Tax Professional

Knowledge Competency Assessment

JUNE 2016

Paper 2

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	Individual & Share Scheme	40	Blue
2	Taxation of Trusts & Farmers	40	White
3	Other taxes and Tax Administration	40	Pink
4	Share Scheme	40	Green

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 note that a **summary of the monetary changes and tax rates** in respect of the **2017-year of assessment** are provided in an **Appendix** at the end of this paper.

Question 1 **40 Marks**

Omphilo Dlamini (Omphilo) is 48 years old and a South-African resident. Omphilo is married in community of property to Derick Dlamini (48 years old and a South-African resident). Omphilo is an engineer based in Johannesburg. Neither Omphilo nor Derick are registered Value-Added Tax (VAT) vendors.

Omphilo provided you with the following information for the year of assessment ending 28 February 2017 in respect of her employment:

	Note	R
Salary	1	750,000
Medical scheme fee contributions (only contributed by Omphilo)	2	24,000
Company car	3	?
Subsistence allowance	4	2,000
Entertainment allowance	5	6,000
Loan from employer	6	?
Pension fund contributions (only contributed by Omphilo)	7	56,250

Additional employment-related information:

1. Omphilo's annual salary for the 2017 year of assessment amounted to R750 000. In addition to her annual salary, her employer paid a variable performance bonus of R27 500 on 19 March 2016, relating to her 2016 year of assessment annual performance appraisal.

2. Omphilo and her employer contribute to a medical scheme on a one-to-one basis. Omphilo is the main member of the medical scheme, her husband and two minor children are registered dependants in respect of the entire 2017 year of assessment. Neither Omphilo nor any of the dependants on the medical aid fund suffers from any disability as defined. Omphilo paid R18 000 medical expenses not recovered from her medical aid.

3. Omphilo was granted the right of use of a Chevrolet Cruze on 1 March 2016. The retail market value at that date amounted to R228 900 (including VAT). The Chevrolet Cruze is subject to a maintenance plan of 3 years and 60 000 kilometres. The cost of the maintenance plan is included in the retail market value of the motor vehicle. Omphilo is

the first person to obtain the right of use of this vehicle. Omphilo pays for the full cost in relating to fuel, licensing, maintenance and insurance of the vehicle.

Omphilo's total actual kilometres as substantiated by her logbook amounted to 29 000 kilometres for the year of assessment ended 28 February 2017 of which 23 000 km is for business purposes.

Her cost for fuel, licensing, maintenance and insurance for the year of assessment amounted to:

	R
Fuel	36,000
Licensing	700
Maintenance	3,200
Insurance	6,000

4. The subsistence allowance granted to Omphilo was to cover incidental cost on a 5-night and 6-day work related business trip to Cape Town. Omphilo does not keep any of receipts for the incidental cost incurred.

5. Omphilo received an entertainment allowance of R6 000 for the year of assessment. This entertainment allowance is used for client meals. Omphilo keeps all her receipts, the total of the receipts for client meals amounts to R5 700 for the year of assessment.

6. Omphilo obtained a loan of R40 000 from her employer on 1 June 2016 at an interest rate of 3% per annum. No payments were made in settlement of the loan during the current year of assessment. The repo rate (repurchase rate) amounted to 7%. None of the funds borrowed were applied for trade or study purposes.

7. Omphilo's employer contributes 7.5% of her annual cash salary to the pension fund. In addition to the employer contribution, Omphilo contributes 7.5% of her cash salary to the pension fund.

8. Omphilo's employer withheld R211 786 Employees' Tax (PAYE) for the year of assessment.

Additional non-employment related information:

1. Omphilo and Derrick value financial freedom. They received the following amounts during the 2017 year of assessment:

	Omphilo	Derrick
	R	R
Local interest	20,000	17,500
Local dividends	3,500	15,000

2. Omphilo contributed R1 000 per month to a Retirement Annuity Fund during the entire year of assessment.

3. Omphilo contributes R15 000 annually to a registered Public Benefit Organisation. Omphilo received the section 18A certificate for the 2017 year of assessment. Omphilo had R5 000 non-deductible qualifying donations carried forward from the 2016 year of assessment.

4. Omphilo and Derrick sold their primary residence (which formed part of their joint estate) for R3 500 000 on 17 May 2016. They purchased their home on 1 August 2008 for R1 750 000.

