

Occupational Certificate Tax Professional

External Integrated Summative Assessment (EISA)

SAQA ID: 93624

November 2017

DAY 2: Paper 4 - Corporate 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 4. It is an external integrated summative assessment paper with case study and required.
3. This external integrated summative assessment paper consists of one case study. The questions thereon are divided into 2 parts, Part A and Part B.
4. Time: Day 2: 8 hours (Choice of 2 of the 3 papers)
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. Total marks for Paper 4: 50
9. Pass mark: 50 % pass is required per paper and competence achieved on all exit level outcomes per paper.

CASE STUDY

Background

You are a tax consultant employed in an accounting firm. One of your clients is Nebula South Africa (Pty.) Ltd (Nebula SA), a company tax resident in South Africa. Nebula New Zealand Ltd (Nebula NZL), a company tax resident in New Zealand, holds 75% of the ordinary shares in Nebula SA, while Nebula Holdings (Pty.) Ltd (Nebula Holdings), a company tax resident in South Africa, holds the remaining 25% of the ordinary shares in Nebula SA. All of the companies referred to above have a 31 December year end.

Your tax manager recently met with the financial manager of Nebula SA, Ms Koizumi. During this meeting, four issues were discussed. A summary of what was discussed in respect of these four issues, appears below, under separate headings:

1. Objection to disallowance of foreign exchange loss in 2016 additional income tax assessment

- Ms Koizumi only joined Nebula SA in September 2017. There was no time for a detailed hand-over from her predecessor, Mr Kansai, since he had been ill and resigned quite suddenly as a result. Ms Koizumi has recently received an additional income tax assessment issued to Nebula SA in relation to the 2016 year of assessment. She would like to object to this assessment, but feels a little out of her depth and is, therefore, requesting assistance in drafting the objection letter. Ms Koizumi has provided the following information that she feels is relevant:
 - The original assessment (dated 11 July 2017) reflected taxable income in the amount of R15,800,530. This is in accordance with the taxable income reflected in the 2016 ITR14 submitted by Mr Kansai on 10 July 2017.
 - The additional assessment (dated 1 November 2017) is in Ms Koizumi's possession and she has sent you the following excerpt:

Taxable income		
Code	Description and detail	Amount assessed
	Taxable income - subject to normal tax	18 582 030

Tax calculation			
Code	Description and detail	Computations & adjustments	Amount assessed
	Normal tax		5 202 968.40
	Foreign tax credits refunded / discharged		0.00
Subtotal			5 202 968.40
Current assessment before provisional tax credits and s89quat interest			5 202 968.40
	Provisional tax credits		-3 760 526.14
	1st provisional payment	-1 800 000.00	
	2nd provisional payment	-1 960 526.14	
	Penalties		80 369.72
	Underestimation of provisional tax para 20 Fourth Schedule	80 369.72	

- Ms Koizumi indicated that the difference between the taxable income per the original assessment and the taxable income per the additional assessment, relates to a foreign exchange loss that SARS has disallowed. She is aware of this because when she received the additional assessment, she submitted a request for reasons and the response from SARS was as follows:

“On 14 July 2017 we notified the taxpayer [Nebula SA] that the 2016 year of assessment had been selected for audit and supporting information in relation to the foreign exchange loss claimed in the 2016 ITR14 in the amount of R2,781,500 was requested. No information was provided. The SARS auditor attempted to contact the taxpayer via phone and email on the following dates: 19 July, 26 July, 2 August and 5 September 2017, but received no responses. Therefore, on 31 August 2017, a letter of audit findings was issued to the taxpayer indicating that the foreign exchange loss had been disallowed on the basis that no or insufficient relevant material was provided.”

- Unfortunately, as Mr Kansai had been ill at the time, he had missed the letters dated 14 July 2017 and 31 August 2017, as well as the various follow up emails and calls by the SARS auditor.

