

IGNORE VALUE-ADDED TAX

**1 Background**

Buy2Rent (Pty) Ltd ('Buy2Rent') is a company resident in South Africa for income tax purposes with a year of assessment ending on 30 June. Buy2Rent is a large property company based in Johannesburg that purchases commercial and residential properties and renovates them either to resell at a profit or to let.

Buy2Rent was founded in 2005 by Pete Cook, who began the business after receiving a large inheritance. Pete asked his friend, Max Windy CA(SA), to assist him in setting up a legal structure for Buy2Rent.

Pete is 42 years old, and Max is 38. Both are South African tax residents who pay tax at a marginal rate of 45%.

**2 Interest-free loans**

With Buy2Rent's rapid expansion, accounting transactions became more complicated. Pete appointed Max as chief financial officer (CFO) and director. On his appointment, Max opted to receive an interest-free loan rather than a 20% shareholding. Pete agreed as Buy2Rent's Memorandum of Incorporation does not prohibit financial assistance to directors. Pete therefore retained 100% of the equity shares and voting rights of Buy2Rent.

The following decisions were documented in the minutes of the 1 July 2019 board meeting:

<b>Buy2Rent</b>	
<b>Minutes of meeting of the board of directors</b>	
<b>Held on 1 July 2019 at Park Offices</b>	
<b>Present</b>	
Pete Cook (PC)	Chief executive officer (CEO)
Max Windy (MW)	Chief financial officer (CFO)
<b>1 Introduction</b>	
The meeting was held to authorise a loan to MW to enable him to purchase a vacation home for himself.	

## 2 Financial assistance provided to MW

The board authorised Buy2Rent to lend money to MW in his capacity as director of Buy2Rent on the following conditions:

- An interest-free loan of R1 million.
- Repayable after three years.

## 3 Financial assistance provided to PC

Pete suggested that he also receive an interest-free loan to enable him to purchase a vacation home for himself. The board authorised Buy2Rent to lend money to PC in his capacity as sole shareholder on the following conditions:

- An interest-free loan of R2,5 million.
- Repayable when Buy2Rent achieves an asset to debt ratio of 3 : 1.

**RESOLVED: The loans were to be awarded.**

## 3 Change in board of directors

In 2020, the Memorandum of Incorporation was amended to include a requirement that the financial statements be audited. To improve Buy2Rent's corporate governance, Pete and Max decided to set up an audit committee, a risk committee, and a social and ethics committee.

Four new members were appointed to the board to meet King IV's minimum committee member requirements:

Executive directors: Lara Upton, Kit Tiger and Shark Ti.

Non-executive director: Prof. Oby Kenobi. She was appointed as the chair of the audit committee. She is an esteemed professor at a local university.

Lara, Kit and Shark were each given a 5% shareholding in Buy2Rent. Max acquired a 10% shareholding, while 30% of the equity shares were sold to an external investor.

At 1 July 2021, the shareholding was as follows:

Shareholder	Shareholding
Pete Cook	45%
Max Windy	10%
Lara Upton	5%
Kit Tiger	5%
Shark Ti	5%
External investor	30%
<b>Total</b>	<b>100%</b>

#### 4 Appointment of a new audit firm

You are the audit manager at JEDI Inc. ('JEDI'), and were assigned to the audit of Buy2Rent for the 30 June 2022 year end.

You received the following documents:

Document name	Ref.
Client planning meeting	A315-15
Minutes of Buy2Rent Board meeting: 15 December 2021	A315-16

<b>Client</b>	Buy2Rent (Pty) Ltd	<b>Year end</b>	30 June 2022	<b>A315-15</b> <b>Page 1 of 2</b>
<b>Prepared by</b>	Quinton Jinn	<b>Reviewed by</b>		
<b>Prepared date</b>	16 February 2022	<b>Review date</b>		
<b>Subject:</b> Client planning meeting				

#### Attendees

Name	Position
Deppa Bilaba (DB)	Audit partner
Kara Jaris (KJ)	Audit manager
Quinton Jinn (QJ)	Third-year trainee
Max Windy (MW)	Chief financial officer

#### 1. Introduction

DB welcomed MW to the meeting. MW stated that he was very excited to be working with JEDI as the new auditors of Buy2Rent.