5. Omphilo inherited Johannesburg Stock Exchange (JSE) listed shares from her grandfather on 1 September 2014. Her grandfather purchased the shares for R800 000. The market value of the shares on the date of her grandfather's death amounted to R1 700 000. She sold the shares for R2 500 000 on 20 February 2017. These shares are excluded from Omphilo and Derrick's the joint estate.

QUERIES:

1. Omphilo's employer will implement a Broad Based Employee Share Scheme in terms of section 8B of the Income Tax Act, No. 58 of 1962 (as amended). Omphilo is uncertain what the tax implications will be when she:
   a) receives the "qualifying equity shares"; and
   b) when she disposes of the "qualifying equity shares".

2. Omphilo is concerned that she needs to be registered as a provisional taxpayer. Her concern is due to her level of "taxable income". She would like to know whether she should be registered as a provisional taxpayer given her level of "taxable income" for the 2017 year of assessment?

QUESTION 1 – REQUIRED		**Marks**
(a)	Calculate the normal tax due by Omphilo Dlamini in respect of the 2017 year of assessment.	30
(b)	Draft a memorandum to Omphilo Dlamini addressing the tax implications arising from her queries. *Communication skills - Layout and Presentation*	9 *1*
TOTAL MARKS		**40**

Question 2 **40 Marks**

PART 1 **(15 marks)**

Michael Harrison (married out of community of property) created an *inter-vivos* trust for the benefit of his wife Tracy, his 18 year old son Trevor and 12 year old daughter Michelle.

Michael sold a rent producing property to the trust at the market value of R15 million. The purchase price was settled by way of a 5% low interest rate loan. A market-related interest rate is 15%.

Other assets in the trust consist of:

1. Cash in the bank of R800 000. This was donated to the trust by Michael's father. The cash is invested in a money market which earns interest at a rate of 6% per annum.
2. A 20% shareholding in an American listed company of which the shares are also listed on the JSE. These shares were donated by Tracy.
3. A 4% shareholding in Telkom, donated by Michael's mother. All receipts from these shares are to be accumulated in the trust for the benefit of Trevor and Michelle. The accumulated funds can only be distributed to them when they reach the age of 30.

In terms of the trust deed the following distributions must be made once a year on 1 June from the net income of the trust:

- An annuity of R20 000 to Tracy, payable from the net interest earned in the trust.
- An annuity of R10 000 to Trevor, payable pro-rata from the net receipts from the rent producing property (92%) and foreign dividends (8%).
- A cash payment of R2 000 to Michelle, payable from the net receipts from the rent producing property.

All other distributions can only be made by the trustees of the trust by way of discretionary payments, and no beneficiary has a vested right to any of the accumulated funds or capital in the trust.

Income and expenditure of the trust for the year 28 February 2017 were as follows:

	Rent producing property	Cash	American shares	Telkom shares	Total
	R	R	R	R	
Receipts/accruals	2 000 000	48 000	60 000	10 000	2 118 000
Tax deductible expenses	(550 000)	(500)	0	0	(550 500)
Interest on loan	(750 000)				(750 000)
	700 000	**47 500**	**60 000**	**10 000**	**817 500**

QUESTION 2 PART 1 - REQUIRED:		**Marks**
(a)	Discuss with reference to case law and the Income Tax Act whether the sale of the rent producing property will be a donation, a settlement or other disposition. Use calculations where necessary to substantiate your answer. ***Ignore Donations tax and CGT.***	10
(b)	Calculate Michael Harrison's taxable income for the year ending 28 February 2017. Supply brief reasons to substantiate your answer.	2
(c)	Calculate Trevor's taxable income for the year ending 28 February 2017. Supply brief reasons to substantiate your answer.	3
TOTAL MARKS		**15**

PART 2 **(25 marks)**

Farmer Nkulu, is a resident of South Africa and is 52 years old. He is married out community of property and has no children. He is mainly a sheep farmer.

