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ADVANCED QUESTIONS ON SA
TAX

WITH SELECTED SOLUTIONS
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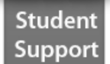

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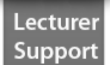

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ADVANCED QUESTIONS ON SA TAX 2017

WITH SELECTED SOLUTIONS

2nd Edition

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PREFACE

Advanced Questions on SA Tax is a publication for students and incorporates the legislation up to and including the Rates and Monetary Amounts and Amendment to Revenue Laws Act, 2016; the Taxation Laws Amendments Bill of 2016 (where applicable to the year of assessment); and the Tax Administration Laws Amendment Bill of 2016 (where applicable to the year of assessment). Most scenarios have been based on the 2017 year of assessment.

This tutorial book includes questions and selected solutions on South African income tax, estate duty and value-added tax. Up-to-date questions are graded allowing students to develop their abilities from an introductory level to an advanced level. Questions are graded with the following legend:

– Easy *
– Medium **
– Difficult ***

Each chapter has a contents page referring to the sections being tested in each question. Where solutions are included this is denoted by an S and the solutions can be found at the end of each chapter. Mark plans are allocated to every solution. Integrated questions are also provided to assist students preparing for their final examinations.

The Editorial Team
January 2017

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Jennifer Roeleveld, David Warner, Craig West, Peter Cramer, Keith Huxham, Grant Bayne, and SAIT, together with past academic trainees of the UCT College of Accounting.

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GENERAL ASSUMPTIONS

Applicable legislation:

Advanced Questions on SA Tax incorporates all legislation at the time of going to print, up to and including the Taxation Laws Amendments Bill and the Tax Administration Laws Amendments Bill of 2016.

Most questions focus on years of assessment commencing 1 March 2016 for individuals, and no later than 1 January 2017 for companies. Where relevant, solutions to questions assume that the existing legislation (including the above amendments) continue to be applicable into the future.

Market value:

We are aware that there is some difference of opinion as to whether market value (as referred to in the Income Tax Act) includes or excludes VAT, and whether this amount should be further reduced by a VAT component in every circumstance. To the best of our knowledge there is no authoritative position on this issue.

In order to reduce uncertainty, in our solutions to this edition we have attempted to be explicit as to whether the market value amount given includes or excludes VAT in each particular circumstance.

Where an amount is referred to as being the 'open market value' that amount includes VAT by virtue of the definition of 'open market value' in the VAT Act.

Where an amount of proceeds is deemed to be equal to market value (for example, in terms of paragraph 38 of the Eighth Schedule to the Income Tax Act), we have taken what seems to be the majority view, that if a VAT-inclusive value has been provided it should be reduced by the actual VAT output that arises on the transaction. This prevents instances of double taxation and is consistent with the treatment of expenditure required by section 23C.

Where no VAT arises (for instance when a capital asset becomes trading stock), or where the taxpayer in question is not a VAT vendor or VAT has been excluded from the scope of the question, we have simply provided a market value without reference to VAT.

We acknowledge that a valid approach in the case of income amounts may also be to make an adjustment equal to the market value multiplied by the tax fraction.

CHAPTER 1: CAPITAL ALLOWANCES AND RECOUPMENTS

Index to sections

Question	Sections	Grade	
Question 1.1	s8(4)(a), s8(4)(k), s8(5), s11(a), s12C, s23C, s24, s24I, s25D, VAT	***	S
Question 1.2	GI, s8(4)(a), s8(5), s11(a), s12C, s23A, s23C, Eighth Schedule, VAT	**	S
Question 1.3	s8(5)(b), s11(a), s11(e), s12C, VAT	***	S
Question 1.4	s8(4)(a), s11(a), s11(d), s11(e), s11(f), s11(g), s11(o), s12C, s13(1), s22, s23C, Eighth Schedule, VAT	***	S
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Question 1.7	GI, s8(4)(a), s10(1)(k)(i), s11(a), s11(c), s11(d), s11(e), s11(gB), s11(i), s11(*l*), s11(w), s12C, s13(1), s18A, s23C, Eighth Schedule, VAT	**	
Question 1.8	GI, s8(5)(b), s11(g), s12C, s23C, s23A, VAT	**	
Question 1.9	GI, s11(e), s11(o), s12C, s13*quin*, s23C, s23D, Eighth Schedule, VAT	***	
Question 1.10	GI, s8(4)(a), s8(4)(e), s8(4)(k), s11(a), s11(c), s11(e), s11(f), s11(g), s11(gB), s11(gC), s11D, s12C, s22, s23C, s23I, Eighth Schedule	***	
Question 1.11	GI, s8(4)(a), s11(e), s12C, s23C, s23D, Eighth Schedule, VAT	***	
Question 1.12	s8(4)(a), s8(4)(k), s8(5), s11(a), s11(e), s23C, leasing, Eighth Schedule, VAT	**	S

QUESTION 1.1 (Solution at end of chapter) (47 Marks)

'Product (Pty) Ltd' (Product) is a company that is involved in a manufacturing process. The following information is provided in respect of the year ended 28 February 2017. Product (Pty) Ltd is a registered VAT vendor. All amounts exclude VAT unless otherwise stated or the context shows indicates otherwise.

Taxable income before taking into account the information below is R5 million.

The following information has not been taken into account in arriving at the taxable income of R5 million:

1. Product purchases some of its raw materials in the USA. On 1 June 2016 raw materials were purchased for $200 000. The full purchase price is payable on 31 May 2017. Initially Product took the view that the Rand would remain constant against the Dollar, but on 1 November 2016 a forward exchange contract was entered into to cover the $200 000 debt. The forward exchange contract was at a rate of $1 = R9.80. Both the purchase and the debt were recorded on 1 June 2016 at the spot rate, which was $1 = R9.50. At 28 February 2017 the spot rate was $1 = R9.85. The debt was translated on 28 February 2017 at the forward rate in the Foreign Exchange Contract (FEC). A market-related rate for a similar forward exchange contract on 28February 2017was $1 = R9.90. The spot rate on 1 November 2016 was $1 = R9.60.

2. On 1 November 2016 Product leased a new machine for five years. (The lease is an instalment credit agreement for VAT purposes.) The lease agreement provides for a deposit of R10 000 (payable on 1 November 2016) and 60 monthly instalments of R4 000 commencing on 1 December 2016. Had it bought the machine for cash it would have cost R150 000 (including VAT). The machine was brought into use in a process of manufacture on 1 December 2016.

3. A new machine was acquired from Sellit (Pty) Ltd (not a connected person) under a suspensive sale contract on 10 May 2016. The contract provides for 60 monthly payments of R6 000, starting from 30 June 2016. The machine could have been purchased for R200 000 (including VAT). Fixit (Pty) Ltd installed the machine for R20 000 (including VAT). The machine was brought into use on 1 June 2016.

   Sellit's gross profit percentage is 40% on sales. Finance charges earned on this lease for Sellit's year ended 28 February 2017 were R24 000.

4. A five-year lease agreement in respect of a machine came to an end on 30 June 2016. The lease agreement provided that at the end of the lease the machine would be given to Product. On 30 June 2016 the market value of the machine was R30 000. Product continued to use the machine.

5. On 1 August 2016 Product sold a machine to its holding company (Hold Ltd) for R40 000. The machine had been purchased new by Product for R200 000 (including VAT) in January 2012 and had been brought into use in a process of manufacture on 1 June 2012. Product's holding company is not a VAT vendor. The holding company immediately sold the machine to a fellow subsidiary (Make (Pty) Ltd) for R80 000. The fellow subsidiary is a VAT vendor. On 1 August 2016 the market value of the machine was R50 000 (excluding VAT). Make paid for the machine on 1 December 2016.

6. On 1 February 2017 Product sold a machine (purchased used), which had cost it R100 000 (including VAT) in June 2014, to Make for R20 000 (including VAT). The machine had been used by Product in a process of manufacture. Make brought the machine into use, on 10 February 2017, in a process of manufacture. The market value of the machine on 1 February 2017 was R150 000 (excluding VAT).

7. On 1 June 2016 Product declared a dividend of R200 000 and in payment distributed a motor car with a book value of R200 000 and a market value of R250 000 (excluding VAT) to its holding company. The holding company gave the use of the car to one of its employees. The car had originally cost R240 000. The tax value of the motor car at the start of the current year of assessment was R156 000.

Notes

1. Prior to adjusting for the items (1) to (7) above, Product's VAT account had a credit balance of R80 000 at 28 February 2017.

2. The Commissioner allows wear and tear of 20% *per annum* on the straight-line basis on all qualifying assets in terms of section 11(e).

3. Assume that all companies have a February year-end.

YOU ARE REQUIRED TO:

1. Calculate Product's taxable income for the year ended 28 February 2017. (27 Marks)

2. Determine the balance of Product's VAT account at 28 February 2017. (8 Marks)

3. In respect of (3), determine the income tax effects for Sellit. (7 Marks)

4. In respect of (5), determine the income tax and VAT effects of the transaction for both Hold and Make. (5 Marks)

QUESTION 1.2 (Solution at end of chapter) **(24 Marks)**

PART A (13 Marks)

'Elt (Pty) Ltd' (Elt), with a 31 March year-end, manufactures healthier alternatives to coffee and tea that are also suitable for persons allergic to milk.

In 2016 Elt urgently required an additional machine for use in its manufacturing process, but did not have the necessary finance. Elt came to an arrangement with Stanco Bank (an unrelated third party) as follows: Elt would sell its manufacturing machine, Machine A, to Stanco on 1 January 2017 for R850 000 (including VAT).

Stanco would lease this machine (in terms of a finance lease with a cash cost including VAT of R860 000) back to Elt for a payment of R25 585 per month for 48 months, commencing on 1 January 2017. At the end of the lease Elt would take over the machine for R100 000, at which point its market value would be R120 000. Machine A, a new machine, had cost Elt R730 000 (excluding VAT) on 1 June 2015.

Elt (Pty) Ltd and Stanco are both registered VAT vendors.

YOU ARE REQUIRED TO:

1. Calculate all tax consequences for Elt in respect of the above transactions for the year of assessment ended 31 March 2017. Elt is not a small business corporation. (6 Marks)
2. Discuss and calculate the income tax and VAT implications at the end of the lease for Elt. (7 Marks)

PART B (11 Marks)

'Babu Close Corporation' (Babu) has, for some years, been buying assets and leasing these to clients in terms of operating and finance leases. All assets are depreciable assets. In 2013 Babu also purchased a piece of land with a warehouse thereon for R1 500 000, which they then let out to a client for ten years at a rental of R300 000 per year. For the year of assessment, ended 30 June 2017, Babu has extracted the following information from its accounting records:

Land and warehouse rentals received	300 000
Operating lease income	2 000 100
Finance lease income	850 000
Rates paid in respect of land	(122 000)
Administration expenses (incurred in respect of operating and finance lease income in relation to income earned)	(640 000)
Salaries and wages - operating leases	(560 000)
Depreciation	
Operating lease assets (equals the tax wear and tear)	(320 000)
Finance lease assets all used by lessees in manufacturing processes:	
purchased new 1 July 2013	R1 500 000
purchased new 1 December 2015	R960 000
purchased new 1 March 2017	R820 000

All amounts above exclude VAT where applicable.

YOU ARE REQUIRED TO: Calculate Babu's taxable income for its year of assessment ended 30 June 2017. Babu has a balance of R8 100 carried forward from its 2016 year of assessment in terms of section 23A.

QUESTION 1.3 (Solution at end of chapter) **(21 Marks)**

'Manufacturing Limited' (the company) intends purchasing a new machine for use in its manufacturing process. The machine has a cash cost of R130 000 (excluding VAT of R18 200). The company may acquire the machine through a finance house in one of two ways. You have been approached to advise the company as to which alternative would be the most beneficial to the company's cash flow.

Option 1: Lease the machine at a rental of R2 700 a month over sixty months. The company will acquire ownership of the machine at the end of the lease by paying R200. The expected market value will be R60 000 at the end of the lease. The lease is a finance lease and the finance house will acquire the machine for R130 000 (excluding VAT of R18 200).

Option 2: Purchase the machine on a suspensive sale. The terms will also be for sixty months with monthly repayments of R2 300 after an initial deposit of R30 000 on 1 March 2016. The first repayment will commence at the end of March 2016.

The Commissioner allows a straight-line wear and tear allowance, over six years, for machines not qualifying for the section 12C allowance. Both the company and the finance house are registered VAT vendors.

Assume all amounts include VAT where applicable, unless otherwise stated.

YOU ARE REQUIRED TO:

1. Calculate the after-tax cash flow effects of each option and advise the company as to which option it should choose. Assume that the machine is acquired on 1 March 2016 and that the income tax legislation is the same from 2017 onwards. You may ignore the time value of money and capital gains tax. (15 Marks)
2. Discuss and calculate the income tax and VAT implications of the lease agreement (option 1) for the finance house. (6 Marks)

QUESTION 1.4 (Solution at end of chapter) **(35 Marks)**

'Excel Manufacturers (Pty) Ltd' (Excel) manufactures heavy industrial machinery. The company is a wholly owned subsidiary of Excel Holdings Ltd. Excel is registered as a VAT vendor. Excel Holdings Ltd is not a registered VAT vendor. Both companies have a February year-end.

The taxable income of Excel for the year of assessment ended 28 February 2017 was R1 million before taking into account the following. Unless otherwise indicated, all amounts INCLUDE VAT where relevant.

On 1 March 2016 the company commenced manufacturing operations in its newly erected factory situated in Isithebe, Natal. The company had purchased a plot of land on 30 July 2014 for R500 000 cash from a non-vendor and had immediately commenced with the erection of the factory on the property. The cost of erection amounted to R1 710 000 and the factory was completed on 30 January 2016 and brought into use at that date.

On 30 June 2016 a section of the factory was destroyed by a fire. Two of the company's manufacturing machines (machines A and B) were destroyed in the fire.

On 1 March 2016 Excel had purchased a new machine, Machine A, under a suspensive sale agreement. The machine was delivered to the factory and installed on 31 March 2016 on which date it was brought into use.

The company incurred the following costs in respect of Machine A:

Cost of machine – 36 monthly instalments of R8 750 each	R315 000
Delivery cost	3 705
Installation cost	5 130

The cash cost of the machine, excluding delivery and installation was R285 000. You may assume that interest is incurred evenly over the term of the agreement.

After the fire, the company sold what remained of Machine A as scrap for R28 500. The company received insurance proceeds in respect of the damage to Machine A amounting to R206 400. The insurance proceeds were used to settle the outstanding balance on the suspensive sale agreement.

On 1 August 2016 the company entered into an agreement for the purchase of a new machine (Machine C) to replace Machine A. Machine C cost R456 000 and was brought into use immediately. Excel acquired Machine C for cash from Metal Makers (Pty) Ltd, which is not registered as a vendor for VAT purposes.

Machine B had been acquired new on 1 February 2016 from a non-vendor for R267 900. The machine was brought into use on 1 March 2016 on which date the market value of the machine was R228 000.

Machine B had not been insured by Excel. What remained of the machine was donated to Excel Holdings Ltd on 15 August 2016. The open market value of Machine B at the date of donation was R17 100. Machine B was not replaced during the 2017 year of assessment.

Repairs to the part of the factory that was damaged by the fire commenced during November 2016 and a total cost of R68 400 was incurred on repairs during the company's year ended 28 February 2017. Included in the total cost was an amount of R31 920, which represented the cost of new loading platforms that were installed in the factory's despatch area. The new platforms were considered to greatly improve the efficiency of the factory despatch area and alleviated the queuing problems that had been experienced in the past.

In order to minimise any disruptions to the company's production schedule, it was decided that Excel should lease alternative premises whilst its factory was under repair. As luck would have it, the warehouse on the site adjoining Excel was available and the company accordingly entered into a two-year lease agreement with a registered vendor for the lease of the warehouse on 1 August 2016. From this date, Excel carried on manufacturing activities on the leased property.

The lease agreement provided for the following:

- The lessee was liable for the payment of a lease premium of R45 600 on 1 August 2016 (this was duly paid by Excel).
- The lessee undertook to effect certain improvements to the warehouse at a cost of R59 950 (Excel completed such improvements at a total cost of R63 840 on 31 October 2016).
- The lessee was liable for rental from 1 August 2016 at the rate of R8 550 a month, payable on the first day of the month (the company duly paid the rentals on the first day of each month, as required).

Stock valued at R370 000 was also destroyed in the fire on 30 June 2016. The insurance claim for this stock amounted to R342 000 and was settled by the end of the company's 2017 year of assessment. Excel had a stock balance of R190 000 (excluding VAT) at the start of the current year of assessment and purchased stock during the year totalling R479 000. Closing stock at the end of the year of assessment was R100 000 (excluding VAT). Closing stock correctly excluded inventory that was destroyed.

After completing extensive quality control checks on the stock that survived the fire, it was discovered that several stock items had suffered smoke damage. The company decided to auction the smoke-damaged stock and publicly declared its intention to donate any proceeds on the sale of such stock to a local charity. It was hoped that the company would derive favourable publicity from the auction, which cost the company R3 990 to organise. The company auctioned stock with an open market value of R57 000 for R91 200. It paid over R80 000 over to the local charity as promised. Excel further donated all of the stock that was not sold at the auction to the charity. The unsold stock that was donated had a cost of R26 220 and an open market value of R20 520 at the date of donation. The charity is not a public benefit organisation.

YOU ARE REQUIRED TO: Determine the taxable income of Excel Manufacturers (Pty) Ltd for the year of assessment ended 28 February 2017. The VAT implications of all transactions must be considered, where appropriate, in calculating Excel's taxable income.

Excel wishes to defer tax in any year where possible. Take capital gains tax into account.

QUESTION 1.5 **(19 Marks)**

'Ingoma Ltd' (Ingoma) is a South African manufacturer of lawnmowers. The manufacture of lawnmowers is regarded by the Commissioner as a process of manufacture. Ingoma is a registered VAT vendor. All amounts exclude VAT unless indicated otherwise.

For its year of assessment ending 28 February 2017 the following information was extracted from Ingoma's income statement:

	Note	R
Sales		6 600 000
Cost of sales		(3 450 000)
Gross profit		3 150 000
Other income		
Interest received		65 000
Dividends received (not foreign dividends)		50 000
Expenses		
Bad debts	1	(60 000)
Damages paid	2	(150 000)
Depreciation on building	3	(240 000)
Depreciation on plant and machinery	4	(945 000)
Depreciation on furniture	5	(13 125)
Legal expenses	2	(30 000)
Salaries and wages	6	(760 000)
Sundry expenses (all tax deductible)		(355 000)

Notes

1. Bad debts includes an amount of R15 000 in respect of a loan to an ex-employee. The original amount of the loan was R10 000 and it had been made to the employee in the 2016 year of assessment. The balance of R5 000 represents interest charged on the loan in the 2016 year of assessment. No interest had been accounted for in the 2017 year of assessment.

   The remainder of the bad debts is in respect of trade debtors.

2. The damages were paid to a rival manufacturer of lawnmowers, which sued Ingoma, since it believed that an advertisement flighted on television by Ingoma was too similar to one of its own advertisements. This advertisement had been produced by Ingoma in the 2016 year of assessment and was intended to be flighted for an extended period.

The legal expenses relating to defending this claim amount to R20 000 and the balance is in respect of debt collection.

3. Depreciation relates to Ingoma's factory building. Construction of the building was completed on 1 January 2014 at a cost of R2.4 million and brought into use in housing Ingoma's manufacturing process on that date. The factory was built on land leased from the local municipality for 50 years and the construction of the factory was a contractual obligation of the lease. The lease expense for the year of assessment is included in sundry expenses.

4. Included in plant and machinery is an item of plant that was acquired from 'Sangoma Ltd' (Sangoma), Ingoma's holding company, on 1 September 2016 for R1.45 million and brought into use by Ingoma directly in its manufacturing process on 1 October 2016. The market value of the item on 1 September 2016 was R1.3 million and on 1 October 2016 it was R1.25 million.

   The remainder of the plant and machinery consists of plant that was acquired as a liquidation dividend from a subsidiary of Ingoma on 1 August 2016 and was brought into use in Ingoma's manufacturing process on the same date. The plant is stated at its market value at the date of acquisition. The market value of the plant on that date was R3.5 million. The subsidiary had used the plant, but not in a manufacturing process, since acquiring it on 1 July 2014.

   The Commissioner allows section 11(e) wear and tear on qualifying plant and machinery at the rate of 25% *per annum* on the straight-line method.

5. Since purchasing the furniture on 1 October 2014, Ingoma has provided for depreciation of 20% *per annum* on the straight-line method. The only acquisitions since that date have been three tables costing R500 each, which were purchased and brought into use on 1 February 2017.

   The Commissioner allows section 11(e) wear and tear on furniture at the rate of 15% *per annum* on the straight-line method.

6. The salaries and wages expense includes an annuity of R20 000 which is paid to one of Ingoma's ex-employees, who retired in the 2014year of assessment, at the age of 65.

None of the costs in note 7 below have been included in Ingoma's income statement.

7. During December 2016 Ingoma had commenced research into remote control devices. On 1 December 2016 it purchased new equipment costing R120 000 and on 15 January 2017 it purchased new equipment costing R180 000, to be used in this research. The research and development was approved in terms of section 11D(9).

   Revenue costs totalling R140 000 were incurred on this research for the period 1 December 2016 to 1 February 2017. Arising out of this research, Ingoma was able to develop a world-first remote controlled lawnmower, which it called the 'Eezi-mow'.

   Ingoma registered a patent over the Eezi-mow's design at a cost of R15 000 on 1 February 2017. Ingoma also registered a trademark over the Eezi-mow logo. This trademark cost R5 000 to register on 1 February 2017.

   Ingoma incurred advertising costs of R150 000 during February 2017, which it paid to an ad agency for the production of a television advertisement to coincide with the launch of the Eezi-mow on 1 February 2017.

   In addition, Ingoma had incurred R10 000 per month to the SABC as advertising costs for flighting the advertisement during the month of June.

YOU ARE REQUIRED TO: Calculate the taxable income of Ingoma Ltd for its year of assessment ending 28 February 2017. You may assume that Ingoma wishes to defer its liability for taxation wherever possible. Show all workings clearly. (Ignore CGT.)

QUESTION 1.6 **(32 Marks)**

'The Cape Town Golf Company (Pty) Ltd' (the Company), a VAT vendor, is the Cape Town subsidiary of the group South Africa Golf Company (Pty) Ltd. There are six other subsidiaries situated throughout South Africa. All companies have a 30 June year-end. The Company is involved in a number of activities: it manufactures golfing equipment, operates a golf academy, a driving range and a pro-shop which sells golf equipment and clothing.

The company manufactures equipment at its warehouse in Epping and it runs the driving range, golf academy and pro-shop at its golf park in Kenilworth. The golf academy employs four professionals who give lessons to individuals at the range as well as at clinics and schools. This involves travel and the company provides the vehicles for the professionals to travel in.

You have been assigned to this company on your first audit and the audit senior has approached you to calculate the company's taxable income. The financial year end is 30 June 2017. All amounts exclude VAT where applicable, unless indicated otherwise. You have been provided with the following information:

1. Fees from lessons, clinics and appearances at schools (including VAT) 456 000
2. Sales from pro-shop sales (including VAT) 570 000
3. Sales of equipment (including VAT) 1 140 000
4. The cost of sales appearing in the income statement has been correctly calculated for tax purposes at R600 000.

   Some equipment, manufactured at a cost of R50 000, had been stolen from the factory. The company was partially insured however, and received a payment of R34 200 from the insurers.

5. Other operating income includes the following:
   - 5.1 Interest earned on call account 75 000
   - 5.2 Annual annuity received 125 000
     This annuity comprises dividends of R60 000 on local shares and the balance represents interest on an investment.
   - 5.3 Profit on sale of Toyota Camry (refer 6.1) 66 000

6. The following information relates to the motor cars used by the company:
   - 6.1 A Toyota Camry, originally acquired from a dealer on 1 January 2016, with a book value of R50 000 at 30 June 2017, was sold on 30 June 2017 for R116 000. A capital gain was realised on the disposal of this vehicle, and a replacement vehicle was purchased (refer 6.2). Depreciation is provided for at 33.3% *per annum*.
   - 6.2 A second motor car was acquired from a subsidiary, a non-vendor, on 1 March 2017 for no consideration. The subsidiary had never used this car in its business. The car had cost the subsidiary R70 000 and its open market value at the date the Cape Town Golf Company acquired it was R102 600.
     The Commissioner allows a write off per Interpretation Note 47 of five years on motor cars.

7. The company moved to Epping during October 2016. Previously, manufacturing had been conducted in Salt River, but the company had moved to Epping when a building became available that would cater for its increased size.

7.1 The Salt River building was sold for R1 482 000 (including VAT). The building had been acquired from its holding company on 1 January 2010 for R1 710 000 (including VAT). The holding company had received section 13(1) tax allowances on this building at a rate of 2% *per annum*.
7.2 The building in Epping was bought from a third party for R1 368 000 (including VAT). The estimated useful life of the building in Epping is 50 years.

Both transactions occurred on 1 October 2016.

8. The following information relates to the company's machines:
   8.1 Machine 1 is used to manufacture the company's new line of golf equipment. It was acquired new on 31 August 2015 for R1 140 000 (including VAT). The company also incurred costs of R91 200 (including VAT) in transporting the machine to the factory.
   The company further incurred costs of R125 400 (including VAT) in moving the machine to the new premises during October 2016.
   8.2 Given the increased size of the new factory, the company acquired a new machine for R570 000 (including VAT) on 1 November 2016 and brought it into use on this date.
   8.3 A third machine is used to make golf balls. It was acquired new on 1 August 2015 for R342 000 (including VAT). When the company moved premises, it decided to discontinue making balls and the machine was sold to a subsidiary for R119 700 (excluding VAT). The subsidiary was not a VAT vendor. The open market value of the machine on the date of sale was R285 000.

   Note that the Commissioner allows qualifying machines to be written off over eight years in terms of section 11(e).

9. Included in the income statement is a bad debts expense of R70 000. Included in this amount is the following:
   9.1 A decrease in the doubtful debts provision of R10 000 (the doubtful debts provision on 1 July 2016 was R80 000).
   9.2 A loan of R15 000 made to an employee at the start of the current year. The employee resigned on 31 December 2016 and the company decided to write off the loan as irrecoverable.
   SARS allows a deduction of 25% of qualifying doubtful debts in terms of section 11(j).

10. The expense for salaries in the income statement was R400 000. Included in this amount are the following:
    10.1 Two lump sums: one of R15 000, paid voluntarily to a pro-shop employee for outstanding service during the year and one for R20 000 paid to one of the professionals when he reached the bonus target set out in his contract.
    10.2 Two annual annuities: one for R36 000, paid to the driving range's caretaker, who had retired due to ill-health and the other for R24 000, paid to the surviving spouse of an ex-employee.
11. Travelling expenses of R35 000 in the income statement included R20 000 for the chief purchaser's trip to Scotland to buy the new machine (refer 8.2). The remainder was in respect of professionals who had attended clinics outside of Cape Town.

12. The advertising expense of R80 000 was spent on magazine and newspaper advertisements.

13. Other sundry expenses, all deductible, of R285 000 were incurred.

14. During the year the company began research into a new type of golf club. During the year, it expensed R100 000 of research expenditure and capitalised, as development expenditure, a further R140 000. This research expenditure was incurred to pay salaries (not included in the salaries above). The research and development has been approved in terms of section 11D(9).

15. In April 2017 the company acquired a trademark from its holding company for R60 000. The company spent a further R10 000 to renew the trademark for a further ten years.

YOU ARE REQUIRED TO: Calculate the taxable income of The Cape Town Golf Company (Pty) Ltd for the year of assessment ending 30 June 2017. (Note that the company wishes to defer its tax liability wherever possible.)

QUESTION 1.7 **(34 Marks)**

'Environ Gardening Services (Pty) Ltd' (Environ) carries on the business of maintaining gardens, and also manufactures fountains and fish ponds. Environ is a registered VAT vendor.

The following provisional income statement has been prepared for the year of assessment ended 28 February 2017. All amounts, including those in the notes, exclude VAT where applicable unless otherwise indicated or shown by the context.

Income			**Note**	**R**
Contract income and sales				1 642 150
Interest	–	local bank accounts		16 200
	–	loans		350
Dividends	–	on SA listed shares		14 500
Compensation (incl. VAT)	–	for loss of profits		130 000
	–	for damaged machinery	1	50 000
Profit on sale of truck			3	15 000
Expenditure				
Trade expenditure	–	all tax deductible		(942 500)
Repairs to trucks				(9 100)
Legal expenses			2	(1 800)
Depreciation			3	
	–	trucks at 30% per year		(91 000)
	–	machinery at 25% per year		(64 500)
	–	small tools at 20% per year		(20 000)
Cost of registering trademark			4	(4 500)
Bad debts written off			5	(22 000)
Pension fund contributions			6	(35 000)
Donations to qualifying public benefit organisations				(20 000)
Life insurance premiums paid	–	on sole shareholder's life	7	(4 800)
	–	on chief foreman's life		(5 400)
Damages paid			8	(22 100)
Net income				625 500

Notes

1. The compensation received was in respect of a fire in the business premises on 1 March 2016. The damage to the machinery was too great to be repaired and new replacement machinery was purchased and brought into use in a process of manufacture on 1 September 2016 (see note 3). The tax value of the damaged machinery at the date of the fire was R30 000, having originally cost R75 000. This machinery qualified for the section 12C allowance. It was not used in the 2017 year of assessment.

2. Environ used the services of a legal firm to assist with a dispute in respect of its claim for compensation in (1) above and its fee came to R1 800.

3. Depreciation
   3.1 Trucks
   The trucks are not 'motor cars' as defined in the VAT Act. Three original trucks cost R114 000 (including VAT) on 1 March 2014. One of these trucks was sold for R34 200 (including VAT) on 1 January 2017. A new truck was purchased on the same date for R136 800 (including VAT). The Commissioner allows qualifying machines to be written off over four years in terms of section 11(e).
   3.2 Machines and equipment
   A new moulding machine was acquired under a suspensive sale agreement for R118 008. The cash purchase price would have been R98 000 (including VAT). The agreement, which was entered into on 1 September 2016, provided for 36 monthly instalments of R3 278. The machine was used in the manufacturing process from 1 September 2016. Nothing in respect of this machine is included in the provisional income statement. Total finance charges for the year of assessment are R20 008.
   The depreciation amount of R64 500 is in respect of new machinery purchased on 1 March 2015 (excluding the damaged machine).
   3.3 Small tools
   The depreciation of R20 000 is in respect of small items of equipment, each of which cost less than R5 000. These were purchased on 1 March 2016 and are used in the garden maintenance department of the business.
4. Environ registered a trademark, 'Lighted Waters', in respect of a bird bath and fountain it had manufactured. The trademark was for a five-year period from 1 July 2016.
5. Bad debts were in respect of:

	R
a. a loan given to an employee who died	10 000
b. interest on the employee's loan	500
c. customers who were unable to pay their debts	11 500
	22 000

6. Environ has contributed to a pension fund on behalf of its employees at the rate of 8% of their remuneration.
7. The policy relates to the death, disablement or illness of the foreman and the shareholder. The premiums paid on the life of the foreman has been included in his taxable income as a taxable fringe benefit. The shareholder is not an employee of Environ.
8. Environ paid damages of R22 100 to one of its customers. A fish pond installed on a roof garden leaked, causing damage to the ceiling and furniture below. Environ did not dispute the claim and paid for the repair.

YOU ARE REQUIRED TO: Calculate Environ Gardening Services (Pty) Ltd's taxable income for the year of assessment ended 28 February 2017. You should start your answer with sales and deal with every item in the question and, where an item has no tax effect, state this fact and give reasons.

The company does NOT use any elective provisions in the Income Tax Act.

QUESTION 1.8 **(30 Marks)**

The S&L Group comprises a group of companies offering a diversified range of water reticulation products. All companies in the group have the same year end and are all residents of South Africa. All companies in the group are VAT vendors.

For its financial year ended 28 February 2017, you have received the following two queries which require your attention:

QUERY 1 (11 Marks)

S Mining (Pty) Ltd imports pumps and motors and also acquires piping locally for supply mainly to the mining industry. To transport this equipment, the company uses heavy duty trucks, which it leases under various finance leases. On 30 June 2016 a 36-month lease came to an end. In terms of the lease agreement the cash cost was R285 000 (including VAT) on 1 June 2013 and lease instalments were R9 262 per month. In terms of the lease agreement, S Mining can pay a settlement amount of R100 000 to take ownership of the truck at the end of the lease. As it does not want to acquire the truck, the lessor has agreed to a reduced rental of R1 000 per month for two years because of the bad condition of the truck. The market value of the truck at 30 June 2016 was R130 000. The lessor was a company not part of the group (i.e. a third party). S Mining and the lessor are registered VAT vendors.

YOU ARE REQUIRED TO: Determine the income tax and VAT implications in respect of this transaction for the year of assessment ended 28 February 2017 for S Mining.

QUERY 2 (19 Marks)

L Leasing (Pty) Ltd is a company in the group that leases assets (other than the truck in query 1 above) to other companies in the group. L Leasing (Pty) Ltd is a registered VAT vendor.

Land was acquired for R968 000 (including VAT) on 1 December 2015 and was immediately leased to S Manufacturing for a monthly rental of R6 450 (including VAT). In terms of the lease agreement, S Manufacturing was required to build a warehouse on the land to house its finished products at a cost of at least R1.5 million (excluding VAT). The warehouse was duly constructed and completed and brought into use on 1 March 2016. The cost incurred by S Manufacturing amounted to R1.6 million (including VAT of R176 000).

On 1 January 2017, L Leasing acquired a machine from an outside party under a three-year suspensive sale agreement. The monthly instalment was R1 800. Finance charges are R18 060 in total. This machine was immediately leased to S Manufacturing for three years for use in its manufacturing process for R2 300 per month. This lease is an 'instalment credit agreement' as defined in the VAT Act. The cash cost in terms of the lease was R47 880 (including VAT). You may assume that interest is incurred evenly over the term of the agreement.

In addition to the above, L Leasing reflected the following income and expenditure in its trial balance (therefore excluding VAT where applicable) in the 2017 year of assessment:

Income from operating leases	98 000
Expenditure	
Rates on land and buildings	27 000
Administration expenses for all leased assets	62 000
Section 11(e) in respect of operating lease assets	96 000

YOU ARE REQUIRED TO: Calculate the income tax effects for L Leasing in respect of the above transactions for the year of assessment ended 28 February 2017. There is a balance brought forward from 2016 in terms of section 23A of R1 020.

QUESTION 1.9 **(31 Marks)**

You are the audit manager of 'Prencam Limited' (Prencam or the company), a registered VAT vendor. You have been asked to advise management on the income tax consequences of the following transactions entered into by the company during its year of assessment ended 30 June 2017.

Note that all amounts below include **VAT** where appropriate, that all supplies are from registered VAT vendors and that all companies are in possession of all necessary tax invoices.

1. On 15 January 2017 the company entered into a sale and leaseback agreement with one of its subsidiaries, Go West (Pty) Ltd. In terms of the agreement, the subsidiary sold a machine that it had been using directly in its manufacturing process to Prencam and immediately leased the asset back from Prencam. Go West is a VAT vendor.
   The details of the agreement are as follows:

Original purchase price of the machine to Go West (Pty) Ltd (new)	R5 130 000
Date brought into use by Go West (Pty) Ltd	20 December 2015
Selling price of machine to Prencam Ltd	R5 500 000
Open market value 15 January 2017	R4 000 000
Selling price and 'cash value' in terms of lease agreement	R4 800 000
Term of lease agreement	48 months
Monthly payment in terms of lease agreement	R120 000
Date first monthly payment commences	31 January 2017
Financial year-end of Go West (Pty) Ltd	30 June

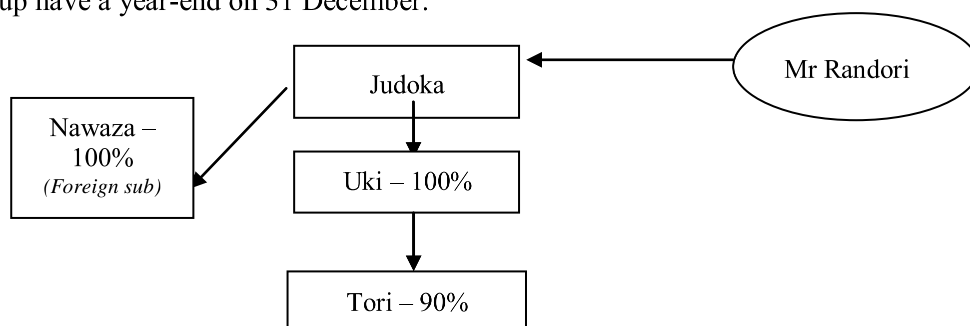
2. On 1 May 2016 the company acquired a new machine for R11 million for direct use in its manufacturing process. On 5 February 2017 the company incurred costs of R25 000 to move the machine to a different place in its factory. On 20 June 2017 the company sold the machine to Go West (Pty) Ltd for R3 million. The open market value of the machine on 1 May 2016 was R10 million and on 20 June 2017 it was R3.2 million.

3. On 15 April 2017 the company purchased and brought into use one new and unused floor of a sectional title building to house some of its administration functions. The company paid a property developer R3.8 million for the floor. The property developer had preserved the framework of a pre-existing building and had added the floor as an improvement.

YOU ARE REQUIRED TO: Calculate the income tax effects of the above transactions for Prencam's 2017 year of assessment. Give full explanations for your workings. The Commissioner allows section 11(e) allowances over four years on qualifying assets.

QUESTION 1.10 **(37 Marks)**

'Judoka Martial Arts Group (Pty) Ltd' (Judoka) is a leader in producing Judo Gis (suits worn by Judo practitioners) and other martial arts apparel. The group consists of Judoka, the holding company; Uki (Pty) Ltd, a wholly owned subsidiary; Tori (Pty) Ltd, a 90% held subsidiary of Uki; and Nawaza plc, a wholly owned British subsidiary. The majority of Judoka's shares are held by Mr Randori, a wealthy retired Judo practitioner. Judoka is a registered VAT vendor, while Uki and Tori are not VAT vendors. Judoka and its subsidiaries form a 'group of companies' as defined. All companies in the group have a year-end on 31 December.



Judoka was undergoing severe cash flow problems and could not afford to build the factory it needed to expand its operations. It therefore entered into a lease agreement with Uki, in terms of which Uki agreed to build a factory building for a value of R2 000 000 on land that it owned. Judoka then leased the building from Uki for R250 000 per year for 15 years and brought it into use in a process of manufacture on 30 June 2017. A lease premium of R150 000 was payable on 30 June 2017 and the agreement also stipulated that Judoka must improve the building to a value of at least R900 000. All amounts referred to in the lease agreement are exclusive of VAT.

Due to its cash flow problems, Judoka was only able to implement improvements to the value of R570 000 (including VAT) in the 2017 year of assessment, with the remaining improvements to be affected in 2018 if cash flows improved. The improvements for the 2017 year were completed and brought into use on 30 November 2017.

Judoka purchased a delivery van under a suspensive sale agreement for R10 000 per month for 24 months on 1 January 2017. The cash cost of the van on that date was R180 000 (including VAT). SARS allows such vehicles to be written off over four years. You may assume that finance charges are incurred evenly over the term of the agreement.

Judoka had various machines that it used in a manufacturing process. One such machine, Machine A, was destroyed in a fire on 15 March 2017. The insurance company paid out R150 000. Judoka also managed to sell the remains of the machine for scrap, for a total of R5 700 (including VAT). The original cost of Machine A was R342 000 (including VAT) when it was bought new on the 1 July 2014. It was immediately brought into use directly in a process of manufacture from that date.

Another machine, Machine B, was originally purchased second-hand from Uki for R228 000 on 30 November 2016, when the open market value was R200 000. Judoka used the machine directly in a process of manufacture. Judoka felt that, due to lack of demand, the capacity offered by Machine B was no longer needed and the machine was donated to Tori on 1 December 2017, at which date its open market value was R180 000.

After many years of research and development, Judoka developed a new lightweight suit for professional judo practitioners called the ‘Yokogawa’. Research and development costs had amounted to R300 000 (excluding VAT) for the 2017 financial year. The research and development has been approved in terms of section 11D(9).

The company had registered an international patent on the new lightweight suit for R25 000 (excluding VAT) on 1 July 2017. It also purchased a design from a small Japanese company to enhance the look of the suit. The design cost R30 000 (excluding VAT) and was paid for at the end of June 2017.

In July 2016, a patent for the production of boxing gloves was sold to Nawaza for R100 000 (excluding VAT) due to the more protective patent laws in Great Britain. Judoka agreed to pay an annual royalty of R10 000 to Nawaza in order to use the patent to produce the gloves. Nawaza does not pay any South African income tax (other than withholdings tax on royalties). SARS has classified the patent as ‘tainted intellectual property’ as defined in section 23I.

Judoka is currently in the process of suing another company, Adibas, for industrial espionage relating to its patent on the Yokogawa Gi, for R5 000 000. The legal costs for the year amounted to R250 000 (excluding VAT). Judoka’s legal advisors have indicated that there is a good probability of winning the case.

Judoka declared a dividend *in specie* to Mr. Randori on 27 November 2017. In settlement of this dividend, Judo suits with a market value of R20 000 were distributed to Mr Randori.

Judoka had an assessed loss of R1 200 000 carried forward from its 2016 year of assessment.

Judoka had the following sales amounts for the 2017 year. These amounts are inclusive of VAT where appropriate:

Sales in SA	R2 000 000
Sales in Europe, Asia and the rest of Africa	R3 000 000
On 31 December 2017, the following items were on hand (excl. VAT):	
Raw materials	R 100 000
Work in progress	R 24 000
Finished goods	R 50 000
Spare parts	R 15 000
Opening stock (excl. VAT) at 1 January 2017	R180 000

YOU ARE REQUIRED TO: Calculate the taxable income of Judoka for the year ended 31 December 2017 from the above available information. Give reasons to support your workings where appropriate.

QUESTION 1.11 **(16 Marks)**

'Aaron Enterprises (Pty) Ltd' (Aaron) is a company involved in leasing assets to third parties. Aaron is a registered VAT vendor and only transacts with registered VAT vendors, unless otherwise stated. The following transactions were entered into in Aaron's year of assessment ended 31 December 2017:

(CSARS allows a write off period of six years for qualifying assets per Interpretation Note 47.)

Machine A
Aaron acquired Machine A from 'Jason Manufacturing CC' (Jason) on 1 March 2017 for R260 000 as Jason needed an injection of cash at the time.

Aaron then entered into a finance lease agreement with Jason whereby Machine A, which was to be used in Jason's manufacturing process, was leased to Jason at a monthly rental of R4 500 from 1 March 2017. The cash cost of the machine in terms of the lease agreement was R260 000.

Jason had originally purchased Machine A new for R255 813 on 1 June 2016 and brought into use immediately in its manufacturing process. Jason also has a 31 December year-end. Jason and Aaron are not connected persons.

Machine B
An operating lease entered into with Peter Mach, five years previously, came to an end on 30 November 2017. The lease instalments per month were R3 200.

Aaron paid R140 000 for this machine which it had purchased new from a non-vendor on 1 December 2012. In terms of the lease agreement the machine has a nil value at the end of the lease and will revert back to Aaron.

The lessee requested to buy the machine from Aaron for R50 000. Aaron agreed and sold the machine to Peter Mach for R50 000 on 1 December 2017. Peter Mach had always used the machine in a manufacturing process.

All amounts include VAT.

YOU ARE REQUIRED TO: Calculate all the income tax effects of the transactions for Aaron for the year of assessment ended 31 December 2017. You may IGNORE section 23A.

QUESTION 1.12 (Solution at end of chapter) (16 Marks)

Tranco Ltd, a registered VAT vendor, with a February year of assessment, operates a fleet of buses used for the transport of passengers between Cape Town and the Eastern Cape. It also has a fleet of trucks that it uses for the transport of goods for commercial customers. All amounts unless otherwise stated including VAT.

On 1 September 2011 Tranco acquired the use of ten large trailers that had a total cash cost of R228 000, in terms of a finance lease. The period of the lease was for sixty months and the lease instalments were R4 800 a month. 40% of the revenue from trailers used by Tranco has always been from the transport of passengers' luggage and the balance is from commercial goods.

In terms of the lease agreement, Tranco acquired all the trailers for an amount of R20 000 on expiry of the lease after paying the final instalment on 31 August 2016. At that time the market value of the trailers was R114 000. Tranco continued to use the trailers in its business until it sold them to a fellow subsidiary, Bussit Ltd, for R20 000 on 28 February 2017. The open market value of the trailers on that day was R120 000. Bussit's only business is the transport of fare-paying passengers. Tranco and Bussit are not members of the same group of companies for income tax purposes.

SARS allows a five-year section 11(e) allowance for trailers.

YOU ARE REQUIRED TO:

1. Calculate all the VAT effects for Tranco relating to the acquisition and disposal of the above trailers. Give reasons for your answer. Where amounts do not have a VAT consequence, state this fact with reasons. (6 Marks)
2. Calculate all effects on Tranco's taxable income arising in respect of the above trailers for the year of assessment ended 28 February 2017. (10 Marks)

SOLUTION 1.1

Product (Pty) Ltd

			R	
1.	Taxable income		5 000 000	
				(1)
1	Cost of stock s11(a) \$200 000 × 9.50 translated at s25D spot rate at acquisition		(1 900 000)	
	Debt \$200 000 × (9.50 – 9.85) - s24I(3)		(70 000)	(1)
	Premium on FEC = \$200 000 (9.80 – 9.90) - s24I(3)		20 000	(1)
				(1)
2	s11(a) lease rental = R10 000 + R12 000 =	22 000		
	less s23C VAT $^{22}/_{250}$ × R150 000 × $^{14}/_{114}$	(1 621)	(20 379)	(1)
				(1)
3	Cost 200 000 × $^{100}/_{114}$ - s23C	175 438		
	Installation R20 000 × $^{100}/_{114}$ - s23C	17 544		(1)
	s12C(1) R192 982 × 40%	192 982	(77 193)	(1)
	Finance - s24J(2) $^{160\ 000}/_{60}$ × 9		(24 000)	(1)
				(1)
4	Lease recoupment s8(5)(b)		30 000	
	s11(e) R30 000 × 20% × $^{8}/_{12}$ - no s23C as no consideration		(4 000)	(1)
5	Cost R200 000 × $^{100}/_{114}$ - s23C =	175 439		
	less s12C(1) allowances granted	(175 439)	0	(1)
	Tax value	0		
	Proceeds (R50 000 limited to R175 439) recoupment - s8(4)(k)	50 000	50 000	(1)
	Capital gains tax - s26A			
	Proceeds para 35 with 38 (R50 000 – R50 000)	0		(1)
	Base cost para 20(1)(a) and 20(3)(a) (R175 439 – R175 439)	0	0	(1)
6	s12C(2) cost *less* VAT s23C R100 000 × $^{100}/_{114}$	87 719		
	s12C (20%)	(52 632)	(17 544)	(1)
	Tax value	35 088		
	s8(4)(k) proceeds R150 000 ltd to R87 719 – tax value of R35 088 =		52 631	(2)
	Capital gains tax - s26A			
	Proceeds para 35 with 38 (R150 000 – R52 631)	97 369		(1)
	Base cost para 20(1)(a) and 20(3)(a) (R87 719 – R52 361)	(35 088)		(1)
		62 281		

SOLUTION 1.1 continued

7	s11(e) allowances (R240 000 × 20% × $^{3}/_{12}$) no VAT adjustment			(1)
	Input denied		(12 000)	
	In specie dividend s8(4)(k) (R240 000 − R156 000 − R12 000)			(2)
	(market value R250 000 ltd to cost R240 000)		96 000	
	Capital gains tax − s26A			
	Proceeds para 35 with 38 (250 000 - R96 000)	154 000		(1)
	Base cost para 20(1)(a) and 20(3)(a) (R240 000 − R156 000 − R12 000)	(72 000)		(1)
		82 000		
	Sum of capital gains (R62 281 + R82 000)	144 281		(1)
		80%	115 425	(1)
	Taxable income		3 123 515	(27)

		Debit	Credit	
2.	Pre-adjustment balance		80 000	
1	Import input s13(2) 110% × R1 900 000 × 14%	292 600		(1)
	Import output s13(2) 110% × R1 900 000 × 14%		292 600	(1)
2	Input R150 000 × $^{14}/_{114}$ read with s8(11), s9(3)(c), s10(6)	18 421		(1)
3	Input R220 000 × $^{14}/_{114}$ read with s8(11), s9(3)(c), s10(6)	27 017		(1)
4	Lease	0		(1)
5	s10(4) output R50 000 × 14%		7 000	(1)
6	s7(1) output R20 000 × $^{14}/_{114}$		2 456	(1)
7	s8(14) − no VAT	0		(1)
	Balance	44 018		
		338 038	382 056	(8)

3.	Suspensive sale			
-	Total instalments	360 000		
	less VAT s23C read with s8(11), s9(3)(c) & s10(6) of the VAT Act	(24 561)		(1)
-	*less* finance charges	(160 000)	175 439	(1)
-	*less* HP debtors allowance (R175 439 × $^{51}/_{60}$) × 40% s24		(59 649)	(2)
-	cost s11(a) R200 000 × $^{100}/_{114}$ × 60%		(105 263)	(1)
-	Finance charge income s24J(3)		24 000	(2)
				(7)

SOLUTION 1.1 continued

4. **Hold**

VAT: nil - Hold is not a VAT vendor

Income tax:	Cost s11(a) – trading stock	(40 000)	(1)
	Gross income – selling price (scheme of profit making)	80 000	(1)
	Taxable income	40 000	
Make			
	Definition of input tax – deemed input		(1)
VAT:	R50 000 × $^{14}/_{114}$	(6 140)	
Income tax:	s23C: cost R50 000 less VAT 6 140 = R43 860		(1)
s12C(1) =	43 860 × 20% (second hand)	(8 772)	(1)
			(5)
			(47)

SOLUTION 1.2

PART A – Elt (Pty) Ltd

1. **Sale Machine A**

				R	
Wear and tear s12C(1)	Used in process of manufacturing 730 000 × 20% (Year 2)			(146 000)	(1)
Recoupment					
S8(4)(a)	Proceeds excl. of VAT	850 000 × $^{100}/_{114}$ = R745 614			
	Ltd to cost		730 000		
	Tax value	730 000 – 292 000 – 146 000	(292 000)	438 000	(2)
CGT	Proceeds para 35	745 614 – 438 000	307 614		
	Base cost para 20	730 000 – 438 000	(292 000)		
Capital gain			15 614		(2)
Taxable capital gain s26A			× 80%	12 491	(1)
Lease Machine A					
VAT output s8(11), s9(3)(c) and s10(6) of the VAT Act		860 000 × $^{14}/_{114}$	105 614		
Lease payments			25 585		(1)
less VAT s23C – each lease payment is reduced by proportionate share input VAT claimed at the start of the lease		105 614 × $^{1}/_{48}$	(2 200)		(1)
s11(a) rental expense			23 385		
			× 3	(70 154)	

SOLUTION 1.2 continued

2. s8(5)(b) Elt would include a recoupment in income of the market value of the asset less consideration.
R120 000 − R100 000 = R20 000 (2)

No VAT will be payable as it is in terms of the lease agreement and VAT was already paid. (1)
ELT will be entitled to a wear and tear allowance on the asset acquired in terms of s11(e) only. (1)
The s11(e) could be claimed on the R120 000 market value. (1)

(13)

PART B - Babu CC

			R	
Land and warehouse rentals − gross income			300 000	(0.5)
Operating leases − gross income			2 000 100	(0.5)
Finance leases − gross income			850 000	(0.5)
Land rates - s11(a)			(122 000)	(1)
Administration expenses - s11(a)			(640 000)	(0.5)
Salaries and wages - s11(a)			(560 000)	(0.5)
Wear and tear operating leases − capital allowances			(320 000)	(0.5)
s23A(1) - rental income on allowances affected assets	Income	850 000		
Admin expenses	640 000 × $^{850\,000}/_{2\,850\,100}$	(190 870)		
		659 130		(2)
s12C(1) allowance				
Balance brought forward		8 100		(1)
1 500 000 × 20%		300 000		
960 000 × 20%		192 000		(3)
820 000 × 20% (accelerated allowance of 40% not available to assets leased)		164 000		
		664 100		
s23A(2) amount allowed		(659 130)	(659 130)	(1)
Carried forward to 2018		4 970		
Taxable income			848 970	(11)
				(24)

SOLUTION 1.3

Manufacturing (Pty) Ltd

				R	
(1)	**<u>Option 1</u>**				
	1/3/2016 – 28/2/2021				
	Lease payments	(R2 700 × 60) – R18 200 =		(143 800)	(2)
	Lease payments net of VAT S23C – VAT is claimed at the start of the lease in terms of s9(3)(c) of the VAT Act				
	2021				
	s8(5) recoupment -	Market value	60 000		
		less paid	(200)	59 800	(1)
	No VAT adjustment at the termination of the lease as this would have been accounted for at the start of the lease.				
	2021 onwards				
	Wear & tear s11(e)	$^{R60\,000}/_{6}$		(10 000)	(1)
	Not brought into use for the first time - therefore s12C cannot be claimed				
	Cash outflow — lease payments			(143 800)	(1)
	Tax saving - s11(a) deduction	R143 800 × 28%		40 264	(1)
	Recoupment - s8(5)	R59 800 × 28%		(16 744)	(1)
	Paid for machine			(200)	(1)
	Outflow 2017 - 2021			(120 480)	
	Inflow 2021 onwards - tax saving s11(e)	R10 000 × 28% × 6		16 800	(1)
	Total outflow			(103 680)	
	<u>Option 2</u>				
	Cash cost			130 000	
	VAT			18 200	
				148 200	(1)
	Payments	R30 000 + (R2 300 × 60)		(168 000)	(1)
	Finance charges			(19 800)	
	Per year s24J(2) (assumed equal, since no YTM given)	R19 800 × $^{12}/_{60}$		(3 960)	(1)
	Tax effects				
	2017– 2021	s12C over life fully deducted (R130 000 × 20% per year)		(26 000)	(1)
		Net of VAT s23C			
		Finance charges s24J(2)		(3 960)	
				(29 960)	
		Tax @ 28%		(8 389)	

SOLUTION 1.3 continued

2021				
Cash flow	Payments	(R168 000 − R18 200)	(149 800)	(1)
	Tax saving	R8 389 × 5	41 944	(1)
Total outflow			(107 856)	

Option 1 would be the better option having total cash outflows of R103 680 compared to R107 856 for option 2. (1)

(16)

(2) Finance House - lease

VAT

1)	Input VAT claimed on receipt of tax invoice s16(3)	(18 200)	(1)
2)	Output VAT on delivery or payment of deposit, whichever earlier. Read with s8(11), s9(3)(c) & s10(6) of VAT Act	18 200	(1)

INCOME TAX

1)	Lease income will be R2 700 × 12 (gross) per annum Gross rental (i.e. without any VAT adjustment) is included in gross income	32 400	(1)
2)	s12C(1) will be (R130 000 + R18 200) × 20% for 5 years s12C allowance is based on the cost incl. VAT − the CSARS permits the lessor to add the output tax on the lease agreement to the cost of the asset for the purposes of claiming capital allowances.	(148 200)	(2)
3)	s8(4)(a) Recoupment		
	Tax value 0		
	Proceeds 200	200	(1)
			(6)
			(22)

SOLUTION 1.4

Excel Manufacturers (Pty) Ltd

Other taxable income		1 000 000	
s13(1) Annual building allowance	R1 710 000 × $^{100}/_{114}$ × 5%	(75 000)	(1)

Allowance based on cost (excl. cost of land), net of VAT in terms of s23C

Machine A

Total costs	315 000	
Cash cost	(285 000)	
Finance charges	30 000	(1)

SOLUTION 1.4 continued

Per month	$^{30\ 000}/_{36}$	833		
Incurred for period 1.3.2016-30.6.2016: s24J(2)	4 × R833.33		(3 333)	(2)
'Cost' for 12C:				
Cash cost net of VAT s23C	285 000 × $^{100}/_{114}$	250 000		(1)
Delivery net of VAT	3 705 × $^{100}/_{114}$	3 250		(1)
Installation net of VAT	5 130 × $^{100}/_{114}$	4 500		(1)
		257 750		
s12C(1) (2017) 40% new and unused		(103 100)	(103 100)	(1)
Tax value at 30.6.2016		154 650		
Proceeds:				
Scrap	(28 500 × $^{100}/_{114}$)	25 000		
Insurance	206 400 × $^{100}/_{114}$ net of VAT – s8(8)	181 053		
		206 053		(1)
Recoupment				
s8(4)(a)	206 053 – 154 650		51 403	(1)
Cannot be deferred as proceeds not used to purchase replacement asset				

Machine C:

New – no deemed input as new		456 000		
s12C(1) allowance: 40% new and unused assets used in manufacturing		(182 400)	(182 400)	(1)
		273 600		

Machine B:

s12C(2) based on lower of cost or market value at date the asset is acquired (not the date asset is brought into use). No VAT as acquired from non-vendor and no deemed input.		267 900		(1)
s12C(1) new and unused	267 900 × 40%	(107 160)	(107 160)	(1)
Tax value at 30.6.2016		160 740		
No deemed recoupment i.t.o. s8(4)(k) as tax value > deemed proceeds		(15 000)	0	(1)
For VAT Excel would have to account for a s18(1) VAT adjustment on the donation				(2)

Output VAT = R17 100 × $^{14}/_{114}$ = R2 100.
VAT exclusive Proceeds = R17 100 – 2 100 = R15 000
No s11(o) as donated to a connected person

Repairs: s11(d)	(R68 400 – R31 920) × $^{100}/_{114}$	32 000	(1)
New loading platforms constitute an improvement therefore no s11(d)			
s13(1) - Improvement of manufacturing building	R31 920 × $^{100}/_{114}$ × 5%	(1 400)	(1)

SOLUTION 1.4 continued

Lease:

Lease rentals s11(a):	8 550 × $^{100}/_{114}$ × 7	(52 500)	(1)
Lease premium s11(f):	45 600/2 years × $^{100}/_{114}$ × $^{7}/_{12}$	(11 667)	(1.5)
Improvements s11(g):	(59 950 × $^{100}/_{114}$) × $^{4}/_{21}$ months	(10 017)	(1.5)
s11(g) limited to lease contracted price			
s13(1) on improvements not allowed under s11(g):	(63 840 – 59 950) × $^{100}/_{114}$ × 5%	(171)	(1.5)
Stock:			
Insurance claim gross income, net of VAT - s8(8)	342 000 × $^{100}/_{114}$	300 000	(1)
No adjustment necessary for loss of trading stock as included in purchases or opening stock deductions.			
Opening inventory	s22(2)	(190 000)	(0.5)
Purchases	s11(a) (479 000 × $^{100}/_{114}$)	(420 175)	(1)
Closing inventory	s22(1)	100 000	(0.5)
Cost of auction: advertising s11(a)	3 990 × $^{100}/_{114}$	(3 500)	(1)
Stock auctioned Gross Income:	91 200 × $^{100}/_{114}$	80 000	(1)
Amount paid over (advertising s11(a))		(80 000)	(0.5)
Stock donated	s22(8)	20 520	(1)
s11(a) & s22(8) proviso (a) trading stock donated for promotion of products		(20 520)	(1)
No VAT on the items donated, advertising, it is in the course of making taxable supplies, therefore no change in use in terms of s18(1).			
Taxable income		322 980	

Capital gains tax:	Machine A	Machine B	
Proceeds para 35/deemed proceeds para 38	206 053	15 000	
less s8(4) recoupment	(51 403)		
	206 053	15 000	(1)
Base cost para 20(1)(a)	257 750	267 900	
less ss12C/11(e) para 20(3)(a)	(103 100)	(107 160)	
	154 650	160 740	(2)
Donations tax added			
= 0 since ‘A’ > ‘M’	0	0	
	154 650	160 740	
Capital gain/(loss)	51 403	(145 740)	

SOLUTION 1.4 continued

This loss of R145 740 is 'ring-fenced' as the disposal is to a connected person. Para 39	(1)
The stock donated does not give rise to any capital gains tax consequences as the amounts relating thereto are dealt with entirely as revenue income and expenditure.	
	(35)

SOLUTION 1.12

TRANCO LTD

1. VAT effects	Input tax	Output tax	
VAT input on ICA at commencement of lease s9(3)(c): R228 000 × $^{14}/_{114}$ × 60% To extent that the trailers will be used for making taxable supplies. The transport of passengers is an exempt supply s12(g)	16 800		(1)
VAT on termination of lease: nil as ICA			(1)
VAT output tax on supply of trailers to Bussit:			
s8(16) deemed to be wholly in course of enterprise.			(1)
s10(4) applies as Bussit is a connected person and is not entitled to an input tax deduction: R120 000 × $^{14}/_{114}$		14 737	(2)
s16(3)(h) applies as Tranco was not entitled to a full input deduction on acquiring the trailers; based on lower of cost and MV at time of supply: R120 000 × $^{14}/_{114}$ × 40%	5 895		(1)
	22 695	14 737	
			(6)

2. Effect on taxable income				
Monthly instalments	4 800			(0.5)
less portion of VAT input tax s23C claimed:				
R228 000 × $^{14}/_{114}$ × 60% × $^{1}/_{60}$	(280)			(1)
	4 520			
s11(a) 6 months			(27 120)	(0.5)
s8(5) recoupment on termination of lease:				
Market value of trailers		114 000		(1)
less consideration		(20 000)		(1)
Recoupment			94 000	
Note: No VAT arises on transfer as all VAT is dealt with at inception of the ICA.				
Wear and tear for period 1 September 2016 to 28 February 2017:				
s11(e)(vii) - Market value: R114 000 × 20% × $^{6}/_{12}$			(11 400)	(1)
Recoupment on disposal to Bussit:				
s8(4)(k) Market value R120 000 × $^{14}/_{114}$		105 263		(1)
Output VAT is determined i.t.o. s10(4)				

SOLUTION 1.12 continued

Limited to cost on which allowances were granted		114 000		(0.5)
less tax value (R114 000 − R11 400)		(102 600)		(0.5)
			2 663	
Capital gain on disposal to Bussit:				
Proceeds are deemed to be MV para 38 less output VAT	105 263			(1)
less recoupment para 35(3)(a)	(2 663)			(0.5)
		102 600		
Base cost:				
Expenditure para 20(h)(ii) [R20 000 + R94 000]	114 000			(1)
less allowances para 20(3)(a)	(11 400)			(0.5)
		(102 600)		
Capital gain		0		
s26A taxable capital gain at 80%			0	
			58 143	
				(10)
				(16)

CHAPTER 2: ASSESSED LOSSES AND DEBT REDUCTION

Index to sections

Question	Sections	Grade	
Question 2.1	s20, s20A, Eighth Schedule	**	S
Question 2.2	Compromise, s19, s20, s103(2), Companies Act 151, 2008	***	S
Question 2.3	s20, s20A	**	
Question 2.4	s20, s20A	***	
Question 2.5	GI, s11(a), s11(d), s20, s20A, s23(b), Eighth Schedule	***	S
Question 2.6	GI, s8(4)(a), s11(a), s11(e), s19, s20, s20A, s23(b), Fourth Schedule, Seventh Schedule, Eighth Schedule	***	
Question 2.7	GI, s8(4)(a), s11(a), s12C, s13, s19, Eighth Schedule	***	
Question 2.8	Assessed losses s19, s20, foreign losses, VAT	**	

QUESTION 2.1 (Solution at end of chapter) (22 Marks)

YOU ARE REQUIRED TO: Indicate whether the following statements are TRUE or FALSE. If the statement is FALSE, give supporting reasons.

1. ‘Assessed loss’ is a term which is not defined in the Income Tax Act.
2. An assessed loss is the amount by which deductions and allowances, including capital losses, exceed income.
3. If no trade is carried on by a taxpayer for an entire tax year, any assessed loss balance from the previous year may not be carried forward to any subsequent years.
4. A balance of assessed loss from a previous year may always be set off against taxable income of the current year.
5. If a company carries on two different trades in South Africa, an assessed loss in the one trade may be set off against taxable income in the other trade.
6. If a South African resident company carries on one trade in South Africa and another trade in Europe, an assessed loss from the European trade may be set off against taxable income from the South African trade.
7. If a South African resident company carries on one trade in South Africa and another trade in Europe, an assessed loss from the South African trade may be set off against taxable income from the European trade.
8. If a natural person carries on two trades in South Africa, an assessed loss from one trade can never be set off against taxable income from the other trade.
9. If Dr Smith carries on part-time farming he may set off any loss from his farming activities against taxable income from his medical practice.
10. A company may not set off a loss from part-time farming activities against taxable income from its other trades in terms of s20A.
11. A capital loss (in terms of the 8th Schedule) reduces taxable income.
12. Shareholders of a company can utilise their share of a balance of assessed loss, in the company, in determining their taxable income.

QUESTION 2.2 (Solution at end of chapter) **(18 Marks)**

The balance sheet of Badluck (Pty) Ltd is as follows:

	R
Share capital	100 000
Accumulated loss	(5 000 000)
Shareholders loan	1 000 000
Trade creditors	4 800 000
	900 000
Cash	900 000

Badluck has no prospect of recovery and is about to be liquidated. The claims of the trade creditors are preferred to the shareholders loan, which has been back-ranked. Mr Smart is of the opinion that his entrepreneurial skills will enable him to turn Badluck around and that within a couple of years it will be profitable.

Badluck, which is still trading, has an assessed loss balance of R6 million. Mr Smart has been in negotiations with the trade creditors, who have indicated that they are prepared to enter into an agreement with Badluck in terms of which they will reduce their claims by 70 cents in the Rand, i.e. they will accept 30% in full and final settlement of their claims. This would mean that Badluck would have to pay the creditors R1 440 000. Mr Smart is prepared to arrange a bank loan to meet the shortfall.

Mr Smart's accountant has suggested that he should consider a section 155 (Companies Act, 2008) scheme of arrangement in terms of which the creditors will have a five cents in the Rand compromise with the company (i.e. they will reduce their claims by five per cent). Thereafter they will sell the claims against the company to Mr Smart for R1.2 million. Mr Smart will at the same time acquire the entire share capital and shareholder loan for R10 000.

The trade creditors' claims arose as a result of the sale of trading stock to Badluck in previous years of assessment. The trading stock has all been sold by Badluck.

Badluck is a registered VAT vendor.

YOU ARE REQUIRED TO: Discuss the income tax implications, for all parties, for the year of assessment ended 28 February 2017, of the two take over plans being considered, i.e.:

1. The creditors compromise their claims by 70% and Mr Smart then buys the shares and shareholders loan for R10 000.
2. The creditors compromise their claims by 5% and sell their claims to Mr Smart for R1.2 million whereafter Mr Smart acquires the shares and loan account for R10 000.

QUESTION 2.3 **(16 Marks)**

S20A of the Income Tax Act disallows the set-off of an assessed loss from one trade against income from another trade in certain situations.

Mrs Madonsela (who is taxed at the maximum marginal tax rate) has approached you for advice regarding the application of s20A. Mrs Madonsela has three shops in Bloemfontein. Two of the shops are clothing retailers. One is in central Bloemfontein and the other is in the suburbs. The third shop is an organic food shop. All of the shops are operated by Mrs Madonsela as a sole trader. Mrs Madonsela also runs a farm on a part-time basis. The farm always makes a tax loss.

YOU ARE REQUIRED TO: Address the following matters on behalf of Mrs Madonsela:

1. If one of the clothing shops makes a loss during the year, and the other clothing shop and the organic food shop make a profit, how will her tax be determined? (14 Marks)
2. Would the tax position be different if she were to form a private company and transfer all her businesses (including the farm) to the private company? (Ignore CGT.) (2 Marks)

QUESTION 2.4 **(19 Marks)**

Jan Nierop is an independent individual with various types of business ventures and investments. Jan owns two residential flats that he leases out, and also runs a successful coffee shop. Jan and his extended family are also keen amateur pilots, and Jan owns a light aircraft that he rents to family members as well as other pilots.

Jan incurs losses in some of his trades and has heard about ring-fencing of losses. He is concerned that he may be affected and has asked you as a recent graduate of Taxation 3 to enlighten him.

Jan has given you the following information for the year of assessment ended 28 February 2017:

	Property rentals	**Coffee shop**	**Aircraft**
	R	**R**	**R**
2017 taxable trading profit/(loss)	(1 000)	900 000	(8 000)

Property rentals
The rentals are in respect of two residential apartments: one apartment (**A**) is situated at the coast and the other (**B**) is situated in the city. Neither are let to family members. The profit history of these properties is as follows:

	A	**B**
	Rands	**Rands**
2015	(2 000)	(8 000)
2016	(500)	(4 000)
2017	4 000	(5 000)

Aircraft
Jan rents his aircraft to family members for 85% of its total usage on a continual basis, and to other pilots for the remainder of its usage. The profit history of this endeavour is as follows:

	A
	Rands
2015	(3 000)
2016	(1 000)
2017	(8 000)

YOU ARE REQUIRED TO: In a letter to Jan:

1. Consider whether Jan is potentially at risk for ring-fencing of his losses on an overall basis. Do not consider previous years for this part. (4 Marks)
2. Discuss whether the rental losses can be ring-fenced and advise Jan if there are any factors which would assist him in defending an intention by CSARS to ring-fence any or all of his losses.
(13 Marks)

Lay out of letter. (Ignore VAT.) (2 Marks)

QUESTION 2.5 (Solution at end of chapter) (20 Marks)

Lois Laine, a South African resident, aged 45, has as her primary source of income the receipts and accruals of an investment portfolio left to her by her late father. She also earns rental income from a beach house that she purchased for R2 million on 1 March 2013. This purchase was financed by a mortgage bond. During the year of assessment ended 28 February 2017, interest on the bond amounted to R240 000. Repairs and maintenance, municipal rates and insurance amounted to R20 000 for the same period.

Shortly after purchasing the house, Lois entered into a ten-year lease with a Mr Gerber, a resident of Miami in the United States, who is not a relative of Lois. In terms of the lease, Mr Gerber rented the entire house for six months of each year. This was from 1 March to 31 August, at a total rent of R90 000 (i.e. R15 000 a month). Lois stays in house for two months each year and for the remainder of the year the house is let to members of Lois's family, who pay her a reduced rental of R2 000 per month.

Prior to the 2017 year of assessment, Lois incurred the following assessed losses in respect of the lease of the house:
2014: R19 000
2015: R18 000
2016: R22 000

The taxable income from her investment portfolio over the same period was:
2014: R680 000
2015: R700 000
2016: R830 000

During the 2017 year of assessment, Lois calculated her taxable income from the portfolio (excluding the rental trade) at R900 000.

On 30 October 2016, Lois disposed of a small plot of land that she owned and realised a capital gain of R50 000.

Other than the items mentioned above, Lois had no other income or deductible expenditure, or capital gains or losses during the year. Lois is unable to supply any information as to if and when taxable income will be derived from the beach house.

YOU ARE REQUIRED TO:

1. Advise Lois whether and on what basis, her rental trade might be subject to the ring-fencing provisions of s20A. (7 Marks)
2. Calculate Lois's taxable income, before the set-off of any assessed loss, for the year of assessment ended 28 February 2017. (5 Marks)
3. Calculate the taxable income or assessed loss in respect of Lois's rental trade, Lois's taxable income for the year and the balance of assessed loss carried forward, if any, as at 28 February 2017. You must explain how and why the assessed losses in each of the previous three years affect your calculations. (Ignore VAT.) (7 Marks)

QUESTION 2.6 **(46 Marks)**

Ntombi Ntuli, aged 45 and married out of community of property to Sipho, is the senior public relations executive of a large Cape Town company, where she has been employed since 1 March 2016. She is also quite an entrepreneur and has interests in certain private ventures. The deadline for submission of the first provisional tax payment for the year of assessment ending on 28 February 2017 is approaching and she has asked you for assistance in this regard. The information she has provided is set out below.

Employment income
Ntombi's tax returns are all up to date and she has been assessed for 2016, with the assessment dated 1 July 2016. Her taxable income for that year was R800 000. This included a taxable capital gain of R56 000 and a restraint of trade payment of R250 000 from her previous employer.

Ntombi's current salary is R60 000 a month. The company provides her with a motor car that cost R285 000 (including VAT) when purchased on 1 March 2016. The company pays for all expenses related to the car. Ntombi does not keep accurate records of distances travelled.

Employees' tax of R20 000 per month is deducted from Ntombi's salary.

Rental income
On 1 March 2016 Ntombi purchased a sectional title unit in an upmarket resort for R2 million. She saw this as a good investment opportunity, as there is strong demand for leases on this type of unit from foreigners who spend part of the year in South Africa.

Ntombi's wealthy uncle, Mr Goniwe, who normally resides in the UK where most of his business interests are, signed a five-year lease to rent the unit from 1 August to 28 February each year, commencing in 2016, at an open market rental of R10 000 per month. The unit is available for the use of Ntombi and her immediate family for the remaining five months. On average, her immediate family occupy the property for four of the remaining months and pay Ntombi a reduced rental. Ntombi occupies the property herself for one month per year.

Ntombi's interest payable on the mortgage bond over the unit is presently fixed at R120 000 a year and levies and other expenses (including repairs) related to the unit are R44 000 a year.

Art for Africa
Ntombi is also a talented artist with many contacts in the art world. During 2011 she decided to make use of these skills and commenced trading in her own time, selling her own paintings and those of other artists, under the name 'Art for Africa'. The Commissioner considers this trade to be one of 'dealing in collectibles' and 'the practice of creative arts' for the purposes of section 20A(2)(b). This trade has incurred assessed losses in each year as follows: 2012: R10 000; 2013: R8 000; 2014: R7 000; 2015: R12 000; and 2016: R2 000.

SARS was previously satisfied that the business would be able to generate a reasonable level of taxable income within a reasonable period and Ntombi was allowed to set these trade losses off against her other income.

For the year of assessment ending on 28 February 2017, Ntombi expects gross income from the sale of artworks to be R180 000. Expenditure on the acquisition of trading stock is expected to be R160 000 and operating expenses, including advertising, travel and accommodation to attend local and overseas exhibitions is expected to amount to R50 000. All of this expenditure is deductible in terms of section 11(a). There was no opening or closing trading stock in the business.

In addition, on 1 March 2016 Ntombi sold an antique display case that was used in the business, for an amount of R130 000. She had purchased the asset for R50 000 on 1 March 2015 and SARS allowed wear and tear at 20% a year. This is the only disposal of a capital nature Ntombi expects to have during the year of assessment. This business is not a registered VAT vendor.

Artefacts (Pty) Ltd

A few years ago Ntombi registered a private company called 'Artefacts' in order to acquire the business of a sole trader dealing in rare African art, mainly for the export market. Taxable income for the year of assessment ending 28 February 2017, before considering the waiver referred to below, is expected to be R500 000. The company has an assessed capital loss carried forward from 2016 amounting to R20 000. The company has an end-February financial year-end.

When the company was registered, Ntombi's uncle, Mr Goniwe, advanced it R600 000 to enable it to purchase the goodwill and trademarks of the sole trader. The company subsequently sold one of the trademarks at its cost of R10 000. The company's liabilities exceed its assets and in order to restore it to solvency, Mr Goniwe waived his loan of R600 000 to the company on 1 March 2016.

YOU ARE REQUIRED TO:

1. Discuss (with supporting calculations) the income tax effects of the waiver of the debt on Artefacts (Pty) Ltd and on Mr Goniwe. (7 Marks)
2. Advise Ntombi what amount she will be required to pay for her first provisional tax payment for 2017 assuming she will use the basic amount to determine her liability. (9 Marks)
3. Calculate Ntombi's taxable income for the year of assessment ending on 28 February 2017 and advise Ntombi of the minimum amount she will need to disclose as an estimate of taxable income for her second provisional tax payment for 2017 in order to avoid a penalty for underestimation. (30 Marks)

All workings should be shown and where appropriate, reasons should be supplied for the treatment of the information provided. (Ignore VAT.)

QUESTION 2.7 (25 Marks)

Sneakers (Pty) Ltd (Sneakers) is a manufacturer of manufactures sneakers (shoes), lifestyle fashion, and athletic apparel for the South African fashion industry. The company was founded on 1 January 2015, and since then has struggled to secure a stable position in the industry.

Sneakers is a key customer of High-Tops (Pty) Ltd (High-Tops), a well-established South African fashion company. The two companies are not connected persons, although they do share a December year-end.

When Sneakers was founded, High-Top extended an interest-free loan of R2.5 million to it in order to enable it to set up its business. Sneakers used the loan as follows:

- Purchase of land in Epping Industria – R250 000
- Construction of factory building on land purchased (completed 1 March 2015) – R800 000
- Purchase of Machine A (new) – R600 000
- Purchase of Machine B (new) – R450 000
- To fund deductible expenditure – R400 000

On 1 June 2017, Sneakers' outstanding balance owing to High-Top was R1.6 million in respect of the loan above, and R300 000 in respect of purchases of canvas material used in making sneakers. The canvas material worth was purchased in 2017, and R100 000 worth of the canvas material was on hand at year-end. Machine A was still in use, but Machine B had been sold by the company in 2016 for R400 000.

On 1 June 2017 Sneakers' management acknowledged that the company's financial situation was unsustainable, and it approached High-Top with a request for a portion of its amounts outstanding to the written off. High-Top agreed to write off 40% of each of the balances owing by Sneakers, and to accept the remaining 60% in full and final settlement of the two amounts owing. The reduction of the loan would be applied in proportion to its original use. This was sufficient to satisfy Sneakers' other creditors and prevent the possibility of the company's liquidation.

Sneakers had an assessed loss of R93 260 and an assessed capital loss of R33 300 carried forward from its 2016 year of assessment.

YOU ARE REQUIRED TO:

Discuss, with supporting calculations, the effects of the agreement by High-Top to release Sneakers from 40% of its outstanding debts on the taxable income of Sneakers (Pty) Ltd for its 2017 year of assessment. (25 Marks)

QUESTION 2.8 **(9 Marks)**

The following information is given for the year of assessment ending 28 February 2017, in respect of Worm (Pty) Ltd, a South African resident company.

1. At 29 February 2016 Worm had a balance of assessed loss of R10 million.

2. Worm has two South African trades (divisions) as well as a trading operation in France. The two South African trades are a manufacturing business and a retailing business. The French operation is a commercial property business. The taxable incomes for the three trades for the year ended 28 February 2017 are as follows:
   – South African manufacturing taxable income R6 000 000
   – South African retailing taxable loss (R2 000 000)
   – French commercial property taxable loss (R5 000 000)

3. In January 2017 Worm and one of its major trade creditors entered into a compromise arrangement. Worm owed the creditor R6 840 000 in respect of trading stock purchases made over a long period of time. This trading stock was sold during the year of assessment in which it was purchased. The creditor, aware of Worm's perilous financial position, agreed to a full and final payment of R3 420 000 in respect of its claim provided that payment was made before 31 January 2017. Worm raised a loan from its major shareholder and paid the R3 420 000 on 28 January 2017.

4. Worm is a VAT vendor.

YOU ARE REQUIRED TO:

1. Calculate Worm's taxable income or assessed loss for the year ended 28 February 2017. (7 Marks)

2. Explain the income tax and VAT consequences, of the compromise, for the creditor for the year ended 28 February 2017. (2 Marks)

SOLUTION 2.1

1.	FALSE	An assessed loss is defined in s20(2) as the amount by which the deductions in sections 11 to 19 exceed income. Section 11(x) incorporates all deductions in sections 11 to 37H (i.e. Part 1) of the Act. Capital losses are dealt with in the Eighth Schedule which is in Part VI.	(2)
2.	FALSE	Capital losses are carried forward separately from assessed losses.	(2)
3.	FALSE	The carry forward prohibition does not apply to natural persons.	(2)
4.	FALSE	The assessed loss could be ring-fenced for deduction against taxable income from that trade only - s20A.	(2)
5.	TRUE		(1)
6.	FALSE	Section 20 provides that losses from foreign trades may not be set off against income from South African trade.	(2)
7.	TRUE		(1)
8.	FALSE	The general rule is that it may. However, if s20A applies, a loss from one trade may not be set off against income from another trade.	(2)
9.	FALSE	Part-time farming is specifically referred to in s20A as a trade which is subject to ring-fencing.	(2)
10.	FALSE	Section 20A only applies to natural persons.	(2)
11.	FALSE	Capital losses (in terms of the Eighth Schedule) are not included in taxable income in terms of s26A. Capital losses are set off against capital gains.	(2)
12.	FALSE	A company is a legal person in its own right. The losses of one person cannot be utilised by another person.	(2)
			(22)

SOLUTION 2.2

Badluck (Pty) Ltd - 28 February 2017

1 ***The Company***

The creditors balance has been reduced by R3 360 000. ($^{1\,440\,000}/_{30\%}$ × 70%) or (R4 800 000 − 1 440 000). (1)

There will be a VAT output generated by the reduction (in terms of s22(3) of the VAT Act) (assuming the company is a VAT vendor) of R3 360 000 × $^{14}/_{114}$ = R412 612. (1)

The creditors have been paid in full and therefore have no further claims against the company. (1)

The reduction amount relates to a debt owed on trading stock which has been disposed of, therefore the reduction amount (net of VAT) is deemed to have been recovered or recouped by the taxpayer in terms of s19(5). This will be offset against the assessed loss, which has value and is therefore worth preserving. (1)

SOLUTION 2.2 continued

The Shareholders	
The sale of the shares by the original shareholders will result in a capital gain/loss depending on base cost.	(1)
The cost of the shares acquired by Mr Smart will be the base cost for future use should he ever sell the shares.	(1)
The nominal amount paid for the loan account will be its base cost for Mr Smart. Any recovery by Mr Smart above this amount will result in a capital gain. However, repayment of the loan account may be treated as gross income should SARS consider that Mr Smart was engaged in a scheme of profit making, in which case the purchase price should be allowed as a s11(a) deduction.	(1)
The Creditors	
The trade creditors are likely to apply s11(i) to the extent of the reduction.	(1)
In addition, the bad debt write off will also result in a reversal (input) of the output VAT paid on sales to the company.	(1)
	(9)
2 ***The Company***	
The advantage of a section 155 (Companies Act, 2008) compromise is that the creditors are bound by it.	
The reduction is R240 000. (4 800 000 × 5%)	(1)
There will be a VAT output generated by the reduction (in terms of s22(3) of the VAT Act) (assuming the company is a VAT vendor) of R240 000 × $^{14}/_{114}$ = R29 474.	(1)
The s19(5) recoupment is R240 000 − R29 474 = R210 526	(1)
The Shareholders (past and future)	
The purchase of the creditors balance of R4 560 000 for R1 200 000 has no immediate tax consequences for Mr Smart. No VAT is levied on the transaction because it is a financial service.	(1)
As long as SARS is satisfied that there was no scheme of profit making (by Mr Smart), repayment of the creditor claim (now in the hands of Mr Smart) of R4 560 000 will not give rise to gross income. The repayment will result in a maximum capital gain of R3 360 000 for Mr Smart (i.e. the extent to which the repayment by the company exceeds the amount paid by Mr Smart for the creditors' claims).	(1)
Likewise, the repayment of the shareholder loan will give rise to a capital gain to the extent it exceeds the amount of the purchase price allocated to the loan.	(1)
The Creditors	
The trade creditors are likely to apply s11(i) to the extent of the compromise.	(1)
In addition, the bad debt write off will also result in a reversal (input) of the output paid on sales to the company.	(1)
The disposal by the creditors of their remaining debtors book (a capital asset) will result in a capital loss.	(1)
	(9)
	(18)

SOLUTION 2.5

LOIS LAINE

1. Section 20A

S20A might apply to the rental trade as Lois is a natural person. (1)

In any year of assessment, losses from certain trades might be ring-fenced if Lois's taxable income, before setting off *any* assessed losses, exceeds the amount at which the maximum marginal rate of tax is payable (i.e. R701 301 in 2017). (1)

In terms of s20A(2) ring-fencing will apply to:

1) A trade in respect of which an assessed loss has been incurred in three of the last five years (including the current year) (s20A(2)(a)); or (1)

2) A 'suspect trade' as provided for in s20A(2)(b) in respect of which an assessed loss has been incurred; (1)
unless the taxpayer can satisfy the facts and circumstances test provided for in s20A(3) (read with s20A(4)). (1)
As Lois's house is let to a non-relative for 50% of the year, it is not a suspect trade (s20A(3)(iii)). (1)
From the question it can be assumed that Lois will not be able to satisfy the facts and circumstances test. Because she has incurred assessed losses in $^{3}/_{5}$ years, s20A(2)(a) will apply. (1)

(7)

2. Taxable income excluding the set-off of any assessed loss

Taxable income from investment portfolio		900 000	(1)
Capital gain from sale of land	50 000		(1)
less annual exclusion	(40 000)		(1)
Aggregate capital gain	10 000		
Taxable capital gain at 40%		4 000	(1)
(The capital gain is not applied against ring-fenced losses (s20A(6))			(1)
Taxable income for the year before assessed losses		904 000	
			(5)

3. Balance of assessed loss from rental trade

Neither the assessed loss for 2014, nor 2015 would have been subject to ring-fencing, as the $^{3}/_{5}$ year requirement was not met in those years, and it is not a suspect trade. (1)

The 2016 assessed loss would have been ring-fenced as Lois's taxable income was R830 000 and that was the third year in the past five years that the trade had an assessed loss. (1)

Taxable income/assessed loss from rental trade for the year of assessment ended 28 February 2017:

Rent received and accrued for 6 months from Mr Gerber	90 000	(1)
Rent received and accrued for 4 months from family members: R2 000 × 4	8 000	
less expenditure (to the extent 'from carrying on any trade'):		
The two months during which Lois occupies the property are not part of her trade, or would be prohibited from deduction as private/domestic expenditure - s23(b).		
Bond interest: R240 000 × $^{10}/_{12}$	(200 000)	(1)
Other expenses: R20 000 × $^{10}/_{12}$	(16 667)	(1)
	(118 667)	

SOLUTION 2.5 continued

The 2017 assessed loss will be ring-fenced in terms of s20(1) as Lois's taxable income of R904 000 before the set-off of any assessed losses is greater than R701 300.		(1)
Therefore balance of assessed loss that is ring-fenced:		
2014	0	
2015	0	
2016	(22 000)	(1)
2017	(118 667)	(1)
Balance of assessed loss carried forward and ring-fenced in terms of s20A	(140 667)	
Lois's taxable income for the 2017 year of assessment will be	904 000	
Her assessed loss from 2016 and 2017 is ring-fenced and can only be used against future profit from her rental trade in her 2018 year of assessment and beyond.		(8)
		(20)

CHAPTER 3: FINANCIAL INSTRUMENTS

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Question	Sections	Grade	
Question 3.1	s24I, s25D	**	S
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Question 3.5	Asset acquisition and disposal, s25D, Eighth Schedule para 43	***	
Question 3.6	Foreign currency assets and non-residents	**	
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Question 3.11	S11(e), s24I (including FECs), s25D	**	
Question 3.12	s8(4)(a), s12C, s24I, s45, Eighth Schedule para 43	***	
Question 3.13	GI, 23C, 24, VAT	*	S
Question 3.14	s31 transfer pricing, dividends tax	**	S
Question 3.15	s24I, Eighth Schedule para 27	***	S
Question 3.16	s12C, s8(4)(a),s8(4)(e), s24I, s24I, s24J, s31, Eighth Schedule para 43 and 66, VAT	***	
Question 3.17	s24J definition of 'instrument' and 'income instrument', incurral of interest, gain on redemption	**	
Question 3.18	GI, s11(a), s11(e), s11(f), s11(g), s12C, s23C, s23A, s23D, s24, s24J, VAT	***	
Question 3.19	s31 transfer pricing, dividends tax	***	
Question 3.20	GI, s9C, s22, Eighth Schedule	***	

QUESTION 3.1 (Solution at end of chapter) (23 Marks)

Impro (Pty) Ltd is a South African resident company. Impro manufactures electronic components that are sold both in South Africa and in Europe. The following information relates to Impro's imports and exports for the year ended 28 February 2017.