- Mr Kansai prepared the 2016 ITR14 and Ms Koizumi has not been able to find his workings regarding the calculation of the foreign exchange loss that was deducted in the 2016 ITR14. She is, however, aware that the loss arose as a result of the repayment of loans from Nebula NZL. She has provided you with a schedule which sets out the details that she has available (see Annexure A). The background is that the loans were provided by Nebula NZL to Nebula SA in order to assist with Nebula SA's working capital requirements since the nature of Nebula SA's business is such that, during certain months of the year, Nebula SA struggles to fund its day-to-day operating expenses from a cash flow perspective.
 - Ms Koizumi is also aware that the calculation of the second provisional tax payment for 2016 reflected this same deduction of R2,781,500. The difference between the taxable income per the 2016 second payment provisional tax return and the final 2016 ITR14 relates to unanticipated income that accrued after the estimate was prepared.
2. **Objection to dividends tax liability on deemed dividend *in specie* in relation to a shareholder loan in the 2016 year of assessment**
- On reviewing the letter of audit findings dated 31 August 2017 (which Mr Kansai had not attended to) Ms Koizumi noted that the disallowance of the foreign exchange loss was not the only adjustment made. The letter also stated the following:

“A dividends tax assessment in respect of a dividend in specie has been raised in terms of section 64E in respect of the shareholder loan. The dividends tax liability amounts to R354.75. This letter will serve as a notice of assessment of dividends tax. Kindly attend to the payment notice on eFiling.”
 - Ms Koizumi would also like your firm's assistance in objecting to the dividends tax liability referred to above. She acknowledges that there was indeed a small interest free loan from Nebula SA to Nebula NZL for the latter portion of the 2016 year of assessment. However, Ms Koizumi does not believe that the deeming provision in section 64E(4) should apply to Nebula SA. Ms Koizumi is not concerned with the

manner in which the dividends tax liability was calculated (the amount is, in any event, insignificant for Nebula SA), but she feels that SARS should not have applied section 64E(4) in the first place and would like to file an objection.

- The relationship manager, Ms Malta, at the SARS Large Business Centre in Cape Town has indicated that, although an objection to income tax should be prepared using a NOO1 form and an objection to dividends tax should be prepared using a ADR1 form, Nebula SA may prepare one objection letter which contains both disputes (namely, the disallowance of the foreign exchange loss and the dividends tax liability).

3. Interest withholding tax implications of proposed loan from Nebula NZL

- As noted under issue 1 above, there are certain months of the year in which Nebula SA struggles to fund its day-to-day operating expenses from a cash flow perspective. Once again, Nebula NZL is considering granting a loan to its subsidiary to fund its working capital requirements.
- A draft loan agreement has been prepared. In terms of this agreement, the term of the loan would be 3 years (from 1 January 2018 to 31 December 2020) and the loan would bear interest at a market related interest rate. Furthermore, the interest would be payable biannually (i.e. on 30 June and 31 December each year). The amount of the loan is still being negotiated.
- Your tax manager mentioned to Ms Koizumi that she should probably consider the interest withholding tax ('interest WHT') implications if they decide to go ahead with the loan. As the previous loans from Nebula NZL had been interest-free, Ms Koizumi had not considered interest WHT and asked your tax manager if she could have a tax opinion advising them of any obligations they may have from an interest WHT perspective, so that they can take this into account when deciding whether or not to accept a loan from Nebula NZL.
- Your tax manager would like you to prepare this opinion and has sent you the double tax agreement between South African and New Zealand (included as Annexure B), in case it is relevant.

4. Tax efficiency of proposed distribution to the shareholders of Nebula SA

- Ms Koizumi indicated that despite the cash flow problems in certain months, Nebula SA is still expected to realise a profit for the 2017 year of assessment. Nebula SA will likely declare a dividend to their shareholders in January 2018. The amount of the distribution is likely to be R500,000 (in cash) and it can be assumed that the solvency and liquidity tests will be satisfied, as per the requirements of the Companies Act, 2008.
- Ms Koizumi mentioned to your tax manager that this will be the first time that they will make such a distribution. She also said that one of her colleagues suggested that Nebula SA should elect to reduce contributed tax capital as this could, potentially, result in no dividends tax liability for Nebula NZL. In light of this comment, Ms Koizumi asked your tax manager to prepare an opinion advising on what the dividends tax consequences of the distribution and whether there may be a way to reduce the dividends tax liability to Rnil.
- Your tax manager would like you to prepare this advice. To assist you, your tax manager provides you with the following additional information:
 - Nebula SA's contributed tax capital balance is R800,000 and it can be assumed that this balance will remain unchanged at the date of proposed distribution.
 - The shares held by Nebula NZL and the shares held by Nebula Holdings are part of the same class of shares (ordinary shares).

