

# **OCCUPATIONAL CERTIFICATE: TAX PROFESSIONAL**

SAQA ID: 93624

**Knowledge Competency Assessment**

**November 2016**

**Paper 1**

**QUESTIONS**

<b>CANDIDATE NUMBER</b>									
-------------------------	--	--	--	--	--	--	--	--	--

## 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	Companies	40	Green
2	Analysis of Financial Statements	40	White
3	VAT and Transfer Duty	40	Blue
4	General Income Tax Principles	40	Pink

Total marks: 160 Marks

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 (Tipp-ex) 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.
8. Please take note of the **tax rates and tables provided** in Annexure A to this paper (see page 11).

**QUESTION 1: COMPANIES**

**40 Marks**

Retro (Pty) Ltd is a South African resident company with a 31 December financial year-end. The company sells vinyl music records to the local market. Retro (Pty) Ltd always wants to pay the minimum tax possible while still adhering to South African tax legislation

The company's sole holder of shares is Joan Simmons, a 29-year old South African resident and the company's sole director is Nate Nash, a 32-year old South African resident. Joan does not have any other shareholdings or business interests besides her interest in Retro (Pty) Ltd.

The preliminary income statement of the company for the year ended 31 December 2016 was as follows:

	<b>R</b>
Revenue (sales)	15 000 000
Cost of sales	(10 000 000)
<b>Gross profit</b>	<b>5 000 000</b>
Other income: interest	2 000 000
Employee cost	(1 000 000)
Other operating expenses	(1 500 000)
Finance charges	(500 000)
<b>Profit before tax</b>	<b>4 000 000</b>

The following transactions have not been taken into account in determining the profit before tax above:

1. Purchase of laptop for R6 500 on 31 August 2016. In terms of Interpretation Note: No. 47 and Binding General Ruling: No. 7 a write-off period of three years is allowed on computers.

2. Purchase of passenger vehicle for R200 000 on 1 December 2016. In terms of Interpretation Note: No. 47 and Binding General Ruling: No. 7 a write-off period of five years is allowed on passenger vehicles.
  
3. The director (Nate) authorised a loan of R1 million to Joan Simmons on 1 December 2016 based on her shareholding in the company. The loan does not bear any interest.

<b>REQUIRED</b>		<b>MARKS</b>
(a)	Discuss whether or not Retro (Pty) Ltd is a small business corporation as contemplated in section 12E of the Income Tax Act.	15
(b)	Calculate, supported with reasons and references to relevant legislation, the normal tax payable by Retro (Pty) Ltd for the 2016 year of assessment if assumed that the company is a small business corporation. Start your answer with the profit before tax figure provided. Ignore VAT.	12
(c)	Calculate the normal tax payable by Retro (Pty) Ltd for the 2016 year of assessment if assumed that the company is NOT a small business corporation. Start your answer with the profit before tax figure provided. Ignore VAT.	5
(d)	Briefly discuss, supported by calculations, any possible dividends tax consequences that will arise from the information in the question. Also indicate who will be liable for the dividends tax (if any).	8
<b>TOTAL MARKS</b>		<b>40</b>

**QUESTION 2: ANALYSIS OF FINANCIAL STATEMENTS**

**40 Marks**

You are a registered tax practitioner and was recently appointed (on 1 November 2016) by RaceCo (Pty) Ltd (“RaceCo”) to assist with their tax and financial reporting affairs. The company imports specialised helmets used by racing drivers and motor cyclists for distribution to the local market. RaceCo is a South African resident company.

You have been requested to submit the company’s IT14 corporate income tax return for the financial year ended 31 December 2014 and to review the company’s financial statements to identify any tax risks and instances of non-compliance to tax and company law.

The bookkeeper of the company has prepared the financial statements for the year ended 31 December 2014. He has indicated that he did not use any particular financial reporting framework such as IFRS or IFRS for SMEs as he has no knowledge of these standards.

