

Tax Technician

# Knowledge Competency Assessment

June 2015

Paper 2: Question

## Instructions to Candidates

1. This competency assessment paper consists of two questions.
2. Answer each question in a separate answer book.

Question	Topic	Marks	Answer Book
1	Analysis of Financial Statements	40	BLUE
2	Normal Tax Calculation and Dividends Tax	40	WHITE
3	VAT	20	GREEN

Total marks: 100

Time: 4 hours plus ½ hour reading time

The marks specified are an indication of the expected length and detail of your response.

3. Enter your examination number on the cover of each answer book as well as on all answer sheets.
4. Your name must not appear anywhere in the answer books.
5. Answers may not be written in pencil and correction pens (Tippex) may not be used.
6. Answer the questions using effective presentation and pay particular 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 answer books are handed in to the invigilator before leaving the examination room, as answer books handed in thereafter will not be marked.

**Question 1**

**40 marks**

You are the tax manager of Books Galore (Pty) Ltd ('BGL'). The company was selected for an audit by the South African Revenue Service (SARS). The Financial Director of BGL is concerned about certain accounts in the financial statements from a tax perspective and has asked you to identify possible tax risks from the information provided.

The Financial Director has provided you with certain background information to the company, extracts of the notes to the financial statements and the detailed operating expenses schedule.

<p>Question 1 Required</p>	<p>Marks</p>
	<p>Total</p>
<p>Critically analyze the information provided. Identify and explain the nature of the possible tax risks.</p>	<p>40</p>

### Background information to books galore limited

The company prints and publishes books. The company was registered in South Africa during January 2006. The original year-end was 28/29 February, but during the last annual general meeting it was decided to change the year-end to 31 October to be in line with the holding company, The Book Club Limited. Both the company and its holding company are managed and controlled in South Africa. The special resolution changing the year end was registered with the Registrar to comply with the Companies Act. The Commissioner of SARS was also notified of the change.

Mr. Galore, not a shareholder of BGL was appointed as Public Officer of BGL on 5 January 2006. His details are as follows:

Identity number: 600314 0066 083

Cell phone number: 082 123 4567

Residential address: 56 Main Street, Waterkloof, 9876.

Included in the R1 585 000 (refer note 10) bonuses provided for at year end, is an amount of R567 456 which depends on the final results of the company (profits) and the performance of employees during the year. It is however not yet certain if the total provision will be paid, as the employee performance evaluations have not yet been finalized.

Mr. Galore was arrested for drunk driving. He could only make one phone call from jail and he phoned the company's accountant. Mr. Galore requested the accountant to cash a company cheque of R15 000 to bail him out. He also requested him to account for the cheque as legal fees in the company's records (refer detailed Statement of Profit or Loss and Other Comprehensive Income). This was not identified by the auditors during the year-end audit.

Included in 'Entertainment' is an amount of R10 675 paid to "The Party Farm". This amount was paid in respect of Gallo's (Mr. Galore's daughter) 21st birthday party.

Donations of R1 000 consist of the following:

- R500 was paid to Boys Town. No section 18A certificate was received.
- R500 given to homeless people in Pretoria.

Included in consulting fees is an amount of R78 732 paid to TaxServe. The tax firm assisted BGL with an objection to SARS. The objection related to certain expenses claimed in the 2012 IT14, which SARS disallowed. The objection was rejected and the assessment made final.

Sundry income of R4 079 consists of local dividends received. It appears as if it was incorrectly classified as sundry income and not investment income in the Annual Financial Statements.

Mr. Galore also owns 50% membership interest in a CC registered in South Africa.

The audit report was not qualified.

The company has no foreign investments.

**Books Galore Limited**

(Registration number 2005/000008/07)

Financial Statements for the period ended 31 October 2014

Notes to the Financial Statements

3. Intangible assets

	Oct 2014			Feb 2014		
	Cost	Accumulated amortisation	Carrying value	Cost	Accumulated amortisation	Carrying value
Patent	71 188	(47 540)	23 648	71 188	(42 794)	28 394

Reconciliation of intangible assets – October 2014

	Opening balance	Amortisation	Total
Patent	28 394	(4 746)	23 648

Reconciliation of intangible assets – Feb 2014

	Opening balance	Amortisation	Total
Patent	35 513	(7 119)	28 394

4. Loan to group company

	Oct 2014	Feb 2014
<b>Loans and receivables</b>		
Not So Incredible (Pty) Ltd	9 171 041	8 830 124
The loan is unsecured and bears interest at 4.5% per annum (28 Feb 2013:6%). The loan is repayable by mutual agreement.		
<b>Current assets</b>		
Loans and receivables	9 171 041	8 830 124

**Books Galore Limited**

(Registration number 2005/000008/07)

Financial Statements for the period ended 31 October 2014

Notes to the Financial Statements

7. Trade and other receivables

Trade receivables	37 465 379	45 051 438
Prepayments	-	36 593
VAT	1 206 626	-
Other receivables	1 622 373	195 107
	<b>40 294 378</b>	<b>45 283 138</b>

All amounts are short-term. The carrying value of trade receivables is considered a reasonable approximation of fair value.