#### 2. Overview of the operating environment

MW provided the audit team with an overview of the operations and future changes.

Factors such as Covid-19, low economic growth and high unemployment levels impede growth and investment. In addition, Covid-19 accelerated the rate of change in consumer behaviour and work patterns, further contributing to a reduced demand for space. These factors unfavourably affected Buy2Rent's ability to achieve targeted growth and liquidity levels and could lead to reduced asset values. Volatility in financial markets is expected to continue and could negatively affect Buy2Rent's ability to raise funding.

The board therefore decided to start the process of listing on the Johannesburg Stock Exchange as a real estate investment trust by June 2026. This will allow easier access to funding to expand the company's footprint.

During the current financial year (FY2022), the company purchased a controlling interest in a property company, Galac Properties ('Galac'), in Poland. This expanded the existing asset base by R160 million upon consolidation at an exchange rate of EUR 1 : ZAR16,540. The transaction was facilitated by the CEO, whose wife is a member of the board of Galac. Galac has a 31 December year end.

<b>Client</b>	Buy2Rent (Pty) Ltd	<b>Year end</b>	30 June 2022	<b>A315-15</b> <b>Page 2 of 2</b>
<b>Prepared by</b>	Quinton Jinn	<b>Reviewed by</b>		
<b>Prepared date</b>	16 February 2022	<b>Review date</b>		
<b>Subject:</b> Client planning meeting				

### 3. Accounting matters

The board decided to reward the CEO for the acquisition of the controlling interest in Galac by waiving the loan granted to him by Buy2Rent. The decision to do so was taken at a special meeting held on 15 December 2021 (see workpaper A315-16 for the minutes of the meeting). The loan was included in the accounts receivable balance in the statement of financial position at its nominal value. The waiver will be included in the related parties note as follows:

<b>Note 24: Related parties</b>	<b>2022</b>	<b>2021</b>
	<b>R</b>	<b>R</b>
Shareholder's loan	–	2,5 million
<i>The loan to shareholder was settled during the year</i>		

DB explained that the disclosure was incorrect since the loan was not settled but waived and the wording in the note needed to reflect this. MW explained that the purpose of the limited disclosure was to avoid causing unhappiness among employees, who were still required to pay off their loans. Removing Pete's loan would improve the key performance indicators that influence his bonus.

DB noted that while the disclosure was incorrect, it was immaterial since R2,5 million falls below the materiality level of R50 million. In addition, this only affects disclosure and no other parts of the financial statements, as this was a once-off transaction. DB agreed not to include this in the summary of unadjusted differences or the report to the audit committee.

### 4. Finance team

MW deregistered in 2021 as a CA(SA) as he could not keep up with all continuous professional development requirements. He is supported in the reporting function by two part-time students.

Buy2Rent complies with International Financial Reporting Standards.

<b>Client</b>	Buy2Rent (Pty) Ltd	<b>Year end</b>	30 June 2022	<b>A315-16</b>
<b>Prepared by</b>	Quinton Jinn	<b>Reviewed by</b>		
<b>Prepared date</b>	16 February 2022	<b>Review date</b>		

**Subject:** Minutes of Buy2Rent board meeting: 15 December 2021

**Buy2Rent**  
**Minutes of special meeting of the board of directors**  
**Held on 15 December 2021 at Park Offices**

**Attendees**

<b>Name</b>	<b>Position</b>
Pete Cook (PC)	Chief executive officer (CEO)
Max Windy (MW)	Chief financial officer (CFO)
Lara Upton (LU)	Chief operating officer (COO)
Shark Ti (ST)	Chief risk officer (CRO)
Kit Tiger (KT)	Chief information officer (CIO)
Oby Kenobi (OK)	Chair of the audit committee
Ash Tatt (AT)	Independent non-executive director
Adrian Kola (AK)	Independent non-executive director

**1. Introduction**

PC noted that all company directors were present. The purpose of the meeting was to provide the board with an update on the acquisition of a 60% controlling interest in Galac. PC informed the board that the contract to purchase 60% of the shares had been finalised, with the first payment for the shares due on 28 February 2022. PC said the process proceeded smoothly as his wife had ensured that the asset's values were not overstated.

