

All amounts exclude value-added tax (VAT) unless the context indicates otherwise.

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|---------------------|
| 1 Background |
|---------------------|

On 2 January 2023, Marchant Peddlar started as a trainee accountant at Hustle & Co ('Hustle'), a small audit firm in Tshwane.

From 2019, during his university days, Marchant showed entrepreneurial spirit by acquiring vending machines, which were installed at student accommodation complexes near his university. Marchant started this business venture, trading as a sole proprietor, during his first year of studies. He acquired three second-hand vending machines on 1 September 2019, for a total purchase price of R93 000, which were brought into use on that date. These vending machines accept cash and cards as payment and sell cool drinks, energy drinks, chocolates, chips and microwavable foods such as noodles. Since the vending machines provide 24-hour, quick access to products, Marchant can charge higher prices than retailers. Marchant's knowledge of students' preferences enabled him to choose products in high demand.

The machines were financed entirely with a loan from Marchant's father. After acquiring the vending machines, Marchant, with the help of his brother, Johnny Peddlar (when Marchant was not available), took full responsibility for stocking the machines, tracking sales, maintaining inventory levels in the machines, and ensuring that they were in working order. The high sales volumes and excellent gross profit margins allowed Marchant to repay the loan from his father in full shortly after starting the business. Marchant did not register as a VAT vendor with the South African Revenue Service (SARS).

Marchant's business grew at a steady pace during his time as a student. Thereafter, despite his commitment to his training contract at Hustle, Marchant diligently maintained his vending business.

The detailed income statement of Marchant's current operations (with the three vending machines) for the year of assessment ended 29 February 2024 is as follows:

| Description | Notes | R |
|--------------------------------|-------|-----------------|
| Revenue | | 83 496 |
| Cash | 1.2 | 71 348 |
| Cards | | 12 148 |
| Cost of sales | | (34 539) |
| Opening stock | 1.3 | 9 300 |
| Purchases | | 45 700 |
| Closing stock | | (20 461) |
| Refunds | 1.4 | (862) |
| Gross profit | | 48 095 |
| Expenses | | (60 709) |
| Maintenance: Vending machines | 1.5 | (11 754) |
| Depreciation: Vending machines | 1.6 | (9 300) |
| Vehicle expenses | 1.7 | |
| Fuel | | (26 325) |
| Maintenance | | (4 320) |
| Insurance | | (5 984) |
| Bank charges | | |
| Cash deposits | | (1 035) |
| Card fees | | (607) |
| Cleaning materials | | (862) |
| Data costs | 1.8 | (522) |
| Rental | 1.9 | – |
| Loss for the year | | (12 614) |

Notes

- 1.1 As Marchant is not a registered VAT vendor, the amounts in the table are inclusive of VAT where relevant.
- 1.2 Each vending machine accepts cash or card payments. Marchant removes cash sale proceeds from the machines daily to avoid theft losses. He only leaves the minimum amount of cash in the machine to issue change when customers purchase with cash.
- 1.3 Trading stock is mainly purchased from wholesalers or major retailers.
- 1.4 Customers can seek assistance from Marchant to request a refund if the goods did not 'drop' from the machine. The customer can provide details of the unsuccessful transaction, and Marchant will then manually process the refund or credit the amount back to the customer.
- 1.5 The vending machines require regular maintenance, irrespective of the level of sales. The maintenance is important as the lack of maintenance does not only result in the malfunction of machines (in terms of temperature) but also of the note readers (the component that verifies that only valid cash notes are accepted for transactions). A new card reader, with a cost of R7 500, was installed in one of the vending machines on 29 February 2024. This was included in the maintenance amount.

- 1.6 Depreciation on the machines and their components is calculated at 10% per annum on the straight-line basis.
- 1.7 The vehicle expenses include the total expenses incurred by Marchant. Only 15% of the various cost items (fuel, maintenance and insurance) relate to the business. Vehicle maintenance is regarded as fixed for costing purposes. The tax value of the vehicle was Rnil on 1 March 2023.
- 1.8 Data costs relate in full to the operation of the vending machines.
- 1.9 Expenditure does not include any rental payments. The machines operate without formal contracts with the property owners, and the landlords provide electricity connections at no cost.

