

# **Occupational Certificate Tax Professional**

## **External Integrated Summative Assessment (EISA)**

SAQA ID: 93624

**November 2017**

**DAY2: SUMMARY OF OPTIONAL PAPERS**

**CANDIDATE MUST COMPLETE 2 OF THE  
3 PAPERS**

## Instructions to Candidates

1. Candidates must answer **two** of the following three papers:  
Paper 3, Paper 4 or Paper 5.

### PAPER 3

#### SCENARIO

50 MARKS

Mr Anil Naidoo, age 47, is the sole proprietor of New Packaging Enterprises.

New Packaging Enterprises ('NPE') is a registered Value-Added Tax ('VAT') vendor and a registered employer for employees' tax purposes.

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.

#### Issue 1: Restraint of trade payment

On 1 March 2016, Kelly Newton (who worked for NPE for 5 years) decided to resign. She was given a restraint of trade agreement by NPE to sign on 24 March 2016.

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.

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## PAPER 4 – CORPORATE TAX

### 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
<b>Subtotal</b>			5 202 968.40
<b>Current assessment before provisional tax credits and s89quat interest</b>			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 (*this schedule is called Annexure A and will be provided on the day of your exam*). 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).

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## PAPER 5

### Background

CAS (Pty) Ltd (hereafter referred to as “CAS”) is a South African resident company for tax purposes and has a financial year-end that ends on the last day of February. CAS is a Category B vendor for Value-Added Tax (‘VAT’) purposes. The company was incorporated in South Africa in 2004 by Nonhlanhla Gumede (Ms Gumede) when she saw the need for complex tax, accounting, finance and corporate governance training.

Initially the conferences and seminars were held in Gauteng only. However, due to their popularity, training events are now held in all the major cities in Africa.

Ms Gumede turned 40 on 14 April 2017. She lives in Centurion with her husband and two children. She is a South African resident. Ms Gumede was the sole shareholder and director of CAS. Initially she had time to focus all her attention on CAS. However, due to the company rapidly expanding and the fact that Ms Gumede also became a director of two other companies, she decided in 2015 to issue more ordinary shares and appoint more directors to manage CAS. Since 2015, Anton Weynand and Khosi Mkwabane are the other shareholders in CAS. There has been no other changes in shareholding. Anton and Khosi are also directors in CAS and are South African residents.

The management team of CAS identifies key areas for training events. They then contract with subject matter experts to present the training at various locations throughout Africa. CAS also employs four in-house experts in the fields of tax, accounting, finance and corporate governance.

## **1. VAT risks**

For the two month VAT period ended 31 October 2017, the bookkeeper passed the following journal entries. Ms Gumede is concerned that these journal entries will expose CAS to VAT risks.

## **2. Objection to disallowance of VAT input tax credit on the purchase of second-hand fixed property**

The South African Revenue Service (SARS) performed a VAT audit on CAS for this tax period. They requested CAS to supply relevant material to support certain input tax claims. CAS provided all the relevant material as requested by SARS and in terms of the VAT Act. SARS was satisfied with CAS's input claims, with the exception of the purchase of a residential property to be converted into a conference venue. SARS disallowed the input tax claimed on this purchase. Ms Gumede would like to object to the disallowance of the input tax credit. Therefore, Ms Gumede is requesting assistance in drafting an objection letter. Ms Gumede provided the following information via email:

## **3. VAT opinion of proposed transaction**

During the current financial year of assessment, CAS will enter into a contract on the 4<sup>th</sup> of December 2017 with Legal Experts Inc. (hereafter referred to as "Legal Experts"), one of South Africa's leading legal companies. Legal Experts is a South African resident company and a registered VAT vendor. Both the board of directors of CAS and Legal Experts will sign the contract on the same date (4 December 2017). In terms of the contract, Legal Experts will provide sponsorship of legal services that CAS require for seminars and conferences they will host for the period 3 January 2018 to 28 February 2018. CAS and Legal Experts are not connected persons.

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