

Occupational Certificate: Tax Professional

External Integrated Summative Assessment (EISA)

Personal Taxation Question

EXEMPLAR 1

Part A

Aspect of the answer	Details of aspects to be included in answer	Comp	Marks
PART A			
Question (i)			Avail 18 Max: 10
If vehicle transferred to new entity	Fringe benefit on car at rate of 3,5% (no maintenance plan) on determined value for each month that Mr. Fraser is entitled to use it for private purposes (para 7(4)(a)(i)). Based on the current legislation, the determined value is the retail market value of R900,000.		2
	For Mr. Fraser to claim a reduction of the fringe benefit on assessment, he would need to keep accurate records (logbook) of distances travelled for business use (para 7(7)).		1
	Unlikely to claim further reductions as other costs are paid by employer.		1
	The entity (employer) would calculate and withhold employees' tax on 80% or 20% of the full value of the fringe benefit. If at least 80% of the use of the motor vehicle will be for business purposes, then the entity can base the employees' tax on 20% of the fringe benefit otherwise 80% of the fringe benefit will be included for employees' tax. It appears that Mr. Fraser has substantial business travel and therefore the percentage inclusion may be 20%. This will however have to be supported by actual travel in terms of a log book kept by Mr. Fraser if queried by SARS.		3
If vehicle is not transferred to new entity	Since Mr. Fraser uses the vehicle for private travel in addition to business travel, the portion of the travel allowance used for private travel will be included in Mr. Fraser's taxable income.		1
	He can either use actual figures or actual business kms and a deemed cost per km.		1
	Using actual figures, Mr. Fraser would reduce the travel allowance received by the ratio of actual business kms travelled to total kms travelled during the relevant period, multiplied the		3

	total of the costs he incurred, namely wear and tear (limited to R560,000 and determined over 7 years), licencing, fuel, maintenance and insurance costs.		
	Using or actual business kms and a deemed cost per km, Mr. Fraser would use the 2017 deemed expenditure table and would take the fixed cost for vehicles exceeding R560,000 (R144,784) divided by the total kilometres travelled (apportioned for the period during which the allowance was received), plus the fuel cost (136.5c) and repairs cost (79.5c) per the table. The total (in cents per km) is then applied to his actual business kilometres travelled and this amount is used to reduce the travel allowance that would otherwise be included in taxable income.		3
	Requirement to keep logbook.		1
	Employees' tax is based on 80% of the travel allowance. This may be reduced to 20% if the employer (the new entity) is satisfied that at least 80% of the use will be for business purposes.		2
Question (ii)			Avail: 6 Max: 4
If income protection policy kept in personal name	Per s23(r) (applicable from the 2016 tax year), Mr. Fraser would not be permitted to deduct the premiums in respect of the insurance policy.		1
	Any amount received or accrued in respect of the insurance policy payout will be exempt in terms of s10(1)(gl) (applicable from the 2016 tax year).		1
	No tax implications for the new entity.		1
If income protection policy in the name of company	Section 11(a) deduction for the new entity if business continuity policy.		1
	Identify risk of section 11(w) and fringe benefits if proceeds intended to be paid to Mr. Fraser, but that any amounts received or accrued by Mr. Fraser in terms of the insurance policy payout would then be deductible in terms of s10(1)(gG) if previously taxed on the premiums as a fringe benefit.		2
Question (iii)			
Sale on interest-free loan account			Avail: 41 Max: 28
Loan results in an accrual	Peoples Stores case.		1
Identified recoupment	Allowances claimed to be recouped.		1