Your initial inspection of the financial statements indicated that it only consists of a statement of financial position (balance sheet), statement of profit or loss and other comprehensive income (income statement) and statement of changes in equity. No disclosure notes or statement of cash flows have been presented. The financial statements are also not subject to any audit or independent review.

RaceCo is a registered category B Value-Added Tax (VAT) vendor (two-monthly VAT periods). You obtained the following **output tax** amounts from the six VAT201 returns submitted during the 2014 financial year:

<b>VAT PERIOD</b>	<b>OUTPUT TAX AMOUNT</b>
January-February 2014	R120 000
March-April 2014	R235 000
May-June 2014	R333 000
July-August 2014	R323 000
September-October 2014	R528 000
November-December 2014	R760 000
<b>TOTAL</b>	<b>R2 299 000</b>

The holders of shares of RaceCo are the following natural persons:

- Jimmy Bly, a South African resident (also a director);
- Joe Tanto, a South African resident (also a director); and
- Memo Marino, a South African resident (not a director).

You ascertained the following information in respect of the year ended 31 December 2014 after discussions with the financial manager:

- Total sales were R41 million for the year ended 31 December 2014.
- The company had 48 employees throughout the year excluding the two directors.
- As at 31 December 2014, the company had trade creditors of R19.3 million.

REQUIRED	MARKS
Review the information as provided to you and list all your concerns with regards to the financial statements and tax affairs of RaceCo. Specifically advise the company what corrective steps it should take to address each of your concerns listed.	<b>40</b>

**QUESTION 3: VAT AND TRANSFER DUTY**

**40 Marks**

You are a registered tax practitioner and have been approached by one of your clients, Sanjeev Pillay, for advice on a transaction he is considering.

Sanjeev is considering opening a guest house in the coastal town of Ballito in KwaZulu-Natal from 1 November 2016. His focus will be on providing board and lodging, meals, cleaning and laundry services to the many tourists that visit Ballito each year. Sanjeev expects the guest house to collect revenue in excess of R300 000 in its first year of operation. The bulk of the revenue will be collected during the months of December and January when guests are expected to make extended bookings and stay for at least four weeks at a time.

He has identified a property that is suitable for use as a guest house that is available in the market for R2 100 000 (this amount is equal to the property's open market value). It is currently used for residential purposes by a person unrelated to Sanjeev who is not registered for VAT. The extent of the property is 400 square meters. The guest house will occupy 350 square meters while Sanjeev will use the remaining 50 square as his personal residence. He intends to finance the purchase of the property with a mortgage loan.

Sanjeev is uncertain about the VAT consequences of the proposed establishment of the guest house. He is not currently registered for VAT and wants to know whether he would be required or permitted to register and what the consequences of VAT registration would be.

<b>REQUIRED</b>	<b>MARKS</b>
Write a letter to your client, Sanjeev Pillay, advising whether or not he would be required or permitted to register for VAT and what the VAT consequences of registration would be. Also address transfer duty consequences, if any, in your letter. Make reference to legislation where possible.	<b>40</b>

**QUESTION 4: GENERAL INCOME TAX PRINCIPLES**

**40 Marks**

Braai & Barbeque Ltd is a South African resident company that manufactures (considered to be similar to a process of manufacture in the opinion of the Commissioner) gas barbeques and heaters from their factory in Lephalale. They export a number of barbeques each year to a big supermarket in London for distribution there.

Their accountant contacted you as a tax practitioner with a number of problems he encountered while attempting to finalise their accounts and calculate their taxes for the financial year of assessment ending 31 October 2016:

**QUESTION 4: PART A**

The company sells its barbeques with a four year guarantee in respect of the gas connection between the barbeque and the gas bottle. Each year a number of barbeques are sent back for repairs in terms of the guarantee and the accountant noted that the average repairs the past five years amounted to R60 000 per financial year of assessment. He would like to deduct this amount, but indicated that actual repairs only amounted to R25 000 for the current year of assessment.

