



Advantage



Increased Provisional Tax Penalties



Kent Karro
National Tax Partner
Horwath in South Africa

Managing Partner
Horwath Zeller Karro

In the draft Revenue Laws Second Amendment Bill, 2008 there is a seemingly small change to paragraph 20(1) of the fourth schedule to the Income Tax Act.

This paragraph deals with the second provisional tax payment due for rendition by all provisional taxpayers.

Up to now, there was no penalty payable as long as the estimated taxable income in respect of the year then ending is not less than 90% of the amount of the actual taxable income for the period in respect of which the estimate was made and was also not less than the "basic amount" which is the taxable income as disclosed in the latest tax assessment issued to that taxpayer.

In practice, the effect was that the second provisional tax payment could be based with impunity on the taxable income as disclosed in the latest assessment issued by SARS. If a taxpayer considered that the actual taxable income for that year would probably be less than the last assessed amount, a lower estimate could be made. If however that estimate

was lower than 90% of the taxable income as ultimately assessed for that year, a penalty tax of 20% was payable. The penalty was calculated on the difference between the amount of the normal tax on the estimated taxable income and the normal tax calculated on 90% of the actual taxable income. In addition to the penalty, interest was also payable at the current (non-tax deductible) rate of 14% p.a.

The proposed change deletes reference to the "basic amount", being the taxable income as reflected in the latest tax assessment issued by SARS.

The effect is that all provisional taxpayers must make a careful estimate of their taxable income for the second provisional tax return i.e. the return due for lodgement and payment before the last day of the tax year.

If the normal tax on the estimated taxable income is less than 90% of the normal tax as finally assessed for that year, the aforementioned 20% penalty tax will be payable on the difference between the two amounts of normal tax referred to. We understand that SARS

has since agreed to reduce the 90% to 80%.

In many cases, provisional taxpayers will be very hard-pressed to estimate their taxable income for a year before the end of that year. Trading stock is still to be counted and valued, not all expense vouchers and creditors statements will have been received, the final sales for the last month could not yet have been calculated, etc, etc. There are truly so many variables at that stage that very few taxpayers will be able to accurately determine their taxable income before the year end.

Although we understand that the penalty will only be applied by SARS where the taxpayer can not show that due care and responsibility was taken in calculating the provisional payment, this onus of proof will not always be easy to discharge. It is not yet clear whether these changes will be passed into law without further amendment. If so, the effect will be startling with many taxpayers falling into the penalty net.

Contact Kent: +27 21 481 7000
Email: kent.karro@horwath.co.za

Internet Banking Fraud – current schemes



Terence Hatzkilson
Managing Director
Horwath Forensics

Internal Internet banking fraud (EFT fraud) occurs when the employee responsible for effecting electronic payments to creditors misappropriates the fund by transferring them into their private, related and/or personal creditors' bank accounts.

Horwath Forensics has been engaged in several matters where the Internet banking facility was the primary vehicle used in defrauding the companies in question. The foremost reason for the occurrence of these fraudulent schemes is usually a lack of segregation of duties in the creditor's department at the company, where loading and amending of beneficiary details, authorising of payments and effecting of payments are all tasked to a single individual. Although segregation of employee duties is a principal internal control, this can be rendered ineffective through schemes involving the collusion of employees.

Although we are often tasked to investigate matters involving internal EFT fraud, as well as to review existing internal controls and recommend suitable improvements, we have recently seen a spate of external Internet banking fraud cases.

In these situations, the modus operandi involves the interception by fraudsters of official company letter-

heads, primarily through contacts at the Post Offices, however, also through collusion between internal employees and fraudsters. The fraudster will then send out a letter (on the official letterhead) to various customers of the company. The letter usually states that there has been a change in the company's bank account details, and a new bank account number is listed, into which all transfers should be paid. We have also observed instances whereby the letter stated that a separate bank account had been set up by the company for all direct deposits and electronic payments, and requested the customer to utilise the new bank account going forward.

As the letterhead appears to be legitimate, many people have fallen for this scam. For various reasons, recovery of these funds is an arduous process and is certainly not guaranteed.

If any of your creditors indicate that they have changed their bank account details, at the very least, a call to the company to verify the authority of change is recommended. This simple procedure may result in the avoidance of damages.

