QUESTION 1 **50 marks**

Uhuru (Pty) Ltd ('Uhuru') is a company resident in South Africa for income tax purposes and a registered value-added tax (VAT) vendor. It was founded in 2011 by the Chief Executive Officer, Nomzamo Dhlomo, a 38-year-old South African resident. Nomzamo is still the majority shareholder of the company. The company's financial year ends on 31 December and this date has been approved by the South African Revenue Service (SARS) as the company's year of assessment.

Uhuru is a digital marketing agency that specialises in social media, content creation and branding. Uhuru employs more than 85 people. It has key account managers who are responsible for the execution and delivery of clients' marketing briefs. Each one is supported by a marketing assistant.

Stutterheimers Ltd

The clothing sector in South Africa has been under severe pressure over the last number of years as a result of international retail stores that have entered the South African market. During the 2016 year of assessment one of Uhuru's largest clients, Stutterheimers Ltd ('Stutterheimers') a well-known South African clothing retailer, went into business rescue.

At that time Stutterheimers owed Uhuru R2 200 000 for social media management services. Stutterheimers was unable to repay this amount to Uhuru, with a resultant negative financial impact on Uhuru that contributed to a significant working capital shortage. To alleviate these pressures, Nomzamo has since 1 March 2016 provided a loan to Uhuru, with interest on the loan being payable at prime.

Nomzamo financed this loan by increasing a mortgage bond with ZA Bank Ltd ('ZA Bank'). This bond is on her private residence. The amount was paid directly into Uhuru's bank account by ZA Bank. The mortgage bond attracts interest at prime less 1,5% per annum.

Aisha Alexander

In December 2016 Uhuru was contracted by a South African lifestyle company to market and launch the company's new range of sandals called Copacabanas. Nomzamo took the lead in the design of the marketing brief. On her advice, Uhuru accordingly entered into an agreement with Aisha Alexander, a well-known celebrity and a South African resident, to showcase the new Copacabanas on various social media platforms. To enhance the marketability of the product Uhuru sent Aisha on a seven-day trip to Rio de Janeiro, Brazil, to take photos of her wearing the Copacabanas. She had to post the photos on the social media platforms while she was in Brazil. This trip cost Uhuru the following:

- R21 700 for the flight; and
- R45 000 for an all-inclusive package at a 5-star resort.

In terms of the agreement between Uhuru and Aisha, she would be entitled to R5 000 per photo of her wearing the Copacabanas and a further R13 per 'like' each photo received. The agreement required that the photos be taken spontaneously, while having fun and enjoying the sights of Rio de Janeiro. This is the first time that Aisha had been to Brazil and she only spent time there for the purposes of this agreement.

The Copacabanas were launched in Durban in February 2017 following the success of the Brazilian trip. Once again Uhuru entered into an agreement with Aisha for her services, on the same terms as for the Brazilian trip. Aisha spent four days in Durban as part of the marketing campaign.

Aisha's flight to Durban cost Uhuru R4 000 (VAT of R475 included). In addition to the cost of the flight, Uhuru made the following payments on Aisha's behalf:

- R1 200 for invoices for meals (R500 of this cost relates to food and drinks for clients of Uhuru); and
- R2 200 for taxi fares.

During the Durban trip Aisha took seven photos that attracted 13 760 'likes'. As the Durban trip was not fully funded, Uhuru also paid Aisha a daily allowance of R900 for incidentals.

The two agreements that Uhuru entered into with Aisha were temporary employment contracts for the visits to Brazil and Durban, and the payment for both was based on income received during these two visits.

Urban sub-economic housing

In January 2017 Uhuru purchased 15 flats in a new block of flats, *The Essence*, located in Cape Town. Because Uhuru was conducting marketing and social media services for the property developer, each flat was sold to Uhuru for R400 000, instead of the usual open market value of R445 000. The flats were purchased with the intention of selling these to marketing assistants employed by Uhuru and who were based in Cape Town.

Uhuru recognised the need for affordable and quality sub-economic housing in inner cities throughout South Africa, and in particular sought to alleviate the challenges faced by employees travelling long distance from outlying areas to city centres. The 15 flats were sold to Uhuru marketing assistants for R50 000 each at the end of January 2017.

Uhuru's marketing assistants are well paid, earning remuneration of between R8 000 and R20 000 per month. For purposes of the Seventh Schedule, these amounts can be used as the remuneration proxy.

Siphokazi Dhlomo

Siphokazi Dhlomo is a 61-year-old South African resident employed at Uhuru as the Chief Strategy Officer. Siphokazi is Nomzamo's mother and joined Uhuru on 1 January 2017. She was employed by Stutterheimers until her retirement on 31 December 2016. At Uhuru Siphokazi received a salary of R57 578 per month, the same salary as the one she received while in the employ of Stutterheimers. She is a member of, and contributed to the Uhuru Provident Fund.