2 Extract of employment information with Hustle

Marchant's remuneration package for the 2024 year of assessment included the following:

- 1 Basic cash salary of R21 900 per month.
- 2 As a condition of employment, Marchant is a member of the Chartered Accountants (SA) Medical Aid Fund, a medical aid scheme registered under the Medical Schemes Act. Marchant does not have a disability as defined in section 6B(1) of the Income Tax Act. Monthly contributions amounted to R2 840, and Hustle makes no contributions to its employees' medical aid. Marchant is unmarried and does not make any contributions in respect of any dependant registered with any medical aid fund. Marchant had no out-of-pocket medical expenses during his 2024 year of assessment.
- 3 All Hustle employees are granted the use of a cell phone. Marchant was granted the right of use of an iPhone 13 with a cost (equal to the market value) of R13 999. The monthly subscription for the voice and data plan paid by Hustle amounts to R769. The private use of the cell phone is incidental.
- 4 Marchant spent 30 days away from home while on out-of-town audit engagements and received an allowance of R190 per day to cover incidental costs. Marchant did not keep any receipts for costs incurred. Hustle does not recover the allowance for incidental costs from its clients.
- 5 Hustle re-imburses its employees at R5,20 per km travelled for business purposes.

Marchant owns a VW Polo Caddy, purchased on 1 February 2023, with a retail market value of R269 900 on that date. Marchant bears all the costs relating to this vehicle, but did not keep accurate data of the expenditure. The Caddy is used only for personal use or for travel related to Marchant's employment with Hustle.

The distance travelled for the 2024 year of assessment, as substantiated by a travel logbook acceptable to SARS, was as follows:

- Private – 5 600 km
- Business – 8 400 km
- Total – 14 000 km

3 New business opportunity

Marchant was contacted by Jackie Oldman, another vendor involved in the vending machine business. Jackie wanted to dispose of her vending machine business. Jackie operates her business through OldManVendi (Pty) Ltd ('OMV') and owns 100% of the ordinary shares in OMV. OMV is not a registered VAT vendor.

OMV focuses mainly on hotels (primarily staff restrooms), big corporate office buildings and other businesses that have 24-hour operations, such as logistics and courier businesses. OMV owns 32 vending machines operating from 20 sites around the Tshwane and Midrand areas. Jackie expanded OMV's business over many years, and some of her vending machines are more than ten years old.

Marchant is keen to acquire the business as he is of the opinion that the sales can be significantly increased through better management of the machines.

Jackie offered Marchant two options:

Option 1: Buy all the shares in OMV for R692 925 in cash.

Option 2: Buy the assets of the business for a total of R692 925 in cash. The assets comprised the following:

| Assets | Value |
|--|----------------|
| | R |
| Vending machines (open market value: R600 000) | 547 975 |
| Inventory | 42 849 |
| Coins | 11 251 |
| Panel van – 2010 model. Value as per 'Cars4Everyone', a well-known online second-hand car dealer (open market value: R100 000) | 90 850 |
| Total | 692 925 |

The following relates to the incorporation and establishment of VendiBoys and subsequent transactions:

Transaction 1

- After careful consideration, Marchant decided to first incorporate a new company, VendiBoys (Pty) Ltd ('VendiBoys'), on 1 March 2024. VendiBoys was registered as a category B VAT vendor with SARS.
- On 1 March 2024, Marchant transferred the three second-hand vending machines that he had purchased on 1 September 2019 to VendiBoys in exchange for a 100% shareholding. The total tax value of all the second-hand vending machines of R23 250 was also reflective of the market value on 1 March 2024.

Transaction 2

- VendiBoys decided to pursue option 2 and to buy the assets from OMV. The effective date of the transaction was 2 March 2024. VendiBoys' first financial year end was 30 September 2024 (FY2024), which is also the end of its year of assessment.