1. Sales

Sales are made to a customer in Germany and are invoiced in Euros. The following sales were made during the year:

1 April 2016	€100 000
1 August 2016	€50 000
1 February 2017	€140 000

In terms of the sale agreement, payments are made two months after the date of invoice. The above amounts were therefore paid on 1 June 2016, 1 October 2016 and 1 April 2017 respectively.

2. Purchases of raw materials

Raw materials are purchased from a supplier in France. The following purchases were made during the year:

1 April 2016	€60 000
1 February 2017	€40 000

Payments were made on 1 June 2016 and 1 April 2017 respectively.

3. **Manufacturing machinery**
A manufacturing machine was acquired from a supplier in Germany at a cost of €1m on 1 February 2017 and brought into use on 15 February 2017. In terms of the agreement, payment is to be made on 1 June 2017.

Because Impro was concerned about the exchange rate, a forward exchange contract was entered into on 15 February 2017. In terms of the contract, the bank will supply €1m on 1 June 2017 at a rate of €1 = R15.80. The forward rate for a similar contract on 28 February 2017 was €1 = R15.20.

4. On 1 August 2016 Impro lent €200 000 to its subsidiary in Germany. The loan is due in full on 1 August 2018.

The spot exchange rates at the relevant dates are:

€1 equals	
1 April 2016	R14.00
1 June 2016	R14.10
1 August 2016	R13.90
1 October 2016	R13.60
1 February 2017	R14.80
28 February 2017	R14.70
1 April 2017	R15.00
1 June 2017	R15.40
28 February 2018	R14.60

The average exchange rates for the years ended 28 February 2017 and 28 February 2018 were €1 = R14.50 and €1 = R15.90 respectively.

YOU ARE REQUIRED TO: Calculate the income tax consequences of each of the above, including the foreign exchange gains and losses, in respect of Impro's years of assessment ended 28 February 2017 and 28 February 2018.

QUESTION 3.2 (Solution at end of chapter) (11 Marks)

Atom (Pty) Ltd is a South African resident company that carries on a manufacturing process in Pretoria. Atom acquires certain of its raw materials from suppliers in Europe. The product manufactured is sold both in South Africa and in Europe. The following information is provided for the year ended 28 February 2017:

1. On 30 June 2016 Atom paid a debt denominated in Euros. The debt was €100 000 and had arisen on 1 February 2016, when Atom acquired raw materials (stock) from a general supplier.
2. On 30 June 2016 Atom sold products to a French customer for €20 000. In terms of the agreement, the €20 000 was paid on 1 July 2016.
3. On 1 January 2017 Atom purchased a machine for €200 000 from a French supplier. The purchase price was payable on 31 March 2017 and the machine was brought into use on 1 March 2017.
4. On 1 January 2017, Atom sold products to a German customer for €50 000. The purchase price was paid on 31 March 2017.

Spot exchange rates at the relevant dates are as follows:

1 February 2016	€1 = R12.70
29 February 2016	€1 = R13.00
30 June 2016	€1 = R13.50
1 July 2016	€1 = R14.00
1 January 2017	€1 = R14.50
28 February 2017	€1 = R14.10
31 March 2017	€1 = R16.00

The average exchange rates for the years ended February 2017 and 2018 were €1 = R12.50 and €1 = R14 respectively.

YOU ARE REQUIRED TO: Calculate the income tax consequences of the above respect of the years ended 28 February 2017 and 28 February 2018.

QUESTION 3.3 (18 Marks)

A South African resident purchased a new machine, to be used in a trade carried on in South Africa. The machine was purchased in December 2016 from a German supplier for €10 000. In terms of the purchase agreement, the purchase price is to be paid in full on 31 May 2017.

Being concerned about the Rand/Euro exchange rate, the resident is considering hedging the currency exposure with either a forward exchange contract (FEC) or a foreign currency option contract (FCOC).

The year end is 28 February 2017.

YOU ARE REQUIRED TO: Explain how s24I will apply in the following situations:

1. The resident is a company and
   i. the debt is hedged with a FEC; or
   ii. the debt is hedged with a FCOC; or
   iii. the debt is not hedged.
2. The resident is a natural person and
   i. the debt is hedged with a FEC; or
   ii. the debt is hedged with a FCOC; or
   iii. the debt is not hedged.

QUESTION 3.4 (13 Marks)

PART A (7 Marks)

Traders SA (Pty) Ltd (a South African resident) purchased trading stock from its German holding company for €10 000 on 15 December 2016. At that date the spot rate was €1 = R14.10. The amount was payable on 15 March 2017. To hedge against fluctuations in exchange rates, a forward exchange contract was taken at a forward rate of €1 = R14.50. At the year-end, the spot rate was €1 = R14.40; a market related forward rate for a similar FEC at 28 February 2017 was €1 = R14.60. The spot rate on date of settlement was €1 = R14.65.

YOU ARE REQUIRED TO: Calculate the effects of the above transaction on Traders SA (Pty) Ltd's taxable income for the years of assessment ending February 2017 and 2018.

PART B (6 Marks)

Sol Trader trades in his own name. He purchased some trading stock from an Italian supplier on 15 December 2016 for €10 000, when the spot rate was €1= R14.10. The amount was payable on

15 March 2017. Sol simply records the trading stock and amount owing in his books at the forward rate.

To hedge against fluctuations in exchange rates, a forward exchange contract was taken at a forward rate of €1 = R14.50. At 28 February 2017, the spot rate was €1 = R14.40; a market related forward rate for a similar FEC at 28 February 2017 was €1 = R14.60. The average exchange rate for the 2017 year of assessment was €1 = R14.20; the average exchange rate for the 2018 year of assessment was €1 = R14.70. The spot rate on date of settlement was €1 = R14.65.

YOU ARE REQUIRED TO: Calculate the effects of the above transaction on Sol's taxable income for the 2017 and 2018 years of assessment.

QUESTION 3.5 **(23 Marks)**

PART A (12 Marks)

Joe Manu, a South African resident, purchased a new machine for £100 000 on 30 November 2016 for his sole trader business. The machine was brought into use on 5 December 2016 in a process of manufacture.

Joe knew that, should the machine not be adequate for his business, he could resell the machine to the supplier's second-hand dealership.

As it turned out, the machine proved not to be adequate and Joe sold the machine to the second-hand dealership for £105 000 on 25 February 2017 (being the market value at the date of sale).

The spot rate on 30 November 2016 was £1 = R14.80 and on 25 February 2017 was £1 = R15.20. The average exchange rate for the 2017 year of assessment was £1 = R15.00.

This transaction was Joe's only foreign exchange transaction and Joe does not have a permanent establishment in the UK.

Joe has elected to use the average rate of exchange in terms of s25D and the 8th Schedule para 43.

YOU ARE REQUIRED TO: Determine the income tax effects (insofar as the information allows) for the above transaction for the 2017 year of assessment.

PART B (11 Marks)

Assume that all of the facts remain the same as in Part A above, except that Joe sold the machine for $170 000 on 25 February 2017. Ignore the exchange rates given in Part A and use the following exchange rates where necessary:

- Spot rate 30/11/2016 $1 = R9.20
- Spot rate 25/02/2017 $1 = R9.75
- Average for the 2017 year of assessment $1 = R9.55

Joe has again elected to use the average rate of exchange in terms of s25D and the 8th Schedule para 43.

YOU ARE REQUIRED TO: Determine the income tax effects (insofar as the information allows) for the above transaction for the 2017 year of assessment.

QUESTION 3.6 **(23 Marks)**

PART A (5 Marks)

Claudette Dumont is a resident of France. She purchased a holiday property in Cape Town for €150 000 on 30 October 2015. In the 2017 year of assessment, Claudette became increasingly ill and decided to liquidate her foreign assets. She therefore sold the property in Cape Town to a friend for €200 000 (the market value at the time) on 30 January 2017.

Exchange rates are as follows:

• Spot rate 30/10/2015	€1 = R13.20
• Spot rate 30/01/2017	€1 = R14.75
• Average for the 2016 year of assessment	€1 = R14.80
• Average for the 2017 year of assessment	€1 = R14.85

YOU ARE REQUIRED TO: Determine the South African taxable capital gain for Claudette for the 2017 year of assessment. You may assume that she has no other capital gains or losses taxable in South Africa during the year of assessment.

PART B (18 Marks)

Eric van Dorff, 47 years old, is a resident of Belgium. On 1 June 2000 he had purchased a holiday property in Durban for €200 000. Expenditure of €20 000 was incurred in making improvements on 31 January 2016. Other investment opportunities in Belgium resulted in Eric selling his property in Durban. He sold the property for €350 000 on 5 February 2017 to a South African resident. He had the property valued as at 1 October 2001, on which date the property had a value of €230 000.

Exchange rates are as follows:

• Spot rate 01/06/2000	€1 = R11.42
• Spot rate 01/10/2001	€1 = R11.55
• Spot rate 31/01/2016	€1 = R14.60
• Spot rate 05/02/2017	€1 = R14.25
• Average for the 2003 year of assessment	€1 = R11.50
• Average for the 2016 year of assessment	€1 = R14.80
• Average for the 2017 year of assessment	€1 = R14.85

YOU ARE REQUIRED TO: Determine the South African income tax payable for Eric for the 2017 year of assessment. You may assume that Eric has no other South African source income.

QUESTION 3.7 **(13 Marks)**

Shipaid (Pty) Ltd, a South African resident, renders a helicopter supply service to ships rounding the Cape. All services are invoiced in US dollars and are payable within three months of the date of issue. The service is provided by means of three helicopters which were acquired three years ago. The ships that are serviced are all outside the territorial waters of the Republic. All spare parts for the helicopters are imported from the USA.

The company has a February year-end.

On 1 November 2016 a new motor was purchased for one of the helicopters at a cost of $500 000. In terms of an agreement with the supplier, the amount is payable in full on 31 March 2017. The motor was shipped FOB on 1 November 2016 and arrived in Cape Town on 25 February 2017. Shipping costs were R20 000 and import duty was R800 000. VAT was paid on the import and amounted to R350 000. The motor was fitted to a helicopter on 1 March 2017. Shipping costs are zero-rated for VAT.

The debt of $500 000 in respect of the acquisition of the motor was covered by a forward exchange contract (FEC) at a forward rate of $1 = R10.20. The FEC was entered into on 1 November 2016. The market related rate for a similar FEC on 28 February 2017 was $1 = R9.95.

During January 2017, invoices for services rendered to the value of $50 000 were issued on 25 January 2017. February invoices were issued on 25 February 2017 and had a value of $40 000. The January invoices were paid in full on 20 April 2017, while the February invoices were paid in full on 20 May 2017.

Assume that the exchange rates at the relevant dates were:

01/11/2016	$1 = R10.00
25/01/2017	$1 = R9.80
25/02/2017	$1 = R9.75
28/02/2017	$1 = R9.85
31/03/2017	$1 = R9.65
20/04/2017	$1 = R9.60
20/05/2017	$1 = R9.55

The average exchange rates for the 2017 and 2018 years of assessment were $1 = R9.90 and $1 = R9.50 respectively.

YOU ARE REQUIRED TO:

1. Calculate the amounts that are included and deducted from income for the 2017 and 2018 tax years in respect of the import of the motor (assuming that the motor will be treated as a section 11(d) repair). (9 Marks)
2. Calculate the exchange differences in respect of the January and February invoices for the years ended February 2017 and February 2018. Indicate whether each difference is a gain or a loss. (4 Marks)

QUESTION 3.8 (15 Marks)

On 1 August 2016, Makit Ltd purchased raw materials in the USA for $500 000. In terms of the purchase agreement, 25% of the purchase price was payable on 1 August 2016, 25% was payable on 1 February 2017 and the balance was payable on 1 August 2017. Makit decided not to cover the transaction with a forward exchange contract. 20% of the stock was still on hand on 31 December 2016. None of the stock was on hand on 31 December 2017.

In July 2016, Makit purchased a machine in the UK for £100 000. The purchase contract provided for supply FOB Portsmouth on 1 August 2016. In terms of the agreement, payment was to be made on 1 February 2017. Because Makit was concerned about the weakening of the Rand, on 1 August 2016 it entered into a forward exchange contract for the supply of £100 000 on 1 February 2017 at a rate of £1 = R16.

The machine was subject to import duties of R150 000 and VAT of R110 000 when it arrived in Cape Town. The machine was brought into use in a process of manufacture on 1 November 2016. Makit is a registered VAT vendor. Exchange rates at the relevant dates are as follows:

01/08/2016	$1 = R10.00	£1 = R15.67
01/11/2016	$1 = R9.95	£1 = R16.16
31/12/2016	$1 = R9.60	£1 = R14.74
01/02/2017	$1 = R9.80	£1 = R15.61
01/08/2017	$1 = R10.20	£1 = R15.72

The average exchange rates for the 2016 year of assessment were \$1 = R10.05 and £1 = R15.05 and for the 2017 year of assessment were \$1 = R9.85 and £1 = R15.75.

A market related rate for a similar FEC on 31 December 2016 was £1 = R15.50.

YOU ARE REQUIRED TO: Calculate the effects of the two transactions on Makit's taxable income for the years of assessment ended 31 December 2016 and 31 December 2017.

QUESTION 3.9 **(26 Marks)**

Mr Langenlock came to South Africa from the Netherlands and settled as a South African tax resident on 22 February 2016.

He owned the following assets at that date:

Description of asset	**Market value in Euros at 22 February 2016**
House in Netherlands	€500 000
Personal Euro currency account	€8 000
Listed shares in European companies	€320 000

He was also one of the beneficiaries of an offshore discretionary trust, which was set up by his father in 2004. At the time his father was ordinarily resident in the Netherlands and donated €2 million to the trust. The trust was set up in Lichtenstein in Europe and was called the Langenlock Offshore Family Trust.

On Wednesday 15 March 2016, the offshore trust used €1 million to set up a South African company, Reslock (Pty) Ltd. The company has a February year-end. The company bought a house in Camps Bay, South Africa, which Mr Langenlock intended to use as his primary residence.

The exchange rate at the time the funds were brought into South Africa, on Wednesday 15 March 2016, was €1 = R14.51145. The trust invested €300 000 in the share capital of the company and lent the balance of €700 000 to the company on interest-free loan account at that date. On conversion to South African Rands, the company had R10 158 015 of loan capital and R4 353 435 of share capital. The loan had to be repaid in Euros on demand.

The company used the loan to buy the house in Camps Bay for R8 million on 31 March 2016 and paid the transfer duty of R717 500, plus other costs of R142 500 out of the remaining balance. The unused amount of R1 298 015 was kept in the company's bank account until 15 December 2016, at which time it was repaid to the offshore trust, together with interest earned of R103 840. The company therefore reduced its loan by the Euro equivalent of R1 401 855.

The company did not intend to trade. It could allow Mr Langenlock to live in the house for free, provided that he paid all the costs (rates, insurance, water, electricity, maintenance, etc.) of R5 500 per month, or it could charge him a market-related rental of R24 500 per month and the company would then pay the monthly costs.

During the 2017 year of assessment the following occurred:

1. Mr Langenlock sold his house in the Netherlands on 1 August 2016 for €540 000. The amount was transferred to his personal Euro currency account on the same day. The amount was subject to tax in the Netherlands.

2. Half of the listed shares were sold to a South African resident for R2.8 million. The amount was transferred to his SA bank account on the same day. This happened on 15 December 2016.

3. Mr Langenlock earned interest of €3 000 on his personal Euro currency account. The interest accrues 12-monthly in arrears on the last day of February each year and was paid directly into this account.

The exchange spot rates on the relevant dates were as follows:

Date	€	R
22 February 2016	€1	R14.22700
29 February 2016	€1	R14.31689
1 March 2016	€1	R14.31689
15 March 2016	€1	R14.51145
1 August 2016	€1	R15.88380
15 December 2016	€1	R16.22679
04 January 2017	€1	R16.16674
28 February 2017	€1	R16.48947

The average exchange rates for the relevant 12-month periods ended on the last day of February each year were as follows:

12 months ended 29 February 2016	€1	R14.8311
12 months ended 28 February 2017	€1	R15.8614

YOU ARE REQUIRED TO:

1. Calculate Mr Langenlock's taxable income in South African Rands (including taxable capital gains) for the year of assessment ended 28 February 2017, in respect of the above transactions, assuming Mr Langenlock elects the average exchange rate. (11 Marks)
2. Calculate the South African company's taxable income or its assessed loss for its tax year ended 28 February 2017:
   i. if it earned rental income from Mr Langenlock of R24 500 per month, and paid costs of R5 500 per month from April 2016 to February 2017; or
   ii. if it let Mr Langenlock use the house for nothing and Mr Langenlock incurred the monthly costs of R5 500 from April 2016 onwards. (15 Marks)

(Work to the nearest Rand (R) and to the nearest Euro (€).)

QUESTION 3.10 **(26 Marks)**

YOU ARE REQUIRED TO: Identify the relevant sections of the Income Tax Act that apply and list, in point form, the income tax consequences of the following situations:

1. Joe Bloggs, a South African resident, does not have a permanent establishment outside South Africa. He purchased a capital asset – vacant land in the UK – in 2008 in pounds and sold it in the current year of assessment in pounds. (4 Marks)
2. As in (1) above, but Joe had financed the purchase of the land with a UK mortgage loan denominated in Pounds. (2 Marks)
3. DEF Limited, a South African resident, does not have a permanent establishment outside South Africa. It has a 31 March year end. It purchased a new manufacturing machine from a supplier in the USA on 15 March 2016 in dollars, for the purpose of using it in a process of manufacture. It brought the asset into use in a process of manufacture on 30 June 2016. The debt was settled on 31 April 2016. (7 Marks)
4. As in (3) above and, in addition, DEF took out a forward exchange contract on 20 March 2016 to hedge the debt owing to the supplier. The closing date of the forward exchange contract was 31 April 2016. The machine was sold by DEF for an amount in pounds in March 2017. (13 Marks)

QUESTION 3.11 **(11 Marks)**

'Roger Ltd' (Roger) is a South African resident as defined. Roger does not have a permanent establishment outside South Africa. For its year of assessment ended 28 February 2017, it entered into the following transactions:

1. On 1 December 2016 it delivered goods to 'Rafa Ltd' (Rafa), in terms of a contract of sale, for €70 000. Rafa had paid a deposit of €20 000 on 28 November 2016 and the balance was payable on 1 April 2017. In order to hedge its foreign currency risk, on 15 December 2016 Roger took out a forward exchange contract (FEC) for €30 000 with a maturity date of 1 April 2017.
2. On 15 December 2016 Roger purchased computer equipment from Rafa for €15 000. The full amount was payable on 31 May 2017. The computer equipment was brought into use by Roger on 1 April 2017. The computer equipment qualifies for a three-year write-off in terms of section 11(e).

Assume that exchange rates were as follows:

Spot rates:		**Average rates:**	
28 November 2016	€1 = R15.10	2017 year of assessment:	€1 = R15.00
1 December 2016	€1 = R15.30	2018 year of assessment:	€1 = R15.50
15 December 2016	€1 = R15.25		
28 February 2017	€1 = R15.20	**Forward rates:**	
1 April 2017	€1 = R15.40	15 December 2016 (to 1 April 2017):	€1 = R15.45
31 May 2017	€1 = R15.35	28 February 2017 (to 1 April 2017):	€1 = R15.25

YOU ARE REQUIRED TO:

1. Calculate the income tax effects for Roger's 2017 and 2018 years of assessment in respect of the transactions in point 1 above. (5 Marks)
2. Calculate the income tax effects for Roger's 2017 and 2018 years of assessment in respect of the transactions in point 2 above. (6 Marks)

QUESTION 3.12 **(15 Marks)**

SA Ltd is a South African resident company in the manufacturing industry and has a year of assessment ended 30 June. Euro SAS, a French company that is not a resident of South Africa for tax purposes, holds 100% of SA Ltd's equity shares. It also holds 100% of the equity shares of ASA Ltd, another South African resident company. Both South African companies are registered VAT vendors that make only taxable supplies.

On 1 May 2016, SA Ltd acquired a new machine from Swiss Ltd (a Swiss company that is not a connected person of SA Ltd) for €100 000. At that time the Rand/Euro spot rate was 15.7. At 30 June 2016 the spot rate was 15.3. The liability was settled on 15 July 2016, at which time the Rand/Euro spot rate was 15.1. The average Rand/Euro exchange rates for the 2016 and 2017 years of assessment were 15.5 and 14.5 respectively.

SA Ltd brought the machine into use in its manufacturing operation on 31 July 2016, and used it until 31 March 2017. The machine was then sold to ASA Ltd at market value of R2 280 000 (including VAT) on 1 April 2017 for cash.

Euro SAS would like to minimise the taxable income of SA Ltd and has asked for your advice in respect of the above machine.

YOU ARE REQUIRED TO:

1. Advise Euro SAS, with reasons, whether section 45 of the Income Tax Act may be used in order to minimise the effect on SA Ltd's taxable income in respect of the disposal of the machine to ASA Ltd. (3 Marks)
2. Assuming that section 45 may not be used, calculate the effect on SA Ltd's taxable income in respect of the above machine for the 2016 and 2017 years of assessment. (12 Marks)

QUESTION 3.13 (Solution at end of chapter) (13 Marks)

Indumach (Pty) Ltd is a company that sells industrial plant and machinery. A constant mark-up is applied on all plant and machinery sales. The company's annual turnover is approximately R20 million.

On 1 October 2017, Makit (Pty) Ltd purchased a machine from Indumach under a suspensive sale agreement. In terms of the agreement, Makit is required to pay 60 monthly instalments of R5 500 at the end of each month. The machine that was sold to Makit (Pty) Ltd had cost Indumach R124 556 in January 2017, when it was purchased as trading stock. On 1 October 2017 the machine had a cash selling price (including VAT) of R207 594. The machine was brought into use by Makit in a process of manufacture on 1 November 2017. Transfer of ownership will occur on the same date that Makit pays the final instalment.

By 31 December 2017 (Indumach's year-end) the interest earned on the contract was R10 276, calculated on a yield to maturity basis in terms of section 24J(3).

All amounts are inclusive of VAT where applicable.

YOU ARE REQUIRED TO: Compute the effect of this contract on Indumach's taxable income for the year ended 31 December 2017.

QUESTION 3.14 (Solution at end of chapter) (9 Marks)

Foreign plc. holds 51% of the shares in South (Pty) Ltd. Foreign is incorporated in Britain and is a non-resident company, while South is a South African resident company. The 'equity and liabilities' side of the balance sheet of South for its year ended 28 February 2017 is as follows:

Share capital	R100 000
Share premium	200 000
Retained income	500 000
Shareholder's loan	2 000 000
	2 800 000

The shareholder's loan represents a loan made by Foreign on 1 March 2016. Interest of 18% *per annum* is charged on this loan, payable annually in arrears. South paid interest of R360 000 on 28 February 2017 and claimed an interest deduction for this amount.

An independent financial institution has indicated that it would have been prepared to lend South only R1 million at a rate of prime plus 3%. The same financial institution has indicated that it would be prepared to lend to Foreign at the prime rate. You may assume that the prime interest rate is 11% throughout the year of assessment.

YOU ARE REQUIRED TO: Discuss how the loan will be dealt with in the determination of South's South African income tax liability.

QUESTION 3.15 (Solution at end of chapter) **(25 Marks)**

Fresh Furniture imports upholstery fabric from Italy from time to time. These purchases are denominated in Euros (€). On 31 December 2016 Fresh Furniture owed its Italian suppliers €37 500 for purchases made on 30 November 2016, payable on 28 February 2017. On 31 March 2017 the company took ownership of an order of €67 000, which it settled on 30 June 2017. Its only other foreign currency purchase of the year, totalling €27 000, was received on 31 October and the balance due is payable on 31 January 2018.

Fresh Furniture normally hedges its foreign currency exposure using foreign currency option contracts (FCOCs). On 30 November 2016 Fresh Furniture entered into a three-month FCOC for €37 500 at €1 = R16, for a premium of R4 000. On 31 October 2017 it entered into a three-month FCOC for €27 000 at €1 = R18, for a premium of R5 000. The financial manager responsible for hedging was on maternity leave from 1 January to 30 September 2017, and no FCOC was entered into to hedge the 31 March 2017 purchase.

On 30 September 2017 Fresh Furniture sold a vacant plot of land in Phillipi for R390 000, which it had purchased on 1 October 1999 for R500 000. The property was valued on 1 October 2001 at R575 000. The company had intended to develop the land once there was more development in the surrounding area, but the closure of the nearby railway station meant that this development never occurred. During the course of the sale Fresh Furniture incurred selling expenses of R25 000. The time-apportioned base cost in respect of the sale has been determined as R485 000.

Fresh Furniture's taxable income for 2017 before taking into account any of the above amounted to R3 000 000. In addition, Fresh Furniture had other capital gains of R100 000. These have not yet been included to its initial taxable income calculation.

The following Rand/Euro exchange rates may be relevant:

30 November 2016	15.50
31 December 2016	16.35
28 February 2017	17.20
31 March 2017	17.75
30 June 2017	17.60
31 October 2017	17.50
31 December 2017	17.00
31 January 2018	16.50
Average for the 2016 year of assessment	15.80
Average for the 2017 year of assessment	16.20

YOU ARE REQUIRED TO: Calculate the revised taxable income of Fresh Furniture Ltd for its year of assessment ending 31 December 2017 taking into account all of the above information.

QUESTION 3.16 **(45 Marks)**

The coffee bean is one of the most important export crops of Madagascar. The country produces almost 65 000 tonnes of coffee beans annually. The coffee harvest season is from June to September.

Although the country's currency is the Malagasy arairy (MGA), all coffee export contracts are denominated in US dollars (US$). Export tariffs on coffee were abandoned by Madagascar in 1992 following a slump in the international coffee price.

'Fine Coffee (Pty) Ltd' (Fine Coffee) is a South African roastery. The company has a June year-end and is a Category C VAT vendor. Fine Coffee imports all of its Arabica beans from Madagascar.

Fine Coffee placed annual orders with two of its preferred suppliers in Madagascar on 30 April 2017. Its early orders meant that Fine Coffee expected to take delivery before the end of June. Fine Coffee's first order was for 15 tonnes (i.e. 15 000 kilograms) and the second for 5 tonnes of green (i.e. raw) coffee beans, both at an agreed price of US$3.40 per kilogram. In terms of the contract, risk passes to Fine Coffee on delivery, and the purchase price will be settled on 31 July.

In order to protect itself against the majority of its exposure to changes in the Rand–Dollar exchange rate, Fine Coffee entered into two three-month forward exchange contracts. One was for US$50 000, and another for US$15 000, both on 30 April 2017, at a forward rate of R15.50:US$1.

The first order of 15 tonnes cleared customs and was delivered to Fine Coffee on 31 May 2017, and the company began the process of roasting and packaging for distribution. By 30 June 2017 it had sold 75% of the product of these beans. The cost of the production process amounts to R5 per kilogram of roasted coffee. Fine Coffee's standard selling price of roasted beans is R75 per kilogram (excluding VAT).

In June 2017 Fine Coffee was informed by its second supplier that complications with the transportation process meant that its order would not be delivered until July 2017.

Fine Coffee had not paid either of its suppliers at 30 June 2017.

On 28 February 2017 Fine Coffee placed an order for a new commercial wood-fired coffee roaster from Germany for €45 000. The machine arrived on 31 March 2017. The machine replaced the old drum roaster that the company had purchased second-hand on 1 July 2013 for €12 000, and which it had sold on 31 December 2016 to a small Kenyan micro-roastery for KES1.5 million (Kenyan Shillings). The buyer had settled its debt for the purchase price on 31 January 2017. The purchase price of the new roaster was settled on delivery, using the full proceeds on disposal of the old roaster, as well as part of the bank loan below.

In order to part-finance the purchase of the new roaster as well as to increase its available working capital, Fine Coffee borrowed R700 000 from 'First Merchant Bank Ltd' (FMB) on 31 January 2017. In order to assist Fine Coffee in managing its cash flow, FMB agreed to a ten-year term, with quarterly payments of R20 000, and a final instalment of R270 000. This equates to a quarterly yield to maturity of 1.75%.

Fine Coffee has recently formed a wholly-owned subsidiary company, 'Rainy Days Co' (Rainy Days), in Seattle, Washington, USA. Rainy Days runs a chain of coffee shops in the Seattle area. Of the sale of the Arabica coffee beans (above), one tonne was to Rainy Days, at the significantly discounted price of R45 per kilogram.

You may assume that:

- No duties are levied on the import of green coffee beans or roasting machinery into South Africa.
- The Commissioner regards the roasting of coffee beans to be similar to a process of manufacture.
- Fine Coffee wishes to reduce its liability for tax whenever possible.
- Fine Coffee made no other capital disposals during the current year of assessment.

Furthermore, the following exchange rates may be significant:

Date	US$1 =	€1 =	KES 1 =
1 July 2013		R12.50	
Average for 12 months ending 30 June 2014		R13.30	
31 December 2016			R0.14

31 January 2017			R0.12
28 February 2017		R16.85	
31 March 2017		R17.20	
30 April 2017	R14.75		
31 May 2017	R15.00		
30 June 2017	R15.25	R16.45	R0.11
Average for 12 months ending 30 June 2017	R14.95	R16.00	R0.13
31 July 2017	R15.20		
30 September 2017	R15.30		

On 30 June 2017 the three-month forward was R17:US$1, and the one-month forward rate was R16:US$1.

YOU ARE REQUIRED TO:

1. Discuss the VAT implications for Fine Coffee (Pty) Ltd of the import of the coffee beans into South Africa, based on the facts above. (5 Marks)

2. Discuss the South African tax effects of the sale of beans to Rainy Days Co for both that company and Fine Coffee (Pty) Ltd. (9 Marks)

3. Calculate, with supporting reasons, the effects of the above information on the taxable income of Fine Coffee (Pty) Ltd for its year of assessment ended 30 June 2017. (31 Marks)

QUESTION 3.17 (17 Marks)

Harry Rash purchased a farm on 1 December 2016 from Neville Cooper. The purchase price of the farm on the date of Harry acquired the farm was R1 350 000. This purchase price would be settled as follows:

– A deposit of R350 000 was payable immediately on 1 December 2016.
– R15 000 a month is payable for the next five years commencing from 31 December 2016.
– At the end of the five-year period, i.e. 30 November 2021, the final payment of R1 600 000 is payable.

Both Harry Rash and Neville Cooper are registered VAT vendors and the sale agreement included a clause declaring that the sale was of a going concern at the zero rate.

The agreement further states that, if the buyer wishes to settle earlier than 30 November 2021, the settlement amount will be calculated as follows:

- The basic amount of R1 350 000
- Plus an amount based on the final payment, discounted to present value
- Less payments made to date.

YOU ARE REQUIRED TO:

1. Discuss whether or not this purchase arrangement is subject to section 24J for both Harry Rash and Neville Cooper. (10 Marks)
2. Assuming that section 24J does apply, calculate interest incurred by Harry Rash for the year of assessment ended 28 February 2017. The yield to maturity calculated monthly is 2.04%. (2 Marks)
3. If Harry Rash decides to settle on 28 February 2017 for an amount of R1 014 033 plus his monthly instalment for February, what are the income tax implications? (5 Marks)

QUESTION 3.18 **(43 Marks)**

Auslese Limited conducts a manufacturing process from premises that it rents from Spatlese Ltd in Epping, Cape Town. Both Auslese and Spatlese are registered VAT vendors and are not connected persons as defined.

The lease over the premises was concluded in May 2015 and was for a period of 20 years from 1 June 2015. Auslese has an option to renew for a further ten years, which it expects to exercise.

The lease provided for a premium of R500 000 (excluding VAT) which was payable on 1 June 2015, with monthly rentals of R40 000 (excluding VAT) payable monthly in advance from that date. In terms of the lease Auslese has to erect improvements to the premises costing at least R1.5 million (excluding VAT). The improvements were commenced on 1 August 2016 and were completed and brought into use on 1 September 2017. The actual cost of the improvements was R1.2 million (excluding VAT).

Auslese has the following assets:

1. Plant used directly in the manufacturing process. An inspection of the fixed asset register reveals that the total cost of this plant was R15 million (excluding VAT), consisting of three items costing R5 million (excluding VAT) each.
   - One of these items was purchased new from Spatlese and was brought into use on 15 September 2016.
   - The other two items were both purchased on 1 May 2017 from Kabinett Ltd, a registered VAT vendor and the holding company of Auslese, and were brought into use immediately. The market value (including VAT) of the machines purchased from Kabinett Ltd on 1 May 2017 was R3.75 million each.
2. A new delivery vehicle with a cash value of R159 600 (including VAT) that was purchased from Eiswein Ltd, a VAT vendor, in terms of an instalment sale agreement on 1 November 2017. The agreement provides for an initial deposit of R20 000 and 36 instalments of R4 636 from 1 November 2017. The yield to maturity on the agreement is 1% per month. Eiswein had purchased the vehicle from a registered VAT vendor for R105 000 (excluding VAT) on 15 October 2016.

On 1 December 2017 Auslese entered into a sale and lease-back arrangement with Spatlese, where the three items of plant (1 above) were sold to Spatlese and leased back to Auslese. The sale consideration was R10 million (excluding VAT) per item. The market value on the date of the sale was R4.5 million (including VAT) per item. The terms of the lease, which runs from 1 December 2017, are that the lessee would pay an initial lease payment of R700 000 on that date and thereafter 47 monthly instalments of R800 000, commencing on 31 December 2017. For the purposes of the lease, the cash value was R30 million (excluding VAT) in total.

You may assume that all of the above companies have no income or expenditure other than the income and expenditure mentioned above and that the Commissioner for SARS allows section 11(e) allowances at the rate of 25% *per annum* on qualifying assets.

YOU ARE REQUIRED TO:

1. Calculate the taxable income of Auslese for its year of assessment ended 31 December 2017. (21 Marks)
2. Calculate the taxable income of Spatlese for its year of assessment ended 31 December 2017. (14 Marks)
3. Calculate the taxable income of Eiswein for its year of assessment ended 31 December 2017. (8 Marks)

QUESTION 3.19 **(18 Marks)**

The following information appeared in the balance sheet of Lekker Ltd, a SA resident, at 28 February 2017:

	Note	R
Ordinary share capital	1	(100 000)
Share premium		(50 000)
Redeemable preference shares	2	(20 000)
Loan from Foreign Ltd	3	(5 200 000)
Other interest-bearing loans from SA creditors		(1 000 000)
Interest-bearing trade debtor– Foreign Ltd	4	650 997

Notes

1. Foreign Ltd (a non-resident) holds 75% of the ordinary share capital of Lekker.
2. Foreign also holds 50% of the redeemable preference shares.
3. The loan from Foreign is denominated in Rands. On 1 January 2017 Foreign loaned Lekker R5 million at an interest rate of 24% *per annum*, payable annually in arrears. An independent financial institution has indicated that it would have been prepared to lend Lekker only R3 000 000 at a rate of 9%.
4. From time to time Lekker sells trading stock to Foreign. Lekker charges interest at 2% *per annum* if Foreign does not settle the debt by the end of the month of sale. Lekker sold goods to Foreign on 1 January 2017 for R650 000. As this debt was outstanding on 28 February 2017, Lekker charged interest of R997 in respect of the month of February. Lekker usually sells inventory at a mark-up on cost of 150%, however on sales made to Foreign the mark-up is reduced to 25%. Lekker usually charges its customers interest at a rate of 10% *per annum* on credit sales from the date of purchase.

During its 2017 financial year Lekker earned a trading profit of R1 million. This trading profit is after the deduction of all interest accrued. It has an assessed loss of R850 000 to carry forward from its 2016 year of assessment. The only adjustments to be made to convert its trading profit into taxable income are those required in terms of section 31.

You may assume that the South African prime overdraft rate was 11% throughout Lekker's 2017 year of assessment.

YOU ARE REQUIRED TO:

1. Calculate the taxable income of Lekker Ltd for its 2017 year of assessment. (16 Marks)
2. Briefly discuss whether Lekker Ltd is liable for dividends tax as a result of the above information. (2 Marks)

QUESTION 3.20 **(27 Marks)**

Bill Harzia owns shares in various companies. Details of sales of shares held by him during his 2017 year of assessment are as follows. Unless otherwise stated, assume that all shares are held as trading stock by Bill:

1. A (Pty) Ltd: Bill sold 140 of the 200 shares he held in A (Pty) Ltd on 1 June 2016 for R160 per share. Bill had purchased 100 shares on 1 May 2014 for R120 per share and another 100 shares on 3 June 2015 for R145 per share.

2. B Ltd: Bill sold his 100% shareholding in B Ltd on 12 December 2016 for R600 000. He had acquired the shares on 10 January 2000 for R220 000. The market value on 1 October 2001 was R250 000.

3. C PLC: Bill sold 20% of his interest in C PLC, which is not a 'resident' as defined, for the equivalent of R1.4 million on 1 October 2016. He had acquired a 60% interest in the company on 20 March 2013 for the equivalent of R4 million.

4. D Ltd: Bill sold 50% of his interest D Ltd on 20 January 2017 for R1.3 million. Bill had acquired a holding of 60% of the shares in the company on 30 November 2013 for R2 million.

5. E (Pty) Ltd: Bill sold his entire holding in E (Pty) Ltd on 12 January 2017 for R6.2 million. E (Pty) Ltd owned a commercial property in Pinelands which comprised 75% of the total value of the assets of the company, fairly valued. It had acquired the property in August 2015. The company had no liabilities on the date of Bill's sale. Bill purchased his holding on 1 December 2013 for R3.1 million.

6. F Ltd: Bill sold his entire holding of 20% in this company on 12 November 2016 for R3.5 million. Bill had purchased his holding on 1 October 2012 for R5 million.

YOU ARE REQUIRED TO: Calculate the income tax consequences for Bill arising out of the above transactions for the year of assessment ending 28 February 2017.

SOLUTION 3.1

Impro (Pty) Ltd - Section 24I gains and losses
Year ended 28 February 2017

1. Sales:

Gross income in respect of sales: translated at spot rate - s25D

Sales made on 1 April 2016	€100 000 × 14.00	1 400 000	(1)
Sales made on 1 August 2016	€50 000 × 13.90	695 000	(1)
Sales made on 1 February 2017	€140 000 × 14.80	2 072 000	(1)

Foreign exchange gains/(losses) in respect of customer debts - s24I

Amount settled on 1 June 2016	€100 000 × (14.00 – 14.10) – gain	10 000	(1)
Amount settled on 1 October 2016	€50 000 × (13.90 – 13.60) – loss	(15 000)	(1)
Amount outstanding at year-end	€140 000 × (14.80 – 14.70) – loss	(14 000)	(1)

2. Purchases:

Raw material purchased: s11(a) deduction translated at spot - s25D

Purchase made on 1 April 2016	€60 000 × 14.00	(840 000)	(1)
Purchase made on 1 February 2017	€40 000 × 14.80	(592 000)	(1)

Foreign exchange gains/(losses) in respect of supplier debts - s24I

Amount settled on 1 June 2016	€60 000 × (14.00 – 14.10) – loss	(6 000)	(1)
Amount outstanding at year-end	€40 000 × (14.80 −14.70) – gain	4 000	(1)

3. Machine acquired:

Capital allowance: s12C with cost translated at spot on 1 February 2017 - s25D

s12C	€1 000 000 × 14.80 × 40%	(5 920 000)	(1)

Foreign exchange gains/(losses) in respect of supplier debts and FEC - s24I

Amount outstanding at year-end	€1m × (14.80 – 14.70) – gain	100 000	(1)
Open FEC at year-end	€1m × (15.80 – 15.20) – loss	(600 000)	(1)
4. Loan:	€200 000 × (13.90 – 14.70) – gain, but deferred	160 000	(1)

In terms of s24I(10A)(a), gains or losses on unrealised intergroup exchange items (and exchange items between connected persons) are deferred where the item is unhedged by an FEC or FCOC, no portion represents a current liability for IFRS, and it is not directly or indirectly funded by a person who does not form part of the same group or who is not a connected person. (1)

In the current instance these criteria remain met until the item becomes a current liability.

Year ended 28 February 2018

1. Sales:

Foreign exchange gains/(losses) in respect of customer debts settled - s24I

Amount settled on 1 April 2017	Debt €140 000 × (14.70 – 15.00) – gain	42 000	(1)

SOLUTION 3.1 continued

2. Purchases:			
Foreign exchange gains/(losses) in respect of supplier debts paid - s24I			
Amount settled on 1 April 2017	Debt €40 000 × (14.70 − 15.00) – loss	(12 000)	(1)
3. Machine acquired:			
Capital allowance: s12C with cost translated at spot on 1 February 2017 - s25D			
s12C	€1 000 000 × 14.80 × 20%	(2 960 000)	(1)
Foreign exchange gains/(losses) in respect of supplier debts and FEC - s24I			
Amount settled on 1 June 2017	Debt €1m × (14.70 – 15.40) – loss	(700 000)	(1)
FEC settled on 1 June 2017	FEC €1m × (15.20 – 15.40) gain	200 000	(1)
4. Loan:			
In respect of current year	€200 000 × (14.70 – 14.60) – loss	(20 000)	(1)
In respect of prior year deferrals	€200 000 × (13.90 – 14.70) – gain	160 000	(1)

In terms of S24I(10A)(b), once the criteria of s24I(10A)(a) are no longer met, any gains or losses deferred must be realised. (1)

In the current instance this happens in the 2018 year of assessment, because in that year the debt becomes a current liability in terms of IFRS, since it is repayable in the following year.

Note: There is a possible alternative interpretation that debts initially falling under s24I(10A) are not reassessed annually. In terms of this interpretation, if the debt is originally a non-current liability, gains or losses are deferred until the loan is realised and not until it becomes a current liability.

(23)

SOLUTION 3.2

Atom (Pty) Ltd - section 24I gains and losses

<u>Year ended 28 February 2017</u>

(i)	Debt repaid: s24I exchange loss	€100 000 × (13 – 13.50)	(50 000)	(1)
(ii)	Sales: GI at spot i.t.o. s25D	€20 000 × 13.5	270 000	(1)
	Debtor: s24I exchange gain	€20 000 × (13.5 – 14.00)	10 000	(1)
(iii)	Machine acquired			
	Creditor: s24I exchange gain	€200 000 × (14.50 – 14.10) but deferred	0	(1)
	In terms of s24I(7)(a), gains or losses on debts incurred to acquire an asset that has not yet been brought into use are deferred until such time as the asset is brought into use.			(1)
(iv)	Sales: GI at spot i.t.o. s25D	€50 000 × 14.50	725 000	(1)
	Debtor €50 000	€50 000 × (14.50 – 14.10)	(20 000)	(1)

SOLUTION 3.2 continued

<u>Year ended 28 February 2018</u>

(iii)	s12C using cost at spot i.t.o. s25D	€200 000 × 14.50 × 40%	1 160 000	(1)
	Creditor: s24I exchange gain			
	in respect of current year	€200 000 × (14.10 – 16.00)	(380 000)	(1)
	in respect of prior year deferred	€200 000 × (14.50 – 14.10)	80 000	(1)
(iv)	Debtor: s24I exchange gain	€50 000 × (14.10 – 16.00)	95 000	(1)
				(11)

SOLUTION 3.13

Indumach (Pty) Ltd

Suspensive sale price	5 500 × 60	330 000		(1)
Cash selling price (incl. VAT)		(207 594)		(1)
Total finance charges		122 406		
Gross income	R207 594 × $^{100}/_{114}$ - net of VAT output charged		182 100	(1)
s11(a)	R124 556 × $^{100}/_{114}$ less VAT - s23C		(109 260)	(1)
Interest accrued - GI	Interest earned s24J(3) given		10 276	(1)
s24(2) Debtors allowance: read with Interpretation Note 48				
- HP debtors allowance:	S24			
Selling price		182 100		(1)
Cost		(109 260)		(1)
Gross profit		72 840		
Gross profit percentage =	$^{72\ 840}/_{182\ 100}$ =	40%		(1)
Debtor at commencement of suspensive sale agreement		330 000		(1)
less total finance		(122 406)		(1)
Cash price including VAT		207 594		
Add interest accrued		10 276		
less payments	R5 500 × 3	(16 500)		(1)
Capital outstanding		201 370		
less VAT	201 370 × $^{14}/_{114}$	(24 730)		(1)
		176 640 × 40%	(70 656)	(1)
Effect on taxable income (increase)			12 460	
				(13)

SOLUTION 3.14

Foreign (PLC) and South (Pty) Ltd

The loan between Foreign and South constitutes an affected transaction for purposes of s31: (1)

Foreign is a non-resident and South a resident, and both parties are connected persons in relation to each other. (1)

From the information given it would seem that the loan would not have been granted on the same terms and conditions had an independent third party provided the loan. (1)

A tax benefit arises for South, because it is able to deduct the interest from its taxable income. Foreign's interest earned is exempt from normal tax in terms of s10(1)(h), although it will be subject to a 1% withholding tax in terms of s50B.

The taxable income of the party that derives a tax benefit (South) must be calculated as if the loan had been entered into on an independent arm's length basis - s31(2). The difference is disallowed as a deduction. (1)

In addition, in terms of s31(3) the amount of that difference is deemed to be a dividend *in specie* for the purposes of Part V (i.e. dividends tax). (1)

Applying s31(2), the interest that would have arisen had the loan been between South and an independent third party would have been R1m x (11% + 3%) = R140 000. The balance of the interest i.e. R360 000 – R140 000 = R220 000 must therefore be disallowed in terms of s31(2). The interest deduction on the loan is limited to R140 000. (2)

The difference is also deemed in terms of s31(3) to be a dividend *in specie* declared by South on the last day of the period of six months following the end of South's 2017 year of assessment. (1)

South is therefore liable for dividends tax of R220 000 × 15% = R33 000 at the end of the month following the date on which the dividend is deemed to have been declared. Its taxable income in the 2017 year of assessment also increases by R220 000 due to the limit placed on its interest deduction. (1)

This transaction is not subject to the exclusion in s31(7), since South does not hold the shares in Foreign.

(9)

SOLUTION 3.15

Taxable income (given)			3 000 000	
s24I on debt of €37 500		$({}^{1150}/_{1900} \times 1\ 500\ 000)$	(31 875)	(1)
FCOC:				
Premium deducted in 2016 YoA			0	(1)
MV of FCOC on 31 Dec 2016	(16.35 − 16.00) × 37 500 =	13 125		(1)
MV of FCOC on 28 Feb 2017	(17.20 − 16.00) × 37 500 =	45 000		(1)
s24I on FCOC		$({}^{13\ 125}/_{37\ 500} - {}^{45\ 000}/_{37\ 500}) \times 37\ 500$	31 875	(1)

SOLUTION 3.15 continued

s11(a) purchases of €67 000 translated at spot on 31 March			€67 000 × 17.75	(1 189 250)	(1)
s24I on debt of €67 000			(17.75 − 17.60) × €67 000	10 050	(2)
s11(a) purchases of €27 000 translated at spot on 31 October			€27 000 × 17.50	(472 500)	(1)
s24I on debt of €27 000			(17.50 − 17.00) × €27 000	13 500	(2)
FCOC:					
Premium				(5 000)	(1)
MV of FCOC on 31 Oct 2017			0		(1)
MV of FCOC on 31 Dec 2017 (spot better than FCOC rate)			0		(1)
s24I on FCOC			$(^{0}/_{27\,000} - ^{0}/_{27\,000}) \times$ €27 000	0	(1)
s11(i) in respect of debt written off			R300 000 × 40%	(120 000)	(1)
Capital gains (given)			100 000		(1)
Disposal of loan to Couch Kingdom					
Proceeds (R1 600 × 40%)		960 000			
Base cost		(1 600 000)			
Capital loss			(640 000)		(1)
Disposal of land					
Proceeds R390 000 < para 20 expenditure (R500 000 + R25 000), therefore para 27 applies.					(1)
Expenditure before 01/10/01 < MV, therefore use lower of MV or TABC					(1)

TABC	
P = R390 000 × R25 000	365 000
B =	500 000
N =	2
T =	16
Y = (given)	485 000
MV @ 01/10/01	575 000

Proceeds		390 000			(1)
Base cost					
Valuation date value i.t.o para 27	485 000				
Plus expenditure after 01/10/01	25 000				(1)
		(510 000)			
Capital loss			(120 000)		
Adjusted capital loss			(660 000)		(1)
Carried forward to 2018 year of assessment					(1)
			Revised taxable income	1 236 800	(1)
					(25)

CHAPTER 4: DIVIDENDS, FOREIGN DIVIDENDS AND DIVIDENDS TAX

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QUESTION 4.1 (Solution at end of chapter) **(20 Marks)**

YOU ARE REQUIRED TO: Indicate whether the following statements are TRUE or FALSE and give reasons for your answers.

1. A dividend can only be profits distributed by a resident company as authorised by the directors.
2. A return of contributed tax capital is a dividend as defined.
3. The acquisition by a listed resident company of its own shares is a dividend as defined.
4. The issue of capitalisation shares (as contemplated in section 47 of the Companies Act, 2008) is not a dividend.
5. A repayment of a loan from a shareholder by a company is a dividend as defined.
6. All dividends received by or accrued to a taxpayer are exempt from tax in terms of section 10(1)(k).
7. Contributed tax capital can only be returned to shareholders when profits are exhausted.
8. ‘Equity share’ is a term that is defined in the Income Tax Act.
9. A preference share (limited in terms of section 37 of the Companies Act, 2008) is an equity share as defined.
10. Foreign dividends do not include redemptions of participatory interests in a foreign collective investment scheme.

QUESTION 4.2 **(22 Marks)**

YOU ARE REQUIRED TO: Indicate whether the following statements are TRUE or FALSE and give reasons for your answers if FALSE.

1. Contributed tax capital is only the amount paid by the shareholder to the company for the shares.

2. If a shareholder buys a share in a company from another shareholder, the amount paid represents the contributed tax capital.
3. A return of capital as defined excludes contributed tax capital.
4. When a listed resident company buys back shares as a general repurchase on the open market, the directors must inform each prior shareholder of the amount being returned as contributed tax capital.
5. A distribution of an asset, *in specie*, by a company to its shareholder is treated as a disposal by the company for the purposes of capital gains tax.
6. When a company distributes an asset as an *in specie* dividend the company is deemed to have disposed of the asset for its market value for the purposes of the 8th Schedule.
7. A cash dividend received by a South African resident from a REIT is subject to dividends tax.
8. The definition of 'distribution' in the Companies Act, 2008 excludes distribution actions taken upon the final liquidation of the company. This means that such distributions cannot be dividends for the Income Tax Act.
9. When a person, who holds shares in a company as trading stock, receives a liquidation distribution in respect of those shares, the full amount of the distribution is included in gross income.
10. After 1 April 2012, when a shareholder receives a return of capital or foreign return of capital (as defined in s1), capital gains tax arises.
11. When a company, in liquidation, distributes an amount to a shareholder, the shareholder must reduce the base cost of his shares by the value of the distribution.
12. All companies withhold dividends tax at a flat rate of 15% on all dividends paid after 1 April 2012.

QUESTION 4.3 (Solution at end of chapter) (15 Marks)

Three independent parts follow.

PART A (8 Marks)
At 31 December 2010 A (Pty) Ltd had share capital of R1 million (represented by 1 000 000 shares) and share premium of R500 000. All the capital relates to the equity share class (the company's only share class). On 28 February 2017, the company had an issue of 10 000 shares for a total value of R500 000. The company has a year-end of 31 March each year.

YOU ARE REQUIRED TO: Answer the following:

1. Based only on the above information, what is the contributed tax capital of the company for the year ended 31 March 2017? Support your answer with discussion.
2. Two months after the share issue above, the directors declared a distribution of R2 million to the shareholders, providing that the amount of R250 000 within the distribution is a return of contributed tax capital. Identify the dividend. Support your answer with discussion.
3. If the company had previously, before 1 January 2011, had a capitalisation issue of 100 000 shares (at R2 per share) from revenue profits in June 2000, how does your answer in (1) above change? Support your answer with discussion.
4. The capitalisation issue in (3) above is repurchased by the company in the current year of assessment for R3 per share, how much of the repurchase (if any) is a dividend as defined?

PART B (4 Marks)

Joe owns 15% of the equity shares (Class A shares) and 10% of the preference shares (Class B shares) in X Ltd. The contributed tax capital in relation to each class of share in the company is as follows (i.e. the contributed tax capital below is the full contributed tax capital in the company):

Class A	R5 000 000
Class B	R15 000 000

The directors have declared a distribution of R10 000 000 to Class A shareholders and R4 500 000 to Class B shareholders. Of these amounts, R2 million of the Class A distribution represents a return of contributed tax capital and there is no return of contributed tax capital to the Class B shareholders.

Subsequent to the distribution, the directors issue 100 000 capitalisation shares to the Class B shareholders of Class B shares (with a value of R30 per share).

YOU ARE REQUIRED TO: Determine how much of the distributions received by Joe represent a return of contributed tax capital or a dividend as defined in the Income Tax Act.

PART C (3 Marks)

LE Ltd is a foreign company that moves (with effect from 1 April 2016) its place of effective management to South Africa. The company's shares had a closing price on a listed exchange (translated to Rands) of R55 per share (with 4 378 932 shares in issue).

The directors of the company (on 15 March 2017) issued further shares (100 000) to the market at a price of R60 per share.

YOU ARE REQUIRED TO: Determine this company's contributed tax capital (assuming a year-end of 31 March 2017).

QUESTION 4.4 **(12 Marks)**

Hold Co Ltd is a company resident in South Africa, formed on 1 January 2017. It has the following assets (at cost) at its first year-end, namely 31 December 2017:

Investments in foreign subsidiaries	14 000 000
Investments in foreign associates	8 000 000
Investment shares in foreign companies	1 000 000
Immovable property (South Africa)	5 000 000
Loans to subsidiaries and associates	20 000 000

The property is the premises from which the company administers its investments. The company's income consists of dividends from the investments and interest income from loan finance granted to the subsidiaries and associates. It is company policy to never hold an investment of less than 10% of the equity shares and voting rights of the targeted investment. At times, the company needs to buy the shares over a few years of assessment. These are held as 'investment shares in foreign companies' until such time as a 10% holding is obtained.

In addition, the company receives a small portion (never more than 10%) of its total income from management fees charged to subsidiaries and associates. No income is derived from the property from which the company operates. The gross income of the company is in excess of R5 million.

Hold Co Ltd has only five shareholders (each holding an equal percentage of equity shares and voting rights).

YOU ARE REQUIRED TO:

1. Explain whether or not Hold Co Ltd would meet the requirements of a 'headquarter company'. (8 Marks)
2. Assuming Hold Co Ltd is a headquarter company, discuss whether or not a dividend declared by the directors of Hold Co Ltd to its shareholders would be a foreign dividend or a domestic dividend and what exemption for normal tax, if any, the shareholders may receive on receipt of such a dividend. (4 Marks)

QUESTION 4.5 **(30 Marks)**

YOU ARE REQUIRED TO: Indicate whether the following statements are TRUE or FALSE, providing reasons for your answer.

1. A company is subject to dividends tax on dividends declared.
2. If a double tax agreement prescribes a lower rate of dividends tax, the company or regulated intermediary must apply the lower rate.
3. If a double tax agreement prescribes a lower rate of dividends tax, the company or regulated intermediary must apply the higher rate.
4. Dividends declared to retirement funds are not subject to dividends tax.
5. If the beneficial owner has made a declaration that such owner is subject to a reduced rate of dividends tax in terms of a double tax agreement, such declaration will apply until the beneficial owner disposes of that share.
6. Dividends declared to resident company shareholders are subject to dividends tax.
7. Dividends declared by dual-listed companies (one listing on the JSE) are not subject to dividends tax.
8. A dividend can be such cash or otherwise distributed to a shareholder as exceeds contributed tax capital.
9. Capitalisation shares issued constitute a dividend.
10. Contributed tax capital consists of any amount in the share capital or share premium accounts of the company declaring the dividend.
11. A dividend *in specie* is always subject to dividends tax.
12. A dividend *in specie* from a resident company and paid to a resident natural person shareholder is usually subject to dividends tax.
13. Dividends *in specie* are subject to dividends tax at the book value of the asset given by the company.
14. Loans made by a resident company to a shareholder are subject to dividends tax.
15. Dividends from foreign listed companies in respect of shares listed on the JSE that are not dividends *in specie* are subject to dividends tax where no exemptions in terms of s64F apply.

QUESTION 4.6 **(14 Marks)**

ResCo (Pty) Ltd, a South African resident unlisted company, declares a dividend of R1 million to its shareholders on 31 December 2017. This dividend is a cash dividend and does not represent a reduction in contributed tax capital. The shareholders at the time of declaration are:

• ABC Ltd – a JSE listed company	10%
• ForCo LLC – a foreign company	15%
• Shane Holder (a South African resident taxpayer)	26%
• Pierre Duvet (a non-resident taxpayer – Pierre has lodged a declaration with ResCo indicating that he is entitled to a reduced dividends tax of 5% in terms of the relevant double tax agreement)	14%
• Holder Family Trust (the trust is Shane Holder's family trust. The vested beneficiaries in the dividend income (equally) are Shane's two children, Molly (21) and Bobby (15))	25%
• Animal Welfare (Shane had previously organised that the company issue 10% of its shares to this public benefit organisation, registered per s30, so that dividends declared could assist the on-going public benefit activities).	10%

YOU ARE REQUIRED TO:

1. Calculate the dividends tax to be withheld by the company. (6 Marks)
2. If Pierre Duvet only presented his declaration five months after the dividend was declared, how would that influence your answer to (1) and what are the consequences for Pierre Duvet and ResCo (Pty) Ltd? (8 Marks)

QUESTION 4.7 **(8 Marks)**

CS Ltd is a resident collective investment scheme in securities (not a REIT). It has holdings in various listed resident companies. Any dividends received from its holdings are declared to the participants in the collective investment scheme within 12 months.

YOU ARE REQUIRED TO: Determine when dividends tax will be withheld and by whom.

QUESTION 4.8 (Solution at end of chapter) **(22 Marks)**

The balance sheet of Kelvin (Pty) Ltd at 29 February 2016 was as follows:

	Note	**R**
Capital	1	3 000 000
Capital profits		3 000 000
Revenue profits		5 000 000
Shareholder loan	2	500 000
		11 500 000
Represented by		
Cash		11 500 000

Notes

1. Kelvin has never had a capitalisation issue.
2. The shareholder, who holds 100% of the shares, is a South African resident. The shareholder originally purchased the shares for R4.5 million in October 2008.

The company went into liquidation in March 2016. All distributions in terms of the liquidation were made before 28 February 2017 (the end of the shareholder's year of assessment).

YOU ARE REQUIRED TO:

1. Calculate the amount received by the shareholder (indicating the amount of the dividend separately) as a result of the liquidation of Kelvin.
2. Calculate the income tax effects for the shareholder for the year of assessment ended 28 February 2017 assuming the shareholder is a natural person.
3. Calculate the income tax effects for the shareholder for the year of assessment ended 28 February 2017 assuming the shareholder is a resident company.

QUESTION 4.9 **(11 Marks)**

During the year of assessment ended 31 December 2017, Calcite (Pty) Ltd, a resident company, did the following:

a. 1 April 2017: it had a 1:1 capitalisation issue of equity shares to the value of R80 000.

b. 31 July 2017: it repaid contributed tax capital of R20 000 to its sole shareholder, by giving him a fixed asset with a tax value of R20 000 and a market value of R120 000. The asset had originally cost R100 000 on 30 November 2015.

c. 31 August 2017: it sold a fixed asset (land) for a capital profit of R95 000 and paid this amount as a dividend to its sole shareholder. The capital profit equals the capital gain for the purposes of the 8th Schedule.

d. 30 September 2017: Calcite (Pty) Ltd had, on hand, trading stock that had cost it R60 000. The stock has a market value of R85 000. It distributed the trading stock as a dividend *in specie*.

YOU ARE REQUIRED TO: Calculate the monetary effect of the above transactions on:

1. The normal tax of Calcite (Pty) Ltd. (5 Marks)
2. The total dividends tax to be withheld or paid by Calcite (Pty) Ltd and by when the dividends tax withheld or payable must be paid to SARS. Calcite's sole shareholder is a natural person and is resident in South Africa for tax purposes. (6 Marks)

Notes

i. The company is not registered for VAT, nor is it required to be registered.

ii. The company is not a 'small business corporation' or a 'micro business'.

QUESTION 4.10 **(17 Marks)**

Cross (Pty) Ltd, a resident company, loans money to the following people on 1 April 2016:

a. R50 000 to an employee on the factory floor in terms of the general staff loan scheme (interest-free).

b. R100 000 to the managing director in terms of the general staff loan scheme (interest-free).

c. An additional R250 000 (interest free) to the managing director, who is also a 20% equity shareholder, by virtue of his shareholding.

d. R200 000 to a 20% equity shareholder (a natural person), at a market-related interest rate of 9% by virtue of his shareholding.

e. R500 000 to the 40% equity shareholder (a resident company) (interest-free) by virtue of his shareholding.

Assume the official rate is 8.5% throughout the year. The company has a year-end of 31 March 2017.

YOU ARE REQUIRED TO: Determine the income tax implications for the company and borrower for each of the above loans for the year of assessment ending 31 March 2017.

QUESTION 4.11 (Solution at end of chapter) (14 Marks)

The following is the balance sheet of Desperate (Pty) Ltd at 31 March 2016:

State capital	500 000
Capital profits	200 000
Revenue profits	1 300 000
	2 000 000
Represented by:	
Plant and machinery	600 000
Trading stock	1 000 000
Cash	400 000
	2 000 000

Notes

1. Plant and machinery originally cost R1 million. The tax value at 31 March 2016 was R200 000.
2. The sole shareholder, a resident company, had originally acquired the shares when the company was near insolvent for the amount of R400 000 on 1 December 2008.
3. The company has never had any capitalisation issues, i.e. share capital represents the originally contributed capital.
4. The shareholder is placing Desperate (Pty) Ltd into liquidation with effect from 1 April 2016, on which date the appointed liquidator will dispose of the plant and machinery and trading stock at their market values of R1.2 million and R1.5 million respectively to independent third parties.
5. Liquidation costs may be assumed to be nil.

YOU ARE REQUIRED TO: Calculate the income tax effects for Desperate (Pty) Ltd and the sole shareholder arising from the liquidation of Desperate (Pty) Ltd. (Ignore VAT.) Note that Desperate is neither a small business corporation nor a micro business.

QUESTION 4.12 (30 Marks)

Ohm (Pty) Ltd is a South African resident company that is a wholly owned subsidiary of Volt (Pty) Ltd, which is also a South African resident.

At 31 March 2016 Ohm's balance sheet was as follows:

	Note	R
Capital	1	1 500 000
Retained capital profits (revaluation of land and buildings)		800 000
Retained revenue profits		1 700 000
Shareholder loan		2 000 000
		6 000 000

Represented by		
Land and buildings	2	2 800 000
Plant and machinery	3	1 700 000
Trading stock		1 000 000
Debtors		400 000
Cash		100 000
		6 000 000

Notes

1. In 1994 Ohm had a three for one capitalisation issue paid up out of retained income. In 1999 share capital was reduced from shares having a nominal value of R1.00 to shares having a nominal value of R0.50. This was represented as share capital of R1 million and share premium of R500 000 on 31 December 2010. Of this capital, R500 000 represents previously capitalised profits.
2. Of the cost of land and buildings, 80% is in respect of buildings. At 31 March 2016 the tax value of the buildings was 50% of original cost.
3. Plant and machinery cost R3 000 000 and at 31 March 2016, had a tax value of R600 000.

On 1 April 2016 Ohm was put into liquidation. In the course of liquidation, the following took place:

1. Land and buildings were sold for R5 million. Of this amount, R4 million was for the buildings.
2. Plant and machinery was sold for R3.5 million.
3. The trading stock, which had a market value of R1.8 million, was transferred to Volt as an *in specie* dividend with the liquidation distribution.
4. Debtors were sold to a bank for R400 000.

All sales took place in April and May 2016. The liquidation distribution was made on 31 May 2016.

YOU ARE REQUIRED TO:

1. Calculate Ohm's taxable income for the period from 1 April 2016 up to its final liquidation.
2. Prepare a liquidation balance sheet, i.e. after the disposal of all assets other than stock and before dividends tax.
3. Calculate the dividends tax (if any) to be withheld or paid on the liquidation of Ohm.
4. Calculate Volt's taxable income from the year ended 31 March 2017 if it has taxable income of R10 million, other than the liquidation distribution from Ohm. Volt had acquired the shares in Ohm in July 2007 for R1.5 million. (Ignore VAT and the Corporate Rules.)

QUESTION 4.13 **(32 Marks)**

The balance sheet of Nohope (Pty) Ltd, at 31 March 2016 was as follows:

	Note	**R**
Capital	1	1 500 000
NDR		400 000
Retained income		1 100 000
Deferred tax		70 000
		3 070 000

	Note	R
Plant and machinery	2	600 000
Motor vehicles	3	100 000
Inventories		900 000
Debtors		600 000
Creditors	4	(300 000)
Cash		1 170 000
		3 070 000

Notes

1. Share capital had comprised 1 million R1.00 ordinary shares (at 31 December 2010) with R500 000 share premium. Of this balance, R440 000 represented previously capitalised revenue profits at that date.
2. Plant and machinery cost R1 200 000 (excluding VAT) in September 2013. The tax value at 31 March 2016 was R480 000.
3. The tax value of motor vehicles is the same as the book value.
4. Included in creditors is a provision of R200 000 for possible damages. A customer of Nohope had sued the company for damages in 2015. The claim is subject to litigation.

All of the shares in Nohope were purchased by Supreme (Pty) Ltd on 1 June 2001 for R2.8 million. The investment in Nohope was valued at R3 million at 1 October 2001. At 31 March 2016 Supreme's balance sheet was as follows:

	R
Capital	800 000
Retained income (revenue)	2 500 000
	3 300 000
Investment in Nohope	2 800 000
Cash	500 000
	3 300 000

Supreme has never had a capitalisation issue. On 1 April 2016 Mr Sharp purchased all of the shares in Supreme (Pty) Ltd for R3 million. Immediately thereafter, Nohope was placed into liquidation. In the course of liquidation, the following happened:

Sale of a going concern:

- Plant and machinery was sold for R600 000
- Motor vehicles were sold for R100 000 (assume a base cost of R100 000)
- Inventories were sold for R1 200 000

All the above sales were in terms of the sale of a going concern meeting all the requirements for zero-rating for VAT purposes.

Other transactions:

- Debtors were ceded to a discount house for R400 000
- Trade creditors were paid in full
- The customer who had sued Nohope was paid R50 000 in an out-of-court settlement
- Liquidation costs were R30 000

Once Nohope had been liquidated, Supreme was placed into liquidation. Liquidation costs in respect of Supreme were R10 000. The liquidation of both Supreme and Nohope was completed by 31 August 2016.

Nohope is a VAT vendor. Supreme is not a VAT vendor.

YOU ARE REQUIRED TO:

1. Compute the amount received by Mr Sharp as a result of the liquidation of Supreme (Pty) Ltd.
2. Assuming that Mr Sharp is a share dealer and that the Commissioner for the South African Revenue Service will apply the *Nemojim* principle (based on the balance sheet at 31 March 2016), compute the effect of the above information on his (Mr Sharp's) taxable income, for the year ended 28 February 2017. Assume the time-apportioned base cost of the NoHope shares held by Supreme is R2 691 250.

Ignore the Corporate Rules.

QUESTION 4.14 **(16 Marks)**

Hillock (Pty) Ltd is a South African resident company. The company's balance sheet at 29 February 2016 shows the following:

	Note	2016
ASSETS		
Non-current assets		
Property, plant and equipment	1	11 250 000
Total non-current assets		11 250 000
Current assets		
Cash and cash equivalents		3 400 000
		3 400 000
Total assets		14 650 000
EQUITY AND LIABILITIES		
Capital	2	1 900 000
Other reserves		1 750 000
Retained earnings		11 000 000
Total equity		14 650 000
Total liabilities		0
Total equity and liabilities		14 650 000

Notes

1. The plant and machinery was originally acquired second-hand for R15 million on 1 March 2014. It was sold for R13 million on 15 March 2016, the date the shareholder decided to voluntarily liquidate the company. The machinery had been used in a process of manufacture but had been taken out of use on 29 February 2016. The company had never qualified either as a micro business or a small business corporation.
2. The share capital account (at 31 December 2010) comprised R1 500 000 share capital and R400 000 share premium. Of this balance, R100 000 represented profits previously capitalised.

Additional information

- The company stopped trading on 17 March 2016. It earned no other taxable income from trading activities.
- The liquidator declared the final distribution on 30 June 2016 to the company's sole shareholder, Mrs Mountain and declared that no further distributions were to be made.

YOU ARE REQUIRED TO: Calculate any income tax implications for Mrs Mountain for her year of assessment ended 28 February 2017. (Ignore VAT.) You must assume that the shares were acquired for R4 million in June 2008.

SOLUTION 4.1

1. FALSE A dividend is, for income tax purposes, any amount transferred or applied by a resident company for the benefit of any person by virtue of any share in that company is a dividend (subject to three exclusions; see 2–4 below). This definition only applies to 'resident' companies. (2)

2. FALSE The return of contributed tax capital is one of the exclusions to the dividend definition and constitutes a 'return of capital' as defined. (2)

3. FALSE An open market purchase by a listed company of its own shares on the JSE is not a dividend (because, as a practical matter, the seller cannot distinguish this sale from any other JSE market sale). (2)

4. TRUE The issue by a company of its own shares is not a dividend as defined. (1)

5. FALSE The shareholder is receiving this payment in the role of creditor and not as a shareholder, i.e. the payment is not 'in respect of any share'. The holding of shares is effectively incidental. (2)

6. FALSE The s10(1)(k) exemption does not apply to: (5)

   (aa) dividends (received by residents or a dividend in para (b) of the dividend definition) from REITs or controlled property companies per s25BB

   (bb) *deleted*

   (cc) *deleted*

   (dd) certain dividends from equity instruments as defined in section 8C, to the extent the instrument was received in the circumstances of section 8C

   (ee) dividends received by companies from (A) cession of the right to that dividend; or (B) from a discretionary distribution by a trustee of a trust

   (ff) dividends received by a company in respect of a borrowed share

   (gg) dividends received by a company not exceeding compensation paid in respect of any other borrowed share (where the shares are of the same kind and of the same or equivalent quality), subject to a proviso

   (hh) dividends received by a company other than dividends in (gg) above to the extent that the aggregate of dividends does not exceed the aggregate of deductible expenditure of that company (if the expenditure is not related to the dividends so received)

   (ii) dividends in respect of services rendered (employment), other than a s8C dividend

   (jj) dividends in respect of restricted equity instruments, where those dividends arise from the redemption of shares in or winding up of the company (from 1 March 2017)

   Note that (hh) is effective only from years of assessment commencing on or after 1 April 2014.

   Note also that (ii) is effective only for amounts received/accrued on or after 1 March 2014.

   Note further that 'dividend' as defined is only as declared by a resident company and therefore automatically excludes foreign dividends from the scope of s10(1)(k).

SOLUTION 4.1 continued

7.	FALSE	Contributed tax capital is a concept divorced from other law. The return of contributed tax capital is determinable by the directors of the company or persons with comparable authority with reference to the particular class of shares and in relation to the holding.	(2)
8.	TRUE	Equity share is a defined term.	(1)
9.	FALSE	An equity share must have a right to share in profits or returns of capital beyond a specified amount. Such limited preference shares do not carry such rights.	(2)
10.	TRUE	Foreign dividend is separately defined and excludes such redemptions.	(1)
			(20)

SOLUTION 4.3

PART A

1. Contributed tax capital is the sum of the share capital and share premium accounts immediately before 1 January 2011 plus the consideration received for future issues of shares. (1)

   Based on the scenario, the company will have a contributed tax capital (by 31 March 2017) of:

   R1 000 000 + R500 000 + R500 000 = 2 000 000 (1)

   This contributed tax capital is represented by 1 010 000 shares. (1)

2. A dividend as defined includes any amount transferred or applied by a company for the benefit of any person in respect of any share in that company. However, one of the three exclusions from the definition is the return of contributed tax capital. (1)

   The dividend is therefore: R2 000 000 − R250 000 = 1 750 000 (1)

3. Contributed tax capital does not include (from the starting balance) amounts in share capital and share premium that would have been a dividend in terms of the old dividend definition.

   The R200 000 previously capitalised profits represent an amount that, in terms of the old definition of dividend, would have been a dividend when returned to shareholders. Such amount is therefore excluded from the scope of contributed tax capital. (1)

   The contributed tax capital is: R2 000 000 − R200 000 = 1 800 000 (1)

4. As none of the capitalisation issue generated contributed tax capital, it is submitted that the entire R300 000 (100 000 shares @ R3 per share) represents a dividend as defined. (1)

SOLUTION 4.3 continued

PART B

Each class of share is considered separately.

Class A shares

Total distribution applicable to Joe	R10 000 000 × 15%	1 500 000	(1)
Reduced by the return of contributed tax capital	15% × R2 000 000	(300 000)	(1)
Dividend		1 200 000	

Class B shares

Total distribution is a dividend	10% × R4 500 000	450 000	(1)
The capitalisation issue of class B shares is not a dividend (being the issue by the company of its own shares)			(1)

PART C

For companies becoming resident on or after 1 January 2011 (as LE Ltd has with its move of its place of effective management), the contributed tax capital is the sum of the market value of all shares (submitted to be the shares in issue and not authorised share capital) immediately before it becomes resident plus the consideration in respect of subsequent issues of shares. (1)

This means the contributed tax capital for the year ended 31 March 2017 will be:

4 378 932 shares × R55 =	Market value before resident	240 841 260	(1)
100 000 × 60	Subsequent share issue	6 000 000	(1)
	Contributed tax capital	246 841 260	
			(15)

SOLUTION 4.8

Kelvin (Pty) Ltd

1 The shareholder receives:

Repayment of the loan account

Remaining cash of the company (as there are no other assets).

Where applicable, the company would have to withhold dividends tax

Total equity in Kelvin (Pty) Ltd	11 500 000 − 500 000 (loan)	11 000 000	(1)
less contributed tax capital		(3 000 000)	(1)
Dividend		8 000 000	
Shareholder receives:			
Loan repayment		500 000	(1)
Cash	11 500 000 − 500 000	11 000 000	(2)
Amount received by shareholder (inclusive of dividends tax withholding)		11 500 000	(1)

SOLUTION 4.8 continued

2 ***Normal tax - Natural person***

Dividend received		8 000 000	(1)
less exemption (s10(1)(k))		(8 000 000)	(1)
CGT:			
Proceeds - para 77	11 000 000		(1)
less dividend (included in gross income)	(8 000 000)		(1)
	3 000 000		
less base cost:			
Expenditure - para 20(1)(a)	(4 500 000)		(1)
Capital loss	(1 500 000)		
Para 19(1)(a) does not apply as the dividend was subject to dividends tax i.e. is not an 'exempt dividend' per that paragraph - para 19(3)(b).			(1)
Total capital gains and capital losses	(1 500 000)		(1)
less annual exclusion	40 000		(1)
Assessed capital loss carried forward	(1 460 000)		(1)
Taxable income		0	
Dividends tax: 15% × R8 000 000		1 200 000	(1)

3 ***Normal tax***

Dividend received			8 000 000	(1)
less exemption (s10(1)(k))			(8 000 000)	(1)
CGT:				
Proceeds (R11 500 000 − R500 000)		11 000 000		(1)
less dividend (included in gross income)		(8 000 000)		(1)
		3 000 000		
less base cost		(4 500 000)		(1)
Capital loss		(1 500 000)		
Para 19: loss limitation				
Dividends in last 18 months:				
Liquidation dividend (exempt from dividend tax - s64F(a))	8 000 000			(1)
Loss does not exceed 'exempt dividend' and is fully disregarded		1 500 000		
Capital gain or loss to be aggregated		0		
Taxable income			0	
				(22)

Note: Base cost is not reduced by the return of capital as the return of capital occurred on disposal of the share - see para 76B(2).

SOLUTION 4.11

Desperate (Pty) Ltd

Income tax

Sale of trading stock (gross income)		1 500 000	(0.5)
Opening stock s22(2)		(1 000 000)	(0.5)
s8(4)(a) recoupment (R1.2 mil ltd to R1 mil − R200 000)		800 000	(1)
CGT on plant			
Proceeds (1.2m − 0.8m) =	400 000		(1)
Expenditure (1.0m − 0.8m) =	(200 000)		(1)
Capital gain	200 000		
Inclusion @ 80%		160 000	(0.5)
Taxable income		1 460 000	
Tax @ 28%		408 800	(0.5)
Balance sheet after realisation of assets:			
Stated capital		500 000	
Capital profits	200 000		
Plant sale (1 200 000 − 600 000)	600 000	800 000	
Note that capital and revenue profits must be determined on an accounting basis			
Revenue profits	1 300 000		
Stock sale (1 500 000 − 1 000 000)	500 000		
Tax	(408 800)	1 391 200	
		2 691 200	
Represented by:			
Cash		2 691 200	
Opening balance	400 000		(0.5)
Plant proceeds	1 200 000		(0.5)
Stock proceeds	1 500 000		(0.5)
Tax paid	(408 800)		(0.5)
The liquidation dividend payable to the shareholder will be:			
Cash	2 691 200		
less contributed tax capital	(500 000)	2 191 200	(1)
This dividend is not subject to any withholding as it is payable to a resident company (s64F(a)).			(1)
Sole shareholder			
Dividend received		2 191 200	(0.5)
s10(1)(k)		(2 191 200)	(0.5)
Capital gains tax:			
The base cost is not reduced by the return of capital as this occurs with the disposal of the share (para 76B(2)).			(1)

SOLUTION 4.11 continued

Disposal of shares:			
Proceeds (all amounts other than the return of capital)	2 691 200		(1)
Reduced by dividend in gross income	(2 191 200)		(0.5)
	500 000		
Base cost	(400 000)		(0.5)
Capital gain or capital loss	100 000		
Inclusion of taxable capital gain @ 80%		80 000	(1)
			(14)

CHAPTER 5: FRINGE BENEFITS, ALLOWANCES AND SHARE GAINS

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Question	Sections	Grade	
Question 5.1	Planning, GI, s8(1), Seventh Schedule para 7, 11	**	S
Question 5.2	GI, s8(1), s8C, s11(a), s11(d), s11(e), Seventh Schedule para 5, 7, 9, VAT	***	S
Question 5.3	GI, s6*quat*, s6A, s8(1), s10(1)(k)(i), s10B, s11(a), s11(k), s18, Seventh Schedule para 7, 9, 13, VAT	***	S
Question 5.4	GI, s8(1), s10(1)(i), s10(1)(k), s10(1)(gG), s11(a), s11(e), s11(*l*), s11(n), s11(w) s18, Seventh Schedule p7, 11, 12, 12A, 12C VAT, Second Schedule	***	S
Question 5.5	GI, s8(1), s8C, s10(1)(i), s10(1)(k), s11(a), s11(k), s18, Seventh Schedule para 7, 11, 12, 13, 12A, 12B, Eighth Schedule, VAT	***	
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Question 5.7	s8C, s58, Seventh Schedule para 11, Eighth Schedule	***	S
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Question 5.9	GI, s6(2), s6A, s6B, s7, s8C, s10(1)(i), s10(1)(k), s11(a), s11(i), s23(m), Seventh Schedule para 5, 6, 7, 10, 12A, 16, Eighth Schedule	***	
Question 5.10	GI, s6(2), s6A, s6B, s8, s8C, s10(1)(k), s10(1)(nD), s11(nB), s25B, Second Schedule, Seventh Schedule para 6, 7, 12A, 12B, Eighth Schedule	***	

QUESTION 5.1 (Solution at end of chapter) (17 Marks)

Eric Clayton has been given the choice by his employer company to select, as from 1 March 2016, either the free use of a company car with all expenses of running the car for both business and private purposes fully paid for by the company, or a car allowance of R3 000 a month for the use of his own car for business purposes. The following information is also relevant:

– Eric will keep a detailed logbook, and estimates he will travel a total of 40 000 km a year. Of this, 25 000 km will be for private use.

– If he takes the company car option, the company will purchase a car on 1 March 2016 at its retail market value of R214 000 (including VAT). There is no maintenance plan for this vehicle. The company will bear all of the vehicle-related costs.

– If Eric chooses the car allowance option he will purchase a car on 1 March 2016, at the same cost. The company will grant him an interest-free loan of R214 000 to purchase the car. Annual expenses to be incurred by Eric in respect of running his own car will be:

	R
Fuel	9 900
Maintenance	2 000
Licence	120
Insurance	1 440
	13 460

The following must be assumed:

– Marginal rate of tax for Eric for the 2017 year of assessment will be 41% on any income/inclusions over and above his salary.

– The current provisions of the Income Tax Act will remain unchanged in future years.
– The interest-free loan will be repaid at the end of five years, at which date the car will be sold for R20 000.
– Assume the official rate is 7% throughout the year.

YOU ARE REQUIRED TO: Calculate which of the two alternatives will provide:

1. The greatest annual cash flow advantage for Eric in respect of the year ended 28 February 2017.
2. The greatest cash flow advantage at the end of five years. Ignore any time value of money.

QUESTION 5.2 (Solution at end of chapter) (33 Marks)

Mr Gordon Zola, a South African resident, is an employee of Mntala Ltd (a registered VAT vendor). In respect of his employment with Mntala, he has enjoyed or will be enjoying the fringe benefits as discussed below.

Mntala gave Gordon an item of stock as a long service award on 30 June 2016 after 15 years of service. The item, a watch, has a market value of R10 000 and a cost of R6 500 (both excluding VAT).