Siphokazi had been a member of a medical scheme, registered under the *Medical Schemes Act,* 1998 (Act 131 of 1998) in South Africa, up to the date of her retirement. Stutterheimers made all contributions to the medical scheme for both Siphokazi and her spouse. After retirement Siphokazi herself continued to make the full contribution to the medical scheme on behalf of herself and her spouse.

At the date of her retirement a retirement fund lump sum benefit of R2 242 528 accrued to Siphokazi from the Stutterheimers Provident Fund. At that date R203 866 of her contributions to the Fund had not previously been allowed as deductions. In terms of a tax directive received from SARS, an amount of R684 418 was withheld as tax on the retirement fund lump sum benefit.

A severance benefit of R600 000 had accrued to Siphokazi from a previous employer in the 2013 year of assessment. This lump sum was a 'severance benefit' as defined in section 1(1) of the *Income Tax Act,* 1962 (Act 58 of 1962) and employees' tax of R51 300 had been correctly withheld by the employer.

On 7 July 2017, following the opening of the SARS tax season, Siphokazi completed and submitted her ITR12 tax return. On the same day she was issued with an ITA34 Notice of Assessment, which shocked Siphokazi as it reflected a net amount payable of R713 083,30. The following is an extract of the ITA34 for the 2017 year of assessment:

Code	Description	Computations and adjustments	Amount assessed
Employment income [IRP5/IT3(a)]			**734 134**
3601	Income – taxable	575 779	575 779
3601	Income – taxable	115 155	115 155
3810	Medical scheme fees fringe benefit	43 200	43 200
Retirement fund lump sum withdrawal benefit received			**2 038 662**
3920	Retirement fund lump sum withdrawal benefit	2 038 662	2 038 662
DEDUCTIONS ALLOWED			
Code	**Description**	**Computations and adjustments**	**Amount assessed**
Retirement fund contributions			**(13 183)**
4004	Current provident fund contribution deduction (limited to the amount contributed) equal to the lesser of: R350 000 or 27,5% of the higher of remuneration or taxable income	13 183	(13 183)
TAXABLE INCOME			
Code	**Description**	**Computations and adjustments**	**Amount assessed**
	Taxable income – subject to normal tax		**720 951**
	Taxable income – subject to retirement fund lump sum withdrawal benefit table		**2 038 662**
TAX CALCULATION			
Code	**Description**	**Computations and adjustments**	**Amount assessed**
	Normal tax		215 020,90
	Rebates Primary	13 500	(13 500)
	Retirement fund lump sum withdrawal benefit tax liability		693 418,32
Total assessed taxes			**894 939,20**
Less taxes already paid			
	Employees tax		(181 855,89)
4102	PAYE – Pay As You Earn	181 855,89	
Net amount payable under this assessment			**713 083,30**

Masego Marks

Masego Marks ('Masego') is a 28-year-old South African resident for tax purposes and has been employed at Uhuru as a key accounts manager since 2013.

In terms of Uhuru's employment contracts with its key account managers, all key account managers are entitled to a cash salary of R40 000 per month as well as an annual percentage commission based on their client portfolio spend. A commission of R127 000 was authorised on 31 December 2016 and paid to Masego in January 2017.

Uhuru key account managers are also entitled to the use of an Uhuru-owned smartphone that may also be used for private purposes. Each key account manager is responsible for purchasing prepaid vouchers for their phones. When a new model is released every year, Uhuru replaces their employees' smartphones with the new model. From 1 November 2015 until 31 October 2016 Masego had the right of use of an Uhuru-owned smartphone, which had an open market value of R13 599. This usage was considered to be for a major portion of the useful life of the phone. His smartphone, model 6, was replaced by the new smartphone, model 7, which had a cost price of R9 499 on 1 November 2016. Masego estimated that about 20% of his phone calls on both the model 6 and 7 smartphones were for business purposes.

In June 2016 Uhuru entered into a monthly lease agreement with VLS (Pty) Ltd, a company that provides vehicle fleet management services, for the lease of 20 Mini 3-door hatch motor vehicles for R4 500 per vehicle per month. These lease agreements must be renewed by the 25th of the month or the vehicles have to be returned to the lessor. The lease agreements are not operating leases as defined in section 23A(1) of the Income Tax Act, are held by the employer and the ownership thereof will be acquired by the employer on the termination of the lease. On 1 June 2017 each vehicle had a retail market value of R290 500. As a key account manager Masego was allowed the use of one of the Mini's from 1 June 2016. Masego bore the full cost of all fuel and kept accurate records of expenditure, totalling R13 500. Masego's logbook showed that he travelled a total of 20 000 km during the 2017 year of assessment in the Mini, of which 4 800 km were for private purposes.