REQUIRED

PART A

You are required to draft one objection letter (accompanied by a supporting Annexure A) addressed to Ms Malta at the SARS Large Business Centre in Cape Town, in respect of issues 1 and 2 as summarised in the case study. Specifically, you are required to prepare the following:

1. Objection to disallowance of foreign exchange loss in 2016 additional income tax assessment

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1.1. As a starting point, you are required to consider the information provided in Annexure A and determine whether you agree with the deduction of R2,781,500 claimed by Nebula SA in respect of the foreign exchange loss in the 2016 ITR14. Using the yellow shaded area in Annexure A please re-calculate the foreign exchange gain or loss. You may assume that your updated Annexure A will be included as an annexure to your objection letter and submitted to SARS as a PDF document. Therefore, please ensure that all calculations are typed out in full and are clearly explained in the Annexure A.

1.2. You are required to prepare an objection letter in which Nebula SA objects to the 2016 disallowance of the foreign exchange loss of R2,781,500 (or, if applicable, a different amount per your calculation in 1.1 above). The letter must contain the following:

- The grounds for the objection, including the relevant legislation pertaining to foreign exchange differences, as well as the application of this legislation to the facts of the scenario, with specific reference to your supporting calculation prepared in Annexure A per 1.1 above; and
- A request for remission of the underestimation penalties levied on the additional assessment.

<p>2. Objection to the dividends tax liability on the deemed dividend <i>in specie</i> in relation to the shareholder loan in the 2016 year of assessment</p> <p>2.1. In the same objection letter prepared in 1.2 above, but under a separate heading, you are required to object to the dividends tax liability of R354.75. This part of your objection letter must contain the following:</p> <ul style="list-style-type: none"> • Grounds for the objection, including the relevant legislation, as well as the application of the law to the facts of the scenario. 	5
<p>Communication skills - layout, professional language and coherence of arguments</p> <p><i>[NOTE: Please provide full section references in support of your arguments in the objection letter. Also note that you are not required to consider section 24J or section 31 of the Income Tax Act No 58 of 1962.]</i></p>	4

<p>PART B</p> <p>You are required to draft <u>one</u> opinion to Ms Koizumi in which you address <u>issues 3 and 4</u> as summarised in the case study. Specifically, the client has requested that you only address the following, using the structure provided below:</p> <p>3. Interest withholding tax implications of proposed loan from Nebula NZL</p> <p>3.1. Advise the client as to the interest withholding tax ('interest WHT') implications for Nebula SA (if any) on the proposed loan from Nebula NZL;</p> <p>3.2. Include any compliance requirements that Nebula SA should be aware of in relation to the interest WHT.</p> <p>4. Tax efficiency of proposed distribution to the shareholders of Nebula SA</p> <p>4.1. Advise the client of the dividends tax implications for Nebula NZL, Nebula Holdings and Nebula SA of the distribution, assuming <u>no election</u> with regard to contributed tax capital is made.</p> <p>4.2. Advise the client of whether it would be possible to have a dividends tax liability of Rnil if an election is made to reduce to contributed tax capital of Nebula SA.</p> <p>Layout, professional language and coherence of arguments</p> <p><i>[NOTE: Please provide full section references in support of your advice in the opinion. Also note that you are not required to consider section 24I, section 24J or section 31 of the Income Tax Act No 58 of 1962.]</i></p>	<p>8</p> <p>10</p> <p>3</p>
<p>Total marks for the paper</p>	<p>50</p>

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