Contact Terence: +27 11 217 8000
Email: terence.hatzkilson@horwathsa.co.za

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Audit Risks - Mind the gap



One of the greatest dangers to the public perception of the audit profession is the wide gap that exists between what directors, shareholders and creditors expect from the statutory auditors and what statutory auditors can actually do.

Many members of the public expect that:

- auditors should accept prime responsibility for the financial statements,
- auditors 'certify' financial statements,
- a 'clean' opinion guarantees the accuracy of financial statements,
- auditors perform a 100% check,
- auditors should give early warning about the possibility of business failure, and
- auditors are supposed to detect fraud.

According to the auditing profession, the reality is that:

- management, as preparers of the financial statements, is primarily responsible for their content, even though management may request the auditors to prepare them;
- an audit only provides reasonable assurance that financial statements are free of material misstatement;
- an audit is no guarantee of solvency or financial performance;
- auditors are only required to test selected transactions - it does not make economic

sense, in to-days world, to check all transactions; and

- although auditors plan and conduct an audit engagement with an attitude of professional scepticism recognizing that circumstances such as fraud may exist that will cause the financial statements to be materially misstated, an audit does not guarantee that fraud will be detected.

Whenever any company fails, public opinion is likely to consider the auditors who gave its financial statements a clean slate as negligent if not worse.

To demand that a statutory audit—which only aims to provide a reasonable assurance that financial statements are free from material misstatement—should also provide an assurance that the company will survive and grow is thus an example of an expectation gap.

A statutory audit is not a strategy audit, which evaluates the strategy formulation process and evaluates strategies against the vision and mission of the company. Neither can it be a propriety audit which extends beyond scrutinising the mere formality of expenditure to examine its wisdom and economy and brings to light cases of improper expenditure or waste of shareholder money.

Another incorrect but common general perception is that it is the responsibility of statutory auditors to detect fraud. However, it is often impossible for a statutory audit to detect fraud perpetrated by management, since the focus of auditing techniques is not towards detecting such fraud. A statutory audit is not an investigation and the statutory auditor cannot be expected to employ the techniques of an investigator.

While there is certainly an expectation gap, it would be wrong to ascribe every public criticism of the auditing profession to the expectation gap. Audit failures also occur. Some audit failures are due to the professional negligence of the auditor, while others are due to the failure of auditing techniques themselves.

While the auditing profession should certainly educate the public about its proper role and try to close the expectation gap, it should at the same time put its own house in order and root out the negligence and conflicts of interests which lead to audit failures.

Let the individual members of the profession take the challenge of improving the integrity and the ethical standard of the profession.

Contact Steven: +27 11 217 8000
Email: steven.firer@horwathsa.co.za

Horwath Risk Consulting SA



Horwath Risk Consulting SA was launched in September 2007 to create an additional "value add service" to both existing and potential clients. Derek Cellarius was appointed CEO and principal consultant.

As long as there is risk, there will be rewards. Managing business risk is a continual challenge, and business leaders take the challenge to heart.

Horwath Risk Consulting SA will help your organisation realise the benefits of:

- Assessing key business risks unique to your industry and organisation; Implementing risk management methods and systems for improved performance;
- Monitoring risk management effectiveness on an ongoing basis, through internal auditing;
- Documenting risk management processes to increase the confidence of regulators, shareholders, and other stakeholders;
- Managing business risk to reduce the cost of capital and improve shareholder value.

Horwath Risk Consulting SA was recently awarded a tender with the Department of Public Enterprises (DPE). The proposal was in response to a tender calling for support to the Risk Management Unit of DPE. We tendered in competition with eight other professional firms, including some of the Big Four. We

were eventually selected out of a short list of 3 firms because our "test" risk assessment of Eskom's 2008 5-year business plan was considered to be the best. The duration of the assignment is one year and may be extended.

Derek is assisting DPE with its risk management programme and has recently completed a risk review of the corporate plans (business plans) of all nine State-Owned Enterprises (SOE). He presented his findings to the then Minister of Public Enterprises, Mr Alec Erwin and the Director-General of DPE. A risk assessment of the quarterly plans of the SOE will be performed on a regular basis.