As Uhuru does not offer post-retirement benefits to its key account managers, the company encourages them to join a retirement annuity fund of their own choice. Uhuru then contributes the same amount as the contributions made by employees to their retirement annuity funds. Masego is a member of a retirement annuity fund and made contributions amounting to R45 000 to the fund during the year of assessment.

Additional information

- Uhuru only transacts with VAT vendors, unless indicated otherwise.
- All amounts provided include VAT where applicable, and in all cases Uhuru obtained valid VAT invoices.

EXTRACT FROM THE

CONVENTION BETWEEN THE GOVERNMENT OF THE REPUBLIC OF SOUTH AFRICA AND THE GOVERNMENT OF THE FEDERATIVE REPUBLIC OF BRAZIL FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME

The Convention was published in *Government Gazette* No 29073 dated 28 July 2006.

Article 1
Persons Covered

This Convention shall apply to persons who are residents of one or both of the Contracting States.

Article 2
Taxes Covered

1. This Convention shall apply to taxes on income imposed on behalf of a Contracting State.
2. There shall be regarded as taxes on income all taxes imposed on total income, or on elements of income.
3. The existing taxes to which the Convention shall apply are:
   (a) in Brazil:
      (i) the federal income tax (hereinafter referred to as "Brazilian tax"); and

   (b) in South Africa:
      (i) the normal tax;
      (ii) the secondary tax on companies; and
      (iii) the withholding tax on royalties;
      (hereinafter referred to as "South African tax").

Article 3
General Definitions

1. For the purposes of this Convention, unless the context otherwise requires:
   (f) the terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" mean respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;
   (h) the term "national" means:
      (i) any individual possessing the nationality of a Contracting State;
      (ii) any legal person, partnership or association deriving its status as such from the laws in force in a Contracting State; and

   (i) the term "person" includes an individual, a company and any other body of persons that is treated as an entity for tax purposes.

2. As regards the application of the provisions of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State.

Article 4
Resident

1. For the purposes of this Convention, the term "resident of a Contracting State" means any person who, under the laws of that State, is liable to tax therein by reason of that person's domicile, residence, place of management or any other criterion of a similar nature, and also includes that State and any political subdivision or local authority thereof.
2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then that individual's status shall be determined as follows:
   (a) the individual shall be deemed to be a resident solely of the State in which a permanent home is available to the individual; if a permanent home is available to the individual in both States, the individual shall be deemed to be a resident solely of the State with which the individual's personal and economic relations are closer (centre of vital interests);
   (b) if sole residence cannot be determined under the provisions of subparagraph (a), the individual shall be deemed to be a resident solely of the State in which the individual has an habitual abode;
   (c) if the individual has an habitual abode in both States or in neither of them, the individual shall be deemed to be a resident solely of the State of which the individual is a national;
   (d) if the individual is a national of both States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

Article 14
Independent Services

1. Income derived by a person that is a resident of a Contracting State in respect of professional services or other activities of an independent character shall be taxable only in that State, unless:
   (a) the remuneration for those services or activities is paid by a resident of the other Contracting State or is borne by a permanent establishment or a fixed base situated therein. In such case, the income may also be taxed in that other State; or
   (b) that person, employees of that person or any other person on behalf of that person are present, or the services or activities continue, in the other Contracting State for a period or periods exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned. In such case, only so much of the income as is derived from the services or activities performed in that other State may be taxed in that other State; or
   (c) the services or activities are performed in the other Contracting State through a fixed base regularly available to that person in that other State for the purpose of performing that person's services or activities. In such case, only so much of the income as is attributable to that fixed base may be taxed in that other State.
2. The term "professional services" includes especially independent scientific, technical, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists and accountants.

Article 15

Income from Employment

1. Subject to the provisions of Articles 16, 18 and 19, salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.
2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:
   (a) the recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in any twelve-month period commencing or ending in the fiscal year concerned, and
   (b) the remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and
   (c) the remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.
3. Notwithstanding the preceding provisions of this Article, remuneration derived in respect of an employment exercised aboard a ship or aircraft operated in international traffic by an enterprise of a Contracting State may be taxed in that State.

MONETARY CHANGES – ITC 2018

Applicable in respect of years of assessment commencing **on or after 1 March 2016 (i.e. 2017 year of assessment)** – *unless specifically stated otherwise*

REBATES (section 6)
Primary rebate increases from R13 257 to **R13 500**;
(Secondary and tertiary rebates remained unchanged)

MEDICAL REBATES (section 6A)
Benefits to the taxpayer: R270 increases to **R286**;
Benefits to the taxpayer and one dependant: R540 increases to **R572;**
Benefits to each additional dependant: R181 increases to **R192**.

SECTION 9D inclusion adjustment if the resident is a natural person (section 9D(2A)(f))
For purposes of paragraph 10 of the Eighth Schedule: 33,3% increases to **40%** of that company's net capital gain for the relevant foreign tax year if the resident is a natural person.