All of the trade receivables have been reviewed for indicators of impairment. None were found to be impaired.

Some of the unimpaired trade receivables are past due as at the reporting date. The age of financial assets past due but not impaired is as follows:

Not more than 3 months	3 982 209	5 134 656
More than 3 months but not more than 6 months	847 313	557 957
More than 6 months but not more than 1 year	311 986	1 330 348
More than 1 year	492 051	61 533
	<b>5 633 559</b>	<b>7 084 494</b>

8. Cash and cash equivalents

Cash and cash equivalent consist of:

Cash on hand	10 000	5 000
Bank balances	11 969 852	91 831 616
Short-term deposits	32 390 620	-
	<b>44 370 472</b>	<b>91 836 616</b>

**Books Galore Limited**

(Registration number 2005/000008/07)

Financial Statements for the period ended 31 October 2014

Notes to the Financial Statements

10. Trade and other payables

Trade payables	17 830 048	6 585 837
VAT	-	2 207 520
Provision for bonuses	1 585 000	225 641
Accrued leave pay	309 696	395 990
Accrued expenses	3 105 558	174 454
Other payables	360 696	157 235
	<b>23 190 998</b>	<b>9 746 677</b>

All amounts are short-term. The carrying values are considered to be a reasonable approximation of fair value.

12. Investment revenue

Interest revenue

Not So Incredible (Pty) Ltd	503 018	488 384
Bank	1 595 661	-
	<b>2 098 679</b>	<b>488 384</b>

13. Finance costs

Bank overdraft	3 696	-
South African Revenue Service	7 326	10 625
	<b>11 022</b>	<b>10 625</b>

22. Comparative figures

The current year represents an 8 month period as the company changed its year end from February to October.

Comparative figures have been reclassified in certain instances.



**Books Galore Limited**

(Registration number 2005/000008/07)

Financial Statements for the period ended 31 October 2014

The supplementary information presented does not form part of the financial statements and is unaudited

Detailed Operating Expenses

	8 months ended 31 October 2014 R	12 months ended 28 February 2014 R
Note(s)		
Advertising	5 586 836	5 072 740
Annual duty	4 000	-
Auditor's remuneration	424 973	170 000
Bad debts	20 891	233 144
Bank charges	221 281	238 473
Cleaning	202 159	117 434
Commission paid	798 113	-
Computer expenses	209 837	296 137
Consultancy fees	91 893	208 147
Consumables	1 930	-
Delivery expense	70 520	305 362
Depreciation and amortisation	382 255	609 860
Donations	1 000	2 020
Employee costs	11 230 921	23 412 943
Entertainment	154 693	239 700
Fines and penalties	100	12 550
First aid equipment	3 518	-
Gifts and promotions	597 857	1 099 879
Insurance	192 173	375 808
Lease rentals on operating lease	394 943	1 007 547
Legal expenses	21 569	111 697
Licenses	8 583	82 414

**Books Galore Limited**

(Registration number 2005/000008/07)

Financial Statements for the period ended 31 October 2014

Detailed Operating Expenses (continued)

	10 months Ended 31 October 2014 R	12 months ended 28 February 2014 R
Note(s)		
Levies	-	151 987
Loss on foreign exchange differences	29 513	-
Management fees (related party)	3 941 444	-
Membership fees	142 281	96 484
Motor vehicle expenses	40 180	193 488
Pest control	-	1 057
Petrol and oil	554 561	1 326 905
Repairs and maintenance	48 301	173 488
Secretarial fees	1 000	4 399
Staff training	36 934	-
Staff welfare	23 085	39 307
Subscriptions	1 327 751	782 641
Sundry expenses	-	11 634
Telephone and fax	556 854	934 016
Tender costs	-	1 457 173
Travel – local	409 800	845 483
Travel – overseas	336 661	544 956
Utilities	201 539	1 792 418
Validation of lab equipment	-	2 895
	<b>28 967 770</b>	<b>42 764 364</b>

## Question 2

Consists of 2 related parts

40 marks

### Part A

32 marks

Lavender's accountant, Les, has done a preliminary tax calculation for the year of assessment ended 30 September 2014. She has determined a taxable income of R1 980 000.

