

**1 Background**

The 34-year-old Ms Emily Nkoane, a South African tax resident, is employed as the chief executive officer (CEO) of Mega Baby (Pty) Ltd ('Mega Baby'). Mega Baby is an online retailer that supplies baby equipment and napkins (nappies) and napkin liners for babies to customers across South Africa. Mega Baby has a no-export policy. Emily founded the company in April 2004 in South Africa and it grew into one of South Africa's largest online retailers in baby products. Mega Baby has a 31 March financial year end and is a registered Category A value-added tax (VAT) vendor.

Since its incorporation the company's equity shares were held as follows:

- Ms Emily Nkoane – 80%
- The Mega Baby Employee Share Trust – 20%

Its total annual turnover over the last three years comprised 70% from the sale of baby equipment and 30% from the sale of napkins and napkin liners for babies.

Emily met Mr Thato Omoregie, a 40-year-old tax resident of Namibia, on an online dating website in May 2019. They got married, out of community of property, in terms of the laws of the Republic of South Africa, on 1 October 2019. Emily changed her surname to Nkoane-Omoregie upon marrying Thato.

Thato was deemed to be exclusively a resident of South Africa with effect from 1 October 2019 for purposes of the application of the agreement entered into between the governments of South Africa and Namibia for the avoidance of double taxation.

Neither Emily nor Thato is (or was) a registered VAT vendor.

**2 The Omoregie Family Trust and donations**

- 2.1 Emily established the Omoregie Family Trust on 1 July 2019. In terms of the Trust deed, Thato was nominated as the sole trust beneficiary and he has a vested right to the income and capital of this Trust. The trustees are Emily and her attorney.

Emily donated R800 000 in cash to the Omoregie Family Trust on 1 July 2019. The Trust immediately invested the total amount in a local interest-yielding investment held at Investco (Pty) Ltd ('Investco'), a local private investment company. This investment was held by the Trust until the end of the 2020 year of assessment.

The main purpose of the donation to the Trust was not to reduce or postpone or avoid tax.

- 2.2 On 2 October 2019, Emily also donated half of her 22% shareholding in Redesign Ltd ('Redesign') as a wedding gift to Thato (not through the Trust). Redesign is a local South African investment company that invests in and holds immovable properties in South Africa. Emily originally acquired the 22% shareholding in Redesign for speculation purposes and paid R1,3 million for the shares on 1 February 2019. The market value of the entire 22% shareholding amounted to R1,5 million on 2 October 2019 and to R1,4 million on 29 February 2020.

Emily has made no other donations or deemed donations since 1 March 2018.

The Trust earned the following interest on the Investco investment for the 2020 year of assessment:

Date earned	Period	Amount
30 September 2019	1 July to 30 September 2019	R15 000
29 February 2020	1 October 2019 to 29 February 2020	R25 000

### 3 Mrs Emily Nkoane-Omoregie

SUMMARY OF RECEIPTS / ACCRUALS AND EXPENSES FOR THE YEAR OF ASSESSMENT ENDED ON 29 FEBRUARY 2020		
	Ref.	R
<b>Receipts / accruals</b>		
Salary	3.1	960 000
Devoted service award	3.3	50 000
Cash inheritance	3.4	1 000 000
Distribution received on 22% shareholding in Redesign	3.5	200 000
Gross dividends received on 80% shareholding in Mega Baby	4.1	560 000
Interest received from Mega Baby	4.3	107 333
<b>Expenses</b>		
Cash donated to the Omoregie Family Trust	2.1	(800 000)
Shares donated to Thato Omoregie	2.2	?
Provident fund contributions	3.2	(72 000)
Insurance policy premiums	3.6	nil
Debt advanced to Mega Baby	4.3	(9 200 000)