	Section 8(4)(k) to apply and deem at market value between connected persons. Recoupment included in gross income.		1
Connected person	Identify that Mr. Fraser will be a connected person in relation to the company by reason of 100% shareholding. Reference to section 1 definition of connected person.		1
Capital gains tax	Identified sale as disposal of all assets – art gallery, studio building, trade receivables and motor vehicle. No CGT on transfer of cash balance as not an ‘asset’. Proceeds as loan amount allocated to each asset per sale agreement, adjusted to market value if non-arm's length between connected persons (para 38), plus liabilities assumed (creditors) (para 35(1)(a)), less recoupment (para 35(3)(a)).		2
			3
	Base cost as historic cost of each asset, less allowances.		1
	Inclusion rate for natural person 40% (since transaction will occur in 2017 year of assessment).		1
	Identified BMW as personal use asset not subject to CGT under para 53.		1
	Annual exclusion for natural person R40 000 (since transaction will occur in 2017 year of assessment).		1
	Allowances if any to be claimed on ‘cost’ which would be the value at which sold (loan amount).		1
Sale as asset-for-share transaction			
Section 42	Identify that transaction should qualify for roll-over under section 42 due to below requirements being met:		1
	<ul style="list-style-type: none"> Market value of assets exceed base costs per information provided as at 29 Feb and assuming such values are still accurate as at 1 August 2016. Also, likely that market value will exceed base cost for any trading stock transferred. However, the transfer of vehicles will not qualify for roll-over relief since market value is likely to be less than base cost. Cash would not qualify but no CGT on transfer thereof in any event; 		3
	<ul style="list-style-type: none"> Assets to be used for the same purpose as Mr. Fraser (i.e. capital assets will be held as capital assets by the private company); 		1
	<ul style="list-style-type: none"> Assets are disposed to a resident company in exchange for shares to be issued by resident company; 		1
	<ul style="list-style-type: none"> Qualifying interest - full-time involvement or greater than 10% shareholding; and 		1

	<ul style="list-style-type: none"> No indication that opted out 		1
Effect of rollover	Assets deemed disposed at base cost, therefore no capital gain or loss realised.		1
	Cost history of assets rolls overs to the private company and the private company 'steps into the shoes' of Mr. Fraser.		1
	Mr. Fraser and private company deemed to be one and the same for allowances - therefore continue claiming section 13quin and section 13(1).		1
	Trade receivable qualifies as allowance asset and therefore s 11(i) still available for company.		1
	Relief extends to assumption of trade creditors in terms of section 42(8) as debts incurred in normal course of business.		1
Advice re clawbacks	Advise clients regarding clawbacks in the event that:		1
	<ul style="list-style-type: none"> Mr. Fraser disposes of the shares issued to him within 18 months (and other criteria apply); 		1
	<ul style="list-style-type: none"> Mr. Fraser ceases to hold a qualifying interest within 18 months; 		1
	<ul style="list-style-type: none"> The company disposes of the asset acquired with 18 months 		1
	Consequence: Ring fenced capital gain		1
VAT on transfer for both methods			
	No VAT on vehicle as did not claim input tax due to s 17 prohibition.		1
	Since a going concern is disposed of: roll-over of VAT in terms of s8(25) if s42 transaction; zero-rating in terms of s11(1)(e) if sale on interest-free loan account.		2
	Both sections require new entity to be a registered VAT vendor.		1
	<p>For s8(25), it must be a supply of an enterprise which is capable of separation (appears true in the present scenario) and the parties must agree in writing that the enterprise is disposed of as a going concern.</p> <p>For s11(1)(e), the following requirements must be met:</p> <ul style="list-style-type: none"> Enterprise is disposed of as a going concern (appears true based on facts); Enterprise will be an income-earning activity on the date of transfer (appears true based on facts); 		4

	<ul style="list-style-type: none"> The assets necessary for carrying on the business have been disposed of (appears true based on facts); and The consideration is inclusive of tax at zero percent. 		
	VAT registration requirements - voluntary registration possible if acquire going concern that has made taxable supplies exceeding R50 000.		1
Question (iv)			Avail: 12 Max: 7
Employment tax incentive	Identify that the company could qualify for the employment tax incentive since:		1
	<ul style="list-style-type: none"> Ages of employees within qualifying range of 18 to 29; Wage is within qualifying range (more than R2,000 and less than R6,000); Artists are not connected persons in relation to the employer and are not domestic workers; Employees are South Africans (require valid ID); and Employment date after 1 October 2013. 		2.5
	Note that incentive is schedule to end on 31 December 2016, but its effectiveness will be reviewed.		1
	Benefit is reduced amount of PAYE paid by the new entity, while leaving the artists' wages unaffected. However, the artists may in any event be below the tax threshold thus no obligation to withhold PAYE and thus no benefit.		1
	The employment tax incentive is however available to an eligible employer. Since the above requirements to qualify will also be met by Mr. Fraser trading as "The Design@rt Shop" as the employer, Mr. Fraser can also apply for the employment tax incentive.		1
Small business corp	Identify that the new entity may qualify as a SBC since:		1
	<ul style="list-style-type: none"> Only shareholder is Mr. Fraser (natural person); Gross income less than R20m (current R13,5m); Mr. Fraser does not hold any other shares (only other assets are properties); No personal services to be provider be <i>The Art Spot</i> - sale of goods; and No investment income to be earned. 		2.5
Benefits	Benefits: Lower tax rates; accelerated allowances.		2
Question (v)			Avail: 11