**2. Other matters**

MW congratulated the CEO on finalising the transaction. MW proposed that the loan to PC be waived, because he is a shareholder of the company. OK objected to the waiver as she believed that the loan should never have been awarded in the first place.

LU proposed that MW also be released from his obligation to pay back his loan. AT explained that even though the debt has not prescribed, Buy2Rent should write off the loan. The loan was not likely to be recovered soon in view of MW's financial position, which has been aggravated by the destruction of his vacation home in a fire.

No further objections or questions were raised. No further information was provided.

**RESOLVED: The board resolved to vote on waiving the loans issued to PC and MW.**

**3. Voting**

All members, except OK, voted in favour of the waivers.

**RESOLVED: With the approval of the majority of the board, the loans to PC and MW were to be waived.**

## 5 Additional information

- The official rate of interest was 5% during the period 1 March 2018 to 1 July 2022.
- The determination of the number of days (correctly calculated) was as follows:

<b>Period</b>	<b>Number of days</b>
1 March 2021 to 30 November 2021	275
1 March 2021 to 15 December 2021	290
1 March 2021 to 31 December 2021	306

**INITIAL TEST OF COMPETENCE, JUNE 2023**

**PROFESSIONAL PAPER 4**

**This paper consists of two questions. Answer each question in a separate answer book.**

<b>PAPER 4 QUESTION 2 – REQUIRED</b>		<b>Marks</b>	
		<b>Sub-total</b>	<b>Total</b>
(a)	Describe, with reference to workpaper A315-15, the risks of material misstatement at the overall financial statement level for Buy2Rent.  <i>Communication skills – clarity of expression</i>	11  1	  12
(b)	With respect to the shareholder’s loan –  (i) discuss the matters that Deppa should consider in determining whether the financial statements of Buy2Rent are fairly presented in all material respects in terms of the applicable financial reporting standards, and whether it complies with relevant legislation; and  (ii) discuss your concerns with regard to the decision made by Deppa to exclude the waiver from the summary of unadjusted differences.  <i>Communication skills – logical argument</i>	  8  11  1	     20
(c)	Calculate the impact of the loans granted to Pete and Max on the total tax payable to SARS by – <ul style="list-style-type: none"> <li>• Pete for the year of assessment ended 28 February 2022;</li> <li>• Max for the year of assessment ended 28 February 2022; and</li> <li>• Buy2Rent for the year of assessment ended 30 June 2022.</li> </ul> <ul style="list-style-type: none"> <li>○ Provide reasons for nil effects.</li> <li>○ Do not consider the waivers.</li> </ul>	     6	     6

**Continued**

**INITIAL TEST OF COMPETENCE, JUNE 2023**

**PROFESSIONAL PAPER 4**

**This paper consists of two questions. Answer each question in a separate answer book.**

<b>PAPER 4 QUESTION 2 – REQUIRED (cont.)</b>		<b>Marks</b>	
		<b>Sub-total</b>	<b>Total</b>
(d)	Discuss the normal tax implications regarding the waiver of the loans for the year of assessment ended 28 February 2022 for Pete and Max.  <ul style="list-style-type: none"> <li>Do not discuss any potential capital gains tax consequences for Pete.</li> </ul>	5	5
(e)	Discuss, supported by calculations, the tax implications regarding the waiver of the loans for Buy2Rent for the year of assessment ended 30 June 2022.  <ul style="list-style-type: none"> <li>Assume that para. 12A of the Eighth Schedule does not apply to the waiver of the loan to Pete.</li> </ul>	7	7
<b>Total for question 2</b>			<b>50</b>
<b>TOTAL FOR PAPER 4</b>			<b>100</b>