Gordon has enjoyed the use of a company-owned car since 2014. Mntala originally acquired the car at its retail market value of R180 000 (including VAT) on 1 March 2014 and it does not have a maintenance plan. Mntala pays all maintenance costs (R2 100 per month including VAT), but Gordon pays all fuel costs (R1 500 per month).

On 30 August 2016, Mntala gave the car to Gordon. It had an estimated retail market value of R100 000 (including VAT) at that date. The company ceased paying maintenance costs on disposal to Gordon. Gordon has not kept a log book.

Mntala gave Gordon the right to use a company-owned holiday cottage in Plettenberg Bay. Mntala incurs costs of R2 200 per month (including VAT) in respect of maintenance and electricity of the cottage. Gordon used the cottage for 14 days during April 2016 and paid a nominal rental of R75 per day. The cottage is normally let to non-employees for R500 per day.

Mntala allowed Gordon to purchase options to acquire a total of 1 000 shares in Mntala. The options cost R1 each and were restricted until Gordon acquired the shares for R6 per share. The shares were trading at R12 on 1 March 2016, the day Gordon acquired and exercised the options. The shares were unrestricted equity instruments. Gordon still held the shares on 28 February 2017.

Mntala has given Gordon a reimbursive entertainment allowance of R500 per month from 1 March 2016 to 28 February 2017. Gordon is required to account to Mntala and produce proof of actual expenditure, which is expected to be R500 per month (including VAT) for this entire period.

Gordon also receives a cash salary of R100 000 *per annum*. Mntala has set up a provident fund for the benefit of its employees. Gordon contributes 8% of his cash salary to the provident fund and Mntala contributes a similar amount.

Assume that the Commissioner allows a write-off period of five years for all assets qualifying for s11(e) and that Mntala is in possession of all tax invoices, where appropriate.

YOU ARE REQUIRED TO:

1. Calculate the effect of the above information on Gordon's taxable income for the year of assessment ending 28 February 2017. (16 Marks)

2. Calculate the VAT effects of the above information for Mntala for the year of assessment ending 28 February 2017. Note the instances in which the above information has no VAT effect. (8 Marks)

3. Calculate the income tax effects of the above information for Mntala for the year of assessment ending 28 February 2017 in respect of Gordon's employment. (9 Marks)

QUESTION 5.3 (Solution at end of chapter) (45 Marks)

Henry Rackman, a South African resident, aged 40, commenced employment with Good (Pty) Ltd on 1 March 2016. In terms of his employment contract Henry's **monthly** remuneration package is as follows:

1. Cash salary (monthly) R45 000
   This is the amount payable (before tax) after deducting Henry's contribution to the company's retirement fund (a pension fund) of 8% of gross cash salary, R124 in respect of UIF and Henry's contribution of R1 000 to a medical aid fund. Good contributed 10% of Henry's gross cash salary to the pension fund and R2 090 to the medical aid fund monthly. Henry's wife and son are dependants on his medical scheme.

2. The use of a company car
   Henry has unrestricted use of the car. Good pays all costs relating to the car. The car, which had a cash price of R342 000 (including VAT), is leased by Good in terms of a 60 month finance lease, which commenced on 1 March 2015. The monthly rentals are R7 600.

   For the period 1 March 2016 to 31 December 2016, Good incurred the following costs in respect of the car:

	R
Fuel	14 000
Insurance	10 260
Licence	1 000
Maintenance	6 270

   (All costs include VAT where appropriate and there is no maintenance plan.)

3. The use of residential accommodation, which Good rents at a monthly rental of R25 000
   The rent includes electricity, water and rates. The house has eight rooms. Henry is responsible for furnishing the house. Use a remuneration proxy of R681 819. It is not customary for Good to provide employees with accommodation.

4. An entertainment allowance (monthly) R5 000
   Henry is required to entertain clients on a regular basis. During the year ended 28 February 2017 he incurred R48 000 in entertainment costs. Henry is not required to account for his expenditure and does not earn any commission or variable income.

5. Health club fees (monthly) R1 000
   Henry has been a member of the health club for many years. When he commenced employment, Good assumed responsibility for his monthly fees.

Henry's only other income for the year ended 28 February 2017 was dividends. During the year Henry received the following dividends:

- from South African listed equities R50 000
- from Emerald (Pty) Ltd (net of withholdings tax) R57 000

Emerald is an Irish company in which Henry holds 5% of the shares. The remaining shares are held 40% by South African residents and 55% by a Swiss resident.

The relevant exchange rate for the year ended 28 February 2017 is €1 = R10. Ireland subjects dividends to a 5% withholding tax. Good is a registered VAT vendor.

YOU ARE REQUIRED TO:

1. Calculate Henry's tax liability for the year ended 28 February 2017.
2. Calculate the VAT inputs and outputs for Good (Pty) Ltd in respect of Henry's employment for the year ended 31 December 2016. Clearly indicate if an item has a Rnil effect and provide a short reason.
3. Calculate the effect of Henry's employment from March 2016 on Good (Pty) Ltd's taxable income for the year ended 31 December 2016.

QUESTION 5.4 (Solution at end of chapter) (42 Marks)

Chantyl van der Haas, a South African resident, was employed by Touch Limited – a company in Cape Town – until 31 December 2016, when she retired, having reached the age of 60. She was not an agent or representative for the company. Her cash salary at retirement was R20 000 per month.

Chantyl held a senior management position in the company and, as part of the terms of her employment contract, an insurance policy was taken out on her life (not a pure risk policy), of which Chantyl was the beneficiary. The premiums on this policy of R1 252 per month were paid by the employer and included in Chantyl's hands as a fringe benefit. The company correctly claimed a deduction for these amounts. Total premiums paid by the company and included as a fringe benefit to the end of the 2016 year of assessment had amounted to R45 000. On Chantyl's retirement, the insurer paid out an amount of R100 000 to Chantyl.

Touch Limited also gave Chantyl a long service award, as she had been with the company for 20 years. This was a gold watch, which they purchased for R6 500 (including VAT). Chantyl also received a lump sum of R750 000 from the company's provident fund to which she had contributed for 21 years. She had always contributed 7.5% of her cash salary while Touch Limited contributed 8% of her salary to the fund. She had joined this fund on 1 January 1994. Chantyl's total contributions to the fund up to 29 February 2016 were R185 000. In addition she contributed to a retirement annuity fund. Her contributions were R3 500 per year and her first contribution was made on 1 January 1993. She has always been allowed a full tax deduction in respect of the RAF. She is due to retire from this fund when she turns 65 on 28 December 2021.

In addition to the above, Chantyl had the use of a BMW 3 series owned by Touch Limited. Touch Limited acquired the motor vehicle at its retail market value of R190 000 (including VAT) on 1 June 2014 but the use thereof was only granted to Chantyl on 30 November 2015. Touch Limited paid for all maintenance and all business fuel in respect of the car as it had no maintenance plan. This amounted to R8 011 (including VAT) for maintenance and R10 200 for business fuel for the year of assessment ended 28 February 2017. Unfortunately, Chantyl failed to keep a logbook of her travels. Chantyl returned the car to Touch on retirement.

The staff of Touch Limited collected and purchased a leaving present for Chantyl which they presented to her on her last day. The painting which they purchased cost them R2 500 (including VAT).

In anticipation of her retirement, Chantyl purchased a home in a retirement village on 1 January 2016. As she did not have sufficient cash at the time she asked Touch if they would subsidise part of the purchase until retirement date. Touch agreed and advanced an amount of R200 000 to her on 2 January 2016. Touch Limited agreed to charge her interest at a rate of 3% *per annum* payable monthly. The R200 000 proved to be in excess of her needs, so on 1 March 2016 she invested R50 000 of it in a fixed deposit account at 10% *per annum* (simple interest). On 31 December 2016 she repaid the full R200 000 to Touch Limited. The official interest rate is 8%.

Chantyl belongs to Touch Limited's medical aid and contributed R13 824 to the fund for the year ended 28 February 2017. Chantyl chose to remain a member of the medical aid fund after retirement. In addition to the above, Chantyl had a few serious operations and paid an additional R61 000 in medical expenses, of which only R31 000 was recovered from the medical aid fund. Her children are not dependants on her scheme.

As Chantyl had to be able to be contacted after hours, Touch Limited paid her cell phone bill in full. From March 2016 to 31 December 2016 this amounted to R4 500 (excluding VAT). She uses the phone only for business purposes. The phone was in the company's name.

Chantyl was not liable to account to Touch Limited for any entertainment expenses. She received an allowance for entertaining of R4 000 up the date of retirement. She incurred entertainment expenses of R5 600. The following information is also relevant for the year of assessment ended 28 February 2017:

Interest received on fixed deposit @ 6.5% (refer above)	R4 192
Interest received on money market account	R32 000
Dividends from local investments	R124 000

The following is also relevant:

- Chantyl is a widow with two major children and has substantial share investments.
- The Commissioner for SARS allows wear and tear of 20% on applicable assets.
- Touch Limited is a registered VAT vendor.

YOU ARE REQUIRED TO:

1. Calculate the taxable income of Chantyl van der Haas, giving brief explanations, where necessary, for the year of assessment ended 28 February 2017.
2. Calculate the tax effects for Touch Limited in respect of all of the above information for the year of assessment ended 28 February 2017.

QUESTION 5.5 **(50 Marks)**

Marco Vernetti, a South African resident, aged 57, is employed as the financial manager/director of 'Martini Limited' (Martini), a South African company and registered VAT vendor. Marco is married to Maria, a housewife, aged 42. They have one child, a son named Enzio, aged 20, who is studying Business Science full-time at UCT. None of the above individuals has a 'disability' as defined in the Income Tax Act.

In addition to his cash remuneration, Marco received a number of non-cash benefits for his 2017 year of assessment:

1. Marco received a travel allowance of R8 000 per month. Up until 28 February he drove a Ferrari that had cost him R900 000 (including VAT but excluding finance charges) on 1 July 2013. He kept a logbook and travelled a total of 26 000 kilometres in the car for the year, of which 10 000 related to business trips. Martini pays for all fuel in respect of the vehicle and Marco pays for all maintenance. The amount paid by Martini for fuel was R18 000 for the year. Maintenance cost Marco R22 000 (including VAT) for the year. In addition, Marco incurred a total of R110 000 relating to finance charges on the vehicle for the year. On 28 February 2017 Marco sold the Ferrari for R940 000.

2. Although she is not an employee of Martini, Martini gave Maria the use of a BMW 320i that it had acquired at its retail market value of R240 000 (VAT included). Maria had the use of this car throughout the year. Maria had to pay for all maintenance costs and half the cost of all fuel. The total cost of fuel (for Martini and Maria) was R14 000 for the year and the total

maintenance costs were R12 000 for the year. Maria kept a logbook and travelled 12 000 kilometres during the year of assessment.

3. On 1 May 2016, Martini gave Marco an interest-free loan of R1 million. Marco used half of this loan to buy shares in a UK company (he holds 5% of the issued share capital) and the other half to invest in a South African property real estate investment trust (REIT). The UK company is not a 'controlled foreign company' for the purposes of s9D.

   Marco received dividends of £1 000 (after withholdings tax of 5%) from the UK company. Marco has elected to use the average exchange rate for the year, which was R11 = £1.

   The property collective investment scheme paid Marco dividends of R25 000 for the year.

   The full amount of the loan was still outstanding at 28 February 2017.

4. On 1 December 2014, Marco was awarded the option to acquire 1 000 shares in Martini for a consideration of R5 per share when the market value amounted to R7 per share. Once he exercises his option and acquires a parcel of 1 000 shares, he cannot dispose of them for a period of one year from the date of acquisition thereof. The offer is not in terms of a 'broad-based employee share plan' subject to s8B.

   On 1 December 2015, Marco exercised his right and acquired 1 000 shares at R5 per share. The market price of the shares on that date was R8 per share. On 1 December 2016, the market value amounted to R14 per share. On 1 February 2017 he sold the shares for R16 per share.

5. During the year, Martini settled a debt of R3 200 that Marco owed to the City of Cape Town.

6. Maria and Enzio are registered as dependants on Marco's medical aid. Martini contributed R1 200 per month from March up to and including November 2016 and R1 500 per month for the remainder of the 2017 year of assessment, towards medical aid subscriptions in respect of Marco. Marco also contributed R1 000 per month towards these subscriptions for the entire year. Martini also paid medical expenses of R5 000 (none of which were recoverable) in respect of an illness suffered by Maria. Marco paid total medical expenses (none of which were recoverable) of R10 000 for the year.

7. Marco's cash salary was R40 000 per month for the entire year. Marco contributed 10% of this amount to a staff pension fund and Martini contributed an equal amount to the fund.

8. On 1 January 2017, Marco was awarded a non-pensionable cash bonus of R50 000 for being appointed a director of Martini.

9. Marco is bringing forward an assessed capital loss of R25 000 from his 2015 year of assessment. He made no capital gains or capital losses in his 2016 year of assessment, but made a capital gain of R6 000 during his 2017 year of assessment on the sale of a dormant property.

You may assume that the official rate of interest remained constant at 7% *per annum* throughout the 2017 year of assessment.

YOU ARE REQUIRED TO:

1. Calculate Marco's normal tax liability (after rebates) for his 2017 year of assessment (show all amounts that are to be carried forward to his 2018 year of assessment).
2. Calculate the VAT effects of item (2) above for Martini for its year of assessment ended 28 February 2017.

QUESTION 5.6 **(15 Marks)**

Pumzi Khumalo is employed by 'Ubuntu Trading Limited' (Ubuntu) as a manager. On 1 June 2016 the directors of Ubuntu decided to implement a broad-based employee share plan that will benefit all full-time employees of the company who have been in its employ for at least one year (as at the date the plan is implemented – 1 July 2016).

Pumzi is entitled to receive 5 000 ordinary shares in Ubuntu for their par value (R1) on 1 July 2016. The shares will be issued by Ubuntu on that date. She is not allowed to dispose of the shares for a period of three years from this date (unless she resigns or is dismissed – in which case Ubuntu has the right to acquire the shares from her at their then market value). There are no other restrictions on the shares. Employees who receive the shares are entitled to full dividends and voting rights.

Pumzi acquires the shares on 1 July 2016, on which date the shares are trading at R8 per share. This is their highest value to date.

Ubuntu issues a total of 1 350 000 ordinary shares to 250 other qualifying employees (excluding Pumzi) on 1 July 2016. 230 of these employees each receive 5 000 shares and 20 receive 10 000 shares.

YOU ARE REQUIRED TO:

1. Discuss the income tax effects of the acquisition of the shares by Pumzi for her 2017 year of assessment. (4 Marks)
2. Discuss the income tax effects of the above transactions for Ubuntu's year of assessment ending 28 February 2017. (8 Marks)
3. Assume that Pumzi sells her shares on 1 July 2019 for R25 per share (their then market value). Discuss the income tax effects for her 2020 year of assessment. (Assume that 2017 income tax legislation will still be applicable.) (3 Marks)

QUESTION 5.7 (Solution at end of chapter) **(15 Marks)**

Winston Wilson, a sales director whose income is normally mainly derived from commission, was offered the right to acquire 40 000 shares in his employer company on 1 March 2016. The exercise price of the options was R30 per share and the market value of the shares on 1 March 2016 was R45 per share. Winston would not have to pay anything for the options. In terms of the offer there were no restrictions on when the options could be exercised or whether or not they could be sold, there were only restrictions on the underlying shares. The terms of the restrictions on the shares were that the shares could only be disposed of at the earlier of six months from the date of acquisition of the shares or the date of Winston's resignation or dismissal.

Winston accepted the offer on 10 March 2016, at which date the market value of the shares was R50 per share. He exercised half of the options on 1 July 2016 at which date the market value of the shares was R55 per share.

He was granted an interest free loan from his employer on 1 July 2016 for the full exercise price of the options exercised by him and his father (see below) on that date. Winston gave the other half of the options to his father on the same date and his father exercised the options immediately.

The market value of the shares on 1 January 2017 was R20 per share. Winston and his father sold their shares on 1 February 2017 for R16 per share. Assume that the official rate of interest was 10% *per annum* throughout the 2017 year of assessment and that the full amount of the loan was repaid on 1 February 2017.

YOU ARE REQUIRED TO: Discuss and calculate the tax effects for Winston and his father of the above transactions for the year of assessment ended 28 February 2017.

QUESTION 5.8 **(40 Marks)**

Perry Platt (Agent P) works as head of security at a large oil firm (a VAT vendor). He is 66 years old and a South African resident. He has a wife, Candice, and two minor children, Phineas and Ferb.

In the previous tax year he earned remuneration of R280 000, excluding a travel allowance of R6 000 per month.

In the current tax year, Perry received a salary of R22 000 per month. He also received a bonus of R25 000 in December 2016.

Perry contributed 8% of his salary towards the company's pension fund. In addition, Perry contributes R5 000 a month into a retirement annuity fund (RAF).

Perry contributed to a medical aid fund. He paid R3 200 per month to cover himself and his three dependants. During the current year Candice had to have extensive psychological counselling. This cost was not covered by the medical aid and came to an additional R36 000 for the tax year. Phineas also required extensive plastic surgery to clear his nasal passages as he was continually wheezing. This cost of R18 000 was also paid for by Perry as it was not covered by his medical aid.

Perry used his 2014 VW Jetta for private and business use. The car had a cash cost of R168 000 (including VAT) on acquisition date. He financed the car over five years and pays finance costs of R1 400 per month (relating to the interest portion only). The company gave Perry a car allowance of R6 000 per month to compensate him. He travelled 38 000 kilometres in the tax year, 12 000 of which were private. He kept a logbook and paid for all maintenance on the car. During the year he replaced the tyres and had two services. The tyres cost R4 560 (including VAT) and the services cost R1 140 in total (including VAT). During the year he also paid R24 000 for all petrol. He has retained proof of all the expenditure.

Perry was given a cell phone allowance of R400 per month. He had no itemised billing on his cell phone so could not prove any business calls.

The company bought two books in the year which they gave to Perry. The first was *Security Techniques and Counter-Espionage* by Craig Williamson and cost R228 (including VAT). The other was *How to Grow Beautiful Orchids* by Keith Gardner at R114 (including VAT).

Perry had the use of a company unit at the Beacon Isle Hotel for the summer vacation. The unit was donated to the company and they pay a levy of R2 400 per year. The unit is normally let out to the public for R6 500 per week. Perry used it for one full week, i.e. seven days in the year. He also used the company boat which was anchored in Plettenberg Bay. The boat had a market value of R340 000 (including VAT) when Perry used the boat for the week he was in Plettenberg Bay at the Beacon Isle Hotel.

The company also gave Perry a loan of R200 000 for the period 1 March 2016 to 1 October 2016.The loan was repaid on 1 October 2016. The loan was secured and interest of 5% was charged. The official rate was 10%.

The company expected Perry to entertain certain guests. He was given an entertainment allowance of R1 200 for the year.

Perry was given the use of a house by the company from 1 June 2016, as the company required Perry to be available near the company's main oil refinery in Milnerton. Perry moved into the company house on 1 June 2016. The house had three bedrooms, a lounge, kitchen, dining room and two bathrooms. The company paid all electricity and water bills, and furnished the house. The house was owned by the company. Perry's remuneration proxy is R337 600.

During the year Perry saved a pensioner, Mr Clive Eastwood, and prevented a tanker exploding, when a fire was caused by a burning tanker truck that lost control on Nelson Mandela Boulevard. Perry was hailed as a hero and received a certificate from the city for saving Mr Eastwood's life and averting what could have been a major disaster in the city. The company bought Perry a flat-screen TV as a way of recognising his bravery and the positive press from his actions. The TV cost R11 400 (including VAT).

Perry had recently invested some money offshore. For the current tax year he received interest R1 000 from the UK and dividends of R3 000 from investments in Germany. These were listed investments and the dividends received are not exempt under section 10B(2).

YOU ARE REQUIRED TO: Calculate Perry's tax payable for the year of assessment ended February 2017.

QUESTION 5.9 (50 Marks)

Bill Bunting, a South African resident, commenced employment as a senior executive with 'IT Systems Ltd' (Systems), a listed company that is a registered VAT vendor, on 1 June 2016. This was after a short period between 1 January 2016 and 31 May 2016 when Bill traded as a small IT business in his own name. Bill is 35 years old and has a wife and two minor daughters, Emma and Sophie. These four people are the sole beneficiaries of the BB Trust, a discretionary trust which was established by Bill in 2014 by means of a donation of R1m. Other than the loan referred to below, no other funds have been introduced into the trust.

Up until 31 December 2015, Bill had been employed by another company and had received a restraint of trade payment from it on 31 December 2015 amounting to R200 000. This payment was subject to the condition that Bill would repay the amount if he worked in the IT industry (either under his own name or for an employer) within a two-year period of ceasing employment with that company. The company invoked the relevant contractual clause on 17 February 2016 and Bill refunded the company the full amount on 3 March 2016.

During the period that he was a sole trader, Bill continued his membership of a medical aid scheme and contributed an amount of R4 000 a month to cover himself and his three dependants. He earned fee income of R100 000 between 1 January and 29 February 2016; and R180 000 between 1 March and 31 May 2016. He incurred tax deductible operating expenses of R45 000 and R88 000 for those periods respectively. His major customer was placed in liquidation on 15 May 2016, owing him R158 000 which represented a large portion of the abovementioned fee income. Bill has been advised that there is no prospect of recovering any part of this amount and he has written it off. Bill has never been registered as a VAT vendor.

In terms of his contract of employment with Systems, Bill earns a cash salary of R32 000 a month. The company took over payment of his monthly medical aid contribution of R4 000 and also pays a provident fund contribution equal to 8% of Bill's cash salary. He contributes the same amount to the provident fund.

Systems provides Bill with a company motor car that it purchased at its retail market value on 1 June 2016 for R342 000, including VAT and a maintenance plan. It pays all the costs associated with the car but deducts R250 a month from Bill's salary as a contribution towards use of the vehicle. Bill is provided with a parking bay at the company's business premises that it leases for R500 a month,

including VAT. The company leases a number of such bays that are made available to all management staff. Bill did not maintain a logbook.

On commencing his employment with Systems, Bill was immediately provided with a notebook computer which the company purchased for R16 000 on 1 June 2016 and a cell phone contract costing R250 a month. The company also pays R200 a month for an internet subscription for Bill. All these amounts include VAT. Bill uses these goods and services mainly for business purposes, but it is estimated that at least 25% comprises private use.

Bill's contract also made provision for his participation in Systems' share incentive scheme. He, or his nominee, was entitled to 30 000 options to acquire equity shares in Systems at R33 a share, the market price on 1 June 2016. The options could be exercised at any time. However, Bill would only be entitled to dispose of 80% of the shares so acquired after 1 June 2018. The remaining 20% (6 000 options) was free of any restrictions from 1 June 2016. Bill ceded these 6 000 options to the BB Trust on 1 June 2016, for no consideration and the trust immediately exercised them. The market price of a share on that date was R37 and R4 for an option. Systems granted the trust an interest-free loan for the full purchase price of the shares. This was in terms of a loan facility available to all participants or their nominees in terms of the normal rules of the share scheme. Systems did not declare any dividends during its year of assessment ended 28 February 2017.

In terms of Systems' bonus scheme, Bill was allocated an amount of R100 000, based on the company's EVA (economic value added) for the financial year ended 28 February 2017. Payment of the bonus was subject to the approval of the company's remuneration committee, which approved the bonus allocations on 15 April 2017, after considering the report of the independent auditors.

On 15 November 2016, Bill's entire department, including each employee's partner (spouse), was granted an all-expenses paid trip to a casino resort in Swaziland, after meeting an important deadline. The cost per person of this trip was R10 000. Bill and his wife accepted the award and while gambling in the casino, Bill won a R200 000 jackpot using a ticket that cost him R100. Systems also awarded Bill a prize for creating a company slogan related to a recent marketing campaign. This was a TV set that the company acquired on 10 December 2016 (the date of the award) at a special price of R11 400 (including VAT). The market value of the TV set at that time was R13 000.

Bill joined a retirement annuity fund on 1 January 2016 and contributes R5 000 a month. He also has a disability insurance policy, in respect of which he pays a monthly premium of R1 000. During April 2016 he was hospitalised with an unknown virus and was paid R25 000 compensation in terms of this policy. He also incurred expenses related to this illness amounting to R21 000 that were not recovered from his medical aid scheme.

The BB Trust had receipts and accruals (none of which is from the shares in Systems) comprising R40 000 in local dividends and R60 000 in interest during the year of assessment ended 28 February 2017. The dividend income was distributed to Bill and the interest income was distributed in equal portions to Emma and Sophie in order to pay their school fees.

Other than as mentioned above, Bill had no transactions that would affect his liability for tax in terms of the Income Tax Act.

YOU ARE REQUIRED TO: Calculate the income taxes payable by Bill Bunting in respect of the year of assessment ended 28 February 2017.

All workings should be shown and, where appropriate, reasons should be supplied for the treatment of the information provided.

During the year of assessment ended 28 February 2017, assume that the official rate of interest was 12% *per annum* for the period 1 March 2016 to 31 August 2016 and 13% thereafter.

QUESTION 5.10 **(59 Marks)**

Nigel Diamond, a South African resident, is employed by Sound Alive (Pty) Ltd. Nigel turned 64 on 20 April 2016 and, in terms of company policy, will retire on 31 December 2016. Nigel is a senior executive of Sound Alive (Pty) Ltd, but is not a director.

Nigel has the following employment package with Sound Alive:

1. Monthly cash salary (after deducting employees tax of R10 000 and employee medical aid contributions of R2 300) of R28 700 until 1 June 2016 (see (4) below) and thereafter R30 000 (after employees' tax of R9 300 and employee medical aid contributions of R1 700).

2. The company contributes R6 500 per month to the company provident fund and contributes the balance of the medical aid contributions of R1 000. The company's contributions to the provident fund ceased on Nigel's retirement, but the medical aid contributions continued.

3. During the year of assessment, Sound Alive paid R120 000 in medical expenses that the medical aid would not cover for Nigel's wife after she was injured in a sky-diving accident. Nigel's wife is a dependant on Nigel's medical scheme throughout the year.

4. Nigel's son graduated from university in December 2015. Having secured a job, starting 1 June 2016, he ceased being a dependant on Nigel's medical aid at that date and joined his employer's medical aid. Nigel's daughter (17 on 5 January 2017) is still in school and is a dependant on the medical scheme throughout the year.

5. Nigel travels frequently for business and receives a travel allowance of R5 000 per month until retirement. This allowance is NOT in respect of the company car, see (6) below. You may therefore assume that the restriction in section 8(1)(a)(i)(aa) does not apply and reductions may be claimed. He keeps a logbook for his travel which reflects (to 31 December 2016) business kilometres of 32 000 and private kilometres of 7 500. Nigel pays all expenses for the motor car (except for maintenance covered by the vehicle maintenance plan). His fuel costs amounted to R48 000, licence costs were R594 and insurance was R6 231 for the year. Nigel sold the car on 31 December to his brother for a reduced value of R30 000 when the market value was R65 000. He had originally purchased the car for R294 000 (including VAT) and paid cash.

6. Sound Alive supplied the use of a company car to Nigel. However, as Nigel preferred to use his own car, the use was granted to his wife. Nigel's wife travelled a total of 13 000 kms for the year. Use continued after Nigel's retirement. The company originally acquired the car at its retail market value of R350 000 (including VAT) and it has a maintenance plan. Use of the car was granted to Nigel's wife when the car was purchased in 2014. Nigel paid for all the fuel and the licence for this car, amounting to R17 000 for fuel and R605 for the licence for the year.

7. Nigel was permitted, as a senior executive, to participate in an employee share scheme. This scheme was only available to the senior executives. Nigel was permitted to acquire 40 000 shares in total in terms of the scheme, subject to a maximum purchase of 10 000 shares per year. The shares were to be purchased at R30 per share. Once each packet of 10 000 shares was acquired, they could not be traded for one year. The employer will repurchase any shares still under restriction at the price at which the employee may acquire the share plus 10% on the date an employee resigns or retires.

Nigel purchased 10 000 shares per year on 1 March 2013 and 1 March 2014. On 1 March 2015, he purchased 5 000 shares and on 1 February 2016, he purchased a further 5 000 shares. On 1 March 2016, he purchased his final allotted 10 000 shares.

The market value of the shares in Sound Alive was the following on these dates:
1 March 2013 – R35
1 March 2014 – R38
1 March 2015 – R40
1 February 2016 – R28
1 March 2016 – R33
31 December 2016 – R40
1 February 2017 – R37

On 1 March 2016, Nigel donated 25 000 shares acquired in terms of the employee share scheme to the Diamond Trust.

8. Nigel has the right to use any of the music recordings in the vast library of Sound Alive. During the year, he used recordings with a market value of R6 000.

9. Nigel had only worked for Sound Alive for the last five years. Before his employment with Sound Alive, he had worked for Music Machine. Music Machine had paid Nigel a restraint of trade of R500 000 not to work for another music production company. During 2016, having discovered the breach of the restraint of trade, Music Machine successfully sued Nigel, who in terms of the court order, had to refund the R500 000 to Music Machine. Nigel made payment of R500 000 on 1 June 2016.

10. On retirement from the Sound Alive Provident Fund, Nigel was entitled to maximum retirement lump sum of R3 million. He decided that he did not require all the funds on retirement and transferred half the funds to a provident preservation fund. The other half was taken as a retirement lump sum. Apart from the employer contributions in (2) above, Nigel had also made additional contributions in terms of the fund rules amounting to R200 000 up to 29 February 2016. Nigel did not make any contributions in the current year of assessment.

11. The Diamond Trust (resident in the Isle of Man for tax purposes) holds the shares donated by Nigel on 1 March 2016 together with South African shares and non-South African interest-bearing investments donated by Nigel's deceased father in a prior year of assessment. Nigel's father had always been resident in the United Kingdom for tax purposes. The income from these investments amounted to R40 000 dividends from South African companies and R200 000 interest in the current year of assessment. The trust had retained interest income of R300 000 comprising R160 000 retained from the previous financial year (ended 29 February 2016) and the balance from earlier years of assessment. Nigel, his wife Caroline, his son Jonathan and his daughter Rosie are beneficiaries in terms of this trust.

    The trust is discretionary as regards income, except for an annuity of R50 000 *per annum* that must be paid to Nigel from the interest income. In addition, the trust is vested as regards capital equally for each beneficiary (i.e. each beneficiary has a 25% vested right to capital in the Trust).

YOU ARE REQUIRED TO: Calculate the normal tax liability (after rebates) of Nigel Diamond for the year of assessment ended 28 February 2017. Your answer must refer to each item mentioned, providing a brief reason for the exclusion of any amount from your calculations. Your calculations should be supported with brief reasons.

SOLUTION 5.1

Note 1: When the travel allowance deemed cost table is used, the 'value' always includes VAT, regardless of whether the employer or employee was able to claim an input VAT.

Note 2: The determined value is equivalent to the retail market value on the date the employer obtained the vehicle, excluding finance charges - para 7(1)(a) of the 7th Schedule. Except in the case of motor vehicle dealers, manufacturers and rental companies, the retail market value includes VAT (as per Regulation 362 definition).

		Company car	**Allowance**	
R214 000 × 3.5% × 12		89 880		(1.5)
Reduced in terms of para 7(7) of the 7th Schedule (as detailed records of travels will be kept). Since the company will bear all of the vehicle-related costs, Eric is not entitled to a further para 7(8) adjustment.				
Para 7(7) adjustment for business km (as he kept a logbook): R89 880 × $^{15\,000}/_{40\,000}$ km		(33 705)		(1)
Company car benefit in 2017 tax year		56 175		
Interest free loan R214 000 × 7% - para 11 of the 7th Schedule			14 980	(1)
Travel allowance R3 000 × 12			36 000	(0.5)
Option A: Actual expenses based on actual distance				
Actual expenses				
Wear & tear ($^{R214\,000}/_{7}$)*	30 571			(1.0)
Deemed interest - para 11(5) of the 7th Schedule	14 980			(1)
Other expenses (9 900 + 2 000 + 120 + 1 440)**	13 460			(1)
	59 011			
Predicted reduction of allowance (R59 011 × $^{15\,000}/_{40\,000}$ km)	22 129			(1)
* The wear & tear must be spread over 7 years - s8(1)(*b*)(iiiA)(*bb*)				
** Eric is not a VAT vendor; amounts must include VAT				
Option B: Actual distance and deemed expenditure				
Deemed expenditure - s8(1)(*b*)(iii)				
Rate per km based on vehicle costing R214 000				
Fixed cost ($^{R68\,684}/_{40\,000}$ km × 100c)	171.7			(1)
Fuel	100.0			(0.5)
Maintenance	42.5			(0.5)
	314.2			
Predicted reduction of allowance (15 000 km × R3.142)	47 130			(1)
Reduction limited to amount of allowance			(36 000)	(1)
		56 175	14 980	
Tax @ 41%		23 032	6 142	(1)

SOLUTION 5.1 continued

Cash flow			
Tax	(23 032)	(6 142)	(0.5)
Actual costs		(13 460)	(0.5)
Allowance		36 000	(0.5)
Net cash inflow/(outflow) per year	(23 032)	16 398	
Cash flow per year × 5	(115 159)	81 991	(1)
Repayment of loan		(214 000)	(0.5)
Proceeds on disposal of motor car		20 000	(0.5)
Net cash outflow for five-year period	(115 159)	(112 009)	
Travel allowance gives greater annual cash flow advantage, and is the better option at the end of five years (least net cash outflow).			(0.5)
			(17)

SOLUTION 5.2

PART A - Gordon Zola

1.	Long service award - para 5(2) of the 7th Schedule			
	Lower of cost and market value (trading stock)	6 500		(1)
	less exemption (being the lesser of R5 000 and the aggregate cost to the employer)	(5 000)	1 500	(1)
2.	Right of use of car - para 7 of the 7th Schedule — R180 000 × 3.5% × 6		37 800	(1.5)
	No para 7(7) or para 7(8) adjustments, as Gordon did not keep a logbook.			
	Acquisition of car - para 5 of the 7th Schedule Market value		100 000	(1)
	Note 1: From 1 March 2015, the determined value is equivalent to the retail market value on the date the employer obtained the vehicle, excluding finance charges - para 7(1)(a) of the 7th Schedule. Except in the case of motor vehicle dealers, manufacturers and rental companies, the retail market value includes VAT (as per Regulation 362 definition).			
3.	Holiday house - para 9(4) of the 7th Schedule			
	R500 × 14 days	7 000		(0.5)
	less paid 75 × 14 days	(1 050)	5 950	(0.5)
4.	s8C applies when Gordon disposes of the options (acquires the shares). No further s8C effects after Gordon acquires the shares.			
	Note 2: Since the options are restricted equity instruments, they are deemed to vest on disposal, which is also the date on which all restrictions are lifted - s8C(3)(b)(i)). The amount to be included is R12 − R6 = R6 per option less *R1 paid = R5 × 1000.*		5 000	(2)
5.	Reimbursive allowance is not taxable - s8(1)(*a*)(ii)		0	(0.5)

SOLUTION 5.2 continued

6.	Cash salary - gross income, para (*c*)		100 000	(0.5)
	Employer's provident fund contributions	R100 000 × 8%	8 000	(0.5)
	Note 3: From 1 March 2016 (and thus included for the purposes of this solution), contributions by an employer to any retirement fund constitute a fringe benefit - para 2(l) and para 12D of the 7th Schedule.			
	Taxable income subtotal		258 250	
	less Retirement fund contributions - s11(*k*): Gordon's own provident fund contribution R8 000 + Employer's contribution R8 000 (note 4) = R16 000, limited to *lesser* of:			(1)
	*R350 000, or			(0.5)
	*27.5% of the higher of the remuneration (R250 690 note 5) or taxable income (R258 250), thus R258 250 × 27.5% = R71 019.			(0.5)
	The full contribution is therefore allowed as a deduction.		(16 000)	(0.5)
	Note 4: From 1 March 2016 the employer's contributions to the provident fund - to the extent they were included in the employee's gross income as a fringe benefit - are deemed to be made by the employee - proviso (iii) to s11(k).			
	Note 5: Remuneration calculation - definition of 'remuneration' in 4th Schedule			
	Fringe benefit: long-service award - para (*b*) of 'remuneration'	1 500		(0.5)
	Fringe benefit: company car - para (*c*B) of 'remuneration'. 80% of the cash equivalent is included, thus R37 800 × 80%. *Note: As there is no logbook, the lower inclusion rate of 20% is not applicable.*	30 240		(1)
	Fringe benefit: acquisition of car - para (*b*) of 'remuneration'	100 000		(0.5)
	Fringe benefit: holiday house - para (*b*) of 'remuneration'	5 950		(0.5)
	Gain from s8C equity instruments vesting - para (*e*) of 'remuneration'	5 000		(0.5)
	Reimbursive allowance - exclusion par (vi) of 'remuneration'	0		(0.5)
	Salary - para (*a*) of 'remuneration'	100 000		(0.5)
	Fringe benefit: provident fund contributions - para (*b*) of 'remuneration'	8 000		(0.5)
	Total remuneration	250 690		
	Taxable income		242 250	

PART B - VAT effects - Company

1.	VAT output - s10(13)	R1 500 × $^{14}/_{114}$	184	(1)
	VAT input - s17 (when acquired by company)	R6 500 × 14%	(910)	(1)
2.	VAT output - s10(13)	R180 000 × $^{100}/_{114}$ × 0.3% × $^{14}/_{114}$ × 6	349	(3)
	VAT input on maintenance costs - s17	R2 100 × $^{14}/_{114}$ × 6	(1 547)	(1)
3.	No VAT effects	Exempt supply - s12	0	(0.5)
4.	No VAT effects	Not a fringe benefit, thus no deemed supply - s18(3)	0	(0.5)

SOLUTION 5.2 continued

5.	No VAT effects	Not a fringe benefit, thus no deemed supply - s18(3)	0	(0.5)
6.	No VAT effects	Salary: not a supply - s18	0	(0.5)
		Provident fund contribution: exempt supply - s12. A superannuation scheme is a financial service - s2(1)(*j*).	0	

PART C - Income tax effects - Mntala

1.	s22(8) recoupment of trading stock		10 000	(1)
	s22(8) proviso - deemed s11(*a*) expenditure of recoupment		(10 000)	(0.5)
	s11(*a*) cost of stock/opening stock		(6 500)	(0.5)
2.	s11(*e*) on motor car	R180 000 (input denied) × 20% × $^{6}/_{12}$	(18 000)	(1)
	s11(*d*) maintenance costs	R2 100 × $^{100}/_{114}$ × 6	(11 053)	(1)
3.	s11(*a*) - maintenance and electricity	R2 200 × $^{14}/_{30}$	(1 027)	(1)
	Rental: gross income, general definition	R75 × 14	1 050	(0.5)
4.	No deduction as no cost incurred by company (CSARS v Labat Africa)		0	(0.5)
5.	s11(*a*) reimbursive allowance	R500 × 12	(6 000)	(1)
6.	s11(*a*) salary		(100 000)	(0.5)
	s11(*l*) employer contributions to provident fund	R100 000 × 8%	(8 000)	(1)
	s11(*a*) VAT output on fringe benefits	R184 + R349	(533)	(0.5)
				(33)

SOLUTION 5.3

Note: All paragraph references are to those of the 7th Schedule.

Henry Rackman

(a)	Cash salary - gross income, para (*c*)	(R45 000 + R124 + R910)/0.92 × 12	600 443	(2)
	Fringe benefit: medical aid - para 12	R2 090 × 12	25 080	(1)
	Employer's pension fund contributions	R600 443 × 10%	60 044	
	Note 1: From 1 March 2016, contributions by an employer to any retirement fund constitute a fringe benefit - para 2(l) and para 12D of the 7th Schedule.			
	Fringe benefit: company car - para 7	R342 000 × 3.5% × 12	143 640	(2)

SOLUTION 5.3 continued

Note 2: As Henry did not maintain a logbook, he is not entitled to the para 7(7) reduction. He is also not entitled to the para 7(8) reduction, as he did not bear any of the vehicle-related costs. Note that the employer leases the car in terms of a finance lease, so the 'operating lease' provisions of para 7(4)(a)(ii) are not applicable.

Note 3: The determined value is equivalent to the retail market value on the date the employer obtained the vehicle, excluding finance charges - para 7(1)(a) of the 7th Schedule. Except in the case of motor vehicle dealers, manufacturers and rental companies, the retail market value includes VAT (as per Regulation 362 definition).

Fringe benefit: Accommodation - para 9

Note 4: As the employer does not own the accommodation, the fringe benefit is the lower of the formula and the cost borne by the employer - para 9(3C) of the 7th Schedule.

Formula					
(A-B) × $^{C}/_{100}$ × $^{D}/_{12}$			109 227		(2)
Remuneration factor (A) = R681 819		681 819			
Employee does not control the company, thus B		75 000			
C		18%			
D		12			
Cost					
Rent	R25 000 × 12		300 000		(1)
The lesser of:				109 227	(0.5)
Fringe benefit: health club fees - para 13	R1 000 × 12			12 000	(0.5)
South African dividends			50 000		(0.5)
less dividend exemption - s10(1)(*k*)(i)			(50 000)	0	(1)
Emerald dividend ($^{57\,000}/_{0.95}$)			60 000		(1)
less s10B(3) exemption	R60 000 × $^{26}/_{41}$		(38 049)	21 951	(1)
Entertainment allowance	R5 000 × 12			60 000	(0.5)
Entertainment expense - s11(*a*) read with s23(*m*)				0	(0.5)
As Henry only earns a fixed salary, the restrictions of s23(*m*) are applicable.					
Taxable income subtotal				1 032 386	
less retirement fund contributions - s11(*k*): Henry's own pension fund contribution R48 035 (R600 443 × 8%) + Employer's contribution R60 044 (note 5) = R108 079, limited to *lesser* of:					(1)
*R350 000, or					(0.5)
*27.5% of the higher of the remuneration (R981 950 note 6) or taxable income (R1 032 386), thus R1 032 386 × 27.5% = R283 906.					(0.5)
The full contribution is therefore allowed as a deduction.				(108 079)	(0.5)

QUESTION 5.3 continued

Note 5: From 1 March 2016 the employer's contributions to the pension fund - to the extent they were included in the employee's gross income as a fringe benefit - are deemed to be made by the employee - proviso (iii) to s11(k).

Note 6: Remuneration calculation - definition of 'remuneration' in 4th Schedule

Salary - para (*a*) of 'remuneration'	600 443		(0.5)
Fringe benefit: medical aid contributions - para (*b*) of 'remuneration'	25 080		(0.5)
Fringe benefit: pension fund contributions - para (*b*) of 'remuneration'	60 044		(0.5)
Fringe benefit: company car - para (*c*B) of 'remuneration'. 80% of the cash equivalent is included, thus R143 640 × 80%. *Note: as there is no logbook, the lower inclusion rate of 20% is not applicable.*	114 912		(1)
Fringe benefit: accommodation - para (*b*) of 'remuneration'	109 227		(0.5)
Fringe benefit: health club fees - para (*b*) of 'remuneration'	12 000		(0.5)
An entertainment allowance is fully included - para (*b*A) of 'remuneration'	60 000		(0.5)
Total remuneration	981 707		
TAXABLE INCOME		924 307	

Normal tax per individual's tax table (R924 307 − R701 300) × 41% + R206 964			298 397	(1)
less primary rebate - s6			(13 500)	(0.5)
less medical scheme fees tax credit - s6A	(R572 + R192) × 12		(9 168)	(0.5)
less additional medical expenses tax credit - s6B	*See Note below*		0	
			275 729	
less s6*quat* rebate				
Irish tax	R60 000 × 5%	3 000	(3 000)	(0.5)
Limited to SA tax - the limit does not apply	(R21 951/R924 307 × R298 397)	7 087		(1)
Normal tax liability			272 729	

Note: As Henry is younger than 65 and there is no 'disability', the s6B(3)(c) additional medical expenses tax applies.

S6B credit = 25% × [Step 1 + Step 2 − Step 3]

Step 1: Excess medical scheme fees			
Henry's contributions	R1 000 × 12	12 000	(0.5)
Employer's contributions - s6B(4)(*b*)		25 080	(0.5)
Reduced by 4 times the s6A medical tax credit	4 × R9 168	(36 672)	(1)
Step 1 'Excess contributions'		408	

SOLUTION 5.3 continued

	Step 2: Other qualifying medical expenses		0		(0.5)
	Step 3: Taxable income × 7.5%	R924 307 × 7.5%	69 323		(1)
	s6B credit = 25% × [R408 + R0 − R69 323]	(Limit to Rnil)	0		(0.5)
(b)	*Note: All section references are to the VAT Act.*		**Inputs**	**Outputs**	
	Car	Input denied - s17(2)(*c*)	0		(0.5)
	Insurance - s17	R10 260 × $^{14}/_{114}$	1 260		(1)
	Maintenance - s17	R6 270 × $^{14}/_{114}$	770		(1)
	Licence	Provincial govt not an enterprise	0		(0.5)
	Rent - residential accommodation	Exempt supply - s12	0		(0.5)
	Health club	Input denied - s17(2)(*b*)	0		(0.5)
	Use of car fringe benefit	R300 000 × 0.3% × $^{14}/_{114}$ × 10		1 105	(2)
	Health club fringe benefit	No input (denied), thus no output		0	(0.5)
	Accommodation fringe benefit	No input (exempt), thus no output		0	(0.5)
	Medical aid fringe benefit	Exempt supply - s12		0	(0.5)
	Pension fund fringe benefit	Exempt supply - s12		0	(0.5)
	Salary	Not a supply - s18		0	(0.5)
	Entertainment allowance	Not a fringe benefit, thus no deemed supply - s18(3)		0	(0.5)
(c)	December year-end (period March to December 2016)				
	Cash salary - s11(*a*)	R600 443 × $^{10}/_{12}$		500 370	(1)
	Pension fund - s11(*l*)	10% × R 500 370		50 037	(1)
	Medical aid fund - s11(*a*)	R2 090 × 10		20 900	(1)
	Car rental - s11(*a*)	R7 600 × 10		76 000	(1)
	Fuel - s11(*a*)			14 000	(0.5)
	Insurance - s11(*a*)	10 260 × $^{100}/_{114}$		9 000	(0.5)
	Licence - s11(*a*)			1 000	(0.5)
	Maintenance - s11(*a*)	R6 270 × $^{100}/_{114}$		5 500	(1)
	Accommodation - s11(*a*)	R25 000 × 10		250 000	(0.5)
	Entertainment allowance s11(a)			60 000	(0.5)
	Health club fees - s11(*a*)	R1 000 × 12		12 000	(0.5)
	VAT on fringe benefit - s11(*a*)	Refer solution part (b)		1 105	(0.5)
	Reduce taxable income by			999 912	
					(45)

SOLUTION 5.4

Note: All paragraph references are to those of the 7th Schedule.

1. **Chantyl van der Haas**

Salary - gross income, para (*c*)	R20 000 × 10		200 000	(1)
Payment of an insurance policy - para 2(*k*) & 12C	R1 252 × 10		12 520	(1)

Note 1: This policy is commonly referred to as a 'key-man' policy, the proceeds of which may be either for the benefit of the employer (for the purpose of covering costs associated with the employee's retirement, such as the repurchase of shares) or the employee (as part of their employment package). In this instance, it is for the benefit of the employee. Accordingly, the contributions paid by the employer constitute a fringe benefit.

Proceeds from insurance policy - gross income, para (*d*)(ii)			100 000	(1)
Exemption - s10(1)(*gG*)(ii)	GI para (d) amount, as premiums included as fringe benefit		(100 000)	(1)
Long service award - para 5(2)	6 500 × $^{100}/_{114}$	5 702		(1)
less exemption	Lesser of R5 000 or aggregate cost	(5 000)	702	(1)
Company contribution to provident fund	R200 000 × 8%		16 000	(1)

Note 2: From 1 March 2016, contributions by an employer to any retirement fund constitute a fringe benefit - para 2(l) and para 12D of the 7th Schedule.

Company car - para 7		190 000		(0.5)
less 15% (completed 12 months before use)	Para 7(1), proviso (*a*)	(28 500)		(1)
	Determined value	161 500		
Fringe benefit	R161 500 × 3.5% × 10		56 525	(1)

No para 7(7) or para 7(8) adjustments, as Chantyl did not keep a logbook.

Note 3: The determined value is equivalent to the retail market value on the date the employer obtained the vehicle, excluding finance charges - para 7(1)(a) of the 7th Schedule. Except in the case of motor vehicle dealers, manufacturers and rental companies, the retail market value includes VAT (as per Regulation 362 definition).

Painting from staff	Not a fringe benefit from employer		0	(0.5)
Low-interest loan - para 11	200 000 × (8% – 3%) × $^{306}/_{365}$		8 384	(2)
Cell phone - para 6(4)(*bA*)			0	(0.5)
Dividends received - gross income, general definition		124 000		(0.5)
less dividend exemption - s10(1)(*k*)		(124 000)	0	(0.5)
Interest received - gross income, general definition	R32 000 + R4 192	36 192		(1)
less interest exemption - s10(1)(*i*)	Below 65	(23 800)	12 392	(1)

QUESTION 5.4 continued

Entertainment allowance			4 000	(0.5)
Entertainment expense - s11(*a*) read with s23(*m*)			0	(0.5)
As Chantyl only earns a fixed salary, the restrictions of s23(*m*) are applicable.				
Income			310 522	
less interest included as a fringe benefit in respect of the low-interest loan, to the extent it was invested to produce taxable income - para 11(5) & s11(a)	R8 384 × $^{R50\ 000}/_{R200\ 000}$ or R50 000 × 5% × $^{306}/_{365}$	(2 096)		(1)
less interest actually paid - s11(*a*)	50 000 × 3% × $^{306}/_{365}$	(1 258)		(1.5)
Total interest expense			(3 353)	

Note 4: The fringe benefit resulting from the low-interest loan is treated as deemed expenditure in terms of para 11(5) of the 7th Schedule, since it is used to earn income, in this case interest income.

Although earning interest is not a trade, this deduction is allowed in terms of Practice Note 31. However, the deductible portion is limited to the amount of income generated by the loan. The taxpayer is entitled to apply the exemption to whichever portion of interest he/she chooses. If used against the other interest income of R32 000 it is sufficient to utilise the full exemption of R23 800, and none of the interest earned from the reinvestment of the low-interest loan is exempt. The interest income of R4 192 is therefore greater than the combined interest expense of R3 353 and no limit in terms of Practice Note 31 is necessary.

Taxable income subtotal	307 169	
less retirement fund contributions - s11(*k*): Chantyl's retirement fund contributions = R34 500 (note 4) limited to *lesser* of:		(0.5)
*R350 000, or		(0.5)
*27.5% of the higher of the remuneration (R274 305 note 5) or taxable income (R305 685), thus R305 685 × 27.5% = R84 063		(0.5)
The full contribution is therefore allowed as a deduction.	(34 500)	(0.5)

Note 4: Retirement fund contributions

Chantyl's own provident fund contributions	R200 000 × 7.5%	15 000	(0.5)
Employer's provident fund contributions	R200 000 × 8%	16 000	(0.5)
Chantyl's RAF contributions		3 500	(0.5)
		34 500	

Note 5: Remuneration calculation - definition of 'remuneration' in 4th Schedule

Salary - para (*a*) of 'remuneration'	200 000	(0.5)
Fringe benefit: long-service award - para (*b*) of 'remuneration'	702	(0.5)
Fringe benefit: provident fund contributions - para (*b*) of 'remuneration'	16 000	(0.5)
Fringe benefit: company car - para (*c*B) of 'remuneration'. 80% of the cash equivalent is included, thus R56 525 × 80%. *Note: As there is no logbook, the lower inclusion rate of 20% is not applicable.*	45 220	(1)

QUESTION 5.4 continued

Painting from staff - not an amount from the employer		0		(0.5)
Fringe benefit: low-interest loan - para (*b*) of 'remuneration'		8 384		(0.5)
Fringe benefit: cellphone - para (*b*) of 'remuneration'		0		(0.5)
An entertainment allowance is fully included - para (*b*A) of 'remuneration'		4 000		(0.5)
Total remuneration		274 305		
Taxable income before retirement benefit lump sum			272 669	
Lump sum from provident fund		750 000		(0.5)
less para 5 of the 2nd Schedule				
Contributions not previously qualifying for deduction	Current year's contributions are deductible under s11(*k*).	(185 000)	565 000	(1.5)
It is submitted that contributions not deducted up until the end of the prior year would be applied first against any lump sum received in the current year, before being considered for deduction in terms of s11(k) in the current year.				
TAXABLE INCOME			**837 669**	

Note: As Chantyl is younger than 65 and there is no 'disability', the s6B(3)(c) additional medical expenses tax credit applies. However, only the taxable income was asked, so there is no need to calculate the rebate.

2. **Tax implications for Touch Limited for the year of assessment ended 28 February 2017**

Income tax

Salary - s11(*a*)		(200 000)	(0.5)
Payment on insurance policy - s11(*w*)	R1 252 × 10	(12 520)	(1)
Policy relates to the death of the employee and the amount of expenditure incurred in respect of premiums is a taxable fringe benefit for the employee in terms of para 2(*k*).			
Gold watch award - s11(*a*)	6 500 × $^{100}/_{114}$	(5 702)	(1)
Contributions to provident fund - s11(*l*)	200 000 × 8%	(16 000)	(1)
Wear & tear BMW - s11(*e*)	190 000 × 20%	(38 000)	(0.5)
Interest received - gross income, general definition	200 000 × 3% × $^{306}/_{365}$	5 030	(1)
Entertainment allowance - s11(*a*)		(4 000)	(0.5)
Maintenance - s11(*a*)	8 011 × $^{100}/_{114}$	(7 027)	(1)
Fuel - s11(*a*)		(10 200)	(0.5)
Cell phone expense - s11(*a*)		(4 500)	(0.5)
VAT outputs on fringe benefits - s11(*a*)	Deductible, as not recoverable from the employee		
Use of car	141 667 × 0.3% × $^{14}/_{114}$ × 10	(522)	(2)
Gold watch	702 × $^{14}/_{114}$	(86)	(0.5)

QUESTION 5.4 continued

VAT (all section references are to the VAT Act)

VAT inputs			
Motor car	Input denied - s17(2)(*c*)	0	(0.5)
Cell phone - s17	4 500 × 14%	630	(0.5)
Gold watch - s17	6 500 × $^{14}/_{114}$	798	(0.5)
Maintenance - s17	8 011 × $^{14}/_{114}$	984	(0.5)
Fuel	Zero rated - s11(1)(*h*)	0	(0.5)
VAT outputs on fringe benefits as above	R522 + R86	608	(0.5)
			(42)

SOLUTION 5.7

Winston Wilson

Since the shares are 'restricted equity instruments' the options are also restricted equity instruments - s8C(7). (1)

s8C effectively ignores the underlying options as they are exercised for restricted equity instruments or disposed of to a connected person - s8C(3). (1)

Note: It is not necessary to address the tax consequences before the vesting date of 1 January 2017, as any gains or losses are exempt in terms of s10(1)(nD).

s8C is calculated in respect of the shares when they are deemed to vest, i.e. January 2017.

On vesting, Winston has a s8C loss of R20 − R30 = R10 per share × 20 000 shares = (200 000) (2)

Winston's father's loss is deemed to be Winston's (s8C(5)) and is calculated as:

R20 − R30 = R10 × 20 000 shares = (200 000) (1)

The interest-free loan results in a fringe benefit for Winston - para 11 of the 7th Schedule. This fringe benefit will be included in Winston's taxable income as it was obtained as a result of services rendered by him - para 16 of the 7th Schedule. (1)

Fringe benefit 40 000 options × R30 per share × 10% × $^{215}/_{365}$ 70 685 (2)

Although the fringe benefit inclusion is then considered interest incurred by the taxpayer (para 11(5)), no deduction is permissible as it would not meet the requirements of s11(*a*), since it was not incurred to earn taxable income.

CGT (all paragraph references are to the 8th Schedule)

Shares sold by Winston

Proceeds - para 35	20 000 shares × R16.50	330 000		(1)
Base cost - para 20(1)(*h*)	20 000 shares × R20	(400 000)		(1)
Capital loss			(70 000)	

SOLUTION 5.7 continued

Shares sold by Winston's father: (taxed in his own hands)

Proceeds - para 35	20 000 shares × R16.50	330 000		(1)
Base cost - para 20(1)(*h*)	20 000 shares × R20	(400 000)		(1)
Capital loss			(70 000)	

Donations tax - s58(2)

Market value of option on 1 January 2017 (as donation only deemed to take place when restricted equity instrument vests). (1)

R20 − R30 = creates a negative position. No donation takes place. (1)

Summary of income tax consequences

Winston

Shares sold by Winston - s8C(2)	(200 000)	
Shares sold by Winston's father - s8C(5)	(200 000)	
Fringe benefit from loan	70 685	
Capital loss R70 000 *less* annual exclusion R40 000 = R30 000 carried forward to 2018	0	(0.5)

Winston's father

Capital loss of R70 000 *less* annual exclusion R40 000 = R30 000 carried forward to 2018	0	(0.5)
		(15)

CHAPTER 6: EMPLOYEES TAX AND PROVISIONAL TAX

Index to sections

Question	Sections	Grade	
Question 6.1	Fourth Schedule para 19, 21, tax credits	**	S
Question 6.2	GI, Second Schedule, Fourth Schedule para 19, 20, 21, Eighth Schedule	***	S
Question 6.3	GI, s6A, s8(1), s10(1)(i), s10(1)(k), s10B, s11(a), s11(k), s11(n), Fourth Schedule (employees' tax and provisional tax), Seventh Schedule	*	
Question 6.4	GI, s8(1), s10(1)(i), s11(a), s23(k), s23(m), Fourth Schedule (employees' tax and provisional tax), Seventh Schedule	***	S
Question 6.5	GI, s10(1)(i), s11n, s23(m), Fourth Schedule, Seventh Schedule	***	S
Question 6.6	GI, s11(k), s23(m), Fourth Schedule	*	
Question 6.7	GI, s6, s6A, s6B, s8(1), s10A, s11(a), s11(k), s11(nB), s18A, s23, Fourth Schedule, Seventh Schedule	***	
Question 6.8	GI, s6, s6A, s6B, s8(1), s10(1)(i), s11(a), s11(d), s11(e), s11(i), s11(k), s18A, s23, Fourth Schedule, Seventh Schedule	***	

QUESTION 6.1 (Solution at end of chapter) (14 Marks)

Billy Bob, aged 45, has been employed for a number of years at a travel agent promoting undeveloped areas of the globe. He receives a monthly salary of R10 000. Billy Bob is on a comprehensive scheme at the company's medical aid as he regularly finds himself in hospital due to his clumsy antics. The company pays the full amount of the medical aid, being R1 230 per month. The company deducts 25% of Billy Bob's salary as employees' tax. Back in April 2013, Billy Bob started selling deep-fried chicken necks during his spare time. He did not form a registered company, but traded under the name 'Red's chicken necks'. His profit from the sale of chicken necks for the 2017 tax year was R6 550 per month.

His cousin told him that he may estimate his earnings for the purposes of his provisional tax returns. He estimates that his earnings for the year will be R180 000.

Billy Bob recently met you when you placed an order for his delicious chicken necks. You got chatting and he was fascinated that you were studying tax. In a subsequent letter to you, Billy Bob admitted that he submitted his 2014 tax return on 1 May 2016 and only submitted the 2015 tax return on 31 October 2016. He was assessed for his 2014 tax year and received a letter verifying this on 22 June 2016. The assessed tax for 2014 was R200 000. The 2015 tax year was assessed on 24 December 2016 and was for R190 000.

YOU ARE REQUIRED TO: Answer Bob's questions below:

1. Who has to register for provisional tax and when?
2. As an individual, when would one's first provisional tax return be due?
3. What would Billy's first provisional tax payment be for the 2017 tax year if based on the basic amount and **not** on an estimate?
4. What would Billy's second provisional tax payment be, based on his estimate (excluding any penalties that may be levied by SARS)?

QUESTION 6.2 (Solution at end of chapter) (25 Marks)

John Jones (known to his friends as JJ) is a provisional taxpayer. During the 2017 year of assessment, the following took place:

In August, JJ had submitted his return timeously and had based his payment on his 2014 assessment (which was the most recent he had). The taxable income reflected on that assessment amounted to R240 000.

Two weeks before the end of February, JJ submitted his second provisional payment. He had received his 2015 assessment by 28 December 2016, which reflected taxable income as R300 000. However, JJ decided to make an estimate as he was expecting the downward trend of his earnings to continue as a result of failing farming operations. He made his second payment based on an estimate of taxable income, in which he had included an estimated taxable capital gain of R100 000 on the planned sale of his farm. His total estimate was R150 000.

After submitting his assessment, he concluded a more lucrative sale of the farm than he had anticipated. He sold the farm on 26 February 2017 for R7 million. The base cost of the farm has been determined as R5.5 million. The farm was not his primary residence. He had no other capital gains effects for the year and has no assessed capital loss balance from the previous year.

Part of the farm's failure was as a result of JJ's poor health. He incurred medical costs of R60 000 in this regard during the months of September 2016 to January 2017. JJ does not belong to a medical aid.

JJ received a lump sum from a retirement annuity fund of R555 000 on 24 February 2017 (no contributions had been disallowed). This was the first time he had received such a lump sum. The tax directive correctly calculated the tax on the lump sum to be an amount of R9 900.

His other taxable income (i.e. excluding the lump sum and the sale of the farm) amounted to R50 000 before taking the above information into account. JJ is 64 years of age.

YOU ARE REQUIRED TO:

1. Calculate the first provisional tax payment, giving reasons for your selection of basic amount (where applicable). (5 Marks)
2. Calculate the second provisional tax payment, giving reasons for your selection of basic amount (where applicable). (4 Marks)
3. Calculate the total tax (including penalties) JJ should pay on 30 September 2017 to avoid interest penalties. (16 Marks)

Ignore VAT.

QUESTION 6.3 (32 Marks)

Thomas Gobbler, age 63, worked as a manager at the local entertainment centre – Wizards. He received a total salary for the 2017 tax year of R158 000. Wizards had instituted a bonus scheme that paid large annual bonuses to certain employees. Under this bonus scheme, Thomas received R75 000 as a bonus in the year.

Thomas retired on 31 December 2016.

Thomas contributed 4% of his salary to the company pension fund.

In addition to the salary and bonus, Thomas received a travel allowance of R2 300 per month. He used his own car for business purposes. He owned a BMW 533i that cost R301 000 (including VAT). He did not keep a logbook and was responsible for paying his own fuel and maintenance on the vehicle. His total mileage for the year was 46 000 km.

Thomas also worked part-time as a clown at parties on the weekends. He ran this little business on his own and thought himself particularly talented with respect to acting as a clown. He earned R36 000 and incurred costs of R5 000 for balloons, party tricks and maintenance of his clown suit.

In addition to the above, Wizards paid R4 300 per month to Thomas' medical aid. Thomas had two dependants on his medical aid. After retiring, Thomas took over the contributions to the medical scheme.

Thomas also had a number of investments. From foreign investments he received R40 000 in foreign dividends and R20 000 in foreign interest. He also received local interest from his call account amounting to R51 500. The foreign dividends received by Thomas are not exempt under s10B(2).

Thomas contributed R1 200 per month to a retirement annuity fund (RAF). Wizards did not account for the RAF deduction when calculating employees' tax. He contributed to the RAF for the full year.

Thomas has received his 2016 tax assessment on 29 December 2016. The assessed amount represented R350 000 taxable income. Thomas wanted to pay as little provisional tax as possible. Thomas had paid provisional tax of R100 for the first provisional tax payment.

Ignore VAT unless specified.

YOU ARE REQUIRED TO:

1. Calculate Thomas' taxable income for the year ended 28 February 2017. (11 Marks)
2. Calculate the employees' tax that Wizard will have to withhold. (10 Marks)
3. Calculate the minimum amount that Thomas would have had to pay in respect of his second provisional tax payment due 28 February 2017 in order to avoid an underestimate penalty. (10 Marks)
4. What would the penalty be if Thomas only made payment of the second provisional tax in March 2017 (based on your amount determined in (3))? (1 Mark)

QUESTION 6.4 (Solution at end of chapter) (19 Marks)

Ms Jane Dube, aged 50, is employed by Tradewinds (Pty) Ltd, a South African company that carries on business in Johannesburg.

The following information relates to Jane's tax affairs for the year of assessment ended 28 February 2017.

1. **Employment**
   In terms of her employment contract Jane receives the following remuneration.
   – Cash salary (monthly) R20 000
   – Use of a company car
     The car cost the company R180 000 (excluding VAT). Jane has unrestricted use of the car. Tradewinds pays for all fuel and maintenance for the car, which does not have a maintenance plan. Jane has not kept any records of kilometres travelled.

– Use of residential accommodation. Jane lives in a flat which Tradewinds owns.
  In 2008 Tradewinds had bought a block of flats near its place of business with the view to offering employees residential accommodation as part of their remuneration package. It is both customary and necessary to provide such accommodation. The costs borne by Tradewinds in respect of Jane's flat are:

Portion of bond interest	R20 000
Rates	R1 000
Insurance	R500
Electricity and water	R12 000

  The flat is supplied to Jane unfurnished. Jane's remuneration proxy is R216 000. Jane has no interest in Tradewinds.

2. **Other income**
   Jane's only other income for the 2017 tax year is interest from a South African bank of R90 820. Jane does not belong to a medical aid and incurred no medical expenditure during the year of assessment.

3. **Provisional tax**
   In December 2015 Jane received her 2015 assessment, which reflected a taxable income of R350 000. Her 2016 assessment, which is dated October 2016, reflects a taxable income of R400 000.

YOU ARE REQUIRED TO:

1. Calculate the employees' tax that must be withheld from the monthly remuneration Jane Dube receives from Tradewinds (Pty) Ltd. (7 Marks)
2. Assuming that Jane used the basic amount in calculating her 2017 first provisional payment and estimated her taxable income as R380 000 for her second provisional payment, calculate the third 2017 (top-up) payment, which she must make if she wishes to avoid the imposition of penalties and interest, and state the date by which the third payment is to be made. (12 Marks)

QUESTION 6.5 (Solution at end of chapter) (61 Marks)

You are a tax practitioner and have recently gained a new client, Mrs Missy Maude, a South African resident who is 66 years old. Missy was employed full-time by 'Interiors (Pty) Ltd' (Interiors) until her retirement on 29 February 2016. On retirement from Interiors, Missy received a retirement fund lump sum from the company's pension fund of R500 000, which was correctly included in her taxable income for 2016.

Between 1 March 2016 and 28 February 2017 Missy was re-employed by Interiors on a part-time basis. During the 2017 year of assessment she also worked as an interior design consultant in a private capacity.

Interiors paid Missy a gross monthly salary of R25 000. Throughout the 2017 year of assessment the company granted her the use of a motor car. The motor car had previously been used by the marketing manager since acquisition until 29 February 2016. The motor car had cost R200 000 (including VAT) when purchased on 30 April 2014, which was equivalent to the retail market value on that date. The retail market value on 1 March 2016 was R180 000. Missy was responsible for all fuel costs and throughout the year the car was subject to a comprehensive maintenance contract that excluded only tyres and top-up oil. With the consent of Interiors, she uses the car for purposes of her private consulting business as well.

Missy maintained a detailed logbook. She travelled a total of 25 000 kilometres in the car between 1 March 2016 and 28 February 2017. Of this, 20 500 kilometres related to the business of Interiors. Interiors was satisfied that this distance was correct and in line with what they had anticipated at the beginning of the year of assessment.

Missy belongs to the Sigma Retirement Annuity Fund. During the 2017 year of assessment her contributions were R3 500 a month. Interiors paid these contributions on her behalf over and above her cash salary. Her medical aid contributions throughout the year were R3 000 per month. The company paid the contributions to the medical aid scheme, being 50% (R1 500) as a company contribution and 50% (R1 500) as a deduction from Missy's cash salary. Missy's husband, Joe, her only dependant on the scheme, had an operation on 30 June 2016. R20 000 was paid by Missy and was not recovered from the scheme. Missy provided proof of this payment to Interiors and the company take into account any optional items when calculating employees' tax for Missy.

In addition to her remuneration from Interiors, Missy had the following receipts or accruals during the 2017 year of assessment:

- A monthly pension of R9 597, after employees' tax of R403 a month
- Local interest of R60 000
- Foreign interest of R15 700
- Consulting income of R150 000. No employees' tax was withheld from this income.

Foreign interest was earned evenly throughout the year. Missy will qualify for a section 6*quat* rebate of R1 200 against normal tax in respect of foreign taxes on this interest. This rebate is applied on the same basis as the primary and secondary rebates in section 6 of the Income Tax Act.

Expenditure in respect of the consulting income comprised home office expenses of R500 a month for an appropriate portion of bond interest, rates and cleaning; and legal expenses of R10 000. The home office is specifically equipped for her trade as a consultant and used exclusively for that purpose. The legal expenses relate to action taken against a client who refuses to pay her on the basis of a dispute regarding the amount she charged. Missy's financial statements show an allowance for doubtful debts of R20 000. This is the first time that Missy has provided for doubtful debts in her tax return.

Missy had taxable capital gains of R12 000 and R16 000 during the 2014 and 2015 years of assessment respectively, but had no capital gains or losses in the 2016 or 2017 years of assessment.

Previous income tax assessments for Missy are as follows:

Year of assessment	Taxable income	Issue date of assessment
2013	R290 000	28 October 2014
2014	R310 000	24 January 2015
2015	R350 000	16 September 2016
2016	R960 000	15 December 2016

Missy is a provisional taxpayer.

YOU ARE REQUIRED TO:

1. Calculate Missy Maude's taxable income for the year of assessment ended 28 February 2017. (17 Marks)
2. Calculate the employees' tax that Interiors was obliged to withhold from Missy's remuneration for the year of assessment ended 28 February 2017. (14Marks)

3. Calculate Missy's compulsory and voluntary provisional tax payments in respect of the year of assessment ended 28 February 2017 on the basis that she wants to pay the minimum amounts required in terms of the Fourth Schedule and does not want to incur any penalties, additional tax or interest. Indicate clearly the dates by which the provisional tax must be paid and the returns submitted. (30 Marks)

All workings should be shown and reasons should be supplied for the treatment of the information provided.

QUESTION 6.6 **(26 Marks)**

Theresa Strydom, aged 40, received a salary of R9 500 per month for the period from 1 March to 30 June 2016. On 30 June she received a bonus of R5 000. She contributes 7% of her salary to the company pension fund and 10% to a retirement annuity fund.

On 1 July the business was sold to another company and Theresa was employed by the new owners at a salary of R7 000 per month, plus an entertainment allowance of R1 000 per month. She does not have to account for this allowance. The new company had no pension fund, so she increased her retirement annuity contribution to 12.5% of her salary. Both employers agreed to take the RAF contributions into account.

YOU ARE REQUIRED TO:

1. Calculate the employees' tax deductible from Theresa's salary:
   a. for the period ended 30 June 2016
   b. for the period 1 July 2016 to 28 February 2017.
2. Calculate the effect the above calculations have on Theresa's final liability for tax.

QUESTION 6.7 **(46 Marks)**

Miss Adora Belle Holmes is an estate agent employed by Rondebosch Properties (Pty) Ltd since May 2015. She is 38 years old and is divorced with two children, aged eleven and four.

Adora receives a basic salary of R2 000 per month, an entertainment allowance of R1 000 per month, plus 2% commission on every property that she sells. Her total commission received for the 2017 year of assessment came to R603 980.

Because her job requires her to travel extensively, since she takes prospective customers from one property to the next, Adora also receives a travel allowance of R8 000 per month.

In addition to the above, Rondebosch Properties allows its employees to borrow money from the company so that they can buy a motor car that will portray the correct image of the company to their clients. When she joined the company Adora borrowed R258 000 to purchase a Volvo S40. Rondebosch Properties charges Adora interest of 2.5% *per annum* on the loan. Adora is required to pay the interest monthly, but is not required to repay any portion of the capital part of the loan until she sells the car.

Adora kept accurate records both of her mileage and her fuel costs. She travelled 33 000 kilometres during the tax year in her Volvo, of which 28 000 was for business. She incurred total petrol costs of R24 500. She did not have any maintenance costs because her car is on a maintenance plan, which formed part of the acquisition price of the car.

Based on her 2016 logbook Adora was able to convince Rondebosch Properties that her business usage for 2017 would exceed 80% of her total mileage.

Rondebosch Properties is based in a small office in the Fountain Centre. Company management are the only employees with permanent offices there. The company's agents can book meeting rooms there if they wish, but are expected to work most of the time either at home or on the road. Adora set up an office in her home, which she equipped with a computer and printer and furniture suitable for meeting the occasional client there. This office uses 10% of the total floor space of her home.

Rondebosch Properties does not have a pension or provident fund. However it does make contributions to the Golden Years retirement annuity fund on behalf of its employees. Since she began working for Rondebosch Properties in May 2015, the company has been contributing R5 000 to the fund monthly on her behalf. When she joined the fund, Adora herself made arrear contributions of R10 000, as she had not previously made any provisions for her retirement. At 1 March 2016, the undeducted portion of this contribution amounted to R8 200.

Rondebosch Properties also does not require its employees to belong to a medical aid fund. Due to previous complications, if employees choose to belong to a medical aid this will not be factored into their employees' tax calculations. Adora makes contributions of R3 000 per month in respect of herself and her two children to the Oxide medical aid fund. The medical aid plan is only a hospital plan and Adora had to pay costs of R8 000 herself in respect of her eldest child's dental braces.

As part of her marketing activities, Adora frequently takes potential customers for lunch while showing properties to them. Adora pays for this from her entertainment allowance. She is not required to account to Rondebosch Properties for the use of her entertainment allowance, nor is she required to refund any unused portion of the allowance. During the 2017 tax year her total expenditure in this regard was R9 000.

Prior to her appointment at Rondebosch Properties, Adora had worked as an estate agent for another company in the Northern suburbs. On her resignation, Adora had accepted a restraint of trade from this company of R20 000, in exchange for which she agreed not to act as an agent in competition with them. There was some dispute as to whether Adora's acceptance of employment with Rondebosch Properties was in contravention of this agreement. In August 2016 it was agreed that Adora would repay half of the amount of the restraint and the matter would not be pursued any further.

Rondebosch Properties encourages all of its employees to contribute to the Rondebosch Improvement District, which is a section 18A charity aimed at addressing social issues in the Rondebosch area. Participating employees make regular contributions to the charity that are withheld from their salaries and this is taken into account for employees' tax purposes. Adora committed to making a R3 000 monthly contribution from March 2016 onwards.

Apart from the items above, Adora's most significant expenses for the year were as follows:

- Interest on home loan R72 000
- Interest on motor car loan R6 450
- Rates R6 000
- Levies R4 500
- Groceries R30 000
- School fees R32 000
- Purchase of annuity (see below) R60 000

Adora invested in a purchased annuity that would pay her R1 250 per month for the next ten years, commencing on 30 September 2016.

Additional information

You may assume that the official rate of interest has remained unchanged at 6% throughout the year of assessment.

YOU ARE REQUIRED TO:

1. Calculate the employees' tax that will be withheld from Adora Belle Holmes's salary for the 2017 year of assessment in total. (15 Marks)

2. Calculate the total tax payable by or refundable to Adora Belle Holmes for the year of assessment ended 28 February 2017. In calculating taxable income, you should begin with the balance of remuneration calculated in (1) above. (31 Marks)

Show all workings. Where you believe that information provided has no effect this should be stated in your solution.

QUESTION 6.8 **(50 Marks)**

George Smiley is a computer programmer. George works for uPhone Ltd, making software applications for mobile phones (apps). With uPhone's consent George also provides consulting services to IT start-up projects in his spare time.

George is an excellent computer programmer, but does not know much about tax. He has asked you to assist him in the preparation of his 2017 tax return and has provided you with the following notes:

My employment package with uPhone entitles me to a basic salary of R20 000 per month. I also receive a travel allowance of R2 000 per month, as well as the following (I am not sure if they have any tax consequences):

- The use of a high-end Nokia cell phone. I looked on the internet and this phone would cost R9 340 if I bought it myself. I need this phone because of my work designing cell phone apps. For my private calls I have a much cheaper phone that I bought for myself for R935.
- For seven days every year I am allowed to stay in a holiday house that uPhone owns. This year I took my holiday in December. I know that uPhone bought this house a few years ago for R1 700 000 and, when it is not being used by employees, the company rents it to other holidaymakers for R950 per day.
- uPhone pays for the software updates for my home computer. I do not use the computer for any uPhone work, but they could licence the software for R35 per month on a business deal, whereas it would have cost me R55 per month. My boss said I did not have to refund uPhone the R420 that they paid for my full year's updates.
- uPhone employees can get preferential rates on home loans from a local bank because uPhone has agreed to settle the debts of any of its employees that default with the bank. I used this opportunity last year to take a R2 500 000 loan to purchase my current house. In terms of the deal, I pay 7% interest per year. I did some research and, if I took the loan on my own, the best rate I could get would be 10%. The SARS website says that the official rate of interest is 8% *per annum*.
- 5% of my basic salary is withheld by uPhone and paid over to the uPhone provident fund on my behalf. uPhone also apparently matches my contribution to the fund each month. uPhone takes all provident fund contributions into account for employees' tax purposes. At the end of February I received a statement from the fund saying that the total amount in my name with the fund is now R95 000.
- uPhone pays monthly medical aid contributions of R2 400 for my wife and me. I pay any costs not covered by the medical aid. Although my wife is disabled (see below) uPhone said that they would not factor this into my employees' tax calculation.
- During the month of December, uPhone paid out bonuses. I received a bonus of R50 000.

During December I was sent to work on a big government project in Pretoria for two weeks (14 days). uPhone booked and paid for my hotel accommodation and gave me R4 200 to cover my meals and incidental costs. I did not keep any records of the actual costs I incurred while I was there.

I drive a Nissan Micra that I bought second-hand for R72 300. I have kept a logbook of my mileage for the year. I am responsible for all costs, but I did not keep any records of the actual costs. My mileage is as follows:

From home to uPhone office and back	8 250 kms
Visiting uPhone clients	9 500 kms
Trip to Durban for family wedding	1 800 kms
Other	850 kms
Total	20 400 kms

Apart from the income above, I earned R37 240 consulting on IT projects in my private capacity. I do all of this work from home over the Internet. I use an iMac computer that I purchased in the last tax year for R23 000. Last year I claimed 33% of the purchase price in my tax return (I checked this on the SARS website and that is the correct rate).

This year I incurred the following expenses in regard to private consulting:

- Broadband internet connection – R199 per month
- New printer – R2 599
- Repairs to fax machine – R235

I use all of the above almost exclusively for consulting.

One of my customers, who has for some time owed me R2 000 for consulting work, was put into liquidation during the year and I received a settlement of R200. I was informed that there is no chance that I will receive anything more, so I have given up on collecting the balance.

In order to have an acceptable quality of life when I retire, I have been contributing to a retirement annuity fund. I have contributed R1 500 per month for the whole year of assessment. uPhone does not take the RAF contributions into account for employees' tax purposes.

I also decided to invest R250 000 that I had inherited, but my friend Bill Haydon suggested that it might be better for tax if I put the investment in my wife's name, which I did. We put the money into those new Post Office bonds and my wife received an IT3(b) statement saying that they earned R17 080 interest by 28 February 2017.

My wife is a dependant on my medical aid. She is a paraplegic and is wheelchair bound. SARS has told me that they consider her disabled. I received a statement from my medical aid fund in February indicating that they had received contributions of R28 800 during the year and that I had medical expenses of R12 300 that the fund did not cover (I had to pay this myself).

That is all my financial information as far as I know. I hope you can help!

The following information may also be relevant in assisting George:

- George is 38 years old. He is a South African tax resident.
- George is married to Anne, who is 32. They are married out of community of property and do not have any children.
- George is not a VAT vendor.
- You have confirmed that all of the information that George has looked up on the SARS website is correct.

YOU ARE REQUIRED TO:

1. Determine the employees' tax that would have been withheld by uPhone Ltd from George Smiley's salary for the month of December 2016. (21 Marks)

2. Calculate George Smiley's final tax liability for the year of assessment ending 28 February 2017. Use the balance of remuneration calculated in (1) above as your starting point. (33 Marks)

Show all workings.

SOLUTION 6.1

Billy Bob

1. Per 4th schedule, para 1 :

(a)	Persons (other than companies) earning income other than remuneration or allowances (per s8(1))	(0.5)
(b)	Companies	(0.5)
(c)	Any person notified by the Commissioner	(0.5)

Except:

Public benefit organisations, recreational clubs and sectional title body corporates; (0.5)

and also except: (per 4th schedule, para 18)

(a)	Owners or charterers of ships or aircraft who are taxed in terms of s33;	(0.5)
(b)	Natural persons under the age of 65 years who do not carry on a business and who either: earn below the tax threshold or whose taxable income from interest, dividends or rental does not exceed R20 000;	(1)
(c)	Natural persons of 65 years or older who do not carry on a business, are not directors of private companies and whose taxable income: does not exceed R120 000 and is not derived otherwise than from remuneration, interest, dividends or rental.	(1)

2. End of August of each year of assessment (0.5)

3. **1st provisional**

Basic - latest assessment/most recent is 2014 (refer para 19) scaled up by 1.24 (see proviso to para 19), being 8% per annum since the last assessment, i.e. 3 years × 8% = 24% (hence the factor of 1.24).	248 000		(1)
Tax on basic	49 440		(0.5)
primary rebate	(13 500)		(0.5)
s6A rebate (assuming no dependants)	(3 432)		(0.5)
s6B rebate (based on taxpayer estimate - as Billy Bob is on a comprehensive medical aid scheme and in the absence of any further information it appears unlikely that he will have sufficient medical expenditure to qualify for an additional rebate)	0		(0.5)
	32 508		
Divide by 2	16 254		(0.5)
Employees tax paid to date (6 × 25% × 10 000)	(15 000)		(1)
	1 254		
1st provisional payment		1 254	

SOLUTION 6.1 continued

4. **2nd provisional**

Estimate used	180 000		(1)
Tax on estimate	32 400		(0.5)
primary rebate	(13 500)		(0.5)
s6A rebate	(3 432)		(0.5)
s6B rebate (based on taxpayer estimate)	0		(0.5)
	15 468		
Employees tax paid to date (12 × 25% × 10 000)	(30 000)		(1)
1st provisional payment	(1 254)		(0.5)
Limited to	nil		
2nd provisional payment		nil	
			(14)

SOLUTION 6.2

John Jones

PARTA - First provisional payment

Taxable income estimate - scaled up by 1.24		297 600	(1)
Being the 2014 assessment (as the basic amount) scaled up by 8% per annum for 3 years (see paragraph 19 with its proviso).			(1)
Tax on estimate		62 536	(1)
less primary rebate		(13 500)	(0.5)
less s6A rebate		0	(0.5)
less s6B rebate		0	(0.5)
Tax due		49 036	
First provisional payment $^{R49\ 036}/_{2}$		24 518	(0.5)
			(5)

PART B - Second provisional payment

Taxable income estimate		150 000	(0.5)
Tax on estimate		27 000	(1)
less primary rebate		(13 500)	(0.5)
less s6A rebate		0	
less s6B rebate			
Qualifying medical expenditure	60 000		(0.5)
Reduced by 0.8% × R150 000	(11 250)		(0.5)
	48 750		
Included at 25%		(12 188)	(0.5)
Tax due		1 313	
less first provisional payment		(24 518)	(0.5)
Second provisional payment		0	
			(4)

SOLUTION 6.2 continued

PART C - Tax liability

Normal tax calculation

Other taxable income		50 000	(0.5)
Add taxable capital gains s26A:			
Proceeds	7 000 000		(0.5)
Base cost	(5 500 000)		(0.5)
Capital gain	1 500 000		
Annual exclusion	(40 000)		(0.5)
Net capital gain	1 460 000		
Include (at 40%)		584 000	(0.5)
Taxable income before retirement lump sum benefit		634 000	
Retirement annuity lump sum	555 000		(0.5)
No applicable para 5 (2nd Schedule) deductions	0	555 000	(0.5)
TAXABLE INCOME		1 189 000	

Lesser of:

Estimate (at least 90% of final taxable income (excluding lump sum) as it is less the R 1 million)

Note that retirement lump sums are not required to be included in the taxpayer's estimate - see proviso to para 19(1)(a).