The income tax effect of the following items have not yet been taken into account in the calculation of the taxable income of R1 980 000, as Les was uncertain as to the correct tax treatment of the items.

All amounts in the question exclude VAT, unless specifically stated otherwise.

Lavender had an assessed capital loss, as envisaged in paragraph 9 of the Eighth Schedule to the Income Tax Act, of R15 000 carried forward from the 2013 year of assessment.

#### 1. Fixed assets

- 1.1 A second-hand engraver was purchased for R10 000 and brought into use in the manufacturing process on 1 June 2014. A delivery cost of R800 was incurred to deliver the engraver at Lavender's premises. SARS' Binding General Ruling 7 (Interpretation Note No. 47) allows for a write-off period of 5 years on this type of equipment.
  
- 1.2 Woodworking tools to the total value of R5 600 were purchased on 15 January 2014.

1.3 A new machine cutter, used in the manufacturing process, was imported from London at a total cost of £50 000. The order was placed on 5 July 2014 and the machine was shipped free on board (FOB) on 1 August 2014. It was delivered at Lavender’s premises on 5 September 2014 and brought into use on the same day. A forward exchange contract (FEC) for a three-month period at a forward rate of £1 = R11.85 was entered into on 1 September 2014 to serve as a hedge against the debt. The debt was settled on 31 October 2014.

The following exchange rates are applicable:

Date	Spot Rate
	£1 = R
5 July 2014	£1 = R11.90
1 August 2014	£1 = R11.75
1 September 2014	£1 = R11.70
5 September 2014	£1 = R11.83
30 September 2014	£1 = R11.80
31 October 2014	£1 = R11.94

FEC rate 30 September 2014, market related for one-month period:

£1 = R11.82

Average exchange rate for 2014 year of assessment: £1 = R11.82

1.4 Lavender bought a scale, being one of the assets used in the process of manufacture, from one of its shareholders for R80 000 on 1 November 2013. The shareholder holds a 40% interest in Lavender. The shareholder originally purchased the machine for R70 000 and has claimed allowances of R14 000 on the asset until the date of sale. A recoupment under section 8(4)(a) of R14 000 and a capital gain of R10 000 resulted from the sale transaction.

1.5 Lavender owns the building from which it conducts its manufacturing process. The building was purchased on 1 October 2002 at a cost of R1 500 000.

1.6 On 1 March 2014, an old brass burner, Machine BB1, used in the manufacturing process, was sold for R547 200 (including VAT) to an independent third party. Machine BB1 was purchased and brought into use during the 2010 year of assessment and had already been written-off in full for tax purposes at 1 October 2013 (tax value = Rnil). The original cost price amounted to R400 000 (excluding VAT). Machine BB1 was replaced with a new brass burner, Machine BB2, that was purchased on 15 June 2014 for R1 350 000. Lavender elected par 66 of the Eight Schedule to be applied to this transaction.

## 2. Learnership agreement

Lavender entered into a 10-month registered learnership agreement with Jean Bothe, a person with a disability, on 1 November 2013. You may assume that the learnership was successfully completed on 31 August 2014.

## 3. Doubtful debts

The Commissioner allowed 25% of the doubtful debt provision of R75 000 for tax purposes in the 2013 year of assessment. The allowance for doubtful debts was increased by R25 000 for the 2014 year of assessment and 25% of this allowance will be allowed by the Commissioner.

## 4. Lump sum paid to retired employee

An amount of R120 000 was paid directly to one of Lavender's employees who retired at the age of 65. This payment was made to cover his post-retirement medical aid contributions.

## 5. Trading inventory

5.1 On 1 August 2014, Lavender purchased raw material to the value of R1 400 000. 20% of this raw material was still on hand at year end. Lavender had no raw material on hand on 1 October 2013.

5.2 A table lamp was donated to be auctioned in favour of the “Save-the-Rhino” fund (a Public Benefit Organisation) on 1 September 2014. The lamp had a cost price of R17 500 and a market value of R35 000 on the date of donation. A section 18A receipt was obtained in respect of this donation. The lamp was not included in closing inventory.

Question 2 – Part A Required	Marks
	Total
<p>Calculate the normal tax liability of Lavender Decor Ltd for the company’s year of assessment ending 30 September 2014.</p> <p>Start your calculations with the supplied starting taxable income of R1 980 000.</p> <p>Show all your calculations.</p> <p>Indicate, with reasons, if an amount has no tax implications and round-up all amounts to the nearest Rand.</p>	32

Part B

8 marks

Lavender Decor Ltd has not paid a dividend since September 2013. Les informs you that Lavender would like to declare a dividend of R100 per share on 15 October 2014, payable to the shareholders on 22 November 2014. Lavender’s shares are owned by the following (the shareholding has not changed since the company was formed):

Shareholder	Number of shares held
May Peaches (South African resident individual)	10 000
Lavender Family Trust (South African resident trust)	70 000
Pealave (Pty) Ltd (South African resident family investment company)	20 000
<b>Total number of shares in issue</b>	<b>100 000</b>

Les would like to know how this dividend will be treated for dividends tax purposes.