			Max: 7
Tax rate	Income taxed at 41% unless distributed.		1
Potential to distribute income	Low income earners (e.g. if children are beneficiaries) may be taxed at lower rate.		1
	Principles in section 25B regarding distribution/vesting of income; conduit principle.		2
Connected person	Identify that Mr. Fraser will be a connected person in relation to the trust by reason of being a beneficiary thereof. Section 1 definition of 'connected person'.		1
Attribution rules	Meaning of 'donation, settlement or other disposition' in the case of interest-free loan (Berold/Wouldge cases).		1
	Sections 7(3) and section 7(5) (if discretionary trust) may apply to the extent of a donation, settlement or other disposition (interest not charged on loan).		2
Estate duty implications	Future growth above loan amount potentially outside estate.		1
	Identify that loan amount still in estate but may qualify for 4A rebate (currently R3.5 million).		1
	Identify the risk of section 3(3)(d) since he appears to be trustee and beneficiary.		1
Question (vi)			Avail: 6 Max: 5
Any relevant considerations	Consideration of other taxes: e.g. Dividends tax applied to distributions at 15% with the private company option (in contrast to trading trust); shares and increase in value to remain included in Mr. Fraser's estate with private company option (in contrast to trading trust); small business corporation tax saving due to low tax rates (in contrast to trading trust), but R20 million gross income limit so benefit is limited; effective tax rate comparison thereafter; tax saving on transfer of assets to company if asset for share transaction (tax deferred to disposal of assets by the private company), etc. Any valid arguments accepted.		5
	Conclusion as to which entity form would be more beneficial.		1
Professional opinion writing skills			Avail: 10 Max: 7
	Tax opinion issued meets the requirements set out in s 223(3) of the TAA as well as non-TAA implications such as disclaimer, limitation of liability, limited use, etc.		1
	Candidate carries out the instruction of the client - in this case staying within the boundaries set by the lawyer's advice. However recognises (a) the advice of the lawyers as a limitation in the background to the opinion and limits liability for reliance on that advice and (b) other		2

	opportunities and suggests to client in a manner that gives client a chance to consider without drafting a significant part of the opinion outside the agreed instruction/scope of work.		
	Style of writing appropriate for tax opinion to be issued to an artist (i.e. person who does not necessarily have a tax or financial background). Views technically correct but put in a manner that makes it understandable. Use of non-technical language or techniques such as illustrative examples, diagrams or similar to explain more complex principles.		1
	Candidate based all views on authority (case law, reference to legislation, etc.).		1
	Candidate illustrated a broad perspective of tax implications of transactions by referring to numerous taxes.		1
	Comparison of alternatives presented in a useful manner.		1
	Candidate's views provided as to tax benefits from utilising flexible income are within the framework of tax laws and not overly aggressive.		1
	Views presented in a structured manner making effective use of numbering, headings, etc.		1
	Candidate comes to a logical conclusion based on the issues identified and views expressed in the opinion and makes a clear recommendation to the client.		1

<i>Not competent</i>	0%	68 marks
<i>Not sufficiently competent</i>	25%	
<i>Average competence</i>	50%	
<i>Above average competence demonstrated</i>	75%	
<i>Demonstrated excellent competence</i>	100%	

Part B

Aspect of the answer	Details of aspects to be included in answer	Comp	Marks
Question (i)			Avail: 32 Max: 22
Disallowance of input tax re land purchase	Constructing and selling of units would have constituted taxable supplies. Moon Stone assumedly registered as VAT vendor on this basis.		1
	Therefore land acquired for purposes of being supplied in making such taxable supplies.		1
	Notional input tax in para (b) of definition of input tax.		1
	Appears not to meet resident requirement.		1
	Documentation requirements in s20(8).		1
	Appears not to meet requirement to have obtained copy of ID.		1
	Therefore appears not to be entitled to claim input tax.		1
Output tax on change in use	Basis to determine use of assets and ratio of taxable supplies - BGR16 on 12 month historic revenue.		1
	Residential rental is exempt supply (s12(c)).		1
	In present case, SARS applied BGR16 correctly to determine only exempt supplies		1
	Change in use SARS appears to apply is s18(1) (use for purpose which is wholly not taxable supplies).		1
	Change in use takes place when the goods are applied in a manner that is wholly other than to make taxable supplies (s 9(6)). All VAT periods up to June 2015 should still reflect the sale of R600 000 if BGR16 is applied. It is therefore submitted that the deemed supply under s18(1) can only take place on or after this date.		2
	Section 18B however applies to all supplies of fixed property on or after 1 January 2012 - as indicated above the deemed supply would be after 1 January 2012.		1