(R1 189 000 − R555 000) × 90%		570 600	(1)
Basic amount - scaled up by 1.16		348 000	(1)
Being the 2015 assessment (as the basic amount) scaled up by 8% per annum for 2 years (see paragraph 19 with its proviso).			(1)
Tax on basic		78 160	(0.5)
less primary rebate		(13 500)	(0.5)
less s6A rebate		0	
less s6B rebate			
Qualifying medical expenditure	60 000		(0.5)
Reduced by 0.8% × R348 000	(26 100)		(0.5)
	33 900		
Included at 25%		(8 475)	(0.5)
Total tax liability based on basic		56 185	
less total tax paid (Para 20(1)(b)(ii))		(24 518)	(1)
Difference on which penalty will be levied		31 667	
Tax on taxable income excluding lump sum benefit, i.e. on R634 000		180 717	(1.5)
less primary rebate		(13 500)	(0.5)
Add tax on retirement lump sum benefit (given)		9 900	(0.5)
less s6A rebate		0	

SOLUTION 6.2 continued

less s6B rebate			
Qualifying medical expenditure	60 000		(0.5)
Reduced by 0.8% × R634 000 (taxable income excluding lump sum benefits)	(47 550)		(1)
	12 450		
Included at 25%		(3 113)	
		174 004	
Add under estimate penalty (R31 667 × 20%)		6 333	(1)
less provisional tax		(24 518)	(0.5)
less employees' tax on lump sum benefit (given)		(9 900)	(0.5)
Tax liability		145 920	
			(16)
		Total	(25)

SOLUTION 6.4

Jane Dube

1	Monthly employees' tax		**R**	
	Cash salary		20 000	(0.5)
	Company car	R180 000 × 1.14 × 0.4% × 80%	5 746	(2)
	Residential accommodation			
	Determined using the formula (R216 000 – R75 000) × 18% × 1/12		2 115	(2)
	Monthly remuneration		27 861	
	Annual remuneration	(R27 861 × 12)	334 332	(1)
	Tax per the table		73 923	(0.5)
	less rebate		(13 500)	(0.5)
			60 423	
	Therefore, monthly employees' tax is (R60 423/12)		5 035	(0.5)
2	First provisional payment		**R**	
	Tax on R350 000 (cannot scale up as does not meet para 19 proviso (a) of more than 18 months after 2015 year end)		78 780	(1.5)
	less rebate		(13 500)	(0.5)
			65 280	
	Tax for first period (÷ 2)		32 640	(0.5)
	less employees' tax	(R5 035 × 6)	(30 211)	(1)
			2 429	

SOLUTION 6.4 continued

Second payment			
Tax on R380 000 (estimate)		88 080	(1)
less rebate		(13 500)	(0.5)
		74 580	
less first provisional		(2 429)	(0.5)
Employees' tax	(R5 035 × 12)	(60 423)	(1)
Second provisional payment		11 729	
Taxable income for the year		**R**	
Remuneration		334 332	(0.5)
Remaining 20% of company car	R180 000 × 1.14 × 0.4% × 20% × 12	17 237	(1)
No reduction on fringe benefit as no logbook maintained.			
Interest		90 820	(0.5)
less s10(1)(i) exemption		(23 800)	(0.5)
		418 589	
Tax per the table		100 652	(0.5)
less rebate		(13 500)	(0.5)
		87 152	
less employees' tax	(R5 035 × 12)	(60 423)	(1)
provisional tax	(R2 429 + R11 729)	(14 157)	(1)
Short-paid		12 572	

Jane's third (top up) payment must be R12 572 by 30 September 2017.

No under-estimate penalty as the tax needed to be paid on 90% of actual (R418 829 × 90% = R376 946) is less than the tax that has been paid on the estimate of R380 000 above.

(19)

SOLUTION 6.5

1. Calculation of Missy Maude's taxable income

Salary	R25 000 × 12			300 000	(0.5)
Use of motor vehicle:					
Determined value	200 000				
Reduce by 15% (one completed year)	(30 000)				
	170 000				(1)
Monthly rate (maintenance plan)	3,25%				(1)
Cash equivalent for the year	5 525	× 12	66 300		(1)
Reduction on assessment:					
Business use: $^{20\,500km}/_{25\,000km}$ × R66 300			(54 366)		(1)
Cost of fuel for private use: 4 500km × 100.0 cents			(4 500)	7 434	(1)

SOLUTION 6.5 continued

Medical aid contributions > 65 - fringe benefit para 12A			18 000	(1)
Retirement annuity contribution - fringe benefit para 2(1)(h) and 13	R3 500 × 12		42 000	(1)
Monthly pension	R10 000 × 12		120 000	(1)
Consulting income			150 000	(0.5)
Foreign interest (no exemption for foreign interest)			15 700	(0.5)
Local interest		60 000		
Exempt: R34 500 s10(1)(i) > 65		(34 500)	25 500	(0.5)
Home office expenses (not disqualified under s23(m) or 23(b))	R500 × 12		(6 000)	(1)
Legal expenses: qualifies in terms of s11(c) (recovery will be included in GI)			(10 000)	(1)
Allowance for doubtful debts s11(j)	R20 000 × 25%		(5 000)	(1)
			657 634	
Retirement contributions s11(k) R42 000 =		42 000		(1)
limited to *lesser* of:				
*R350 000, or		350 000		(1)
*27.5% of the higher of remuneration *(see below)*		373 260		
or taxable income,		657 634		
	× 27.5% =	180 849		(1)
The full contribution is therefore allowed as a deduction.			(42 000)	(1)
No excess to carry forward to following year of assessment				
Taxable income for the year			615 634	(17)

2. Employees' tax calculation

Salary			300 000	(0,5)
Use of a motor vehicle: p7 motor vehicle fringe benefit (20% as employer satisfied that at least 80% used for business)	20% ×	66 300	13 260	(1)
Medical aid contributions > 65	Fringe benefit p12A		18 000	(1)
RAF contribution			42 000	(0.5)
Remuneration			373 260	
less				
Retirement contributions s11(k) R42 000 =		42 000		(1)
limited to *lesser* of:				
*R350 000, or		350 000		(1)
*27.5% of remuneration		373 260		
The 4th Schedule requires only 'with respect to remuneration'	× 27.5% =	102 647		(1)
The full contribution is therefore allowed as a deduction.			(42 000)	(1)
No excess to carry forward to following year of assessment				
Balance of remuneration			331 260	

SOLUTION 6.5 continued

Tax per the tables:			72 970	(1)
less rebate > 65			(20 907)	(1)
less s6A rebate 12 × R572 (rebate for member and one dependant)			(6 864)	(1)
less s6B rebate				(0.5)
Own contributions to medical aid scheme	R3 000 × 50% × 12	18 000		(0.5)
Deemed employee contributions (paragraph 12A - 7th Schedule with s6B(4))		18 000		(1)
Reduced by 3 × R572 × 12 months (rebate for member and one dependant)		(20 592)		(1)
Other medical expenses		20 000		
		35 408		(1)
Included at 33.3%			(11 791)	
Employees' tax for the year			33 408	
				(14)

3. Provisional tax for 2017

First payment due by end August 2016

Use basic amount as the estimate:				
Previous assessment (2014 as 2015 issued after August 2016)		310 000		(1)
less taxable capital gain		(12 000)		(1.5)
		298 000		
Scale up by 8% a year for three years	298 000 ×	1,24	369 520	(1)
Tax per the tables:			84 831	(1)
less rebate > 65			(20 907)	(1)
less s6A rebate 12 × R572 (rebate for member and one dependant)			(6 864)	(1)
less s6B rebate (over 65)				
Own contributions to medical aid scheme	R3 000 × 50% × 12	18 000		(0.5)
Deemed employee contributions (paragraph 12A - 7th Schedule with s6B(4))		18 000		(0.5)
Reduced by 3 × R572 × 12 months (rebate for member and one dependant)		(20 592)		(1)
Other medical expenses		20 000		(1)
		35 408		
Included at 33.3%			(11 791)	(1)
Tax for the year on basic amount			45 269	
50% thereof			22 635	(1)
less				
Employees' tax paid				
Interiors 50% × R33 408		16 704		
Pension fund (R403 × 6)		2 418	(19 122)	(1)
s6*quat* rebate (50% × R1 200)			(600)	(1)
First provisional tax payment			2 912	

SOLUTION 6.5 continued

Second payment due by end February 2017

Use lesser of basic amount or 90% of actual taxable income for the year:				(1)
Basic amount:				
Previous assessment (2016)		960 000		(0.5)
less gross income (e) retirement fund lump sum		(500 000)		(1)
		460 000		
90% of actual:	90% × R615 634	554 071		(1)
Therefore, use basic amount			460 000	(1)
Tax per the tables:			115 560	(1)
less rebate > 65			(20 907)	(0.5)
less s6A rebate			(6 864)	(0.5)
less s6B rebate (since Missy is > 65 her s6B rebate calculations is not dependent on her taxable income, and is therefore the same as calculated above)			(11 791)	(0.5)
Tax for the year on basic amount			75 998	(1)
less				
Employees' tax paid				
Interiors		33 408		
Pension fund (R403 × 12)		4 836	(38 244)	(0.5)
s6*quat* rebate			(1 200)	(1)
First provisional tax payment			(2 912)	(0.5)
Second provisional tax payment			33 641	

Voluntary third payment due by end September 2017

Taxable income			615 634	(1)
Tax per the tables:			173 554	(1)
less rebate > 65			(20 907)	(0.5)
less s6A rebate			(6 864)	(0.5)
less s6B rebate			(11 791)	(0.5)
less s6*quat* rebate			(1 200)	(1)
Normal tax for the year			132 792	
less				
Employees' tax (total from above)		38 244		(1)
Provisional tax paid (R2 912 + R33 641)		36 553	(74 798)	(1)
Third provisional tax payment			57 994	
				(30)
				(61)

CHAPTER 7: RETIREMENT BENEFITS AND PLANNING

Index to sections and second schedule

Question	Sections	Grade	
Question 7.1	Second Schedule, s11(a), s11(m)	*	S
Question 7.2	Retirement from funds, Second Schedule	*	S
Question 7.3	Second Schedule, s6, s6A, s6B, s11(k)	**	S
Question 7.4	Fringe benefits, lump sums, s10(1)(gC)	**	S
Question 7.5	Second Schedule, s6, s6A, s6B,	***	
Question 7.6	Retirement lump sums, severance benefits, s10(1)(gC), s11(k),	***	
Question 7.7	Fringe benefits, lump sums, company deductions, severance benefits, VAT	***	
Question 7.8	General, resignation	***	
Question 7.9	Retirement benefits and fringe benefits – comprehensive	***	
Question 7.10	Tax planning for retirement, multiple lump sums	***	
Question 7.11	Retirement, divorce, TAA s240	***	
Question 7.12	Retirement, provisional tax, fringe benefits, CGT	***	

QUESTION 7.1 (Solution at end of chapter) (28 Marks)

YOU ARE REQUIRED TO: Determine whether the following statements are TRUE or FALSE. In each case give an explanation for your answer.

1. A person who retires due to ill-health or superannuation qualifies for the R500 000 exemption, irrespective of his age.
2. A lump sum paid by an employer to an employee, who is 56, for a variation in his employment contract is treated as a severance benefit.
3. An annuity of R50 000 *per annum* paid by an employer to a former employee who retired because of ill-health may be deducted in full by the employer.
4. A lump sum paid to an employee who is retrenched enjoys no exemptions.
5. An employer cannot deduct a termination lump sum paid to a retiring employee under section 11(a).
6. A lump sum received from a pension fund by a retiring employee is subject to the withdrawal or retirement lump sum tax tables.
7. Pension benefits paid to a former spouse, in terms of a divorce settlement on or after 13 September 2007, from the pension fund of the other spouse (member of the fund) are deemed to be received by the other spouse for income tax purposes.
8. The spouse receiving divorce benefits from the fund of the other spouse after 1 March 2011 is responsible for the tax thereon.
9. Retirement from a provident fund before the age of 55 is treated as resignation for income tax purposes.
10. Lump sum benefits received as a result of retirement from a state pension fund are taxed in the same way as retirement lump sums received from any other pension fund.
11. To fall into the definition of a provident fund in the Income Tax Act, the fund must provide for not more than one third of the benefits to be commuted for a lump sum.
12. Continued use of a company car by a former employee after his retirement is not subject to tax.

13. Retirement from a pension fund before the age of 55 is treated as resignation for the purposes of the Income Tax Act.
14. An annuity paid to a retired person by a pension fund is subject to PAYE.
15. The retirement lump sum benefit paid to a retired person by a pension fund is subject to tax per the individual progressive tax table.

QUESTION 7.2 (Solution at end of chapter) **(20 Marks)**

Five case studies follow:

CASE 1
Mrs Mando retired after 40 years of service. As a result of her retirement, Mrs Mando received a lump sum of R585 000 from a pension fund. She had been a member of the fund for 35 years. During her membership of the fund all of her contributions had been allowed as a section 11(k) deduction.

YOU ARE REQUIRED TO: Calculate the tax payable on the lump sum.

CASE 2
Mr Levy retired, at the age of 65, in October. Mr Levy had been a member of a provident fund for 40 years. His contributions to the fund up to the end of the prior year amounted to R60 000. During the current year to October he contributed a further R2 500, being 2% of his salary. When he retired he received a lump sum of R585 000.

Contributions to provident funds were disallowed as a deduction until section 11(k) was amended with effect from 1 March 2016.

YOU ARE REQUIRED TO: Calculate the tax payable on the lump sum.

CASE 3
In June 1990 Able Musso joined a retirement annuity fund to which he contributed R15 000 *per annum*. The contributions were all deductible in terms of section 11(n) prior to its deletion. In November 2016 he received a retirement lump sum of R960 000.

YOU ARE REQUIRED TO: Calculate the tax payable on the lump sum.

CASE 4
In 2012 Martha Matt received a lump sum of R420 000 from a retirement annuity fund, when the upper limit of the tax-free bracket was R315 000. All her contributions had qualified for a tax deduction under section 11(n) prior to its deletion.

In December 2016 Martha retired from employment and received a lump sum of R550 000 from the pension fund. Martha had been a member of the fund for 25 years. Of her contributions to the fund, R9 000 had not been allowed as a deduction (in terms of section 11(k)).

YOU ARE REQUIRED TO: Calculate the tax payable on the lump sum received from the pension fund.

CASE 5
Bob Thomas retires from Pension Fund X on 30 September 2016 and receives a lump sum of R450 000. The remaining two-thirds was used to purchase an annuity. All contributions to the pension fund had qualified for deduction.

Bob had previously withdrawn from the Z Provident Fund on 1 March 2016. He had received a gross lump sum of R230 000. His contributions, none of which had been deductible, had been R80 000 since joining this fund.

YOU ARE REQUIRED TO: Calculate the tax payable on both the withdrawal AND retirement from the funds for the 2017 year of assessment.

QUESTION 7.3 (Solution at end of chapter) (20 Marks)

On 30 October 2016 Arthur Smart retired at the age of 60. As a consequence of his retirement Arthur received the following amounts:

	R
– a retirement lump sum from his employer	80 000
– cash in lieu of accumulated leave	20 000
– a set of golf clubs (from his colleagues)	8 000
– a lump sum from a pension fund	550 000
– a monthly annuity from the pension fund (commencing 1/11/2016)	7 000

Notes

1. Arthur had been a member of the pension fund for 31 years. All of his contributions had been allowed as a deduction under section 11(k).
2. Arthur contributes R6 000 *per annum* to a retirement annuity fund (RAF) (since he was 55) from which he will retire when he is 65. Because of the large lump sums he had received, Arthur contributed an additional R40 000 to the RAF in December 2016. The additional contribution does not relate to any arrear or 'catch-up' payment. Disallowed deductions under the old section 11(n) up to 29 February 2016 totalled R20 000.
3. Arthur was earning a salary of R10 350 per month when he retired. On 1 January 2016 his salary had been increased by 15%.
4. Arthur's only source of income in the year ended 28 February 2017 was his employment. The only deductions against his salary were his pension contributions of 7.5% and medical aid contributions of R800 per month. Other qualifying medical expenses of R40 000 were incurred in the 2017 year. He was the only member of the medical aid fund. Arthur incurred no additional medical expenditure in 2016. Arthur continued to pay medical contributions after his retirement.

YOU ARE REQUIRED TO: Calculate Arthur's tax liability for the year ended 28 February 2017. (You may assume that Arthur's average rate of tax for the 2016 year of assessment was 18%.)

QUESTION 7.4 (Solution at end of chapter) (25 Marks)

Andrew Chabot, a South African resident, was a sales manager of Skervin International Ltd, a South African resident company. As a result of illness he retired on 1 October 2016. Andrew was 58 years old at retirement date and had been employed by Skervin for 40 years. The company paid him R60 000 in respect of a restraint of trade agreement, in terms of which he undertook not to use any specialised product knowledge to assist competitors for a period of five years from the date of his retirement.

31 of Andrew's 40 years' service was spent in the Republic, and the remainder in foreign countries.

Andrew belonged to the company's pension fund as a condition of his employment. At retirement date he had been a member for 40 years. The pension fund paid out a lump sum on 30 October 2016 of R600 000 and an annuity of R4 600 a month commencing on 30 October 2016. Contributions of R11 400 to the pension fund had not been allowed as a tax deduction in terms of section 11(k) at

29 February 2016. Of this amount, R2 565 was in respect of non-republic service. This was the first lump sum Andrew had ever received.

Andrew earned a salary of R6 900 a month up to 30 September 2016, of which he contributed 8.5% to the pension fund.

Andrew also earned commission of R17 175 up to 1 October 2016. He was required to entertain clients as part of his duties, but did not have to account to Skervin for his expenditure, nor is he reimbursed for such expenditure. Up to 1 October 2016 he had spent R500 on country club subscriptions and R2 200 on drinks and dinners for clients.

Andrew is also a member of a retirement annuity fund that will pay out an amount of R85 000 on 1 October 2021, being one-third of his total benefits. At 1 October 2021 he would have been a member of the fund for ten years. At 29 February 2016, contributions to this fund of R1 900 had not been allowed as a tax deduction. On 28 February 2017 he made an annual current contribution of R17 100 to this fund.

Andrew had the use of a company car, which he purchased from Skervin on 1 October 2016 for R31 200, its book value at that date. The market value at 1 October 2016 was R30 000. The car had cost Skervin R178 000 (including VAT) three years ago when Andrew was first granted use thereof. Andrew has always only paid for all private fuel of the car, which was R609 for the year up to 1 October 2016 and during which period his private kilometres were 10 000 out of a total of 40 000 kilometres.

Andrew does not belong to a medical aid and incurred no medical expenses during the year of assessment.

YOU ARE REQUIRED TO:

1. Calculate Andrew's Chabot's tax payable for the year of assessment ended 28 February 2017. (18 Marks)
2. List ALL amounts that qualify as balance of remuneration for PAYE for all employers. (6 Marks)

QUESTION 7.5 (23 Marks)

Mrs Rich retired on 31 December 2016 at the age of 65. The following information is provided for the year ended 28 February 2017.

At the time of her retirement Mrs Rich was being paid a monthly salary of R20 000. This had been her salary since 1 January 2016. Mrs Rich has had an annual salary increase of 10% *per annum* every year for the past ten years. Mrs Rich was a member of a pension fund, to which she contributed R2 000 per month in her last year of employment. When she retired she received a lump sum of R700 000 from the pension fund and a monthly annuity of R6 000. The first annuity was paid in January 2017. Mrs Rich had been a member of the pension fund for 30 years. Pension contributions which had not been allowed as a section 11(k) deduction up to 28 February 2015 amounted to R40 000 and those which had been disallowed during the 2016 year of assessment amounted to R5 500.

In March 2015 Mrs Rich had received a lump sum of R120 000 when she left a provident fund, of which she had been a member for 20 years. Her annual contributions had been R1 500.

Mrs Rich is a member of a retirement annuity fund (RAF), to which she contributes R30 000 *per annum*. She joined the RAF in June 1999 and will retire from it when she turns 69 in July 2019. Contributions to the fund disallowed under section 11(n) (prior to its deletion with effect from 1 March 2016) totalled R31 000 at 28 February 2015 and a further R12 500 at 29 February 2016.

Mrs Rich's only other income is interest of R43 500 and SA dividends of R60 000. During the year Mrs Rich paid medical expenses in respect of herself of R6 000 and R8 500 in respect of her husband. Mr Rich is a handicapped person as defined. They do not contribute to a medical aid fund.

YOU ARE REQUIRED TO: Compute Mrs Rich's normal tax for the year ended 28 February 2017.

QUESTION 7.6 **(24 Marks)**

On 30 October 2016 Gabor Brablink retired from employment at the age of 64, a month before his 65th birthday. Gabor was from the Czech Republic but had worked for South African company Yaskia Ltd, which operated both in SA and in the Czech Republic.

Gabor had formally immigrated to SA on 1 March 2008. He had been employed by Yaskia Ltd for 28 years up to his retirement, of which 11 years had been spent in South Africa. Since 2008 he had only been employed in South Africa.

Gabor was a member of Yaskia Pension Fund throughout his employment with Yaskia Ltd. Gabor was earning a salary of R20 000 per month in October 2016. His contributions to the pension fund were 8% of his cash salary and Yaskia Ltd contributed the same amount to the fund. On his retirement the pension fund paid him an amount of R700 000. The remaining two-thirds of his pension account was converted into a pension of R8 000 per month. Payment of this annuity commenced in November. Pension contributions not allowed as deductions up to 29 February 2016 totalled R27 000.

Yaskia Ltd gave Gabor R100 000 on 30 October 2016 as a retirement lump sum in terms of his employment contract.

Gabor had received a pay-out from a retirement annuity fund (RAF) on 29 February 2016 of R250 000. Part of his contributions in the past had not been allowed as a deduction under section 11(n) (prior to its deletion with effect from 1 March 2016) and these amounted to R7 400 at 29 February 2016. He had contributed to the fund for ten years. Gabor then took out another RAF to which he contributed R2 000 per month, commencing 1 March 2016 and continuing for the next ten years.

In addition to the above, Gabor had South African investment income of R56 500 in the form of interest. He did not belong to a medical aid or incur any medical expenditure during the year of assessment.

YOU ARE REQUIRED TO:

1. Calculate Gabor's tax payable for the year of assessment ended 28 February 2017. (21 Marks)
2. Calculate all the tax effects for Yaskia Ltd, giving brief reasons where appropriate, in respect of the above for its year of assessment ended 28 February 2017. (3 Marks)

QUESTION 7.7 **(36 Marks)**

Edward Bower was an employee of Toptrend (Pty) Ltd, a company manufacturing certain types of furniture. The following information relates to Edward Bower's employment package:

1. Edward is 61 years old and had been on the staff for 40 years before retiring on 31 December 2016. For his last ten years of office he has been entitled to the use of a company car. The current car had cost Toptrend R114 000 (including VAT) on 1 March 2012, from which date Edward had the use.

Edward approached the board of directors of the company before his retirement with the request that, instead of receiving the retirement lump sum due to him in terms of his contract, he would like to take over the company car and a particular sanding machine, which had become redundant. The sanding machine had a book value of R4 000 and a tax value of R5 000 at 31 December 2016. This was the same value as in 2014 when it was withdrawn from use due to a change in technology. A decision was made at 31 December 2016 to scrap the machine and it was written off at its book value of R4 000 on 31 December 2016.

The board of directors agreed to Edward's request and decided to award the company car and sanding machine to Edward for his long and devoted service. For these purposes the car was valued at R29 000 and the machine at R3 000. (These were the market values at the time.)

The Commissioner allows wear and tear at 20% straight line on assets not qualifying for the section 12C allowance.

2. Edward Bower had been granted a loan of R150 000 (by Toptrend) at an interest rate of 5% *per annum* in 2014. Edward had used R60 000 of the loan to pay off his home loan and the remaining R90 000 was invested in a money market interest-bearing investment. On 31 December 2016 Edward repaid the full amount of the loan using his retirement lump sum (see (3) below). Edward received interest of R9 000 up to 31 December 2016 on the money market investment, at which date he withdrew the investment and any reinvested interest to buy other equipment he needed to fund his hobby of making wooden tables. (Assume an official interest rate of 8%.)

3. Edward Bower had been a member of Toptrend's provident fund for 40 years. His contributions amounted to 8% of his annual salary and Toptrend contributed the same amount to the fund. At 1 March 2016 his total past contributions amounted to R172 800. His salary for the period 1 March 2016 to 31 December 2016 was R80 000.

   The provident fund paid out an amount of R540 000 on retirement and the balance of R800 000 funded an annuity of R6 000 per month commencing from 1 January 2017.

   Edward immediately contributed R20 000 of his lump sum to a new retirement annuity fund. This fund was to pay out an amount of R30 000 when Edward turned 70.

   Edward had received a previous lump sum of R140 000 when he turned 61 on 1 March 2016 from a retirement annuity fund (RAF) of which he had been a member for 12 years. All previous RAF deductions had been deducted in terms of section 11(n) prior to its deletion.

YOU ARE REQUIRED TO:

1. Calculate Edward Bower's taxation payable for the year of assessment ended 28 February 2017.
2. Calculate all the income tax consequences (excluding CGT) of the above transactions in the computation of the taxable income of Toptrend (Pty) Ltd for its year of assessment ending 28 February 2017. You may assume that Toptrend is a registered VAT vendor.

QUESTION 7.8 **(23 Marks)**

PART A (6 Marks)

Jack Russell retired from employment on 30 November 2016, at the age of 62, after 35 years and ten months employment. When he retired he received a lump sum of R750 000 and a monthly annuity of R16 000 from the pension fund of which he had been a member for his entire period of employment. During that time his contributions to the fund were 8% of his cash salary. His cash salary in his last

year of employment was R90 000 *per annum*. Total pension contributions not allowed as a section 11(k) deduction up to 29 February 2016 amounted to R3 000.

Jack is also a member of a provident fund from which he will retire on 30 June 2025. He joined the fund on 1 July 1995. Contributions to the provident fund are currently R400 per month. Total contributions up to 29 February 2016 amounted to R41 000. Prior to 1 March 2016, contributions to provident funds were disallowed as deductions.

When he reached the age of 60 on 30 September 2014 Jack had retired from a retirement annuity fund (RAF) and had received a lump sum of R650 000. Jack joined the RAF on 1 July 1971. All retirement annuity contributions per the old section 11(n) have been allowed as a deduction. Total pension contributions not allowed as a section 11(k) deduction up to 30 September 2014 amounted to R2 500. Total contributions to the provident fund up to 30 September 2014 amounted to R33 800.

YOU ARE REQUIRED TO: Calculate the taxable portion of the lump sum from the pension fund and the tax payable on such lump sum.

PART B (13Marks)

On 1 October 2016 Manley Jordan, age 50, decided to take early retirement from his employer, as he had inherited quite a sizeable portfolio of SA shares and needed to spend time managing this portfolio.

Manley belonged to the company's provident fund and chose to take 100% of the benefits due to him on withdrawal from the fund. He had been a member of this fund for 20 years. In terms of the rules of the fund, an amount of R300 000 accrued to him on 1 October 2016. Of this amount, R120 000 was in respect of his contributions to the fund and included a contribution of R3 500 for the current year of assessment up to 1 October 2016. His salary, the highest ever earned, at 1 October 2016 was R7 000 per month.

Manley requested that the company's provident fund transfer R100 000 of his lump sum directly into a retirement annuity fund. The balance of R200 000 (paid to Manley) was used to purchase a plot of ground on the beachfront. Dividends received on his shares amounted to R40 000 for the year.

Manley is not a member of a medical aid and did not incur any medical expenditure during the current year of assessment.

YOU ARE REQUIRED TO: Calculate Manley Jordan's normal tax payable for the year of assessment ended 28 February 2017.

PART C (4 Marks)

Mike Mill, aged 62, retired from a pension fund on 31 December 2016. Mike had joined the fund on 1 January 1976. When he retired he received a lump sum of R750 000.

Mike is also a member of a provident fund, which he joined on 1 January 1999. He will retire from the provident fund on 31 July 2023. Mike's salary on 31 December 2016 was R15 000 per month.

Mike has always contributed a fixed R1 000 a month to the provident fund. His contributions to the pension fund were all allowed as a deduction, but none of the previous years' provident contributions have been allowed.

YOU ARE REQUIRED TO: Compute the taxable portion of the lump sum from the pension fund and the normal tax payable on such lump sum.

QUESTION 7.9 **(36 Marks)**

Mr Jose Ferreira, aged 57, retired from employment with Model Phones (Pty) Ltd on 31 October 2016 after 30 years' service. His service benefits in his last tax year until retirement consisted of the following:

1. A cash salary of R10 000 per month from which Model Phones deducted contributions of eight per cent to the A Pension Fund and R2 000 in medical aid contributions. Model Phones contributed R3 000 per month to Jose's medical aid. Jose's only dependant of the fund is his wife Maria. On his retirement Jose remained a member of the medical aid fund but paid all the contributions himself.

2. Exclusive use of a Mercedes Benz SLK that Model Phones had acquired at its retail market value of R400 000 (including VAT). Model Phones pays the first R1 000 per month towards fuel. The total fuel costs amounted to R16 000 for the period. Jose is responsible for all maintenance costs on the vehicle, which amounted to R6 000 for the period. Jose was also given a travel allowance of R3 000 per month in respect of this vehicle. He has kept a logbook and his total mileage over the period was 15 000 kilometres, of which 5 000 was business mileage.

   Jose's wife Maria is also given the exclusive use of a Porsche Boxster which had cost Model Phones R560 000 (including VAT) on 1 March 2016. Maria is responsible for all running costs of this vehicle, which were R8 000 for fuel and R10 000 for maintenance. Maria paid Model Phones a usage fee of R10 000 per month for the use of the Boxster. Maria does not keep a logbook.

   When Jose retired he returned the SLK, but Maria decided to purchase the Boxster from Model Phones for R400 000. The car was sold to her on 31 December 2016, on which date its market value was R450 000. She continued to use the car until the date of sale. Its market value on 31 October 2016 was R460 000. Maria is not an employee of Model Phones.

3. Jose's family were given the use of a house owned by Model Phones. The house had cost Model Phones R200 000 when they purchased it in December 2003. It has six rooms and is furnished, but electricity is not provided by Model Phones. At that time Model Phones and Jose entered into a rental agreement for the house in terms of which Jose can purchase the house from Model Phones at any stage for R150 000. He is required to pay a rental of 10% of the purchase price *per annum* to Model Phones. Jose's costs in running the house in the current period until the date of sale (refer below) were R4 000 for maintenance and R3 000 for electricity.

   On 15 August 2016 Jose exercised his option and acquired the property for R150 000. Its market value on that date was R2.5 million. You may assume that Jose's 'remuneration proxy' is R320 000.

   Jose was granted a low interest loan of R1 000 000 (bearing interest at the rate of 3% *per annum*) from Model Phones on 1 April 2016. He immediately invested half of the capital from this loan in his personal bond and the other half in acquiring 7% of the equity shares in Douro Ltd, a company registered and managed in Portugal. No other South African residents hold any of the shares in Douro. On 31 May 2016 (its financial year-end), Douro declared a total dividend to shareholders of €50 000, which was subject to a 5% withholdings tax that was paid over to the Portuguese tax authorities. Assume that the relevant exchange rate for Jose's for this transaction is €1 = R8.

   Jose still owned the shares in Douro and the loan was still outstanding on 28 February 2017.

Jose received a lump sum of R750 000 from the A Pension Fund on retirement and a monthly pension of R20 000 from 30 November 2016. He joined the fund on 1 April 1985 when he joined the employment of Model Phones. His contributions to the pension fund that had not been allowed as a section 11(k) deduction totalled R36 000 to 29 February 2016 (R32 000 at 28 February 2014 and R33 500 at 20 May 2014).

Jose had also been a member of the B provident fund and the C retirement annuity fund (RAF):

- He joined the B provident fund on 15 March 1980. He retired from this fund on 28 February 2014 at age 54 and received a lump sum of R350 000. Total contributions not allowed as tax deductions up to that stage in respect of this fund amounted to R200 000.
- Jose joined the C RAF on 1 June 2000. At 28 February 2014 there were no disallowed contributions. He retired from this fund on 20 May 2014 and received a lump sum of R70 000 and a fixed monthly annuity of R3 000 per month. Total contributions not allowed as tax deductions from 1 March to 20 May 2014 amounted to R7 000.

On 1 November 2016 Jose commenced employment with Cell-U-La Ltd. He received a cash salary of R20 000 per month from that date until 1 January 2017 when he received a 10% increase. Cell-U-La has a provident fund which Jose joined from 1 November 2016. Cell-U-La contributes an amount equal to 10% of Jose's salary and Jose contributes a further 5% of his salary to the provident fund. Jose will retire from the provident fund on 31 December 2019.

YOU ARE REQUIRED TO:

1. Calculate Jose's taxable income for his year of assessment ended 28 February 2017. Assume that the official rate of interest was 12% *per annum* for the entire 2017 year of assessment. Assume for this part that the 2nd Schedule in its current form applied to all the prior lump sums (as did the particular tax tables).
2. Calculate the income tax effects in respect of the Porsche Boxster in the hands of Model Phones for its year of assessment ended 28 February 2017. Assume a rate of 20% *per annum* for wear and tear and that Model Phones is a registered VAT vendor.

QUESTION 7.10 **(43 Marks)**

Mr Sasha Distell, who turned 55 on 23 May 2016, is currently employed by 'KWV Limited' (KWV). Sasha has always enjoyed good health. He has been a member of KWV's pension fund since joining KWV on 15 June 1990. All of his years of service have been spent in South Africa. The pension fund allows for retirement from the age of 50 years and his pension fund interest has a total value of R3 million. He would like to retire from KWV on 28 February 2017, by which date he will have made total contributions to the fund that will not have been allowed as a tax deduction amounting to R250 000. He is considering the following options:

Option A
He would retire from the fund and take as much of the R3 million as possible as a cash pay-out. He would invest the cash received in a mix of JSE-listed and UK-listed shares.

Option B
Without retiring, he would transfer his full fund interest, after tax, into the XYZ provident preservation fund.

Option C
Without retiring, he would transfer his full fund interest, after tax, into the XYZ pension preservation fund.

YOU ARE REQUIRED TO:

1. Calculate, giving full explanations, the income tax consequences for Sasha of each of the three options listed above. (16 Marks)

2. Calculate, giving full explanations, how your answer under options A and B would differ if the KWV pension fund had been a provident fund and if Sasha's total contributions to the provident fund not allowed as a tax deduction will amount to R250 000 by 28 February 2017, and his interest in the fund had a total value of R3 million at 28 February 2017. (9 Marks)

3. Calculate, giving full explanations, what Sasha's income tax consequences would be for his year of assessment ending 28 February 2017 under option A only if in addition to his membership of the KWV pension fund Sasha had been a member of the XYZ provident fund from which he had retired (in terms of the rules of the fund) on 1 March 2016.

   Assume that when he retired from the provident fund the provident fund interest had a total value of R2.4 million and that total contributions to the provident and pension funds not allowed as a tax deduction had amounted to R535 000 by 1 March 2016 and were R550 000 by 28 February 2017. (18 Marks)

QUESTION 7.11 (48 Marks)

PART A

Terence Majaya retired from his position as financial manager of a large listed company on 31 October 2016, the date of his 65th birthday. His monthly cash salary was R50 000, from which he contributed 4% to the company's provident fund and 4% to the company's pension fund. The company makes further contributions for its employees on a Rand-for-Rand basis. Retirement from the employer results in retirement from the funds (in terms of the rules of the funds).

While contributions to the above employer funds had been equal all these years, investment returns on the retirement savings had not been equal. Accumulated retirement savings in the pension fund amounted to R1 500 000 and in the provident fund R2 100 000. He will take the one-third of each amount as a lump sum from each fund. The balance will be used to purchase a pension annuity yielding a monthly annuity of R20 000 beginning 1 November 2016.

Until 1 March 2015, Terence had also been a member of the Explore Pension Fund. He withdrew from this fund on 1 March 2015 (as retirement was only permitted in terms of the rules of the fund from age 65), choosing to place half in the All Gray Retirement Annuity Fund and to receive the rest in cash. His total accumulated retirement savings were R750 000 in the Explore Pension Fund at the time of his withdrawal.

All the contributions to the pension and retirement annuity funds had been allowed in full in terms of section 11(k) and the old section 11(n) respectively. The contributions to the provident fund which had been disallowed had amounted to R200 000 by 1 March 2015 and R238 000 by 29 February 2016.

The portion received in cash from the Explore Pension Annuity Fund (on 1 March 2015) was donated to a newly created trust (the Majaya Trust) on 1 April 2015. Terence paid any taxes on the receipt of the lump sum from the fund and arising from the donation from other cash reserves. The Trustees invested the lump sum received from Terence partly in interest-bearing investments and partly in foreign equity shares. The beneficiaries of the trust are Sophie (35) and Lyla (33), Terence's two daughters. Sophie is resident in South Africa and Lyla is resident in the United Kingdom.

The trust earned interest income of R9 000 and foreign dividends received amounted to a rand equivalent of R5 000. The foreign dividends are not exempt under section 10B(2). All the income was distributed equally to the two beneficiaries.

Apart from the above, Terence has interest income of R26 000 for the year.

YOU ARE REQUIRED TO:

1. Calculate the income tax payable by Terence for the year of assessment ended 28 February 2017. (30 Marks)
2. Discuss the current and future effects for Terence if instead of taking the provident fund lump sum on retirement, he transferred this retirement lump sum to a provident preservation fund. (5 Marks)

PART B (7 Marks)

Sam and Sarah have decided to divorce after eight years of marriage. The divorce order, granted on 1 March 2016, awards Sarah half of Sam's retirement savings in the XYZ pension fund at the date of the order. Sam's total accumulated retirement savings in the fund amounted to R550 000 on 1 March 2016. Sarah exercised her right in terms of section 37D(4)(b)(ii) of the Pension Funds Act on 1 April 2016 and requested that the fund transfer half of her share of the accumulated retirement savings to the ABC Pension Preservation Fund and pay the other half in cash. Sam, at 1 March 2016, had not been entitled to deduct R5 000 of contributions to the XYZ pension fund. Sarah has approached you for advice.

YOU ARE REQUIRED TO: Calculate and discuss the tax payable (if any) by Sam and Sarah on Sarah's election in terms of the divorce order.

PART C (6 Marks)

John, an accountant, has decided that he would like to provide tax advice and compliance services. He has been provided with two opportunities as follows:

a. to begin his own practice; or
b. to be employed in an existing tax practice, where he will be required to provide advice and compliance services to clients of the practice.

In addition to the above, John provides his family with tax advice and assists them to complete their returns. He is not paid for this work.

YOU ARE REQUIRED TO: Discuss the circumstances under which John must register as a tax practitioner (in terms of s240 of the Tax Administration Act) for each of John's opportunities above and, if he must register, by when the registration must take place.

QUESTION 7.12 **(48 Marks)**

Kate Lawrence, aged 57 on 1 February 2017, decided to take early retirement to pursue other interests. She retired on 31 December 2016 from employment with Engen Limited and from the Engen provident fund.

The accumulated benefit amount due to her from the provident fund was R2.8 million. Kate decided to take R800 000 in cash and to purchase a pension annuity with the balance of R2 million for her remaining lifetime. She received an annuity of R11 500 per month from 1 January 2017. The employer had paid all her contributions, amounting to R720 000, in terms of the rules of the fund. Included in this amount is R20 000, contributed in the current year.

Kate had also contributed to a retirement annuity fund for ten years. The amount in the fund was R65 000 when she reached 'retirement age' (elected on joining the Retirement Annuity Fund) on 1 February 2016, at which the full amount was paid out as a lump sum. All contributions had been allowed under section 11(n) prior to its deletion.

In terms of her employment contract with Engen the following is relevant for the period 1 March 2016 to 31 December 2016:

	Note	**R**
Gross salary for the period		430 000
Loan repaid to Engen on 31 December 2016	1	50 000
Painting awarded on 30 June 2016	2	–
Reimbursement of travel costs	3	122 000
Share options	4	
Employees' tax deducted evenly over the period		106 705
Medical aid contributions deducted from Kate's salary	5	2 400

Notes

1. Kate had borrowed R100 000 from Engen at an interest rate of 3% in 2014. At the end of February 2016 she used her retirement annuity pay-out to repay R50 000.

   Kate had used the R100 000 to cover the running costs of the small business she had set up in 2014.

   Assume an official rate of interest of 7%.

2. Engen purchased an Isabel le Roux oil painting for R14 820 (including VAT) on 30 June 2016 and gave this to Kate for her ten years of valuable service.

3. Kate was reimbursed for travelling costs she incurred on trips organised by Engen on presentation of all her vouchers and details of the work she performed.

4. In 2013 Kate was granted an option to acquire 1 000 shares in Engen Ltd at R10 per share. The market value of a share was R15 at the time. Kate exercised the option in 2013 and paid R10 000. The terms of the arrangement are that once the option is taken up the shares may not be sold for three years. The three years expired on 30 June 2016 when the market value of a share was R25.

   On 15 February 2017 Kate sold all her Engen shares for R27 000.

5. Kate paid all the medical contributions herself and continued with these contributions of R2 400 per month to the medical aid fund after retirement. Her 80-year-old father is her only dependant on the medical aid fund. She incurred additional qualifying medical expenditure (not covered by the medical aid fund) of R64 000.

Kate retired early to devote more attention to her small business, which was doing well. She offered a laundry service of washing and ironing from her home. Besides her father, who helped operate the washing machines, she employed one or two casual workers to do the folding and ironing for customers as required.

The income statement for the business for the year of assessment ended 28 February 2017 was as follows:

	R
Gross income	485 250
Wear and tear on machines (all tax allowable)	(6 000)
Interest paid on loan from Engen	(1 250)
Washing powder and consumables	(51 000)
Salaries paid	(72 000)
Net profit	355 000

On 27 February 2017 Kate decided to sell a parcel of shares she had inherited from her late mother. The market value of the shares included in her deceased mother's estate in 2006 was R252 000. The shares had not performed well and she sold them for R234 000.

Kate paid a first provisional tax payment on 31 August 2016 based on her basic amount. She had received her 2015 assessment on 31 January 2016, which showed a taxable income of R702 000. She received her 2016 assessment on 1 November 2016, which showed a taxable income of R751 000. Kate based her second provisional tax payment for 2017 on her basic amount.

YOU ARE REQUIRED TO:

1. Calculate the tax payable in respect of the retirement lump sum. (7 Marks)
2. Calculate Kate Lawrence's taxable income for the year of assessment ended 28 February 2017. (22 Marks)
3. Calculate Kate's first and second provisional tax payments for the year of assessment ended 28 February 2017. (11 Marks)
4. Calculate Kate Lawrence's final tax liability for the year of assessment ended 28 February 2017. You must assume that NO additional taxes, penalties or interest will be incurred on assessment. (8 Marks)

SOLUTION 7.1

1.	FALSE	The retirement lump sums benefits table applies to lump sums from the employer due to ill health or retirement only if the age of 55 has been reached. The first R500 000, of aggregated qualifying lump sums, is taxed at 0%.	(2)
2.	TRUE	A variation in employment qualifies to be taxed per the retirement lump sum table if the person has reached the age of 55.	(2)
3.	TRUE	s11(m) provides that annuities payable to former employees are deductible in full (as well as annuities payable to dependants of former employees).	(2)
4.	FALSE	It is treated as a severance benefit and taxed per the retirement lump sum table in which the first R500 000 is taxed at 0%.	(2)
5.	FALSE	The employer can deduct the amount if it is in the production of income (*Provider*).	(2)
6.	TRUE		(1)
7.	TRUE	The spouse receiving the benefit becomes responsible for the tax where the election to receive such benefit has been made. If no election is made, para 2B of the 2nd Schedule specifies that it accrues to the member (with a right of recovery of taxes from the former spouse) on date of departure from the fund (see paragraph 2(b)(iA).	(2)
8.	TRUE	The receiving spouse is responsible for the taxes on such amounts (see paragraph 2(b)(iA).	(2)
9.	TRUE	Para 4(3) of the 2nd Schedule, provided that the employee has not retired as a result of ill-health.	(2)
10.	FALSE	The taxable portion of the lump sum is determined in terms of Formula C (paragraph 2A of the 2nd Schedule).	(2)
11.	FALSE	The full amount can be taken as a lump sum (refer definition of pension and provident funds in s1 of the Act).	(2)
12.	FALSE	It continues to be a fringe benefit (7th Schedule definition of 'employee').	(2)
13.	FALSE	It depends on the rules of the fund. See definition of 'retirement date' and 'normal retirement age' in section 1.	(2)
14.	TRUE	The pension annuity is included in the definition of 'net remuneration'.	(2)
15.	FALSE	The retirement lump sum benefit is taxed according to the retirement lump sum benefit table. Any annuity paid from the amount not taken as a lump sum is taxed per the individual progressive tax table.	(1)
			(28)

SOLUTION 7.2

CASE 1 - Mrs Mando			
Lump sum received		585 000	(1)
There are no applicable para 5 deductions against this lump sum			
Taxable portion		585 000	
Tax payable	First R500 000 @ 0%, next R85 000 @ 18%	15 300	(1)
CASE 2 - Mr Levy			
Lump sum received		585 000	(1)
Para 5 - previously disallowed contributions (provident fund)		(60 000)	(1)
Prior to the amendment of s11(k) all provident fund contributions were disallowed as a deduction. Under the amended s11(k) provident fund contributions are deductible up to certain limits. A contribution of 2% of salary would fall well below those limits and would be deductible in the current year under s11(k).			
Taxable portion		525 000	
Tax payable	(R525 000 − R500 000) × 18%	4 500	(1)
CASE 3 - Able Musso			
Lump sum received		960 000	(1)
There are no applicable para 5 deductions against this lump sum.			
Taxable portion		960 000	
Tax payable	R36 000 + (R960 000 − R700 000) × 27%)	106 200	(1)
CASE 4 - Martha Matt			
Lump sum received		550 000	(1)
Para 5 deductions against this lump sum		(9 000)	(1)
Taxable portion		541 000	
Previous lump sum		420 000	(1)
No disallowed pension deductions had been applied to the RAF lump sum.			
		961 000	
Tax payable	(R961 000 − R700 000) × 27% + R36 000	106 470	(1)
less tax on previous lump sum	less than R500 000 therefore	0	(1)
		106 470	
CASE 5 - Bob Thomas			
Withdrawal lump sum		230 000	(1)
Para 6 deductions			
Deductions not ranking for deduction in terms of s11(k) or s11(n).		(80 000)	(1)
(all contributions to Pension fund X had been allowed as a deduction)			
Prior to the amendment of s11(k) all provident fund contributions were disallowed as a deduction			
Withdrawal taxable lump sum		150 000	

SOLUTION 7.2 continued

Tax on withdrawal (R150 000 − R25 000) × 18%		22 500	(1)
Retirement lump sum		450 000	(1)
Para 5 deductions		0	(1)
		450 000	
Add taxable withdrawal lump sum (above)		150 000	(1)
		600 000	
Tax per retirement lump sum tables (R600 000 − R500 000) × 18%		18 000	(1)
less tax on previous lump sum when determined in terms of **this** retirement lump sum table (R150 000 reduced by first R500 000)			
As less than R500 000 tax is		0	
Tax on retirement lump sum		18 000	(1)
			(20)

SOLUTION 7.3

Arthur Smart			
Salary (R10 350 × 8)		82 800	(1)
Retirement lump sum from employer	80 000		
Severance payment taxed per retirement tax table	(80 000)	0	(0.5)
Accumulated leave pay (not a severance benefit as entitlement arises when services performed in the past)		20 000	(1)
Golf clubs (receipt is capital and not employment related)		0	(1)
Pension annuity (R7 000 × 4)		28 000	(1)
		130 800	
less retirement contributions s11(k) (7.5% × R82 800 + 6 000 + 40 000) =	52 210		(1)
limited to *lesser* of:			
*R350 000, or	350 000		(1)
*27.5% of the higher of remuneration	130 800		
or taxable income	130 800		
× 27.5% =	35 970		(1)
Contribution allowed as a deduction.		(35 970)	(1)
Excess to be allowed as para 5 deduction for the lump sum	16 240		
Taxable income excluding retirement lump sum benefit		94 830	

SOLUTION 7.3 continued

Severance benefit	80 000		(1)
Lump sum from pension fund	550 000		(1)
less applicable para 5 deductions - RAF contributions disallowed in prior year	(20 000)		(1)
less applicable para 5 deductions - retirement contributions disallowed in current year	(16 240)	593 760	(1)
Taxable income		688 590	
Tax payable on 94 830		17 069	(1)
less rebate s6(2)(a)		(13 500)	(1)
Add tax on retirement lumpsum (R593 760 − R500 000) × 18%		16 877	(1)
less medical credit rebate s6A R286 × 12 months		(3 432)	(1)
less s6B rebate			
Own contributions to medical aid scheme	9 600		(0.5)
Reduced by 4 × R572 × 12 months (rebate for member)	(27 456)		(1)
	0		
Other medical expenses	20 000		(1)
	20 000		
Reduced by 7.5% of taxable income (R688 590)	(51 644)		(1)
	0		
Included at 25%		0	
Total tax payable		17 014	
			(20)

SOLUTION 7.4

Andrew Chabot

1. Restraint of trade receipt (paragraph (cA))		60 000	(1)
Salary (R6 900 × 7)		48 300	(1)
Pension Fund annuity R4 600 × 5		23 000	(1)
s10(1)(gC) exemption not applicable as only applies to foreign retirement funds			(1)
This restriction was previously uncertain until clarified by an amendment to s10(1)(gC), although technically this amendment only applies from 1 March 2017.			
Commission		17 175	(1)
No entertainment deduction as not earning wholly or mainly commissions and no allowance (s23(m))		0	(1)
Use of a company car R178 000 × 0.4% × 7	43 610		(1)
less Business use R43 610 × $^{30\,000}/_{40\,000}$	(32 708)		(1)
Private use 100c × 10 000	(10 000)	903	(1)
Purchase of motor car at amount greater than market value therefore no fringe benefit		0	(1)
		149 378	

SOLUTION 7.4 continued

less retirement contributions s11(k) (8.5% × R48 300 + R17 100) =		21 206		(1)
limited to *lesser* of:				
*R350 000, or		350 000		(1)
*27.5% of the higher of remuneration (R149 378 − R903 + 80% × R43 610)		183 363		
or taxable income		149 378		
	× 27.5% =	50 425		(1)
The full contribution is therefore allowed as a deduction.			(21 206)	(1)
No excess to be carried forward				
Taxable income excluding retirement lump sum benefit			128 172	
Tax payable (excluding lump sum)			23 071	(1)
Rebate			(13 500)	(1)
Lump sum from pension fund		600 000		(1)
Para 5 deductions that did not rank for deduction in terms of s11(k) prior years		(11 400)		
Para 5 deductions that did not rank for deduction in terms of s11(n) prior years		(1 900)		
		586 700		(1)
s10(1)(gC) exemption - see explanation above		0		
Taxable retirement lump sum benefit		586 700		
Normal tax on retirement lump sum benefit (R586 700 − R500 000) × 18%)			15 606	(1)
Total normal tax			25 177	

2. Balance of remuneration comprises the above:

Salary	48 300	(1)
Pension annuity	23 000	(1)
Company car fringe benefit 43 610 × 80%	34 888	(1)
Commission	17 175	(1)
The following may be deducted from remuneration:		
Retirement contributions (see calculation of limits above. As higher limit is based on remuneration, the deduction from balance of remuneration would be the same).	(21 206)	(1)
The restraint of trade payment (para iA 4th Schedule) is included in remuneration and balance of remuneration. The T1/T2 annual payment formula will have to be used to calculate PAYE.		(1)
		(25)

CHAPTER 8: INVESTMENT INCOME – RESIDENTS AND NON-RESIDENTS

Index to sections

Question	Sections	Grade	
Question 8.1	s9, s10(1)(h), s10(1)(k), s10(1)(*l*), s23(f), s37J, s49B, s64E	*	S
Question 8.2	s6*quat*, s9, s10(1)(h), s10(1)(i), s10(1)(k), s10(1)(*l*), s10B, s37J, s49B, s64E	**	S
Question 8.3	Residence, s9, s10(1)(*l*), s35	*	
Question 8.4	s9, s10(1)(h), s10(1)(k), s10(1)(*l*), s18A, s23(f), s35	**	S
Question 8.5	s8(1), s9, s10(1)(h), s10(1)(i), s10(1)(k), s10(1)(*l*), s10A, s11(a), s23(m), s26A, s35, s35A	**	
Question 8.6	s9D – controlled foreign company definition	**	
Question 8.7	s6*quat*, s9D, s10(1)(i), s10(1)(k), s10B, s11C	**	
Question 8.8	s6*quat*, s9D, s10B	***	
Question 8.9	s6*quat*, s9D, s10B	***	S
Question 8.10	s6*quat*,s9, s10(1)(h), s10(1)(i), s10(1)(*l*), s25D, s35, s49B	**	
Question 8.11	s6*quat*, s9D, s10B	***	S
Question 8.12	s6*quat*, s9D, s10(1)(i), s10(1)(k)	***	
Question 8.13	s6*quat*, s9D, s10B	***	
Question 8.14	s6*quat*, s9D, s10B	**	
Question 8.15	s6*quat*, s9D, s10B	***	
Question 8.16	Residence, s9, s10(1)(h), s10(1)(*l*), s49B	*	
Question 8.17	Residence, s9, s10(1)(i), s10(1)(h), s10(1)(k), s10A, s10B	***	

QUESTION 8.1 (Solution at end of chapter) (17 Marks)

Tim Daniels is not a resident of South Africa and does not have a permanent establishment in South Africa, nor has he visited South Africa in the last two years. In the 2017 year of assessment he earned interest of R30 000 on a deposit in a South African fixed deposit and dividends of R10 000 from investments he had made in 2008 in South Africa. In addition he earned royalties of R250 000 in respect of a patent he had devised in South Africa in 2008. Expenses in connection with the royalty received amounted to R25 000. The royalties are only earned from use in the South Africa of the patented process.

YOU ARE REQUIRED TO: Discuss Tim's South African tax position in respect of the amounts accruing. Include a calculation of taxable income in your answer. You may ignore the application of double tax treaties.

QUESTION 8.2 (Solution at end of chapter) (18 Marks)

Mrs Smit, aged 50, has lived her entire life in Johannesburg, but is now considering immigrating to Australia. Mrs Smit's annual income is as follows:

1. Dividends
    - From South African companies R50 000
    - From foreign companies R20 000

    Mrs Smit owns less than 5% of the shares in the foreign companies. Section 10B(2) does not apply.
2. Interest
    - From her brother (a resident) on a loan made R60 000
    - From a French bank R30 000

3. Royalty
   - From South Africa R150 000
   - From France R200 000

   The royalty is in respect of a patented process that Mrs Smit invented in South Africa. The royalties are paid in respect of the use of the patent in South Africa and France respectively.
4. Rental income R100 000

   The rental is received from the letting of a house that Mrs Smit owns in France.

Before she makes her final decision to emigrate, Mrs Smit wishes to know what her South African tax position will be if she stays or if she emigrates.

YOU ARE REQUIRED TO:

1. Calculate Mrs Smit's South African taxable income for the year ended 28 February 2017 if she does not emigrate.
2. Calculate Mrs Smit's South African taxable income for the year ended 28 February 2017 if she emigrates on 1 March 2016. Indicate whether or not any withholdings taxes apply. (Ignore the impact of any double tax treaty.)

Complete tasks 1 and 2 in tabular format. Assume for both tasks that all amounts accrue evenly over the year of assessment.

QUESTION 8.3 **(17 Marks)**

Mr Olivier, an avid surfer and globetrotter, lived in South Africa, which he considered to be his true home. On 30 June 2015, he divorced his wife and immigrated to Brazil where he bought a house in Ipanema, a surfing hotspot in Rio de Janeiro. He returned to South Africa only once to visit his children for a period of three months from 20 November 2016 until 20 February 2017. During the past six years of assessment, Mr Olivier was physically present in South Africa as follows:

Year of assessment ended	Days in South Africa
28 February 2017	92
29 February 2016	122
28 February 2015	140
28 February 2014	95
28 February 2013	100
29 February 2012	200

Mr Olivier's income for the 2017 year of assessment consisted of the following:

- Whilst in Brazil he developed a design of a new surfboard that he subsequently patented. He then proceeded to market the design whilst on holiday visiting his children in Cape Town. A South African surf shop, Surfs-Up Ltd, sold the surfboards in South Africa and paid Mr Olivier royalty income of R50 000 for the 2017 year of assessment, for the use of his design in South Africa. The royalty was earned evenly throughout the year of assessment.
- As part of his divorce settlement he received a flat in Newlands that he rents out to his friend Andrew, a South African resident. He received rentals of R60 000 for the 2017 year of assessment.
- Mr Olivier also owns shares in a number of UK companies. Dividends the equivalent of R40 000 were received in the 2017 year of assessment.

You may assume that all amounts accrue evenly over the year of assessment.

YOU ARE REQUIRED TO:

1. Explain, giving full reasons, whether or not Mr Olivier is a 'resident' as defined in section 1 of the Income Tax Act for the year of assessment ended 28 February 2017. (5 Marks)
2. Assuming Mr Olivier is a non-resident for the entire 2017 year of assessment, calculate his gross income as well as any other South African tax liability arising from his receipts for his year of assessment ended 28 February 2017. Give full explanations. (10 Marks)
3. Explain how your answer to (2) would differ if the flat was located in Paris. (2 Marks)

QUESTION 8.4 (Solution at end of chapter) (15 Marks)

John Berry was formerly resident in South Africa but immigrated to Botswana in 2010. Prior to his immigration he had written a book whilst on holiday in Botswana.

He settled in Gaborone, Botswana and then had his book published. The book turned out to be a bestseller and to date he still receives royalties from all over the world in respect of book sales.

John dedicated the book to the Wildlife Society of South Africa and each year he donates the net income from books sold in Botswana to the Wildlife Society. The Wildlife Society of South Africa does not issue section 18A certificates.

As his book concerns bird life in Africa, it has sold well in South Africa. John invested the royalties earned from South African sales in a fixed deposit in a bank in South Africa and used the interest from this investment to become a shareholder of Environlife (Pty) Ltd in South Africa. John is not a director of this company. Environlife carries on all its business in South Africa and mainly sells goods manufactured in Botswana.

Years ago John inherited a house in Hermanus, South Africa and shares in South African companies from an uncle in South Africa. John let the house to relatives for two months in the current year of assessment.

During the 2017 year of assessment South African Television (SATV) produced a documentary on bird life in South Africa. Being an expert in this field, John was asked to assist with the preparation of this documentary. He was paid R100 000 by SATV for advising it on various aspects of the film. The advice was given by telephone from Botswana and followed up in faxes and letters, which were written in Gaborone.

The following information relates to the 2017 year of assessment:

Receipts and accruals:		**R**
Interest on fixed deposit		12 500
Gross dividends on inherited South African shares		21 900
Gross dividend from Environlife (Pty) Ltd		30 500
Rentals – Hermanus house		8 750
Royalties from book sales	– South Africa	32 000
	– Botswana	15 000
	– Worldwide*	25 000
SATV receipt		100 000

*Worldwide royalties exclude royalties from South Africa and Botswana.

Expenditure incurred in respect of the following:	**R**
Broker's fees (in respect of South African shares)	1 250
Sundry revenue expenses for the rental period (rentals)	2 050
Royalty-linked management fees (incurred in the country of sale)	22 500
Sundry revenue expenses (SATV payment)	5 000

You may assume that all amounts accrue evenly over the year of assessment and that John has not visited South Africa in either the current or prior year of assessment.

YOU ARE REQUIRED TO: Calculate John's final liability for South African taxes in respect of amounts he earned from South Africa for the year of assessment ended 28 February 2017.

QUESTION 8.5 (23 Marks)

Mrs Ivy Chandler, aged 55, worked for many years as an agent for a Cape Town-based company called Daisy Limited. Her remuneration was normally derived approximately 75% from commission and 25% from fixed salary.

She decided to opt for early retirement on 1 October 2016 and to immigrate to the UK, which she did on 1 December 2016.

The following amounts accrued to her during her 2017 year of assessment:

	Note	R
Salary (1/3/2016 to 1/10/2016)		85 000
Commission (1/3/2016 to 1/10/2016)		125 000
Entertainment allowance	1	10 000
Reimbursement of entertainment expenditure	2	3 250
Retirement lump sum from employer	3	20 000
Accumulated leave pay (to 1/10/2016)		6 500
Interest on fixed deposit	4	20 000
Annuity receipts	5	2 000
Interest on UK investments	6	10 000
Royalties	7	300 000
Salary (1/12/2016 to 28/2/2017)	8	60 000
Proceeds on sale of primary residence	9	6 000 000

Notes

1. Mrs Chandler was regularly required to entertain clients on behalf of Daisy. Her actual expenditure in this regard was R6 000 for the 2017 year of assessment. She was not required to account to Daisy for the use of the allowance.
2. Besides the expenditure referred to in note (1) above, Mrs Chandler was instructed by Daisy to acquire rugby season tickets for certain selected clients. She bore the cost thereof and was reimbursed in full by Daisy.
3. The retirement lump sum was received from Daisy. This was the only lump sum that Mrs Chandler had ever received.
4. The fixed deposit in Boland Bank had been made during her 2015 year of assessment and the interest thereon of R20 000 was earned evenly throughout her 2017 year of assessment.
5. Mrs Chandler used cash and her retirement lump sum to purchase an annuity for R30 000 on 1 October 2016. The annuity was to pay R400 per month for ten years from that date.
6. The investment consisted of a fixed deposit in a UK bank that had been made in 2013. The interest thereon of R10 000 (translated correctly) was earned evenly throughout her 2017 year of assessment.
7. The royalty income related to a book that Mrs Chandler had written in the UK during 2009. R118 500 of the royalties related to sales of the book in South Africa from 1 March 2016 to 30 November 2016, while R43 500 thereof related to sales of the book in South Africa from

1 December 2016 to 28 February 2017. The balance of the royalty income was in respect of sales of the book in the UK and was earned evenly throughout her 2017 year of assessment.

8. The salary related to her employment in the UK and was earned after 1 December 2016.
9. The house had a base cost of R3.9 million and was sold in February 2017. Assume section 35A applies and no attempt was made by Mrs Chandler to reduce the withholding.
10. Employees' tax of R46 260 had been withheld by her employer by 1 October 2016. Mrs Chandler is not a provisional taxpayer.

YOU ARE REQUIRED TO: Calculate the income tax still owing by Mrs Chandler for her 2017 year of assessment. (Ignore VAT.)

QUESTION 8.6 **(17 Marks)**

PART A

YOU ARE REQUIRED TO: Identify whether or not, and for whom, the companies are controlled foreign companies in each of the following scenarios. In each case, the percentages reflect ownership of participation or voting rights.

1. A, resident in South Africa, owns 51% of Z Co, a South African company. The remaining interests are held by non-residents.
2. B, resident in South Africa, owns 49% of Y Co, a foreign company effectively managed in South Africa. The remaining 51% of participation rights are held by non-residents.
3. C, a resident of South Africa, owns 30% of X Co, a foreign company. Other South African residents (unconnected to C) own 25% and the remaining rights are held by non-residents.
4. D, a resident of South Africa, owns 10% of W Co, a foreign company. Eleven other South African residents each own 4% of company. The remaining interests are held by non-residents.
5. E, a resident of South Africa, owns 10% of V Co, a foreign listed company. Eleven other South African residents each own 4% of the company. Non-residents hold the remaining interests.
6. Does your answer in (5) above change if the eleven residents are connected to E?
7. Does your answer in (5) change if the eleven residents are not connected but all the non-residents are connected to E?
8. F, G, H and I each hold 15% of U Co, a foreign company. J, a non-resident, holds the remaining interest. U Co holds 55% of T Co, a foreign company. The remaining interest in T Co is held by non-residents.
9. How does your answer to (8) change if F, G, H and I are all connected persons?

PART B

A controlled foreign company (CFC A) has been identified. The net income has been determined as amounting to R500 000 and the company would have taxable income of R490 000 if it were treated as a South African resident taxpayer. Determine the section 9D(2) inclusion in income for the resident taxpayer in each scenario below. In each case, the percentages reflect ownership of participation or voting rights.

1. Assume Z holds 11% of CFC A and the foreign tax paid by CFC A amounted to R98 000.
2. Y holds 7% of CFC A.

3. Y holds 7% and is connected to Z, holding 11%.
4. Z holds 11% of CFC A and the foreign tax paid by CFC A amounted to R122 500.

QUESTION 8.7 **(20 Marks)**

Note: Discuss only South African tax and ignore any double tax treaties.

X Ltd, a foreign company, receives 100% of its profits from a non-South African source. Mr A (a South African resident) holds 9% of the equity shares and 18% of the preference shares in X. This equates to 12% of the participation rights and voting rights. Mr A incurred interest of R30 000 on a loan used to acquire his shares.

X Ltd earns profits of £100 000 and is subject to company tax of £20 000 in the UK. £40 000 of the after-tax profit was declared as the total dividend to equity shareholders and £20 000 was declared as the total dividend to preference shareholders. Both are subject to a foreign withholdings tax of 5%. The spot rate on the date of the dividend was £1 = R13.50.

The above is Mr A's only source of income.

The second proviso to section 9D(2A), as regards the foreign taxes paid in relation to SA Tax, does not apply.

YOU ARE REQUIRED TO: Calculate the South African income tax liability of Mr A, assuming an average exchange rate of £1 = R13.90 for the foreign company's tax year and £1 = R14 for Mr A's 2017 year of assessment), if:

1. The foreign company is a controlled foreign company for the entire foreign tax year.
2. The foreign company is not a controlled foreign company for the entire foreign tax year.

Parts (1) and (2) must be treated as independent from each other. In addition, it is assumed, where X Ltd is or is treated as a controlled foreign company, that this is the first year that the inclusion is to be applied (i.e. no previous section 9D inclusions).

If applicable, assume that the limit for section 10B(2)(c) is in excess of the foreign dividend inclusion.

QUESTION 8.8 **(41 Marks)**

Jane Doe has a number of foreign investments and has approached you to determine the South African income tax consequences of such investments. Jane is not a share dealer (i.e. all the shares are held on capital account). Some of the information below may/may not be relevant. Section 9D(9)(b) does not apply to any of the companies below. In addition, the further proviso to section 9D(2A) regarding the quantum of foreign taxes also does not apply to any of the companies below. None of the companies are 'headquarter companies' as defined.

Investment 1 (Euros):

Jane holds 11% (participation and voting rights) of Bob Ltd, a foreign company, acquired on 1 September 2014 from a non-resident. The participation rights do not match the equity share holdings. Jane's participation rights only matched eight percent of the equity shares of Bob Ltd. Other residents, unconnected to each other or to Jane, hold 40% of the participation (and voting) rights. Bob Ltd has declared a dividend to its equity shareholders (gross of withholdings tax) of €2 000 000 on 31 August 2016. The company withheld 10% of the dividend for tax purposes in terms of the laws of that foreign country.

Bob Ltd holds 51% of the equity shares in Rob Ltd, a foreign company operating in the same country as Bob Ltd. The participation and voting rights match the equity holdings for all shareholders. All the other equity shares, participation and voting rights are held by unconnected non-residents. Rob Ltd declared a gross dividend to its shareholders of €250 000 on 31 August 2016. The company was required to withhold 10% of the dividend for tax purposes.

The companies have the following financial information in Euros:

Bob Ltd	**31 August** *2015*	**31 August** *2016*
Profit (matching net income for section 9D(2A) purposes):	12 000 000	15 000 000
Taxes (proportional to all forms of income received) (35%)	(4 200 000)	(5 250 000)
Profit after taxes	7 800 000	9 750 000

Included in the 31 August 2016 profit for Bob Ltd is its share of the dividend from Rob Ltd (gross of withholdings tax) of €127 500 (51% of €250 000). Both companies have a 31 August year-end.

Rob Ltd	**31 August** *2015*	**31 August** *2016*
Profit (matching net income for section 9D(2A) purposes):	800 000	900 000
Taxes (proportional to all forms of income received)	(280 000)	(315 000)
Profit after taxes	520 000	585 000

Neither Bob nor Rob Ltd declared dividends in the foreign year ended 31 August 2015. Both companies have August year-ends.

Exchange rate information:
Investment 1
Average exchange rate: 1 September 2015 to 31 August 2016: €1 = R12.45
Spot rate on dividend declarations: €1 = R11.3
Average exchange rate: 1 September 2014 to 31 August 2015: €1 = R9.89

Investment 2 (Pounds)
Jane holds 15% of the participation rights and voting rights (equating to a 9% holding of equity shares) of Thomas Ltd, a foreign company. Other residents, connected to Jane, hold 40% of the participation rights and voting rights of Thomas. Thomas Ltd holds 60% of the participation (and voting) rights of Teddy Ltd. The remaining participation (and voting) rights of both Thomas Ltd and Teddy Ltd are held by unconnected non-residents.

The companies each have foreign tax years ending on 30 June each year. Jane acquired her interest in Thomas Ltd from another connected resident on 1 May 2016.

Financial information for the companies is as follows:

Thomas Ltd
Net income (per section 9D(2A)) from 1 May 2016 to 30 June 2016 was £250 000; from 1 July 2016 to 28 February 2017 was £1 900 000. For the period 1 July 2015 to 30 June 2016, net income (per section 9D(2A)) was £3 250 000 and from 1 March 2016 to 28 February 2017 was £4 000 000.

Taxes are levied at a flat rate of 30% on all above amounts. Thomas Ltd declared a gross dividend to equity shareholders amounting to £500 000. Five per cent was withheld for tax purposes by the company.

Teddy Ltd
Net income (per section 9D(2A)) from 1 May 2016 to 30 June 2016 was £40 000; from 1 July 2016 to 28 February 2017 was £700 000. For the period 1 July 2015 to 30 June 2016, net income (per section 9D(2A)) was £750 000 and from 1 March 2016 to 28 February 2017 was £800 000.

Taxes are levied at a flat rate of 30% on all above amounts. Teddy Ltd declared no dividends.

Average exchange rate from 1 July 2015 to 30 June 2016: £1 = R15.18
Spot rate on dividend declarations: £1 = R15.89

Investment 3 (Yen)
Double Ltd is a foreign company. Jane holds 11% of the participation rights (equal to 7% of the equity shares). Other unconnected residents hold 49% of the participation rights in Double Ltd. Double Ltd holds 100% of the participation rights in Trouble Ltd (a South African company) and 85% of Twins Ltd, a foreign company. All these companies have February year-ends.

The following information is relevant:

Company	Net income (s9D(2A))	Taxable income	Taxes levied
Double Ltd	¥90 000 000	¥100 000 000	¥45 000 000
Trouble Ltd	N/A	R45 000 000	R12 600 000
Twins Ltd	¥70 000 000	¥85 000 000	¥30 600 000

Average exchange rate: 1 March 2016 to 28 February 2017: ¥1 = R0.08738

Additional information

Average exchange rates for the period 1 March 2016 to 28 February 2017:
€1 = R12.50
£1 = R14.90
¥1 = R0.08738

YOU ARE REQUIRED TO:

1. Discuss, for each investment, which companies are controlled foreign companies in relation to Jane AND, if the foreign company is a CFC, but you believe that Jane will NOT have a section 9D inclusion, you need to provide a reason your assertion. You do NOT need to consider the further proviso to section 9D(2A) regarding the quantum of foreign taxes.
2. Calculate Jane's taxable income and income tax payable for the 2017 year of assessment based on the information provided.

Note: Jane does not elect to apply the average exchange rate. If applicable, assume that the limit for section 10B(2)(c) is in excess of the foreign dividend inclusion.

QUESTION 8.9 (Solution at end of chapter) (23 Marks)

Gill Jaymor earns South African employment income of R500 000 *per annum*. Apart from the South African employment income, he has the following investment in a foreign company. All percentage holdings reflected represent the participation rights and also equal voting rights unless the contrary is stated. Note that the further proviso to section 9D(2A) does not apply (concerning the quantum of foreign taxes paid). Assume further that if apportionment is required in terms of section 9D(2), the calculation producing the lowest result must be selected. In all cases, Gill's holdings in the companies represent equity shareholdings of less than 10%. Dividends declared by the foreign companies represent dividends across all classes of shares (i.e. equity and preferential-type shares) such that any dividend would be received in proportion to the participation rights held.

Gill directly holds 18% (since 1 October 2015) of Charlie, an unlisted foreign company with a September year-end. Other connected residents hold a further 40% of Charlie. Charlie had a holding of 8% in Delta, an unlisted foreign company. On 1 May 2016, Charlie acquired a further 48% in Delta, resulting in a holding of greater than 10% of the equity shares and voting rights in Delta. Delta has a June year-end. Delta is held exclusively by non-RSA residents (including Charlie's holding in Delta).

Net income (as per section 9D(2A) and after any applicable section 9D exemptions) has been calculated for the following periods for Charlie and Delta respectively:

Period	Charlie (in Euro)	Delta (in GBP)	Average exchange rate for the period shown (1 foreign unit = ? Rands)	
			Euro	**GBP**
1 March 2016 to 28 February 2017	150 000	228 000	10.29	14.76
1 October 2015 to 30 September 2016	180 000		9.96	
1 July 2015 to 30 June 2016		200 000		14.5
1 May 2016 to 30 June 2016		68 000		14.66

Charlie declared a dividend on 30 October 2016 of €50 000 (spot rate on that date was €1 = R9.79). Dividends from Charlie are subject to a 5% with holdings tax in the country of origin.

Charlie is subject to a corporate rate of 35% on all income, whereas Delta is subject to a corporate rate of 25% on all income. Both companies earn passive income streams only and none is from a South African source.

YOU ARE REQUIRED TO: Calculate the normal tax liability for Gill for the 2017 year of assessment. No employees' tax or provisional tax credits are to be calculated. You need to elect any option that will reduce the section 9D inclusion (if any). If applicable, assume that the limit for section 10B(2)(c) is in excess of the foreign dividend inclusion. You are required to show any amount to be carried forward in terms of any relevant Income Tax Act provision.

QUESTION 8.10 (12 Marks)

Four separate case studies follow. In all cases ignore the effects of double tax treaties.

1. Mr Bright, who is resident in the United Kingdom, invented a process in the UK, which he patented. A South African company uses the process in South Africa and pays Mr Bright a royalty of R50 000 per month. Mr Bright does not carry on business in the Republic.

   Will Mr Bright be subject to tax in South Africa?

2. Mr Slim, who is ordinarily resident in South Africa, invented a process, at his laboratory in Johannesburg and patented it. The process is used in Country X by a company that pays Mr Slim a royalty of R50 000 per month. The royalty is taxed in Country X. The tax paid in Country X is R300 000. Mr Slim has other South African taxable income (excluding the royalty) of R400 000. Mr Slim has no permanent establishments outside of South Africa.

   Discuss the treatment of the foreign tax paid in terms of the Income Tax Act.

3. Mr Lumba emigrated from South Africa to America in 1997. Because of exchange control regulations at the time, he was forced to invest R1 million in a South African bank. During the year ended 28 February 2017 interest of R120 000 accrued to Mr Lumba. Mr Lumba visited South Africa twice during the year to see his mother. Both visits were three weeks long.

   Is Mr Lumba subject to South African tax on his interest income in the 2017 year of assessment? Will the outcome be the same in the 2018 year of assessment?

4. Mrs Sharp, who is ordinarily resident in South Africa, invested £50 000 in a bank in London. For the year ended 28 February 2017 interest of £2 000 accrued to Mrs Sharp. The interest accrues monthly.

   Discuss the South African tax in respect of the interest.

QUESTION 8.11 (Solution at end of chapter) (13 Marks)

Y Ltd holds 19% of the equity share capital in W Ltd, which in turn holds 100% of the equity shares capital in Z. All of the profits earned by Z and W are from non-South African sources. Y Ltd is ordinarily resident in South Africa. Neither W nor Z is a South African resident company.

The profits and distributions of Z and W are as follows:

Z LTD	**$**
Profits for the year	500 000
Taxation	(100 000)
After tax income	400 000
Dividends distributed	(200 000)
Retained income	200 000
W LTD	
Profits for the year	1 000 000
Dividends received	200 000
Retained income	1 200 000
Taxation	(480 000)
After tax income	720 000
Dividends distributed	(720 000)
less withholding tax	(20 000)
Dividend paid	700 000

YOU ARE REQUIRED TO: Calculate the South African tax payable by Y Ltd, assuming an exchange rate of $1 = R10; it is a 2017 year of assessment for the companies; the further proviso to section 9D(2A) regarding the quantum of foreign taxes does not apply; and

1. Assuming W and Z are not CFCs
2. Assuming W and Z are CFCs
3. Assuming W and Z are not CFCs but the holding of Y in W is only 9%.

QUESTION 8.12 (42 Marks)

John Bell, a South African resident aged 47, has a small trading operation and a number of investments in equities. His retail trade is currently profitable and provides taxable income of R700 000 (all from a South African source).

Investments

1. John invested in Lab Co Ltd, a company registered and with its place of effective management in the United Kingdom. He acquired his 11% interest (matching the participation and voting rights) in the company for R3 million on 1 November 2015. John acquired his interest from a non-resident friend. Other residents hold 40% of Lab Co Ltd and non-residents hold the remaining interests.

   Lab Co Ltd has a financial and tax year ending on 30 September each year. It has net income (per section 9D(2A) before the further proviso to that section concerning the quantum of taxes); taxable income (as if the company was a resident); its foreign taxable income (for its country of residence); and foreign taxes levied on the foreign taxable income as detailed in the table below.

Period	Net income	Taxable income as if company SA resident	Actual UK taxable income	Foreign taxes
1 October 2015 to 30 September 2016	£100 000	R1 500 000	£120 000	£24 000

2. John also owns 15% of the shares in Vizsla Ltd (a Hungarian company). Vizsla Ltd in turn holds 51% of the shares in Weimaraner Ltd (a German company), which were acquired on 1 July 2015. Both Vizsla Ltd and Weimaraner Ltd have 30 June year-ends. John bought his shares in Vizsla Ltd on 1 August 2014. He bought the shares from a fellow resident. John's brother, Ethan, is a resident in the United Kingdom. Ethan owns 40% of the shares in Vizsla Ltd and residents unconnected to John or Ethan own the remaining 45%. The shareholdings match the participation and voting rights in each of these companies. Both Vizsla Ltd and Weimaraner Ltd are not listed.

   The net incomes (per section 9D(2A) before the further proviso); taxable incomes (as if the companies were resident); the foreign taxable incomes (for the relevant country of residence); and foreign taxes levied on such foreign taxable incomes are detailed in the tables below.

Vizsla Ltd	Net income	Taxable income as if company SA resident	Actual Hungarian taxable income	Foreign taxes
1 July 2014–30 June 2015	HUF 15 000 000	R560 000	HUF 12 000 000	HUF 4 200 000
1 July 2015–30 June 2016	HUF 18 000 000	R676 500	HUF 20 000 000	HUF 7 000 000

Weimaraner Ltd	Net income	Actual German taxable income	Foreign taxes
1 July 2015–30 June 2016	€900 000	€1 000 000	€200 000

   Note: You may assume that Weimaraner Ltd's foreign taxes are less than 75% of the normal tax that would have been levied on taxable income derived as if Weimaraner Ltd was a resident.

   Vizsla Ltd declared a dividend to its shareholders on 31 August 2016 of HUF 10 000 000. There was no withholdings tax levied on this dividend.

3. John also has a number of other foreign investments from which dividends (already correctly translated to Rands) amounted to R545 000 (gross of withholdings taxes). Withholdings taxes (already correctly translated to Rands) levied on such dividends amounted to R27 250. All holdings were below 5% and were in listed foreign companies, which were NOT listed on the JSE Securities Exchange. All of these companies derived all of their profits and investment incomes from non-SA sources.

   The exchange rates to be considered are provided in the table below:

Dates	Hungarian Forint (HUF) Ft1 =	Euro (EUR) €1 =	British Pound (GBP) £1 =
Average rate: 1 July 2014 to 30 June 2015	0.039	10.53	
Average rate: 1 July 2015 to 30 June 2016	0.035	9.53	
Average rate: 1 October 2015 to 30 September 2016			11.06
Average rate: 1 March 2015 to 29 February 2016	0.034	9.55	11.17
Average rate: 1 March 2016 to 28February 2017	0.036	9.75	11.10
Spot: 31 August 2016	0.033		

YOU ARE REQUIRED TO:

1. Discuss whether or not each of the above foreign companies is controlled foreign companies as defined in section 9D in relation to John AND whether or not the date of acquisition AND size of John's holding influences any potential section 9D(2) inclusion. Only calculations regarding the size of the holding may support your answer. (15 Marks)
2. Calculate the tax liability (after rebates) for John Bell for the year of assessment ending 28 February 2017. You must support your calculations with explanations (where decisions are required). You must also show any amounts to be carried forward to the next year of assessment. If applicable, assume that the limit for section 10B(2)(c) is in excess of the foreign dividend inclusion. (27 Marks)

QUESTION 8.13 **(11 Marks)**

Gerry Gereldson, a South African resident, 55 years old, owns a few foreign investments. He would like you to advise him as to the best way to minimise his South African tax liability with regard to his investment in Almond Investments Ltd.

Gerry owns 15% of the equity share capital (which also equates to the participation rights and voting rights of this listed company) of Almond Investments Ltd. Eleven unconnected residents each hold 4% of the participation rights in Almond (i.e. a total of 44%). The company has a 31 December year-end.

The net income (as per section 9D(2A)) has been determined as being £90 000 and includes no South African profits or South African dividends. The corporate taxes are at a flat rate of 20% on the net income above and are less than 75% of the taxable income that would have been levied on Almond Investments Ltd had it been a resident of South Africa. The company also declared a total dividend of £30 000 to the shareholders on 31 December 2016. The company was obliged to withhold 10% of the dividend as a withholdings tax.

Gerry had borrowed money from a South African bank to acquire this holding. The interest incurred on this specific loan was R40 000.

Gerry has other South African taxable income before taking the above into account of R400 000. A section 6*quat* rebate has been brought forward from the 2016 year of assessment amounting to R1 080.

Exchange rates:

- Spot rate at the date of dividend declaration on 31 December 2016 was £1 = R12.50
- Average exchange rate for the year of assessment ended 28 February 2017 was £1 = R13.90
- Average exchange rate for the foreign tax year of Almond ended 31 December 2016 was £1 = R13.60

YOU ARE REQUIRED TO: Prepare supporting tax liability calculations to advise Gerry as to the South African tax implications of his investment for the 2017 year of assessment, assuming that Almond Investments Ltd delists with effect from 1 June 2016. You are also required to calculate any carry-forwards permitted in terms of any provision, or provide a reason for the inability to carry forward an amount, if applicable.

QUESTION 8.14 **(15 Marks)**

Mrs Thembe, 70 years of age, has various offshore investment holdings.

Investment 1

Mrs Thembe purchased 25% of 'Chorus Investment Holdings Ltd' (Chorus) from Jill Johnson (a resident). The transaction took place on 1 May 2015. Chorus has a foreign tax year ending 31 December. Other unconnected residents hold 40% of the participation rights of this unlisted company with five of these unconnected residents each holding 4% of the participation rights. The equity shareholding matches the participation and voting rights.

The net income (as determined in terms of section 9D(2A)) for the year ended 31 December 2016 amounted to £120 000. The net income from 1 May to 31 December 2016 was £85 000. Corporate taxes were 20% on all net income amounts above. The further proviso to section 9D(2A) concerning the quantum of foreign taxes does not apply.

Chorus declared a gross dividend to its shareholders of £15 000 on 28 February 2017 (spot rate was £1= R14.30). This dividend was subject to a withholdings tax of 10%.

The average exchange rate for the period ended 31 December 2016 was £1 = 14.15 and for 28 February 2017 was £1 = 14.20.

Investment 2

On 1 July a dividend of €1 000 (spot rate was €1 = R9.35) was received (gross of withholdings tax) from another European in which Mrs Thembe owns three percent of the equity shares. This country applies a withholdings tax of 5% on dividends declared. This company is not a controlled foreign company as defined.

Investment 3

On 1 September 2016 Mrs Thembe received a foreign dividend of €500 (spot rate was €1 = R9.54) from a company in Europe in which she owns less than 1% of the equity shares. This country does not have a withholdings tax on dividends declared by companies. This company is not a controlled foreign company as defined.

A loan from a South African bank was used to acquire investments (2) and (3). Interest of R9 000 was incurred on this loan in the year of assessment ended 28 February 2017.

Average exchange rate for Euros was €1 = R9.40 for the year of assessment ended 28 February 2017.

YOU ARE REQUIRED TO: Calculate Mrs Thembe's South African tax liability for the year of assessment ended 28 February 2017, providing reasons for your answers where necessary. You are also required to calculate any carry forwards permitted in terms of any provision, or provide a reason for the inability to carry forward an amount, if applicable.

You may assume that Mrs Thembe elects to translate her dividend income into Rands at the average rate for the year of assessment in terms of section 25D(3).

QUESTION 8.15 **(40 Marks)**

John Williams has a successful South African business and a number of foreign investments. He is uncertain as to the impact these foreign investments will have on his South African tax liability. His accountant has confirmed that the South African business generated taxable income (in John's personal capacity as a sole trader) of R1 400 000.

With respect to the foreign investments, you may assume that John is not a share dealer. None of the companies are 'headquarter companies' as defined.