- 3.1 Emily received a gross monthly salary of R80 000 from Mega Baby.
- 3.2 Emily and Mega Baby each contributed 7,5% of her gross monthly salary to Mega Baby's approved provident fund on Emily's behalf. Emily's remuneration (as defined in par. 1 of the Fourth Schedule) amounted to R1 082 000 (correctly calculated) for her 2020 year of assessment.
- 3.3 In terms of Mega Baby's remuneration policy, Emily received a cash amount of R50 000 on 31 March 2019 in recognition of her devoted and continuous service to Mega Baby since April 2004.
- 3.4 Emily inherited R1 million in cash from her late father, Mr Kabelo Nkoane, which was paid to her on 1 February 2020 (the day on which his deceased estate was finalised).
- 3.5 Emily received a distribution of R200 000 from Redesign on 31 May 2019. She received a written notice from the directors of Redesign, which indicated that the entire distribution represented a return of contributed tax capital.
- 3.6 An insurance policy is in place at a local insurance company that covers Emily against any injury or death occurring at the workplace or in fulfilling her employment duties as the CEO of Mega Baby. Mega Baby pays the total monthly premium of R2 400.

#### 4 Mega Baby

- 4.1 On 29 February 2020, Mega Baby declared a gross dividend of R700 000 to its shareholders. This was paid on the same date.
- 4.2 Mega Baby makes use of external and independent courier companies to deliver the goods purchased by Mega Baby's online customers to their physical addresses across South Africa. However, this is very costly and Mega Baby's board of directors therefore decided that the company should handle its own deliveries. It accordingly started its own internal delivery division effective from 1 February 2020.

Mega Baby had to appoint 20 drivers for the new delivery division. A single-cab second-hand delivery vehicle was allocated to each driver on 1 February 2020, which they all started to use immediately. All the delivery vehicles were in good condition. Mega Baby purchased each delivery vehicle for R400 000 (exclusive of VAT) from a local independent VAT vendor on 1 February 2020. The open market value of each vehicle amounted to R500 000, but because Mega Baby purchased all 20 vehicles from the same supplier, it qualified for a special price per vehicle in the form of a volume rebate. Drivers must keep the delivery vehicles at their private residences and are also allowed to use them for private purposes at no consideration.

Online customers have the option to elect delivery times that fall outside normal business hours or over weekends. Some drivers are therefore required to work between 17:00 and 20:00 on weekdays, for which they are paid a night shift allowance. In addition, these drivers are paid for overtime worked for deliveries that need to take place during night shift hours, during weekends or on public holidays.

Remuneration relating to the number of night shift and overtime hours worked and logged by drivers during February and March 2020 were as follows:

<b>New delivery division</b>	<b>February 2020</b>	<b>March 2020</b>
	<b>R</b>	<b>R</b>
Night shift allowances	190 000	220 000
Overtime pay	285 000	330 000

All nightshift hours worked and logged during a specific calendar month are paid by Mega Baby on the fifth day of the month following the month during which it was worked and logged. All overtime is paid on the last day of the same month during which it was worked and logged.

- 4.3 To enable Mega Baby to finance the acquisition of the 20 delivery vehicles, the company issued 23 000 debentures on 1 January 2020 in terms of an arrangement (section 80L of the *Income Tax Act*) to Emily at a face value of R400 each. The debentures bear interest at 7% per annum (which equals the official rate of interest) and are redeemable in full by Mega Baby on 31 December 2051 at a premium of 3% on the issued face value. This is the day on which Emily will become 65 years old and when she plans to retire. The debentures are not repayable on demand and Mega Baby may not be discharged from any portion of its liability to make payments of the underlying capital or interest. The yield to maturity amounts to 7,0292% (correctly determined).