The following information relates to his 2017 year of assessment:

	NOTES	R
Sales – Sheep	1	535 150
Purchases		
- Sheep	1	838 500
- Plough	2	137 000
Building of dam		45 000
Wages paid to employees digging the dam		30 000

Repairs to fences		6 000
Prevention of soil erosion		9 000

NOTES

1. Sheep (ewes)details

Market value	R550
Cost	R300
Standard value	R6
Opening stock number: 1 March 2016	350

- 2 795 sheep were purchased during the year. Of these 205 sheep were purchased to replace those which he had to be sold in August 2016 due to drought. Farmer Nkulu elected the provisions of par 13(1)(*a*) of the First Schedule to the Income Tax Act to be applied to him.
- 3 sheep were donated to a PBO, all necessary documentation was obtained.
- 9 sheep were slaughtered - 2 for the farm labourers, 3 for the domestic labourer and 4 for private consumption by Farmer Nkulu.
- 10 sheep was inherited from Farmer Nkulu's father.
- Purchases disallowed in the previous year of assessment (2016) was R55 000.

2. The plough was purchased on 1 May 2016 and brought into use the first time on 31 October 2016.
3. Capital development expenditure brought forward from the previous year was R23 000.

QUESTION 2 PART 2 – REQUIRED	**Marks**
Calculate Farmer Nkulu's taxable income for the 2017 year of assessment.	**25**

Question 3 **40 Marks**

You are the recently appointed (during June 2016) internal tax consultant of DDS Incorporated ("DDS" or "firm"), a resident company in South Africa that operates a large law firm situated in Sandton, Johannesburg.

Shortly after commencing your position, you were tasked to assist with the following tax matters:

MATTER 1

DDS often provides legal services to client called Huger CC. The South African Revenue Service ("SARS") is currently busy with an audit of the VAT affairs of Huger CC.

DDS received a letter from the SARS requesting all the tax invoices issued by DDS to Huger CC in respect of legal services rendered for the past ten years.

The management of the firm is uncertain whether it is obliged to comply with the request from the SARS.

MATTER 2

DDS needs to invoice a client in Pretoria for services rendered. The client has agreed to pay for the legal services and the disbursements (travel expenses to Pretoria incurred by DDS).

The relevant amounts (excluding VAT) are as follows:

Legal service: drafting of contracts	R12 000
Fuel claim: travel to Pretoria	R500
Gautrain tickets: travel to Pretoria	R1 000
Total	**R13 500**

The finance department of the firm is uncertain as to which of the amounts are subject to VAT.

MATTER 3

It was recently discovered that the financial manager made the following error when submitting the income tax return (IT14) for DDS in respect of the year ended 31 December 2012:

Repairs and maintenance was incurred to the amount of R100 000. Unfortunately, the financial manager accidently left out a “0” and only claimed an expense of R10 000. The 2012 tax return was submitted on 1 May 2013 and the 2012 tax assessment was issued on the same date.

He is now uncertain as to the recourse available to the firm to claim the balance of R90 000. Should it be claimed in the current (2016) year? What steps are available to the firm?

MATTER 4

It is unclear whether you, as the internal tax consultant of DDS, are required to be registered or affiliated with a professional body.

QUESTION 3 - REQUIRED:		**Marks**
(a)	Advise management whether the firm is legally obliged to comply with the request from the SARS (refer matter 1).	7
(b)	Advise the finance department on the correct levying of VAT on the transaction. Also indicate the requirements of a valid invoice for VAT purposes. Refer to case law and legislation where relevant (refer matter 2).	15
(c)	Advise the firm as to the possible recourse available to claim the balance of the expense or to have the assessment amended (refer matter 3).	15
(d)	Advise whether you, as the internal tax consultant of DDS, is required to be registered or affiliated with any professional body (refer matter 4).	3
TOTAL MARKS		**40**

Question 4 **40 Marks**

Patrice Motsepe, a South African resident, aged 57, is employed as the financial director of 'African Rainbow Minerals Ltd' (ARM), a South African mining company and registered VAT vendor. Patrice is married out of community of property to Precious, a housewife, aged 42. They have one child, a son named Kabelo, aged 20, who is currently studying at a South African university. None of the above individuals has a 'disability' as defined in the Income Tax Act.