1. Trader Co

Trader Co is a foreign company in which John holds 9% of the equity shares and 11% of the participation rights. The voting rights match the participation rights. John's family own the remaining 89% of the participation rights, of which 49% are held by non-resident family members. The Commissioner is satisfied that the operations represent a foreign business establishment in terms of section 9D(9)(b) and that all net income attaches to that foreign business establishment. The net income (before section 9D(9)(b)) amounted to €2 000 000. The company has a 30 April year-end and is in a tax jurisdiction that levies tax of only 15% on all forms of income. The company declared a gross dividend on equity shares on 15 May 2016 of €400 000. This was subject to a withholdings tax of €40 000. Spot rate on the date the dividend accrued was €1 = R10.49. The average exchange rate for the period 1 May 2015 to 30 April 2016 is €1 = R10.28.

2. Duel Co

Duel Co is listed on both the JSE and a foreign exchange. The company declared a dividend of £5 000 000 to shareholders. John has a 0.5% equity shareholding of JSE-listed shares. Unconnected non-residents control more than 50% of the participation rights and voting rights of this company. The payment occurred on the date the dividend became payable. The spot rate on the date the dividend accrued was £1 = R13.11. No foreign withholdings tax applied to the dividend.

3. Invest Co

Invest Co, an unlisted foreign company, has a 30 September year-end. John bought an equity interest in Invest Co of 6% and a preference share interest of 6% (representing 11% voting rights and 13% participation rights) on 2 January 2016. His interest was acquired from an unconnected non-resident. Other residents hold 40% of the voting rights, but only 36% of the participation rights. The remaining interests are held by non-residents. None of the parties are connected persons.

Net income (per section 9D(2A)) from 2 January 2016 to 30 September 2016 was £120 000; from 1 October 2015 to 30 September 2016 it was £180 000. For the period 1 March 2016 to 28 February 2017, net income was £200 000. No section 9D(9) exclusions apply. Taxes in this jurisdiction are levied at 20% on all forms of income. The net income in each case matches the foreign taxable income. The South African taxable income, if the company had been resident for the period 1 October 2015 to 30 September 2016, would have been R2 600 000 (earned evenly throughout the period). The company declared a gross dividend on equity shares of £160 000, payable on 20 October 2016. A withholdings tax of 5% was applied to this dividend on behalf of the shareholders. The average exchange rate for the period 1 October 2015 to 30 September 2016 is £1 = R12.90. The spot rate of the date the dividend accrued was £1 = R13.40.

Additional information:

Average exchange rates for the period 1 March 2016 to 28 February 2017:
€1 = R10.20
£1 = R13.30

YOU ARE REQUIRED TO:

1. Discuss whether or not each of the above foreign companies are controlled foreign companies in relation to John AND, if the foreign company is a CFC, but you believe that John will NOT have a section 9D inclusion, you need to provide a reason your assertion.
2. Calculate John's taxable income and income tax payable for the 2017 year of assessment based on the information provided. Irrespective of your conclusions in part (1) above, for this part, assume that no section 9D(2) inclusion arises for Trader Co or Duel Co, but that a section 9D(2) inclusion does arise for Invest Co.

Notes

a. John does not elect to translate his income into Rands at the average rate for the year of assessment in terms of section 25D(3).
b. John wished to minimise his section 9D inclusions wherever possible.
c. If required, assume that the limit for section 10B(2)(c) is in excess of the foreign dividend inclusion.

QUESTION 8.16 **(15 Marks)**

You recently received the following email from Peter Guillam, a friend of yours who went to work in the New York office of an international audit firm two years ago:

Dear friend,

As you know, I have been working in New York (in the USA) for the past two years. I am quite concerned about whether I still have to pay tax in South Africa. In particular, I am interested in your opinion of the following two items.

I earned R50 000 interest from money that I had inherited and have put on fixed deposit with a South African bank.

In my spare time I invented a type of waterproof, breathable material that can be manufactured a lot cheaper than Gore-Tex (the name brand that first invented this type of material in the USA). I registered the patent in the USA for R5 000 and also in South Africa for R9 000 (in the hope of a potential market for the product).During the current year of assessment I earned royalties of R120 000 from South African companies and R250 000 from American companies for use of my patents in those countries.

I was only in South Africa for ten days' holiday in the current tax year. I have a great job here and I do not intend ever to return to South Africa (apart from visiting friends and family). My employer here withholds tax each month from my salary, which is paid over to the IRS (the American tax authority). Surely my only tax obligations are in the USA now?

I know that you are studying for your exams at the moment, so if you know anything that would help me figure out whether any income is taxable in South Africa I would greatly appreciate your advice.

Yours sincerely,
Peter

YOU ARE REQUIRED TO: Write a memo to your friend Peter explaining whether the interest and royalty income that he earned

1. should be included in his gross income; and
2. is taxable in South Africa or not.

Your answer need only deal with Peter's interest and royalty income and does not need to cover his salary or the administrative requirements of submitting a tax return.

QUESTION 8.17 **(20 Marks)**

Mrs Wealthy is deciding whether to immigrate to Australia on 1 March 2016. If she does emigrate she will become tax resident in Australia on 2 March 2016. She will have no trade or permanent establishment in South Africa, but will retain a number of investments. Mrs Wealthy is able to estimate with a fair amount of certainty what her income from these investments would be for the 2017 tax year, but she is unsure of how to calculate her South African taxable income.

The following pertains to Mrs Wealthy's investment portfolio:

- Shares: Mrs Wealthy will receive dividends of R183 000 from shares listed exclusively on the Johannesburg Stock Exchange and R50 000 from shares listed exclusively on the New York Stock Exchange. Mrs Wealthy does not own more than 10% of any of the shares in any of the companies in which she has invested.
- Interest: Mrs Wealthy will receive interest of R78 000 from South African banks and R136 000 from deposits with overseas banks. You may assume that this is accrued evenly during the year of assessment.
- Purchased annuity: Mrs Wealthy will receive R30 000 at the end of each month in respect of a 10-year annuity that she purchased on 1 October 2014 for R2 700 000. However, if Mrs Wealthy emigrates she will commute the annuity on 1 March 2016 (before she leaves SA) for a lump sum of R2 400 000.

Mrs Wealthy is 75 years old.

YOU ARE REQUIRED TO: Calculate Mrs Wealthy's 2017 South African taxable income from the above investments if:

1. She decides to immigrate to Australia.
2. She decides to remain in South Africa.

In each case you should indicate why the amounts above are included or excluded from taxable income. You must prepare a separate calculation for each of (1) and (2) above.

You may assume that no income will accrue to Mrs Wealthy on 1 March 2016 other than the commutation amount in respect of the annuity (should she decide to emigrate).

SOLUTION 8.1

As a non-resident, Tim is only taxed in South Africa on his South African source income. (1)

- The interest is of a South African source in terms of section 9(2)(b). The interest is gross income in South Africa for Tim. (1)

In terms of s50B(1) a withholding tax of 15% will be levied on interest that is paid or that becomes due and payable to or for the benefit of a foreign person from a source within the Republic in terms of s9(2)(b) and that is not exempt in terms of s50D (if paid by government or a bank, or if the taxpayer has been in SA for > 183 days in the 12 month period preceding the date on which the interest was paid or has a permanent establishment in SA). (2)

Because Tim's interest is from a South African bank it will be exempt from the withholding tax on interest i.t.o s50D. (1)

Interest accruing to a non-resident will be exempt from tax in terms of s10(1)(h). The s10(1)(h) exemption is not available if the taxpayer has been in SA for > 183 days in the 12 month period preceding the date on which the interest is received or accrues, or has a permanent establishment in SA. If s10(1)(h) were unavailable, the taxpayer could then claim a s10(1)(i) exemption up to the limit of either R23 800 or R34 500. (2)

- Because Tim has not visited South Africa in the last two years the s10(1)(h) exemption is available, and all of his South African source interest is exempt. (1)

- Similarly, the South African dividends received are also of a South African source in terms of section 9(2)(a) with the definition of 'dividend', and are therefore gross income for Tim. However, such dividends are exempt in terms of s10(1)(k) as nothing is indicated in the scenario as to the application of any of the exclusions to this exemption provision. (2)

Unless Tim was entitled to a lower rate of withholding in terms of a Double Tax Agreement, the dividend would likely be subject to a final withholdings tax of 15%, i.e. R1 500. (1)

- The royalty is from a South African source in terms of s9(2)(d). The royalty is therefore gross income in South Africa. However, because section 49A is applied to subject the royalty to a withholding tax of 15%, section 10(1)(*l*) will operate to exempt it from inclusion in taxable income. The R250 000 is therefore taxed at the final rate of 15% (being the withholdings tax on royalties or similar payments to non-residents) and the R22 000 expenses are not deductible for normal tax purposes in terms of section 23(f) as the expenses produce exempt income. None of the exemptions from the withholdings tax apply to Tim. (4)

Taxable income is therefore nil and withholding tax of R30 000 on royalties and R1 500 on dividends would be withheld before remitting the net amounts to Tim. (1)

Interest	30 000	
less interest exemption s10(1)(h)	(30 000)	
South African dividends (para k)	10 000	
less exemption 10(1)(k)	(10 000)	
Royalty	250 000	
less exemption 10(1)(*l*)	(250 000)	
Taxable income	0	(1)
		(17)

SOLUTION 8.2

Mrs Smit		**Resident**		**Non-resident**		
Dividends - South African		50 000		50 000		(1)
s10(1)(k)		(50 000)	0	(50 000)	0	(1)
Dividends - foreign		20 000			Not SA source	(1)
s10B(3): R20 000 × $^{26}/_{41}$		(12 683)	7 317			(1)
Foreign interest			30 000		Not SA source	(1)
South African interest		60 000		60 000		(1)
Resident	s10(1)(i)	(23 800)	36 200			(1)
Non-resident	01/03 - 28/08 s10(1)(h) [**HAS** been in Republic for > 183 days in 12 month period prior to accrual of interest - no s10(1)(h) exemption] *1 March - 28 August = 181 days or less outside SA, therefore 184 days or more in SA in the last 365*			0		(1)
	29/08 - 28/02 s10(1)(h) [has **NOT** been in Republic for > 183 days in 12 month period prior to accrual of interest - exempt]			(30 247)		(1)
	s10(1)(i) in respect of interest not exempt i.t.o s10(1)(h) limited to R23 800			(23 800)	5 953	(1)
Royalty - only SA portion is SA source						
Resident	Worldwide income					
Non-resident	South African royalty -section 9(2)(c)	150 000		150 000		(1)
	French royalty (not SA source) - section 9(4)(c)	200 000	350 000		Not SA source	(1)
Non-resident	01/03 - 28/08 s10(1)(*l*) [**HAS** been in Republic for > 183 days in 12 month period prior to accrual of royalty - no s10(1)(*l*) exemption]			0		(1)
	29/08 - 28/02 s10(1)(*l*) [has **NOT** been in Republic for > 183 days in 12 month period prior to accrual of royalty - exempt]			(75 616)	74 384	(1)
Rental income			100 000		Not SA source	(1)
TAXABLE INCOME			523 517		80 337	

SOLUTION 8.2 continued

Withholding tax on royalties - section 49B	150 000 × 15% × (365 − 181)/365	11 342	(1)
Withholding tax on interest - section 50B	60 000 × 15% × (365 − 181)/365	4 537	(1)
Withholdings tax on dividends - section 64E	50 000 × 15%	7 500	(1)

Mrs Smit as a SA resident may be able to deduct as a rebate against tax payable any foreign tax paid on the foreign income (that is not exempt) in terms of s6*quat*.

The withholdings tax rates of 15% would apply unless reduced rates in terms of the double tax agreement with France apply.

(18)

SOLUTION 8.4

John Berry: Non-resident, not carrying on business through a permanent establishment.

Interest - GI general definition, SA source s9(2)(b)/(c)		12 500		(0.5)
Exemption - s10(1)(h)		(12 500)	0	(0.5)
Dividends - GI para (k), SA source s9(2)(a)		21 900		(0.5)
Dividend from Environlife (Pty) Ltd - GI para (k), SA source s9(2)(a)		30 500		(0.5)
Exemption - s10(1)(k)		(52 400)	0	(0.5)
less brokers fees (not deductible - no income (section 23(f))			0	(1)
Rentals - SA source as SA immovable property			8 750	(0.5)
less sundry revenue expenses			(2 050)	(0.5)
Royalties	- SA - SA source s9(2)(d)	32 000		(1)
	- Botswana (not SA source)	0		(0.5)
	- Worldwide (not SA source)	0		
		32 000		
Exemption s10(1)(*l*) (no exclusions apply)		(32 000)	0	(0.5)
less editing fees (not deductible - no income, since non-SA source or exempt (s23(f))			0	(0.5)
SATV payment (Know-how) - GI para (gA), SA source s9(2)(f)		100 000		(0.5)
Exemption s10(1)(*l*) (no exclusions apply)		(100 000)	0	(0.5)
less sundry revenue expenses - no income (s23(f))			0	(0.5)
Donation (not per s18A)*	No deduction		0	(0.5)
Taxable income			6 700	
Tax per the tables			1 206	(0.5)
less rebate			(13 500)	(0.5)
Amount due			0	

SOLUTION 8.4 continued

Withholding tax (section 49A-D)			
Royalty	32 000 × 15%	4 800	(2)
SATV - know-how payment,	100 000 × 15%	15 000	(2)
which falls within s49B by virtue of the cross-reference in that section to s9(2)(e) and(f)			
Although interest is subject to withholding tax i.t.o s50B, this amount would be exempt as it is paid by a bank - s50D.			(1)
This is a final tax		19 800	
			(15)

** Note that no donations tax would be levied as John is a non-resident.*

SOLUTION 8.9

Gill Jaymor

SA employment income		500 000	(1)
Charlie is a CFC - more than 50% holding by residents throughout foreign tax year			(1)
Delta becomes a CFC - connected residents hold more than 50% in Charlie and are therefore deemed to hold (from 1 May 2016) the interest of 56% in Delta directly.			(1)
Holding in Charlie for s9D purposes - 18%			
Indirect holding in Delta for s9D inclusion - 18% × 56% = 10.08%			
<u>Delta</u>			
s9D - *lesser* of:			
Net income for 1 May 2016 to 30 June 2016 OR	68 000		(1)
$^{61}/_{365}$ × 200 000 (net income for 1 July 2015 to 30 June 2016)	33 425		(1)
Translated at 14.5 (s9D(6) - ave for CFC's YoA) × 56% holding by Charlie × 18% in Charlie		48 853	(3)
No dividends received directly from Delta - so dividends irrelevant for Gill			
<u>Charlie</u>			
s9D:			
Net income	180 000		(1)
× 18% holding × (s9D(6) – average for CFCs YoA)		322 704	(2)
Dividend from Charlie - 50 000 × 9.79 × 18%	88 110		(2)
s10B(2)(c) limit in excess of inclusion	(88 110)	0	(1)

s10B(2)(c) calculation for purposes of illustration:		
s9D from Charlie	*322 704*	
less *corporate taxes related to s9D (at 35%)*	*(112 946)*	
	209 758	
Add Delta profit (would be a CFC of Charlie if Charlie were a resident)	*48 853*	
less *corporate taxes (at 25%)*	*(12 213)*	
Maximum exemption	*246 398*	
Limited to dividend received	*(88 110)*	*(88 110)*
Carried forward exemption	*158 288*	

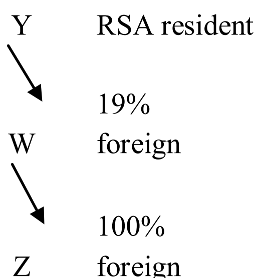
Taxable income	871 557

SOLUTION 8.9 continued

Tax per the tables			276 769	(1)
s6*quat* rebate:				
Corporate taxes for Delta - tax on proportional amount (as above)				
£200 000 × $^{61}/_{365}$ × 25% (tax rate) × 56% × 18% × 14.76 (s6*quat*(4) - average for taxpayer's YoA)		12 432		(2)
Corporate taxes for Charlie - tax on proportional amount (as above)				
€180 000 × 35% × 18% × 10.29 (s6*quat*(4) - average for taxpayer's YoA)		116 689		(2)
No withholdings taxes for Charlie as dividend excluded from taxable income		0		
Total qualifying foreign taxes translated in Rands		129 121		
Limited to:				
Foreign taxable income/total taxable income × SA tax				
Foreign taxable income (R871 557 − R500 000)	371 557			(1)
Total taxable income	871 557			(1)
Limit = $^{371\,557}/_{871\,557}$ × 276 769		(117 991)	(117 991)	(1)
Carry forward		11 130		
less primary rebate			(13 500)	(1)
Normal tax liability			145 278	
				(23)

SOLUTION 8.11

B Ltd



(a) **ASSUME 'W' + 'Z' ARE NOT CFCs**

Gross income			
Dividend	720 000 × 19% × 10	1 368 000	(0.5)
s10B(2)(a) - shareholding exceeds 10%		(1 368 000)	(0.5)
Taxable income		0	
Tax payable		0	(0.5)
s6quat withholding tax	No claim to be made as no SA Tax	0	(0.5)
Tax liability		0	

SOLUTION 8.11 continued

(b) **ASSUME 'Z' + 'W' ARE CFCs**

Z	s9D				
	Profit	500 000 × 19% × 100% × 10		950 000	(1)
W	s9D	1 200 000 × 19% × 10	2 280 000		(1)
	less s9D(9)(f) (or s10B(2)(a) or s10B(2)(b))	200 000 × 19% × 10	(380 000)	1 900 000	(1)
W	Dividend GI	720 000 × 19% × 10		1 368 000	(1)
	s10B(2)(a) - shareholding exceeds 10%			(1 368 000)	(0.5)
Taxable income				2 850 000	
Tax @	28%			798 000	(0.5)
s6*quat* - Z		100 000 × 19% × 100% × 10	190 000		(1)
s6*quat* - W		480 000 × 19% × 10	912 000		(1)
Foreign tax			1 102 000		
Limit to			(798 000)	0	(1)
Carry forward to next year			304 000		(0.5)

(c) **ASSUME 'W' + 'Z' ARE NOT CFCs AND Y's HOLDING IS 9%**

Gross income				
Dividend	720 000 × 9% × 10		648 000	(0.5)
s10B(3)	$^{13}/_{28}$ × 648 000		(300 857)	(0.5)
Taxable income			347 143	
Tax payable			97 200	(0.5)
s6*quat* withholding tax	20 000 × 9% × 10	18 000	(18 000)	(1)
Note: The foreign tax is not multiplied by $^{13}/_{28}$ - see s6*quat(1A) proviso (ii).*				
Tax liability			79 200	
				(13)

CHAPTER 9: CAPITAL GAINS TAX

Index to sections of the Act and paragraphs of the Eighth Schedule to the Act

Question	Sections	Grade	
Question 9.1	s22, s26A, s9H, para 12, 15, 26 and 30	**	
Question 9.2	s9HA, s25, s26A	**	S
Question 9.3	para 12A, para 39, para 56	***	S
Question 9.4	Non-resident, s26A, s49, para 67	***	S
Question 9.5	s8(4)(a), s8(4)(e), s26A, para 65 and 66	***	S
Question 9.6	s26A, s28, s11(e), s11(o), para 30, 45, 49	***	
Question 9.7	s22, s26A, non-resident, para 12, 38, 44	***	
Question 9.8	Capital distribution (basic), para 76B	**	
Question 9.9	Gross income (theory), CGT	***	

QUESTION 9.1 **(24 Marks)**

YOU ARE REQUIRED TO: In each of the following situations indicate, through narrative and, where appropriate, supporting calculations, the income tax implications for the respective taxpayers.

1. Mr Flee, who is not married, lives in Cape Town and is a South African resident. He has the following assets:
   – a house in Cape Town, which is his domestic dwelling
   – a house in Switzerland, which he uses for holidays
   – shares in listed companies in South Africa, Switzerland and the UK
   – furniture in both houses, including valuable works of art
   – sundry private motor vehicles
   – a 12-metre boat which is moored at the Royal Yacht Club in Cape Town

   On 1 November 2016 Mr Flee immigrated to Australia and ceased to be a South African resident. On 1 February 2017 Mr Flee sold the boat. None of the other assets have been sold.

2. The same information as above but, until 1 November 2016, Mr Flee lived in his house in Switzerland and then immigrated to South Africa. In other words, Mr Flee became a resident of South Africa on 1 November 2016.

3. In August 1996 ‘Prop (Pty) Ltd’ (Prop) purchased a farm for R500 000. Farming activities were carried out on the farm until 1 April 2017. On 1 April 2017, Prop changed its intention in regard to the land and it became trading stock. At that date, the land had a market value of R8 million. The land was subdivided and in June 2017 sales of plots commenced. All of the plots were sold by October 2017 for a total of R10 million. Prop has a 31 December year-end.

   You may assume the date of Prop’s change in intention to be 1 April 2017 and that SARS accepted the application of paragraph 12(2)(c) from that date, as Prop was able to discharge the onus in terms of section 102 of the Tax Administration Act 28 of 2011 of proving that the farm was originally a capital asset.

4. Mrs Goodeye had, over a long period of time, purchased paintings by relatively obscure artists. Some of the painters have now become famous and the value of their work has increased dramatically. Although she had vowed never to sell her collection of paintings, Mrs Goodeye has now changed her mind. She intends opening up a market art shop from which she will sell a limited number of her valuable works of art.

5. Teak (Pty) Ltd was a timber merchant, i.e. it imported and sold hardwood timber which was its trading stock. In January 2017 Mr Cabinet, a highly skilled woodworker, acquired all of the shares in Teak. Mr Cabinet purchased the shares in Teak as a means of acquiring a large stock of extremely valuable and rare wood. Once he had acquired the shares, Mr Cabinet caused Teak to cease its former business of selling timber and commence the business of manufacturing high quality furniture.

6. John sells timber as his trade. He removes timber (with a cost of R100 000 and a market value amounting to R150 000) from trading stock to manufacture cabinets for his offices during the 2016 year of assessment. The cost of the manufacture is R30 000, and John completes the cabinets on 30 August 2015. The stock taken was on hand at the end of February 2015. On 1 March 2016 John sells the cabinets for R170 000 in order to raise money for an overseas trip. In terms of Interpretation Note 47 the write-off period is 6 years.

QUESTION 9.2 (Solution at end of chapter) (13 Marks)

Drew Harry died on 30 January 2017. Drew, as a wealthy South African businessman and not a share dealer, had wisely put all his affairs in order before his death. He had valued all of his assets (as at 1 October 2001) and had then determined the most tax efficient base cost in respect of each asset.

The record of his assets at the time of death reveals the following:

Asset	Base cost	Market value
House in Johannesburg (domestic dwelling)	R2.5m	R4.3m
Holiday house in Hermanus	R1.5m	R1.8m
Motor vehicles	R0.4m	R0.35m
Shares in listed companies	R2.0m	R4.0m
Game farm in Mpumalanga	R1.8m	R3.8m
Household furniture	R0.6m	R0.6m

Drew's will provides for the following:

1. The house in Johannesburg is to be sold by the executor and the proceeds split equally between his three children.
2. The holiday house is left to his wife Daisy (to whom he was married out of community of property).
3. The motor vehicles are to be sold and the proceeds are to be given to Daisy.
4. The shares are left in equal portions to his two daughters, Anna and Betty.
5. The game farm is left to his oldest son John.
6. The household furniture is left to his wife Daisy.

In the course of winding up the estate, the executor sold the Johannesburg house for R4.6 million and the motor vehicles for R350 000. All the sales by the executor took place after 1 March 2016.

The estate is wound up on 30 June 2017.

Daisy decided to sell the Hermanus house for R2.5m in July 2017. She had never lived in the house.

In October 2017, John sold the game farm for R4.0m.

YOU ARE REQUIRED TO: Calculate the amount that must be included in taxable income in the **applicable** year of assessment of:

1. Drew
2. The estate of Drew Harry
3. Daisy
4. John

QUESTION 9.3 (Solution at end of chapter) (16 Marks)

Kenstar Ltd is a South African company with a February year-end. The company imports home appliances manufactured in India at wholesale prices and distributes them to local retailers at a significant mark-up. Kenstar Ltd purchased a vacant plot of land for R2 900 000 on credit from Shipco Ltd (another South African company with a February year-end) on 1 January 2017 to use as storage space for its containers. Shipco Ltd had acquired the land years before as part of its investment portfolio.

Unfortunately, due to a manufacturer's defect in one of the home appliances, Kenstar Ltd was obliged to refund nearly R1 million to disgruntled customers. Kenstar Ltd has initiated a lawsuit against the Indian manufacturer, but is suffering severe cash flow problems. In an attempt to raise cash reserves, Kenstar Ltd issued 100 000 ordinary shares on 13 February 2017, of which Shipco Ltd purchased 88 000 shares. Shipco did not own any of Kenstar's shares before this purchase. Kenstar Ltd now has 120 000 ordinary shares in issue.

As a further measure to reduce the company's financial distress, Mr Patel, Kenstar Ltd's managing director, agreed to share its customer distribution list with Shipco Ltd in exchange for a write-off of the R2 900 000 owing in respect of the plot purchased. Shipco Ltd accordingly waived the full amount on 27 February 2017.

YOU ARE REQUIRED TO: Discuss whether or not Shipco Ltd is entitled to claim the loss resulting from the debt write-off in respect of its year of assessment ending 28 February 2017. You may ignore VAT.

QUESTION 9.4 (Solution at end of chapter) (30 Marks)

Jean-Pierre du Chalet (JP), aged 55, a resident of France and an international art dealer, is married out of community of property. He owns various assets in South Africa. The business assets held form part of a permanent establishment that JP holds in South Africa, whereas the assets of a personal nature are not part of such permanent establishment.

Note that JP trades in South Africa in his own name, i.e. he is a sole trader.

Information regarding the income and assets from his activities in South Africa are detailed below:

Personal assets:

1. JP owns a house in Cape Town. He often visits South Africa for up to two months in a twelve-month period to check on his South African business activities. These visits are insufficient to pass the physical presence test for residence. During such visits he brings his wife and children with him. While visiting South Africa, it was his wife's birthday and he gave her the house in Cape Town as her birthday present.

The house in Cape Town had originally been acquired for R2 million on 1 August 2001. The market value was R2.5 million on 1 October 2001 and R6.5 million on 15 February 2017 (his wife's birthday). The significant increase between 1 October 2001 and 15 February 2017 was as a result of improvements made costing JP R750 000 in November 2012 as well as its location. The property is less than two hectares in size. Note that his house in France is considered to be his primary residence.

2. He also purchased a BMW 745Li, at a cost of R860 000, on 15 February 2017 from a South African dealer as an additional present for his wife. The car will be shipped back to France on 28 February 2017.

3. As an art dealer, JP appreciates good art. As a result, each time he returned to South Africa, he returned the artwork in the Cape Town house to his permanent establishment in South Africa and took other art pieces from the trading stock to be displayed in his house for the next 12 months. During the 2017 year of assessment, artworks with a market value of R2 million on 1 January 2017 were returned to the business. These artworks had had a market value of R1.5 million when taken from the trading stock of the business on 1 January 2016.

   The artworks, taken out of the business to display in his home on 1 January 2017 (to replace the ones he had returned), had a cost to the business of R2.3 million and a market value of R4 million.

Business activities:
Apart from the trading stock mentioned in (3) above, the following activities took place in JP's South African business:

1. Sales of stock by the South African permanent establishment to clients worldwide amounted to R15 million. Opening stock (before any adjustments) at cost was R7 million. The cost of stock sold amounted to R9 million. Additional purchases of R3 million were made by the business.
2. Royalties amounting to R4 million were received during the period 1 July 2016 until 28 February 2017 from various art restoration companies in the Republic for a process that JP patented, preventing damage to the canvas of old paintings when corrosive agents are applied to the surface during the cleaning/restoration process. This process is considered part of the business of the permanent establishment.

YOU ARE REQUIRED TO:

1. Determine JP's normal tax payable, for the year of assessment ended 28 February 2017, in South Africa based on the above information, giving reasons where appropriate. You may ignore double taxation treaties and VAT.
2. If JP and his wife decide to immigrate to South Africa, discuss the tax effects in respect of:
   a. the house in France; and
   b. the house in South Africa, if this house is instead donated to his wife on 15 July 2017, when the market value is R6.8 million, after immigrating on 15 February 2017 and she subsequently sells it for R7 million on 1 February 2018. You may assume that the house was used as their primary residence from date of immigration to date of sale and that JP's wife is taxed at the highest marginal rate of tax.

QUESTION 9.5 (Solution at end of chapter) (40 Marks)

Replay (Pty) Ltd had a new and unused manufacturing machine stolen from its factory. The machine had cost R500 000 (excluding VAT) on 20 November 2015. The machine was stolen in February 2017. The company was insured for full replacement cost and the insurers paid out an amount of R627 000. All of the insurance proceeds were used in acquiring, and immediately bringing into use, a

new and unused replacement machine costing R650 000 (excluding VAT) in March 2017. The company has a 31 December year end and is a registered VAT vendor as defined.

YOU ARE REQUIRED TO:

1. Calculate the tax effects for the 2017 year of assessment if the company **does not** elect para 65.
2. Calculate the tax effects for the 2017 year of assessment if the company **does** elect para 65.
3. Using the information above, except that the company buys two new and unused smaller replacement machines, namely:
   Machine A: Cost: R300 000 (excluding VAT)
   Machine B: Cost: R350 000 (excluding VAT)
   Calculate the tax effects for the 2017 year of assessment if the company does elect para 65.
4. As in (3) above, only Machine A is a used machine and Machine B is a new machine.
5. Outline the differences between para 65 and 66.

QUESTION 9.6 **(24 Marks)**

Max Suzuki (married out of community of property and a resident of South Africa) owns a speciality store that sells clothing and accessories for various types of sporting activities, including motor biking.

On 1 March 2016 Max bought a motorbike for R74 000, from the previous owner, who was not VAT registered, to use in his shop front display to advertise his clothing. The market value at that date was R75 000. Now and again he would also use the bike in special promotions to advertise at certain rallies that occurred during the year.

On 1 February 2017 Max decided that he needed a different advertising campaign and took the bike home for his own use. The bike was valued at R70 000 (open market value) at that date. Max also sold imported leather jackets and pants as part of his clothing range. He had two full-length leather coats reflected at a cost of R5 000 each in his stock records. On 21 November 2016 Max gave one of these coats to his wife as a birthday present. The coat had a price tag of R10 000 (including VAT) at that time. The other coat was still on hand at the end of the year.

Max's wife is an artist and had done various sketches depicting sporting activities. These were displayed on the walls in the shop as part of the décor. A customer was particularly keen to buy one of these sketches and, although they were not intended for sale, Max sold it to him for R3 000. As the sketch belonged to his wife Rosalind he had to buy it from her first for R1 500.

Max and Rosalind own their primary residence jointly. Rosalind used an area in the house for her artwork. She has always claimed a portion of the interest on the bond, rates, electricity and water against her income in the ratio of floor space used to total area of the house, which was 20% of the total area. The Commissioner has always permitted this deduction against her gross income.

Max and Rosalind are planning to sell their home for about R2.5 million. The house had an original cost of R800 000 on 1 June 2001. The market value was R1 000 000 on 1 October 2001. In November 2016 they had expended R80 000 on improvements to the house.

Max is registered for VAT, but Rosalind is not. Motorbikes are written off over four years per Interpretation Note (47). Paintings and sketches are not depreciated, as it is thought that they would appreciate in value.

YOU ARE REQUIRED TO:

1. Calculate all the tax effects for Max in respect of the motorbike, coat and sketch.
2. Discuss and calculate the capital gains tax effect for both Max and Rosalind if they sell their home on 28 February 2017.

QUESTION 9.7 **(28 Marks)**

Mr Garnet Boswell, a vendor for VAT purposes, has carried on business in South African for the past 30 years. He and his family were unfortunate victims of crime in Johannesburg. Garnet has decided that his family will be safer in Australia and has decided to emigrate. As the bulk of his wealth is invested in South Africa, he has decided to continue his business operations in South Africa after emigration. Only his business operations constitute a permanent establishment. His business operations consist of the selling of golfing equipment.

Mr Boswell and his family ceased to be ordinarily resident on 1 August 2016. Apart from the family's annual one-month holiday overseas, Mr Boswell and his family had spent all their time in South Africa prior to this date.

On 1 September 2016, Garnet began his trade in Australia, while retaining his South African trade as a permanent establishment in South Africa.

Garnet has recently approached you for advice. His previous accountant did not know the tax implications of his move to Australia. The following selected transactions have occurred during the year and Garnet needs to know the tax implications thereof.

Transactions for the period 1 March 2016 to 31 July 2016:

1. On 30 July 2016 Garnet gave his best friend, a professional golfer, one of the best golf carts on the market. This cart has a cost of R75 000 (excluding VAT) and an open market value of R150 000. The cart has the logo 'Boswell's Golf' on the sides and the roof. Garnet felt this would be good advertising for his business on the South African golf circuit. This cart was in opening stock on 1 March 2016.
2. The following assets were on hand at 31 July 2016 (the day before he ceased to be a resident):

	Market value (R)	**Paragraph 20 Expenditure (R)**
Gauteng house (notes 3, 7)	9 900 000	600 000
Furniture and fittings for Gauteng house	400 000	700 000
Holiday house in Australia (note 4)	3 000 000	3 200 000
Holiday house in Arniston, SA (notes 5, 8)	2 500 000	500 000
Trading stock on hand (note 6)	14 000 000	6 000 000

Notes

3. The house served as Garnet's primary residence. For as long as he has held the property (he was the sole owner), he and his wife have lived there. He purchased the property on 10 September 1988 for R150 000 and improved the house in 1989. The market value on 1 October 2001 was R8 million, of which the value of the residence was R3 million. The property spans five hectares.
4. The Australian property had been purchased for the equivalent of R2.5 million on 2 October 2007 and R700 000 had been spent repairing the property on 31 October 2007. As of their arrival in Australia, this has become the family's primary residence.

5. The Arniston house was purchased for R500 000 on 30 June 1990. No further expenditure has been incurred on the property since that date. The market value on 1 October 2001 was R1.2 million.
6. The trading stock is from Garnet's various golfing stores in South Africa.

Transactions for the period 1 August 2016 to 28 February 2017:

7. Garnet sold the Gauteng house on 30 December 2016 for R11 million. The market value of the residence on its own is R4 million. The house has remained empty following the family's move to Australia and was sold once a suitable buyer was found. The base cost for the house on its own in terms of any of the methods used to determine base cost is considered by SARS to be determinable in the same ratio as the market value of the residence on 30 December 2016 bears to the market value of the total property on that date.
8. He sold the house in Arniston for R3 million on 12 January 2017.

YOU ARE REQUIRED TO: Calculate the net effect of the above transactions on Garnet Boswell's taxable income. Assume that he is married out of community of property.

QUESTION 9.8 **(16 Marks)**

In November 2013 Mrs Amber acquired 10% of the shares in Green (Pty) Ltd for R1 million. Mrs Amber is not a share dealer and is a resident of South Africa.

On 5 February 2017 Green distributed R1 500 per share. R500 per share represents a reduction of the contributed tax capital (CTC).

As a result of the distribution, Mrs Amber received an amount of R135 000 (of which R50 000 represented CTC) after the appropriate amount of dividends tax was withheld.

YOU ARE REQUIRED TO:

1. Calculate the effects of the distribution on Mrs Amber's taxable income for the year ended 28 February 2017.
2. Assuming that the distribution had instead amounted to R12 000 per share, of which R11 000 per share represents a reduction of the contributed tax capital, calculate the effects of the distribution on Mrs Amber's taxable income for the year of assessment ended 28 February 2017.

QUESTION 9.9 **(20 Marks)**

Kate Davidson, unmarried and a resident, recently resigned from her job in Cape Town and as a result moved to Johannesburg to start her own business in public relations. Kate decided that the easiest way to make her move stress-free was to sell most of her belongings in Cape Town and to purchase new assets in Johannesburg.

As a result, the following assets were sold:

- A motor car purchased on 2 May 2010 for R160 000. On 15 October 2016, Kate sold the car for R60 000. Kate was required to use her car for any travelling related to her employment and received an allowance for such expenses.
- While in Cape Town, Kate lived in a penthouse in Bantry Bay. Kate owned 50% of the penthouse and the other 50% was held in a discretionary trust, of which she is a beneficiary. The penthouse, along with all its contents (furniture etc.), was sold on 20 October 2016 for R8 million. Of the total selling price, R800 000 related to the contents of the flat. The penthouse itself had been

purchased at an auction in April 2011 for R2.2 million (excluding furnishings). Kate owned all the contents of the penthouse, which she had acquired for R400 000.

- In December 2011, Kate inherited a large yacht (12 metres long) from her late grandfather when the market value was R350 000. The yacht was moored in the Hout Bay harbour and was used by Kate on a regular basis. As she had no use for the yacht in Johannesburg, Kate sold the yacht for R360 000 on 5 November 2016.

  (Assume for CGT purposes that the base cost of an inherited asset for the heir is the market value on date of inheritance.)

Kate needed to find premises from which she could establish her business and subsequently operate. Coincidently, 'Tolet (Pty) Ltd' (Tolet), a property owning company, had recently completed the erection of a new office park (Southern Gardens) and was anxious to secure long-term tenants for the new offices. The offices were exactly what Kate needed for her new public relations venture.

'Prop Co Ltd' (Prop Co) also had premises available for Kate. Both Prop Co and Tolet required R20 000 per month in rental. Prop Co also required an amount of R30 000 over and above the rentals to enter into the lease. Tolet, desperate for tenants, offered to pay Kate an amount of R50 000 to enter into the lease, on the condition that any improvements made to the offices, which she occupied, were to remain should the lease agreement not be renewed. Apart from the above, the clauses were all standard for lease agreements. Kate agreed to the terms of Tolet's agreement, with the lease commencing 1 March 2017.

Kate is a little worried about this contract, because a friend of hers, who had been on a one-week introductory course on income tax, said that the Commissioner would merely see the payment to her as an adjustment to the monthly rental to be deducted and would subsequently disallow a portion of her rental deduction.

Apart from the above, Kate had taxable income of R600 000 for the year of assessment ended February 2017.

YOU ARE REQUIRED TO:

1. Discuss whether the amount of R50 000 received by Kate in terms of the agreement with Tolet is gross income, using case law where appropriate. You may ignore the anti-avoidance provisions of the Income Tax Act.
2. Based on the above information, calculate Kate's taxable income for the year ended 28 February 2017.

SOLUTION 9.2

1 Drew Harry - February 2017

			R	
-	House in Johannesburg	Proceeds - s9HA(1)	4 300 000	(0.5)
		Base cost (given)	(2 500 000)	(0.5)
		Capital gain	1 800 000	
		Primary residence exclusion	(2 000 000)	(0.5)
		Capital gain	0	
-	Holiday house (to wife)	deemed not disposed of in terms of s9HA(2)	0	(0.5)
-	Motor vehicles (personal-use asset para 53)		0	(0.5)
-	Shares	Proceeds - s9HA(1)	4 000 000	(0.5)
		Base cost (given)	2 000 000	(0.5)
		Capital gain	2 000 000	
-	Game farm	Proceeds - s9HA(1)	2 660 000	(1)
		Base cost (given)	(1 800 000)	(0.5)
		Capital gain	860 000	

s9HA(1) deems assets to have been disposed of at market value as contemplated in para 31 of the 8th Schedule. Para 31(1)(f) states that the market value of a farm must be determined according to the definition of *fair market value* in s1 of the Estate Duty Act, which stipulates that the arm's length price must be reduced by 30%.

-	Household furniture (personal-use asset para 53)		0	(0.5)
Total of capital gains/(capital losses)		(R2 000 000 + R860 000)	2 860 000	(0.5)
less annual exclusion (on death)			(300 000)	(0.5)
Aggregate and net capital gain			2 560 000	
Include in taxable income 40%			1 024 000	(0.5)

2 Estate - 2018 year of assessment

-	Sale of house	Proceeds - para 35(1)	4 600 000		(0.5)
		Deemed base cost - s25(2)(a)	(4 300 000)		(0.5)
		Capital gain	300 000		
		Primary residence exclusion	(300 000)	0	(0.5)
(para 48 applies and extends primary residence exclusion to estate - Note 3)					
-	Motor vehicles	personal-use asset para 53		0	(0.5)
Total capital gains				0	

SOLUTION 9.2 continued

Notes

1. *It is submitted that if the asset is disposed of in the same tax year as the year of death and the R300 000 (annual exclusion) is fully utilised, the estate will still qualify for the R40 000 (annual exclusion) in the same year. If it is sold in a subsequent year, the estate will qualify for a R40 000 exemption.*
2. *The assets left directly to heirs are deemed to be disposed of in terms of section 9HA(1) and deemed to be acquired by the heirs equal to the market value on date of death (s 9HA(3)). There is therefore no capital gains tax effect for the shares and game farm in the estate.*
3. *It is submitted that the actual disposal by the estate of the primary residence would qualify for a full primary residence exclusion irrespective of whether the residence is disposed of within the same year as the death of the deceased.*

3 **Daisy - 2018 year of assessment**	**R**	
Proceeds from sale of Hermanus house - para 35(1)	2 500 000	(0.5)
Deemed base cost - s9HA(2)(b)	(1 500 000)	(0.5)
Capital gain	1 000 000	
less annual exclusion	(40 000)	(0.5)
Aggregate capital gain	960 000	
Included in taxable income (40%)	384 000	(0.5)

Note: The house is not a primary residence and therefore does not qualify for the R2m exclusion.

4 **John - 2018 year of assessment**		
Proceeds from sale of farm - para 35(1)	4 000 000	(0.5)
Deemed base cost - s9HA(3)	(2 660 000)	(0.5)
Capital gain	1 340 000	
less annual exclusion	(40 000)	(0.5)
Aggregate capital gain	1 300 000	
Included in taxable income (40%)	520 000	(0.5)
		(13)

SOLUTION 9.3

All paragraphs references refer to the Eighth Schedule

Shipco owns 73% of Kenstar's equity shares ($^{88\ 000}/_{120\ 000}$). (0.5)

In terms of s1, they are connected persons (> 20% shares). (1)

In terms of s41, they are also members of the same group of companies as defined (> 70% shares). (1)

From Kenstar Ltd's point of view (the debtor)

The debt write-off triggers a deemed disposal in terms of para 12A, as the debt was discharged by the creditor for no consideration. (1)

SOLUTION 9.3 continued

A capital gain arises, and is dealt with as follows - para 12A:

- Firstly, reduce the base cost of the asset purchased with the debt by the amount of the debt discharged; (1)
- Secondly, use any excess amount (i.e. debt write-off > base cost) to reduce any assessed capital loss of the debtor; and (1)
- To the extent that the reduction is neither offset against the base cost nor against any assessed capital loss, it has no further tax consequences for Kenstar. (1)

However, there is an exclusion for group companies in terms of para 12A(6)(*d*):

*Kenstar and Shipco are members of the same group of companies and the transaction was not entered into in order to avoid any tax imposed by the Act. (1)

*The exclusion thus applies and par 12A as a whole is not applicable. (1)

Conclusion: Kenstar will not reduce the plot of land's base cost or its assessed capital loss. (1)

Note: Due to the wording in the paragraph, one must first determine if there was a tax avoidance scheme and then determine which event occurred first, i.e. did they become group members before or after the debt arose. Therefore, in this particular set of circumstances, there was no need to determine if they became group members before or after the debt arose, as there was no tax avoidance scheme.

From Shipco Ltd.'s point of view (the creditor)

The loss-limitation rules of para 39 and the debt defeasance rules of para 56 apply to the creditor. (1)

Shipco has disposed of a debt owed by a debtor. (0.5)

Shipco has incurred a capital loss equal to the amount of debt written off, i.e. R2 900 000 (being proceeds of Rnil less base cost of R2 900 000). (1)

Para 39 determines that capital losses between connected persons are disregarded ('clogged') and may only be set off against a capital gain from that same connected person. (1)

However, para 56 applies where a creditor has disposed of a debt owed by connected persons. (1)

Para 56(1) concludes that the capital loss is permanently disregarded (i.e. not 'temporarily' ring-fenced as determined by para 39). (1)

Conclusion: Shipco may not recognise a capital loss on the waiver of the loan. (1)

Note: The relief offered by para 56(2) is not available to Shipco, as the debtor did not reduce the base cost of the asset or reduce an assessed capital loss.

(16)

SOLUTION 9.4

1. **Jean-Pierre du Chalet (JP): normal tax payable**

JP is married out of community of property and a non-resident.

Personal assets:

(1) **House in Cape Town**

The house in Cape Town is NOT a primary residence (as it is not his main residence) - para 44 (definition of 'primary residence'). (1)

Roll-over relief **does** apply despite his spouse being a non-resident as the transaction involves immovable property in SA - para 67(3) read with para 2(1)(b). (1)

No donations tax is payable as the donation is made by a non-resident. (1)

(2) **Motor car purchase and donation:**

No capital gain or loss would be determined as the asset is neither immovable property nor an asset that is part of a permanent establishment in SA - s9(2)(j) and para 2(1)(b). (1)

(3) **Trading stock to personal use and *vice versa***

Art works returned to the business represent assets becoming part of a permanent establishment. (1)

		R	
No CGT effect - added to opening stock (i.e. income tax deduction) because acquired for no consideration (s22).		(2 000 000)	(1)
The artworks removed from the business represents the removal of trading stock for private or domestic use. There is therefore no CGT effect.			
s22(8) recoupment - cost (for private or domestic use)		2 300 000	(1)
Business activities:			
Sales		15 000 000	(0.5)
Purchases		(3 000 000)	(0.5)
Opening stock		(7 000 000)	(0.5)
Closing stock:		700 000	
Opening stock	7 000 000		(0.5)
added to opening stock	2 000 000		(0.5)
removed from stock	(2 300 000)		(0.5)
sold	(9 000 000)		(0.5)
purchases	3 000 000		(0.5)
Royalty - s49D(a) withholding tax will be inapplicable (connected to permanent establishment)		4 000 000	(1)
Add taxable capital gains		0	
Taxable income		10 000 000	

SOLUTION 9.4 continued

		Marks
On the taxable income	4 019 431	
less Primary rebate - s6	(13 500)	
Tax payable after primary rebate	4 005 931	(1)

2(a) The house in France is deemed to have been disposed of at the date of immigration and reacquired at market value at that date. (1)

- The disposal has no CGT effect as the property is outside South Africa and he was a non-resident. (0.5)
- JP therefore as a resident now owns a property outside South Africa with a base cost of the market value from the date of his immigration. (0.5)

(b) There is no deemed disposal of the property in South Africa on his immigration, therefore the property has a base cost as discussed in (1) above. (0.5)

- No deemed disposal on immigration (0.5)
- There is no donations tax on the donation to his spouse (exempt per s56(1)(b)). (0.5)
- Roll-over would have applied on the donation of the property by JP to his wife on 15 July 2017 - para 67
- The sale of the property by JP's wife results in a CGT event. The base cost must be determined as if JP's wife had always been the owner - para 67.
- Since the property was used as the primary residence after immigration, the primary residence exclusion may be applied, but the capital gain or capital loss must first be apportioned for the periods of non-residence, i.e. 1 Oct 2001 to 14 Feb 2017 (5 616 days) was not used as a primary residence, but from 15 Feb 2017 to 1 Feb 2018 (351 days) was used as a primary residence. (2)

Proceeds exceed expenditure both before and after 1 Oct 2001 therefore choose either (para 26(1)):

	R		Marks
Market value, or	2 500 000		(0.5)
20% of proceeds as valuation date value (using 'P' below)	1 018 182		
Time apportionment:			(0.5)
R - Proceeds on sale	7 000 000		(0.5)
B - Expenditure pre 1 Oct 2001	2 000 000		(0.5)
A - Expenditure post 1 Oct 2001	750 000		(0.5)
Acquisition date	1-Aug-2001		
Sale date	1-Feb-2018		
Valuation date	1-Oct-2001		
T =	17		(1)
N =	1		(0.5)

$$P = R \times \frac{B}{(A+B)}$$

		Marks
Therefore P =	5 090 909	(1)

SOLUTION 9.4 continued

Therefore	$Y = B + \frac{[(P-B) \times N]}{(T+N)}$			
	2 000 000 + (5 090 909 – 2 000 000 × $^{1}/_{18}$)	2 171 717		(1)
Base cost:				
Valuation date value (greater)		2 500 000		
Expenditure post 1 Oct 2001		750 000		
		3 250 000		
Proceeds		7 000 000		(0.5)
				(0.5)
Base cost		(3 250 000)		
Capital gain		3 750 000		
	Primary residence $^{351}/_{5\,967}$ *days*		Not PR $^{5\,616}/_{5\,967}$ *days*	
Split capital gain between period of primary res and not - para 47	220 588		3 529 412	(1)
Primary residence exclusion R2m limited to - para 45	(220 588)			(0.5)
	0		3 529 412	
Sum remaining gains		3 529 412		(1)
Annual exclusion		(40 000)		(0.5)
Assume no capital losses carried forward		0		
Net capital gain		3 489 412		
Inclusion in taxable income	40%	1 395 765		(1)
Assuming JP's wife is taxed on the highest marginal rate (41%), the tax payable is =			572 264	(0.5)
				(30)

SOLUTION 9.5

Replay (Pty) Ltd

		R	R	R	
1 Paragraph 65 has **not been elected,** therefore section 8(4)(e) may not apply.					
s12C (20%)	R500 000 × 20% (Year 3)			(100 000)	(1)
s8(4)(a) - proceeds (limited to cost) - tax value					(1)
Proceeds	R627 000 × $^{100}/_{114}$	550 000			
Cost	(Proceeds limited to cost)	500 000	500 000		(0.5)
Tax value					

SOLUTION 9.5 continued

	Cost		500 000			(0.5)
	Allowance	2015	(200 000)			(0.5)
	Allowance	2016	(100 000)			(0.5)
	Allowance	2017	(100 000)	(100 000)		
Recoupment					400 000	(1)
s12C - new replacement machine		R650 000 × 40%			(260 000)	(1)
Add taxable capital gains:						
Proceeds - para 35(1)				550 000		(0.5)
less recoupment - para 35(3)(a)				(400 000)		(0.5)
				150 000		
Base cost:						
Expenditure - para 20(1)(a)				500 000		(0.5)
less allowances - para 20(3)(a)				(400 000)		(0.5)
				100 000		
Gain				50 000		
Inclusion (80%)					40 000	(1)

2 **Election of para 65** means that s8(4)(e) may be applied

s12C (20%)	(100 000)	(1)
Recoupment of R400 000 (as per above) deferred		
s8(4)(eB) - R400 000 × 40%	160 000	(1)
s12C - new replacement machine (40%)	(260 000)	(1)
Taxable capital gain:		
The gain of R50 000 is deferred.		
Para 65(4) - R50 000 × 40% × inclusion of 80%	16 000	(2)

Both the recoupment and the capital gain are recognised in the ratio of capital allowance or deduction allowed on the replacement machine in the current year to the total allowances or deductions to be granted on such machine.

3 Election of para 65 means that s8(4)(e) may be applied - **multiple assets**

s12C (20%)	(100 000)	(1)
Recoupment of R400 000 (as per above) deferred		

s8(4)(eA) requires that the recoupment be split between each of the replacement machines. In the absence of information as the extent to which the proceeds from the insurance were spent on each machine, it is assumed that the recoupment is to be allocated in the **ratio of expenditure.**

Replacement Machine A - R400 000 × 300/(300 + 350)	184 615	(1)
Replacement Machine B - R400 000 × 350/(300 + 350)	215 385	(1)

SOLUTION 9.5 continued

s8(4)(eB)			
Replacement Machine A - R184 615 × 40%		73 846	(1)
Replacement Machine B - R215 385 × 40%		86 154	(1)
s12C - new replacement Machine 1 (40%) (R300 000 × 40%)		(120 000)	(1)
s12C - new replacement Machine 2 (40%) (R350 000 × 40%)		(140 000)	(1)

Taxable capital gain:

The gain of R50 000 is deferred.

Para 65(3) requires that the capital gain be split between each of the replacement machines. In the absence of information as the extent to which the proceeds from the insurance were spent on each machine, it is assumed that the proceeds are to be allocated in the **ratio of expenditure**.

Replacement Machine A - R50 000 × 300/(300+350)	23 077		(1)
Replacement Machine B - R50 000 × 350/(300+350)	26 923		(1)
Para 65(4)			
Replacement Machine A - R23 077 × 40% × 80%		7 385	(1)
Replacement Machine B - R26 923 × 40% × 80%		8 615	(1)

(d) Election of para 65 means that s8(4)(e) may be applied - **multiple assets**

s12C (20%)		(100 000)	(1)
Recoupment of R400 000 (as per above) deferred			
Replacement Machine A - R400 000 × 300/(300 + 350)	184 615		(1)
Replacement Machine B - R400 000 × 350/(300 + 350)	215 385		(1)
s8(4)(eB)			
Replacement Machine A(used) - R184 615 × 20%		36 923	(1)
Replacement Machine B (new) - R215 385 × 40%		86 154	(1)
s12C - Machine A (used) replacement Machine 1 (20%) (R300 000 × 20%)		(60 000)	(1)
s12C - Machine B (new) replacement Machine 2 (40%) (R350 000 × 40%)		(140 000)	(1)
Taxable capital gain:			
The gain of R50 000 is deferred.			
Replacement Machine A - R50 000 × 300/(300 + 350)	23 077		(1)
Replacement Machine B - R50 000 × 350/(300 + 350)	26 923		(1)
Para 65(4)			
Replacement Machine A (used) - R23 077 × 20% × 80%		3 692	(1)
Replacement Machine B (new) - R26 923 × 40% × 80%		8 615	(1)

4 Para 65 considers involuntary disposals (where proceeds accrue as a result of compensation for loss) whereas paragraph 66 considers any other reinvestment in replacement assets. The other differences between the two paragraphs are as follows: (1)

Para 66 considers only depreciable assets whereas para 65 considers the involuntary disposal of any asset. (1)

Only para 65 refers to the paragraph applying to personal use assets disposed of by way of operation of law, theft or destruction (para 65(7)). This provision appears to not be relevant in any event, as gains and losses on disposal of personal use assets are disregarded (para 53). (1)

Only para 66 refers to ceasing to use the asset for the purposes of trade (para 66(5)). (1)

(40)

CHAPTER 10: DONATIONS TAX AND ESTATE DUTY

Index to sections

Question	Sections	Grade	
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Question 10.2	Donations tax (exemptions, calculations)	*	
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Question 10.5	Discussion: estate duty, donations tax, CGT	***	
Question 10.6	Individuals (partnerships), estate duty, donations tax	***	

QUESTION 10.1 (Solution at end of chapter) (10 Marks)

During the period 1 March 2016 to 28 February 2017, Mrs Good (a South African resident) made the following donations:

– **20 March**

She donated an amount of R40 000 to her niece who was going on an overseas trip.

– **1 April**

She donated R5 000 to the 'Society for the Prevention of Cruelty to Animals' (SPCA). The SPCA is an approved public benefit organisation.

– **30 April**

She donated R50 000 to her husband.

– **10 June**

She donated R70 000 to her son to invest.

– **1 October**

In July, Mrs Good and her husband were divorced. In terms of the divorce order, she was required to pay her husband R20 000 per month for the rest of his life. Her accountant calculated that the present value of the obligation was R1.5 million. On 1 October, Mrs Good formed a trust, the sole beneficiary of which was her ex-husband and donated R1.5 million to the trust.

– **20 December**

She donated R5 million to each of her two children. The donation will only take effect when she dies.

– **10 January 2017**

She sold her car, which had a market value of R180 000, to her friend for R100 000.

YOU ARE REQUIRED TO:

1. Calculate the donations tax payable (if any) by Mrs Good on each donation.
2. Indicate by when the donations tax must be paid.

QUESTION 10.2 **(16 Marks)**

A farmer, John Grove, aged 69, made the following donations:

1. An annuity of R5 000 per month to his sister, aged 63, for her maintenance (for her lifetime).
2. John granted his sister a further annuity of R2 000 per month for her lifetime.
3. John sold foreign shares that his father, a non-resident, had left him in his will, for R200 000. He donated half of the proceeds from the sale to his sister, who distributed the amount to her three children.
4. John retired from farming and donated the *usufruct* in his farm to his nephew Joe, aged 38, for the rest of John's life (see point 5 for the value).
5. John promised Joe ownership of the farm when he, John, died. The farm is valued at R1 500 000.
6. Gifts given during the year amounted to R10 000.
7. A donation of R10 000 was made to an approved public benefit organisation.

YOU ARE REQUIRED TO: Calculate the total donations tax paid by John. For each donation calculate the value, show any exemptions that apply and explain which exemption you have applied, if any.

QUESTION 10.3 (Solution at end of chapter) **(20 Marks)**

Fatima Bakhtiar, a South African resident, died on 1 January 2017. She had been married out of community of property to Sayyid Bakhtiar. She is survived by Sayyid and their two sons, Yusuf and Ismail.

The following information relates to Fatima's estate at 1 January 2017:

1. Fatima was the *fideicommissary* in respect of a residential property that had to pass on to her brother Saleh on her (Fatima's) death. The market value of the property was R4.5 million at 1 January 2017. She had received the *fideicommissum* by donation from her father, Umar, on 1 March 2013, when the property had a market value of R3.9 million.
2. An amount of R600 000 was paid into the estate in respect of a lump sum payment from a provident fund. For income tax purposes, R280 000 of this lump sum represents contributions that were not tax deductible.
3. Fatima had been enjoying a *usufruct* for life in respect of a bed and breakfast cottage. This *usufruct* had been left to her in the will of her late mother, Aisha, who died on 30 June 2006. The *bare dominium* in the cottage had been left to Fatima's brother subject to it (the *usufruct*) passing to Fatima's two children, Yusuf and Ismail, under the same will. The cottage had a market value of R250 000 in Aisha's estate at 30 June 2005 and this value increased to R370 000 by 1 January 2017.
4. Fatima was a 50% shareholder in Twosun (Pty) Ltd, a company that organised tours for foreign and local tourists. On 1 March 2013, Fatima had donated R50 000 to the company, to enable it to do extensive advertising, as it was a new company. The auditor of the company valued Fatima's shares at R260 000 at 1 January 2017 for Estate Duty purposes. The executor sold Fatima's 50% shareholding to Fatima's partner, Nick (who was the other 50% shareholder), for R250 000 in the course of winding up the estate.

5. Fatima had been receiving an annuity of R500 per month from an insurance company. In terms of the annuity contract, the R500 per month was to continue to be paid to her eldest son, Yusuf, on her death. The annuity was a purchased annuity that had another five years to run before it terminated. Of the R500, 45% was a return of the capital sum initially paid in by Fatima to purchase the annuity.

6. Gross proceeds of R410 000 were received by the estate from the sale of shares in foreign companies. These shares were listed on the New York Stock Exchange and had a market value of R400 000 at 1 January 2017.

   None of these holdings amounted to a 10% (or greater) stake in any company or group of companies.

   These shares were inherited by Fatima from the estate of her late grandfather in 1996. Her grandfather had at all times been ordinarily resident in the USA.

7. Cash in bank accounts amounted to R120 000 at 1 January 2017.

8. Fatima's business partner, Nick, had taken out an insurance policy on Fatima's life so that, in the event of her death, he could buy out her share in Twosun (Pty) Ltd (see point 4). The policy paid out R250 000 to Nick. Nick had made contributions of R75 000 (inclusive of interest at 6%) towards this policy. Fatima had taken out an identical policy, making the same contributions as Nick. However, her policy lapsed at the date of her death.

9. Fatima had contributed R12 000 (inclusive of interest at 6%) to a life insurance policy, which paid out R21 000 to her youngest son, Ismail, on her death.

10. The executors in Fatima's estate paid out the following expenses out of the cash in the estate:

Death bed and funeral expenses		12 200
Administration expenses	– South Africa	92 000
	– Non-SA	1 200

11. All cash left in the estate after paying estate expenses was left to Sayyid, on the condition that he pay a monthly annuity to Fatima's aged father, Umar. The annuity was to be R2 000 per month payable for Umar's lifetime.

   The age next birthday of the relevant parties is as follows:

	01/01/2017	**01/03/2013**	**30/06/2006**
Fatima	49	46	39
Sayyid	52		42
Yusuf	21		11
Ismail	19		9
Saleh	47		37
Aisha	–		69
Umar	73	70	63

YOU ARE REQUIRED TO: Calculate the estate duty payable by the deceased estate of the late Fatima Bakhtiar. Indicate clearly the gross value of property and/or exemptions and deductions in the estate. Ignore the effects of the provisos to the valuation of *usufructuary* and like interests.

QUESTION 10.4 (Solution at end of chapter) (25 Marks)

Lady Bianca was born in England and immigrated to the Republic in 1995 after her divorce. She had an aunt, Anne, who was resident in the Republic all her life. In 1996 Bianca's brother, the Earl of Harrod, also immigrated to the Republic. Lady Bianca has two children, Henrietta and Wilber.

On 5 November 2016, Lady Bianca was involved in a tragic accident. She was surfing at Bloubergstrand when a huge wave caught her off-guard. She lost control and drowned.

The following relates to her estate at the date of her death:

1. An estate in Constantia, which was one of her favourite getaways. She left the *usufruct* of this estate to her daughter and the *bare dominium* to her brother. The market value at the date of her death was R1 460 000.
2. She enjoyed a *usufruct* in a yacht that was docked at the Royal Yacht Club. The *usufruct* had been donated to her by her aunt a few years after Bianca immigrated. On 1 March 2010 her aunt sold the yacht, subject to Bianca's *usufruct*, to the Royal Yacht Club for R250 000. At the date of sale the yacht was valued at R1 350 000 and at Bianca's death the value had increased to R1 500 000.
3. The *usufruct* held over a farm in Stellenbosch will now pass to the Institute for the Aged. The market value (R2 200 000) has not changed since 1 May 2015, when she had donated the bare dominium to the institute. The institute is a registered public benefit organisation.
4. In terms of an insurance policy on her life, Lady Bianca's daughter, Henrietta, is to receive R15 000 *per annum* for the rest of her life. Bianca paid all the premiums, which amounted to R30 000. Interest on this amount from the date of payment to the date of death was R20 000. The surrender value on date of death was R124 000.
5. Her aunt, Anne, did not have many family members in the republic and had therefore decided to pass on some of her property, since she was getting too old to enjoy most of it. She had donated the *usufruct* of a holiday home in Plettenberg Bay on 31 July 2012 to Bianca and the *bare dominium* to her brother, the earl. The value of the home on 31 July 2012 was R200 000, and at date of Bianca's death R360 000. Of the increase in value, R60 000 is due to improvements made by the earl in 2013, with Bianca's consent. These improvements had cost the earl R65 000.
6. In 2014 Lady Bianca decided to play the stock market. At the date of her death she had shares listed on the JSE, which had cost her R100 000 and had a market value of R450 000. She also had unlisted shares, which had cost her R85 000. An independent valuation of these shares on 5 November 2016 amounted to R120 000. The listed shares were sold by the executors in the course of winding up the estate for R440 000 and the unlisted shares for R110 000.
7. Bianca's place of residence, House of Rhodes in Cape Town, would go to her youngest child, Wilber. Its market value on 5 November 2016 was R5 000 000.
8. Other assets at the time of her death:

	R
Cash and similar assets	109 500
A property (Wellington Place, UK) inherited seven years ago from a deceased uncle ordinarily resident in England (market value)	1 420 000
Mercedes SLK motor car (market value)	300 000

9. Expenses after death were as follows:

		R
a.	Death bed expenses	3 000
b.	Funeral costs	10 000
c.	Debts due in the republic (including income tax owing)	25 000
d.	Administration and other costs of the estate	9 800
e.	A foreign debt that she did not settle before her immigration	28 000

10. Lady Bianca had a large assessed capital loss carried forward from previous years, which absorbed all the capital gains arising on her death.

Table of ages:

	Bianca	**Earl**	**Anne**	**Wilber**	**Henrietta**
1 March 2010	38	36	60	11	15
31 July 2012	40	38	62	13	17
1 May 2015	43	41	65	16	20
5 November 2016	45	43	67	18	22

YOU ARE REQUIRED TO: Calculate estate duty payable, if any, by the estate of the late Lady Bianca. Show inclusions of property and any deductions separately. Ignore the application of any provisos to the valuation of the *usufructuary* and like interests.

QUESTION 10.5 **(38 Marks)**

Hugo Mars was a South African resident who had originally immigrated to South Africa from Canada in 1998 in search of new business opportunities. While on his way to an origami class, on a cold and rainy day in August 2016, Hugo was involved in a fatal car accident. Hugo was 57 years old and was survived by his wife, Grace, and two sons.

In March 2016, Hugo bought a new car for his eldest son, Scott. Hugo had done this in recognition of Scott's successful graduation from university in the prior year and his having started his first job. The car cost Hugo R350 000 and was registered in Scott's name.

At the date of his death, Hugo owned the following assets:

1. A house in Constantia, which Hugo and his family lived in. Hugo had originally purchased the house in 1996 and he had added a room to the house in 2004. Hugo ran his architectural consultancy business from this additional room. This room accounted for 10% of the value of the house. Hugo was not very knowledgeable about tax and therefore he never had the house valued during his lifetime. In terms of Hugo's will, the house is left to his sons in equal shares. The executor of his will has since confirmed that the house is currently valued at R3 400 000, which exceeds all the expenditure incurred in respect of the house.
2. A computer that Hugo had purchased in 2014 and used for entertainment purposes, such as watching DVDs or playing video games. From time to time, he also used the computer to email his clients and print specifications for buildings that he was commissioned to design. In terms of his will, this computer would be left to Hugo's youngest son, Shaun.
3. A holiday house in Vancouver. Hugo had acquired this holiday house in 1994 and had been using it annually when he and his family went on holidays to Canada. In terms of his will, the house would be sold and the proceeds split equally between Shaun and Scott.
4. A flat in Sandton. Hugo had granted Grace the *bare dominium* of this flat in 2013, as he thought this might improve her credit rating.

Hugo had also taken out a Yellow Umbrella life insurance policy in 2004 in case anything happened to him. The proceeds from this policy would go to Grace and would enable her to care for the family. Hugo had paid all the premiums for this insurance policy.

Hugo and Grace were married out of community of property.

YOU ARE REQUIRED TO: Draft a memo to the Executor of Hugo Mars's estate, in which you explain:

- the donations tax implications of the gift to Scott;
- the income tax implications of the house in Constantia and the computer at the date of Hugo's death; and
- the estate duty implications of all of the above property.

Your explanation should include how the taxes related to each item would be calculated. The calculations themselves are not required.

QUESTION 10.6 **(50 Marks)**

Tom Jobs, aged 55, was an entrepreneur who ran a successful partnership with John Wozniak and Steven Cook distributing electronics in South Africa. The partnership registered as a VAT vendor in 2009 when its sales exceeded the VAT threshold for the first time.

In 2011, Tom was diagnosed with a rare form of pancreatic cancer and passed away on 30 November 2016. Tom was survived by his wife, Lynette, and his three children. Tom and Lynette were married out of community of property. Tom was a dependant on Lynette's medical aid.

The partnership was formed in 1997, with Tom entitled to 50% of the profit or loss of the partnership. John and Steven shared the remaining profit or loss equally. The following information from the accounting records of the partnership relates to the 2017 year of assessment up until the date of Tom's death. All amounts are net of VAT, where applicable.

	Note	
Sales		R8 550 000
Cost of sales	1	(R4 250 000)
Salaries	2	(R500 000)
Depreciation on building	4	(R64 638)
Net partnership profit		R3 735 362

Notes

1. There was no stock on hand at the beginning of the year or at the date of Tom's death.
2. The salaries were paid to Tom and Steven, with Steven receiving 70% of the amount and Tom 30%. John did not receive a salary.
3. The partnership's only asset is a building that it purchased in 2005 from William Gates for R1 596 000. William was not a VAT vendor and had been renting out the building prior to selling it. In addition to the purchase price, the partnership incurred transfer duty of R127 680. The building has always been used to house the administration and distribution functions of the partnership. The market value of this building on 30 November 2016 was R2 350 000.

Tom and his family lived on a three-hectare farm that Tom had originally purchased for R450 000 on 1 July 1995. On 1 October 2001 an estate agent was appointed to perform a valuation and estimated that Tom could sell the farm for R800 000 on that date. In August 2003 Tom spent a further R25 000 to install a swimming pool. At the date of his death, the market value of the farm was R2 500 000. The market value of undeveloped farming land in the area was R500 000 per hectare at that date.

Despite Tom's age, he had been a thrill seeker and always ready to do extreme sports. On 22 March 2016, he decided that, in spite of his illness, he was going it to do a free-fall parachute jump. On the way to the parachute jump, Tom promised his yacht to his son in the event that he died. The market value of the yacht at that date was R80 000 and remained unchanged at the date of his death in November.

On 1 July 2016, Tom sold his spare car to his niece for R220 000. The car had previously been used by Lynette to run the daily household errands. The market value of the vehicle on the date of sale was R350 000.

A holiday home owned by Tom was given to Lynette on 12 October 2016 for no consideration. The market value of the property at that date was R710 000. On the same day Tom also sold the vacant plot next door to Lynette's sister, Grace, for R90 000, being the same price as Tom had originally paid for the plot in February 2006. The plot was now worth R340 000.

In terms of Tom's will, the farm was to be sold by Tom's estate, as Lynette had indicated that, should Tom die, she would prefer to live in a smaller house that was closer to the city.

Tom was a fiduciary owner of another property, which was valued at R2 000 000 at the date of his death. Upon Tom's death, the property must be transferred to his cousin Louis (the *fidei commissary*), who is a male aged 38 years and six months.

R30 000 of costs were incurred in respect of executor's fees and administration costs.

Other than the above, Tom's only asset at the date of his death was cash of R50 000, which was left to his wife in terms of his will.

YOU ARE REQUIRED TO:

1. Calculate the donations tax payable by Tom for his 2017 year of assessment. (6 Marks)
2. Calculate the normal tax payable by Tom for his 2017 year of assessment. You may ignore any CGT that may arise on limited interests (i.e. the fiduciary ownership). (31 Marks)
3. Calculate the estate duty payable by Tom's estate. (13 Marks)

Show all workings. Where you believe that information provided has no effect this should be stated in your solution.

SOLUTION 10.1

Mrs Good			R	
(a)	- 20 March	The donation is subject to the s56(2)(*b*) exemption of R100 000		(1)
		Donations tax payable - s64	0	
	- 1 April	The donation is exempt in terms of s56(1)(*h*)		(1)
		Donations tax payable - s64	0	
	- 30 April	The donation is exempt in terms of s56(1)(*b*)		(1)
		Donations tax payable - s64	0	
	- 10 June	The balance of the s56(2)(*b*) exemption applies, i.e. R60 000 (R100 000 − R40 000)		(1)
		Donations tax payable - s64 (R70 000 − R60 000) = R10 000 × 20%	2 000	(1)
	- 1 October	The contributions to the trust is a settlement of her legal obligations under the divorce settlement. It is therefore not a donation (see *Welch's Estate*).		(1)
		Donations tax payable - s64	0	
	- 20 December	The donation is exempt in terms of s56(1)(*d*). *Note: This is not to be confused with the donation mortis causa of s56(1)(c).*		(1)
		Donations tax payable - s64	0	
	- 10 January	In terms of s58(1) the donation is R80 000 (R180 000 − R100 000)		(1)
		Donations tax payable : R80 000 × 20%	16 000	(1)
(b)	The donations tax is payable by Mrs Good by the end of the month following the month during which each donation took effect - s60(1).			(1)
				(10)

SOLUTION 10.3

Fatima Bakhtiar (All section references are to the Estate Duty Act)		R	R	
	Property in the estate - s3(2) and s3(3)			
1.	Fiduciary interest - valued in terms of s5(1)(*b*)			
	R4.5m × 12% × 7.77109 (ANB Saleh)		4 196 389	(1.5)

SOLUTION 10.3 continued

2.	Lump sum (provident fund) *Note: Retirement lump sums are excluded from the deceased estate's property - s3(2)(i). Contributions to a retirement fund that did not receive a deduction are now included in the dutiable part of the estate - s3(2)(bA). This rule applies to the estate of the person who dies on or after 1 January 2016. However, if such contributions were deducted against any lump sum pay-outs to the retirement fund member or that have been used to offset the tax liability for annuity payments to the retirement fund member, these will remain excluded from the dutiable value of the estate.*		280 000	(1)
3.	Usufruct			(0.5)
	$^{370\,000}/_2 \times 12\% \times 8.29061$ (ANB Yusuf)	184 052		(1.5)
	$^{370\,000}/_2 \times 12\% \times 8.29841$ (ANB Ismail)	184 225	368 276	(1.5)
4.	Twosun (Pty) Ltd (unquoted shares are always included at the valuation (or fair market value) amount) - s5(1)(*f*)*bis*		260 000	(1)
5.	Annuity 500 × 12 × 3.6048 (PV 5 years capitalised at 12%)		21 629	(1.5)
6.	Proceeds on sale of listed foreign shares		410 000	(1)
7.	Cash in bank		120 000	(1)
8.	Nick's policy on Fatima's life As the policy belonged to Nick (not a family member) and the beneficiary is not a family company, policy excluded from deemed property - s3(3)(*a*)(iA)		0	(1)
9.	Fatima's policy (as the person receiving the benefit did not pay the premiums - the proceeds are not reduced)		21 000	(1)
	Gross value of the estate - s3(1)		5 677 294	(1)
	less Allowable deductions: Foreign listed shares inherited from non-resident - s4(*e*)		(410 000)	(1)
10.	Expenses - s4(*a*) and s4(*c*) R12 200 + R92 000		(104 200)	(1)
	Foreign administration expenses non SA debt - as the foreign assets included in the estate are fully deductible, no further deduction is permitted for the foreign debt - s4(*f*). The foreign debt deduction also does not apply as the debt does not exceed those foreign assets.		0	

SOLUTION 10.3 continued

Surviving spouse - s 4(*q*)			
R280 000 (contributions to retirement fund included in estate) + R250 000 (realised amount on sale of shares - Twosun) + R120 000 (cash in bank) − R104 200 (as above). The proceeds from the foreign shares are not included as they have already been fully deducted. Similarly the foreign administration costs are not adjusted for as they did not affect the property.	545 800		(1)
less annuity to Umar			
2 000 × 12 × 5.02437 (ANB 73 male - Umar)	(120 585)	(425 215)	(1.5)
Net value of the estate - s4		4 737 879	
less abatement - s4A		(3 500 000)	(1)
Dutiable estate		1 237 879	
Estate duty at 20% - s2 and the 1st Schedule		247 576	(1)
			(20)

SOLUTION 10.4

Lady Bianca (All section references are to the Estate Duty Act)	R	R	
Property in the estate - s3(2) and s3(3)			
1) Constantia estate - market value		1 460 000	(1)
2) Value of *usufruct*: yacht			
12% × 1 500 000 × 50 years (Royal Yacht Club)			
180 000 × 8.3045		1 494 810	(2)
3) *Usufruct* in farm: Stellenbosch			
12% of R2 200 000 × 70% × 50 years			
184 800 × 8.3045		1 534 672	(2)
4) Insurance policy:			
Insurance annuity is deemed property R15 000 × 8.31161		124 674	(1)
5) Holiday home: value of *usufruct*			
12% × 360 000 × ANB of brother			
43 200 × 7.94344		343 157	(2)
Value of *usufruct* without improvements (for purposes of deduction below): 12% × 300 000 × ANB brother			
36 000 × 7.94344	285 964		(2)
6) Quoted shares		440 000	(1)
Unquoted shares - (market value at death)		120 000	(1)
7) Bianca's House of Rhodes - Cape Town		5 000 000	(1)

SOLUTION 10.4 continued

8)	Other assets:		
	Cash	109 500	(1)
	House in England	1 420 000	(1)
	Mercedes SLK	300 000	(1)
	Gross value of estate - s3(1)	12 346 812	
	less allowable expenses		
	Usufruct in Stellenbosch farm - charitable bequests - s4(*h*)	(1 534 672)	(1)
	Holiday home (R343 157 − R285 964) - s4(*j*)	(57 193)	(1)
	Foreign asset deduction - s4(*e*)(ii)	(1 420 000)	(1)
9)	Death bed expenses - s4(*a*)	(3 000)	(1)
	Funeral expenses - s4(*a*)	(10 000)	(1)
	Debts due in Republic - s4(*b*)	(25 000)	(1)
	Admin costs - s4(*c*)	(9 800)	(1)
	Debts due outside Republic to be deducted from foreign assets (as all the foreign assets are excluded through other deductions, no foreign assets remain against which to make the deduction - s4(*f*)). Also no foreign debt deduction as the foreign assets included exceeded the foreign liability.	0	
	Net value of estate - s4	9 287 148	
	less abatement - s4A	(3 500 000)	(1)
	Dutiable estate	5 787 148	
	Estate duty at 20% - s2 and the 1st Schedule to the Estate Duty Act	1 157 430	(1)
			(25)

CHAPTER 11: TAXATION OF TRUSTS AND ESTATES

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QUESTION 11.1 (Solution at end of chapter) (10 Marks)

Daryl Jones, a South African resident, aged 56, established a resident family trust, the Daryl Jones Family Trust, on 1 March 2016. The trust is a discretionary trust and the trustees are Daryl and his attorney, Bruno Stark.

On 1 March 2016 Daryl donated a block of flats to the trust that had cost him R1.3 million and which had a market value of R2 million. He made no other donations during the year of assessment.

The beneficiaries of the trust are Daryl's two children, Harry, who is 21 years of age, and Jimbo, who is 16 years of age. Both are residents of the Republic.

During the year of assessment, ended 28 February 2017, the trust earned rental income from the block of flats amounting to R190 000 and incurred running costs in respect of the flats amounting to R30 000. Interest earned by the trust on local bank deposits (Daryl donated R50 000 cash in 2012) amounted to R5 600.

On 28 February 2017 the trustees distributed R60 000 of the net rental income of the flats to each of the beneficiaries. The balance of the income was retained in the trust.

YOU ARE REQUIRED TO:

1. Calculate the taxable income of Daryl, Harry and Jimbo arising from the Daryl Jones Family Trust for the year of assessment ended 28 February 2017 (ignore CGT and assume that none of the three had any income other than that derived from the trust). (7 Marks)
2. Calculate the donations tax payable by Daryl in respect of the year of assessment ended 28 February 2017. (3 Marks)

QUESTION 11.2 (Solution at end of chapter) **(32 Marks)**

Below are a number of statements relating to the taxation of trusts.

YOU ARE REQUIRED TO: Indicate whether you consider that the statement made is TRUE or FALSE. Provide brief reasons for your answer.

1. If a beneficiary of a testamentary trust has a vested right to income received by the trust, then such income accrues to the beneficiary.
2. A trust qualifies for the dividend exemption in respect of the South African dividend content of its gross income.
3. A trust qualifies for the section 10(1)(*i*) interest exemption on interest received form a South African investment.
4. The provisions of section 7(5) can apply to income retained in a testamentary trust.
5. It is not possible for a trust to end up with an assessed loss for a year of assessment.
6. All discretionary trusts are *inter vivos* trusts.
7. A contingent right in a discretionary trust becomes a vested right when the trustees exercise their discretion and agree to award an amount to a beneficiary.
8. If gross rentals are deemed to accrue to a trust, then expenses (deductible in terms of the Income Tax Act) incurred in producing these rentals will be deductible by the trust.
9. Income that flows through a trust retains its identity.
10. An annuity, funded by South African dividends and awarded to a beneficiary who is neither ordinarily resident nor carrying on business in the Republic from a South African trust, is not subject to tax.
11. A beneficiary is only taxed on actual payments received by him from a trust.
12. When the trustees vest an interest in an asset of the trust in a beneficiary, the asset is deemed to have been disposed of by the trust for its then market value for capital gains tax purposes.
13. Capital gains tax arises at the time at which the trustees of a trust distribute an asset, in which a beneficiary has a vested right, to that beneficiary.
14. When a trust sells a domestic dwelling (occupied by the beneficiaries as their primary residence), the trust qualifies for a R2 million exclusion.
15. When an asset is vested in the beneficiary of a trust by the trustees, the capital gain that arises is always taxed in the beneficiary's hands and not in the trust.
16. Revenue amounts received by a portfolio of a collective investment scheme in securities will be taxed in the hands of the unit holder if distributed to him or her.

QUESTION 11.3 (Solution at end of chapter) **(16 Marks)**

The Good Family Trust was formed by Mrs Ann Good on 1 March 2016. The beneficiaries of the trust are:

- Mrs Ann Good
- Mr Arnold Good (Ann's husband)
- Brenda aged 22, Ann and Arnold's daughter
- Barry aged 16, Ann and Arnold's son

In terms of the trust deed an annuity of R100 000 (*per annum*) must be paid to any child (of Ann and Arnold) who has attained the age of 21.

Apart from the annuity all income distributions are at the sole discretion of the trustees.

On 1 March 2016 the following assets were donated to the trust:

Asset	**Donor**
A building in Cape Town	Ann Good (52)
South African listed shares	Arnold Good (56)
Money market investment	Mary Mann (Ann's mother) (75)

The income for the trust, for the year ended 28 February 2017 was as follows:

	R
Rental (from the building)	500 000
Dividends (gross amount, from the shares)	200 000
Interest (from the money market investments)	300 000
	1 000 000

All dividends were received prior to the vesting date of the discretionary distribution (below). SARS therefore accepted the trust as being the beneficial owner of the shares.

On 28 February 2017 the trustees paid the R100 000 annuity to Brenda. In addition, they made a discretionary distribution of R50 000 (each) to Brenda and Barry. All distributions were made from the general pool of income. All the persons are South African residents. Ann and Arnold are married out of community of property. No trustee remuneration was paid.

YOU ARE REQUIRED TO: Calculate the taxable income of:

1. The trust
2. Brenda
3. Barry
4. Ann
5. Mary

QUESTION 11.4 **(18 Marks)**

On 1 March 2012 Bill and Mary Brown (South African residents and married out of community of property) formed a trust in the United Kingdom (UK). On 1 March 2012 Bill donated £200 000 to the trust. The trust immediately invested the capital in the following three foreign assets:

1. Eight per cent of the shares in Small, a small unlisted UK company (not a controlled foreign company (CFC))
2. Five per cent of the shares in Large, a large UK company listed on both the London and Johannesburg Stock Exchanges
3. Residual amount in interest-bearing bonds

The beneficiaries of the trust are Bill and Mary's two children, Dee and Dave, who are both over 18 years old and are both resident in South Africa. In terms of the trust deed, distributions of income are at the sole discretion of the trustees. The beneficiaries do not have a vested right to the income or capital of the trust.

The income of the trust for the year ended 28 February 2017 is as follows:

	£
Dividends from Small	12 000
Dividends from Large	8 000
Interest	4 000
	24 000

You may assume an exchange rate of £1 = R18.

YOU ARE REQUIRED TO:

1. Calculate the taxable income for the year ended 28 February 2017 for Dave, Dee and Bill if:
   a. The trustees make no distributions during the year.
   b. The trustees distribute all of the income equally to Dee and Dave.
2. Calculate the taxable income of Dave for the 2018 tax year if the trustees made no distributions in the 2017 year and:
   a. They distribute all of the income retained from the 2017 year of assessment (now capital) to the two beneficiaries in the 2018 year of assessment.
   b. Bill and Mary had died in the 2016 year of assessment and the trustees distribute all of the income retained from the 2017 year of assessment (now capital) to the two beneficiaries in the 2018 year of assessment.

QUESTION 11.5 (Solution at end of chapter) (36 Marks)

Lenny Armstrong, a South African resident, formed a trust in the Republic. The trustees of the trust are Lenny, his accountant and the lawyer who drew up the trust deed.

The beneficiaries of the trust are Lenny, his spouse Sophia (to whom he is married out of community of property), their two children, Grace and Timothy, and an approved 'public benefit organisation' (PBO).

All of the beneficiaries except for Grace are residents of the republic. Grace is a major child and is resident in Spain. Timothy is still a minor child.

The trust is discretionary and no beneficiary has a vested right to capital or income of the trust unless the trustees make a decision to vest an amount in a beneficiary. The only exception is Timothy's vested right to R2 000 per month (see below).

On 1 March 2016 Lenny transferred the following assets (acquired after 1 October 2001) to the trust:

	Market value	**Base cost**
By donation	**R**	**R**
Shares in SAB Limited	600 000	400 000
Shares in BCX Limited	200 000	250 000
Vacant plot of land	1 200 000	800 000
By sale (through loan from Lenny)		
Rent-producing shops	2 100 000	500 000
Lenny's primary residence	1 200 000	650 000

The loan of R3 300 000 is interest free and repayable on demand. The trust could have obtained a loan from a bank under an arm's length transaction at an interest rate of 9% per year. The trust therefore saved R297 000 in interest per year.