Question 2 – Part B Required	Marks
	Total
<p>Advise Les of the dividend tax implications in respect of the dividend that Lavender Decor Ltd wishes to declare to its shareholders. Include a calculation of the amount of dividends tax to be withheld by Lavender Decor Ltd.</p> <p>Include an explanation of the administrative requirements of the dividend tax provisions in the Income Tax Act.</p>	8

### Question 3

20 marks

You are a tax advisor in a firm in Durban. Your manager has asked you to attend to a query from a client, Boogaloo Books (Pty) Ltd ('BB'), which distributes books and other printed material to clients in South Africa and in Europe. BB is based in Durban, where it leases offices in a business park. It is registered as a 'Category B' VAT vendor.

BB's bookkeeper, Stanley Naidoo, became ill and was admitted to hospital in early November 2014 and his manager, Melanie Subramoney, is concerned that the most recent VAT return for BB is outstanding. Melanie has provided you with the following information and she has asked you to calculate the VAT payable to or refundable from SARS for the tax period ended 31 October 2014.

Local sales: total amount invoiced in each month (the amounts reflected below are the amounts debited to the Trade Debtors account in each month):

September 2014	980 100
October 2014	900 000

Amounts received from local Trade Debtors in:

September 2014	800 000
October 2014	930 000

In October 2014 BB sold books to a customer in Belgium, Europe. The selling price of the books amounts to a total of R186 000, based on the company's price list, which lists the price of each book, exclusive of VAT. In line with its usual practice for overseas sales, BB delivered the books directly to the customer in Belgium. The customer paid BB R186 000 on 22 October 2014.



BB has suffered cash flow problems due to the delay in receiving payment from some of its debtors. As a result, BB started charging interest on overdue accounts. The interest charged to the Trade Debtors accounts was as follows:

September 2014	13 800
October 2014	21 740

BB received the following amounts from debtors which it had written off several months ago:

Received on 23 September 2014 from Bonanza Books CC - a South Africa client	18 500
Received on 28 October 2014 from Stirling Readers - a client based in England	28 600

BB pays insurance premiums of R12 000 per month on a short-term insurance policy that covers all risks relating to the loss or destruction of the company's assets. Of this amount, R1 400 relates to the insurance of the company's pool car.

BB's offices were burgled one night in August 2014. A large number of books (trading stock) and ten computers used in the offices were stolen in the robbery. The burglars also found the keys to BB's pool car (a Toyota Corolla) and stole the car from the office basement parking area. The insurance company paid BB R300 000 on 15 September 2014 in settlement of the insurance claim. This amount was made up of: R120 000 for the trading stock, R80 000 for the ten computers and R100 000 for the pool car. BB replaced all the assets in October 2014. The replacement of the trading stock is included in the October purchases as shown below. Replacement computers were purchased at a total cost of R120 000 and a new Toyota Corolla was purchased to replace the pool car at a total cost of R180 000.

BB provides its sales manager, Jim Flint, with the use of a company car. All fuel and maintenance costs on the vehicle are paid for by BB. BB acquired the vehicle, a BMW 320i, at a cost of R380 000 in July 2013.

Purchases: amounts invoiced by suppliers for trading stock purchased in each month (the amounts reflected below are the amounts credited to the Trade Creditors account each month):

September 2014	638 720
October 2014	730 200

Amounts paid to Trade Creditors in:

September 2014	732 900
October 2014	710 300

Salaries and Wages paid in:

September 2014	382 000
October 2014	415 000

Fuel Costs paid in:

September 2014	2 890
October 2014	3 730

Motor Vehicle Repair and Maintenance costs paid in:

September 2014	820
October 2014	2 830

Provision for Depreciation on BB's fixed assets in:

September 2014	28 000
October 2014	27 500

BB purchased tea, coffee, milk and sugar at a total cost of R3 200 on 15 October 2014 to replenish the supplies in the staff kitchen.

BB pays rental of R32 000 per month for its offices in Durban.

#### Assumptions for this question

- All the necessary documentation has been obtained by BB wherever relevant.
- BB does not make any exempt supplies.

Question 3	Marks
Required	Total
Calculate the amount of VAT payable to / refundable by SARS for the tax period ended 31 October 2014 and indicate how, and by when, the VAT return must be submitted and the VAT paid (if applicable) to SARS.	20