SECTION 10(1)(q)(ii) Scholarship or bursary to relative of employee exemption
(*aa*) Remuneration proxy: R250 000 increases to **R400 000**
(*bb*)(A): R10 000 increases to **R15 000**
(*bb*)(B): R30 000 increases to **R40 000**

RESIDENTIAL ACCOMMODATION (paragraph 9 of the Seventh Schedule)
Symbol B of R73 650 increases to **R75 000**.

CGT ANNUAL EXCLUSION (paragraph 5(1) of the Eighth Schedule)
R30 000 increases to **R40 000**

CGT INCLUSION RATES (paragraph 10 of the Eighth Schedule)
In the case of a natural person or a special trust (as defined in s1): 33,3% increases to **40%**
In the case of a company and a trust (not being a special trust): 66,6% increases to **80%**

RATES OF NORMAL TAX

- In respect of the taxable income (excluding any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit or severance benefit) of natural persons, estates and special trusts

Taxable Income (R)	Rate of Tax
0 – 188 000	18% of taxable income
188 001 – 293 600	R33 840 + 26% of the amount above R188 000
293 601 – 406 400	R61 269 + 31% of the amount above R293 600
406 401 – 550 100	R96 264 + 36% of the amount above R406 400
550 101– 701 300	R147 996 + 39% of the amount above R550 100
701 301 and above	R206 964 + 41% of the amount above R701 300

- **Small Business Corporation (as defined in section 12E)**
  (Applicable in respect of years of assessment ending on or after 1 April 2016)

Taxable Income	**Rate of Tax**
0 – 75 000	0% of taxable income
75 001 – 365 000	7% of the amount above R75 000
365 001 – 550 000	R20 300 + 21% of the amount above R365 000
550 001 and above	R59 150 + 28% of the amount above R550 000

TRAVEL ALLOWANCE

Value of the vehicle (R)	Fixed cost (R p.a.)	Fuel cost (c/km)	Maintenance cost (c/km)
0 – 80 000	26 675	82.4	30.8
80 001 – 160 000	47 644	92.0	38.6
160 001 – 240 000	68 684	100.0	42.5
240 001 – 320 000	87 223	107.5	46.4
320 001 – 400 000	105 822	115.0	54.5
400 001 – 480 000	125 303	132.0	64.0
480 001 – 560 000	144 784	136.5	79.5
Exceeding 560 000	144 784	136.5	79.5

Alternative fixed rate for certain reimbursive travel allowances: **329** cents per kilometer (previously 318 cents)

SUBSISTENCE ALLOWANCE

- Local travel:
  - Allowance for incidental costs only **– R115** (previously R109) for each day.
  - Allowance for meals and incidental costs **– R372** (previously R353) for each day.
- Overseas travel:
  - Actual accommodation plus a prescribed amount based on the relevant country (which amount will be provided in the ITC if it differs from the amount listed in the Regulation in the SAICA Student Handbook).

TRANSFER DUTY (Section 2(1)(b) of the Transfer Duty Act)

In respect of acquisition of property on or after **1 March 2016:**

Value of property (R)	Rate
0 – 750 000	0%
750 001 – 1 250 000	3% of the value above R750 000
1 250 001 – 1 750 000	R15 000 + 6% of the value above R1 250 000
1 750 001 – 2 250 000	R45 000 + 8% of the value above R1 750 000
2 250 001 – 10 000 000	R85 000 + 11% of the value above R2 250 000
10 000 001 and above	R937 500 + 13% of the value above R10 000 000

INITIAL TEST OF COMPETENCE, JUNE 2018
PROFESSIONAL PAPER 4

QUESTION 1 – REQUIRED		**Marks**	
		Sub-total	**Total**
(a)	Advise Nomzamo on whether the interest expense incurred by her on her mortgage bond would be deductible in the determination of her 2017 taxable income.	9	
	Refer to case law where applicable.		
	Communication skills – logical argument	*1*	10
(b)	Discuss the possible normal income tax consequences, if any, for the marketing assistants on the flats sold to them by Uhuru during the 2017 year of assessment.	8	8
(c)	Discuss the normal income tax implications for Aisha in terms of the temporary employment agreement with Uhuru for the marketing of the Copacabanas in Brazil for the 2017 year of assessment.	8	
	Communication skills – clarity of expression	1	9
(d)	Calculate the amounts that would qualify to be claimed as input tax in Uhuru's VAT return relating to Aisha's trip to Durban in February 2017. Provide reasons for any amounts not included in your calculations.	6	6
(e)	Identify and correct the errors in the assessment that was issued to Siphokazi for the 2017 year of assessment.	10	10
(f)	Calculate the amounts to be included in Masego's gross income for the 2017 year of assessment. Provide reasons for any amounts not included in your calculations.	7	7
Total			**50**