Derek is also assisting DPE to develop its risk reporting procedures and is currently investigating a software solution for risk management at DPE. Thereafter, Derek will assist DPE in benchmarking risk management procedures at some of the SOE.

Many entities, although aware of the potential value of an enterprise-wide risk management system, are uncertain about how to start the implementation process. Call on Horwath Risk Consulting SA for risk management and internal audit expertise to improve your compliance processes, corporate governance, and business performance.

Contact Derek: +27 12 348 6335
Email: derek.cellarius@horwathsa.co.za

Launch of national website

Over the last three years the four South African member firms of Horwath International have collaborated as a team, sharing industry knowledge, expertise and assisting clients who require the services of a nationally networked firm. As a result, we have strengthened our positioning as a first choice auditing and advisory firm.

Today we are proud to announce that Horwath in South Africa will be launching their new website, www.horwath.co.za, before the end of the year. More than just an extreme makeover, this new website reflects both our local and international footprint, enhancing our credibility as a significant competitor in the market. Furthermore it substantiates and reinforces all that we offer and stand for.

- The comprehensiveness of our services which extends beyond auditing, accounting and tax compliance.
- Our BEE status which compared to other mid-tier firms, (excluding black-owned firms) is unrivalled.
- Our commitment to added value.

Given these and other credentials featured on our website we anticipate furthering the growth of Horwath in South Africa and so look forward to building on our relationship with you.

Ten ways to save tax with a retirement annuity (RA)

Most people know that contributions to a RA are tax-deductible up to a certain maximum, but few people realise that a RA may actually provide them with an opportunity to save tax in 10 different ways.

1. Contributions are tax-deductible up to a certain maximum.
2. Disallowed contributions can be carried over to the next year of assessment and, if unused during the contribution period, can be offset at retirement to increase the tax-free portion of the lump sum, or claimed as a tax deduction against the annuity purchased with the non-commuted amount.
3. The abolition of retirement fund tax means that no tax on interest or rental income would be imposed on the fund.
4. Your lump sums at death, disability or re-

irement are tax-free up to a certain amount.

5. The balance of the tax-free lump sum is taxed at a more concessionary rate of tax on a sliding scale.
6. You can deduct a further R1 800 per year in respect of arrear contributions (these are really re-instatement contributions).
7. On death, any benefits paid out by way of an annuity are free of estate duty. (This provides a planning opportunity for the wealthy estate owner to make a large single-premium contribution to a RA to reduce his or her estate for duty purposes). You could also donate a lump sum to your spouse (donations tax exempt) also saving estate duty of 20%.
8. If you leave your employer and receive a withdrawal benefit from your pension or provident fund, you can preserve your retire-

ment benefit by transferring it into a RA fund tax-free.

9. On retirement, you have a choice between a conventional annuity and any investment-linked living annuity.

10. Most people experience a big increase in medical expenses once they retire. Thankfully, once you have reached age 65, your medical expenses become fully tax-deductible. A RA can be used to build up a fund for post-retirement medical expenses in a tax-efficient way. On retirement although the annuity is fully taxable, to the extent that it is used to cover medical expenses it is deductible again. It is therefore, in essence, tax-free.

Contact Nigel: +27 011 217 8000
Email: nigel.willmott@horwathsa.co.za

Branded Resort Developments

Integrated Resort Development (IRD) is a relatively new term. Although the definitions of resort developments vary somewhat, in effect, an IRD is a residential development integrating additional elements into and around the traditional residential component.

IRD developments which cater to primary home buyers are often at an urban edge and essentially provide residents with a gated community lifestyle whilst those which cater to secondary home buyers are generally situated in tourist destinations and are often modelled on a destination resort concept rather than a gated community.

Increasingly international branded hotels are integrated in IRD developments, which often provide IRD's with the additional value of being associated with an internationally recognised and established leisure brand. The presence of such branded hotels allows a development to benefit from the reputation of an established leisure brand and ongoing

marketing efforts by international hotel management companies. The inclusion of a prestigious hotel development allows for the augmentation of the product offering of an IRD and as a result the sales prices are able to reflect this perceived added value.