## 5 Sale of cash gift cards

You are a registered tax practitioner and Mega Baby is one of your clients. You received the following voice-note message on your phone from Mega Baby's head of finance. He requested tax advice regarding the board of directors' decision to start selling cash gift cards to its online customers:



*Hi there, it is Bruce here from Mega Baby. Our board decided to allow our customers to purchase cash gift cards from us in the near future. The following terms and conditions have been approved and adopted for the sale of these cash gift cards:*

- 1 Gift cards will only be issued for cash amounts denominated in South African rand.*
- 2 Gift cards can be purchased for any amount of cash requested by a customer, but no gift card may be issued for an amount of less than R100.*
- 3 No gift card will be issued for specified goods or services supplied by Mega Baby.*
- 4 Each gift card that is purchased will be emailed to its purchaser and display a unique cash discount barcode linked to the cash amount paid for it.*
- 5 Gift cards can be redeemed as a discount by any person by means of a purchase on the Mega Baby website.*
- 6 Gift cards can only be redeemed at Mega Baby and not at any other retailer.*
- 7 Any consideration paid by the customer to Mega Baby in exchange for the gift card remains the property of the bearer of the gift card until it is redeemed.*
- 8 All gift cards will expire 36 months after its date of issue.*
- 9 If a gift card expires, or is stolen or lost, the cash amount linked to it will be forfeited.*
- 10 Gift cards can only be redeemed for goods/services and cannot be exchanged for cash.*

*We already asked an IFRS specialist to advise us regarding the income recognition aspects on the sale of cash gift cards for financial reporting purposes. We are however unsure about the VAT and normal tax treatment of such cash gift card sales, so need your advice on this, please.*

*Chat soon*

## 6 Additional information

- Mega Baby obtained valid tax invoices and supporting documentation for all its transactions as required in terms of the *Value-Added Tax Act*.
- None of the entities or equity interests held in any of the entities mentioned above represents a 'permanent establishment' in the Republic of South Africa as defined.
- All equity shares held are equivalent to the voting rights.
- Binding General Ruling No. 7 allows a four-year write-off period on delivery vehicles.

**INITIAL TEST OF COMPETENCE, SEPTEMBER 2021**

**PROFESSIONAL PAPER 4**

PAPER 4 QUESTION 1 – REQUIRED		Marks	
		Sub-total	Total
(a)	Calculate Emily's taxable income for the 2020 year of assessment. <ul style="list-style-type: none"> <li>Clearly indicate all items that have a nil effect and provide a brief reason for these items only.</li> </ul>	20	20
(b)	Advise Emily, purely from a tax perspective, what the – (i) advantages; and (ii) disadvantages will be if she decides to invest the cash inheritance from her late father (see note 3.4) in local tax-free investments. <ul style="list-style-type: none"> <li>No calculations are required.</li> </ul>	2 4	6
(c)	Briefly explain, with respect to note 4.2 and with supporting calculations, the implications for Mega Baby with regard to – (i) VAT for the tax period ended 31 March 2020; and (ii) normal tax for the 2020 year of assessment.  <i>Communication skills – presentation</i>	3 3 1	7
(d)	Discuss, with respect to note 4.3, the tax consequences for Mega Baby for the 2020 year of assessment. <ul style="list-style-type: none"> <li>Ignore VAT.</li> <li>No calculations are required.</li> </ul>	6	6
(e)	Explain the following regarding the policy to be adopted for the sale of cash gift cards: (i) How the VAT should be accounted for by Mega Baby when a cash gift card – <ul style="list-style-type: none"> <li>is sold to one of its customers; and</li> <li>is redeemed in full by a customer on the acquisition of napkins and napkin liners for babies within 36 months after its date of issue; and</li> </ul> (ii) How Mega Baby's gross income, as defined in the <i>Income Tax Act</i> , will be impacted when a cash gift card – <ul style="list-style-type: none"> <li>is sold to one of its customers; and</li> <li>expires before it is fully redeemed by a customer.</li> </ul> <ul style="list-style-type: none"> <li>Support your answer with reference to the principle(s) of relevant case law.</li> <li>No calculations are required.</li> </ul> <i>Communication skills – logical argument</i>	3 7 1	11
<b>Total for question 1</b>			<b>50</b>