines the period of limitations for the issuance of assessments by SARS. 1

In the case of a self-assessment (i.e. a VAT return), SARS cannot issue a return five years after the date of assessment of an original assessment (i.e. five years after 25 October 2010). 1

However, due to the fact that the VAT claimed was incorrect due to the fraud, the limitation of five years does not apply and SARS is within its rights to issue an assessment to Rebel. 2

Question 4 – Suggested Solution

40 Marks

Part A

10 Marks

Steve McGarret is a South African resident for the whole of the 2015 year of assessment.	(1)	
He is ordinarily resident in Pretoria, because:	(1)	
<ul style="list-style-type: none"> • He always returns from his wanderings abroad (Australia for work) to South Africa; • His normal lifestyle is in South Africa; • He works at a Financial Advisory Firm in Pretoria; • He lives with his sister in a security complex in Centurion / family life is in South Africa; 	(1) (1) (1) (1)	} Max: 3
Case law in support of answer		
<i>Candidate must apply information in scenario to principles to obtain marks</i>		
Levene	(1)	
Ratio decidendi	(1)	
Cohen	(1)	
Ratio decidendi	(1)	
Kuttel	(1)	
Ratio decidendi	(1)	
Communication skills – logic and argumentation	(1)	
	Available marks	10
	Max	10

Part B

20 Marks

The issue that needs to be addressed by the Candidate is whether the amount from the disposal of the block of flats is income or capital in nature.

Capital receipts are a result from the disposal of a capital asset acquired as an investment, whilst receipts of an income nature are the result of a scheme of profitmaking.	(1)
Elandsheuwel Farming-case	(1)
Whether Jenny Fuller keeps the flats as an income or capital asset depends on her intention.	(1)
Stott-case	(1)
Jenny's intention with the acquisition is what she says it is (her ipse dixit)	(1)
This is however not decisive.	(1)

The courts will also consider the following factors when they determine Jenny's intention

NB! Candidates must apply facts in scenario to the factors highlighted

- The period which the asset was owned – Jenny owns the flats for 10 years; (1)
- The frequency of property transactions – Jenny does not acquire and dispose of fixed property on a frequent basis; (1)
- The flow of income – Jenny has generated rental (lease) income for the past 10 years; (1)
- Jenny's occupation is that of a physiotherapist –she is not a property-dealer / developer; (1)
- The reason for her sale – Jenny wishes to emigrate to Canada; (1)
- Other valid factors... (accounting, behaviour with disposal etc.) (1)

Max: 4

The indication from the abovementioned factors is that Jenny's initial (original) intention is of a capital nature. (1)

The courts have confirmed that each person is entitled to use his capital assets to his best advantage (Stott case – award mark here if not awarded earlier). (1)

The mere decision to sell does not necessarily change Jenny's intention. (1)
John Bell-case (1)

A change in intention occurs when Jenny does something more than to just realise her assets to her best advantage – Jenny's actions should therefore transform the nature of the asset to that of trading stock. (1)

Jenny must cross the so-called "Rubicon" and embark on a trade of property dealing. (1)

Natal Estates-case. (1)

Conclusion (depending on the merit of Candidate's argument):

If the property is sold as a single unit, there is no indication that there was a change in intention, resulting in the amount being of a capital nature and not being included in gross income. (1)

If the R750 000 is spent, the character of the transaction is changed to realise a bigger profit and can it be seen as a change in intention – the amount is therefore not of a capital nature (therefore income in nature) and consequently not included in gross income. (1)

Communication skills – presentation and layout (1)

Available 21

Max 20

Part C

10 Marks

Expenses will qualify for deduction under the general deduction formula if they meet the positive requirement of s 11(a) AND the deduction is not specifically prohibited by any of the negative provisions of s 23. (1)

In evaluating the deductibility of home office expenditure, the provisions of s 23(b) and s 23(m) must be considered.

Determine whether section 23(m) applies: (1)

Section 23(m) determines that an individual may not deduct any section 11 – expenditure, losses or allowances which are connected to the rendering of any service to an employer or which relates to any office held for which remuneration is received, except the deductions allowed in section 23(m)(i) – (iv). (1)

The provision could potentially apply as Tony Stark is in receipt of remuneration. The definition of “remuneration” in para 1 of the Fourth Schedule includes salary and commission. (1)

The section 23(m) prohibition does not apply if Tony Stark is an agent or representative who receives > 50% of his remuneration from commission.

Percentage of total income earned from commission = $R70\,000 / R120\,000 = 58,3\%$. (1)

As Tony Stark earns more than 50% of his income from commission the section 23(m) prohibition is not applicable. (1)

Determine whether section 23(b) applies: (1)

Section 23(b) determines that expenditure incurred in respect of a part of a residence which is used for trade purposes, can only be deducted if:

- The part is specifically equipped and fitted for the trade; and
- The part is frequently and exclusively used for the trade; and
- The employee earns his income mainly from commission and carries out his duties mainly (> 50%) in a place other than in an office provided to him by his employer OR:
- Duties are performed mainly from the study (s 23(b)(ii)).
- Tony Stark’s study is *specifically equipped for the trade;* (1)
- The study *is frequently and exclusively used for trade purposes; and* (1)
- Tony carries on his duties mainly [70%] from a place other than an office provided to him by his employer. (1)

Tony Stark therefore meets the requirements of section 23(b) and his home office expenses are deductible. (1)

IF the expenditure meet all the requirements of s 11(a) or other deduction provisions, eg s 11(e).

Communication skills – logic and argumentation

	(1)
Available	12
Max	10