IRD developments which cater predominantly to second home buyers are increasingly offering purchasers the option of entering their property in a 'rental pool', which provides the owner with a yield on investment; in fact certain IRD developments guarantee a rental yield for a specific period of time to entice investment buyers. Typically, owners decide during which periods of the year they will make use of their property, and, for the rest of the year the property is placed in a rental pool from which the owner receives rental revenue.

The predominant ownership schemes employed in the IRD market are freehold-, leasehold-, sectional- and fractional-title ownership,

and timeshare/ vacation ownership. Through freehold title ownership, the buyer essentially purchases the land and/ or buildings and obtains legal ownership title indefinitely.

Under leasehold title ownership, the purchaser owns the land and/ or buildings for a specific period set out in the lease agreement. Sectional title ownership refers to the ownership of a section of a title and a share of associated common areas.

Fractional title ownership entails the fractionalisation of a title unit into equal parts; owners are able to occupy the residential unit for a set period of time corresponding to their ownership share. Timeshare/ vacation ownership is a scheme where buyers acquire the right to stay at an establishment for a set time period. The difference between this and with fractional ownership is that one does not gain any tangible ownership over the timeshare facility.

Contact Michèle: +27 21 527 2100
Email: mdw@horwath.co.za

Fringe benefits and STC - interest rate

If inadequate interest is charged to an employee (including working directors) on loans (other than for the purpose of furthering his own studies) in excess of R3 000 from his employer (or associated institution), tax on the fringe benefit may be payable.

Unless interest is charged at the "official" rate or greater, the employee is deemed to have received a taxable fringe benefit calculated as being the difference between the interest actually charged and interest calculated at the "official" rate.

For employees' tax purposes, the tax deduction must be made whenever interest is payable. If not regularly, then on a monthly basis for monthly paid employees, weekly for weekly paid employees, etc.

In general, only distributions of income from a company / close corporation are subject to STC. To the extent that there are profits / reserves available for distribution, loans or advances to or for the benefit of a shareholder / member will be deemed to be dividends subject to STC unless interest at the "official" rate (or market related rate in the case of for-

eign currency loans) is payable on the loan or fringe benefits tax is payable on an interest free (or subsidised interest) loan to an employee.

The "official" rate of interest was increased for both the above purposes from 12% per annum to 13% per annum with effect from 1 September 2008.

The "official" rate of interest over the past 6 years is set out in a table on page 4.

Kent Karro recently completed a course in International Tax Law at UCT and obtained a distinction.

FRAUD 101 - "Real cases from the forensic frontline"

Our client bought 100% of a business ('Company A') for R 60 million. The purchase price was determined using a multiple of 3 times profits, and was based on an analysis of the 2005 audited financial statements which reflected an operating profit of R 19 million.

A financial due diligence was carried out before the deal was signed. However, the auditors who conducted the procedures failed to uncover significant financial statement fraud.

Although the deal was based on 2005 numbers, it was concluded just one month prior to the end of the 2006 financial year. Consequently, the auditors analysed the latest 2006 management accounts to verify the sustainability of revenue and profits. In 2005, total revenue was R 45 million, however, at the time of the due diligence fieldwork, 2006 sales were only R 23 million. When the auditors queried the significant drop in sales for 2006, man-

agement presented them with an invoice of approximately R 20 million in respect of sales of a new product, which had never before formed part of historical revenue.

In their report, the auditors noted that management had represented that 2006 revenue and profits were trending in line with 2005. Although significant red flags had been raised in this area, the due diligence report concluded that 2006 revenue and profits were in line with expectations and performed no further procedures in this area.

The deal went ahead.

It turns out that the R 20 million invoice was fraudulent in that it actually related to revenue earned in a related party company to the shareholders of Company A. This revenue was 'shifted' into Company A to overstate revenue in a scheme designed to boost the purchase price.

Actual 2006 revenue was only R 24 million (almost half of 2005) and the company incurred a loss of R 4 million, down from a profit of R 19 million in 2005. These and other factors resulted in the company being liquidated, less than a year after the deal had been concluded!

We were engaged to unravel the fraudulent scheme, quantify the losses and examine means of recovery. During our investigation, we were able to identify, through Business Intelligence procedures, that the sellers of the company (although locked into strict restraint of trade agreements) had opened a business directly in competition with Company A. This also contributed to the failure of the business that was sold.