Transaction 3

- Vendiboys' acquisition of the assets of OMV was funded by two loans:
 - A loan of R450 000 from Marchant's father; and
 - A loan from Marchant, who increased his personal loan at a bank for this purpose.
- Both loans to Vendiboys earn interest at a rate of prime plus 3,5% per annum and are repayable in equal monthly instalments over three years.

Marchant decided to involve his brother, Johnny, in the vending business, as Johnny has previous logistics experience. Johnny passed his matric exam a few years ago but did not qualify for tertiary studies. He lives with his parents and previously made deliveries for a delivery company. Marchant and Johnny are the only directors of Vendiboys.

Marchant is responsible for compiling the annual financial statements. While the Companies Act does not mandate audited financial statements for Vendiboys, Marchant realised that banks would require it for loan advances in the future and thus opted to have audited financial statements. The directors decided to appoint Qotho Inc. as Vendiboys' auditors.

Both Marchant and Johnny play integral roles in the business' daily operations. To ensure they do not complicate their tax situation, the brothers allocate some private expenses incurred by them, such as all their personal vehicle fuel expenses, as expenses to Vendiboys.

Marchant prepared the following management accounts of VendiBoys for the two months ended 30 April 2024. The amounts in this table are inclusive of VAT, where applicable:

| Description | Notes | R |
|--------------------------------------|---------------|------------------|
| Revenue | 3.1, 3.2, 3.3 | 181 428 |
| Cash | | 178 627 |
| Cards | | 2 801 |
| Cost of sales | 3.4, 3.5 | (99 878) |
| Refunds | | (3 778) |
| Gross profit | 3.6 | 77 772 |
| | | |
| Expenses | | (129 428) |
| Employee costs | 3.7 | (65 000) |
| Maintenance: Machines | 3.8 | (8 043) |
| Depreciation: Vending machines | 3.8 | (11 550) |
| Rental payments to property owners | 3.9 | (6 400) |
| Subscription to OpKconnect platform | 3.10 | (1 000) |
| Vehicle expenses | 3.11 | |
| Fuel | | (5 587) |
| Maintenance | | (11 832) |
| Insurance | | (2 650) |
| Bank charges | 3.12 | |
| Cash deposits | | (1 235) |
| Card fees | | (120) |
| Interest | | (16 011) |
| Loss for the two-month period | | (51 656) |

Notes

- 3.1 The management accounts reflect the sales for the two months.
- 3.2 From time to time, the selling prices of slow-moving products are adjusted downward to stimulate the sales of these products.
- 3.3 To ensure that the vending machines offer products that are in demand, Marchant and Johnny recently added vapes and vape juices to the vending machines. VendiBoys will soon apply for the necessary retail tobacco and e-cigarette trading licence. The addition of these products has already contributed to a sizeable increase in sales. Marchant successfully negotiated with a supplier to purchase bulk vapes and vape juices at significantly reduced prices. However, in view of recent media reports alleging that this supplier sells counterfeit products, Marchant is actively exploring alternative supplier options.
- 3.4 Customers do not want to buy products that have passed their expiry dates, resulting in write-offs on products stocked in the vending machines. Removing expiry dates can extend the shelf life of products and reduce write-offs. Johnny discovered that the best way to remove the expiry dates is to use colourless nail polish remover as that dissolves certain types of ink.