Furthermore, the company pays a full time repairman to be available at the supermarket in London should any repairs be reported there. The salary for the repairman is £250 per month and on average the exchange rate for the year they paid R48 000 for his wages.

<b>REQUIRED – PART A</b>	<b>MARKS</b>
Discuss, with reference to relevant legislation and case law, which of the above amounts would be tax deductible for Braai & Barbeque Ltd in respect of the year of assessment ending on 31 October 2016.	<b>13</b>



**QUESTION 4: PART B**

Braai & Barbeque Ltd's driver was seriously hurt in a gas explosion while delivering a barbeque to a private house in Ermelo (South Africa). He delivers and also installs the barbeques and heaters on delivery. The gas bottle was deficient and exploded while he was connecting it to the newly delivered barbeque. The driver is claiming damages from the company to the amount of R1 500 000 as he is not able to drive any more. They incurred legal costs amounting to R25 000 in respect of the claim and had to pay both amounts.

<b>REQUIRED – PART B</b>	<b>MARKS</b>
Advise Braai & Barbeque Ltd what amounts, if any, the company can claim as a deduction for income tax purposes for the year of assessment ending on 31 October 2016. Your answer must also include references to relevant case law and legislation, where appropriate.	<b>12</b>

**QUESTION 4: PART C**

Braai & Barbeque Ltd had a competition at the Rand Show for the barbequer of the year on their barbeque and Peter Nkabinde, a chef at a top restaurant in Johannesburg, came first. The prize was R100 000 and a barbeque worth R25 000 from the company. Peter contacted the company's accountant to find out if he must include this in his tax return.

<b>REQUIRED – PART C</b>	<b>MARKS</b>
Explain to Peter, supported with reference to relevant tax legislation, the possible tax implication(s) of the prize. Also consider tax legislation relating to employment.	<b>5</b>

<b>QUESTION 4: PART D</b>
---------------------------

Braai & Barbeque Ltd had their financial statements audited during the previous year of assessment and paid audit fees amounting to R880 000. Their main business is the gas barbeque and heater factory earning them R20 million for the 2015 year of assessment. The company does however have a big investment in the stock exchange earning South African dividends of R80 million for that year of assessment.

On its tax assessment the SARS only allowed  $R20/80 + 20 \times R880\ 000$  of the audit fee – therefore pro-rata to the non-exempt income, as they noted that the dividends were exempt from tax. The accountant contacted the auditors and they confirmed that more than 92% of the audit was spent on verifying and checking the gas barbeque and heater factory and its income.

<b>REQUIRED – PART D</b>	<b>MARKS</b>
Discuss, with reference to relevant legislation and specific case law, how the audit fee should be treated by the SARS for normal tax purposes.	<b>10</b>

**ANNEXURE A**

**Small Business Corporations:**

<b>Tax Rates for Small Business Corporations</b> (Applicable in respect of years of assessment ending on or after <b>1 April 2016</b> )	
<b>Taxable income (R)</b>	<b>Rate of tax (R)</b>
0 – 75 000	0%
75 001 – 365 000	7% of taxable income above R75 000
365 001 – 550 000	R20 300 + 21% of taxable income above R365 000
550 001 and above	R59 150 + 28% of taxable income above R550 000

**SARS Official Rate of Interest:**                      **8%**

**Transfer Duty Rates:**

In respect of acquisition of property on or after **1 March 2016**

<b>VALUE OF PROPERTY</b> <b>(Rand)</b>	<b>RATE</b>
0 - 750 000	0%
750 001 - 1 250 000	3% on the value above R750 000
1 250 001 - 1 750 000	R15 000 + 6% of the value above R1 250 000
1 750 001 - 2 250 000	R45 000 + 8% of the amount above R1 750 000
2 250 001 - 10 000 000	R85 000 + 11% of the amount above R2 250 000
10 000 001 and above	R937 500 + 13% of the value exceeding R10 000 000