In addition to his cash remuneration, Patrice received a number of non-cash benefits for his 2017 year of assessment:

1. Patrice received a travel allowance of R8 000 per month for the entire 2017 year of assessment. Up until 28 February 2017 he drove an Audi that had cost him R900 000 (including VAT but excluding finance charges) on 1 July 2013. He kept a logbook and travelled a total of 26 000 kilometres in the car for the year, of which 10 000 related to business trips. ARM pays for all fuel in respect of the vehicle and Patrice pays for all maintenance. The amount paid by ARM for fuel was R18 000 for the year. Maintenance cost Patrice R22 000 (including VAT) for the year. In addition, Patrice incurred a total of R110 000 relating to finance charges on the vehicle for the year. On 28 February 2017 Patrice sold the Audi for R940 000. Patrice had maintained proof of his expenses.

2. Although she is not an employee of ARM, ARM gave Precious the use of a BMW 320i that it had acquired at its retail market value of R240 000 (VAT included). Precious had the use of this car throughout the 2017 year of assessment. Precious had to pay for all maintenance costs and half the cost of all fuel. The total cost of fuel (for ARM and Precious) was R14 000 for the year and the total maintenance costs were R12 000 for the year. Precious kept a logbook and travelled 12 000 kilometres during the year of assessment and had maintained proof of her expenses.

3. ARM gave Patrice an interest-free loan of R1 million on 1 May 2016. Patrice used half of this loan to buy shares in a UK company (he holds five per cent of the issued share capital) and the other half to invest in a South African property Real Estate Investment Trust (REIT). The UK company is not a ‘controlled foreign company’ for the purposes of section 9D of the Income Tax Act.

   Patrice received dividends of £1 000 (after withholdings tax of five per cent) from the UK company. Patrice has elected to use the average exchange rate for the year, which was: R11 = £1.

The property collective investment scheme paid Patrice dividends of R25 000 for the year.

The full amount of the loan was still outstanding at 28 February 2017.

4. On 1 December 2014, Patrice was awarded the option to acquire 1 000 shares in ARM for a consideration of R5 per share. Once he exercises his option and acquires a parcel of 1 000 shares, he cannot dispose of them for a period of one year from the date of acquisition thereof. The offer is not in terms of a ‘broad-based employee share plan’ subject to section 8B of the Income Tax Act.

   Patrice exercised his right and acquired 1 000 shares at R5 per share on 1 December 2015. The market value of the shares was R8 per share on 1 December 2015. The market value amounted to R14 per share on 1 December 2016. He sold the shares for R16 per share on 1 February 2017.

5. During the 2017 year of assessment, ARM settled a debt of R3 200 that Patrice owed to The City of Johannesburg.

6. Precious and Kabelo are registered as dependants on Patrice’s medical aid. ARM contributed R1 200 per month from March up to and including November 2016 and R1 500 per month for the remainder of the 2017 year of assessment, towards medical aid subscriptions in respect of Patrice. Patrice also contributed R1 000 per month towards these subscriptions for the entire year. ARM also paid medical expenses of R5 000 (none of which were recoverable) in respect of an illness suffered by Precious. Patrice paid total medical expenses (none of which were recoverable) of R10 000 for the year.

7. Patrice’s cash salary was R40 000 per month for the entire 2017 year of assessment. Patrice contributed ten per cent of this amount to a staff pension fund (a defined ‘contribution component fund’) and ARM contributed an equal amount to the fund. You may assume that Patrice’s ‘remuneration’ is correctly calculated as R831 482 in respect of the 2017 year of assessment.

8. Patrice was awarded a non-pensionable cash bonus of R50 000 on 1 January 2017 for being promoted from manager to director of ARM.

9. Patrice is bringing forward an assessed capital loss of R25 000 from his 2015 year of assessment. He made no capital gains or capital losses in his 2016 year of assessment, but made a capital gain of R6 000 during his 2017 year of assessment on the sale of a dormant property.

You may assume that the official rate of interest remained constant at seven per cent *per annum* throughout the 2017 year of assessment.

QUESTION 4 – REQUIRED		**Marks**
Show all your calculations and round all amounts off to the nearest Rand. You need not discuss any case law or provide references to any legislation.		
(a)	Discuss the tax consequences of the shares options (refer to transaction 4) in respect of the 2015, 2016 and 2017 years of assessment from Patrice Motsepe's point of view. Your answer must be supported by calculations and short explanations.	10
(b)	Ignore transaction nr. 4 (the share options). Calculate the normal tax liability (after all applicable rebates) of Patrice Motsepe in respect of the 2017 year of assessment. • Your answer must be structured in the format applicable to natural persons. • Also indicate, with a reason, if an amount has a Rnil impact on the taxable income calculation. • Show all amounts that are to be carried forward to his 2018 year of assessment. • You may ignore employees' and provisional tax.	30
TOTAL MARKS		**40**