- 3.5 Cost of sales includes costs of purchases at wholesalers and inventory purchased from OMV.
- 3.6 Marchant enjoys the business' marketing side and is constantly looking for new expansion opportunities and venues at which to install vending machines. VendiBoys occasionally experiences theft from vending machines at university hostels and, in the long run, wants to focus on expanding into the corporate environment. Marchant frequently promotes the vending business with clients during audit engagements to identify possible future sites and uncover new opportunities. He also discusses potential new locations for vending machine installations and has successfully persuaded several audit clients to proceed with installations. He even asked Hustle's staff planner to book him on clients who may have suitable locations for his vending business.
- 3.7 Soon after acquiring the vending machines, Marchant realised that VendiBoys needed to scale up the human resources further to accommodate the expansion of operations and Marchant's limited availability because of his work at the audit firm. VendiBoys accordingly hired one part-time admin staff member to assist with the daily business administration. Johnny is responsible for inventory and restocking of machines, but VendiBoys also hired two vending machine technicians who assist with restocking and repairing the machines. The two vending machine technicians and admin assistant are paid fixed monthly salaries.
- 3.8 Marchant decided that using a standardised depreciation period of ten years for all vending machines and their components would simplify asset management and the accounting entries for depreciation. Regular maintenance is performed on all machines, and a fixed maintenance fee is incurred for each period. Marchant's experience shows that vending machines that are seven years and older need significantly more maintenance to resolve issues and maintain optimal performance.
- 3.9 VendiBoys is required to pay a fixed monthly rental to the owners of the properties where the machines acquired from OMV are located. This rental allows VendiBoys to install vending machines at each location, for use of the electricity in the building and for general security around the machines.
- 3.10 As the business expanded, VendiBoys recognised the need for more efficient management of its growing number of vending machines. To address this, VendiBoys invested in the first week of March 2024 in a software application called OpKconnect. This system provides real-time monitoring and management capabilities, allowing VendiBoys to remotely track inventory levels, machine performance and sales data.
- By utilising OpKconnect, VendiBoys can optimise restocking schedules, reduce downtime and improve overall operational efficiency. The advanced analytics and reporting features also enable the company to make data-driven decisions, which enhances profitability and customer satisfaction. Further details on the system are provided in the section titled 'OpKconnect application system'. VendiBoys pays a monthly subscription fee for the use of the OpKconnect system.
- 3.11 Vehicle expenses relate to the panel van that is used by the technicians. This van can carry a large quantity of inventory items, which helps to optimise route planning and avoid the technicians running out of stock while restocking the vending machines. The brothers have not yet charged their personal fuel expenses to the company.

- 3.12 One of the managers working with Marchant at Hustle overheard the following conversation: Marchant was complaining about the extremely high bank deposit fees, although he accepted it as one of the unavoidable costs of running his vending machine business. Marchant agreed to assist his friend, who has a small bakery business, by including the cash from the bakery's sales in VendiBoys' weekly cash deposits, so that his friend would save the cash deposit fees. VendiBoys would transfer the monies to the bakery's account as soon as it is available in VendiBoys' account. In exchange, VendiBoys would buy inventory from one of the large wholesalers on the bakery's account, and VendiBoys would benefit from volume discounts, but paying for it in cash. VendiBoys is not acting as an agent on behalf of his friend.
- 3.13 VendiBoys has not insured the vending machines or its inventory against theft or damage.

4 Further information relating to the OpKonnnect application system

The OpKonnnect application ('app') manages sales transactions and inventory levels. The app provides wireless connectivity for vending machines, by means of a small device installed inside each machine. This device communicates with nearby cellular towers to transmit data securely to the cloud. This includes data on sales transactions, inventory levels and machine health. Data transmission between the devices and the cloud platform, hosted by a third-party provider, is encrypted to ensure the confidentiality and integrity of the data. There have been isolated instances that resulted in a loss of connectivity of devices to the cellular network, but the third-party provider is continuously working to reduce this.

The app includes modules for sales transactions, inventory management, and machine health monitoring needs. Data is continuously monitored, and notifications are sent as mobile app notifications. Both Marchant and Johnny receive notifications, which are then routed to the vending machine technicians for action.

The device records cash sale transactions and updates the sales data in real time. The vending machine technicians take the cash from the machine and hand it over to Marchant. Marchant reconciles the cash sales daily to the cash sales data on the app to ensure all the cash has been received. Cash is banked every second day. This process ensures accurate accounting.

The app also supports credit card payments. Those vending machines with credit card readers are connected to a device that processes transactions securely over the cellular network. The credit card sales are recorded alongside cash sales, allowing for comprehensive sales reports.