Contact Terence: +27 11 217 8000
Email: terence.hatzkilson@horwathsa.co.za

The risk of overlooking utility accounts

Durban Property Managers (Pty) Ltd, the specialist property management division of Horwath Mahomedy Omar Paruk recently encountered a situation which they share with you regarding the importance of landlords monitoring tenants' electricity accounts.

The case study presented itself as follows:

- An amount due by a commercial tenant was handed over to attorneys for collection of arrear rentals and subsequently the tenant vacated the premises without settling the rentals.
- Some time later, the landlord procured a new tenant for the premises whose application to open an electricity account was declined by the Municipality.
- It emerged that the ex-tenant had also lapsed into arrears with the Municipality and the deposit held by the Municipality was insufficient to settle the arrears.

Furthermore, the ex-tenant did not terminate

the service and fixed charges continued accruing on the account.

- This situation jeopardised the new tenant, because until the overdue account was settled, it could not open its account and commence trading.
- This directly affected the landlord because, whilst the account remained outstanding, the premises remained vacant thereby depriving the landlord of rental income.
- The landlord had no alternative but to settle the arrears to enable the new tenant to open its account and had to thereafter attempt to recover this amount from the ex-tenant.
- As legal proceedings had already been instituted against the ex-tenant, the recovery of the landlord's outlay was immediately included in the impending action.

In general, legal proceedings to recover arrear rentals and other such recoveries can be a lengthy and expensive exercise.

Therefore, to circumvent the problem described above, landlords should seriously consider including the following additional clauses in their Lease Agreements:

- obliging tenants to present their original Electricity Accounts, as and when requested by the landlord.
- permitting landlords to access tenants' account balances directly from the Municipality as and when required by the landlord.
- authorising landlords to oblige tenants to top-up their existing rental deposits to compensate the landlord for the additional risk of unpaid electricity accounts.

Landlords who implement such 'safety' precautions should find themselves better prepared in the event of such problems arising.

Contact Yusuf: +27 31 337 3311
Email: yusuf.paruk@horwath.co.za

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The "official" rate of interest over the past 6 years is as follows:

With effect from 1 September 2002	13.5 % p.a.
With effect from 1 March 2003	14.5 % p.a.
With effect from 1 July 2003	13.0 % p.a.
With effect from 1 September 2003	12.0 % p.a.
With effect from 1 December 2003	9.5 % p.a.
With effect from 1 March 2004	9.0 % p.a.
With effect from 1 September 2004	8.5 % p.a.
With effect from 1 September 2005	8.0 % p.a.
With effect from 1 September 2006	9.0 % p.a.
With effect from 1 March 2007	10.0 % p.a.
With effect from 1 September 2007	11.0 % p.a.
With effect from 1 March 2008	12.0 % p.a.
With effect from 1 September 2008	13.0 % p.a.

The Horwath Advantage

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Contact Details

Horwath Leveton Boner
Johannesburg
Tel: +27 11 217 8000
Fax: +27 11 217 8001

Horwath Zeller Karro
Cape Town
Tel: +27 21 481 7000
Fax: +27 21 481 7081

Horwath Mahomedy Omar Paruk
Durban
Tel: +27 31 337 3311
Fax: +27 31 337 3312

Horwath Lubbes
Pretoria
Tel: +27 12 348 6335
Fax: +27 12 348 6384

Media Enquiries: Monique Ross, monique.ross@horwathsa.co.za

Editor: Kent Karro, National Tax Partner - Horwath in South Africa, Managing Partner - Horwath Zeller Karro
Sub-editor & Design: Monique Ross, Marketing Executive - Horwath Leveton Boner
Editorial Committee: Peter Katz, National Marketing Partner - Horwath Leveton Boner, Donna Rachelson, Marketing Consultant to Horwath in South Africa, Joel Berkowitz, Audit Partner - Horwath Zeller Karro, Susan Greiner - Horwath Zeller Karro, Yusuf Paruk, Audit Partner - Horwath Mahomedy Omar Paruk and Faure Bosman, Audit Partner - Horwath Lubbes.

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