	Section 18B applies to a vendor that continuously or regularly constructs, extends or improves fixed property to sell. VAT409 - in the context of fixed property, 10 units may be viewed as continuous development.		1
	Section 18B may apply - this would allow Moon Stone to not have a deemed supply while the property is temporarily rented out. Temporary nature of rental demonstrated by marketing. This only applies for 36 months or when permanently rented out (neither yet).		1
Input tax claim denied on security costs	Input tax can only be claimed to the extent that services acquired for purposes of making taxable supplies.		1
	BGR16 also applies. Section 18B does not apply in respect of such operating costs.		1
	BGR16 does not apply when basis of apportionment not fair and reasonable.		1
	In this case, mixed purpose given residential rental and sale intention.		1
	May be able to suggest apportionment basis that is more equitable.		1
	s17(1)(iii) however requires this to be pre-approved which may cause difficulty for Moon Stone in this case.		1
	May have grounds to argue partial disallowance.		1
Penalty for late payment	Penalty correctly imposed under s39 of the VAT Act (read with s213 of TAA) if payment late. If assessment not correct, the penalty may however be affected.		1
Interest at prescribed rate	Interest correctly imposed under s39 of the VAT Act. Interest amount depends on assessment amount.		1
Understatement penalty	Understatement penalty, as defined in s 221 of the TAA, could be levied if VAT liability not assessed correctly by taxpayer (e.g. incorrect statement in a return resulting in a prejudice to the <i>fiscus</i>).		1
	Penalty to be imposed on shortfall - this does not include 10% late payment penalty and interest. Therefore basis for calculating the penalty not correct.		1
	Rate of 200% questionable as this rate is applied in instances of repeated/obstructive intentional tax evasion. Tax evasion requires intention from taxpayer to knowingly not pay tax (SARS Short TAA Guide). Above arguments demonstrate that no such intention from Mr. Fraser.		2

Professional opinion writing skills	Candidate has drafted views in respect of each element of the assessment, similar to grounds that would be required when objecting.		1
	Views on grounds to argue clearly written and presented using headings, numbering.		1
	Views provided in such a manner that client would be aware that SARS may have a different view and these are candidate's views on matter. Assumptions and understanding indicated where information was not clear.		1
Question (ii)			Avail: 8 Max: 6
Request for reasons	Identified right to request reasons. Rule 6 - 30 days (definition of day - business day).		2
	Value add to client: No form - manual submission that may not record on system, could make process difficult forward.		1
Objection	Identified objection to be made as step to dispute. Rule 7 - 30 days from date of assessment (still within period to object) or reasons.		2
	Explain process - ADR1 form, grounds complete.		2
Professional opinion writing skills	Candidate demonstrates awareness of process and makes clear recommendations in a manner understandable without overwhelming details. Candidate does not suggest approach or mechanisms that does not exist or are not applicable in this case that could result in client missing dates for dispute resolution, for example, not recommend to appeal, etc.		1
Question (iii)			Avail: 6 Max: 4
Obligation to pay not suspended by objection	Section 164. Refer to factors listed in s164(2) to make the request - specifically irreparable hardship. This should prevent instruction to bank from being realised.		3
Advise client against moving assets (as this has been suggested)	New entity could be held liable as connected person (s183 of TAA) and possible offence (s234(o) of TAA); Or any other valid points.		2

Professional opinion writing skills	Candidate demonstrates awareness of process and makes clear recommendations in a manner understandable without overwhelming details. Candidate does not suggest approach or mechanisms that does not exist or are not applicable, for example, not to dispute instruction to bank/settlement at this early stage, etc. but rather a s164 request to suspend payment until dispute resolved.		1
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<i>Not competent</i>	0%		32 marks
<i>Not sufficiently competent</i>	25%		
<i>Average competence</i>	50%		
<i>Above average competence demonstrated</i>	75%		
<i>Demonstrated excellent competence</i>	100%		

	100 marks Part A: 68 marks Part B: 32 marks
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