

Occupational Certificate Tax Professional

External Integrated Summative Assessment (EISA)

SAQA ID: 93624

November 2017

DAY2: Paper 3 - Individuals Taxation

CASE STUDY AND REQUIRED

CANDIDATE NUMBER									
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Instructions to Candidates

1. Candidates must answer **two** of the following three papers:
Paper 3, Paper 4 or Paper 5.
2. This is Paper 3. It is an external integrated summative assessment paper with case study and required.
3. Time: Day 2: 8 hours (Choice of 2 of the 3 papers)
4. Enter your examination number on each document and save all documents with your examination number.
5. Your name must not appear anywhere in the answer books or saved documents.
6. Answer the questions using effective presentation skills and pay 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 assessment stationary is handed in to the invigilator before leaving the examination room and saved documents are forwarded as per assessment requirements.
8. Open book policy applies. All solid bounded books are allowed.
9. Candidates have full access to the internet.
10. The assessment is only available in English and is typed.
11. Total marks for Paper 3: 50
12. Pass mark: 50 % pass is required per paper and competence achieved on all exit level outcomes per paper.

CASE STUDY

SCENARIO

50 MARKS

Mr Anil Naidoo, age 47, is the sole proprietor of New Packaging Enterprises. Anil is a South African resident and lives in Benoni, Gauteng. He is divorced and has two children. He started his sole proprietorship on 1 January 2010, to fulfil his lifelong dream of owning his own business. Having himself worked in the gift bag manufacturing industry for 15 years before starting the business, he felt he had the knowledge of creating trendy gift bags and packaging that will assist him in developing his business in South Africa.

New Packaging Enterprises ('NPE') is a registered Value-Added Tax ('VAT') vendor and a registered employer for employees' tax purposes. NPE is wholly making taxable supplies in its manufacturing and retail business. NPE is a Category B vendor and is situated in central Gauteng. NPE manufactures and retails gift bags and specialised packaging locally.

Anil is a friend of one of the audit partners, Mr Paul West, at LMN Incorporated ('LMN'). You are also employed by LMN as a tax manager in the Tax Department. Anil contacted Paul after he received an additional assessment from the South African Revenue Service ('SARS') in respect of the 2017 tax year. Anil is very distressed as SARS has disallowed some of the expenses that he claimed on his 2017 ITR12 tax return. Anil now owes SARS money and, in addition, SARS has levied penalties.

Today is 13 December 2017. The office is very quiet as most staff are already on leave for the December holidays. Paul asked that you accompany him to his meeting with Anil today. At the meeting you were provided with the following information:

2017 tax year

Anil filed his own 2017 ITR12 on eFiling on 20 November 2017. He admitted that he was in a bit of a hurry to submit his tax return as he saw on a billboard next to the highway something about the tax season for individuals closing on the 24th of November 2017. Anil prides himself for not leaving matters to the last minute but he has been so busy with the Festive Season around the corner, that he forgot all about his personal tax return. Anil is not a tax practitioner, but he did ask his accountant Mrs Williams, who is a general tax practitioner, to quickly review his tax return before he submits it. Mrs Williams did not identify any problems with Anil's tax return.

On the same date that Anil filed his 2017 ITR12 tax return, SARS issued a ITA34 Assessment and also a letter to verify certain information on the ITR12 tax return submitted. Anil uploaded the following documents on SARS eFiling on 21 November 2017:

1. The IT3(b) tax certificate that he received from Investec (see issue 2 below);
2. The financial statements of NPE for the year ended 28 February 2017.

SARS issued an ITA34 Additional Assessment on 12 December 2017. Please find attached as **Annexure A**, an extract from the ITA34 Additional Assessment issued to Mr Anil Naidoo.

Anil gave you the following background information relating to the amounts that SARS disallowed:

Issue 1: Restraint of trade payment

On 1 March 2016, Kelly Newton (who worked for NPE for 5 years) decided to resign. In her last three years at NPE she headed the research division for specialised packaging. During January 2016 after extensive research and trials, Kelly and her team developed a ‘wonder-packaging’ that would keep perishable items cool for 48 hours. NPE however wanted more trials to be conducted and did not allow the ‘wonder-packaging’ to be released for sale. Kelly was furious and at the same time disappointed. She felt that the politics and red tape within the business were too much for her to handle and her research would be better appreciated at another business. This prompted her decision to resign on 1 March 2016. Her last working day at NPE was 31 March 2016.

She was given a restraint of trade agreement by NPE to sign on 24 March 2016. Kelly signed the agreement after consulting her attorney. Her attorney advised her that she should sign the agreement as the restraint of trade amount of R3 000 000 was more than fair. He also advised her that the period of restraint which was 48 months from 1 April 2016 was also more than fair. Kelly was not allowed to be involved directly or indirectly in any development of specialised packaging during this period.

Kelly received her last salary payment and leave pay-out on 31 March 2016 together with her final pay slip from NPE. The restraint of trade payment of R3 000 000 was also paid to Kelly on 31 March 2016 but as a separate payment from NPE and no employees’ tax was withheld from this payment.

Issue 2: Interest paid

Anil Naidoo also owns 20% of the ordinary shares in Paper Man (Pty.) Ltd (‘Paper Man’), a paper manufacturing company that he started with his two childhood friends (who each hold 40% of the ordinary shares). Paper Man started trading on 1 May 2016 and is a South African resident company for tax purposes. The company needed to buy machinery however it was unable to raise finance from any of the financial institutions. Anil decided to borrow the money in his personal capacity from a SAFRICA Bank at the prime interest rate for a five-year period and then lend the money to Paper Man for five years at a higher interest rate.

Anil signed the agreement with the bank on 1 June 2016 and the first repayment instalment on the loan commenced on 30 June 2016. Anil also prepared a loan agreement between himself and Paper Man.

During the 2017 year of assessment, he received interest income of R180 000 from Paper Man and paid interest of R130 000 on the loan to SAFRICA Bank. Anil also received interest of R12 500 as per the IT3(b) tax certificate received from Investec Bank.

Anil indicated that he wishes to object to the additional assessment issued by SARS. He is however unsure what arguments to use as he was under the impression that both the restraint of trade payment and the interest paid are deductible but based on the additional assessment it appears that SARS is not allowing the deductions. Anil requested that LMN assist him in explaining the correct tax treatment of the above deductions and provide recommendations on how he should proceed.

REQUIRED	
<p><i>You may assume that the necessary risk management procedures in relation to client acceptance and engagement acceptance for services to be delivered to Mr Anil Naidoo, have been completed and were approved.</i></p>	
<p>Prepare a memorandum to Anil Naidoo in which you:</p> <ol style="list-style-type: none"> 1. Explain to him what the tax implications are of the restraint of trade payment and the interest paid to SAFRICA Bank. 2. Indicate any tax issues/risks that you have identified relating to the above issues and your review of the ITA34 Additional Assessment, and 3. Provide recommendations to address the tax issues/risk. <p>Your answer should include consideration of tax compliance matters. Your answer should include reference to the relevant case law and the principles thereof.</p> <p>You may assume that the R130 000 interest was correctly calculated therefore you are not required to include the method of calculating the interest in your memorandum.</p>	50 Marks
Total marks for the paper	50 Marks