The platform receives the data transmitted by devices from multiple vending machines. It provides a centralised dashboard where owners can remotely monitor the status and performance of their vending machines in real time. The monitoring includes determining inventory levels, analysing sales data, and troubleshooting technical issues. Johnny uses the inventory module within the app to monitor product levels and ensure timeous ordering of inventory. Marchant believes that, as the app is reliable and accurate, there is no need for regular inventory counts.

Marchant regularly downloads the data from the app, captures it in the accounting records, and analyses data for decision making regarding product choices. The following data fields are available:

| Sales transactions data | Machine health and operational efficiency metrics |
|---|--|
| Transaction ID | Temperature and humidity levels |
| Transaction date | Status of device connectivity |
| Transaction time | Power supply status |
| Product ID | Location (geographic information; coordinates) |
| Product name | Low stock alert threshold |
| Quantity sold | |
| Unit price | Alerts and notifications |
| Total sales amount | Low stock levels alert |
| Customer receipt (yes/no) | Machine malfunction alert |
| | Cash collection alert |
| Inventory management data | |
| Product ID | Cash collection |
| Product name | Collection date |
| Quantity on hand | Collection time |
| Expiry date (for perishable products) | Amount of cash collected |
| Product selling price adjustment (yes/no) | Credentials of cash collector |
| Discounted price | |

5 Additional information

- 1 VendiBoys only buys from registered VAT vendors.
- 2 VendiBoys keeps valid tax invoices on file in compliance with the VAT Act.
- 3 All taxpayers will elect the most beneficial tax relief in terms of the Income Tax Act.
- 4 All persons are South African residents for tax purposes.
- 5 You may assume that the information provided in the 2023/2024 SAICA Tax Legislation Handbook is applicable to all years of assessment.
- 6 None of the taxpayers has an assessed loss or an assessed capital loss brought forward from the previous year of assessment.
- 7 In terms of Binding General Ruling 07 the write-off period for the second-hand vending machines is five years.

INITIAL ASSESSMENT OF COMPETENCE, JANUARY 2025

PROFESSIONAL PAPER 1

**This paper consists of one scenario and two required parts.
Answer each required part in a separate answer book.**

| PAPER 1 PART I – REQUIRED | | Marks | |
|---------------------------|---|-------------|-----------|
| | | Sub-total | Total |
| (a) | <p>Calculate Marchant's normal tax payable for his 2024 year of assessment.</p> <ul style="list-style-type: none"> Start your calculation of the vending machine trade with gross profit of R48 095. Provide brief reasons for amounts that do not affect the taxable income calculation. | 20 | 20 |
| (b) | <p>Discuss, from income tax and VAT perspectives, whether it would have been more advantageous for VendiBoys to acquire the shares in OMV, or to have purchased the assets of the business.</p> <ul style="list-style-type: none"> Calculations are not required. <p><i>Y2: Integrative thinking</i></p> | 12 1 | 13 |
| (c) | <p>Discuss the income tax implications for VendiBoys for its 2024 year of assessment in relation to the second-hand vending machines acquired in exchange for the 100% equity shares in Vendiboy's issued to Marchant.</p> <p><i>X1: Communication skill – clarity of expression</i></p> | 7 1 | 8 |
| (d) | <p>Calculate the VAT payable or refundable for the March / April 2024 tax period for VendiBoys.</p> <ul style="list-style-type: none"> Provide brief reasons for amounts that do not affect the VAT payable or refundable calculation. The amounts in the management accounts are inclusive of VAT. | 18 | 18 |
| Total for part I | | | 59 |