The following events occurred in the trust's first year of assessment ended 28 February 2017:

- The trust earned net rentals of R300 000 and local dividends of R48 000 (gross amount). SARS and the trustees agree that the trust is the holder of the shares (i.e. the beneficial owner in respect of all dividends).
- The full R300 000 net rentals were distributed to Timothy at the end of the year of assessment.
- A recurring vested monthly amount of R2 000 was distributed to Timothy for his day-to-day expenses out of the dividend income.
- The vacant plot was sold to a third party on 1 January 2017 for R1 400 000. Selling expenses of R32 000 were incurred. The proceeds of R1 400 000 were immediately distributed as follows:

to Lenny	R800 000
to Sophia	R400 000
to the PBO	R200 000

- Half the shares in SAB Limited with a market value of R400 000 were vested in Grace on 1 January 2017. No dividends were declared by SAB subsequent to this date.

YOU ARE REQUIRED TO: For the year of assessment ended 28 February 2017:

1. Calculate the taxable income of the trust, clearly showing income, distributions and attributions. (12 Marks)
2. Calculate the taxable income of Lenny, clearly indicating under which sections or paragraphs income is attributed. (15 Marks)
3. Calculate the taxable income of Timothy. (3 Marks)
4. Briefly state whether Lenny or the trust would have been liable for any other taxes in the 2017 year of assessment and how they would have been calculated. (6 Marks)

QUESTION 11.6 **(45 Marks)**

Mr Orwell was the managing director of a large company (Peninsula Brokers (Pty) Ltd). He died on 31 May 2016 aged 58 years.

He derived income from various sources and his income and expenditure to the date of his death was as follows:

			R	**R**
1.	Dividends (gross)	– shares in Republic companies	22 300	
		– unlisted shares in Australian companies	17 000	39 300

The shares in the companies registered in Australia were purchased with A$500 000 he had inherited in terms of the will of his late mother, who was a resident of Australia. His shareholding is not greater than 9% and the dividends do not qualify for exemption under section 10B(2)(*a*).

2. An annuity from Alliance Insurance Company of (R15 000 × 3 months) R45 000

An insurance policy had matured the previous year and he had purchased an annuity, payable from 1 September 2015 onwards, for R1 800 000. On his death, the annuity was to be paid to his widow and the insurance company used a joint expected life span of 15 years to calculate the capital element of the annuity. This calculation was accepted by the Commissioner.

		R	R
3.	Salary R150 000 × 3	450 000	
	less pension fund contributions	(27 000)	
		423 000	
	less medical Aid contributions (two members)	(13 000)	410 000
4.	Contributions to retirement annuity fund		
	(three monthly payments of R2 500)		(7 500)
	Insurance premiums paid (short-term insurance policy)		(12 000)

Mr Orwell has no pension or retirement annuity fund premiums that were not allowed as a deduction from previous years of assessment.

On Mr Orwell's death the pension fund and retirement annuity fund paid lump sums to his estate together totalling R320 000. As these were in aggregate less than the tax threshold of R500 000 in terms of the Second Schedule of the Income Tax Act, no tax is payable on these amounts.

His widow was entitled to an annuity from the retirement annuity fund of R6 000 per month for life. Mr Orwell left his widow (55 years old on date of his death), to whom he was married out of community of property, and two unmarried children – George, aged 25, resident in the United Kingdom and Angela, aged 19, self-employed as a dress designer in the Republic.

In terms of his will:

a. The shares in the Australian companies were left to his son, George.

b. His wife was to receive a cash sum of R100 000 and the children were to receive R40 000 each on the completion of the winding up of the estate, at which date the residue was to be put into a testamentary trust, to be invested at the entire discretion of the trustees.

c. The trust deed provided for an annuity of R8 000 per month to be paid to Mrs Orwell for life. The balance of the income was to be calculated on the last day of February each year and divided equally between his children.

d. On the death of Mrs Orwell, the trust was to be dissolved and the capital and accumulated income divided equally amongst his surviving children and, if none survived, was to go to a specified charity.

The estate was wound up on 30 November 2016, at which date the assets were distributed to the heirs and handed over to the trustees.

Income received and expenditure incurred by the various parties to 28 February 2017 was as follows:

Estate: 1 June 2016 to 30 November 2016

			R	R
a.	Dividends received	– Republic companies	84 000	
		– Australian companies	43 000	127 000
b.	Interest on the investment of surplus funds			24 000
c.	Lump sum received from pension fund (see above)			320 000
d.	Proceeds of an insurance policy on Mr Orwell's life (paid in terms of a pre-nuptial agreement to his spouse)			1 400 000
e.	Director's fees in respect of the financial year to 30 April 2016, awarded to Mr Orwell by the shareholders at the AGM of Peninsula Brokers (Pty) Ltd held on 3 June 2016.			240 000
f.	Estate duty and other charges (not allowable for income tax purposes) amounted to			300 000

Trust: 1 December 2016 to 28 February 2017

a.	Interest on mortgage participation bonds in RSA Bank	24 000	
b.	Dividends on shares in Republic registered companies	48 000	

Mrs Orwell: 1 June 2016 to 28 February 2017

a.	Annuities received from		
	– Umbrella retirement annuity fund	54 000	
	– Alliance insurance company	135 000	
	– The trust	24 000	213 000
b.	Interest on a bank deposit		15 000
c.	Cash sum received on winding up of estate (see above)		100 000

George Orwell

a.	Dividends received from Australian companies	20 000
b.	Amount received from trust	24 000
c.	Cash sum received on winding up of estate (see above)	40 000

YOU ARE REQUIRED TO:

1. Calculate Mr Orwell's normal tax liability for the period of assessment to the date of his death.
2. Calculate the taxable income of the estate, the trust, Mrs Orwell and George Orwell for the 2017 year of assessment. (Ignore any capital gains effect.)

QUESTION 11.7 **(33 Marks)**

Haroon Desai, a resident of South Africa, aged 64 years, retired on 31 December 2016. Unfortunately, after suffering a bout of pneumonia, he subsequently died on 1 February 2017. He would have been 65 on 28 February 2017.

He is survived by:

- his wife Miriam (to whom he was married out of community of property);
- his married daughter Asia, aged 28; and
- his unmarried son, Calvin, aged 26.

No one in the family is a non-resident.

The following relates to Haroon's employment up to his retirement:

– He earned a cash salary of R24 000 per month.

– He contributed 10% of his salary to a pension fund.

– Haroon's pension fund informed him that he had R1 200 000 due to him at 31 December 2016, of which only R400 000 (i.e. one-third) would be paid out in cash and the remainder would buy a monthly pension. He had been a member of this fund for 19 years and two months. He had contributed 8% of his salary to the fund right up until retirement date.

  Pension and retirement annuity contributions disallowed up to 29 February 2016 amounted to R110 000.

  From 1 January 2017 he received a monthly pension form the pension fund of R15 600. If he died while receiving the pension, in terms of the rules of the fund his spouse would receive a reduced pension of R11 600 per month for the rest of her life.

Other information

Haroon had contributed an amount of R400 per month to a retirement annuity fund for ten years. The deduction of these contributions had always been allowed in full. He retired from this fund in the previous year of assessment on 29 February 2016. He received a lump sum of R16 000 and the remaining two-thirds was paid as an annuity of R300 per month from 1 March 2016. This would cease on his death.

He earned interest of R34 000 from investments in South Africa. Of the R34 000, R25 000 accrued up until 1 February 2017.

Haroon received net rentals of R11 200 per month from an apartment that he owned.

In terms of his will

His wife Miriam is to inherit the investments. The investments bear interest only and are in the form of cash deposit accounts. These amounted to R380 000 at the date of his death.

Miriam would also inherit any pension lump sums due. The family home valued at R2.1 million would be sold by the executor and the cash would go to Miriam. It was acquired on 1 June 1997 for R400 000. No market value was available for 1 October 2001.

His son Calvin would inherit the apartment valued at R1.2 million at the date of his death, subject to him paying half of the rental income to his sister Asia until it is sold. Haroon had purchased the apartment in 2008 for R800 000.

The executor of Haroon's estate received the following:

- the interest on investments of R34 000 earned to 28 February 2017; and
- the net flat rental of R11 200 per month from the date of death.

The lump sum of R400 000 from the pension fund was paid into the estate on 5 February 2017.

The executor sold the family home in February and gave Miriam R2 480 000 (proceeds of R2.5 million less selling expenses).

Interest of R1 500 was earned on monies held in trust by the executor. The estate was not wound up by 28 February 2017.

YOU ARE REQUIRED TO:

1. Calculate the taxable income of Haroon Desai for the period of assessment ended 1 February 2017. (21 Marks)
2. Calculate the tax payable of the deceased estate of Haroon Desai for the year of assessment ended 28 February 2017. (10 Marks)
3. Calculate the taxable income of Calvin Desai in respect of the information provided for the year of assessment ended 28 February 2017. (2 Marks)

QUESTION 11.8 **(12 Marks)**

YOU ARE REQUIRED TO: Discuss the income tax implications for the deceased, the estate and the heir in each case. State who will be taxed on the amounts in the following situations:

1. A bad debt recovered by the executor after the date of death of the deceased, where the business carried on by the deceased was bequeathed to the daughter.

2. An interest in a close corporation is left to a son of the deceased. With the permission of all parties, the executor sells the interest and gives the cash to the son.

QUESTION 11.9 **(23 Marks)**

Jari Cain, a reasonably wealthy individual, died on 1 January 2017, at the age of 57. He was ordinarily resident in South Africa.

Assets held at date of death	**Market value**	**Base cost**
	R	**R**
Investment in listed shares (local)	6 500 000	1 200 000
Primary residence (in South Africa)	4 200 000	1 400 000
Holiday house (in South Africa)	1 500 000	800 000
Apartment in London UK (translated to Rands)	2 000 000	1 900 000
Cash in South African bank account	900 000	
Motor vehicle	300 000	450 000

Notes on assets: The market values for the above assets (all acquired after 1 October 2001) are at 1 January 2017 and the base cost is as defined in the Eighth Schedule to the Income Tax Act. The London apartment is rented out.

Income actually received by Jari for the period 1 March 2016 to 1 January 2017

	R
Dividends received (net of dividends tax) – local	72 000
Interest received – local	37 500
Rentals received – London apartment	201 600

Notes on income received: A previous tenant had omitted to pay for the July 2016 rental of R22 400. It was not considered a bad debt.

Income actually received by the executor of Jari's estate after 1 January 2017 to 28 February 2017

	R
Dividends declared to shareholders registered at 15 December 2016 (net of dividends tax)	2 400
Dividends declared after 1 January 2017 (net of dividends tax)	1 200
Rentals for January and February	44 800
Rental received from tenant for July 2016	22 400
Interest on cash in South African bank account (above)	7 200

Jari's will contained the following bequests:

- to his wife Jill (ordinarily resident): the primary residence, the holiday house and bank account; and
- to his only son (ordinarily resident): the London apartment, investments in listed shares and motorcar.

Jari and Jill were married out of community of property.

YOU ARE REQUIRED TO:

1. Determine the taxable income in the last income tax return of Jari. (16 Marks)
2. Calculate the tax payable in the deceased estate for the year of assessment ended 28 February 2017. (7 Marks)

QUESTION 11.10 **(39 Marks)**

In 1999 Jolene and Ramsey Lesiem, who are both under 65, formed a trust called the Lesiem Trust. Jolene and Ramsey are both South African residents who are married out of community of property. The Lesiem Trust is a South African trust. Jolene donated a small block of flats with a market value of R7 million to the trust. The flats generate rental income. At the same time, Ramsey donated shares listed on the JSE (SA) worth R5 million to the trust. The beneficiaries of the Lesiem Trust are Jolene and Ramsey's two children, Alexis and Claudia and the Eratus Trust, an offshore trust.

Alexis is 25 and Claudia is 17 (unmarried) and they are both South African residents. Alexis and Claudia have an equal vested right to capital, but not to the income of the Lesiem Trust. The Eratus Trust, as a beneficiary of the Lesiem Trust, does not have any vested rights.

The Eratus Trust was formed in 1998 in the Isle of Man with a nominal contribution of R100 and is fully discretionary. The beneficiaries are Alexis, Claudia, Jolene and Ramsey. No beneficiaries have a right to capital or income of this trust. The only income received by this trust currently is interest income, which is received from a bank fixed deposit in the UK. This investment was made when the Lesiem Trust distributed R300 000 to the Eratus Trust in 2002. This was distributed solely out of rental income in the Lesiem Trust. Whenever any of the beneficiaries take a trip to the UK, a distribution is made to them by the Eratus Trust to cover their costs. The trustees of both trusts are Jolene, Ramsey and two other independent persons.

The following information is provided for the trusts for the 2017 year of assessment:

Lesiem Trust		**R**
Net rentals received		450 000
Local listed dividends received into bank account		150 000
Sale proceeds – shares sold (note 1)		52 000
Distributions	Lump sum to Alexis (note 2)	80 000
	Lump sum to Claudia (note 2)	100 000

Notes

1. The valuation date value of these shares at 1 October 2001 was R26 000. They were sold on 1 June 2016.
2. These lump sums were made *pro rata* out of the net rentals and dividends received.

Eratus Trust	**R**
Net interest received (translated to Rands)	32 000
Distributions:	
Lump sum to Alexis	20 000
Lump sum to Ramsey	10 000

Ramsey

Ramsey has other net business income of R500 000

Jolene

Jolene has other net rental income of R250 000

YOU ARE REQUIRED TO:

1. Calculate the taxable income for the following:
   a. The Lesiem Trust
   b. Ramsey
   c. The Eratus Trust

d. Jolene
e. Alexis

2. Briefly explain, without doing any calculations, if there would be any difference to your answers if, instead of donating the assets to the trusts, they were sold at market value on interest-free loan accounts.

QUESTION 11.11 **(50 Marks)**

The Gazpacho Trust was established in 2000 by Bob Florence, aged 59. The trustees of the trust are Bob and three other independent persons. The beneficiaries are Bob's wife Annie, aged 58 and to whom he was married out of community of property and their children Daphne, aged 24, and Mecer, (aged 17 and unmarried). Mecer turned 18 on 20 August 2016. The trust is discretionary as regards income and capital, save that an annuity of R25 000 per month has to be paid to Annie *pro rata* out of the income in the trust. All of the above persons are South African residents, except for Daphne, who is resident in the USA.

Annie donated R6 million to the trust in 2000, which it used to purchase a residential property in Camps Bay for R4 million on 1 March 2000. This property earns rental income payable annually in advance. The property was not valued at 1 October 2001. The trust invested the other R2 million in a portfolio of listed shares in the USA. Bob donated a SA interest-bearing investment in a local investment bank worth R5 million to the Trust in 2004.

At 29 February 2016 the income retained in the trust amounted to R150 000, which consisted of property rentals (75%) and dividends from the USA listed shares (25%). This retained amount yielded no income in the 2017 year of assessment.

On 15 March 2016, the following income was received by or accrued to the trust:

	R
Net rental income for the next 12 months	480 000
USA dividends	120 000
Interest on investment	360 000
INCOME	960 000

No other income was received by or accrued to the trust during the 2017 year of assessment.

The trust sold the residential property for R12 million on 28 February 2017 and the trustees distributed two-thirds of the net proceeds equally between the three beneficiaries. One-third of the net proceeds was retained in the trust. Selling costs of R500 000 were incurred by the trust. Improvements costing R2 million were made to the property in 2010.

The trustees made the following distributions during the 2017 year of assessment:

- to Mecer on 15 August 2016: R40 000 (*pro rata* out of the 2017 year of assessment income);
- to Daphne on 1 September 2016: R20 000 (*pro rata* out of the 2017 year of assessment income);
- to Annie: the monthly annuity paid on the 25th of each month;
- to Mecer on 26 February 2017: R10 000 (out of rental income of the trust for its 2017 year of assessment) and R8 000 (*pro rata* out of income retained in the trust at 29 February 2016); and
- to the three beneficiaries: the two-thirds of net proceeds on disposal of the property.

YOU ARE REQUIRED TO: Calculate the taxable income of the Trust, Mecer, Annie and Bob for their years of assessment ended 28 February 2017, showing all workings clearly. Assume that all taxpayers had no income apart from that given in the scenario.

QUESTION 11.12 **(35 Marks)**

Jan Lotter, an unmarried South African resident, is a beneficiary of a discretionary trust in the Netherlands, which is not a 'resident' as defined. There are two trustees who are independent of Jan. The trustees have the discretion to pay out capital or income to the two beneficiaries, Jan Lotter and his sister Martina Keis. In addition, an annuity of R50 000 must be paid to each of them each year out of the income in the trust. Jan is 30 and his sister, a Dutch resident, is 25. When Martina reaches the age of 30 the trust is to be dissolved and all capital and income distributed equally between Jan and Martina. If either Jan or Martina pre-decease the other, before this date, all the capital and income remaining will be distributed to the survivor.

The trust owns a property in the Netherlands with a base cost of R1 500 000, which is rented out. In addition, the trust also has interest-bearing investments in the Netherlands.

The property was purchased on 1 October 2012 for R1 500 000 from Jan and Martina's father, Teunis, by the trust on interest-free loan account. Teunis, a widower, was for the last ten years (and still is) ordinarily resident in South Africa. The investments were a bequest in the will of Jan's deceased grandfather (who was the creator (or founder) of the Lotter Family Trust) and who was ordinarily and physically resident in Holland until his death.

For the year of assessment ended 28 February 2017 the following transactions were recorded in the records of the trust:

	R
Rentals received (net of expenses) to date of sale	388 000
Proceeds – sale of above rental property	2 500 000
Interest received	370 000
Selling expenses – agents commission to sell property	75 000
Distributions:	
Lump sum to Jan	700 000
Lump sum to Martina	700 000
Annuity to Jan	50 000
Annuity to Martina	50 000

The lump sums were paid out of the net proceeds from the sale of the rental property.

The annuities were paid out of rental and investment income.

The loan of R1 500 000 from Teunis was still outstanding at the end of the 2017 year of assessment.

YOU ARE REQUIRED TO:

1. Calculate the taxable income (if any) of:
   a. Jan Lotter
   b. Martina Keis
   c. Teunis Lotter
   d. The trust

   You may ignore the attribution limitation established in the *Woulidge* case.
2. How would your answer differ if the interest income in the foreign trust were from an investment in South Africa made by the deceased grandfather who was always a Dutch resident?
3. Is there any way Teunis or the trust could have avoided or reduced the capital gains tax implications in South Africa?

QUESTION 11.13 (Solution at end of chapter) (54 Marks)

Rob Marley, aged 58, died on 31 March 2016. He had always been involved in the hospitality industry and had accumulated certain assets during his lifetime. He is survived by his wife Thelma, aged 55, to whom he was married out of community of property and two children, Barry, aged 31, and Sondra, aged 17, all South African residents. Sondra turned 18 on 1 December 2016.

In order to avoid estate duty, Rob created the Marley Trust in 2010 and donated a small hotel and listed shares to the trust at that time. The listed shares comprised both local and foreign shareholdings. At the same time his wife Thelma donated local Government Bonds (interest-bearing) to the trust.

The market value of the assets at the date of donation was:

Hotel	R15 million
Listed shares	R3 million
Government Bonds	R500 000

The trustees have full discretion as to the distribution of both capital and income from the trust after paying an annuity to Thelma until her death. The annuity is fixed at R15 000 per month, but is to increase to R35 000 in the event of Rob's death. The increase would apply in the month following Rob's death.

The market values of Rob's assets at date of death (31 March 2016) were as follows:

House – used as a bed and breakfast (B&B) operation	R3 million
Primary residence	R5.5 million
Cash	R2 million
Motor vehicles and paintings	R600 000
Boat (11 metres)	R150 000

The market value of all the assets (except cash) at 1 October 2001 was greater than the time-apportionment base cost and therefore adopted as the valuation date value.

Market value – 1 October 2001:	
House (B&B)	R2 million
Primary residence	R4.5 million
Motor vehicles and paintings	R400 000
Boat	R150 000

A further R200 000 was spent on improving the B&B house in 2014.

The executor sold the boat on 1 January 2017 for R100 000 to pay for expenses in the estate. The house with B&B operation was left to Rob's son Barry. The estate was finalised on 31 January 2017. On 2 February 2017 Barry received R600, recovered from a client of the B&B, which Rob had written off in the 2016 year of assessment.

The primary residence, motor vehicles and paintings were left to his wife Thelma.

Of the R2 million cash at date of death, R1 million was left to Sondra in order for her to complete her studies in South Africa. The balance of the cash was left to pay estate duty and any costs of the estate.

The cash of R2 million was held throughout the year and interest on the R2 million (earned evenly throughout the year to 28 February 2017) amounted to R160 000.

Net income from the B&B was as follows:

1 March 2016 to 31 March 2016	R41 000
1 April 2016 to 28 February 2017 (accrued evenly)	R440 000

The income of the trust for the 2017 year of assessment was as follows:

Hotel net income	R3 200 000
Foreign dividends (listed shares)	R4 000
Local dividends (listed shares)	64 000
Interest – Government Bonds	40 000

The trustees exercised their discretion during the year and made the following distributions, as well as paying the annuity as stipulated in the trust deed:

To Sondra on 1 July 2016	R100 000
To Barry on 15 March 2016 to assist with the purchase of his new home	500 000
To Thelma – annuity	?

Note: You may assume that all the distributions were made *pro rata* out of the gross income accruing to the trust, the proportions of which remained constant throughout the year of assessment.

YOU ARE REQUIRED TO: Calculate the taxable income from the information supplied for the following for the period or year of assessment ending 28 February 2017:

1.	The trust	(9 Marks)
2.	Rob Marley – last tax return	(14 Marks)
3.	The deceased estate to 28 February 2017 (assume it is not wound up yet)	(8 Marks)
4.	Thelma	(7 Marks)
5.	Sondra	(10 Marks)
6.	Barry	(6 Marks)

QUESTION 11.14 **(15 Marks)**

The Lawrence Harvey Trust was formed in South Africa in 1999.

The trust is discretionary as regards to both income and capital.

The trust was set up by means of an interest-free loan from the creator, Neil Harvey, when he sold an offshore dividend- and interest-bearing investment (not dual-listed on the JSE) to the trust.

The loan outstanding is recorded at R1.5 million in the books of the trust. No repayments have been made.

Neil's two children are the beneficiaries of the trust. Alan is a non-resident and Jacqui is a South African resident.

Neil is still alive and aged 55. Both children are majors.

The income and distribution for the trust for the year of assessment ended 28 February 2017 is as follows:

Foreign dividend income		R120 000
Foreign interest income		R210 000
Distribution, *pro rata* out of all income, to Alan	28 February	R100 000
Distribution, *pro rata* out of all income, to Jacqui	28 February	R100 000

Market-related interest on the loan from Neil would have amounted to R140 000 for the year.

YOU ARE REQUIRED TO: Calculate the taxable income of the trust, Neil, Alan and Jacqui. You MUST apply the *Woulidge* decision using the proportional method.

QUESTION 11.15 **(10 Marks)**

The Bradson Trust has two South African beneficiaries, Bradley, aged 20 and Jason, aged 16. Each beneficiary has a vested right to 50% of the trust income. The trust owns a commercial property unit that it lets out to third parties. This is the trust's only asset and it has no other income. The unit was acquired from Dennis, the grandfather of the two beneficiaries, by way of a market-related sale of the property to the trust on market-related loan account during 2010. All parties are South African residents as defined.

During its year of assessment ended 28 February 2017 the trust earned rental income of R1.2 million from the unit and incurred deductible expenditure totalling R1.6 million in earning the rental income. None of the rental income was distributed. The property was also sold at the end of the year and generated a capital loss of R400 000.

In addition to the vesting of income in the beneficiaries, the Trustees would like to distribute half the capital loss to the beneficiaries and retain the other half.

YOU ARE REQUIRED TO: Discuss whether or not the trustees may distribute the capital loss and discuss the tax effect that the revenue loss will have on the vesting rights for the beneficiaries.

QUESTION 11.16 **(40 Marks)**

Jessica Talanus, aged 61, has various assets and sources of income. On 31 October 2016, while shopping in the local supermarket, she had a heart attack and died.

The executor named in her will was duly appointed to administer and distribute her estate.

Prior to her death the following transactions took place:

- On 1 May 2016 Jessica donated a plot of land (under two hectares) to her two children in equal shares. The plot had cost her R385 000 on 2 November 2006 and had a market value of R3 100 000 at the date of the donation. No other donations were made in the 2017 year of assessment.
- On 1 June 2016 Jessica sold her 50% share in a close corporation to her brother for R50 000. Her 50% share was valued at R40 000 at the time, but her brother was willing to pay R50 000. Jessica had acquired her share in the close corporation on 1 July 1998 for R10 000. No valuation was carried out on 1 October 2001.

For the period 1 March 2016 to 31 October 2016 income and expenditure were as follows:

			R
Rental income			154 000
Rental expenditure			(42 000)
Bad debt in respect of unpaid rental			(5 200)
Interest income	–	SA source	88 000
	–	Foreign source	5 800
Dividends received, net of withholding tax			
	–	listed shares (SA shares)	43 000

A dividend of R4 000 was declared by Anglovaal (SA) on 1 October to shareholders registered at 30 October. The dividend was only paid on 6 November 2016 and is not included in dividends received. All shareholdings are in listed SA shares and no shareholding exceeds 5% of the participation rights.

Jessica had the following assets at 31 October 2016:

	Market value at 31/10/16	**Valuation date value 1/10/01**
	R	**R**
Flats (acquired in 1992)	4 200 000	2 300 000
Primary residence (in South Africa – see note)	5 000 000	–
Money market cash account	980 000	–
Listed shares	2 800 000	800 000
Foreign bank account (converted to Rands)	150 000	–

Note: The primary residence was inherited from her husband who died in 2012. It has always been their only primary residence. The market value at the date of his death was R4 500 000 and he had acquired the property on 3 July 2004 for R800 000. Jessica made certain improvements to the property after his death, which cost her R95 000. For the months of November, December 2015 and January 2016, Jessica let the house out while having a holiday with her family in Greece.

In terms of Jessica's will the following bequests were made:

- The flats to her son, Brutus, on condition that half of the net rental income must be paid to his sister, Romy.
- The primary residence to her daughter, Romy.
- The listed shares to both children in equal shares.
- Cash must be paid out of the money market cash account as follows:

To Brutus	R100 000
To Romy	R100 000

  The balance of R780 000 to be used to pay any expenses in the estate. Any cash remaining would then be distributed equally between the two children.
- Foreign bank account to her son, Brutus.

The following income was received by the executor for the period 1 November 2016 to 28 February 2017. The estate was not wound up at 28 February 2017 and no cash distributions were made before 28 February 2017.

		R
Rental income (net of expenses)		56 000
Bad debt recovered (relating to rentals unpaid at 31/10/16)		3 400
Interest received	– SA source (entire money-market account)	24 000
	– foreign source (foreign bank account)	2 900

		R
SA dividends received, net of withholding tax		
	– Anglovaal (6/11/16)	3 400
	– other	21 000
Sale of listed share	– proceeds	40 000

The executor sold a share included in the listed share portfolio in terms of a delisting arrangement. The share had a market value of R50 000 at the date of death and a base cost of R13 000 at 1 October 2001. The cash was awarded to the two children in equal shares.

Jessica had not remarried after her husband's death and both of her children are majors. Romy is a South African resident, but Brutus is a non-resident for tax purposes.

YOU ARE REQUIRED TO:

1. Calculate the taxable income of Jessica Talanus. (26 Marks)
2. Calculate the tax payable by Jessica's deceased estate. (14 Marks)

SOLUTION 11.1

Daryl Jones

1 Taxable income

	Trust	Daryl	Harry	Jimbo	
Rental income	190 000				
less expenses	(30 000)				
Net rental income	160 000				(1)
s7(3) - distributed to Jimbo (minor)	(60 000)	60 000		0	(1)
s25B - distributed to Harry (major)	(60 000)		60 000		(1)
Retained in the trust	40 000				
s7(5) - Daryl	(40 000)	40 000			(1)
Interest income	5 600				
s7(5) - Daryl	(5 600)	5 600			(1)
less interest exemption - s10(1)(*i*)		(5 600)			(1)
Taxable income	0	100 000	60 000	0	(1)
					(7)

2 Donations tax

Market value of building donated - s62(1)(*d*)	2 000 000	(1)
less general exemption - s56(2)(*b*)	(100 000)	(1)
Donation	1 900 000	
Donations tax at 20% - s64	380 000	(1)
		(3)
		(10)

SOLUTION 11.2

1.	TRUE	s25B(1) applies as it is a testamentary trust and the beneficiary has a vested right	(2)
2.	TRUE	The income derived by the trust retains its identity (*Armstrong)*. The trust may still apply the dividend exemption as it is not limited to natural persons.	(2)
3.	FALSE	The exemption only applies to natural persons. A trust is not a natural person.	(2)
4.	FALSE	S7(5) deems income retained in a trust to be the income of the donor of the asset that gives rise to the income. In a testamentary trust there is no donation if an asset is left to the trust in the valid will of a deceased person. However, another person may also donate to the testamentary trust in which case s7(5) may apply on retained income in respect of the income accrued or received from the new asset donated.	(2)

SOLUTION 11.2 continued

5.	FALSE	If the income of a trust is less than its deductions and allowances allowed in terms of the Income Tax Act, an assessed loss arises. Note that s25B(3) allows the distribution of deductions and allowances associated with the income distributed or vested to be deductions or allowances in the hands of the beneficiary and not the trust. S25B(4) limits the 'distribution' of the deductions and allowances to the income distributed or vested in that beneficiary. The excess is used by the trust against its remaining taxable income (limited to such taxable income) - s25B(5). Therefore, the excess of 'distributed' deductions and allowances may not create an assessed loss. Any subsequent excess is carried forward for use against the beneficiaries' income from the trust in the following year of assessment - s25B(6).	(2)
6.	FALSE	An *inter vivos* trust is one formed during the lifetime of the donor. A testamentary trust can also provide that the amounts are to be distributed at the discretion of the trustees.	(2)
7.	TRUE	s25B(2) refers to a vested right to income as a result of the exercise of the trustees' discretion.	(2)
8.	TRUE	Normal taxation rules apply equally to a trust, being a person (as defined in the Act).	(2)
9.	TRUE	The conduit principle applies, meaning the income derived by the trust retains its identity.	(2)
10.	FALSE	If the trust is South African, the source of the annuity is South Africa. A non-resident includes South African source income in gross income in terms of section 9. Furthermore, the dividend exemption in s10(1)(*k*) does not apply to dividends distributed by way of an annuity - s10(2)(*b*).	(2)
11.	FALSE	A beneficiary is taxed when income of the trust vests in such beneficiary - s25B(2) or section 7(1).	(2)
12.	TRUE	See para 13(1)(*a*)(iiA) of the 8th Schedule, read with para 38 and para 80.	(2)
13.	FALSE	The vesting of an interest in an asset of a trust in a beneficiary is considered a disposal for CGT purposes - para 11(1)(*d*) of the 8th Schedule. The distribution is deemed to take place on the date on which the interest vests - para 13(1)(*a*)(iiA). When a vested asset is distributed no disposal arises.	(2)
14.	FALSE	The R2 million exclusion only applies to the disposal of a domestic property by a natural person who occupied such property for domestic purposes - para 45(1) of the Eighth Schedule	(2)
15.	FALSE	The amount may be taxed in the donor's hands in terms of the attribution rules in part X of the 8th Schedule, i.e. para 80 must be read with para 68 to para 73. Furthermore, a capital gain will only be taxed in the hands of a beneficiary who is a South African resident - para 80(3).	(2)
16.	TRUE	Provided distributed within 12 months after its accrual to that portfolio - s25BA. In order for interest to be taxed in the hands of the unit holder it must be distributed within 12 months of its *receipt*, whereas all other income must be distributed within 12 months after its accrual.	(2)
			(32)

SOLUTION 11.3

Analysis of the income of the trust	**Amount**	**Nature**	**%**	**Donor**
	500 000	Rent	50%	Ann
	200 000	Dividend	20%	Arnold
	300 000	Interest	30%	Mary
Total	1 000 000		100%	
Distributed	(200 000)			
Retained in the trust	800 000			

1. ***The Trust***

				R	
Income				1 000 000	
Distributed (R100 000 + R50 000 + R50 000)				(200 000)	
Retained in the trust				800 000	(0.5)
In terms of s7(5)	Ann (rental)			(400 000)	(0.5)
	Arnold (dividends)			(160 000)	(0.5)
	Mary (interest)			(240 000)	(0.5)
Taxable income				0	

2. ***Brenda (aged 22)***

Annuity - gross income, para (*a*) 100 000 (1)

Note: It is submitted that the portion of the annuity funded by the dividend income has no effect on the determination of the beneficial owner of the underlying shares.

Discretionary distribution - gross income which retains its nature (*conduit pipe* principle) as follows:

	Rent	50%		25 000	(0.5)
	Dividend	20%		10 000	(0.5)
	Interest	30%		15 000	(0.5)
				150 000	
Dividend exemption - s10(1)(*k*)				(10 000)	(1)
Interest exemption - s10(1)(*i*) (younger than 65)					
from annuity (not prohibited by s10(2)(*b*))		30% × 100 000	30 000		(1)
from discretionary distribution			15 000		(0.5)
limited to				(23 800)	(0.5)
Taxable income				116 200	

3. ***Barry (aged 16)***

Discretionary distribution - gross income which retains its nature (*conduit pipe* principle) as follows:

	Rent	50%	25 000	(0.5)
	Dividend	20%	10 000	(0.5)
	Interest	30%	15 000	(0.5)
In terms of s7(3)	Ann (rent)	50%	(25 000)	(1)
	Arnold (dividend)	20%	(10 000)	(1)

SOLUTION 11.3 continued

Interest exemption - s10(1)(*i*) (younger than 65) limited to R23 800	(15 000)	(1)
Taxable income	0	
4. ***Ann (aged 52)***		
Rent - s7(5) retained by trust	400 000	(1)
Rent - s7(3) vested in Barry (her minor son)	25 000	(1)
Taxable income	425 000	
5. ***Mary (aged 75)***		
Interest - s7(5) retained by trust	240 000	(1)
Interest exemption - s10(1)(*i*) (Above 65) limited to	(34 500)	(1)
Taxable income	205 500	
		(16)

SOLUTION 11.5

Note: All paragraph references are to the 8th Schedule.

Lenny Armstrong

1. **The trust**		**Capital R**	**Income R**	
Net rentals			300 000	
Dividends			48 000	
			348 000	(1)
Annuity to Timothy funded out of dividend income - para 7(3) applies	R2 000 × 12		(24 000)	(1)
Lump sum from net rentals to Timothy - para 7(3) applies			(300 000)	(1)
			24 000	
CGT: Vacant plot As proceed is higher than base cost par 26 will apply				
Proceeds - para 35(1)		1 400 000		(1)
Base cost - para 20(1)(a) and para 20(1)(c)	R1 200 000 + R32 000	(1 232 000)		(1)
Capital gain (attributed in the ratio of distribution of proceeds)		168 000		
Attributed to Lenny - para 80(2)	$^{800}/_{1\ 400}$ × 168 000	(96 000)		(1)
Attributed to Sophia - para 80(2)	$^{400}/_{1\ 400}$ × 168 000	(48 000)		(1)
Attributed to PBO - para 80(2)	$^{200}/_{1\ 400}$ × 168 000	(24 000)		(1)
Capital gain of the trust		0		
CGT: Distribution of SAB shares - vested in a non-resident				
Proceeds (MV) - para 38		400 000		(1)
Base cost - para 20(1)(a) and para 38	$^{R600\ 000}/_{2}$	(300 000)		(1)
Capital gain		100 000		(1)

SOLUTION 11.5 continued

Transferred to beneficiary, but para 72 applies, therefore attributed to donor (Lenny)		(100 000)		
Capital gain of the trust		0		
Taxable income			24 000	
s7(5) attribution to Donor (Lenny)			(24 000)	(1)
Taxable income			0	(12)

2. **Lenny Armstrong - taxable income for the year of assessment ended 28 February 2017**

Attribution	S7(3) - dividend annuity to Timothy		24 000	(1)
Dividend exemption	Not allowed - s10(2)(*b*)		0	(1)
Attribution	Dividends retained in the trust - s7(5)		24 000	(1)
Dividend exemption	s10(1)(*k*)(i)		(24 000)	(1)
Timothy (rentals - s7(3)); R300 000 limited to interest foregone (*Woulidge*)			297 000	(1)
Capital gains - 1 March 2016				
Disposals to the trust are at Market value - para 38		**R**	**R**	
Shares in SAB	Proceeds	600 000		
	Base cost	(400 000)		
	Capital gain	200 000		(1)
Shares in BCX	Proceeds	200 000		
	Base cost	(250 000)		
	Capital loss	(50 000)		(1)
Vacant plot	Proceeds	1 200 000		
	Base cost	(800 000)		
	Capital gain	400 000		(1)
Shops	Proceeds	2 100 000		
	Base cost	(500 000)		
	Capital gain	1 600 000		(1)
Primary residence	Proceeds	1 200 000		
	Base cost	(650 000)		
	Capital gain	550 000		(1)
less Primary residence exclusion - para 45(1)(*b*). Proceeds below R2 million.		(550 000)		(1)
		0		
Vesting of SAB shares in non-resident (Grace) - para 72		100 000		(1)
Vesting of gain on disposal of vacant plot - para 80(2)		96 000		(1)
Sum of capital gains		2 346 000		
Annual exclusion - para 5(2)		(40 000)		(1)
Aggregate capital gains		2 306 000		
Taxable capital gain included at 40%			922 400	(1)
Taxable income			1 243 400	
				(15)

QUESTION 11.5 continued

3. **Timothy - taxable income**

Dividends - s7(3)		0	(1)
Rentals	300 000		(1)
less s7(3) limited in terms of *Woulidge*	(297 000)	3 000	(1)
Taxable income		3 000	
			(3)

4. Lenny would be liable for donations tax on the market value of the donations to the trust - s62(1)(*d*). An annual exemption of R100 000 would be allowed to be deducted from the market value - s56(2)(*b*), assuming this had not already been utilised. The donations tax would then be 20% of that net amount - s64. (3)

The trust would have had dividends tax of 15% withheld against the dividends accruing to it of R7 200 (R48 000 × 15%). (1)

The trust would be liable for transfer duty on the transfer of all the immovable properties to the trust. That is the vacant plot, the rent producing shops and the primary residence. The transfer duty would all be as per the progressive tax table for all persons. (2)

Note: From 1 March 2018 the interest difference between the official rate and interest levied on a loan to a trust, from a connected individual, will deemed to be treated as a donation, on the last day of the trust's year of assessment.

(6)

(36)

SOLUTION 11.13

1. **The trust**

	Hotel income	Foreign div	Local div	Interest	Totals	
	R	R	R	R	R	
Income	3 200 000	4 000	64 000	40 000	3 308 000	(1)
less distributions:						
Sondra (minor)	(96 735)	(121)	(1 935)	(1 209)	(100 000)	(1)
Thelma R15 000 + R35 000 × 11	(386 941)	(484)	(7 739)	(4 837)	(400 000)	(2)
Barry	(483 676)	(605)	(9 674)	(6 046)	(500 000)	(1)
	2 232 648	2 791	44 653	27 908	2 308 000	
s7(5) Thelma and Rob (for March only)	(186 054)	(233)	(3 721)	(27 908)	(217 916)	(2)
	2 046 594	2 558	40 932	0	2 090 084	
less s10B(3) & s10(1)(*k*) dividend exemptions	0	(1 599)	(40 932)	0	(42 531)	(2)
Taxable income					2 047 553	

2. **Rob Marley last income tax return**

		R	
Interest - gross income, general definition	R160 000 × $^{1}/_{12}$	13 333	(1)
Interest exemption - s10(1)(*i*)	Below 65, R23 800 limited to	(13 333)	(1)
Net income of B&B		41 000	(1)

SOLUTION 11.13 continued

Income from trust i.t.o. section 7(3) and 7(5) until date of death

Rental income	(R96 735 distributed to Sondra + R2 232 648 retained)/12	186 054	(1)
Foreign dividend	(R121 + R2 791)/12	233	(1)
less exemption	s10B(3)	(147)	
Local dividends	(R1 935 distributed to Sondra + R44 653 retained)/12	3 721	(1)
less exemption	s10(1)(k)	(3 721)	

CGT (all paragraph references are to the 8th Schedule)

			R		
Proceeds = MV at date of death - s9HA(1)					
	B&B House	Proceeds - s9HA(1)	3 000 000		(1)
		Base cost - para 20	(2 200 000)		(1)
		Capital gain	800 000		
	Primary residence	Roll over - s9HA(2)	0		(1)
	Motor vehicles	Roll over - s9HA(2)	0		(1)
	Boat (11m)	Proceeds - s9HA(1)	150 000		
		Base cost - para 20	(150 000)		
			0		(1)
	Note: Not a personal-use asset, as the length exceeds 10m - para 53				
	Cash	Not an 'asset' - para 1	0		(1)
	Aggregate capital gains		800 000		
	less annual exclusion - para 5(2)		(300 000)		(1)
			500 000		
Inclusion rate of 40% - para 10(*a*)			× 40%		(1)
				200 000	
Taxable income				427 139	

3. **The deceased estate**

Interest	R160 000 × $^{10}/_{12}$			133 333	(2)
(All interest taxed in estate until finalisation of estate in terms of s25(1)					
less interest exemption - s10(1)(*i*) read with s25(5)				(23 800)	
Net income of B&B	R440 000 × $^{10}/_{11}$	s25(1)		400 000	

CGT

Primary residence, motor vehicles and paintings to spouse		s25(1)		
B&B House	ascertained heir	Proceeds - s25(3)	3 000 000	(1)
		less base cost - s25(1)	(3 000 000)	(1)
		Capital gain	0	

SOLUTION 11.13 continued

Boat	sold by executor	Proceeds - para 35	100 000		(1)
		less base cost - s25(1)	(150 000)		(1)
		Capital loss	(50 000)		
		Disregard as boat > 10 m - para 15	0		(1)
	Cash	Not an 'asset' - para 1	0		(1)
	Total capital gains		0		
Taxable income				509 533	

The executor of the estate will be able to deduct expenses as if the estate were an individual, except in respect of section 6, 6A and 6B (normal rebates and medical credits).

4. **Thelma (aged 55)**

s7(5) - interest retained in trust		27 908	(1)
s7(3) – Sondra's interest		1 209	(1)
Annuity from trust		400 000	(2)
Foreign dividend exemption - s10B(3)(*b*) and s10B(5)	$^{26}/_{41}$ × R484	(307)	(1)

Note: s10B(5) applies in respect of foreign dividends received in the form of an annuity. However, s10B(5) only prohibits the 100% exemption of s10B(2). Accordingly, it is submitted that the annuity should still be subject to s10B(3)(b).

less interest exemption - s10(1)(*i*)	R27 908 + R1 209 + R4 837 limited to	(23 800)	(2)
Taxable income		405 011	

5. **Sondra**

Interest (ascertained heir in respect of R1m)		taxed in hands of estate $^{10}/_{12}$ - residue 1 month		13 333	(1)
Lump sum (1 month Rob i.t.o. s7(3))	Hotel income	R96 735 – R8 061	88 654		
	Foreign dividends	R121 *less* R10	111		
	Local dividends	R1 935 *less* R161	1 774		
	Interest		1 209	91 748	(1)
less s7(3) interest to Thelma				(1 209)	(2)
less interest exemption - s10(1)(*i*)		Below 65		(23 800)	(2)
less dividend exemption - s10(1)(*k*)				(1 774)	(2)
less foreign dividend exemption - s10B(3)(*b*)		$^{26}/_{41}$ × R111		(70)	(2)
Taxable income				78 228	

Note: The hotel and dividend income will be attributed in terms of s7(3)until the death of the donor.

SOLUTION 11.13 continued

6. **Barry**

Bad debt recovered - no bad debt write-off - capital				0	(1)
B&B income	*1 month as the residue was taxed in the estate*			40 000	(1)
Lump sum	Hotel income		483 676		
	Foreign dividends		605		
	Local dividends		9 674		
	Interest		6 046	500 000	(1)
less	Interest exemption - s10(1)(*i*)	Below 65: R23 800, limited to		(6 046)	(1)
	Dividend exemption - s10(1)(*k*)			(9 674)	(1)
	Foreign dividend exemption - s10B(3)(*b*)	$^{26}/_{41}$ × R605		(383)	(1)
Taxable income				523 897	
					(54)

CHAPTER 12: ESTATE PLANNING

Index to sections

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Question 12.10	Discussion, s7(8), s10(1)(i), s10(1)(k), s10(2)(b), s25B	***	

QUESTION 12.1 (Solution at end of chapter) (28 Marks)

Below are a number of statements relating to trusts, donations tax and capital gains tax.

YOU ARE REQUIRED TO: Indicate whether you consider that the statement made is TRUE or FALSE. Provide brief reasons for your answer.

1. A person can reduce his potential capital gains tax exposure when he dies by bequeathing assets to his spouse.
2. A person can reduce his potential estate duty exposure by bequeathing assets to his spouse.
3. Donations tax is payable if a person donates assets to his spouse.
4. By deeming a person to have disposed of his assets (for market value) at the date of death, the 8th Schedule has created double tax because the same assets will be subject to estate duty.
5. A non-resident who makes his South African company (resident in South Africa) donate assets to a South African resident will be subject to donations tax in South Africa.
6. A South African resident who makes a non-resident company donate assets to a non-resident will be subject to donations tax in South Africa.
7. If a South African resident donates cash to another South African resident, he will be subject to donations tax and capital gains tax on the donation.
8. If a South African resident, who is not a share-dealer, donates shares to another South African resident, he will be subject to donations tax and capital gains tax on the donation.
9. It is possible for a person to 'freeze' the value of his estate by donating all of his assets to his children.
10. Trusts are a good vehicle for estate planning because they last for 50 years, i.e. estate duty will only be paid after 50 years.
11. For estate planning using a trust, it is a good idea to give the beneficiary a vested right to the capital of the trust but not to the income.
12. A person can be one of the three trustees of a trust and one of the five beneficiaries of the same trust.
13. A trust is not a person for the purposes of the Income Tax Act.
14. An *inter vivos* trust is a trust created in terms of the will of a deceased person.

QUESTION 12.2 (Solution at end of chapter) (32 Marks)

Thato Hlomuka, a South African resident, who is 65 years old, has the following assets and liabilities:

a. A house in Hermanus

The house is used for holidays and is not Thato's primary residence. Thato's primary residence is a house in Cape Town that is owned by his wife, Lesedi, age 54.

The Hermanus house was purchased by Thato in March 2004 and cost R1.5 million. In order to finance the acquisition, Thato raised a mortgage bond of R800 000.

b. Listed shares

i. South African companies

Thato acquired the shares in March 2009 at a cost of R1 million. The shares yield a dividend of 3%.

ii. Foreign shares

In June 2009 Thato transferred R750 000 to the United Kingdom (UK). At that time the exchange rate was £1 = R12.00. The R750 000 was used to acquire shares in UK companies.

c. *Usufruct*

Thato enjoys a *usufruct* over a *bona fide* farm, which was donated to him by his father when he (Thato) was 55. The *bare dominium* in the farm is owned by Thato's son, Kamogelo, who is 35. The market value of the farm was R10 million when the *usufruct* was donated to Thato. The current market value of the farm is R15 million.

d. Furniture and art

The furniture and art was acquired in 2009 at a cost of R300 000. The furniture and art is in the Hermanus house.

e. Motor cars

Thato has two motor cars:

i. An Audi A8 that cost R600 000 in 2010.

ii. A 1949 MG that cost R10 000 in 1987.

f. Bank overdraft

Thato has a bank overdraft of R600 000.

Thato and Lesedi are married out of community of property. In terms of Thato's will, his entire estate is bequeathed to his son Kamogelo.

The current market values of the assets are as follows:

– Hermanus house	R3 million
Mortgage bond	R500 000
– Listed shares	
South African	R1.8 million
Foreign	£80 000
– Furniture and art	R400 000
– Motor cars	
Audi A8	R500 000
MG	R200 000

YOU ARE REQUIRED TO:

1. Calculate the taxable capital gain that would be included in Thato's taxable income if Thato died today. Assume an average exchange rate for the current year of £1 = R18. (11 Marks)

2. Calculate the estate duty that would be payable if Thato died 30 November 2016. Assume that the capital gains tax will be the only outstanding tax liability and that Thato's marginal tax rate is 41%. Assume that the total administration cost (which includes executor's remuneration and Master's fees) is R650 000. (11 Marks)
3. Calculate the donations tax payable if Thato donated the *usufruct* to Kamogelo today (assume that Thato has made no other donations). (4 Marks)
4. Calculate the estate duty payable if Thato first donates the *usufruct* to Kamogelo and then dies (assume that the market value of his assets will not change). (4 Marks)
5. Calculate the section 4(*q*) deduction (of the Estate Duty Act) if Thato bequeaths a *usufruct* in the Hermanus house to Lesedi. (2 Marks)

QUESTION 12.3 (Solution at end of chapter) (44 Marks)

Jack Black has approached you for the purpose of discussing estate planning. Jack runs a business, in a private company, which has become very profitable over the past five years. In view of the success of his business, Jack has been told that he should discuss estate planning with an adviser.

Jack is the sole member of the private company that trades under the name 'Blackjack Pty Limited' (Blackjack). The net asset value of Blackjack is currently R15 million. Jack is paid an annual salary of R1 million by the private company and, to date, has not drawn any of the remaining profits out of the private company. The private company has a shareholding of R10 000 and a director's loan account of R790 000, which Jack made when the private company was first formed. Of the assets of Blackjack, R2.5 million is in the form of cash.

Jack is married out of community of property to Gail and they have three children, who are all married. Apart from his interest in Blackjack, Jack has net assets valued at R3.75 million. The main assets are a house and listed shares. In Jack's opinion the value of his principal assets, i.e. the house, the listed investments and the private company, are likely to double every ten years.

Jack is now thinking of forming a South African trust and transferring all of his growth assets into the trust. The beneficiaries of the trust will be Jack, Gail and their three children. Jack feels that he should be the sole trustee of the trust, with a provision that, in the event of his death, his eldest child will become the sole trustee. Jack is not sure what sort of rights the beneficiaries should have.

Jack is also concerned about the large amount of cash in Blackjack and is thinking of drawing it out, but is worried about dividends tax.

Jack has two insurance policies on his life that will pay out R2 750 000 and R5 000 000 respectively in the event of his death. The beneficiary of the first policy is Gail. Gail pays all premiums on the policy. To date, the premiums plus interest amount to R550 000. The second policy was taken out as a life insurance policy by Blackjack. Blackjack is the beneficiary of the policy and pays all of the premiums. To date, premiums plus interest amount to R1 000 000.

In terms of Jack's will, all of his assets are left in equal shares to his three children, subject to a *usufruct* over the house in favour of Gail. The house originally cost R800 000 in April 2002 and has a current market value of R3 million. Jack is 65 years old and Gail is 54 years old.

YOU ARE REQUIRED TO: Advise Jack on the following points:

1. If Jack were to die on 31 December 2016, calculate his approximate estate duty liability be (ignoring any income tax liability for the current year as well as the administration cost to wind down the estate). (10 Marks)

2. Other than putting his assets into a trust, is there anything he could do to reduce this potential estate duty liability, without losing the control over his assets? (8 Marks)

3. What is the advantage or disadvantage of putting his assets into a trust, assuming he will live for another 20 years? Is the fact that he will be the sole trustee likely to cause any problems? (8 Marks)

4. Calculate the taxable capital gain inclusion if Jack were to sell only his house into the trust on interest-free loan. (4 Marks)

5. Briefly discuss whether or not the trust should be fully discretionary or should provide for income and capital to vest in the beneficiaries. Furthermore, discuss any income tax problems if the trust deed makes provision for annuities to be paid to the beneficiaries. (6 Marks)

6. Discuss the manner in which the assets should be transferred to the trust. (8 Marks)

QUESTION 12.4 (Solution at end of chapter) (31 Marks)

You have been approached by a South African client (married out of community of property) for advice based on the following facts:

a. He has recently sold R10 million worth of shares to a trust formed by him for the benefit of his children and their issue. The sale price was R10 million, but no date has been stipulated for payment of the purchase price and no interest has been or will be charged on the outstanding debt.

b. He has two children – a girl, aged six, and a boy, aged eight.

c. The provisions of the trust deed are such that the trustee has a complete discretion whether to pay income over to the beneficiaries, use it for their benefit or retain it in the trust and reinvest it.

d. The trustee has a discretion similar to that set out in (c) as to capital, in that the trustee can, in his or her entire discretion, pay out capital to beneficiaries when, and in whatever proportions, he or she sees fit.

e. Your client has been appointed the sole trustee until his death, at which time a trust company will assume office as trustee.

YOU ARE REQUIRED TO: Under the headings of income tax and estate duty, comment briefly on the implications of these facts to:

1. the client referred to;
2. the beneficiaries; and
3. the trust.

For each party above, comment on the income tax position during the client's lifetime and also after his death.

QUESTION 12.5 **(53 Marks)**

Alex Berry, aged 56, is concerned about his family should something happen to him, as he is the only breadwinner. He has been advised that forming a trust is a good estate planning tool. Alex will transfer certain of his assets into the trust.

The beneficiaries of the trust will be Alex, his wife Lucinda (to whom he was married out of community of property) and their three children, Anne, aged 17, Dan, aged 21, and Matthew, aged 26 (Matthew is resident in the Belgium for tax purposes). The trustees will be Alex, his accountant and his lawyer.

In terms of the trust deed, an annual annuity of R100 000 each will be paid to Alex and his wife. Apart from this, the trust will be discretionary as regards both capital and revenue.

The following South African assets (all acquired after 1 October 2001) will be transferred to the trust:

1. A trading South African share portfolio, costing R2 million and yielding dividends of R54 000 (gross amount) *per annum*, with a current market value of R1.7 million (this was also the market value at the end of the preceding year).
2. The family home bought on 1 October 2009 for R850 000 and which now has a market value of R2.5 million.
3. Interest bearing South African investments of R1 million, yielding interest of R106 000 *per annum*. The capital has remained unchanged.
4. Business premises in South Africa, which yield a rental income of R550 000 *per annum*. This premises had cost Alex R1 950 000 and has a current market value of R5 million.

YOU ARE REQUIRED TO:

1. Briefly discuss the immediate tax implications for Alex and the trust on transfer of the assets to the trust. Assume that all assets are sold to the trust for their current market values, on loan account bearing market-related interest. Deal with each asset separately. Also discuss the tax implications for the trust on subsequent sale of the family home AND the business premises. No calculations are required. (10 Marks)
2. Discuss the tax implications for Alex and the trust if Alex donates the assets to the trust instead of selling them. (6 Marks)
3. If the assets are sold to the trust, for full value, on loan account, discuss if it matters whether or not interest is charged on the loan. (3 Marks)
4. For the 2017 year of assessment, calculate the taxable income for the trust, Alex and his son Matthew, assuming that the income remains at the current levels, the assets were all donated to the trust and that, in addition to the annuities, 5% of the gross income has been distributed to each of the three children this year in terms of the trustees' discretion. Assume that the transfer of assets to the trust takes place on 1 March 2016, and that section 9C will not apply to any shares within the share portfolio. (27 Marks)
5. Calculate the tax implications if the trust sells the business premises for R6 million and distributes the R6 million equally between the five beneficiaries. (7 Marks)

QUESTION 12.6 (Solution at end of chapter) (20 Marks)

John and Kate Flee have decided to take advantage of the relaxation in exchange control regulations. John and Kate are both resident in South Africa and married out of community of property. Once they have complied with all of the necessary requirements, they intend forming a trust in Jersey (a tax haven). The trust will be named the 'Flee Family Trust' and the beneficiaries will be John, Kate and their two children, Richard and Grant. Richard is a medical doctor who is resident in the UK. Grant is a first year accounting student at the University of Cape Town. The trust deed will provide that, with the exception of an annuity payable to Kate, none of the beneficiaries will have a vested right to the capital or the income of the trust. Distributions from the trust will be at the discretion of the trustees.

The trustees will be John and the Channel Island Trust Company. John and Kate will each contribute an equal amount to the trust bank account in Jersey.

After costs relating to the formation of the trust, it is estimated that there will be a sum of £120 000 to be held in trust. The Channel Island Trust Company recommends that half of the trust funds be invested in interest bearing investment and half in equities. It is estimated that the interest yield will be 6% *per annum*. Dividend yield is estimated to be 5% *per annum* and capital appreciation in equities is estimated to be 7% *per annum*. The equities and interest bearing investments are all of a foreign source.

The trust deed will provide for an annuity of £3 000 *per annum* to be paid to Kate.

YOU ARE REQUIRED TO: Answer, with reasons, the following queries from John and Kate Flee.

1. Should they each donate the Rand amount to the trust (together equal to £120 000 after costs) – what are the tax implications? (4 Marks)
2. Should they rather transfer the amount into the trust by way of loan account? If they do, should the loan bear interest or should it be interest free? (7 Marks)
3. How will the interest and the dividends received by the trust be taxed if:
   a. the initial amount (i.e. the £120 000) is donated to the trust; or
   b. the amount is loaned to the trust with market-related interest charged? (5 Marks)
4. How will the annuity paid to Kate be taxed? (4 Marks)

QUESTION 12.7 (36 Marks)

Mr Bandile Dlamini died on 1 July 2015. Besides other assets, he owned a property (not his primary residence) in Ballito, Kwazulu Natal and R1 million cash. In terms of his will his wife, Zinhle, aged 64, received this property and the cash was left to a testamentary trust (the Dlamini Family Trust) created offshore in the Cayman Islands (a tax haven). Bandile and Zinhle were both South African residents.

The trustees of the Dlamini Family Trust were Zinhle, Mr Dlamini's attorney and Mr George White, an agent in the Cayman Islands. The place of effective management of the trust is in the Cayman Islands. The trust was to be fully discretionary as regards income and capital. The beneficiaries were Mr Dlamini's grandchildren.

Mr Dlamini's grandchildren are: Dino, 25 (resident in Botswana); Iminathi, 21 (resident in South Africa); Minenhle, 17 (resident in the UK); and Teboho, 17 (resident in South Africa).

The beach house in Ballito was valued at R5 million on 1 July 2015. This property had never been rented out. The original cost to Mr Dlamini had been R1.2 million when he acquired it in 2005.

Zinhle felt she did not need the property in Ballito and on 1 July 2016 she donated the property to the Dlamini Family Trust to benefit her grandchildren. At the time, the property was valued at R5.3 million. The Ballito property was then to be rented out by the trust at R11 000 per month. The property was rented from 1 September 2016.

The trust felt that the Ballito property was underperforming and sold the property with effect from 1 February 2017 to the tenants at the time for R5.8 million. Selling costs amounted to R300 000. This had been the only immovable property in the trust.

The net proceeds after selling costs from the sale were distributed equally to the four beneficiaries. The cash left to the trust in terms of Mr Dlamini's will was invested by the trustees in an offshore investment. Interest of R85 000 (translated into Rands at the average rate of exchange) was earned on the initial cash deposit bequeathed by the will of Mr Dlamini for the 2017 tax year. At the end of February 2017, R20 000 was paid to each beneficiary out of the interest income.

The rental income from the Ballito property was retained and distributed in equal shares to the beneficiaries on 1 March 2017, together with interest earned in South Africa on these rentals amounting to R3 800 for the 2017 tax year.

YOU ARE REQUIRED TO:

1. For each of the above events, in the 2017 and 2018 years of assessment, briefly discuss, in point form, the income tax implications for all persons involved (up to and including the effect for the beneficiaries of the Dlamini Family Trust). Use calculations to support your answer where necessary. (29 Marks)

   You may group similar beneficiaries, but deal with 2017 first, then 2018. Use the event as the sub-heading in each respective year of assessment.

2. Discuss the difference in the income tax implications of the above transactions if the property which had been transferred to Zinhle on the death of Bandile, was then sold to the Dlamini Family Trust, on interest-free loan account, for its market value of R5.3 million. Support your discussion with calculations where necessary. (7 Marks)

Note: You may ignore the effects of any double tax treaties.

QUESTION 12.8 **(33 Marks)**

Jarrod Oxford, a South African resident, who is now 68 years of age, has many different kinds of investments and assets. He is in the process of revising his will and it is of utmost importance that he fully understands all the tax implications with regard to his assets and income.

Jarrod has the following his financial interests:

a. Jarrod owns an art collection, currently valued at R2.5 million. The collection consists of paintings and sculptures collected over the years. Some of the art is sometimes lent out for exhibitions. The market value of this collection at 1 October 2001 was R2 million. The whole collection had cost him R750 000 between 30 September 1999 and 1 October 2001. In addition to the R2.5 million art collection, he has three other paintings valued at R240 000 each. These paintings had cost R200 000 each in the previous tax year (ended 29 February 2016). In his 2016 tax return he had disclosed them as investments. He is now considering treating them as trading stock and offering them for sale.

b. In 1986 Jarrod had created the Oxford Family Trust in South Africa. He sold South African interest bearing bonds and fixed property to the trust on interest-free loan account. The loan account was R3 million and no portion has been repaid to date.

In terms of the trust deed, Jarrod receives an annuity of R100 000 out of the trust income on the last day of February each year.

In 1987 Jarrod's father, Tony, a resident of the United States, donated a R1 million cash investment in a United States bank account to the trust. Tony died in 2001. The beneficiaries of the Oxford Family Trust are Jarrod, his wife Vera, to whom he was married out of community of property and their two children, Heidi and Jenna. Both children are over 18. Jenna is a resident of the United States, while Heidi is resident in South Africa. The income of the trust for the year ended 28 February 2017 is as follows:

	R
Interest (South African bonds)	200 000
Interest (United States bank account)	100 000
Rent	300 000

In terms of their discretionary powers, the trustees distributed R100 000 each to Jenna and Heidi on 28 February 2017. All income up to 29 February 2016 had been distributed to the beneficiaries.

c. Jarrod is the sole owner of the house in Cape Town in which he and his wife Vera live. The house cost Jarrod R750 000 in 2004. Its current market value is R2.4 million. Jarrod also owns a holiday house, purchased on 1 November 2000 for R500 000. On 1 October 2001, the holiday house had a market value of R560 000, which he chose as the valuation date value. He is considering donating the holiday house to Heidi.

Jarrod receives dividends of R50 000 per year in respect of listed South African shares and interest of R17 000 per year from local bank deposits.

YOU ARE REQUIRED TO:

1. Explain the income tax consequences (for Jarrod) of the R2.5 million art collection if Jarrod were to die on 28 February 2017. (3 Marks)
2. State how Jarrod could minimise his estate duty liability in respect of the R2.5 million art collection. (3 Marks)
3. Explain and calculate the income tax implications of the three paintings if, by the end of the year, he plans to treat the paintings as trading stock. (6 Marks)
4. Calculate how the R100 000 annuity from the trust will be taxed in Jarrod's hands. (4 Marks)
5. Discuss whether any other amounts from the Oxford Family Trust will be taxed in Jarrod's hands. (Ignore *Woulidge* and para 73 of the 8th Schedule.) (4 Marks)
6. Explain the tax consequences for Heidi and Jarrod, if Jarrod were to donate the holiday house to Heidi on 28 February 2017 when the market value is R1.2 million. (10 Marks)
7. Explain the tax implications if the rental property in the trust is sold by the trustees and the proceeds are distributed equally to Jenna and Heidi. (3 Marks)

QUESTION 12.9 **(48 Marks)**

Nitha Naidoo was 47 years of age and married out of community of property, when she died on 17 November 2016 in a motor vehicle accident. Nitha was survived by her husband Saresh, 43 years old and her children Ravi, 20 years old and Caylen, 17 years old. All of the above persons are South African residents for tax purposes.

Before her death, Nitha had been an advertising director for a well-known food brand. Her valid will provided for the following:

1. A testamentary trust is to be created in Australia in favour of her husband and two children. Except for an annual annuity of R150 000 (payable in monthly instalments, from the month after the assets has been transferred to the trust after her death, *pro rata* out of income earned) to her husband, the trust is to be fully discretionary. The trustees are to be Saresh as well as a Trust Management Company situated in Australia. For tax purposes, the trust will be considered to have a place of effective management in Australia.
2. Cash of R200 000 and all of the foreign assets are to be transferred to the trust.
3. The South African rental property is left to her husband, subject to a monthly annuity of R10 000 to each of her children from the gross rental income.
4. The residue of her estate (after all relevant expenses) is to be converted into cash and paid to her husband.

Her employment contract provided that, in the event of death in service, her employer would pay a lump sum to her surviving spouse of R1.5 million. This was paid to Saresh by 31 December 2016.

Nitha's revenue receipts and expenses included the following (to date of death):

- Monthly cash salary of R60 000
  (Nitha's employer also paid the salary *pro rata* for the 17 days in November)
- Rental income (R50 000 accruing monthly on the last day of each month)
- Total rental expenses (to date of death and deductible) R255 000
- Foreign interest (to date of death) R12 000
- South African interest R30 000
- Foreign dividends (all from shares representing less than 10% holdings) R1 600

Assets held by Nitha at date of death:

Asset	Market value	Base cost
South African rental property	R10 000 000	R2 500 000
Foreign shares (translated to Rands)	R2 300 000	R2 400 000
Foreign interest bearing investment	R4 000 000	R4 000 000
Cash	R700 000	-

Note: The market value in the above table refers to market value at the date of Nitha's death.

Nitha had taken out an insurance policy on her own life. The listed beneficiary was her son, Ravi. Nitha had paid all the premiums on the policy. Premiums and appropriate interest on the policy amounted to R300 000. The policy paid out the amount of R900 000 to Ravi, following Nitha's death.

The executor of the estate found that one tenant (who owed R10 000) had vacated the premises. While R5 000 was recovered from the deposit paid on the property, the remainder was written off as a bad debt. The rent from this tenant had accrued in October 2016. Rental expenses incurred after death until 31 January 2017 included the payment of a special levy in December and amounted to R74 000 (all deductible, excluding the bad debt) that the executor duly paid.

The estate received the following income from the estate assets:

- Foreign interest R4 800
- Foreign dividends R3 200
- Local interest R4 500

The estate of Nitha was finalised at the end of January and the assets were transferred to Saresh and the trust respectively.

The trust used the R200 000 cash, plus money borrowed from a bank, to purchase a rental property in Australia in February 2017. The trustees paid the monthly annuity to Saresh for February, but made no discretionary distributions during the 2017 year of assessment. The trust earned the following income for 2017:

- Foreign interest R2 000
- Foreign dividends R1 000
- Foreign rental income (net) R25 000

You may assume that life expectancy and present value factors based on those life expectancies are as follows:

Person	**Life expectancy (ANB)**	**Present value factor**
Saresh (age 43)	26.20	7.90547
Ravi (age 20)	46.53	8.29061
Caylen (age 17)	56.33	8.31926

YOU ARE REQUIRED TO:

1. Calculate the taxable income in Nitha's last income tax return. (21 Marks)
2. Calculate the taxable income of Nitha's estate (if any) (5 Marks)
3. Calculate Saresh's taxable income for the 2017 year of assessment. (7 Marks)
4. Calculate the estate duty payable in Nitha's estate (assuming all taxes owing by Nitha amounted to R400 000). Assume that the total administration cost (which includes executor's remuneration and master's fees) amounted to R650 000. (15 Marks)

QUESTION 12.10 (17 Marks)

Fred and Fran Grant are both residents in South Africa. They have two children, who are at present also resident in South Africa but are considering emigrating. Fran's aunt, June Welloff, who was ordinarily resident in the United Kingdom, passed away in May 2016. In terms of her will, her entire estate was to be held in trust for the benefit of Fran, Fred and their two major children. The will provided that an annuity of £5 000 *per annum* should be paid to Fran out of the income of the trust. In compliance with June's wishes, a trust is about to be set up in Jersey. The trustee is the Jersey Trust Company and the beneficiaries are Fred, Fran and their two children. Unfortunately, June's will was not clear as to the nature of the trust and the trustees are presently considering the structure of the trust. Fred and Fran are concerned about the South African tax implications arising from various scenarios and have asked you for your advice.

The issues, which they would like you to address, are the following:

1. Assuming that the children do not emigrate, what are the tax implications if:
    a. The beneficiaries each have a 25% vested right to the income of the trust and do not have a vested right to the capital.
    b. The beneficiaries have a vested right to the capital of the trust but do not have a vested right to the income. The trustees will have a discretionary power to distribute such income as they deem to be expedient.
    c. The beneficiaries have neither a vested right to the income nor to the capital of the trust.

2. Assuming that both children do emigrate, how will your answer to (1) be affected?

The trustees have indicated that the assets held in trust will comprise non-RSA equities, fixed property and bonds. They estimate that the income of the trust will be £40 000 *per annum*, of which 50% will be interest, 30% will be dividends and 20% will be rental.

YOU ARE REQUIRED TO: Write a report dealing with all of the above issues, assuming a 2017 year of assessment.

SOLUTION 12.1

'ITA' - Income Tax Act
'EDA' - Estate Duty Act

1.	TRUE	In terms of section 9HA(2), assets transferred to the surviving spouse are disposed of for an amount equal to the base cost of the asset in terms of para 20 of the Eighth Schedule. The asset is then transferred to the surviving spouse in terms of section 25(4) at the same expenditure plus expenditure incurred by the deceased estate in regards to that asset. The tax effect on CGT is thus nil.	(2)
2.	TRUE	S4(*q*) of the EDA permits deductions in respect of assets which accrue to the surviving spouse.	(2)
3.	FALSE	In terms of s56(1)(*b*) of the ITA, donations to a spouse are exempt from donations tax.	(2)
4.	TRUE	However, the Income Tax liability (which includes the tax on the capital gain) is allowed as a deduction in the calculation of the estate duty, being a debt due in South Africa - s4(*b*) of the EDA. In addition, the annual exclusion under capital gains tax increases on death in the last tax return from R40 000 to R300 000 - para 5(2) of the Eighth Schedule.	(2)
5.	FALSE	The donation is deemed to be made by the shareholder, who is not a resident - s57 of the ITA. Donations tax is only payable by residents - s54 of the ITA.	(2)
6.	TRUE	The donation is deemed to be made by the shareholder who is a resident - s57 of the ITA.	(2)
7.	FALSE	Cash is not an 'asset' for the purposes of capital gains tax - para 1 of the Eighth Schedule. However, cash is not excluded from the definition of 'property' for the purposes of donations tax - s55 of the ITA. There is therefore donations tax but no capital gains tax.	(2)
8.	TRUE	A share is an 'asset' for the purposes of the Eighth Schedule (para 1) and 'property' for donations tax (s55 of the ITA).	(2)
9.	TRUE	He has transferred ownership of the assets. However, one should remember that section 7 of the Act will apply.	(2)
10.	FALSE	A trust can last for an indefinite period of time. It is only deemed to have a life of 50 years for the purposes of applying the annuity table.	(2)
11.	FALSE	The asset then belongs to the beneficiary, who will be subject to estate duty in his own estate when he dies. However, as the vested right to capital has already been vested in terms of para 13 of the Eighth Schedule, there will not be CGT when the asset is transferred to the beneficiary.	(2)
12.	TRUE	It is not permissible, in law, to be the sole trustee and the sole beneficiary. The trust is required to have an independent trustee as well.	(2)
13.	FALSE	It is included in the definition of 'person' in s1 of the ITA.	(2)
14.	FALSE	An *inter vivos* trust is created by a person during his or her lifetime.	(2)
			(28)

SOLUTION 12.2

Thato Hlomuka

1. All paragraph references are to the Eighth Schedule. 'ANB' is 'age next birthday'. Section 9HA(1) deems a deceased person to have disposed of all of his assets (other than personal use assets and bequests to his spouse or a PBO) for their market values (in terms of para 31) at the date of death.

			R	R	
Hermanus house			**R**	**R**	
	Proceeds - s9HA(1)		3 000 000		
	Base cost - para 20(1)(*a*)		(1 500 000)		
Capital gain				1 500 000	(1)
Listed shares					
(i)	SA shares				
	Proceeds - s9HA(1)		1 800 000		
	Base cost - para 20(1)(*a*)		(1 000 000)		
	Capital gain			800 000	(1)
(ii)	Foreign shares in pounds	**£**			
	Proceeds - s9HA(1)	80 000			
	Base cost - para 20(1)(*a*) ($^{R750\ 000}/_{12}$)	(62 500)			
	Gain - para 43(1)	17 500			(1)
	Convert @ 18 - para 43(1)			315 000	(1)
Usufruct					
	Proceeds - s9HA(1)	R15m × 12% × 6.00726 × 70%	7 569 148		(2)
	Base cost - para 20(1)(*a*), 38 and para 31(1)(*d*)				
	ANB of Thato when he donated to him	R10m × 12% × 7.14414 × 70%	(6 001 078)		(1)
	Capital gain		1 568 070	1 568 070	
	Note: Any capital loss would be disregarded - para 15(c). The market value is determined in terms of para 31(1)(f) at 70% of R15 million.				
Furniture and art (personal-use asset) capital gain/loss excluded - para 53				0	(1)
Motor cars (personal-use asset) capital gain/loss excluded - para 53				0	(1)
Capital gain				4 183 070	
less annual exclusion - para 5(2)				(300 000)	(1)
Net capital gain				3 883 070	
Inclusion rate of 40% - para 10(*a*)				× 40%	(1)
Taxable capital gain				1 553 228	

2. **Estate duty** (all section references are to the Estate Duty Act)

Property in the estate - s3(2)		**R**	
Hermanus house		3 000 000	(0.5)
Listed shares			
(i) SA		1 800 000	(0.5)
(ii) UK	£80 000 × 18	1 440 000	(1)

SOLUTION 12.2 continued

Usufruct -			
s5(1)(f)(i) and 'fair market value' s1:	R15m × 12% × 8.13647 (ANB 36) × 70%	10 251 952	(3)
Furniture and art		400 000	(0.5)
Motor cars	R500 000 + R200 000	700 000	(0.5)
Gross value of the estate - s3(1)		17 591 952	
less allowable deductions			
Mortgage bond - s4(*b*)		(500 000)	(1)
Overdraft - s4(*b*)		(600 000)	(1)
Capital gains tax (@ 41%) - s 4(*b*)	R1 553 228 × 41%	(636 823)	(1)
Administration cost		(650 000)	
Net value of the estate - s4		15 205 129	
less abatement - s4A		(3 500 000)	(1)
Dutiable estate		11 705 129	
Estate duty at 20% - 1st Schedule to the Estate Duty Act		2 341 026	(1)

3. **Donation of usufruct** (all section references are to the Income Tax Act)

Value of donation - s62(1)(a) and 'fair market value' definition - s55 R15m × 12% × 6,00726 (ANB 66) × 70%	7 569 148	(2)
less general exemption - s56(2)(*b*)	(100 000)	(1)
Donation	7 469 148	
Donations tax at 20% - s64	1 493 830	(1)

Note: The donation is valued over Thato's life expectancy.

4. **Dutiable estate per (b) (above)**

Dutiable estate per (b) (above)			11 705 129	
less usufruct (no longer owned)			(10 251 952)	(1)
CGT liability adjustment (for *usufruct* removed)	1 568 070	× 40% × 41%	257 163	(1)
Donations tax liability			(1 493 830)	(1)
			1 453 177	
Estate duty at 20% - 1st Schedule to the Estate Duty Act			290 635	(1)

5. The s4(*q*) of the Estate Duty Act deduction is the value of the usufruct based on Lesedi's life expectancy

R3m × 12% × 7.69355	2 769 678	(2)
		(32)

SOLUTION 12.3

Jack Black

1. **Estate duty calculation (all section references are to the Estate Duty Act)**

	R	R	
Actual and deemed property in the estate - s3(2) and s3(3)			
Blackjack: net asset value (representing the value of the sole shareholder's interest)		15 000 000	(0.5)
Director's loan		790 000	(0.5)
House and investments		3 750 000	(0.5)
Insurance policies			
- Policy to wife (not in terms of ante- or post-nuptial contract, therefore property)	2 750 000		(1)
Reduced by premiums paid by wife plus interest - s3(3)(*a*)	(550 000)	2 200 000	(1)
- Policy to Blackjack (is a family company as Jack is the sole shareholder)	5 000 000		(1)
Reduced by premiums paid by Blackjack and interest - s3(3)(*a*)	(1 000 000)	4 000 000	(1)
Gross value of the estate - s3(1)		25 740 000	
less allowable deductions			
Insurance policy - s4(*q*)	(2 200 000)		(1)
Usufruct in house - s4(*q*) R3m × 12% × 7.69355 (Gail's ANB is 55)	(2 769 678)	(4 969 678)	(1.5)
Net value of the estate - s4		20 770 322	
less abatement - s4A		(3 500 000)	(1)
Dutiable estate		17 270 322	
Estate duty at 20% - 1st Schedule to the Estate Duty Act		3 454 064	(1)

Note: Any capital gains tax payable will be claimed as a deduction - s4(b).

2. (a) Jack could reduce his dutiable estate to nil if he left his entire estate, other than R3 500 000 (in order to take maximum advantage of the abatement), to his wife. S4(q) of the Estate Duty Act would reduce the net value of the estate to R3 500 000. The net value of the estate would then be reduced by the abatement (s4A) and would be nil. (2)

   The above option would result in an increase in the estate duty payable by his wife on her death. However, his wife would be entitled to a R7 000 000 abatement (s4A(2)) less any part of the R3 500 000 used by her deceased spouse. Leaving the property to his wife would also reduce the taxable capital gains in his last tax return as, s9HA(2) read with s25(4) would apply. (2)

   (b) Alternatively, Jack could donate the *usufruct* in his assets to a younger person for their life. For donations tax purposes, the value subject to donations tax would be based over Jack's life expectancy (being the shorter of the donor and donee) - s62(1)(*a*) of the Income Tax Act. However, when Jack dies, the *usufruct* is valued over the life of the beneficiary, i.e. the younger person, resulting in estate duty being paid on a smaller bare dominium value - s5(1)(*b*) of the Estate Duty Act. (2)

SOLUTION 12.3 continued

Option (b) above would also result in a capital gain on the donation of the *usufruct*, as a donation is considered a disposal - para 11(1) of the Eighth Schedule. Capital gains tax would also then arise on the value of the bare dominium at date of death, as he would be deemed to dispose of his assets at market value upon death - s9HA(1). Note that the Eighth Schedule has separate valuation rules for *usufructuary* and like interests - para 31(1)(*d*) of the 8th Schedule. (2)

3. The advantage of putting assets into a trust is that the value of the estate is effectively frozen at its current value. When the donor of the assets (in this case Jack) dies, all that will be included in his property for estate duty purposes will be the original loan (if the assets were sold), or some lesser amount, if some of the loan has been repaid - s3(1) of the Estate Duty Act. If the assets were donated, donations tax would have been paid at the time of the donation, and there will be no estate duty. The downside is that transferring the assets into the trust is a disposal (or deemed disposal if donated) and will be subject to capital gains tax - para 11(1)(*a*) of the Eighth Schedule. An inclusion of 40% of the net gain made is included in his taxable income - para 10(*a*) of the Eighth Schedule. (3)

   His personal home would, however, be exempt from capital gains tax up to R2 million of the gain thereon - para 45(1)(a) of the Eighth Schedule. A further disadvantage is that, once the personal home is in the trust, a further disposal thereof would not enjoy any exclusion because it will be a disposal by the trust and not a natural person. The base cost of assets transferred into the trust would, however, be equal to the selling price if sold (para 35) or market value if donated (para 38). This could be considerably higher than the original cost, thereby ensuring a smaller gain in the future, when these assets are disposed of by the trust. (3)

   The fact that Jack is the sole trustee creates a major problem, which will have the effect of nullifying the effect of the plan. In terms of s3(3)(*d*) of the Estate Duty Act, property which the deceased was competent to dispose of for his own benefit or the benefit of his estate is deemed to be his property when he dies. If Jack is the sole trustee, s3(3)(*d*) will definitely apply, with the result that, when he dies, the full value of the property in the trust at the time of his death will be included in his property. In practice, the Master of the High Court will not allow a trust to be registered without another independent trustee. (2)

4. As mentioned in (3) above, the transfer to the trust will be a disposal for capital gains tax purposes and Jack will have to include the net gain made in his taxable income as follows:

	R	
Proceeds (MV, whether sold or donated - see point 3 above)	3 000 000	
less base cost - para 20(1)(*a*)	(800 000)	
Capital gain	2 200 000	(1)
less R2m exclusion for primary residence - para 45(1)(*a*)	(2 000 000)	(1)
less annual exclusion (assuming no other capital disposal) - para 5(2)	(40 000)	(1)
Net capital gain	160 000	
Inclusion rate of 40% - para 10(*a*)	× 40%	(1)
Taxable capital gain inclusion	64 000	

Note that from 1 March 2017 the difference between the interest charged and the official rate will be deemed to be a donation in terms of s7C.

SOLUTION 12.3 continued

5. In a fully discretionary trust, the beneficiaries have no legal (vested) right to the income or the capital of the trust. It is possible to vest either capital or income in the beneficiaries. As far as income is concerned, if the distribution is discretionary, the beneficiaries have no certainty and are always beholden to the whims of the trustee. On the other hand, vesting income in the beneficiaries removes some of the income tax flexibility that a discretionary trust offers. (2)

   As far as capital is concerned, it is not advisable to give the beneficiaries a vested right, because of the adverse estate duty effects. If a beneficiary who has a vested right to capital dies, the market value of the vested property will fall into his or her estate and give rise to capital gains tax and estate duty. It is therefore preferable to not vest the capital in the beneficiaries. However, the vesting of capital in beneficiaries at a later date is regarded as a disposal for capital gains tax, and this will give rise to a taxable capital gain (or loss). (2)

   Annuities are a method used to give beneficiaries a definite amount of income. The problem with annuities is that they fall into gross income in terms of para (*a*) and, more importantly, the local dividend exemption (section 10(1)(*k*) in respect of such portion of the annuities derived from dividends falls away - s10(2)(*b*). If a large portion of the income of a trust is in the form of dividends (as will be the case here), annuities are not advisable. (2)

6. If the assets are donated, the donation gives rise to donations tax of 20%, which creates immediate cash flow problems. A donation should only be considered if there is a likelihood of the rate of estate duty increasing in the future (since the current donations tax rate is equal to the estate duty rate). In addition, as mentioned above, donations give rise to deemed disposals for capital gains tax, and this will give rise to capital gains, which will increase normal tax payable. (2)

   A better option is to sell the assets to the trust using a loan. This eliminates donations tax without burdening the trust with the need to find cash to pay the purchase price. Capital gains tax will still be applicable on selling price less base cost (after exclusions). If the trust is unable to pay interest the loan could be interest free. Note, however, that from 1 March 2017 the difference between the interest charged and the official rate will be deemed to be a donation in terms of s7C. This will give rise to donations tax payable at every year of assessment that the interest-free loan is outstanding, which erodes the benefit of avoiding donations tax on the outright donation of the assets. (2)

   The other effect of an interest-free loan is that income of the trust may be attributed to the founder in terms of s7 as long as the loan is outstanding, since the non-charging of interest is considered a 'disposition'. This will be limited to the amount of interest that would have been charged at a market-related rate (*Woulidge*). (2)

   It is therefore submitted that from 1 March 2017 it is inadvisable to for a loan to be interest free. Rather, interest should be charged, and if the trust is unable to pay the interest it should be credited to the loan account.

   At death, the balance of the loan account will fall into property for estate duty purposes. The loan may be bequeathed to the trust (to extinguish the debt) without a capital gain arising in the trust - Eighth Schedule para 12A(6)(a). (2)

(44)

SOLUTION 12.4

INCOME TAX (all section references are to the Income Tax Act, unless indicated otherwise)

1. **Client**

The sale on loan account at no interest is not a donation for donation tax purposes because:

- the reference to an interest-free loan being a donation in *Berold's* case was in the context of the meaning of 'other disposition' in the phrase 'donation, settlement or other disposition' in s7. (1)

- as there is no date stipulated for payment of the purchase price it is impossible to place a value on the 'donation' of the interest even if it were considered to be a donation. (1)

- a donation involves the disposal of property, including a gratuitous waiver or renunciation of a right. (1)

- if interest is not charged, no right is created and there can therefore be no renunciation of a right. (1)

One has no inherent right to interest on money lent - the right to interest only arises if it is stipulated in the contract.

The courts have held that an interest-free loan is a 'disposition' for the purposes of s7, the non-charging of interest representing an on-going 'donation', i.e. there is a gratuitous element to the loan not bearing any interest. The gratuitous element is the interest foregone (*Woulidge*). *Note: The fact that it is a disposition does not make it a donation for donations tax purposes.* (2)

Note that from 1 March 2017 the difference between the interest charged and the official rate will be deemed to be a donation in terms of s 7C.