*****END OF PAPER 2*****

APPENDIX:

MONETARY CHANGES IN RESPECT OF THE 2017 YEAR OF ASSESSMENT

Applicable in respect of years of assessment commencing **on or after 1 March 2016 (i.e. 2017 year of assessment)** – *unless specifically stated otherwise*

REBATES (section 6)
Primary rebate increases from R13 257 to **R13 500**;
(Secondary and tertiary rebates remained unchanged)

MEDICAL CREDITS (section 6A)
Benefits to the taxpayer: R270 increases to **R286**;
Benefits to the taxpayer and one dependant: R540 increases to **R572;**
Benefits to each additional dependant: R181 increases to **R192**.

SECTION 9D inclusion adjustment if the resident is a natural person (section 9D(2A)(f))
For purposes of paragraph 10 of the Eighth Schedule: 33,3% increases to **40%** of that company's net capital gain for the relevant foreign tax year if the resident is a natural person.

RESIDENTIAL ACCOMMODATION (paragraph 9 of the Seventh Schedule)
Symbol B of R73 650 increases to **R75 000**.

CGT INCLUSION RATES (paragraph 10 of the Eighth Schedule)
In the case of a natural person or a special trust (as defined in s1): 33.3% increases to **40%**
In the case of a company and a trust (not being a special trust): 66.6% increases to **80%**

RATES OF NORMAL TAX

- In respect of the taxable income (excluding any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit or severance benefit) of natural persons, estates and special trusts

Taxable Income (R)	Rate of Tax
0 – 188 000	18% of each R1
188 001 – 293 600	33 840 + 26% of the amount above 188 000
293 601 – 406 400	61 296 + 31% of the amount above 293 600
406 401 – 550 100	96 264 + 36% of the amount above 406 400
550 101– 701 300	147 996 + 39% of the amount above 550 100
701 301 and above	206 964 + 41% of the amount above 701 300

- **Small business corporation (as defined in s12E)**
  (Applicable in respect of years of assessment ending on or after April 2016)

Taxable Income (R)	Rate of Tax
0 – 75 000	0% of taxable income
75 001 – 365 000	7% of taxable income above 75 000
365 001 – 550 000	20 300 + 21% of taxable income above 365 000
550 001 and above	59 150 + 28% of the amount above 550 000

TRAVEL ALLOWANCE

Value of the vehicle (R)	Fixed cost (R p.a.)	Fuel cost (c/km)	Maintenance cost (c/km)
0 – 80 000	26 675	82.4	30.8
80 001 – 160 000	47 644	92.0	38.6
160 001 – 240 000	68 684	100.0	42.5
240 001 – 320 000	87 223	107.5	46.4
320 001 – 400 000	105 822	115.0	54.5
400 001 – 480 000	125 303	132.0	64.0
480 001 – 560 000	144 784	136.5	79.5
Exceeding 560 000	144 784	136.5	79.5

Alternative fixed rate for certain reimbursive travel allowances: **329** cents per kilometer (previously 318 cents)

SUBSISTENCE ALLOWANCE

- Local travel:
  - Allowance for incidental costs only – **R115** (previously R109) for each day.
  - Allowance for meals and incidental costs – **R372** (previously R353) for each day.
- Overseas travel:
  - Actual accommodation plus a prescribed amount based on the relevant country (which amount will be provided in the ITC if it differs from the amount listed in the Regulation in the SAICA Student Handbook).

TRANSFER DUTY (Section 2(1)(b) of the Transfer Duty Act)

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

Value of property (R)	Rate
0 – 750 000	0%
750 001 – 1 250 000	3% of the value above 750 000
1 250 001 – 1 750 000	15 000 + 6% of the value above 1 250 000
1 750 001 – 2 250 000	45 000 + 8% of the value above 1 750 000
2 250 001 – 10 000 000	85 000 + 11% of the value above 2 250 000
10 000 001 and above	937 500 + 13% of the value above 10 000 000

REPO RATE (“REPURCHASE RATE”)

Increased from 6.75% to **7%** as from 17 March 2016 (thus effective as from **1 April 2016** for purposes of determining the official rate of interest