INITIAL ASSESSMENT OF COMPETENCE, JANUARY 2025

PROFESSIONAL PAPER 1

**This paper consists of one scenario and two required parts.
Answer each required part in a separate answer book.**

| PAPER 1 PART II – REQUIRED | | Marks | |
|----------------------------|--|-------------|------------|
| | | Sub-total | Total |
| (e) | Discuss VendiBoys' business and financial risks arising from the purchase and operation of the assets from OMV. <i>X1: Communication skill – logical argument</i> | 18 1 | 19 |
| (f) | Identify and discuss, with reference to VendiBoys, the risks of material misstatement at the assertion level for FY2024 for the following account balances: <ul style="list-style-type: none"> • Inventory: existence, completeness and valuation; and • Property, plant and equipment: valuation. <i>X1: Communication skill – clarity of expression</i> | 13 1 | 14 |
| (g) | Based on the data fields available from the OpKonnnect app, describe how the audit team could use automated tools and techniques to obtain sufficient and appropriate evidence that VendiBoys' revenue is fairly presented in the financial statements for FY2024. <i>Y1: Critical thinking</i> | 12 1 | 13 |
| (h) | Discuss ethical concerns regarding how the VendiBoys business is run by the Peddlar brothers. <ul style="list-style-type: none"> • Exclude the Companies Act and King IV Report on Corporate Governance from your answer. • Exclude any threats to fundamental principles from your answer. <i>Y5: Professional scepticism</i> | 14 1 | 15 |
| Total for part II | | | 61 |
| TOTAL FOR PAPER 1 | | | 120 |

Natural person income tax rates: 2024 tax year (1 March 2023 to 29 February 2024)

| RATES OF NORMAL TAX | |
|--|---|
| Natural persons and deceased estates (in respect of the taxable income (excluding any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit or severance benefit)) | |
| Taxable income (R) | Rate of tax |
| 0 – 237 100 | 18% of taxable income |
| 237 101 – 370 500 | 42 678 + 26% of taxable income above 237 100 |
| 370 501 – 512 800 | 77 362 + 31% of taxable income above 370 500 |
| 512 801 – 673 000 | 121 475 + 36% of taxable income above 512 800 |
| 673 001 – 857 900 | 179 147 + 39% of taxable income above 673 000 |
| 857 901 – 1 817 000 | 251 258 + 41% of taxable income above 857 900 |
| 1 817 001 and above | 644 489 + 45% of taxable income above 1 817 000 |

| NORMAL TAX REBATES (s6(2)) | 2024 | 2023 |
|---------------------------------------|-------------|-------------|
| Primary rebate | R17 235 | R16 425 |
| Secondary rebate (65 years and older) | R9 444 | R9 000 |
| Tertiary rebate (75 years and older) | R 3145 | R2 997 |

| MEDICAL SCHEME FEES TAX CREDIT (s6A) | 2024 | 2023 |
|---|-------------|-------------|
| Benefits to the taxpayer | R364 | R347 |
| Benefits to the taxpayer and one dependant | R728 | R694 |
| Benefits to each additional dependant | R246 | R234 |

| FIXING OF RATE PER KILOMETER IN RESPECT OF MOTOR VEHICLES | | | |
|---|----------------------------|-------------------------|--------------------------------|
| Value of the vehicle (R) | Fixed cost (R p.a.) | Fuel cost (c/km) | Maintenance cost (c/km) |
| 0 – 100 000 | 33 760 | 141.5 | 43.8 |
| 100 001 – 200 000 | 60 329 | 158.0 | 54.8 |
| 200 001 – 300 000 | 86 958 | 171.7 | 60.4 |
| 300 001 – 400 000 | 110 554 | 184.6 | 65.9 |
| 400 001 – 500 000 | 134 150 | 197.6 | 77.5 |
| 500 001 – 600 000 | 158 856 | 226.6 | 91.0 |
| 600 001 – 700 000 | 183 611 | 230.5 | 102.1 |
| 700 001 – 800 000 | 209 685 | 234.3 | 113.1 |
| Exceeding 800 000 | 209 685 | 234.3 | 113.1 |
| TRAVEL ALLOWANCE (s8(1)) | | 2024 | |
| Cost limitation of vehicle (section 8(1)(b)(iiiA)(bb)) | | R800 000 | |
| ALTERNATIVE FIXED RATE FOR CERTAIN REIMBURSIVE TRAVEL ALLOWANCES | | 2024 (c/km) | |
| Simplified method | | 464 | |