The sale to the trust would be subject to capital gains tax, being a disposal - para 11(1)(*a*) of the Eighth Schedule. (1)

While the children are minor children, s7(3) will clearly effect any income which is distributed to them. The fact that the loan in respect of the purchase price of the shares is allowed to remain interest-free brings the scheme within the meaning of the words 'donation, settlement or other disposition' used in s7. (Refer Berold, Ovenstone and Joss). This means that any income that accrues to or is received by the children or is accumulated for their benefit as a result of the disposition will be attributed back to the provider of that disposition ('the donor'). (2)

Note, however, that the disposition is limited to the amount of interest that the trust could reasonably have been expected to pay on the loan (*Woulidge*). (1)

S7(5) could apply to bring any income not distributed in any year into the 'donor's' income, including income retained that was derived from the reinvestment of income from the original donation. (1)

Any SA dividend income attributed back to the donor similarly retains its identity (the *conduit pipe* principle), unless, in the case of s7(3), the amount being attributed was in the form of an annuity - s10(2)(*b*). Any interest earned on reinvested income will be taxed as discussed above. (1)

SOLUTION 12.4 continued

Any capital distributions made by the trust could result in capital gains being distributed to the minor children, which may then be attributed back to the client - para 69 of the Eighth Schedule. Any capital gain retained by the trust may also be attributed back to the client - para 70. In either event, the attribution is subject to a statutory limit equal to the interest not charged, less any interest already attributed under s7 - para 73. (2)

After the death of the disposer, no further attributions can take place. The donor will be deemed to dispose of the loan account (being an asset) for capital gains tax purposes - s9HA(1) at market value in terms of para 31 of the Eighth Schedule. It is submitted that there would be no capital gain or loss, since the market value of the loan is presumably the loan capital outstanding (unless there has been a significant decrease in the value of the underlying asset, in which case the market value would be the value of such underlying asset). If the loan is bequeathed to the trust and the disposer dies, there will not be a deemed capital gain - para 12A(6)(a)(i) of the Eighth Schedule. (3)

2. **Beneficiaries**

Only amounts distributed in terms of the trustee's discretion are received by or accrue to the beneficiaries in terms of s25B, as the trustees have full discretion as to capital and revenue. However, as discussed above, the beneficiaries are minor children, and so any distribution received by them from the income attributable to the disposition will be taxed in the donor's hands - s7(3). The beneficiaries therefore have no income tax effects. However, the *Woulidge* principle should apply, and to the extent that the income is in excess of interest foregone, the beneficiaries would have income tax effects in terms of section 25B. (3)

After the disposer's death, notwithstanding that the children may still be minors, they would be taxed, in terms of section 25B(2), on any distributions received from the trust, as the donor is deceased. They may only be taxed on the amounts distributed, as the trustees retain full discretionary powers after the death of the donor. Any amounts retained in the trust would now be taxed in the trust as the beneficiaries do not have a vested right. (1)

Subject to the attribution rules of the Eighth Schedule (see above), any vesting of capital gains or capital assets in beneficiaries would result in the beneficiary being subject to capital gains tax on such vesting (before death of the donor) (1)

3. **Trust**

While the income retained in the trust is being attributed to the donor in terms of s7(5) (refer above discussions), there are no income tax consequences for the trust, unless the application of *Woulidge* creates a consequence. (2)

However, from the earlier of the date of death of the disposer and the repayment of the loan onwards, any amounts not distributed by the trust will be taxed in the trust. Note that the trust is taxed at a flat rate of 41% and receives no interest exemption or rebates. (2)

ESTATE DUTY (all section references are to the Estate Duty Act, unless indicated otherwise)

1. **Client**

If the client, immediately prior to death, has power to dispose of the shares for his own benefit or the benefit of his estate, the shares will be included in his estate - s3(3)(*d*), read with s3(5). (1)

SOLUTION 12.4 continued

If the trust deed makes it clear that the trustee cannot dispose of the shares for his own benefit or the benefit of his estate, s3(3)(*d*) cannot operate. If the trust deed is clear in this regard, the mere fact that the client is the sole trustee will not, it is submitted, bring s3(3)(*d*) into operation. (1)

If s3(3)(d) does not apply, only the balance of the loan account due (at the date of death) will fall into the client's estate. If the value of the shares has fallen such that the Trust does not have assets sufficient to cover the full value of the loan account at death, a 'write down' could be motivated. (1)

2. **Beneficiaries**

   The beneficiaries have no vested interest in either capital or income, thus no part of the Trust assets not actually distributed to them could fall into their estates on their death. (1)

3. **Trust**

   There are no estate duty implications for a trust. (1)

(31)

SOLUTION 12.6

John and Kate Flee

1. - If the amount is donated to the trust it is subject to donations tax of 20% - s64. Donations made by residents of the Republic are subject to donations tax no matter where they are made - s54. (1)
   - The donations tax creates an immediate cash flow problem of £120 000 plus costs × 20% × exchange rate (note that in terms of s25D a natural person can elect average rather than use the spot rate). (1)
   - If a donation is made there will be no estate duty implications when John or Kate die, as section 3(3)(d) of the Estate Duty Act will not apply, since neither John nor Kate will be able to dispose of the property of the trust for their own benefit. (1)
   - A donation is not recommended because of the immediate cash flow problem. However, a donation would be advisable if an increase in the estate duty rate is anticipated and there is no other practical means of transferring the assets into the trust. (1)

2. - The non-charging of interest is not considered to be a donation for the purposes of donations tax - see note below. It is, however, a 'disposition' for the purposes of s7. (1)

   However, it is submitted that since this is a foreign trust, the first consideration should be whether s31 applies. In this case there is a agreement between a resident (John and Kate respectively) and non-resident (the trust), who are connected persons (since John and Kate are beneficiaries of the trust), and the agreement is not at arm's length (since the loan is interest-free). A tax benefit exists, since John and Kate avoid the inclusion of investment income and/or interest in their own taxable income. (2)

   In terms of s31, interest will be deemed to accrue to John and Kate at an arm's length rate. The interest not charged will also be treated as a donation for the purposes of donations tax in terms of s31(3). (1)

SOLUTION 12.6 continued

For the purposes of s7 the loan should then no longer be considered to be interest free, and no attribution is necessary. (1)

From 1 March 2017 the difference between the interest charged and the official rate will be deemed to be a donation in terms of s7C. This means that there will be donations tax payable on the difference between interest calculated at the official rate and interest actually charged at every end of a year of assessment that the interest-free loan is outstanding. However, s7C does not apply where s31 applies.

An alternative view is that s31 should only be considered after s7. In terms of this view, a tax benefit only exists to the extent that the interest not charged exceeds the income already attributed i.t.o. s7. The income attributed i.t.o. s7(8) would then be subject to donations tax i.t.o. s7C, while any further interest i.t.o. s31 would be subject to donations tax i.t.o. s31(3). It is submitted that either approach will result in the same tax consequences for the lender.

- At the time of death, the balance of the loan account will fall into property for estate duty purposes - s3(2) of the Estate Duty Act. (1)

Based on the above there is no advantage to John and Kate in not charging interest, and the trust loses the opportunity to deduct the interest incurred against any South African source income. It is therefore advisable for the loan to be interest bearing. (1)

3. a. If the amount is donated, donations tax will arise. Furthermore, s7(8) will apply to the extent that income is retained in the trust or distributed to Richard, since income is received by a person who is not resident as a result of a donation, settlement or disposition. s7(8) will deem this income to be the income of the donors. (2)

   b. If the amount is lent on loan account bearing interest, the interest will be taxed in South Africa, because John and Kate are resident in South Africa - gross income, general definition. If the interest is a market-related interest, s31 will not apply, as the transaction is at arm's length, and s7(8) will not apply because there has been no donation, settlement or disposition. (2)

   The amounts must be translated into Rands in terms of s25D (0.5)

   The s6*quat* rebate will apply in respect of any foreign tax paid by the trust on the income. (0.5)

4. Kate is a SA resident. To the extent that the trust invests the money in South Africa:

   The local dividend exemption of s10(1)(k)(i) does not apply to dividends paid in the form of annuities - s10(2)(b). (1)

   South African interest would be subject to the s10(1)(i) exemption of either R23 800 or R34 500. Note: s10(2)(b) does not prohibit the application of this exemption against interest in the form of an annuity. (1)

   To the extent that the trust invests the money overseas:

   s10B(5) will prohibit any full exemption of foreign dividends under s10B(2). However, it does not prohibit exemption under s10B(3), meaning that $^{26}/_{41}$ of all foreign dividends would be exempt. (1)

   There are no exemptions in respect of foreign interest. (0.5)

   The amount is converted into Rands in terms of s25D. (0.5)

   (20)

CHAPTER 13: VALUE-ADDED TAX

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QUESTION 13.1 (Solution at end of chapter) (28 Marks)

Intebe CC, a vendor for VAT purposes on the invoice basis, has the following assets in its balance sheet at 30 June 2017:

	Note	R
Land and buildings	1	405 000
Plant and machinery	2	720 000
Motor vehicles	3	392 980
Investments in listed companies	4	450 000
Inventory	5	430 000
Debtors		320 000

Notes

1. The land and buildings consist of land which cost R100 000 plus transfer duty of R5 000 and factory buildings which cost R342 000 (including VAT). The open market value of the land and buildings is R2 million and R1 million respectively.
2. Plant and machinery originally cost R1 368 000 (including VAT) and is all used in the manufacturing process. The tax value is R480 000. The open market value is R900 000.
3. The motor vehicles balance consists of two motor cars at a book value of R120 000 each and two delivery vehicles at a book value of R76 490 each. The motor cars cost R240 000 each and have an open market value of R110 000 each. The delivery vehicles cost R220 000 (including VAT) and have an open market value of R75 000 each.

   The managing member has had the use of one of the motor cars since its acquisition by the company. The managing member pays a nominal amount of R100 for fuel and R100 for maintenance.
4. Investments in listed companies represents the cost of shares purchased.
5. Inventory has an open market value of R892 000.

Intebe CC is intending to deregister and dispose of some of its assets to other companies or CCs in the group or to outsiders. It will then ensure that its turnover of taxable supplies is under R1 million, while providing mainly financial services to the group.

Intebe will deregister on 31 August 2017, the end of its two-month VAT period.

There are two fellow companies in the group, Radebe (Pty) Ltd and Odwan CC. Odwan CC is not a vendor, while Radebe is. An individual holds 60% of the member's interest in Intebe CC, 60% in Radebe and 60% in Odwan CC.

Intebe enters into the following transactions during July and August. You may assume that open market values at 31 August 2017 are the same as at 30 June 2017.

Assume all amounts below include VAT where appropriate.

- Inventory is sold to Radebe for R430 000 (open market value) on 25 August 2017.
- The land is kept, but the buildings are sold to Odwan CC for R900 000. The R900 000 will be payable in two equal instalments – one on 27 August 2017 and one on 27 September 2017.
  The land is then leased to Odwan CC for R15 000 per month from 1 September 2017. A market-related rental is R20 000. The first rental will be payable on 30 September 2017.
- One machine with a cost of R85 550 (including VAT) was sold on 25August 2017 to a small business corporation, with no connections to Intebe and which was not a registered vendor, for R41 000. Its open market value at 30 June 2017 and at date of sale was R51 000.
- The remainder of the machinery was sold to Odwan CC for R600 000 on 26 August 2017. Odwan then in turn would rent this machinery to Radebe for R7 000 per month.
- One of the motor cars was retained as a company car for the managing member. The other motor car was leased in terms of a rental agreement to Radebe for R2 000 per month commencing on 31 August 2017. This was to continue until the instalment credit agreement under which it was purchased by Intebe came to an end. The two delivery vehicles were both sold to Radebe for R76 490 each on 28 August 2017.
- In addition to the above, one debtor was unable to pay as he had gone insolvent. An amount of R8 900 owing was written off on 25 August 2017. The debt had arisen in January 2017.
- As Intebe was scaling down operations, two employees were retrenched on 29 August 2017. All other employees not retained were transferred to Radebe and Odwan.
  - Abe, who had only been with the company for one year was given a framed mirror which cost Intebe R4 788 (including VAT) together with R5 000 cash. The mirror was purchased by Intebe to give to Abe.
  - Eric had, for the past two years, had the private use of a computer owned by Intebe. This computer had cost R8 100 (including VAT). Wear and tear has never been claimed thereon. On his retrenchment, this computer was given to Eric for services rendered in addition to a lump sum of R25 000 in cash. The open market value of the computer at this date was R1 500.

YOU ARE REQUIRED TO:

1. Calculate Intebe's VAT inputs and outputs for the tax period 1 July 2017 to 31 August 2017.
2. Calculate Radebe's input and outputs for its two-month tax period ended 30 September 2017.

QUESTION 13.2 (Solution at end of chapter) (39 Marks)

The balance sheet of 'Annie Ltd' (Annie) (note 1) at 31 December 2016 was as follows:

	Note	R
Land and buildings, at cost		2 000 000
Patent, at cost		1 900 000
Computer equipment, at cost	2	171 000
Motor vehicles, at cost	3	370 000

Trading stock, at net realisable value	4	165 000
Trade debtors		250 000
Bank balance		140 000
		4 990 000
Share capital		1 000
Retained income		4 664 000
Trade creditors		325 000
		4 990 000

Notes

1. Annie is a wholly owned subsidiary of 'Belinda Ltd' (Belinda). Belinda also holds all the share capital of 'Christa Ltd' (Christa). Annie and Christa are registered VAT vendors, while Belinda is not a vendor. Christa supplies some of Annie's trading stock.

2. Computer equipment consists of a mainframe computer with a cost of R120 000 and various desktop computers with a combined cost of R51 000.

3. Annie owns three vehicles: two motor cars with a cost of R110 000 each and a delivery vehicle with a cost of R150 000.

4. Since the directors considered that the net realisable value of the stock had declined below its cost, they decided to write stock at cost down by 25% to arrive at the net realisable value. The stock consists of identical items. The cost of stock is determined on a weighted-average basis. At 31 December 2016 there were 1 000 items in stock.

5. All fixed assets, the patent and trading stock on the balance sheet were purchased from registered VAT vendors.

The following transactions occurred during Annie's two-month VAT period ended 28 February 2017:

a. Annie lets a portion of the land and buildings to Belinda. The monthly rental of R11 000 (excluding VAT) is payable on first of each month and has been calculated by including rates of R2 000. Belinda paid January 2017's rental on 30 December 2016 and February's rental on 28 February 2017. An open market value for the rentals (including rates) is considered to be R12 000 per month (including VAT).

b. Annie purchased 500 units of stock from Christa at a total cost of R160 each (excluding VAT) on 15 January 2017 and a further 300 units from Christa at a cost of R180 each (excluding VAT) on 31 January 2017. Annie sold 700 units of trading stock to outside customers for R175 each, a fair market price (excluding VAT) on 20 January 2017. Since Belinda required some items of Annie's stock, Annie gave Belinda 100 items for no consideration on 20 January 2017.

c. Annie purchased a second-hand desktop computer from Belinda for R6 000 on 28 December 2016. The open market value of the computer was considered to be R4 000. Annie paid the full price on 5 January 2017.

d. Annie entered into a finance lease agreement in respect of another delivery vehicle on 1 February 2017. The cash value of the vehicle is R140 000 (including VAT) and the total amount payable in respect of the lease agreement amounts to R160 000. The lease payments of R26 667 each are payable monthly for a period of six months from that date, after which the vehicle will be returned to the lessor.

e. Insurance on the motor cars amounts to a total of R1 000 per month (excluding VAT) and on the delivery vehicles a total of R600 per month (excluding VAT).

f. Annie pays the bus and taxi fares in respect of conveying staff to and from its office premises. This amounts to R1 000 per month (excluding VAT).

Annie wishes to enter into the following transactions at the beginning of March 2017:

i. The land and buildings will be sold to an outside party for R1 400 000 (excluding VAT).
ii. The desktop computers will be sold to Christa for a total of R50 000 (excluding VAT).
iii. The patent will be sold to Belinda for R1 500 000 (excluding VAT).
iv. The delivery vehicle will be sold to Christa for R65 000 (excluding VAT). One of the motor cars will be sold to Belinda for R90 000 (excluding VAT).
v. The debtors' book, which is expected to stand at R400 000 (including VAT) will be sold to an independent VAT vendor for R350 000 (including VAT). Of these debtors, R40 000 (including VAT) are considered to be doubtful, but are unlikely to be written off for some months.
vi. 50% of the trading stock will be sold to Belinda for 120 each (excluding VAT).

Assume that the open market values of the assets at the beginning of March 2017 will be as follows:

	R
Land and buildings	1 800 000
Patent	2 000 000
Computer equipment, mainframe	60 000
Computer equipment, desktop computers, total	54 000
Motor vehicles – motor cars (each)	100 000
Delivery vehicle (each)	135 000
Trading stock, per unit	150
Trade debtors	375 000
Bank balance	425 000

You may assume that all the necessary tax invoices will be issued and in Annie's possession.

YOU ARE REQUIRED:

1. To calculate Annie's output tax and input tax for its VAT period ended 28 February 2017.
2. To calculate Annie's output and input tax in respect of transactions (i) to (vi) above.
3. Annie is considering deregistering for VAT, as the value of its taxable supplies in a twelve-month period is unlikely to exceed R1 million. Calculate whether, from a VAT point of view, it would be in Annie's best interests to deregister immediately prior to entering into the transactions (i) to (vi) above, or immediately after entering into them.

QUESTION 13.3 (Solution at end of chapter) (39 Marks)

YOU ARE REQUIRED TO: Calculate the VAT and income tax effects of the information in each of the undermentioned cases. (Ignore CGT.)

Unless otherwise specified, assume all parties are VAT vendors and all amounts exclude VAT unless otherwise stated or implied.

1. GB (Pty) Ltd has the following balance sheet at 31 December 2016:

	R
Share capital	1 000
Trading stock at cost (open market value R60 000)	40 000
Cash	22 600
Trade creditors	(102 600)
Accumulated loss	41 000
	1 000

   On 1 January 2017 the trade creditors agree to accept the trading stock, at cost price, of the company in full and final settlement of the indebtedness of the company to them, and to write off the remaining balance of R57 000, as GB (Pty) Ltd has indicated to them that it will be unable to settle the outstanding amount. GB has an assessed loss, for tax purposes, of R22 000 and is registered as a vendor for VAT purposes.

2. Company A has a branch in Botswana and a branch in Namibia. Both branches are separately identifiable, but only the branch in Namibia maintains an independent system of accounting. Neither of the branches is registered as a separate vendor and neither carries on any manufacturing process.

   Company A purchases R114 000 of trading stock, of which it sends 30% to the Namibian branch and 25% to the Botswana branch. The R114 000 includes VAT. The stock is then all sold for the following prices:

– Company A (sold to various customers)	R77 000
– Botswana branch	R40 320
– Namibia branch	R44 000

   Company A also purchases two new machines, costing R57 000 (including VAT) each, one of which is sent to each branch. The Commissioner allows a write off of 20% on such machines.

3. Mr A, a bookmaker, accepts R104 000 from various people betting on a horse race. He pays out R250 000 in winnings.

4. X Ltd insured its new manufacturing machine (which it had recently purchased for R200 000 (excluding VAT) and not yet brought into use) and pays a premium of R7 000 (including VAT) to ABC Insurance Ltd. X Ltd also insures against other risks relating to its business and pays a premium of R1 000 (including VAT) in this regard. On 15 January 2017, X Ltd sold an old machine (which was written off for tax purposes) for R4 000 cash and put the money in a strongbox on the premises.

   That night, the premises of X Ltd were burgled and the R4 000 cash as well as the new machine were stolen. X Ltd submitted a claim to the insurance company, which paid out the following claims:

– Cash	R4 000
– Machine	R200 000

QUESTION 13.4 (Solution at end of chapter) **(16 Marks)**

Bigsky (Pty) Ltd provides the following information in respect of the period 1 January 2017 to 28 February 2017. (Note that Bigsky accounts for VAT on a two-month basis.)

On 10 January 2017 the following assets were purchased for the purposes of providing fringe benefits to certain employees (all prices include VAT):

1. A motor car was purchased for R387 600.
   The use of the car was given to an employee from 1 February 2017.
2. A motorbike was purchased for R92 340.
   The use of the motorbike was given to an employee from 1 February 2017.
3. A bicycle was purchased for R23 940 and given to an employee as a bonus on 1 February 2017.
4. A television set was purchased for R12 540 and given to an employee as a long service award on 30 January 2017. The employee has worked for Bigsky for 30 years and had never previously received such an award.
5. A state-of-the-art racing bike was acquired for R57 000. The bike belongs to Bigsky, but the use is granted to an employee, who is a keen amateur cyclist, for a few months during the year. The use was granted from 1 February 2017.
6. A house was purchased for R2 million in January. The use of the house was given to a manager from 1 February 2017. The manager's salary in the previous tax year was R1.5 million. Bigsky does not pay any expenses in respect of the house.

YOU ARE REQUIRED TO: For each of the events described in (1) to (6), calculate the input and output VAT for Bigsky.

QUESTION 13.5 **(52 Marks)**

PART A (45 Marks)

Nitrate (Pty) Ltd, Gastin (Pty) Ltd and Elecfin (Pty) Ltd are a group of companies supplying gas equipment and electrical goods. Nitrate is the holding company and Gastin and Elecfin are both 100% held subsidiaries and are both VAT vendors.

The group want to reorganise their trading activities in the light of the demand for gas and the fall-off in electrical goods. They do not want to take advantage of any of the corporate rules as there are assessed losses that they want to make use of and they do not want the 18-month restriction if they subsequently sell any assets.

Elecfin is to be deregistered for VAT on 1 July 2017, as it will not be making taxable supplies of more than R1 million. Elecfin leases the land and building from where part of the operations of the group takes place. It is leased from a non-vendor for R12 500 per month.

Elecfin has the following assets in its balance sheet before taking into account the transactions below:

	Note	**R**
Equipment at book value	1	250 000
Motor vehicles at book value	2	430 000
Investments at cost	3	720 000
Trading stock		1 560 000
Debtors	4	220 000
Creditors	4	340 000

Notes

1. The equipment originally cost R500 000 (including VAT) and is used other than in a manufacturing process.
2. Motor vehicles consist of one motor car costing R280 000 (including VAT) and two delivery vehicles costing R160 000 (including VAT) each. The manager has always had the use of the motor car and the company has always paid for all maintenance, while the manager pays for all fuel.
3. The investments represent the cost of shares purchased in listed companies.
4. The debtors and creditors are all in respect of sales and purchases of trading stock.

In June 2017 Elecfin sells one of its delivery vehicles to Gastin and the other to a third party. The open market value at the time is R98 000 per vehicle. The vehicle is sold to Gastin for its book value of R160 000 (excluding VAT) and to a third party, who is not a vendor, for R100 000 cash.

As Gastin does not have immediate cash, the vehicle is sold in terms of an instalment credit agreement over two years. The first payment is on 15 June 2017 and then every month on the same date. The payments are R8 360 per month.

The motor vehicle is retained for use by the manager.

The land is leased to Nitrate from 1 June 2017, for R15 000 (including VAT) per month. Nitrate will then sublease to Gastin. Nitrate only supplies financial services to the group. From 30 June 2017, Nitrate charges a rental of R16 000 per month to Gastin. The open market value of a related rental is R16 500.

The equipment is sold to Gastin on 15 June for its book value of R250 000. Its open market value is R300 000 at the time.

Some of the trading stock is sold to Gastin at its book value of R1 260 000 on 15 June 2017. The open market value of this stock is R900 000. The remaining stock on hand with an open market value of R80 000 is retained. On 30 June 2017, two items of stock costing R12 000 each are given to two employees, for long service. The market value (excluding vat) is R5 500 each (they had been employed for ten years and 16 years respectively and have never previously received such awards).

Certain purchases of second-hand trading stock on hand are made in June 2017, R28 000 from vendors (paid in cash) and R286 000 from non-vendors. Of the R286 000 from non-vendors, the open market value is R300 000. Elecfin has only paid R143 000 of this by 30 June and will pay the balance of R143 000 on 30 July 2017. (None of this stock was taken over by Gastin and none of it is on hand at 30 June 2017.)

Debtors are retained to realise in due course except for a debt of R7 500, which is written off as bad on 30 June 2017.

Half of the creditors (i.e. half of R340 000) agree to be taken over by Gastin on 30 June 2017, after agreeing to a 1% compromise in respect of the amount owing to them by Elecfin. This was in lieu of part-settlement of the purchase of assets and stock. The balance will be duly paid by Elecfin in full, but only after deregistration. All of the creditors agreeing to the compromise are VAT vendors.

Elecfin made sales of R832 000 (including VAT) in June 2017.

YOU ARE REQUIRED TO:

1. Calculate all VAT effects for the tax period of two months ended 31 July 2017 for Elecfin (Pty) Ltd. Give reasons for all the transactions.
2. Calculate the VAT effects of any transactions affecting Gastin (Pty) Ltd.
3. Ignoring the corporate rules, suggest other ways in which the VAT effects of the above transactions could have been reduced.

PART B (7 Marks)

YOU ARE REQUIRED TO: Discuss and calculate the value and time of supply rule when second-hand immovable property is purchased (on/after 10 January 2012) by a vendor, who is a company, on a one-month VAT period basis, where payment of the purchase price (consideration) of R2.5 million is to take place six monthly over two years. The open market value of the property is R2 million. The purchaser will be making wholly taxable supplies. Purchaser and seller are not connected parties. Due to administrative delays, registration will only be processed in the seventh month.

When: 1. Purchased from a non-vendor.
2. Purchased from a vendor.

QUESTION 13.6 **(18 Marks)**

Wild Five is a game lodge situated in the lower Sabi. The company offers exclusive getaways (considered 'commercial accommodation') aimed at local and foreign visitors. Wild Five is VAT registered.

The following is an extract from the income statement prior to adjustments:

Wild Five (Pty) Ltd

Income statement for two-month period ending April 2017

		2017 Mar/Apr Actual
Sales		421 483.85
Cost of sales	Note 1	90 223.83
GROSS PROFIT/(LOSS)		331 260.02
Expenses	Note 2	434 314.39
Other income		–
NET PROFIT/(LOSS) BEFORE TAX		(103 054.37)

Notes

1. Cost of sales is made up of the following:

Opening stock	20 223.83
Purchases	90 000.00
Closing stock	20 000.00

One of the main sources of income is the restaurant situated on the premises. The restaurant focuses on a healthy alternative menu and 20% of the purchases for the period are unprepared fruit and vegetables.

2. The expenses include the following:
   Depreciation of R3 800 for the two months on a new biltong-making machine. The new biltong-making machine was bought on 1 October 2016 for a value of R114 000 from a non-vendor.

   Wild Ed is a private farm school that provides education to the children of Wild Five's staff and other children in the area. It is a subsidiary of Wild Five. Wild Ed charges a reduced fee of R280 per month per child for the tuition and all stationery. Wild Five paid R4 200 per month for this service. Wild Ed pays rental on a classroom of R1 140 (including VAT) per month and stationery costs of R10 000 (including VAT). A number of teachers provide their services free of charge or they are paid for by an Iranian aid programme. The school has a turnover of approximately R28 000 per month.

The following items are not included in the income statement and need to be dealt with:

1. A car, which was purchased in December 2016 for R228 000 (including VAT). In April 2017, an enraged elephant bull wrote off the car. Insurance paid an amount of R171 000 in April 2017. Wild Five immediately bought a new car for R228 000 (including VAT).

2. Wild Five also bought a new Quantum minivan. This vehicle can carry 18 people at a time. Wild Five bought the vehicle to transport people from the airport to Wild Five and other lodges in the area for a fee. Fees collected for transfers totalled R17 000. The vehicle cost R285 000 (including VAT).

3. Wild Five sold its old computer to the daughter of one of the main shareholders of the company. She bought the computer for R5 when the open market value was R6 000. The computer was made available on 30 April 2017 and the invoice was issued on 1 May 2017.

4. Wild Five bought a faster second-hand computer from another vendor to manage their reservations. The computer was bought for R5 700 (including VAT), while the open market value amounted to R7 500.

Unless otherwise stated, assume all figures include VAT where applicable. Round to the nearest Rand.

YOU ARE REQUIRED TO:

1. Determine the VAT inputs and output for Wild Five for the two-month VAT period ending April 2017. (16 Marks)
2. Determine whether Wild Ed needs to register for VAT, and if so, calculate the VAT inputs for Wild Ed. (2 Marks)

QUESTION 13.7 **(30 Marks)**

Goo Goo Dolls (GGD) is a resident company registered for VAT. The company is a retailer of toys and dolls. GGD has a February year-end. The company was formed on 1 March 2016.

During the year ended 28 February 2017, the company purchased new trading stock for an amount of R410 400 (including VAT). All these purchases were from vendors. GGD made sales during the year of R700 000 (excluding VAT). Of this amount, R10 000 was made to one particular customer whose

order was delivered to Australia. The company also earned interest income of R7 890 during the year on its savings account.

On 15 March 2016, GGD bought five used computers from two different suppliers to deal with its administration and the running of the business. Three of these computers were bought from a non-vendor and two from a vendor. The consideration paid for the computers was R5 000 each and the open market value on 15 March was R4 200 each. GGD paid for the computers in full on the transaction date.

GGD purchased a VW Polo Playa on 1 February 2017 for R130 000 (including VAT). The company's sales representative, Bryce Mac, was immediately given use of the motor car (for the rest of the year), as Bryce did not own his own car and needed transport for both private and business purposes.

The company also purchased a new delivery vehicle on 2 January 2017, under an instalment credit agreement. The purchase required monthly payments of R4 000 for 24 months and GGD duly made its first payment on 2 January. The cash value of the van on this date was R87 500 (including VAT). Petrol costs for the van during January and February amounted to R1 140.

During December 2016, GGD sold one of its computers (that had been bought on 15 March 2016) to New Found Glory, a company in the same group of companies (i.e. both companies are held by the same holding company). GGD sold the computer to New Found Glory for R2 000. The open market value on the date of sale was R2 500. New Found Glory is a non-vendor.

GGD entered into a rental agreement with Snow Patrol (Pty) Ltd (not a connected person) on 1 March 2016 to lease shop premises from that company, which owned the shop space in an exclusive shopping centre. The lease was on a month-to-month basis and was for a rental of R8 000 per month (including VAT). On 1 August 2016, GGD decided that it would be withdrawing from the lease at the end of August. At this date (1 September 2016) it would move into its own premises from which it would trade. This was an old house that was bought from a vendor (who had previously used the premises for trading). The fixed property cost R320 000 (including VAT) and GGD paid R200 000 of this on 1 September. It would pay the remainder a year later on 1 September 2017.

During November 2016, a fire started in the trading premises and destroyed some trading stock, as well as the roof of the building. Repairs to fix the damage cost R21 000 (including VAT). GGD received an insurance payout to the amount of R18 900 in respect of these damages.

On 23 December 2016, GGD gave its most expensive antique doll to a private museum (not a PBO). The cost of this particular doll was R6 000 (excluding VAT) and its open market value on 23 December was R10 000. No advertising benefit accrued due to this donation.

GGD incurred a salaries and wage expense of R200 000 during the year.

Goo Goo Dolls owned a yacht that had been bought during the year for R400 000 (including VAT). An input tax deduction was denied as the yacht was acquired for entertainment purposes. During the 2017 year, an employee had been granted the right of use of the yacht for a period in total of 104 days. The employee paid R10 000 in total for the usage of the yacht.

YOU ARE REQUIRED TO: Show the VAT effects for Goo Goo Dolls' 2017 year of assessment. Give brief reasons for the inclusion or exclusion of items for the purposes of calculating the VAT effects. All VAT effects should be rounded to the nearest Rand. Clearly distinguish between input and output tax (for example, by using two columns).

QUESTION 13.8 **(20 Marks)**

The 'AB Bank Ltd' (the bank), a registered VAT vendor with a financial year ending on 30 April, purchased a mainframe computer for R1.5 million (excluding VAT) on 1 September 2016. The bank is a category C vendor, with a monthly VAT period. When the mainframe was purchased, the bank estimated that it would be used 25% in making taxable supplies and the balance in making exempt supplies. The bank submitted its September 2016 VAT return accordingly, claiming the appropriate input.

Two mutually exclusive transaction options are considered below:

1. The bank sells the mainframe for R1.2 million (excluding VAT), a market-related price, on 28 April 2017.
2. From 1 January 2017, the bank's use of the mainframe changed, such that it commenced using the mainframe 100% in making taxable supplies. The open market value of the mainframe on 30 April 2017 was R1.2 million.

YOU ARE REQUIRED TO: Fully explain and calculate what the correct VAT treatment would be for the bank's VAT period ended 30 April 2017, in the circumstances provided in items (1) and (2). Include appropriate description of or reference to the VAT Act in your explanations.

QUESTION 13.9 **(23 Marks)**

For purposes of this question, assume that all amounts are exclusive of VAT unless otherwise stated. Note that the term 'open market value' includes VAT where appropriate. Also assume that Argon is in possession of all tax invoices relating to inputs where appropriate.

'Neon Ltd' (Neon) is the holding company of 'Argon Ltd' (Argon) and 'Xenon Ltd' (Xenon). Argon and Neon are registered VAT vendors. Neon makes only taxable supplies. Xenon's VAT registration was cancelled with effect from 1 March 2017.

During Argon's two-month VAT cycle ended 31 March 2017, the following transactions occurred. All amounts excluded VAT unless stated in the accompanying notes.

	Note	**R**
Sales to vendors	1	2 300 000
Sales to non-vendors	2	1 400 000
Sale of office furniture	3	7 000
Administration fee charged	4	60 000
Insurance refund received	5	16 800
Purchases of trading stock from vendors		1 850 000
Purchases of trading stock from non-vendors		640 000
Rent paid	6	50 000
Lease deposit paid on bakkie	7	6 000
Purchase of machine from Xenon	8	120 000
Hire of box at Sahara Park Newlands	9	160 000
Subscriptions paid	10	3 600
Trading stock on hand 1 April 2017	11	620 000

Notes

1. Payment has only been received for 80% of these sales.
2. 30% of these sales were to Xenon, all of which occurred on 31 March 2017. Argon always sells to Xenon at cost less 10%. The price normally charged to other customers is cost plus 50% however, trade discounts are sometimes given to other customers.
3. The office furniture (which had been used by Argon) was sold to Neon on loan account. The open market value of this furniture at the date of sale was R10 000.
4. Argon charges an administration fee of R30 000 per month to Xenon, on the fifth of each month. The above amount represents the administration fees for the months of February and March 2017. A market-related administration fee is considered to be R40 000 per month (including VAT).
5. This represents an insurance claim for partial damage to a passenger car. This represents the amount of the cheque received from the insurers on 15 March 2017.
6. The rent of R25 000 per month is paid to Neon. The rent is payable in advance, on the first of each month. The above amount represents rent for February and March 2017, although the rent for March was only paid together with the rent for April 2017, on 1 April 2017.
7. The lease term over the bakkie is for five years, with a deposit of R6 000 (including VAT) due on 25 March 2017 and 59 monthly instalments of R6 000 (including VAT) due on the 25th of each month thereafter. Total finance charges over the lease term amount to R94 500. Argon assumed all risk relating to damage to or destruction of the bakkie. The date of delivery was 2 April 2017. The lessor is a registered VAT vendor.
8. After the cancellation of Xenon's VAT registration, all machinery, which it had been using and was surplus to its needs, was disposed of to fellow group companies on 10 March 2017. The terms of the sale to Argon were that the selling price was R120 000. 50% settlement was required on the date of sale, with the balance to be paid on 10 May 2017. The open market value of the machine at the date of sale was R100 000.
9. This amount represents the annual charge for the box covering the period from 1 March 2017 to 28 February 2018. The box was hired from a registered VAT vendor. This annual charge includes the erection of advertising boards on the sides of the box for R25 000.
10. This amount was paid to the South African Institute of Chartered Accountants (a registered VAT vendor) in respect of the membership subscription of the financial director.
11. The 40% of the trading stock on hand on 1 April 2017 was purchased from non-vendors.

YOU ARE REQUIRED TO: Calculate, giving full reasons, the VAT payable or receivable by Argon for its two-month VAT period ended 31 March 2017.

QUESTION 13.10 **(20 Marks)**

PART A (7 Marks)

Hurricanes Ltd delivers goods (not fixed property) to Tornadoes Ltd (a registered VAT vendor who makes wholly taxable supplies) on 20 March 2017. The selling price of the goods was R100 000 (excluding VAT) and the open market value of the goods on that date was R120 000. 40% of the selling price was paid by Tornadoes on delivery, with the balance due in one month from that date.

YOU ARE REQUIRED TO: Discuss the VAT effects for Tornadoes Ltd for its one-month VAT period ended 31 March 2017, assuming that:

1. Hurricanes is a registered VAT vendor, the goods are second-hand and Hurricanes and Tornadoes are connected persons.

2. Hurricanes is not a registered VAT vendor, the goods are second-hand and Hurricanes and Tornadoes are connected persons.

(Assume that the required parts 1 and 2 are independent of each other.)

PART B (13 Marks)

'Sledgehammer (Pty) Ltd' (Sledgehammer) and 'Meerkat (Pty) Ltd' (Meerkat) are both subsidiaries of the same holding company, BOV (Pty) Ltd. Sledgehammer is a manufacturer of squash racquets, while Meerkat markets and distributes the racquets. Sledgehammer and Meerkat are registered VAT vendors. The companies entered into the following transactions:

1. On 5 April 2017 a delivery vehicle was sold to Sledgehammer by its banker. The date of delivery was 7 April. The sale agreement requires payment to be made by Sledgehammer monthly, at R6 000 per month over a two-year period. Total finance charges amount to R20 000 over the two-year period. Ownership will only pass to Sledgehammer when it pays the final instalment. Sledgehammer paid the first instalment, referred to as a 'deposit' in the agreement, on 8 April 2017.
2. Meerkat imported titanium (an input used in the manufacture of the racquets) from Dyer CC, an unconnected party in the UK (not a VAT vendor). The invoice value of the titanium was R220 000.
3. A director of Meerkat, Neal Ales, had to fly to Durban on business. Meerkat incurred the following costs in respect of Neal's trip (amounts include VAT):
   - Air ticket R1 250
   - Car hire R980
   - Hotel accommodation R750
   - Meals, drinks and other food and beverages for Neal and clients of Meerkat R220.

YOU ARE REQUIRED TO: Discuss and calculate the VAT effects of the above transactions for Sledgehammer and Meerkat. In respect of transaction one, include in your discussion the time of supply.

QUESTION 13.11 **(25 Marks)**

'Pectoral Ltd' (Pecks) is a company which sells gym equipment to various gyms and private individuals in Cape Town. It is a registered VAT vendor. Francis Pecks, the proud CEO, started the company in his first year at UCT, after discovering how his dancing pectoral muscles appealed to the ladies. He owns 100% of the company. Francis is not a VAT vendor.

Note: All amounts are inclusive of VAT where appropriate unless otherwise mentioned and Pecks is in possession of all valid tax invoices.

During his VAT period ended 31 October 2017, the following transactions occurred:

a. Pecks purchased R100 000 of gym equipment from a Johannesburg VAT vendor and imported R50 000 of gym equipment from a supplier in the United States. Pecks paid customs duty of 40% on the imported equipment.

b. Pecks sold gym equipment to customers in SA to the value of R250 000 (R50 000 of these sales were to non-vendors) and sales to customers in Zimbabwe to the value of R40 000.

c. Pecks paid short-term insurance of R1 500 per month (R500 thereof relates to a motor car) and paid salaries of R15 000 per month.

d. The company's building was broken into and a motor car and two computers were stolen. Insurance paid out R50 000 for the motor car and R10 000 for the two computers.

e. On 28 March 2017 Pecks decided to expand the business and purchased a small office block in Observatory for R4 500 000 (excluding transfer duty of 8%, which was paid on 29 September). The purchase price of the office block was paid in full on 30 September.

f. Pecks bought two used bakkies from a non-vendor. These were a single-cab bakkie for R65 000 (open market value was R60 000) and a twin-cab for R80 000 (open market value was R75 000).

g. On 25 October Francis took some gym equipment with an open market value of R2 500 for his personal use. He paid the company R800 for this equipment on the same date. The cost of this equipment was R3 000 (excluding VAT) when the company acquired it two years previously.

On 31 October 2017 Francis decided to deregister Pecks as a vendor as most of his future customers were expected to be private individuals who are non-VAT vendors.

At 31 October 2017 Pecks had the following assets:

- The two bakkies purchased above, with open market values unchanged from those given above.
- Computers with a cost price (excluding VAT) of R10 000 and an open market value of R5 000.
- Furniture and fittings at cost of R2 500 (excluding VAT) and an open market value of R2 800.

YOU ARE REQUIRED TO: Calculate the VAT effects for Pectoral Ltd for its two-month VAT period ended 31 October 2017. Give reasons for the treatment of each item given.

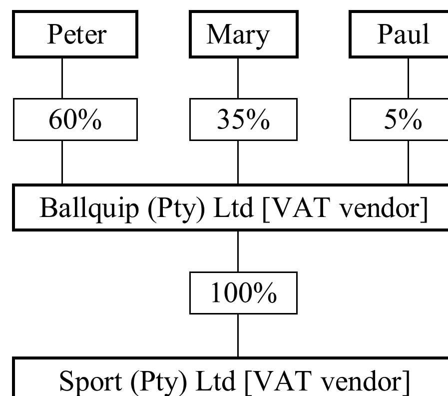
Round all numbers to the nearest Rand. You do not need to total the final VAT owing to or from SARS.

QUESTION 13.12 **(20 Marks)**

'Ballquip (Pty) Ltd' (Ballquip) is a shop located in Sandton, Johannesburg that sells soccer equipment and clothing to members of the public. Ballquip was incorporated in 2013 by three siblings (Peter, Paul and Mary – all three are non-vendors) and the company has since seen a steady increase in sales over the years. Peter and Mary are employed on a full-time basis by Ballquip.

'Sport (Pty) Ltd' (Sport) is a subsidiary company of Ballquip. Sport produces soccer jerseys for Ballquip and also provides short-term loans to local soccer clubs in financial difficulty. Interest on loans made regularly accounts for 20% of Sport's total revenue. The Commissioner for SARS considers this income stream stable for the purposes of any apportionment.

The group structure is as follows:



The group financial account, Peter, usually prepares the monthly VAT returns for Ballquip, but he was ill at the end of June. Mary has been tasked with completing the June VAT return, but her VAT knowledge is a little rusty and she has requested your assistance in determining the VAT effect of the following items.

Sales revenue
Ballquip's June bank statement indicates sales-related receipts of R12 345 780. 50% of these receipts relate to cash sales and the other 50% relates to receipts from debtors.

The balance of trade debtors was R525 479 at 31 May 2017 and 321 478 at 30 June 2017. Debtors have a 35-day credit term and all debtors settle their accounts when they become due and payable.

Management services supplied to Sport (Pty) Ltd
A portion of Peter and Mary's time each month is taken up performing management activities for Sport and Ballquip invoices Sport a nominal monthly charge of R22 800 for this time. Similar management services from a third party would cost Sport R50 000 (including VAT) per month. Peter and Mary's time provided to Sport can be apportioned according to the revenue earned by Sport.

Dispute with creditor
Included in accounts payable is an amount of R7 900 that relates to an invoice received in May 2016 that is under dispute because the goods were considered by Ballquip to be of inferior quality.

Acquisition of new office building
In May 2017 Ballquip had entered into an agreement to purchase an office building from Newcor Ltd (a VAT vendor) for R489 768 562. Ballquip agreed that it would settle the purchase price in six equal monthly instalments beginning in May. Transfer of the legal title into Ballquip's name was made in June 2017 and Ballquip paid its second instalment at that date.

Other information
- All entities that Ballquip transacts with are registered VAT vendors unless otherwise stated.
- All invoices issued and received meet the requirements of valid VAT invoices where applicable.

YOU ARE REQUIRED TO: Discuss the VAT implications of each of the above items for Ballquip (Pty) Ltd's June 2017 VAT return. Ballquip (Pty) Ltd is a 'Category C' VAT vendor. Your discussion should be supported by a calculation of the output VAT payable or input VAT claimable for June 2017 in respect each item.

Note: A portion of the marks allocated will be for clarity of communication, logical thought and appropriateness of tone in the above discussion.

SOLUTION 13.1

1. **Intebe CC**

VAT calculation for period ended 31 August 2017

Output tax		**R**	
Inventory sold	R430 000 × $^{14}/_{114}$	52 807	(1)
Building sold to Odwan			
Value: Sold to a connected person who cannot claim input tax (Odwan is not a vendor) at a consideration (R900 000) lower than open market value (R1 000 000) (s 10(4)). Therefore use open market value. R1 000 000 × $^{14}/_{114}$ = R122 807.			(1)
Time of supply is determined i.t.o. s9(3)(d), because s9(3) overrides s9(2) which deals with transaction between connected parties (s9(3) commences with 'Notwithstanding anything in subsection (1) or (2) of this section'). In this instance s9(3)(d) is not read with s16(4)(a)(ii), because s10(4) applies. Therefore, the time of supply is the earlier of date of registration of the property or the date on which any payment is made. The output tax therefore accounted for in the period in which 27 August 2017 falls. R1 000 000 × $^{14}/_{114}$ = R122 807 in August 2017.		122 807	(1)
Lease of land to Odwan			
Transaction takes place after deregistration - therefore no VAT is charged		0	(1)
Sale of machine (not connected person)	R41 000 × $^{14}/_{114}$	5 035	(1)
Balance of machinery sold			
Sold to connected person who cannot claim input tax for consideration lower than open market value, therefore use open market value			
OMV -	R900 000 − R51 000 = R849 000		(1)
Consideration -	R600 000		
therefore	R849 000 × $^{14}/_{114}$	104 263	(1)
Lease motor car			
No output as input tax was denied i.t.o. s(8)(14) - non supply. Also not in tax period.		0	(1)
Delivery vehicles sold	R76 490 × 2 × $^{14}/_{114}$	18 787	(1)
Deemed output tax on fringe benefit	R240 000 × $^{100}/_{114}$ × 0.3% × $^{14}/_{114}$ × 2 months	155	(2)

Note: No reduction by R85 as employee does not bear full maintenance cost - para 3(b) of regulation 2835 of 22 November 1991.

Input tax			
Bad debt s22(1)	R8 900 × $^{14}/_{114}$	(1 093)	(1)
Mirror purchased	R4 788 × $^{14}/_{114}$	(588)	(1)

Deregistration - deemed output tax (s8(2) & s10(5)):			
- Land			
Lower of cost	R100 000 + R5 000		(1)
or OMV	R2 million		
therefore	R105 000 × $^{14}/_{114}$	12 895	(1)

SOLUTION 13.1 continued

- Motor cars			
No output i.t.o. s8(14) as input denied, therefore non-supply.		0	(1)
- Investments	Exempt supply - no effect	0	(1)
- Debtors			
No effect as on invoice basis. Already accounted for VAT.		0	(1)
Output tax			
- Asset given to employee - fringe benefit	R4 788 × $^{100}/_{114}$ × $^{14}/_{114}$	516	(2)
- Cash given to employee			
Currency - excluded from the definition of 'goods and services'.		0	(1)
- Use of computer by employee			
If used mainly for business then Rnil value para 6(4)(bA).		0	(1)
If not used mainly for business	*(R8 100 × $^{100}/_{114}$) × 15% × $^{2}/_{12}$ × $^{14}/_{114}$ = R21.81 output tax*		
- Computer given to Eric (employee)	R1 500 × $^{14}/_{114}$ (s18(3))	184	(1)
- Lump sum given to Eric - cash		0	(1)
Currency - excluded from the definition of 'goods and services'.			

2. **Radebe**
Tax period ending 30 September 2017
Input tax

Inventory	R430 000 × $^{14}/_{114}$	52 807	(1)
Machinery leased from Odwan CC		0	(1)
Supply by non-vendor, but a supply of goods by means of letting does not qualify as a second-hand good as the rental paid is for use of the goods therefore no deemed input tax deduction permitted.			
Motor car lease			
Supply of motor car by letting - input denied (s17(2)(i) not applicable as does not regularly rents vehicles) and as above not 2nd hand good.		0	(1)
Delivery vehicles	R76 490 × $^{14}/_{114}$ × 2	18 787	(1)
			(28)

SOLUTION 13.2

Annie Ltd

1. **VAT output and input in respect of January/February 2017 VAT period**
<u>Input tax</u>

a) Trading stock purchased	(500 × R160) + (300 × R180)		
	= R134 000 × 0.14	(18 760)	(2)

SOLUTION 13.2 continued

b)	Desktop computer			
	Input limited to lesser of consideration or OMV, claimable to extent paid	R4 000 × $^{14}/_{114}$ =	(491)	(1)
c)	Delivery vehicle			
	Not an ICA as Annie is not entitled to use for ≥ 12 months therefore rental agreement	R26 667 × $^{14}/_{114}$ =	(3 275)	(2)
d)	Insurance	2 × R1 600 × 0.14	(448)	(1)
e)	Bus fare - exempt supply		0	(1)
	Total input tax		(22 974)	
	Output tax			
a)	Lease rentals - consideration of R11 000 × 1.14 = R12 540 exceeds OMV so use actual consideration, i.e. no s10(4) (only February's rent is included in the current VAT period)		1 540	(1)
b)	Trading stock - sold to outsiders	700 × R175 = R122 500 × 0.14	17 150	(1)
	Given to Belinda: s18(1)	(R175 × $^{114}/_{100}$) = R199.50 × 100 = R19 950 × $^{14}/_{114}$ *OR (R175 × 100 × 14%) = R2 450*	2 450	(3)
	Total output tax		21 140	

2. **Output tax on transactions i - vi:**

i:	Land and buildings	R1 400 000 × 0.14 =	196 000	(1)
ii:	Desktop computers	R50 000 × 0.14 =	7 000	(1)
iii:	Deemed consideration	R2 000 000 × $^{14}/_{114}$ =	245 614	(1)
iv:	Delivery vehicle	R65 000 × 0.14 =	9 100	(1)
	Motor cars (input denied)		0	(1)
v:	Debtors book - no VAT		0	(1)
vi:	Trading stock	500 units × R150 × $^{14}/_{114}$ =	9 211	(2)
			466 925	

SOLUTION 13.2 continued

3. **If Annie deregisters before entering into transactions (i) to (vi), a s8(2) deemed supply would result based on the lesser of cost (including VAT) and OMV as the consideration, as follows:**

		OMV	Cost incl. VAT	Lesser	
		R	R	R	
Land and buildings		1 800 000	2 280 000	1 800 000	(1)
Computers - mainframe		60 000	136 800	60 000	(1)
Desktop computers		54 000	57 580	54 000	(1)
[R51 000 − R491 (VAT in 1c above)] × 1.14					
Motor cars		0	(input denied)	0	(1)
Delivery vehicle		135 000	171 000	135 000	(1)
Trading stock	1 000 × R150 =	150 000	221 160	150 000	(1)
Patent (a right capable of cession or assignment)		2 000 000	2 166 000	2 000 000	(1)
Second delivery vehicle		0		0	(1)
Debtors		0		0	(1)
Bank		0		0	(1)
				4 199 000	
Consideration	R4 199 000 × $^{14}/_{114}$ =		Output tax	515 667	(1)

If Annie deregisters after entering into transactions (i) to (vi) the s8(2) deemed supply would be calculated on assets retained, as follows:

Other motor car	Input denied		0	(1)
Trading stock	500 × R150 × $^{14}/_{114}$=		9 211	(1)
Mainframe	R60 000 × $^{14}/_{114}$ =		7 368	(1)
			16 579	
Total output as calculated in 2 above			466 925	(1)
		Output tax	483 504	

Conclusion: It is better to deregister after entering into transactions i–vi.

SOLUTION 13.2 continued

Workings for calculation of cost price of trading stock:

		On hand units	**Cost price**	**Total cost**		
2016-12-31		1 000	$^{165}/_{.75}$ = 220	220 000		(0.5)
2017-01-15	Purchased from C	500	160	80 000		(0.5)
		1 500		300 000		
	therefore average cost		200			(1)
2017-01-20	Sale	(700)	200	(140 000)		(0.5)
	Given to B	(100)	200	(20 000)		(0.5)
2017-01-31	Purchased from C	300	180	54 000		
		1 000		194 000	× 1.14 = 221 160	(1)
	therefore average cost		194			
						(39)

SOLUTION 13.3

1. ***GB (Pty) Ltd***

VAT effect

The transfer of the trading stock to the creditors is a supply. It is submitted that the supply is in the course or furtherance of GB's enterprise, and that s18(1) does not apply.

The debt reduction is an arrangement similar to a compromise with creditors and the vendor must account for output tax equal to the portion of the consideration which has not been paid. (Proviso (ii)(cc) to s22(3).)

	R	
Input tax - claimed in the prior period	0	(1)
Trading stock given back to creditor at cost (supply at 14%) − R40 000 × 14%	5 600	(1)
Reduction amount - R57 000 × $^{14}/_{114}$ (Proviso (ii)(cc) to s22(3))	7 000	(1)
Due to SARS	12 600	

<u>*Income tax effect*</u>

Opening stock	(40 000)	(1)
Disposal of trading stock to creditor - gross income (excl VAT)	40 000	(1)
Debt reduction i.t.o. s19(5) - recoupment i.t.o. s 8(4)(a) - R57 000 × $^{100}/_{114}$) *(R102 600 − R40 000 − R5 600 = R57 000)*	50 000	(1)
Assessed loss brought forward	(22 000)	(1)
Taxable income	28 000	

SOLUTION 13.3 continued

2. ***Company A***

VAT effect

Output tax

		R	Marks
-	Local sales R77 000 × $^{14}/_{114}$	9 456	(1)
-	Botswana sales R40 320 × 0% when sold to customers	0	(1)
-	Namibia sales (R44 000) not supplies when sold to customers (Stock was previously transferred at 0% to the branch)	0	(1)
-	Stock sent to Namibian branch (R100 000 × 30% × 0%) (s11(1)(i))	0	(1)
	Machine sent to Namibian branch (R50 000 × 0%) (s11(1)(i))	0	(1)
		9 456	

Input tax	R			
- trading stock (all to be used in taxable supplies)	114 000			(1)
- machinery (all to be used in taxable supplies)	114 000			(1)
	228 000	× $^{14}/_{114}$	(28 000)	
VAT refund due from SARS			(18 544)	

Income tax effect

Gross income	((R77 000 × $^{100}/_{114}$) + R40 320 + R44 000)	151 864	(2)
Stock purchases in production of income		(100 000)	(1)
Machinery	R50 000 × 2 × 20% - s11(e)	(20 000)	(2)
Taxable income		31 864	

3. ***Mr A***

VAT effect

		R	
Output tax:	R104 000 × $^{14}/_{114}$	12 772	(1)
Input tax:	R250 000 × $^{14}/_{114}$	(30 702)	(1)
Refund due from SARS		(17 930)	

Income tax effect

Gross income	(R104 000 − R12 772)	91 228	(1)
Expenditure (s11(a))	(R250 000 − R30 702)	(219 298)	(1)
Loss		(128 070)	

4. ***ABC Insurance***

VAT effect

Output tax:	(R7 000 + R1 000) × $^{14}/_{114}$	982	(1)
Input tax:	(R4 000 + R200 000) × $^{14}/_{114}$	(25 053)	(1)
Refund due from SARS		(24 070)	

SOLUTION 13.3 continued

Income tax effect				
Gross income	(R8 000 − R982)		7 018	(2)
Expenditure	(R204 000 − R25 053)		(178 947)	(2)
Loss			(171 929)	
X Ltd				
VAT effect				
Output tax				
Machine sold:	R4 000 × $^{14}/_{114}$		491	(1)
Claims received:	R204 000 × $^{14}/_{114}$		25 053	(1)
			25 544	
Input tax				
New machine purchased:	R200 000 × 0.14		(28 000)	(1)
Premiums paid:	R8 000 × $^{14}/_{114}$		(982)	(1)
			(3 439)	
Income tax effect				
Gross income;				
Recoupment on sale of old machine	(R4 000 − R491)		3 509	(1)
Deductions:		R		
Insurance premiums paid (R8 000 − R982)			(7 018)	(1)
Indemnification on loss of machine				
Payment received	R200 000 × $^{100}/_{114}$	175 439		
Tax value (no capital allowance claimed yet)		(200 000)		
s11(o) scrapping loss		(24 561)	0	(2)
Due to the fact that the machine has not been brought into use, it does not qualify for a s12C allowance and therefore also not for a s11(o) scrapping allowance.				(1)
This will have a capital loss effect, which may be deducted from other capital profits or carried forward to the following year: Proceeds (R175 439) less base cost (R200 000) = capital loss of R24 561.				
Theft of cash, net of indemnity s23(c)	(R4 000 − (R4 000 − R491))		(491)	(1)
Loss			(7 509)	
				(39)

SOLUTION 13.4

Bigsky (Pty) Ltd		**Input** R	**Output** R	
1 Input denied (motor car) s17(2)		0		(1)
Output on fringe benefit s10(13), 18(3), regulation 2835	0.3% × R387 600 × $^{100}/_{114}$ × $^{14}/_{114}$		125	(2)
2 Input (not a motor car)	R92 340 × $^{14}/_{114}$	11 340		(1)
Output on fringe benefit s10(13), 18(3), regulation 2835	0.6% × R92 340 × $^{100}/_{114}$ × $^{14}/_{114}$		60	(2)
3 Input (not a motor car)	R23 940 × $^{14}/_{114}$	2 940		(1)
Output on fringe benefit para 5(2) 7th Schedule	R21 000 × $^{14}/_{114}$		2 579	(1)
4 Input	R12 540 × $^{14}/_{114}$	1 540		(1)
Output on fringe benefit para 5(2) 7th Schedule	(R12 540 × $^{100}/_{114}$) – R5 000) × $^{14}/_{114}$		737	(2)
5 Input	R57 000 × $^{14}/_{114}$	7 000		(1)
Output on fringe benefit para 6(2) 7th Schedule	R57 000 × $^{100}/_{114}$ × 15% × $^{28}/_{365}$ × $^{14}/_{114}$		71	(2)
6 Input (for exempt supply) (definition of input tax)		0		(1)
Output on fringe benefit s12(c)			0	(1)
				(16)

CHAPTER 14: TAX AVOIDANCE, ADMINISTRATION, OBJECTION AND APPEAL

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QUESTION 14.1 (Solution at end of chapter) **(25 Marks)**

YOU ARE REQUIRED TO: Indicate whether you consider that the statement made is TRUE or FALSE. Provide brief reasons for your answer.

Below are a number of statements relating to anti-avoidance rules and the 2017 year of assessment.

1. The Income Tax Act contains general anti-avoidance provisions.
2. If Mr A renders services to a company and the company pays an amount of R10 000 to Mr A's wife in respect of the services, the R10 000 will be included in Mrs A's gross income.
3. If an employee instructs his employer to deposit half of his remuneration in a bank account in the name of his son, who is aged 25, his son will be taxed on the amount.
4. In 2013 Mrs Good, a wealthy person, donated R500 000 to her husband, whose income is taxed at a lower marginal tax rate. Her husband invested the amount in a bank account bearing interest at a rate of 10% *per annum*. Mrs Good will have to include the R50 000 interest in her gross income.
5. In 2012 Mr Pious ceded all the rental income from a flat that he owns to a local church. The rental income received by the church in the 2017 tax year is R50 000. Mr Pious will have to include the R50 000 in his gross income.
6. In 2012 Mrs Kind donated R1 million to her son, who was 20 at the time. The son deposited the R1 million in a bank account and earns R100 000 interest *per annum*. The son (who is now 24) has immigrated to the USA, but has retained his R1 million bank account in South Africa. The son, and not Mrs Kind, will be taxed, in South Africa, on the R100 000 interest income.
7. If the tax deduction of a South African company is adjusted in respect of interest paid from R5 million to R3 million in terms of the transfer pricing rules in section 31 of the Income Tax Act, dividends tax of R300 000 will be payable by the company.
8. The partners of a partnership are connected persons in relation to the partnership for the purposes of the Income Tax Act.

9. The partners of a partnership are connected persons in relation to the partnership for the purposes of the Value-Added Tax Act.
10. A dividend paid on a preference share is normally subject to dividends tax, unless the preference share meets the definition of a 'hybrid equity instrument'.
11. Interest paid by a company on a convertible debenture that meets the definition of a 'hybrid debt instrument' is treated as a dividend and is subject to dividends tax.
12. If an option to acquire shares in a company is exercised by an employee when the market value of the shares is R10 and the option strike price is R2, a gain of R8 per share will be included in that employee's income even though he is not permitted to sell the shares for three years.

QUESTION 14.2 (Solution at end of chapter) (11 Marks)

The general anti-avoidance rules (GAAR) in the Income Tax Act are contained in s80A to s80L. Whenever an impermissible avoidance arrangement exists, the Commissioner is empowered to take steps to effectively nullify the tax beneficial aspects of the arrangement. An impermissible avoidance arrangement is outlined in s80A, while the Commissioner's remedies are contained in s80B.

YOU ARE REQUIRED TO: Explain briefly:

1. What an impermissible avoidance arrangement is.
2. What the Commissioner's remedies are when such an arrangement exists.

QUESTION 14.3 (Solution at end of chapter) (20 Marks)

Below are a number of statements relating to the Tax Administration Act (TAA) and the 2017 year of assessment.

YOU ARE REQUIRED TO: Indicate whether you consider that the statement made is TRUE or FALSE. Provide brief reasons for your answer. Your answer must consider the rules promulgated under s103 of the TAA, effective from 11 July 2014.

1. An objection to a tax assessment must be in writing and must state, in detail, the grounds on which it is based or made.
2. In an appeal to the Tax Court, a taxpayer is limited to his grounds of objection as set out in his notice of objection.
3. An appeal against the disallowance of an objection must be made within 21 business days of the date of receipt of the notice disallowing the objection.
4. An appeal against the disallowance of an objection must be in writing and must specify, in detail, the grounds on which it is made.
5. Notwithstanding that a taxpayer has lodged an objection to an assessment, if he does not pay the tax due, interest runs from the date of assessment.
6. The 'due date' on an assessment is also known as the 'second date'.
7. A taxpayer may not represent himself in the Tax Court.
8. In no circumstances may the Commissioner make a refund of tax incorrectly assessed if more than three years have elapsed since the end of the year of assessment to which such tax relates.
9. SARS may not raise a revised assessment if the taxpayer was assessed in terms of the practice of the Commissioner generally prevailing at the time, even if that practice was incorrect in law and this is the reason why the Commissioner wishes to issue the revised assessment.

10. A taxpayer won his case in the Tax Court in respect of the 2014 year of assessment and SARS did not note an appeal. One year later SARS finds that the decision of the Special Court was based on the Judge President's incorrect understanding of the facts. SARS is therefore justified in issuing a revised assessment in respect of the 2014 year of assessment.

QUESTION 14.4 (Solution at end of chapter) (11 Marks)

In 2013 Mrs South, a South African resident, aged 50, formed a trust in Johannesburg. The beneficiaries of the trust are Mrs South and her two children, Adrian, aged 24, and Brian, aged 16. Brian lives with his mother in Johannesburg. Adrian emigrated to the United Kingdom in 2015.

Shortly after forming the trust, Mrs South donated cash of R3 million to the trust and sold a block of flats to the trust for R10 million (the market value at that date) on interest-free loan account. A market-related rate of interest would have been 10% *per annum*. The trustees invested the cash in a money market investment. All of the income of the trust up to 29 February 2016 had been vested in the beneficiaries on that date. The income for the year ended 28 February 2017 is:

Rental	R1 500 000
Interest	R300 000
	R1 800 000

On 28 February 2017 the trustees vested R600 000 in each of the three beneficiaries.

YOU ARE REQUIRED TO: Calculate the taxable income of Mrs South, Adrian, Brian and the trust for the year ended 28 February 2017.

QUESTION 14.5 (21 Marks)

Mr Milka, a dairy farmer, has a large assessed loss of R1 million. His good friend, Mr Creema, is also a dairy farmer but, unlike Mr Milka, runs a profitable farm and does not have an assessed loss. Mr Creema expects his farming income, in the current tax year, to be R500 000. Mr Milka and Mr Creema are not connected persons. They have recently thought of a good scheme. Mr Milka needs a new milking shed that is expected to cost R400 000 to build.

Mr Milka has a large balance of capital development expenditure carried forward from the previous tax year and will therefore not be able to claim a tax deduction in respect of the building. (Note: Capital development expenditure allows for the 100% deduction of qualifying capital expenditure in relation to farming. Such deductions cannot, however, create an assessed loss and any undeducted amounts are carried forward.) Mr Creema, in addition to his farming activities, is the sole member of a close corporation, Buildit CC, which is a building contractor.

Mr Creema wants to purchase a bull from Mr Milka. In terms of the 2nd Schedule, the purchase of livestock qualifies for deduction at cost under s11(*a*), but is included in closing stock at standard value. You may assume that the standard value of a bull is R400.

In terms of the plan, Mr Milka will sell a bull that has a market value of R50 000 to Mr Creema for R500 000. In turn, Buildit CC will build a milking shed for Mr Milka at a cost of R800 000. The normal cost of such a shed would be R400 000. Buildit will receive an amount of R800 000 and will incur building costs of R300 000. Buildit is not concerned about the increased profit because it has an assessed loss of R500 000.

YOU ARE REQUIRED TO: Discuss whether the Commissioner could apply the general anti-avoidance provisions of s80A–s80L of the Income Tax Act to counter the scheme proposed by Mr Milka and Mr Creema. Ignore VAT.

QUESTION 14.6 **(24 Marks)**

Below are a number of statements relating to anti-avoidance rules and the 2017 year of assessment.

YOU ARE REQUIRED TO: Indicate whether you consider that the statement made is TRUE or FALSE. Provide brief reasons for your answer.

1. In a context other than business, an arrangement is an impermissible avoidance arrangement if it lacks commercial substance.
2. In the context of business, an arrangement is an impermissible avoidance arrangement if it has created rights and obligations that would not normally be created between persons dealing at arm's length.
3. An avoidance arrangement lacks commercial substance only if it contains round-trip financing.
4. Natural persons are not subject to the general anti-avoidance provisions in s80A–s80L.
5. If an arrangement lacks commercial substance but its sole or main purpose was not to obtain a tax benefit, it is not an impermissible avoidance arrangement.
6. The onus of proving that the sole or main purpose of an arrangement was to obtain a tax benefit is on the Commissioner.
7. If a company enters into an arrangement solely for the purposes of avoiding value-added tax, it cannot be subject to the anti-avoidance provisions of the Income Tax Act, even though it may also derive an income tax benefit.
8. The Commissioner must give a taxpayer notice of his intention to apply the remedies contained in s80B.
9. The anti-avoidance provisions apply to any party in an arrangement. The term 'party' is wider than 'person' in that it includes, for example, partnerships.
10. A person is a tax-indifferent or accommodating person only if he/she/it is a connected person in relation to any other party.
11. In deciding whether or not an arrangement lacks commercial substance, the Commissioner may treat parties who are connected persons in relation to each other as one and the same person.
12. The Commissioner can only apply the anti-avoidance provisions to the whole of the arrangement, i.e. he cannot selectively apply it to parts of one arrangement.

QUESTION 14.7 **(9 Marks)**

Mrs Smithers has recently received her 2016 assessment, which has a date of notice of 10 February 2017, a due date of 31 March 2017 and a second date of 30 April 2017. When she examined her assessment she was shocked to discover that her taxable income was R200 000 higher than she had anticipated. The increase resulted from the Commissioner treating the proceeds from the sale of a flat which she sold during the course of the year as revenue. She had owned the flat for five years during which time it had been her primary residence. Mrs Smithers wishes to object to her assessment and has approached you for advice.

YOU ARE REQUIRED TO: Advise her:

1. What the latest date for submitting her objection is.
2. What form the objection should take.
3. Assuming that her objection is overruled, what she can then do if she wishes to take the matter further.

QUESTION 14.8 **(40 Marks)**

Due to the current harsh economic climate, your client, Sumbia (Pty) Ltd, is experiencing a severe cash flow crisis. In order to relieve its cash flow problems, Sumbia has decided to sell two of its large manufacturing machines in a sale and lease-back arrangement.

The first machine (Machine A) had originally cost Sumbia R5 million (including VAT). The machine has been used in a process of manufacture and has a book value and tax value of Rnil. The machine will be sold to a bank for R12 million (including VAT) and will be leased back for five years at a monthly lease rental of R250 000. The lease is a finance lease and, in terms of the lease agreement, Sumbia will be entitled to purchase the machine for R50 000 at the end of the lease. At that date the market value will be R2 million.

The second machine (Machine B) had originally cost Sumbia R8 million (including VAT). The machine is used in a process of manufacture and has a tax and book value of Rnil. The machine will be sold to a pension fund (which is exempt from tax) for R18 million (current market value is R10 million). The pension fund will lease the machine back to Sumbia in terms of a finance lease. The lease will be for five years and will provide for a monthly lease rental of R400 000. At the end of the lease, Sumbia will be entitled to continued use at a monthly rental of R1 000.

Sumbia and the bank are both registered VAT vendors. The pension fund is not a VAT vendor.

You may assume that both leases are instalment credit agreements for VAT purposes. Where required, the Commissioner will allow wear and tear at 20% *per annum*.

YOU ARE REQUIRED TO:

1. Explain and calculate the tax effects of the sale and lease-back arrangement of the two machines for Sumbia.
2. Explain and calculate the tax effects of the sale and lease-back for the bank.

QUESTION 14.9 **(16 Marks)**

A South African company owes €1 million to an offshore trust, which is its sole shareholder. In order to prevent the inclusion of foreign exchange gains in the taxable income of the company:

- A non-trading South African discretionary trust is formed, with the off-shore trust as its primary beneficiary.
- The €1 million debt claim that the off-shore trust has against the South African company is ceded to the South African trust, such that the South African company's debt to the off-shore trust is effectively settled, so that it owes the Rand equivalent to the South African trust (say R12 million) and the South African trust owes €1 million to the off-shore trust.

If the Rand strengthens, this will then have no effect on the South African company. The foreign exchange profit will be made by the South African trust and will be of a capital nature. The South African trust would then distribute the profit to the off-shore trust.

If the Rand weakens, the off-shore trust will lend funds to the South African trust (if necessary) to fund any resultant capital loss which the South African trust may make on the weakening of the Rand in relation to the Euro.

The transactions were effected in order to avoid any income tax in the South African company's hands arising from possible foreign exchange gains on the loan. Assume that the 'avoidance arrangement' is entered into in the context of business.

YOU ARE REQUIRED TO: Briefly discuss whether the general anti-tax avoidance provisions of the South African Income Tax Act could apply to any tax saving of the company.

QUESTION 14.10 **(23 Marks)**

Ms Matsuhisa, aged 45, immigrated from Japan in 1990 and acts as a personal lifestyle coach for high-profile individuals. Her former tax consultant, Mr Thrift, carried out an estate-planning exercise during the 2015 year of assessment by forming a private company called Matsuhisa (Pty) Ltd. Because Ms Matsuhisa falls in the highest tax bracket, Mr Thrift then advised her to sell all her investments, valued at R880 000, to Matsuhisa (Pty) Ltd for R880 000.

The authorised and issued share capital of Matsuhisa (Pty) Ltd comprised one ordinary share of R1. This share was registered in Ms Matsuhisa's name and she paid for it in cash. Ms Matsuhisa then lent Matsuhisa (Pty) Ltd R880 000. The company used the proceeds of this loan to pay for the investments that it had purchased from her. The R880 000 was credited to her loan account. No interest was payable on the loan account.

Ms Matsuhisa approached you to assist her in her dealings with SARS, as she had received a letter from the Commissioner of SARS a month ago. The letter states that the Commissioner is invoking the provisions of s80A of the Income Tax Act and is including the taxable income of Matsuhisa (Pty) Ltd in Ms Matsuhisa's taxable income for the 2017 year of assessment.

YOU ARE REQUIRED TO: Discuss, with reasons and reference to legislation, whether or not the Commissioner will be able to apply successfully the provisions of s80A. Ignore VAT.

QUESTION 14.11 **(25 Marks)**

The Hold Group comprises 'Holding Ltd' (Hold) and its single trading subsidiary 'Sub (Pty) Ltd' (Sub), in which it holds 100% of the equity shares. Hold wishes to issue equity to a black economic empowerment company.

Bank SA has advised Hold that it can structure a deal through one or more of its tax-neutral subsidiaries, in order to reduce the tax payable by the Hold Group and increase its profit after tax.

In order to do this, Bank SA proposes that a new subsidiary of Hold is formed, known at this stage as Newco. 100 % of the shares in Newco will be issued to Hold, which will then sell a 26% holding in Newco to the BEE company. The business (i.e. all the trading assets) of Sub will then be sold to Newco as a going concern, at its market value of R5 million. However, it is proposed that use be made of s45 of the Income Tax Act, which allows for a roll-over of any tax consequences on the sale of the assets (e.g. recoupments and capital gains) from one group company to another (i.e. Sub to Newco in this case). This section exists in order to enable intra-group transactions to take place without any immediate tax burden arising from them.

A subsidiary of Bank SA with significant assessed losses will then lend R5 million to Newco at a market related interest rate of 10% a year and Newco will pay this to Sub for the trading assets (business) acquired.

The business transferred to Newco is very profitable and it will be able to get the full benefit of the interest deductions (the interest paid on the R5 million loan would be fully tax-deductible by Newco).

Sub will then distribute the R5 million to Hold as a dividend and Hold will invest this amount in preference shares issued by Bank SA. Hold will earn preference dividends of 9% per year on the R5 million, all of which will be exempt in terms of s10(1)(*k*) of the Income Tax Act. The 9% rate is market related.

YOU ARE REQUIRED TO:

1. Discuss whether the Commissioner could apply the general anti-avoidance provisions (s80A–s80L) to the proposed transaction. (30 marks)
2. Ignoring the possible application of the general anti-avoidance provisions, briefly discuss whether the above could be regarded as a simulated transaction. (5 marks)

Give full reasons for your answers, citing case law if applicable. Ignore VAT.

QUESTION 14.12 (14 Marks)

You have two friends, Andy and Juan, who are insurance brokers. Their brokerage is in a company, ATP (Pty) Ltd, in which they hold all the shares. A friend of theirs, David, is a shareholder in another company, Grand Slam (Pty) Ltd, which for some years has run an insurance brokerage, but has built up a large assessed loss amounting to R10 million due to poor market conditions.

The shareholders of Grand Slam are keen to get rid of their shares in the company. Although it is not profitable, Grand Slam has a valuable client base that Andy and Juan would like to exploit. Also, the tax benefits in using Grand Slam are enticing.

Andy and Juan are therefore contemplating the following plan and have asked for your advice:

Andy and Juan will purchase the shares in Grand Slam from the existing shareholders on 1 November 2017. They are confident that they will be able to acquire the shares for R500 000. Once the shares have been acquired, ATP will cease trading and Grand Slam will seek to enter into fresh insurance contracts with all of ATP's clients and thus increase its client base. There will also be a large drive to market to Grand Slam's client base by telephone and email in order to solicit further business.

The financial year-end of both companies is 31 December.

YOU ARE REQUIRED TO: Discuss whether or not the Commissioner could apply any anti-avoidance legislation to counter Andy and Juan's plan and what the effect of applying the anti-avoidance legislation might be. Do not consider s80C–s80E in your answer.

QUESTION 14.13 (10 Marks)

The Tax Administration Act (TAA) came into force on 1 October 2012 and introduced, among others, 'jeopardy assessments' – a new concept in our law.

YOU ARE REQUIRED TO:

1. Explain what is meant by the term 'jeopardy assessment' and describe under what circumstances such an assessment may be issued by SARS.
2. Indicate how a jeopardy assessment affects the taxpayer's rights.

QUESTION 14.14 (15 Marks)

Mr Bentley is a 63-year-old South African provisional taxpayer. He owns an antique car dealership, which he runs as a sole proprietor. Because of his attendance at overseas motor shows, Mr Bentley was abroad from December 2016 to February 2017. As a result, he was unable to eFile his 2016 personal income tax return on time (the deadline for submission was 31 January 2017). SARS has raised an initial administrative non-compliance penalty against Mr Bentley, which was communicated to him by means of a Penalty Assessment Notice (AP34) issued on 9 February 2017.

Mr Bentley is furious with SARS and refuses to pay the penalty, as this is the first time he has ever been fined. He is now threatening not to submit his 2015 and 2016 tax returns, which were still outstanding when he contacted you on 1 March 2017. His 2014 assessment indicates a taxable income of R240 000.

YOU ARE REQUIRED TO:

1. Explain to Mr Bentley the type and amount of administrative non-compliance penalty charged by SARS and whether (or not) SARS was correct in imposing the penalty.
2. Assume that SARS was indeed correct in imposing the penalty. Advise Mr Bentley as to whether he is entitled to request a remission for the penalty and, if so, whether SARS is likely to grant the remission.

QUESTION 14.15 **(9 Marks)**

You are a postgraduate student at a South African university. Mr Dunno, a friend of one of your family members, approached you for advice regarding his second provisional tax estimate in respect of the 2017 year of assessment. He informed you that SARS estimated a basic amount in terms of para 19(2) of the 4th Schedule to the Income Tax Act. However, Mr Dunno does not agree with the estimate, as he is of the opinion that it includes an amount which is not taxable.

YOU ARE REQUIRED TO:

1. Briefly explain to Mr Dunno, with reference to the Tax Administration Act (TAA), upon whom the burden of proof rests as to the amount that should be used in the estimate. No calculations are required.
2. Since you have provided Mr Dunno with tax advice (free of charge), briefly explain whether or not you are now required to register as a tax practitioner in terms of the TAA. You have acted alone in your capacity as a student.

SOLUTION 14.1

1.	TRUE	The general anti-avoidance provisions are contained in s80A to s80L.	(2)
2.	FALSE	In terms of para (c) of the gross income definition, it is the person who renders the services, and not the recipient of the payment, who is taxed.	(2)
3.	FALSE	In terms of s7(1) income accrues to the father notwithstanding that it has not been paid to him but has been dealt with on his behalf. The fact that the recipient is his son, and the age of his son, would only be relevant in terms of s7(3).	(2)
4.	TRUE	This is income splitting. In terms of s7(2) the income will be deemed to accrue to Mrs Good, as the donation was made with the sole purpose of reducing the donor's tax liability. Note that s7(2) applies to both marriages in and marriages out of community of property.	(2)
5.	TRUE	In terms of s7(7)(*a*), if a person cedes the right to income from an asset while retaining ownership of the asset, the income is taxed in his hands.	(2)
6.	FALSE	Mrs Kind is taxed on the income in terms of s7(8) because the income is a consequence of her donation and has accrued to a non-resident. Although the wording of s7(8) differs from the other donor provisions, the heading of s7 seems to indicate that the intention of the legislature is for this section to be a deeming provision. As Mrs Kind will be taxed on the income, it is submitted that SARS will not tax this amount in the hands of the son as well, otherwise this would lead to economic double taxation.	(2)
7.	TRUE	In terms of s31, where there is an adjustment to bring the taxable income of a company in line with what it would have been if a transaction had been entered into at arm's length, the amount of the adjustment is treated as a dividend *in specie*.	(2)
8.	FALSE	A partnership is not recognised as a person for the purposes of the Income Tax Act.	(2)
9.	TRUE	A partnership is recognised as a person for the purposes of the VAT Act and the definition of connected persons in s1 of that Act deals with partnerships.	(2)
10.	TRUE	Taxation does not apply the doctrine of substance over form (as would be the case in IFRS for financial reporting purposes) to dividends. A dividend on a preference share is a dividend for tax purposes, and would be subject to dividends tax. The exception would be if the preference share met the definition of a 'hybrid equity instrument'. In that case the dividend is deemed to be an amount of income (i.e. not exempt) in the hands of the recipient, but remains a dividend in the hands of the company paying it - s8E(2). However, in terms of s64F, any dividend that constitutes income in the hands of the recipient is exempt from the dividends tax.	(3)
11.	TRUE	S8F recharacterises 'hybrid interest' as a dividend, which will be subject to dividends tax in terms of s64D. S8F must also be read in conjunction with s8FA, which contains the re-characterisation provisions.	(2)

SOLUTION 14.1 continued

12.	FALSE	The share is restricted, which means that the option is restricted as well. The gain will only be taxed when the share vests and will be calculated based on the market value of the shares on the date the shares vests, the strike price of the option, and any consideration paid by the employee to acquire the option - s8C.	(2)
			(25)

SOLUTION 14.2

1. An impermissible avoidance arrangement is envisaged in s80A in one of the following three ways:

    1. In the context of business - s80A(*a*) (0.5)
        - (i) it was entered into or carried out in an abnormal manner which would not normally be employed for *bona fide* business purposes (other than obtaining a tax benefit); or (0.5)
        - (ii) it lacks commercial substance, and (0.5)
        - (iii) its sole or main purpose was to obtain a tax benefit. (0.5)

    2. In a context other than business - s80A(*b*) (0.5)
        - (i) it was entered into or carried out by means or in a manner that would not normally be employed for *bona fide* purposes (other than obtaining a tax benefit), and (0.5)
        - (ii) its sole or main purpose was to obtain a tax benefit. (0.5)

    3. In any context - s80A(*c*) (0.5)
        - (i) it has created rights and obligations that would not normally be created between persons dealing at arm's length; or (0.5)
        - (ii) it would result in misuse or abuse of the provisions of the Act. (0.5)

    Note that requirement (3) is effectively applicable to both (1) and (2). In other words, there are really only two tests, namely the test in the context of business and the test in a context other than business. The test outlined in (3) should merely be added to test (1) and (2). (0.5)

2. The remedies are contained in s80B(1) and are as follows: (0.5)

    The Commissioner may determine the tax consequences by –
    - (a) disregarding, combining or recharacterising any steps in the arrangement (0.5)
    - (b) disregarding any accommodating or tax indifferent party (0.5)
    - (c) deeming connected persons to be one and the same person (0.5)
    - (d) re-allocating any income, expenditure or rebates amongst the parties (0.5)
    - (e) recharacterising any gross income receipt or accrual of a capital nature (0.5)
    - (f) treating the arrangement as if it had not been entered into. (0.5)

    In applying such remedies as are available, the Commissioner must make compensating adjustments to ensure the consistent treatment of all parties to the impermissible avoidance arrangement - s80B(2). (1)

SOLUTION 14.2 continued

If the taxpayer is found to have engaged in impermissible tax avoidance, then the taxpayer will also be subject to an understatement penalty of either 75% or 100% of the increase in income tax resulting from the remedy applied by the Commissioner in terms of s80B (s221–223 of the TAA).	(1)
	(11)

SOLUTION 14.3

Note: The 'Rules' are regulations promulgated under s103 of the Tax Administration Act (TAA) that prescribe, amongst others, the procedures to be observed in lodging objections, noting appeals against assessments, procedures for alternative dispute resolution, the conduct and hearing of appeals and transitional rules. The objections and appeals process is governed by s104 of the TAA, which also refers to 'Rules'. The 'new' Rules are effective from 11 July 2014 and were published in Government Gazette *No. 37819. The solutions to this chapter will only deal with the new rules. As a general transitional rule, if a taxpayer has objected under the old rules and the objection has not been dealt with by SARS upon commencement of the new rules, the dispute must continue and the objection must be dealt with by SARS under the new rules 'as if taken or instituted under the new rules'.*

1	TRUE	Para 7 of the rules requires this.	(2)
2	FALSE	See para 10 of the rules. Provision is now also made for the ability of the taxpayer to add new grounds when lodging a notice of appeal. However, the ability to add new grounds in the notice of appeal is limited in that the taxpayer may not appeal on a ground that constitutes a new objection against a part or amount of the disputed assessment not objected to in the notice of objection. If the taxpayer in the notice of appeal relies on a ground not raised in the objection under rule 7, SARS may require a taxpayer within 15 days after delivery of the notice of appeal to produce the substantiating documents necessary to decide on the further progress of the appeal.	(2)
3	FALSE	The period is 30 days - para 10(1) of the rules and s107(2) of the TAA.	(2)
4	TRUE	See para 10 of the rules.	(2)
5	FALSE	The general rule under the TAA is that interest accrues from the effective date to the date of payment. The effective date would generally be the date that tax is payable under a tax Act. S187(3)(*b*) of the TAA determines that for income tax, the effective date falls seven months after the last day of that year (for a February year-end) and six months in any other case.	(2)
6	FALSE	The 'second date' on a tax return is a different date from the 'due date'. These dates are also not to be confused with the 'date of assessment' as defined in s1 of the TAA.	(2)
7	FALSE	He may do so in terms of s125(2) of the TAA.	(2)

SOLUTION 14.3 continued

8	FALSE	The relevant period is three years (if assessed by SARS) or five years (if self-assessed) from the later of the date of the assessment or the erroneous payment - s190(4) of the TAA - rather than from the end of the year of assessment.	(2)
9	TRUE	s99(1)(*d*) of the TAA.	(2)
10	FALSE	Unless the Commissioner is satisfied that the court order was obtained by fraud, misrepresentation or non-disclosure of material facts - s99(2) of the TAA.	(2)
		The Commissioner may also extend the period before the expiry thereof, by taking into account the circumstances listed in s99(3).	
			(20)

SOLUTION 14.4

Mrs South

For the purposes of s7 it is necessary to establish whether the income is a consequence of a donation, settlement or disposition.

- The R3 million of cash was donated to the trust and any consequential income is therefore subject to s7. (1)
- The sale of the flats is a disposition. In terms of the *Woulidge* principle it is necessary to determine the degree of the generosity. Had the trust borrowed the money to buy the flats it would have paid interest of R1 million (10% of R10 million). Of the rental income of R1.5 million, R1 million is a consequence of the disposition, i.e. two-thirds of the income. Thus, two-thirds of the rental income is potentially attributable to the donor. (2)

1. **Mrs South**

Income vested – s25B			600 000	(1)
Amount accruing to Adrian – attributed to Mrs South i.t.o. s7(8)				
Interest	300 000 × $^1/_3$	100 000		(1)
Rental	1 500 000 × $^1/_3$ × $^2/_3$	333 333		(1)
			433 333	
Amount accruing to Brian - attributed to Mrs South i.t.o. s7(3). Same as above.			433 333	(1)
less interest exemption	s10(1)(*i*), below 65 years		(23 800)	(1)
Taxable income			1 442 867	

2. **Adrian**

Rental income	500 000 × ⅓	166 667	(1)
Taxable income		166 667	

The interest of R100 000 and two thirds of the rental is deemed to be received by Mrs South and is therefore attributable to her.

SOLUTION 14.4 continued

Although the wording of s7(8) differs from the other donor provisions, the heading of s7 seems to indicate that the intention of the legislature is for this section to be a deeming provision. As Mrs South will be taxed on the rental income of Adrian, it is submitted that SARS will not tax this amount in the hands of the son as well, otherwise this would result in economic double taxation.

3. **Brian**

Rental income	500 000 × ⅓	166 667	(1)
Taxable income		166 667	

The interest of R100 000 and two thirds of the rental is deemed to be received by Mrs South and is therefore attributable to her.

4. **Trust**

Taxable income	Rnil	(1)

The full R1.8 million has been taxed in the hands of the beneficiaries and no amount is taxed in the trust.

(11)

CHAPTER 15: INTEGRATED QUESTIONS

Index to sections

Question	Sections	Grade	
Question 15.1	Corporate rules – s45	***	
Question 15.2	s8(4)(a); s10(1)(k), s11(o); s12C; s22; s24I; s24J; s64B, Eighth Schedule (incl. para 19,43 and 66)	***	S
Question 15.3	Employment, partnership, investments, personal service provider	***	
Question 15.4	Personal service provider, small business corporation, s12E, partnership	***	
Question 15.5	Second, Seventh and Eighth Schedules, s7(8), s25	***	S
Question 15.6	Second and Seventh Schedules, s9D, dividends, trusts, s6*quat*	***	S
Question 15.7	Case law, corporate rules s42, s80A–80L, s103(2)	***	
Question 15.8	Second, Seventh and Eighth Schedules, trusts	***	
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Question 15.10	s6*quat*, s9D, s11(a), s11(i), s11(j), s11(*l*), s11(o), s11D, s12C, s12H, s13, s13*quin*, s20B, s22, s23H, s23J, s24I, s24J, s24M, Fourth and Eighth Schedules, VAT	***	
Question 15.11	Individual, s8(1), s11(k), s18, s18A, s22, s24I, Second, Seventh and Eighth Schedules, VAT, trusts	***	
Question 15.12	s19, s20, s31, s103(2)	***	
Question 15.13	Estate planning and estate duty, s8, s12C, s24I, Eighth Schedule, s64E, VAT	***	
Question 15.14	Trusts, s7(5), s7(8), Eighth Schedule, deceased estates	***	
Question 15.15	GI, s6*quat*, s6*quin*, s8(4), s9D, s10(1)(k), s10B, s11(a), s11(i), s12C, s22, Eighth Schedule, liquidation dividends	***	
Question 15.16	GI, s8(1)(a)(i), s10(1)(i), s10(1)(k), s11(a), s22, s23(k), s64E, Fourth Schedule personal service provider definition, Seventh Schedule para 7	**	
Question 15.17	GI, severance benefits, s8(4)(k), s10(1)(i), s11(a), s11(e), s11(k), s11A, s12E, small business corporation, s18, s42, Fourth Schedule, Seventh Schedule	***	
Question 15.18	Trusts, s7, s25B, s10(h), s10(1)(i), s10(1)(k), s18A, donations tax, Eighth Schedule, estate duty (SAIT adapted)	***	
Question 15.19	GI, s11(a), s12H	**	

QUESTION 15.1 **(102 Marks)**

Sellit (Pty) Ltd and Buyit (Pty) Ltd are both 100% subsidiaries of Hold Ltd. All companies have February year-ends. All companies are South African residents.

Sellit has the following assets at 30 June 2017:

	Cost	Book value	Tax value	Open market value
Land (vacant)	1 000 000	1 000 000	1 000 000	3 000 000
Factory building	2 000 000	1 700 000	1 800 000	6 000 000
Land on which factory is situated	500 000	500 000	500 000	1 000 000
Machinery	5 000 000	2 500 000	2 000 000	4 000 000
Trading stock	3 000 000	3 000 000	2 800 000	3 500 000

Apart from trading stock the assets were all acquired on 1 January 2016.

Hold Ltd has decided that Sellit should sell all of its assets to Buyit on 30 June 2017. The sale will be on loan account.

YOU ARE REQUIRED TO:

1. Explain whether the companies are a group of companies. (3 Marks)
2. Explain whether the provisions of section 45 could apply and if so, explain the tax consequences thereof. (11 Marks)
3. Assuming that section 45 DOES NOT apply (or the parties elect not to apply it) and that the tax values are as above at the disposal date, calculate the VAT and income tax effects of the sale of the assets for both Sellit and Buyit if the assets are sold for:
   a. Their book values
   b. Their tax values
   c Their market values (58 marks)
4. Assuming that section 45 DOES apply AND that the tax value does not take into account the current year allowances (where applicable), calculate the VAT and income tax effects for Sellit and Buyit if the assets are sold for:
   a. Their book values
   b. Their market values (11 Marks)
5. If section 45 does apply and the assets are sold for market value, calculate the income tax payable for Buyit if the vacant land and the machinery are sold to independent third parties for a selling price 20% higher than their market values on 30 June 2017, assuming that the sale to the third party is made on:
   a. 30 June 2018
   b. 30 June 2019

   Assume in both cases that the company has an assessed loss for the year of R5 million before taking these transactions into account. (19 Marks)

QUESTION 15.2 (Solution at end of chapter) (60 Marks)

'Spectrum Interferometers (Pty) Ltd' (Spectrum) is a resident company that manufactures interferometers, being instruments that rely upon the interference of electromagnetic waves. The Commissioner for the South African Revenue Service (SARS) is satisfied that this process is one of manufacture for the purposes of the Income Tax Act. The company has a financial year ending on 31 March.

Due to technological advances, with which the company could not keep pace, the sole shareholder of the company, Michael Optic, decided to voluntarily liquidate the company. The company ceased trading on 31 May 2016. The final (and only) liquidation distribution was paid on 28 February 2017 and on that day the liquidator confirmed in writing that no further distributions were to be expected.

Data extracted from the company's balance sheet, notes and fixed asset register at 31 March 2016 reflected the following (without comparatives):

	Note	**R**
Capital	1	12 000 000
Retained earnings		23 849 653
Investments		9 000 000
Machinery	2	4 000 000
Inventories	3	7 100 000
Accounts receivable		6 000 000

	Note	R
Cash		14 000 000
Accounts payable		1 500 000
Other liabilities		2 750 347

Notes

1. The capital at 31 December 2010 comprised R5 000 000 share capital and share premium. In addition, the capital account held R4 000 000 capitalised profits from revenue reserves. On 3 January 2016, the shareholder subscribed for equity shares amounting to R3 000 000 to fund a new machine (see below). These new shares are included in the capital in the extracts above.

2. Machinery had been bought from local suppliers.
   a. Machine A had been purchased (new) on terms. The agreement stipulated that 60 monthly payments of R20 000 had to be made together with a non-refundable deposit of R200 000 and a final payment of R1 600 000. The cash cost of the machine (including VAT) would have been R1 642 500. The yield to maturity is 1.5% per month. The contract began on 1 January 2016 with payments at the end of each month. The debt (matching the 'adjusted initial amount' per section 24J at 31 March 2016) is included in 'other liabilities' above. On 31 May 2016, a settlement payment of R1 444 000 was paid.
   b. Machine B replaced Machine Z in December 2015 and was immediately brought into use. This was a cash acquisition. Machine B was acquired (new) at a cost of R3 000 000 (excluding VAT) utilising the proceeds from the disposal of machine Z. Machine Z had previously been acquired (new) for R1 450 000 (excluding VAT) on 17 May 2013 and was sold for $87 000 (excluding VAT) on 10 December 2015. The payment for machine B was made immediately.

      At that date of disposal of machine Z, the applicable legislation required that companies translate foreign proceeds at spot in determining recoupments and capital gains.

3. Inventories on hand include goods acquired for $100 000 at spot of R10.66 to the Dollar (on 29 March 2016). The debt owing at year-end was reflected at the rand value of inventories and was settled on 12 April 2016. The debt is included with the 'other liabilities' above.

Additional information

1. The company last declared a dividend in 2010. No dividends have been received on investment holdings since that date. Michael Optic had originally bought the shares in Spectrum from the previous shareholders at a total cost of R28 million.

2. In April 2016, Spectrum acquired further raw materials from offshore suppliers. The goods cost $75 000 on 5 April 2016. The company was concerned about rising exchange rates and took out a forward exchange contract to hedge half the debt at R10.767 to the Dollar. The company paid for the goods on 30 May 2016.

3. Machine A was sold for R1.45 million (excluding VAT) and machine B was sold for R1 million (excluding VAT).

4. All inventories were sold for R15 million (excluding VAT).

5. The VAT liability at 31 March 2016 had been settled.

6. The investments in companies were distributed to Michael as an *in specie* dividend on 29 April 2016. The market value of the investments was R13 000 000 on that date.

7. By 31 May 2016, all accounts receivable were received and all accounts payable were paid. You may assume that the liabilities at 31 March 2016 have been determined for accounting purposes on the same basis as for income tax purposes.

8. As the trading period ended and the liquidator settled all income tax liabilities with SARS prior to the first provisional payment being due, no provisional tax was paid. The company had no other income tax credits.

Spot exchange rates at the relevant dates are as follows:

Date	$1 = R
10 December 2015	9.0990
29 March 2016	9.6600
31 March 2016	9.5286
5 April 2016	9.5653
12 April 2016	9.7627
30 May 2016	9.8822
31 May 2016	9.9313

Average exchange rate for the year ended 31 March 2016 was $1 = R9.467 and for the period 1 April 2016 to 31 May 2016 is $1 = R9.775.

YOU ARE REQUIRED TO:

1. Calculate, providing reasons to justify any decisions, the income tax payable by Spectrum Interferometers (Pty) Ltd for the period of assessment 1 April 2016 to 28 February2017. (39 Marks)
2. Calculate the dividends tax payable by Spectrum Interferometers (Pty) Ltd in its own right and/or withheld and payable to SARS on behalf of Michael Optic, up to and including the liquidation dividend. (15 Marks)
3. Calculate the income tax effects for Michael Optic for the year of assessment ended 28 February 2017. (6 Marks)

QUESTION 15.3 **(27 Marks)**

Mrs Jasmine Abrahams, a South African resident, is employed by a large company in Cape Town as a bookkeeper. Mrs Abrahams is also an equal partner, with her sister Rose Alam, in a business that designs and produces women's clothing and accessories. The following information relates to Mrs Abrahams' year of assessment ended 28 February 2017.

Employment

– Cash salary R120 000
– Travel allowance R51 563
  Mrs Abrahams travels to the bank every day to conduct business for her employer. She uses her own car and is paid a travel allowance. Mrs Abrahams' car is a 2013 Mazda, which cost her R159 600 (excluding VAT). Mrs Abrahams does not keep a record of her business mileage. During the period 1 March 2016 to 28 February 2017 the car travelled a total distance of 36 000 kilometres.
– Entertainment allowance R10 000
  Mrs Abraham's employer gives her R10 000 at the commencement of every year to cover any expenditure she may incur on entertaining clients of the business. She is not required to account to her employer for such expenditure. During the year of assessment Mrs Abrahams incurred expenditure of R6 600 on entertainment.

– Consumables allowance R5 000
Mrs Abrahams sometimes does work at home, where she uses her own computer equipment. Her employer pays her R5 000 to cover the costs of paper, printer cartridges, etc. She is not required to account for such expenditure. During the year of assessment, she spent R3 800 on paper and cartridges.

In addition to the cash receipts above, Mrs Abrahams also received the following employment benefits:

– A non-contributory medical aid fund benefit
Mrs Abrahams is the member of the fund and her husband John is a dependant. Her employer contributes R2 000 per month to the fund. Mrs Abrahams did not incur any medical expenses that were not covered by the fund during the current year of assessment.
– A non-contributory provident fund
The provident fund is a defined contribution fund. Contributions made by her employer to the fund in respect of Mrs Abraham's membership are R1 500 per month.
– Lunch in a staff canteen
The employer provides a daily meal in the office canteen. It costs the employer R20 to provide each meal and staff members are only required to pay R5 per meal towards this cost.
– Overseas holiday
Although it is not the practice of the employer to provide such a benefit, the management decided to acknowledge Mrs Abrahams' contribution to the firm by paying for a holiday for her and her husband. The trip cost the employer R40 000, being R22 000 for two air tickets to London and R18 000 for hotel accommodation.

Partnership

Jasmine and Rose share equally in the profits of the partnership, which operates a business named 'Add Dress'. Jasmine had lent R100 000 to the partnership and is paid interest of R12 000 *per annum*. Rose, who runs the business, is paid a salary of R60 000 *per annum*. In addition, the partnership pays contributions of R20 000 *per annum* to a retirement annuity fund (RAF) of which Rose is a member. Jasmine is not a member of the RAF.

The income statement of the partnership for the year ended 28 February 2017 is as follows:

	R
Sales	500 000
Cost of sales	(100 000)
Gross profit	400 000
less	
Salaries: – Rose	(60 000)
– other employees	(130 000)
Rent of premises	(50 000)
Sundry expenses (all tax deductible)	(30 000)
Interest paid to Jasmine	(12 000)
RAF contributions (Rose)	(20 000)
Net profit	98 000

Other income and expenditure

During the year ended 28 February 2017 Jasmine had the following other income and expenditure:

– Dividends:
From SA listed companies (net of dividends tax withheld) R3 000

– Rent R50 000
Jasmine owns the premises in which 'Add Dress' conducts its business operations.
Expenditure in respect of this premises was as follows:
Property rates R6 000
Insurance premium R3 000

Repairs R16 000

The repairs were carried out following a burglary. The door and a window were replaced at a cost of R4 000. The remaining R12 000 was spent installing a security system, which was now considered necessary. The alarm was installed on 1 September 2016.

– RAF contributions R16 000

Jasmine contributes this amount annually to a RAF, which she joined five years ago.

The Commissioner for SARS allows section 11(e) wear and tear over five years in respect of all qualifying assets. The building that Jasmine rents to Add Dress does not qualify for any building allowances.

YOU ARE REQUIRED TO:

1. Calculate Jasmine Abrahams' tax liability for the year ended 28 February 2017, ignoring any tax credits that may have arisen (e.g. employees' tax). (26 Marks)
2. If Jasmine were to interpose a company between her and her employer (without changing the work she performs), discuss the normal tax implications for that company. Jasmine would be the sole member and employee of the company. (6 Marks)

QUESTION 15.4 (25 Marks)

Marie, Claire and Joy, aged 45, 42 and 50 respectively, are partners in an architectural practice, trading as 'MCJ Architectural Services' (MCJ). They share profits and losses in the ratio 40%, 40% and 20% respectively. They have no other business interests. MCJ provides services to a wide range of clients and does not have any regular or major clients. Besides the partners, it presently employs four architectural staff and a receptionist. Its total income is approximately R7 million *per annum*.

The partners are considering selling their partnership interests to a private company, which would be called MCJ (Pty) Ltd. The ordinary shares in the company would be held in the same proportions as the partners' profit-sharing ratios in the partnership. The private company will continue to run the business along the same lines and with the same staff as the partnership, except insofar as MCJ Marketing (Pty) Ltd is concerned (refer below). It is anticipated that the total income of MCJ (Pty) Ltd will be R8 million *per annum*.

A second company, MCJ Marketing (Pty) Ltd would also be set up, with Joy's husband, Alan, as the sole shareholder. Alan has no other business interests. The company's sole object would be to provide marketing services to MCJ (Pty) Ltd. Joy would be its only employee. It is anticipated that the total income of MCJ Marketing (Pty) Ltd will be R1 million *per annum*.

An independent valuation has placed the current value of the partnership at R6 million. This valuation comprises goodwill of R4 million, cash in the bank of R1 million and office equipment of R1 million. There are no partnership liabilities.

The partnership was started during 2013, when the partners each contributed R500 000 in order to buy office equipment that cost R800 000 (and currently has a tax value of R200 000) and to fund running expenses. Besides drawing market-related salaries from the partnership, the partners have not drawn any profits out of the partnership.

The partnership interest would be sold to MCJ (Pty) Ltd on interest-free loan for R6 million (allocated to assets as per the valuation above). The sale would be a zero-rated transaction for VAT purposes. Over time the partners would draw down on their loan accounts to pay off their personal bonds and would thereafter probably invest the balance.

YOU ARE REQUIRED TO: Advise the partners of what the tax implications would most likely be for them and the companies, referred to in the question, if they were to implement the above structure. Ignore VAT, donations tax and estate duty.

QUESTION 15.5 (Solution at end of chapter) (28 Marks)

Jack Twosun died on 31 May 2016. He was 56 years of age and had been fairly active up until his death. He was always considered to be a South African resident.

Jack had worked for Camper-Nicholson, a boat-building company, until his death. He had held the position of managing director for the past six years.

On his death the pension fund of which he had been a member for 30 years paid out a lump sum of R490 000 to his wife Mary. The balance of R1 million in the fund was to be paid out to Mary as a pension annuity of R5 000 per month from June 2016. Contributions not allowed as a section 11(k) deduction up to 29 February 2016 amounted to R9 200. Jack had for the last six years contributed 8% of his cash salary to the fund.

Jack's cash salary for the last four years had remained static at R25 000 per month so that, in the event of his retirement or death, Camper-Nicholson would pay out a deferred compensation amount of R510 000.

Jack had the use of a Mercedes as a company car until his death. Mary was given the car, which had a market value of R200 000 on 31 May, together with R310 000 cash, *in lieu* of the R510 000 amount payable on Jack's death. The Mercedes had cost R387 600 (including VAT) at the date of first use by Jack two years previously. The Mercedes came standard with a five-year maintenance plan, and the company paid all fuel costs.

In addition to the pension fund pay-out, Jack had belonged to a retirement annuity fund. This fund paid out an amount of R400 000 on his death. All his previous contributions to the retirement annuity fund had qualified for deduction in terms of the old section 11(n). He did not make any contributions in the current year of assessment.

Jack was entitled to use the yachting facilities of Camper-Nicholson for repairs to and mooring of his private yacht. This was available to all directors of the company and was valued at R800 per month. Jack made use of these for five days in the month of March.

Jack received an entertainment allowance of R2 000 per month, as he was required to entertain customers. He did not have to account to his employer for his expenditure and spent R500 on entertainment in the three months to 31 May 2016.

In 1997, Jack had formed a trust in the United Kingdom with money inherited from his late father, who was always a resident of the United Kingdom. Jack donated the cash inheritance of R850 000 to the trust and the trustees (being himself, his son Anthony and a UK lawyer), invested this in interest-bearing bonds and shares in the United Kingdom. No shareholding is greater than 10% of the total equity shares in issue.

Jack's two major children, Anthony and Sheila, are vested capital beneficiaries in equal shares and his widowed mother Marge is an income beneficiary for a fixed sum. The trustees may pay excess income to the two children at their discretion. Anthony and Marge are both residents of the United Kingdom and Sheila is a resident of South Africa. The trust will terminate on the death of Marge.

The income and distributions of the trust for the year of assessment ended 28 February 2017 translated to Rands are as follows:

	Interest	**Dividends**
Income to 31 May 2016	12 000	5 200
Income after 31 May 2016	34 500	8 200
Distributions (*pro rata* out of dividends and interest)	Anthony	Sheila
1 May 2016	2 000	2 000
1 September 2016	4 000	4 000

Marge was paid an annuity of R3 750 per month throughout the year.
Assume that the dividends are net of withholdings tax.

Accumulated income in the trust at 1 March 2016 was R4 500.

Jack also received interest from South African bank accounts of R5 200 and dividends on SA shares of R520 up till the date of death.

Jack's assets at 31 May 2016 were as follows:

	Cost	**Market value 31 May 2016**
Domestic dwelling (one hectare), purchased in November 2014 (This was left to Mary.)	2 500 000	4 500 000
Shares in listed SA companies all purchased after 1 October 2001	400 000	300 000
Furniture and personal effects	120 000	110 000
Cash in bank	250 000	250 000
Private yacht (11 metres)	750 000	500 000

All assets except the domestic dwelling and furniture, which were left to his wife Mary, were left to his two children in equal shares.

On winding up the estate the executor, on instruction from the heirs, sold the SA shares for R350 000 and the yacht for R510 000 on 30 September 2016. The proceeds were distributed to Anthony and Sheila in equal shares.

The estate was wound up on 28 February 2017.

YOU ARE REQUIRED TO:

1. Calculate the taxable income of Jack Twosun for the period of assessment ended 31 May 2016.
2. Calculate the taxable income of the estate late Jack Twosun for the period ended 28 February 2017.

QUESTION 15.6 (Solution at end of chapter) (46 Marks)

Peter Bessick, aged 58, is a qualified actuary. He is a South African resident, married out of community of property to Natalie, also a South African resident. The following information relates to his 2017 year of assessment.

Peter retired from Northern Life on 30 June 2016. His employment at Northern Life had commenced in March 2005. On 30 June 2016, he also retired from the Northern Life Pension Fund. Contributions by Peter to the Northern Life Pension Fund that had not been deducted in terms of section 11(k) amounted to R42 000 at 1 March 2016.

On 1 March 2016 Northern Life allowed Peter to take home one of its laptop computers for Matthew, Peter's son, to use for his school work. Northern Life was renting this computer on an operating lease at R2 000 (including VAT) per month. The market value of the computer on 1 March 2016 was R13 000 (including VAT). When Peter retired, he returned the computer to Northern Life.

Peter also received a Rolex watch, with a market value of R50 000, as a long service award on retirement. Northern Life had purchased this watch at a cost of R40 000 (excluding VAT). This was the first long service award that Peter had ever received.

Peter also had the following income and expenses during his 2017 year of assessment:

	R
Salary (R70 000 per month)	280 000
Pension contributions (8% of salary)	22 400
Lump sum from pension fund	6 000 000
Royalty income (net, after withholdings tax)	380 000

The royalty income relates to the rights to a software programme that Peter developed in South Africa in 2006. The intellectual property is used solely by an insurance company in the USA. The withholdings tax is applied at the rate of 5% on payments made to Peter by the company in the USA.

On 1 March 2015, Peter ceded his right to R50 000 per year of South African interest income to his sister, Jayne, aged 50, for three years. Jayne was starting her own business and needed monthly income for this period.

Peter and Natalie are trustees of 'The Onion's Trust', established in Jersey. The trust has three other trustees, who are all residents of Jersey. The trust's place of effective management is in Jersey and it has a February year-end. The beneficiaries of the trust are Peter, Natalie and their two children, Matthew, aged ten and David, aged 21. David is working in the UK and is not a South African resident. During his 2016 year of assessment Peter had donated R2 million to the trust. The trust acquired several investments using this donation, as set out below.

1. The trust acquired a rental property in South Africa, using R1 million of the donation and the balance by way of a bond from Investsure Bank (South Africa). The property cost R2.5 million and was acquired on 1 September 2015.

   Since that date the property has produced rental income of R12 000 per month. Bond interest amounted to R30 000 in total and other deductible revenue expenses were R15 000 for the trust's 2016 year of assessment.

   The trust earned rental income of R36 000 and incurred bond interest of R20 000 and other deductible revenue expenses of R4 000 from 1 March 2016 to 31 May 2016. On this date the property was sold for R3.2 million. The bond balance was R1.4 million and was settled using the proceeds from the sale. Agent's commission amounted to R200 000. You may assume that section 35A is not applicable.

   On 15 June 2016, the trustees decided to distribute the net proceeds from the sale of the property, as well as the net rental income for the 2016 year of assessment and the current year up to the date of sale, to Natalie and Matthew in equal proportions. For the distributions to Natalie and Matthew you may assume that the CSARS is satisfied that the distributions are not being made with the intent to avoid taxation.

2. The trust holds an 8% shareholding in Sunny Horizons LLC, a company registered in the UK, acquired using the remaining R1 million of the donation. Sunny Horizons does not conduct any transactions in South Africa. Sunny Horizons declared a net dividend of £4 500 (net of a 10%

withholdings tax) to the trust in June 2016. The trust distributed this dividend to David in August 2016. The remaining shares in Sunny Horizons LLC are held by non-residents.

Peter also holds 15% of the shares in Gold Dust Ltd, a company registered in Jersey. A total of 60% of the shares in Gold Dust are held by South African residents, who are not connected persons in relation to each other or to Peter. Gold Dust holds 90% of the shares in Silver Linings Ltd, a company registered in Guernsey (which is part of the Channel Islands, as is Jersey). Both of these companies were incorporated on 1 January 2016, the date on which Peter acquired his shareholding in Gold Dust Ltd. The abridged income statements of the two companies for their financial years ended 31 December 2016 are as follows:

Silver Linings Ltd	**Pounds**	**Gold Dust Ltd**	**Pounds**
Pre-tax profit	50 000	Pre-tax profit (including dividends)	100 000
Income taxes	(10 000)	Income taxes	(30 000)
After tax profit	40 000	After tax profit	70 000
Dividend declared 31/12/2016	20 000	Dividend declared 31/12/2016	35 000
		Withholdings tax	(3 500)
		Net dividend	31 500

Peter's average rate of exchange during his 2017 year of assessment was £1 = R15. The average rate of exchange of the companies for their 2016 financial year was £1 = R14. Where applicable, Peter chooses to apply the average exchange rate.

You may assume that the further proviso to section 9D(2A) does not apply to either company.

YOU ARE REQUIRED TO: Calculate Peter's tax liability for his 2017 year of assessment. Assume that Peter has elected to apply the average rate of exchange in terms of section 25D of the Income Tax Act wherever applicable. Peter does not apply any other elective provisions.

QUESTION 15.7 **(55 Marks)**

PART A (13 Marks)

'Sopwith (Pty) Ltd' (Sopwith) provides the following information relevant to its year of assessment ended 30 June 2017:

	Note	**R**
Other trading income		1 500 000
Interest income	1	480 000
Dividends from SA resident companies		120 000
Fixed deposit charges	1	(2 500)
Management fees	2	(30 000)

Notes

1. The interest income relates to a sum of R7 million which was placed on a one-year fixed deposit.
2. The management fees are charged in respect of investment advice given by financial advisors relating to Sopwith's investment in SA resident companies and its interest-bearing investment. Approximately 80% of the advisors' time spent in giving the advice relates to the composition of Sopwith's share portfolio, while the remainder of the time relates to Sopwith's interest-bearing investment.

YOU ARE REQUIRED TO: Calculate Sopwith's taxable income for the year of assessment ended 30 June 2017. Provide a full discussion of the principles applied in the calculation. Cite any cases relevant to your discussion.

PART B (9 Marks)

'Inkwenkwe Wines (Pty) Ltd' (Inkwenkwe) is a South African resident and wholly owned subsidiary of 'New World Wines Ltd' (New World), a company resident in Australia. New World insists on annual dividends being paid by Inkwenkwe. The dividends consist of all of Inkwenkwe's after tax profits for the previous financial year (ending 31 August), provided that Inkwenkwe's liquidity and solvency position before and after the dividend complies with the Companies Act.

In respect of the financial year ended 31 August 2015, Inkwenkwe earned after-tax profits of R25 million and it is liquid and solvent. It has sufficient cash to pay the dividend in full and to remain solvent and liquid. However, Inkwenkwe is planning to expand its operations in the short term and estimates that it will require R10 million to finance this expansion.

Therefore, it has been decided that a full dividend of R25 million will be declared, payable from cash resources and that New World will provide Inkwenkwe with an interest-bearing loan to finance the expansion. Also, it has been decided that Inkwenkwe will transfer the net amount, being the balance of the dividend (after dividends tax) less the R10 million loan, to New World. Inkwenkwe will therefore transfer R11.25 million to New World and retain the balance of R10 million as an interest-bearing loan from New World.

YOU ARE REQUIRED TO: State on which grounds the Commissioner for SARS may argue that the interest on the loan may not be deductible in computing Inkwenkwe's income tax liability.

Discuss whether or not you agree that the interest on the loan is not deductible. Cite any cases relevant to your discussion.

PART C (13 Marks)

'Southern Star (Pty) Ltd' (Southern Star) is a South African resident and a wholly owned subsidiary of 'Northern Lights Ltd' (Northern Lights), a company resident in the USA. Southern Star is a profitable trading company. Certain legislation in the USA compels USA companies with subsidiaries or associates operating in third-world countries to participate in social upliftment programmes within the communities in which they operate. These upliftment programmes take the following forms:

1. Donations to organisations which are not approved public benefit organisations but are considered worthy organisations.
2. Providing support for small businesses.

Southern Star incurs expenditure in respect of each of the above upliftment programmes in order to fulfil this legal requirement.

YOU ARE REQUIRED TO: State on which grounds the Commissioner for SARS may argue that expenditure in respect of the upliftment programmes may not be deductible in computing Southern Star's income tax liability.

Discuss whether or not you agree that the expenditure is not deductible. Cite any cases relevant to your discussion.

PART D (7 Marks)

'H Ltd' (H) holds all of the equity share capital in 'S (Pty) Ltd' (S) and 'X (Pty) Ltd' (X). All the companies are South African residents. X owns trading stock with a cost of R5 million and an open market value of R10 million. X sells its trading stock to S in exchange for shares issued by S. The shares have a market value of R9 million. S will treat the trading stock received from X as trading stock in its hands. H, S and X wish to elect any available relief in terms of the 'Corporate rules' contained in section 41 to section 47 of the Income Tax Act. H, S and X are registered VAT vendors. Section 45 does not apply.

YOU ARE REQUIRED TO: State which corporate rule/s may be applicable to the above sale of trading stock.

ONLY FOR X: Set out in point form the tax effects resulting from the application of the corporate rule/s identified in your answer above. Your discussion should contain reference to any specific anti-avoidance rules that may be applied.

PART E (13 Marks)

Mrs Hagar Toms, a wealthy South African resident, is the sole shareholder of a South African resident company. Hagar has a large money market deposit at a financial institution in South Africa and is subject to income tax on the interest earned.

The company owns a number of high value residential properties in South Africa that it lets out. It has an assessed loss from these renting activities.

On 31 May 2016 Hagar donated the money market deposit to the company. For its financial year ended 30 June 2017, the company earned net taxable income, primarily as a result of the addition of the interest income on the money market deposit to its existing renting activities. It set-off its assessed loss against its taxable income from rental activities and its interest income. The company then declared a dividend to Hagar.

YOU ARE REQUIRED TO: State all of the anti-avoidance provisions of the Income Tax Act that may be applicable to the facts.

List, in point form, the requirements that would need to be met in order for the Commissioner to successfully apply each of the provisions you have identified and briefly discuss whether or not the provisions could be applied.

QUESTION 15.8 **(49 Marks)**

Mario Antonetti, aged 60, was employed as the financial manager of 'Oaktree Interiors (Pty) Ltd' (Oaktree) until his retirement on 31 October 2016. Mario is married out of community of property to Evelyn, aged 53 and has two sons, Bradley aged 16 and Jason aged 14. During the period from 1 March to 31 October 2016, the following information relates to his employment with Oaktree:

1. He earned a salary of R40 000 per month. In terms of the rules of the pension fund, Oaktree contributed 10% of this amount into the company's pension fund and Mario contributed 8%. At 1 March 2016 Mario had made contributions totalling R220 000 that had not been allowed in terms of section 11(k).

2. Oaktree contributed to Mario's medical aid at the rate of R1 200 per month. Mario contributed the same amount. Evelyn, Bradley and Jason are registered as dependants on Mario's medical aid. After Mario's retirement, Oaktree continued to contribute to the medical aid at the full rate of R2 400 per month. Mario no longer contributed. Neither Mario nor his dependants are handicapped. Mario paid medical costs of R25 000 for an operation for Evelyn. The medical aid refunded R13 000 of this amount.

3. Mario received a travel allowance of R10 000 per month in respect of an MGB roadster, which cost Mario R150 000 when he bought it from a non-vendor. Mario keeps a detailed logbook in respect of this car. For the period from 1 March to 31 October 2016 he travelled a total of 9 333 business kilometres in the car. Mario was responsible for all running costs.

4. Oaktree gave Mario the use of a BMW 320i with a cost of R260 000 (including VAT) from 1 January 2016. When Mario retired, Oaktree continued to give him the use of this car without formally transferring the ownership to him. Mario had kept a logbook for this car and had

travelled 3 000 kilometres on business and 7 000 kilometres for private purposes. Oaktree paid all the running costs, excluding maintenance, as the car came standard with a maintenance package.

5. Mario received a lump sum of R3.5 million from the pension fund on his retirement. This was the first lump sum that Mario had ever received. The pension fund received a directive from SARS indicating that there were no disallowed RAF deductions at retirement date.

The following information is also relevant to Mario's 2017 year of assessment:

6. Mario sold the family house in Rondebosch on 1 October 2016 for R6.5 million. The house had been purchased in August 1981 for R410 000, including transfer duty of R10 000. Mario spent R20 000 on building a guest suite in May 2000. The house was not valued at 1 October 2001. The only time that the Antonettis did not reside in the house was from 1 June 2007 to 28 February 2009 when they stayed in rented accommodation.

7. Mario sold a 15-metre yacht for R1.6 million on 20 December 2016. The yacht cost R2 million when it was acquired in 2013.

8. Mario, Evelyn and their two sons are discretionary beneficiaries of the Antonetti Family Trust, established in the Isle of Man. The place of effective management of this trust is also the Isle of Man. The trust holds 100% of the share capital of Alicante (Pty) Ltd, a private company also formed and effectively managed in the Isle of Man. Alicante does not have a 'foreign business establishment'. Alicante and the trust both have a 31 December year-end. On 30 December 2015 Alicante declared a total dividend of 40 000 GBP, out of interest earned in its 2013 financial year. None of this interest arose in South Africa. The dividend was subject to £4 000 withholdings tax in the Isle of Man, paid on the same date. On 15 April 2016, the trust distributed the dividend received to its four beneficiaries in equal proportions.

9. Also on 15 April 2016, the trust distributed foreign interest income of £10 000 to Mario. Withholdings tax of £1 000 was paid by the trust on this income on the same date.

10. Mario contributed R100 000 to a retirement annuity fund on 25 February 2017.

Mario does not have a loan account in the company or the trust (in relation to points (8) and (9) above) and has never made any donations to the company or the trust. He wishes to make use of the average rate for currency conversion wherever possible.

You are to assume that the following exchange rates applied:

Average rate for the period 1 January to 31 December 2015:	£1 = R14.50
Average rate for the period 1 March 2015 to 29 February 2016:	£1 = R15.00
Average rate for the period 1 January to 31 December 2016:	£1 = R16.00
Average rate for the period 1 March 2016 to 28 February2017:	£1 = R16.50
Spot rate on 30 December 2015:	£1 = R17.00

YOU ARE REQUIRED TO:

1. Calculate the tax payable by Mario for his year of assessment ended 28 February 2017. If any amount is not relevant to your calculation, indicate why not. (45 Marks)

2. Discuss what the income tax implications of point (8) above would have been for Mario and the trust if the place of effective management of the trust had, at all times, been South Africa. Consider all relevant years of assessment. (4 Marks)

QUESTION 15.9 **(32 Marks)**

'The Travel Company Ltd' (Travelco) is a company organising tours both locally and offshore. It has a March financial and tax year-end. The following information is relevant for its year ended 31 March 2017. All amounts are exclusive of VAT where appropriate unless otherwise stated.

1. Travelco operates as a franchise of 'The International Travel Company Inc.' (Interco). Interco is registered and effectively managed outside of South Africa. Interco holds shares in all its franchises world-wide, including 10% of the shares of Travelco. Travelco pays Interco a royalty amounting to R1 000 000 *per annum* (on 1 April) for use of the franchise rights.

2. Travelco rents its premises from Rentco. The annual rental is payable in advance each year on 1 December. The annual rental paid on 1 December 2016 was R450 000 (R410 000 on 1 December 2015).

3. Travelco uses ten BizHub machines (a central scanner, printer, fax and email system for document distribution), one in each of its branches around the country. The use of all of these machines was obtained under the same finance lease terms. At the inception of the lease each machine had a market value (and cash consideration) of R79 800 (including VAT). The terms of each lease are: deposit of R20 000 and monthly payments of R2 230 for three years. All leases were entered into before 1 April 2016.

   At the end of each lease, Travelco always purchases the BizHubs at their residual value of R10 000 in terms of the lease (each machine has a market value at the end of the lease amounting to R15 000). Three lease agreements ended on 31 August 2016. On acquisition of the BizHubs at the end of these leases, Travelco immediately sold (in a scheme of profit making) these three BizHubs to Leaseco (a leasing company). The terms of the sale of each machine were: a deposit amounting to R1 000 and two annual payments of R12 000 on each anniversary of the sale (i.e. first payment will be on 31 August 2017). The annual yield to maturity is 17.1%. A cash sale price (including VAT) is R20 000 (per machine). The Commissioner applied section 24 on a gross profit basis.

4. One of the very senior managers had resigned from Travelco in December 2015. A comprehensive resignation package was paid, including a restraint of trade. This restraint was to last for two years and was settled in a single lump sum payment of R1.5 million on 15 December 2015. In July 2016 it was discovered that the manager was working for a competitor in breach of the restraint agreement. The manager was successfully sued by Travelco and the settlement reached resulted in the manager refunding R1.3 million of the restraint payment in January 2017.

YOU ARE REQUIRED TO: Calculate and give reasons for the effects that the information in points (1) to (4) above will have on Travelco's taxable income for the year ended 31 March 2017.

QUESTION 15.10 **(49 Marks)**

Global Baby Ltd is a South African resident company with a March year-end. The company manufactures and imports various baby products for local sale or export. The company is a value-added tax (VAT) vendor rendering monthly returns.

An extract from the financial records has been drawn for the year ended 31 March 2017 and is as follows:

	Note	Debits (R)	Credits (R)
Sales – local			43 000 000
Sales – export			37 000 000
Cost of sales (comprising):			
Purchases		22 000 000	
Opening stock		7 000 000	
Closing stock	1		14 000 000
Other income			
Dividend	2		451 982
Certified emission reduction receipt	3		420 000
Profit on sale of asset	4		240 000
Expenditure			
Depreciation	4	3 500 000	
Bad debts	5	320 000	
Salaries and wages	6	10 450 000	
Other deductible expenses	7	4 250 000	
Unadjusted net profit		47 591 982	
Balances		**95 111 982**	**95 111 982**

Notes

1. The closing stock excludes stock ordered on 1 March 2017 from Peg-Perego (a company in the USA). The stock was ordered for US$500 000 on 1 March 2017, but was still in an airport hangar in the USA on 31 March 2017. Risk of ownership is only transferred after the goods are loaded on the aircraft. The goods were received on 4 April 2017, but payment was made in full on 31 March 2017. The accountant recorded the acquisition on 31 March 2017 by translating the acquisition price at the spot rate on that date and included such amount in purchases because the expenditure was actually incurred (for the purposes of section 11(a)) by year-end. The customs duties levied on arrival of the stock on 4 April 2017 amounted to R35 000. No account has been taken of the customs duty or VAT. The stock is classified as for 'home consumption' for VAT purposes.

2. A dividend was received from Bambino Ltd, a company registered and operated in Italy, on 15 July 2016, but it had accrued on 1 July 2016. The net dividend of €47,500 received is recorded on the trial balance. Italy levies a withholdings tax on dividends of 5%. Global Baby Ltd holds 15% of the equity shares of this company, which are equivalent to the participation and voting rights in this company. The dividend has been translated at the spot rate on the date of receipt. Bambino Ltd has a net income for section 9D(2A) purposes of €1 million before taxes of €200 000 (representing less than 75% of the SA tax that would be levied on the SA taxable income as if Bambino Ltd had been a resident). Global Baby Ltd had acquired this holding from a non-resident on 1 July 2015. Bambino Ltd has a June year-end. Other SA residents hold 40% of the equity shares of Bambino Ltd (and have done so since the company was formed).

3. The company has a registered 'Clean Development Mechanism' (CDM) project. The receipt is in respect of certified emission reductions.

4. The depreciation figure relates to a number of machines, the details of which are below:
   4.1 Machine A was purchased on 1 June 2015 for R500 000 (including VAT) and is used in the process of manufacture. The purchase price is to be settled by the payment of a deposit of R20 000 and an annual payment of R125 000 for five years, the first payment being on 31 May 2016. The annual yield to maturity is 9.5%. The machine was in use throughout the year. The accountant has processed no entries for the finance charges.

4.2 Machine B was acquired from Baby Holdings Ltd, the majority shareholder of Global Baby Ltd. Baby Holdings Ltd had acquired the machine (used) from a third party in order to dispose of the machine to Global Baby Ltd. Baby Holdings Ltd had paid R100 000 (excluding VAT) for the machine and had sold it to Global Baby Ltd for R120 000 (excluding VAT), when the market value (excluding VAT) was R140 000.

4.3 The company manufactures in one building and operates its administration from another. The manufacturing building was purchased for R15 000 000 (excluding VAT) on 1 November 2006 from a third party. It was purchased as a replacement for the previous premises. The disposal of the previous premises resulted in a calculated recoupment of R2 000 000. The administration building was acquired for 80% use for administration and 20% exclusively for research and development activities. The administration building was built at a cost of R10 000 000 (excluding VAT) and brought into use for both administration and research and development on 1 May 2015. The buildings are not 'plant' as defined. Global Baby Ltd seeks to minimise its tax wherever possible.

4.4 Machine C was sold during the year and was not replaced. The machine had been fully written off for tax and accounting purposes. It had originally been acquired for R250 000 (excluding VAT) and was sold during the year for R240 000 (excluding VAT).

4.5 Machine D was sold in the prior year. As the buyer was a start-up business, it was agreed that the purchase price would be settled by means of the receipt of 10% of the value of the products produced by the machine over five years. The machine had originally cost Global Baby Ltd R500 000 (excluding VAT) and allowances of R200 000 had already been claimed to date of sale. An amount of R180 000 (excluding VAT) was received by Global Baby Ltd from the buyer in respect of the first year's production in the prior tax year. During the current tax year, a further R340 000 (excluding VAT) was received.

5 Bad debts as expensed in the trial balance includes R220 000 of debts classified as bad for the year of assessment as well as the increase in the provision for doubtful debts of R100 000. The Commissioner permits 25% of the qualifying doubtful debts list for deduction purposes. Included in the R220 000 bad debts is a loan of R5 000 made to an employee. The loan was interest free. The R220 000 also includes a debt of R50 000 that was bad in the prior financial year, but omitted from the list accidentally. The accountant has therefore claimed the deduction in the current year.

6 Ten registered learnerships ended on 31 March 2017. All Skills Development Levies Act and SETA requirements have been met. The learnerships are for staff who do not have a matric certificate (i.e. NQF Level 4), to complete high school. The learnerships had been for one year, but only four had been successfully completed, of which one was with a disabled learner. None of the other six unsuccessful learnerships were with disabled learners.

Salaries and wages include the salaries paid to research and development staff in terms of a research and development product recognised by the Minister of Science and Technology. The research and development staff salaries amounted to R890 000.

The Commissioner has declared the 'approved remuneration' to be R8 500 000. Included in salaries and wages are the employer contributions to the company pension fund and the medical aid scheme. The employer contributions amounted to R1 870 000 (being 22% of the approved remuneration).

7 The other expenses include the annual insurance premium for the buildings and machinery. The premium is payable in advance on 1 September each year. The payment made on 1 September 2015 was R1 000 000 and the payment made on 1 September 2016 was R1 250 000. The accountant has apportioned these payments over the periods to which they relate. Apart from the insurance premium, the remaining 'other expenses' are deductible.

Additional information

The company made the two compulsory provisional tax payments which totalled R12 300 000 relating to the 2017 year of assessment.

Table of exchange rates

Date	$1 = x Rand	€1 = x Rand
1 July 2016		9.8407
15 July 2016		9.5154
1 March 2017	6.9264	
31 March 2017	6.8221	
Average exchange rate 1 July 2015 to 30 June 2016	7.2231	9.405
Average exchange rate 1 April 2016 to 31 March 2017	7.1674	9.468

YOU ARE REQUIRED TO: Calculate the normal tax liability (after any tax credits) of Global Baby Ltd for its year of assessment ended 31 March 2017. You must begin your answer with the unadjusted net profit per the financial record extract and supply reasons for each adjustment or, where no adjustment is required, the reason for no adjustment.

QUESTION 15.11 **(51 Marks)**

Zachary Wilmot, aged 50, is married out of community of property to Zelda and has two children, Petrus, aged 14, and Philemon, aged 27. All of these persons are South African residents as defined and are in good health. Philemon works at Sports R Us while Petrus is a scholar.

Zack has two main sources of income: he is employed as the marketing manager of 'Cape Golf Tours (Pty) Ltd' (the company) and he also imports and sells golf equipment for his own account, as a sole trader. He is not a registered VAT vendor. He has provided you, his tax advisor, with the following information relating to his 2017 year of assessment.

	Note	R
Salary	1	120 000
Travel allowance	2	36 000
Commission received		185 000
Sales of golf equipment		420 000
Purchases of golf equipment		240 000
Opening stock of golf equipment	3	70 000
Tax return fees paid	4	3 000
Medical contributions paid by Zack	8	14 500

Notes

1. Zack was a non-contributory member of the company's provident fund, until 30 September 2016, when he opted to cash out of the fund. He received a lump sum from the fund of R260 000 on 3 October 2016. The company had contributed to the fund at the rate of 8% of Zack's salary. Zack did not contribute to the fund.
2. Zack uses a Citi-Golf which cost him R85 000 (including VAT) in 2007. He has kept an accurate logbook of his travel during the year. He travelled a total of 33 000 kilometres in the car during the year, of which 14 000 related to work for the company and 12 500 to his sole trader business.
3. In Zack's 2016 tax return he had written closing stock down from its original cost of R75 000 with the approval of SARS. This stock was all still on hand at the end of February 2017 and due to improvement in market conditions, the market value thereof had increased to R78 000 on

28 February 2017. Zack decided to donate 10% of the stock (by value) to the Cape Association for Homeless Children, a registered public benefit organisation per Part II of the 9th Schedule to the Income Tax Act, which duly issued him with a receipt for income tax purposes. The R70 000 above represents the value before Zack's donation.

4. This amount is what you charged Zack in June 2016 for completing his 2015 income tax return.

5. Zack concluded a contract on 3 January 2017 for the purchase of golf clubs for his business at $1 000. This amount is only payable on 3 March 2017. The goods arrived in South Africa on 15 January 2017 and import duty of R720 was payable. Zack took out an FEC of $500 to partially hedge his debt on 20 January 2017, at a forward rate of $1 = R7.20.

   Ruling spot exchange rates are as follows:

3 January 2017	$1 = R6.95
15 January 2017	$1 = R7.00
28 February2017	$1 = R7.10
3 March 2017	$1 = R7.05
28 February 2017 (3-day forward rate)	$1 = R7.15

   Zack is cautious by nature and does not speculate in foreign currency. None of the amounts relating to these golf clubs are reflected in the information above and none of these items have been sold.

6. In 2015 Zack set up a family trust in Guernsey using his offshore foreign exchange allowance. Zack and two Guernsey residents are the trustees, while Zack, Zelda, Petrus and Philemon are the beneficiaries. The trustees have complete discretion regarding income and capital of the trust.

   Zack donated R4 million to the trust on 1 December 2015. Using these funds, the trust purchased shares in non-resident companies on the same date, which it holds as capital assets. All holdings are less than 10% of the equity shares in these companies. During the trust's year ended 29 February 2016 it received dividends from these companies, the equivalent of R26 000. These amounts were retained in the trust. During June 2016 this amount was paid out equally to all beneficiaries. During July 2016 further dividends, the equivalent of R34 000, accrued to the trust. Half of these dividends were paid out equally to Petrus and Philemon, and the balance was retained in the trust. The decision to vest these dividends in the beneficiaries was made before the dividends were received. During February 2017 the trust sold a parcel of shares that it had acquired for R360 000, for R540 000. R270 000 of the proceeds were paid out equally to Petrus and Philemon (R135 000 each) and the balance was retained in the trust.

7. Zack was a member of a retirement annuity fund to which he had not contributed for a number of years. During the year he paid in R40 000 in the form of contributions to reinstate his membership. He also contributed a further R20 000 relating to the 2017 year of assessment.

8. Zack, Zelda and Petrus are registered as dependants on Zack's medical aid. The company matches Zack's contributions on a Rand-for-Rand basis. Zack also paid medical expenses of R10 000 relating to Petrus during his 2017 year of assessment which were not covered by his medical aid fund.

YOU ARE REQUIRED TO: Calculate Zack's tax payable for his 2017 year of assessment. Show all workings clearly. Deal with each item and if amounts are not deductible or not included in income, this must be stated with reasons.

QUESTION 15.12 **(19 Marks)**

'Aloevale (Pty) Limited' (Aloevale), a resident of South Africa, carries on business as a wholesale distributor of Aloe products. Its operations extend throughout the Republic and Botswana.

For the year of assessment ended 28 February 2017 Aloevale was involved in the following transactions:

1. In its 2014 year of assessment Aloevale purchased a stock of Aloe products for R25 000 (including VAT) from a manufacturer (a VAT vendor) that was closing down. Aloevale paid R15 000 (being 60% of the purchase price) on the date of delivery. For the following three years Aloevale tried unsuccessfully to pay the 40% balance owing. Every cheque posted was returned with 'address no longer valid'. As the debt has now prescribed, Aloevale has written the amount owing back to the income statement in the 2017 year of assessment. Aloevale has a small assessed loss of R1 500 carried forward from the previous year.
2. Alin (Pty) Ltd, a manufacturer of Aloe products who owed Aloevale a large sum of money, was in financial difficulty. On 28 February 2017 Aloevale entered into an agreement with Alin whereby Aloevale would purchase a 55% interest in Alin from the existing members. Alin manufactures its products under a patent agreement that was entered into with an inventor from France. The inventor is not a VAT vendor. Alin had purchased this patent for R42 000 on 1 March 2014. The patent gives Alin the sole right to manufacture specific products in South Africa for ten years. Alin also pays a royalty to the French creator, calculated as a percentage of sales. Royalties of R4 000 and R6 000 on 30 June 2016 and 31 January 2017 respectively were paid to him by Alin. Aloevale is keen to maintain the supply of manufactured products it acquires from Alin and hence found it necessary to acquire an interest in the CC. Alin has a large assessed loss and will therefore not pay tax for some years. On the same date (i.e. 28 February 2017) Aloevale agreed to buy all of Alin's stock on hand, thereby increasing Alin's income and cash flow position for the year of assessment ended 28 February 2017.
3. During January 2017, Aloevale sold products at an agreed price of R600 000 to Frans Lategan, who is a resident of Botswana and who is a 25% shareholder in Aloevale. The products sent to Botswana had a cost of R450 000 and a market value of R700 000, which is considered to be an arm's length price. Frans Lategan acts independently of Aloevale.

YOU ARE REQUIRED TO:

1. Explain and calculate the tax and VAT effects of the write-off of the loan in note (1) for the 2017 year of assessment. (4 Marks)
2. a. Discuss whether Alin or Aloevale are at risk of an attack by CSARS under section 103(2). (6 Marks)
   b. Calculate all the tax effects in the current year of the patent purchased and the royalties paid to the French creator. (4Marks)
3. Calculate all the tax effects of the sale of products to Frans Lategan. If any amount is not relevant to your calculation, indicate why not. (5 Marks)

QUESTION 15.13 **(45 Marks)**

PART A

Byron James, aged 55, is married, out of community of property, to Judith, aged 48. They have three children: Belinda is 24 years old, Michael is 18 and Paul is 13. With the exception of Belinda, who immigrated to Australia with her husband in 2014, they are all South African residents.

For most of his working life, Byron was a senior executive of a major listed company. Six years ago he resigned from corporate life and received a large amount of cash from the exercise of his share options. He invested wisely in property and listed shares and also used a large part of his cash to invest in his own company, 'Jimco (Pty) Ltd' (Jimco). The business, which was established to produce soccer gear and memorabilia ahead of the 2010 Soccer World Cup, has grown substantially and Byron's wealth has increased as a result. The growth is expected to continue and it is not unlikely that Byron will receive favourable offers from large groups interested in acquiring the company.

In July 1991, Byron and Judith established a fully discretionary trust, the JB Trust, for the purchase of their family home in Claremont, Cape Town, which the trust acquired for R1 million by means of an interest-free loan from Byron of the same amount. The beneficiaries of the trust were Byron, Judith and any children or grand-children of theirs. Byron and Judith are the trustees. No other assets have been acquired by the trust and the family still resides in the house.

Byron contacted you recently to obtain some guidance relating to his estate plan. He admits to having been somewhat irresponsible in not addressing this important issue sooner.

The following is a schedule of Byron's major assets as at 30 June 2016:

Asset	Note	Year of acquisition	Cost (R)	Market value at 30 June 2016 (R)
Loan to the JB Trust		1991	1 000 000	1 000 000
Apartment block	1	2013	3 000 000	6 000 000
Holiday house		2012	2 500 000	4 500 000
JSE listed shares	2	2011	4 000 000	9 000 000
Jimco shares	2	2011	5 000 000	15 000 000

Notes

1. The apartment block consists of five identical units (that never qualified for any capital allowances). Byron's mother, who is 75 years old, lives in one of the units. She is totally dependent on Byron.
2. None of the shares are trading stock.

Byron has informed you that the following factors need to be taken into account in considering his estate plan:

1. Judith has no independent source of income.
2. Byron's life is covered by an insurance policy. Judith is the beneficiary and will receive R2 million in the event of Byron's death. All contributions were paid by him.
3. In the event of Byron's death, Judith's lifestyle must be maintained.
4. Byron also wants to ensure that, should he predecease his mother, her accommodation and living expenses willcontinue to be met and she will continue to reside in the apartment she currently occupies.
5. Provision must be made for Michael and Paul's maintenance and the completion of their education.
6. Byron wishes to minimise any capital gains tax and estate duty that may arise on his death.
7. When Byron left corporate employment, he transferred his retirement fund interest into a provident preservation fund. The lump sum that would be paid to his dependants if he died today is R3 200 000. This is the gross income amount, and the tax that would be withheld from the amount has been correctly calculated at R904 500.

In terms of Byron's existing will:

1. The apartment block is bequeathed to a testamentary trust to be set up by his executor for the benefit of Michael and Paul. This is subject to a *usufruct* created on Byron's death, in favour of his mother, for the remainder of her life. The value of the *usufruct* is R751 300 (correctly calculated as R1.2 million × 12% × 5.21727).
2. The Jimco shares are to be sold and R3 000 000 awarded to Belinda. The balance, after meeting any liabilities, is left to Judith.
3. The R1 million loan to the trust and the JSE and foreign shares are bequeathed to the trust.
4. The holiday house is bequeathed to Judith.

5. The residue of the estate is left to Judith.
6. In the event of Judith dying before, or at the same time as Byron, all items left to her are to be awarded in equal shares to their children.

PART B

The auditor of Jimco (which is a VAT vendor) is reviewing the following transactions relating to the year of assessment ended 30 June 2016:

1. On 31 July 2015 the company paid a foreign supplier €10 000 in respect of a new machine ('Machine A') that was acquired on 14 June 2015 and €5 000 for a new machine ('Machine B') that was acquired on 15 July 2015. Both machines were brought into use on 1 August 2015, in a process of manufacturing.
2. Raw materials costing €30 000 were purchased on 10 June 2016. Payment was due to the supplier on 31 August 2016 and a forward exchange contract to purchase €30 000 was entered into on 3 June 2016.
3. It turned out that Machine A was not suitable for its intended purpose. On 15 May 2016 the company agreed to sell the machine to one of its customers in Germany. The machine was delivered to the customer on 20 June 2016 (on which date risk passed to the buyer). In terms of the agreement, €6 000 was payable to Jimco on 15 August 2016 and a further €6 000 would be payable on 15 October 2016, on condition that the machine met certain performance specifications.
4. On 1 February 2016, Jimco lent R250 000 to Byron James, in his capacity as shareholder. The full amount was repaid on 31 May 2016.
5. Trading stock which the company had purchased for R25 000 was distributed to Byron as a dividend *in specie* on 15 June 2016, on which date the market value was R30 000. Byron acquired this stock for his personal use and to give as gifts to his wide circle of friends and acquaintances.

Selected R: € exchange rates are as follows:

Date or period	Type	Rate
14 June 2015	Spot	13.1962
30 June 2015	Spot	13.1263
Year to 30 June 2015	Average	11.4606
15 July 2015	Spot	13.0434
31 July 2015	Spot	13.0294
1 August 2015	Spot	13.1038
15 May 2016	Spot	14.1431
3 June 2016	Rate per FEC	14.5027
10 June 2016	Spot	14.4509
20 June 2016	Spot	14.6086
30 June 2016	Spot	14.4833
Year to 30 June 2016	Average	13.9885
30 June 2016	MRFR for 31 August 2016	14.5243
15 August 2016	Spot	14.3243
31 August 2016	Spot	14.5123
15 October 2016	Spot	14.4842

YOU ARE REQUIRED TO:

PART A

1. List the main tax and financial considerations that Byron should take into account when considering his estate plan. (4 Marks)

2. List the benefits of using the JB Trust as part of the estate plan. (5 Marks)

3. Advise Byron regarding any potential estate duty risks arising from the appointment of the existing trustees of the JB Trust. (2 Marks)

4. Calculate, with reasons where appropriate, the dutiable amount of Byron's estate and the estate duty payable if he died 30 June 2016, on the basis of the information provided and assuming the following:
   - The market values at 30 June 2016 provided by Byron are correct.
   - Any assets disposed of by the executor will realise their market values at 30 June 2016.
   - Byron's income tax liability on 30 June 2016, including the liability arising as a result of his death, is R2 500 000.
   - Byron has only ever been married to Judith. (14 Marks)

PART B

1. Calculate all the effects on Jimco's taxable income for the year of assessment ended 30 June 2016 in respect of the foreign transactions detailed in 1 to 3 of the scenario. You should assume that the company will make any election to which it is entitled so as to minimise its tax liability and that all amounts provided exclude VAT. (15 Marks)

2. Calculate all the tax effects for Jimco in respect of the year of assessment ended 30 June 2016 relating to the transactions with Byron James detailed in 4 and 5 of the scenario. (5 Marks)

QUESTION 15.14 **(45 Marks)**

John Fox was ordinarily resident in South Africa. He died suddenly on 31 October 2016 at the age of 62. He was survived by his wife, Emma, to whom he was married out of community of property and his two major children, Jane, aged 34, and Freddy, aged 30. Jane has been a resident of the United Kingdom since 2006 and Freddy is a South African resident.

In 2009 John had established the 'Fox Family Trust' (the trust), a South African trust that is fully discretionary. At that time, he donated an apartment block situated in Cape Town to the trust that had a market value of R5 000 000. During 2012, John lent the trust R2 000 000 on interest-free loan account to purchase land in order to erect a second apartment block. The land was purchased for R1 600 000 in 2013, but construction had not commenced by the time John died. As at 29 February 2016, the trust had an assessed capital loss of R100 000, which arose when a portion of the apartment block's land was expropriated for purposes of widening a road. The beneficiaries of the trust were Emma, Jane and Freddy, as well as any children of Jane and Freddy. The trustees were John, Emma and John's independent accountant.

At the date of his death John carried on a business as a sole trader designing low-cost housing modules. The designs were sold to local and overseas customers. John was not a VAT vendor. This was the only business John had ever owned and he had not disposed of any of its assets in the past.

The assets of John's design business consisted of a sectional title unit in an office park, that John had purchased second-hand in 2008 for R1 500 000 and a trade mark: 'Modulis'. The sectional title unit did not qualify for any capital allowances. As the unit was too large for John's needs he had rented

half of it to a tenant from the time he had acquired it. The tenant was still renting the portion of the premises when John died.

John acquired his primary residence on 1 November 2004. Before purchasing the sectional title unit for his design business, he used space in his primary residence for the purpose of conducting his trade. This represented 20% of the total floor space and John used it for his trade from the date of acquisition until 30 June 2008.

John's relevant receipts and payments from 1 March 2016 to the date of his death were as follows:

	Note	R
Revenue from sale of designs		750 000
Rental on 50% of sectional title unit	1	70 000
Allowable operating costs		(150 000)
Dividends from A Ltd, a foreign company listed on the JSE	2	21 250
Dividend from B Ltd, a REIT which is a South African resident	2	30 000
Provisional tax paid on 30 August 2016		50 000

Notes

1. Rental of R10 000 a month for the period 1 March 2016 to 30 September 2016 was received and banked. Rental for October 2016 was unpaid as at 31 October 2016.
2. The dividends represent the amounts deposited into John's bank account. Any necessary declarations in terms of section 64G of the Income Tax Act ('the Act') had been supplied by John to the companies paying dividends.

John's assets on 31 October 2016 (all acquired after 1 October 2001)

Asset	**Base cost**	**Market value at date of death**
Primary residence	1 000 000	3 500 000
Sectional title unit	1 500 000	2 500 000
Holiday house	1 200 000	3 000 000
Modulis trade mark	nil	400 000
Shares in A Ltd	200 000	500 000
Shares in B Ltd	400 000	300 000
Loan owing by trust	2 000 000	2 000 000
Household furniture and personal effects	700 000	400 000
Valuable work of art - acquired for investment purposes	300 000	800 000

John's last will and testament

In terms of John's will:

1. The primary residence and the loan owing by the trust were bequeathed to the trust.
2. The holiday house and all household furniture and personal effects were bequeathed to Emma.
3. The work of art (which had been hanging on the wall in John's house) was to be sold by the executor and the proceeds distributed to John's sister, Harriet.
4. The assets in John's design business (sectional title unit and trademark) were to be sold by the executor.

5. The shares in A Ltd were to be sold,while half of the shares in B Ltd were left to Jane and half to Freddy.
6. The residue of the John's estate (i.e. the cash realised on the sale of assets by the executor other than the cash bequeathed to Harriet and the amount needed to settle any liabilities of the estate) was left to Emma.

The deceased estate of the late John Fox for the period 1 November 2016 to 28 February 2017

1. The winding-up of the deceased estate was still in process at 28 February 2017.
2. The executor received R40 000 rental on the sectional title unit. R10 000 was in respect of October 2016 and R30 000 was in respect of the period November 2016 to January 2017.
3. On 1 February 2017, the executor sold the sectional title unit for R2 600 000 and the Modulis trademark for R300 000.
4. The primary residence and loan account were transferred to the trust on 15 January 2017, at which date the market value of the primary residence was R3 400 000 and of the loan account was R2 000 000.
5. The work of art was sold for R900 000 on 4 February 2017 and the proceeds were distributed to Harriet.
6. The shares in A Ltd and B Ltd had not been disposed of by 28 February 2017.

The Fox Family Trust

1. The trust received rental income of R50 000 a month during the 2017 year of assessment. On 31 August 2016 it distributed R160 000 of the rental income to Jane and Freddy in equal shares. On 28 February2017 it distributed R100 000 of the rental income each to Jane and Freddy and R200 000 of the rental income to Emma.
2. On 15 January 2017, on receipt of the distribution from John's estate, the trustees debited the loan account owing to John with R2 000 000 and non-current assets with R3 400 000 and credited the trust's capital account with R5 400 000.

YOU ARE REQUIRED TO:

1. Determine the taxable income of the Fox Family Trust for the year of assessment ended 28 February 2017. Your answer should indicate clearly in whose hands the income of the trust will be taxed and should indicate what the treatment of the loan account bequeathed to the trust by John Fox should be. (9 Marks)
2. Determine the income tax liability of John Fox as at 31 October 2016. (28 Marks)
3. Write a note explaining to the executor how he or she should deal with the specific items above that must be taken into account in the calculation of taxable income of the deceased estate of John Fox for the year of assessment ended 28 February 2017. (8 Marks)

You must give reasons for the inclusion or exclusion of relevant items in your calculations or assertions.

QUESTION 15.15 (45 Marks)

'Sharevest Ltd' (Sharevest) is a South African resident company with a number of local and foreign share investments. The company also earns fee income from portfolio management advice. The following information relates to Sharevest's investments and operations for the year of assessment ended 31 December 2017:

‘Aldo Ltd’ (Aldo)

Sharevest held 60% of the equity shares in Aldo, a South African resident company, which is a VAT vendor, with a December year of assessment. Sharevest acquired its stake in Aldo during 2010 for an amount of R1 200 000. The other shareholders of Aldo are Jeff Green, a South African resident, who holds 15% and ‘Rus Ltd’ (Rus), a non-resident company,which holds 25% of the shares.

Aldo manufactured a range of fasteners for sale to local manufacturers. As a result of competitive pressure and cash flow problems that Aldo had been experiencing, it was decided that Aldo would be wound up. The company was placed into liquidation on 1 April 2017 and the liquidation was finalised on 30 November 2017. On that date the liquidator of Aldo paid a final liquidation dividend to shareholders.

Aldo’s pro-forma financial statements for the period 1 January 2017 to 31 March 2017 reflected the following:

	Note	**R**
Statement of comprehensive income		
Revenue - sale of fasteners		5 000 000
Cost of sales		(3 000 000)
Opening stock at cost		2 500 000
Purchases		1 500 000
Closing stock at cost		(1 000 000)
Depreciation		(500 000)
Allowable operating expenses		(300 000)
Provision for retrenchment costs payable to staff	2	(700 000)
Net profit before tax		500 000
Statement of financial position at 31 March 2017		
Shareholders’ equity		
Share capital	1	1 000 000
Accumulated profit	1	1 000 000
Total shareholder’s equity		2 000 000
Liabilities		2 900 000
Shareholders’ loan accounts		490 000
Accounts payable	3	1 710 000
Provisions	2	700 000
Total equity and liabilities		4 900 000
Assets		
Non-current asset - machine	4	3 300 000
Current assets		1 600 000
Inventory		1 000 000
Accounts receivable	5	570 000
Cash at bank		30 000
Total assets		4 900 000

Notes to the pro-forma financial statements

1. Share capital consists of the original contributed share capital of R500 000 and a capitalisation issue of R500 000 on 31 December 2015. Aldo last paid a dividend on 31 December 2014.

2. Provisions consist of retrenchment packages for staff. The retrenchment packages were finally determined by 31 March 2017 and represent amounts that the company was legally obliged to pay in terms of labour legislation.
3. Accounts payable includes an amount of R1 140 000 (including VAT) that Aldo owed to the supplier of its machine. On 1 April 2017, the supplier, which was not connected in any way to Aldo, agreed to waive 50% of the debt and to accept a full and final settlement of the amount owing to it of R570 000. The balance of accounts payable is in respect of purchases of inventory between 1 January 2017 and 31 March 2017.
4. The machine was purchased new for R3 990 000 (including VAT) on 1 December 2016 and brought into use by Aldo in its manufacturing operation on that date.
5. No VAT was due or payable at 31 March 2017.

Transactions between 1 April 2017 and 30 November 2017

1. The machine was sold by the liquidator for R2 850 000 (including VAT).
2. Accounts receivable of R513 000 were collected by the liquidator. All efforts to recover a trade debt of R57 000 (including VAT) were unsuccessful, and the amount was written off.
3. Inventory was sold at an auction and realised consideration of R912 000.
4. Liquidation costs of R171 000 (including VAT), were incurred.
5. The net VAT output tax paid by the liquidator in respect of transactions in this period amounted to R504 000.
6. All liabilities, including income tax and VAT and the liquidation costs, were settled by the liquidator and the final liquidation distribution to shareholders took place on 30 November 2017.

'Vector Ltd' (Vector)

Vector is an investment company that is a tax resident of Lichtenstein. Sharevest holds 20% of the equity shares in Vector and other South African residents hold 40% of Vector's equity shares. The equity shares percentages match the voting and participation rights. Vector has a foreign tax year ending on 30 September. Sharevest acquired its 20% holding in Vector from a non-resident on 1 March 2017, at which date Vector became a CFC.

Vector's net income, as defined in section 9D(2), for its foreign tax year ended on 30 September 2017 was €200 000 and for the period 1 March 2017 to 30 September 2017 the net income was €117 000. The taxable income for Vector's foreign tax year ended on 30 September 2017, calculated as if it was a resident and net income is identical. The foreign tax attributable to Vector's net income was a flat 20%. On 30 September 2017 Vector paid a dividend of €40 000, before the deduction in Lichtenstein of withholdings tax of €4 800.

The average Rand/Euro exchange rate for Sharevest's year of assessment ended 31 December 2017 was 12:1 and for Vector's foreign tax year ended 30 September 2017 the rate was 11:1. The spot rate on 30 September 2017 was 12.5:1. The spot rate on 31 December 2017 was 13:1.

There is no double tax agreement between South Africa and Lichtenstein.

Other income

Sharevest's other income earned during the year consisted of foreign preference dividends from Jake Ltd amounting to R300 000. The net amount received after foreign withholdings tax of 25% was R225 000. Sharevest owned 20% of Jake's preference shares.

Sharevest also earned portfolio fees from advice given at its Cape Town office. It received R750 000 from local clients. It also received R50 000 from a foreign client, after 10% withholding tax was deducted and paid to the foreign government. The foreign country is in the rand monetary area and the rate of exchange of its currency against the rand is fixed at 1:1.

Sharevest will make any election that maximises the reduction of its normal tax payable.

YOU ARE REQUIRED TO:

1. Determine the income tax payable by Aldo Ltd for its year of assessment 1 January 2017 to 30 November 2017. (13 Marks)

2. Determine the amount of the liquidation distribution of Aldo Ltd and the composition of that distribution. You may use either the cash method or the equity method. (11 Marks)

3. Determine the taxable income of Sharevest Ltd for the year of assessment ended 31 December 2017. (13 Marks)

4. Write a note to explain to the accountant of Sharevest Ltd how to treat the specific foreign tax items that must be taken into account in calculating Sharevest's normal tax payable in respect of the year of assessment ended 31 December 2017. (8 Marks)

You must give reasons for the inclusion or exclusion of relevant items in your calculations or assertions.

QUESTION 15.16 (27 Marks)

Jack Armstrong, John Bell and Jill Carter were all employed by a large company, Big (Pty) Ltd, in the IT division. In December 2015 the company approached them with an outsourcing proposal. In terms of the proposal they would terminate their employment on 29 February 2016. Thereafter they could jointly or individually contract with the company to perform IT projects and invoice the company for any work performed.

Jack, John and Jill discussed the proposal and, on the advice of a good friend who is a lawyer, decided to approach the company with a counter-proposal. In terms of the proposal they would form a company, ITserve (Pty) Ltd, in which they would each hold one third of the shares. The company would enter into a service contract with the Big (Pty) Ltd. The company accepted the proposal. On 1 February 2016 a contract was signed between ITserve (Pty) Ltd and Big (Pty) Ltd. In terms of the contract, ITserve will render software management services to Big, in return for which Big will pay ITserve a monthly fee of R100 000. The monthly fee (net of any tax) will be paid on the last day of the month. The contract will commence on 1 March 2016.

At the same time (1 February 2016) ITserve entered into employment contracts with Jack, John and Jill. Each contract provides as follows:

The employee (e.g. Jack) would render all services necessary for ITserve to fulfil its contractual obligations to Big (Pty) Ltd. The employee will be remunerated as follows:

– Monthly cash salary	R15 000
– Use of a company owned car costing	R200 000
– Monthly entertainment allowance	R5 000

The cars will be used for both business and private purposes. ITserve will be responsible for all fuel and maintenance of the cars.

The following is ITserve's income statement for the year ended 28 February 2017:		**R**
Fee income (in terms of contract)		1 200 000
Interest income		20 000
less:		
Salaries	1	(780 000)
Rent	2	(40 000)
Depreciation	3	(110 000)
Insurance	4	(15 000)
Electricity and water		(12 000)
Consumables	5	(18 000)
Telephone		(6 000)
Motor vehicle costs	6	(55 000)
Net profit		184 000

Notes

1. Salaries comprise:

– Jack, John and Jill R15 000 × 3 × 12	540 000
– Allowances for all 3 shareholders/directors R5 000 × 3 × 12	180 000
– Mrs Smith (bookkeeper/receptionist)	60 000
	780 000

2. Rent: 40 000
   The premises, which are rented from Jill, are used solely for the purposes of the business.

3. Depreciation comprises:

Motor cars @ 15% *per annum*	90 000
Computers @ 20% *per annum*	16 000
Office furniture @ 10% *per annum*	4 000
	110 000

   All of the assets were acquired new and were brought into use on 1 March 2016.

4 The insurance premium is in respect of the computers and office furniture.

5. Consumables comprise paper, printer cartridges, etc. The full cost is expensed for accounting purposes. Consumables on hand at 28 February 2017 had a cost of R2 000.

6. Motor vehicle costs comprise:

– fuel	36 000
– insurance	18 000
– licence	1 000
	55 000

ITserve has only one client – Big (Pty) Ltd.
ITserve distributes all of its after-tax profits as a dividend on the last day of February of every year.

YOU ARE REQUIRED TO:

1. Explain, giving reasons, whether ITserve is a personal service provider. (7 Marks)
2. Assuming that ITserve is a personal service provider, compute its taxable income for the year ended 28 February 2017. (10 Marks)

3. Calculate the dividends tax to be withheld by ITserve on the dividend declared on 28 February2017. (3 Marks)
4. Calculate Jill's normal tax for the year ending 28 February 2017, if her only other income is interest of R30 000. Jill is 42 years old. No tax credits are required. (7 Marks)
(Ignore VAT and CGT.)

QUESTION 15.17 **(46 Marks)**

On 31 January 2017 Janine Youngman, 56 years old, resigned as an employee of Sport-Gear Limited. She had been employed as a buyer for the company's teenage range of goods since 2010. Upon her resignation she rented a shop in a local shopping centre and bought and sold the Sport-Gear brand of sporting goods. The following information is available for the year of assessment ended 28 February 2017:

Employment with Sport-Gear Limited

Gross salary	380 000
Termination lump sum	100 000
Annual bonus	32 000
Use of company car	note 1
Medical aid contributions paid by Sport-gear	note 2

Notes

1. The company car cost Sport-Gear R285 000 (incl. VAT) in 2014 and Janine had enjoyed the use of the car from the date of purchase. She ceased to have the use of the car after resignation.

2. Sport-Gear had paid all contributions to the medical aid fund for Janine. On resignation, she took over paying all contributions with effect from 1 February 2017. The contributions have always been R1 500 per month. She and her husband are the only persons covered by the fund. Janine also incurred medical expenses of R45 000, in respect of her husband's illness, which were not paid for by her fund. Her husband is not considered 'disabled' as defined.

Self-employment: Janine registered for VAT on 1 February 2017. All amounts include VAT where VAT applies.

Purchase of stock		120 000
Rent paid		14 000
Salary of assistant		5 000
Interest paid	January	900
	February	900

Janine obtained a loan of R100 000 from a bank, on 1 January 2017, to help her to pay for start-up expenses. This was the only transaction entered into by the business prior to 1 February.

Sales made in February	90 000
Merchandise on hand at 28 February 2017 at purchase price	71 000
Computer purchased 1 February 2017	13 000

Office furniture – acquired at no cost from her parents on 1 February 2017. The market value was R15 000 and her parents had paid R25 000 when they originally purchased the furniture. Janine's parents are not VAT vendors and had previously used the office furniture.

The CSARS allows a three-year write-off period for computers and a six-year write-off period for furniture.

Other information
Janine contributes R600 per month to a retirement annuity fund (since 2011). South African interest received for the year of assessment ended 28 February 2017 was R31 000.

YOU ARE REQUIRED TO:

1. Calculate Janine's taxable income for the year of assessment ended 28 February 2017. (26 Marks)

2. If Janine wanted to put her business into a VAT registered private company:
   i. What VAT and income tax implications should she consider in selling the business to the company? (13 Marks)
   ii. Would the company be either a 'small business corporation' or a 'personal services provider'? (5 Marks)
   iii. What would be the tax consequence for Janine should her business qualify as a 'micro business' (assuming the same turnover going forward)? (2 Marks)

Question 15.18 (SAIT ADAPTED) (50 Marks)

You are a tax advisor at an accounting firm in Pretoria. You regularly receive requests for tax advice from potential new clients and, while some of these requests involve basic tax issues and calculations, some entail detailed tax structures and estate planning.

The following is an extract from a request you have received on 21 October 2016 from a local businessman from Pretoria:

Allow me to introduce myself. My name is Rudi Murloch and I desperately need some tax and estate planning advice. I am getting on in years and I would like to structure my estate in such a way as to minimise the taxes payable by me and my estate, but I also need to provide for my loved ones and dependants in the most efficient manner. I am 50 years old and a resident of South Africa. I provide investment advice to big corporate clients on a freelance basis and have earned R790 000 in fees since the beginning of the 2017 year of assessment. I have no tax deductible expenses or other income, except for anything that may come to light in the information following below. I made a provisional tax payment of R122 000 on 30 August 2016 in respect of the 2017 year of assessment.

The following is a summary of the information that I gathered and that relates to my family's financial affairs:

Murdoch Family Trust

My father, Antonio Murloch, died on 1 May 2015. In terms of his last will and testament, the following bequests were made:

- *A summer home in Cape Town with a market value of R900 000 to me.*
- *Local dividend-yielding shares and interest-bearing securities to his four grandsons (my sons): Carl (40%), Joe (30%), Ken (20%) and Martin (10%), subject to the condition that these assets be kept in trust until Martin, my youngest son, attains the age of 30 years. The will provides that his grandsons have a vested right to both the capital and the receipts and accruals earned from the investment of the capital in the proportion 40:30:20:10 (as per the bequest). But it also provides that no amounts will actually be distributed to a grandson until Martin attains the age of 30 years.*

- *Units in a collective investment scheme with a market value of R590 000 to his daughter-in-law, Sheila (my wife, aged 48, and the mother of his four grandsons).*

The trust was formed in South Africa and my sons are the only beneficiaries of the trust. On 1 June 2015 I sold the summer home to the trust for R900 000 (its market value) on a loan account, which bears interest at 9%. [Assume that SARS regards the 9% as being the appropriate market-related interest rate.] *I sold no assets during the 2017 year of assessment.*

The trust deed provides that the four grandsons have a vested right to the summer home and any receipts and accruals that may result from it, in the same ratio as above (40:30:20:10). No amounts will be distributed to the grandsons until Martin attains the age of 30 years.

On 1 June 2015 Sheila donated the units in the collective investment scheme to the trust – the market value of these units was R600 000 on this date. The trust deed provides that the four grandsons have only a contingent right to the units in the collective investment scheme and the receipts and accruals that may result from these units. The trustees may, however, use their discretion and make awards to the grandsons out of the receipts and accruals from these units in the collective investment scheme.

The receipts and accruals, expenses and distributions of the trust for the year ended 28 February 2017 were as follows:

	R	**R**
Receipts and accruals		254 000
Local dividends	120 000	
Local interest	18 000	
Rentals from the Cape Town property (earned evenly over the year)	92 000	
Interest return on collective investment scheme	27 000	
Expenses paid and incurred		(70 000)
Interest paid (R900 000 × 9% × $^{9}/_{12}$)	60 750	
Other tax deductible expenses relating to the summer home	9 250	
Distribution of returns from collective investment		(22 000)
to Carl	4 000	
to Joe	3 000	
to Ken	2 000	
to Martin	13 000	
Retained in the trust		162 000

As at 28 February 2017: Carl will be 25 years old, Joe 22 years old, Ken 15 years old and Martin 13 years old. Carl is not a resident of the Republic, having emigrated after he finished school. His three brothers are residents of the Republic. Sheila and I are married out of community of property, without the accrual system. None of my children, my wife or I, received any other interest during the 2017 year of assessment.

Rudi Murloch's Estate

After the death of my father, I was faced with the reality of the brevity of life and the fact that I have to take my estate planning more seriously. As of today, the following 'mini statement' reflects my assets and liabilities:

	Note	R
Assets		
Loan account	1	900 000
Primary residence	2	7 000 000
Xtreme Money Market account	3	1 500 000
Cash in cheque account	4	467 000
Liabilities		
Mortgage bond at XYZ Bank	2	300 000

Notes to 'mini-statement'

1. *This is the loan due by the Murloch Family Trust.*

2. *This is the house in Mountain View Drive, Pretoria that the family has always used as their primary residence. No business was ever conducted from this house, which I purchased in May 2006 for R3.2 million.*

3. *This account earns returns at varying rates, but this balance includes capital and interest at the specified date.*

4. *This is the balance on my cheque account at FedBank as of today.*

The following is an extract of my last will and testament:

<u>Last Will and Testament</u>

I, the undersigned, Rudi Murloch (Identity number: 621206 0029 097) of 123 Mountain View Drive, Pretoria, Gauteng, hereby declare this to be my Will. I hereby revoke all previous wills or testamentary writings made by me.

I nominate Discrete Law Inc. (12 Corlett Drive, Illovo, Johannesburg) to be the Executor of my Estate.

I direct that my estate shall devolve as follows:

Special Bequests:

1. *Loan account to the value of R900 000 carrying interest at 9%* per annum*, due by the Murloch Family Trust, to my brother, Elijah Murloch (Identity number 640815 5111 08 4).*

2. *Investment proceeds of my Xtreme Money Market Account to my son, Joe (Identity number 810909 5425 5).*

3. *My house (primary residence) located in Pretoria in Gauteng (123 Mountain View Drive) to my mother Ms Patricia Murloch (Identity number: 370618 0015 057).*

4. *To my beloved wife, Mrs Sheila Murloch (Identity number: 630101 0045 037), to whom I am married out of community of property, R100 000 in cash.*

The rest of my estate, after the abovementioned special bequests, must go to my local tennis club (not an approved Public Benefit Organisation).

In witness whereof I have signed this will in Pretoria on the 9th of July 2016 in the presence of the undersigned witnesses who in my presence and in the presence of each other have signed this will as witnesses.

Date: 9 July 2016

Rudi Murloch
TESTATOR

I am considering donating R1 million of the Xtreme Money Market account to the Murloch Trust and bequeathing the rest of it to Joe. During the 2017 year of assessment I also made a donation of R10 000 to 'Save the Trees', a registered public benefit organisation in terms of section 30 of the Income Tax Act. I obtained a section 18A receipt from them. I made no other donations during the 2017 year of assessment. I am planning to make this donation tomorrow (22 October 2016). I would like my sons to have vested rights to this amount of capital in the trust in equal parts, as well as to the income earned from it.

I am concerned that, should I die tomorrow (after I've made the donation) there may not be enough cash in my estate to settle all outstanding liabilities. If not, I would appreciate any suggestions you may have for making sure there is enough cash available in the estate. I presume that there will be some taxes due to SARS after my death?

YOU ARE REQUIRED TO:

1. Calculate the taxable income of the following persons for the 2017 year of assessment:
   a. Carl
   b. Joe
   c. Ken
   d. Martin
   e. Sheila
   f. The Murloch Family Trust (20 Marks)

2. Describe the tax consequences for Rudi Murloch if he makes the donation to the trust as planned. (10 Marks)

3. Determine whether there would be sufficient cash in the estate to settle all liabilities.
   Assuming that there is not sufficient cash, suggest some steps Rudi could take to ensure there is adequate liquidity in his estate. (20 Marks)

QUESTION 15.19 **(18 Marks)**

Westin Front (Pty) Ltd employs various artisans and professional employees who enter into registered learnership agreements. Westin Front trains these artisans and professionals while subcontracting them to other businesses who require their services. Westin Front has a financial year-end on 31 December of each year.

The following information pertains to three of its employees:

1. Dan Browne is a disabled artisan who was employed on a 15-month learnership commencing 1 October 2016. Dan is paid a salary of R90 000 *per annum*. Dan holds an NQF level 6 qualification. The contract was successfully completed on 30 September 2017 and Dan left Westin Front's employ on the same date.

2. Jackson Mutola is a trainee IT specialist, registered under a 48-month 'Information Technology in Business' learnership. Westin Front obtained Jackson's services on 1 March 2017, by a transfer of his learnership from another organisation on that date. Jackson's learnership originally commenced on 1 January 2016. Jackson is paid a salary of R120 000 *per annum*. Jackson is not disabled. He holds an NQF level 8 qualification.

3. