Tax Professional

EISA Supplementary Examination

July 2017

Paper 2: Solution

South African Institute of Tax Professionals

PROFESSIONAL WRITING: PART A

Aspect of the answer	Details of aspects to be included in answer	Marks	Marks obtained by candidate
Format of opinions	Clients address, date, subject line	1	
Layout of opinions	Layout of opinion is professional. Has an introduction that refers to the clients' emails. Uses headings/ or numbering where appropriate. For 1.2, each query is addressed under a separate heading as requested	1	
Language used in opinion	Clear and concise professional language that achieves the aim of providing taxpayer-centred advice. The advice should be useful to the client and should not create confusion or further uncertainty. Nor should the advice contain irrelevant technical detail. Flow of arguments should be logical, clear and concise.	2	
Views in opinions based on authority	No unfounded views or statements, reference to legislation, practice notes and case law where appropriate. However, where refer to authority, this reference is accurate and relevant	1	
Limitation of liability	In the letter (preferably at the end) or in a separate cover letter to the client, the advisor's limitation of liability should be provided.	2	
		Available: 7 **Max: 7**	

PROFESSIONAL WRITING: PART B

Aspect of the answer	Details of aspects to be included in answer	Marks	Marks obtained by candidate
Format of objection letter	SARS address, date, subject line	1	
Layout of objection letter	Layout of objection letter is professional. Has an introduction that refers to the assessment. Sets out the law and application of law to the facts. Uses numbering where appropriate and uses headings for each of the items as requested (grounds, request for remission of penalty etc)	2	
Language used in opinion	Clear and concise professional language that achieves the aim of providing a well reasoned argument to SARS. The tone should be respectful. The letter should be concise and should not contain irrelevant technical detail. Flow of arguments should be logical and clear.	2	
Views in opinions based on authority	No unfounded views or statements, reference to legislation, practice notes and case law where appropriate. However, where refer to authority, this reference is accurate and relevant	1	
		Available: 6 **Max: 6**	

No	Aspect of the answer	Marks	Candidate Mark obtained
	PART A		
1	**Opinion - Aria Govender – Response to EMAIL 1**		
	Identification of s42 asset-for-share transaction as appropriate section	1	
	Requirements		
	Person disposes of an asset - Aria disposes of various assets	2	
	Market value equal to or exceeds base cost - market value of the property, furniture, computer equipment and motor vehicles exceeds the base cost of those assets per the schedule provided (Base cost = original cost less allowances)	2	
	Disposal must be to a company that is a resident - Aria would need to ensure the Newco would be a SA resident company	2	
	Disposal is in exchange for the issue of equity shares - Aria would receive shares in the company in exchange for the assets, and she should ensure that these shares are 'equity shares' as defined.	2	
	At the close of the day the asset is disposed of, the person must hold a qualifying interest (10%) in the company - Aria will hold 100% as the sole shareholder	2	
	Company must acquire the assets as capital assets if the person held as such - evidently Aria held the assets as capital assets, therefore Newco must acquire the assets as capital assets	2	
	Relief		
	No recoupments: The legislation explicitly states that no allowance is recouped on disposal [s42(3)(a)(i)]	2	
	No CGT: The assets would be deemed to have been disposed of for base cost therefore no CGT arises [s42(2)(a)(i)(aa)]	2	
	Rollover of base cost to Newco and Newco may continue to claim capital allowances.	1	
	VAT		
	Identification of potential relief in s8(25) of the VAT Act.	1	
	If Aria were to do the following, she and Newco would be deemed to be one and the same person for VAT purposes, which would mean that no VAT would arise:	1	
	- ensure that Newco is registered for VAT	1	
	- ensure that Aria and Newco agree that the business will be disposed of as a going concern	1	

No	Aspect of the answer	Marks	Candidate Mark obtained
	- this agreement must be in writing	1	
	NOTE: requirements under s11(1)(e) also accepted here, up to a max of 3 marks	**Available: 23 Max: 19**	
2	**Opinion – Siv Maswana – Response to EMAIL 2**		
	Query 1		
Query 1	Loan 1: As the loan was used to fund the acquisition of a vacant piece of land [which is an asset as contemplated in para12A(2)(a)(i)] which is ostensibly still on hand, the reduction amount of R2 million would reduce the para 20 base cost of the land from R2million to Rnil. Ref: para 12A(3). However, since the parties to the debt (PBholdo and PBopco) are part of the same group of companies (per the s41 definition - more than 70%), para 12A does not apply Ref: para12A(6)(d). Therefore, there are no income tax and/or CGT consequences in respect of the waiver of Loan 1.	6	
	Loan 2: As the loan was used to fund the acquisition of trading stock which is no longer on hand, the reduction amount of R500,000 would result in a recoupment of the previous deductions in the amount of R500,000. Ref: s19(5). This represents and immediate tax cost of R140,000 (500,000 x 28%) for the 2016 yoa.	3	
	Loan 3: The reduction amount is R80,000 (160,000 x 50%). The loan was used to fund a dividend, but para12A and s19 of the Act (which deal with debt reductions) do not provide for this situation (i.e. the Act is silent on the effect where the loan was used to fund a dividend), which means there would arguably be no tax consequences. However, as per SARS IN91 (pg 69), the loan reduction should first be allocated against interest and then against capital. Since the interest was claimed as a deduction, the R60,000 must be recouped in accordance with s19(5). However, this raises a further issue. As the interest was incurred on a loan used to fund a dividend, the interest should not have been deducted [prohibited in terms of s23(f)] in the 2015 and 2016 yoa. Thus the correct approach would be to re-open the 2015 assessment to correct the interest deduction and to ensure the 2016 tax return does not reflect the interest as deductible. Then there would be no s19 tax consequences on the waiver of the R160,000 loan balance.	6	

No	Aspect of the answer	Marks	Candidate Mark obtained
		Available: 15 Max: 12	
	Query 2		
Query 2	Identification of issue: whether the R189,540 should be included in gross income (and thus in taxable income in the 2016 y.o.a) as an amount 'received by' PBopco per the definition of gross income in section 1.	1	
	Marks awarded for identification of relevant cases (2) and the appropriate application of the principles from such relevant cases to the facts (4) *Examples of potential arguments are provided below for study purposes.* In Geldenhuys v CIR [(1947 CPD; 1947 (3) SA 256 (C)] the court held that the words 'received by' mean received by the taxpayer on his / her own behalf and for his / her own benefit. Since the cash paid by customers in respect of the gift cards was non-refundable, the PBopco received such cash for their benefit. In Brookes Lemos Ltd v CIR [(1946 AD; 1947 (2) SA 976 (AD)] which dealt with the receipt of deposits, it was noted "*that the deposits became the absolute property of the company and they could use them as they pleased; and the fact that they had undertaken an obligation to pay to such of their customers as returned containers an amount equivalent to the amount which they had paid as deposits did not constitute the company a trustee with regard to those deposits"* In the context of PBopco, the amount received in respect of the gift cards became the absolute property of PBopco. This argument is strengthened further by the fact that since the cards were non refundable, there was no obligation to repay (unlike in the deposit case above and in Pyotts case). In Greases (SA) Ltd v CIR [1951 (AD); 1951 (3) SA 518 (AD)], deposits were not deposited into a separate trust account but utilised for the benefit of the company and it was held that the deposits should be included in taxable income. In the context of PBopco, the monies were transferred into the 'general-purpose transactional bank account' and not into a spate trust account. Therefore it appears the funds were able to be utilised for the benefit of the company, which further strengthens the case for inclusion in gross income. Any other relevant cases (e.g. ITC1346, Witwatersrand Association of Racing Clubs, Pyotts' case) and associated arguments. Marks also awarded if students try to create an argument with reference to the Consumer Protection Act No.68 of 2008.	6	

No	Aspect of the answer	Marks	Candidate Mark obtained
	Conclusion: The proposed treatment is incorrect. Since PBopco has the use of the gift card receipts and since there is no evidence to suggest that BPopco is in any way acting as a trustee in relation to these receipts, it is submitted that the full amount of R189,540 should be included in gross income in the 2016 year of assessment.	1	
		Available: 8 Max: 6	
	Query 3		
Query 3	In order for BPdormant to carry the assessed loss from 2014 into 2015, it must have carried on a trade in 2015. Otherwise, it will forfeit the right to carry forward its balance of assessed loss under s20(1)(a) into 2015 (SA Bazaars) which means it will also be lost and nothing would be available to utilise against the taxable income in 2016.	2	
	The mere fact that PBdormant kept itself alive in 2015 (maintaining a bank account, preparing financial statements, conducting board meetings) is not sufficient to be considered as 'carrying on a trade'. (SA Bazaars, ITC1802, any other relevant cases. See also IN33 at pg 6 'expenses such as audit and secretarial fees, bank charges, depreciation, interest paid and stationery are not necessarily indicative of trading')	2	
	As per ITC496, in which it was determined that the earning of interest on funds advanced by a holding company to its subsidiary was held not to constitute the carrying on of a trade, the earning of interest on the positive bank balance cannot be said to be 'carrying on of a trade'. (other relevant cases also accepted)	2	
	Conclusion: The 2014 assessed loss will be lost in 2015 and therefore it will not be available to set off against taxable income in 2016.	1	
		Available: 7 Max: 6	

No	Aspect of the answer	Marks	Candidate Mark obtained
	PART B		
1	**NOO1 form review**		
1	Disagree. This is the year in dispute, not the current tax year. Therefore, it should be updated to reflect ‘ 2016’.	2	
2	Disagree. The provisional taxes paid are not in dispute, therefore these amounts should be removed and the fields left blank.	2	
3	Disagree. The numbers in the first columns and second column should be swopped around.	2	
4	Disagree. This an income tax dispute, despite that fact that some administrative penalties have been levied.	2	
		Max: 8 Avail: 8	
2	**Objection Letter**		
	The Law		
	Section 11(a) of the Act provides for a deduction in respect of expenditure and losses actually incurred in the production of income, provided such expenditure and losses are not of a capital nature. Section 23(e) of the Act states that no deductions shall be made in respect of income carried to any reserve fund or capitalised in any way. The creation of a provision does not represent an incurrence of expenditure and should be added back in the tax computation in order to provide for the difference between the accounting treatment and the tax treatment.	2	
	Application		
	Marks awarded for presenting SARS with the factual information in order to reveal SARS’ error to them (5 marks) *Example of a potential response provided below for study purposes* In the letter of audit findings dated 1 April 2017 (ANNEXURE 3), it is stated in paragraph 1.1:	5	

No	Aspect of the answer	Marks	Candidate Mark obtained
	"The company claimed a deduction for provisions for warranties amounting to R4,829,645 in the 2016 income tax return." The taxpayer is not in agreement with this statement. The amount of R4,829,645 relates to the closing balance of the provision for bonus reflected on the balance sheet. The opening balance of the provision for bonus is an amount of R153,895. The net movement in the provision for bonuses for the 2016 fiscal year is R4,675,750. In accordance with the accounting treatment of provisions, the amount of R4,675,750 in respect of the net movement in provision for bonuses, reduced the net profit before tax for the 2016 fiscal year. Therefore, in order to correctly account for the difference between the accounting and tax treatments, the income statement expense of R4,675,750 should be added back in the tax computation. The taxpayer correctly added back the R4,675,750 in its tax computation. This was effected by adding back the closing balance of R4,829,645 and subtracting the opening balance of R153,895. Please refer to the relevant tax schedules in support of this (Annexure 4). The adjustment described in SARS letter of audit findings (Annexure 3), has resulted in a double add back of the closing balance of the provision for warranties.		
	Request for remission of underestimation penalty		
	Fourth Schedule: The taxpayer respectfully requests that the Commissioner exercise his discretion to remit the underestimation penalty imposed in terms of para20(1)(a) **[1]** of the Fourth Schedule to the ITA, as contemplated in para 20(2) **[1]**, taking in to account the following: • The estimate was seriously calculated with due regard to the factors having bearing thereon since the provisional tax calculation took the reversal of the warranty provision into account the second provisional tax calculation was so accurate such that there would have been no tax payable on assessment, had SARS not erred in double counting the closing balance add back of the warranty provision **[2]**; and • Estimate was not deliberately negligently understated. In fact, the estimate was not understated at all as it aligned with the final tax calculation as provided in the 2016 ITR14, which should be the final calculation should SARS concede that there was no basis in law for the adjustment reflected in the original assessment **[2]**.	6	

No	Aspect of the answer	Marks	Candidate Mark obtained
	TAA: As para20(2) of the Fourth Schedule **[1]** deems the underestimation penalty to be a percentage based penalty in terms of Chapt 15 of the TAA (ie s213 of the TAA), we respectfully request that SARS act upon s217(3) of the TAA **[1]** which empowers SARS to remit a penalty imposed under s213 (as is the present case), since: (a) the penalty has been imposed for 'first incidence' ('first incidence' is defined in s208 of the TAA with reference to the last 36 months and in this case, no such penalties have been levied in the last 4 year**[2]**); AND (b) Reasonable grounds for the noncompliance exists (in this scenario, there was arguably no non-compliance, but in any event there were reasonable grounds for the treatment of the warranty provision as set out in our grounds of objection above. **[2]**. (c) the non-compliance in issue has been remedied since it is submitted that the adjustment SARS have to add back the closing balance of the warranty provision was in fact already included in the ITR14 submitted to SARS **[2]**	8	
	Request for remission of understatement penalty		
	'Understatement' per section 221 of the TAA means any prejudice to SARS or the fiscus as a result of • A default in rendering a return • An omission from a return • An incorrect statement in a return or • If no return is required, the failure to pay the correct amount of tax Based on the responses provided above, no default exists in our opinion **[1]** in respect of the warranty provision since we are of the view that the statements provided in the 2016 ITR14 were correct. Nevertheless, we respectfully request that the substantial understatement penalty be remitted as required by s223(3) **[1]**, based on the following: The taxpayer made full disclosure of the tax treatment of the warranty provisions by the date the return was due since the opinion from the registered tax practitioner setting out the background facts, was uploaded along with the ITR14 **[1]**; and	7	

No	Aspect of the answer	Marks	Candidate Mark obtained
	The taxpayer was in possession of an opinion by a registered tax practitioner **[1]** that was issued before the return was due (the return is only due on 30 June 2017, but the opinion was issued before that date) **[1]**, it took account of the specific facts and circumstances of the warranty provision **[1],** and it confirmed that the taxpayer's position is more likely than not to be upheld if the matter proceeds to court **[1]**.		
	Request for suspension of payment		
	We are aware that the taxpayer's obligation to pay tax is, in terms if s164(1) of TAA, not automatically suspended by an objection or appeal. We therefore respectfully request suspension of payment in terms of s164(2) **[1]** of the TAA, taking into consideration the following (as contemplated in s164(3)(a)-(e) of the TAA): • The recovery of tax is not in jeopardy and there is no risk of dissipation of assets – our compliance history and good standing with SARS supports this **[1]** • Our compliance history with SARS is excellent **[1]** • The origin of the dispute was not fraud **[1]** • The payment will result in irreparable hardship to the taxpayer and this is not justified since there is no prejudice to SARS or the fiscus since SARS has proposed a double inclusion in taxable income **[1]** • *(Note: no security has been tendered thus subpara (e) not applicable)*.	5	
	Remission of interest		
	We respectfully request that the Commissioner waive the interest levied on the original ITA34, as in terms of s89quat(3) **[1]**, the interest is payable as a result of circumstances beyond the control of the taxpayer, namely SARS double add back of the closing balance of the warranty provision **[2]**	3	
	Note to marker: Although the question specifically requires the candidate to prepare an objection, bonus marks may also be awarded if the candidate identifies that the taxpayer may request a reduced assessment in terms of s93 of the Tax Administration Act. 2 bonus marks of identification of s93(1)(d)(i).		
		Available: 36 Max: 36	
	TOTAL	**100**	

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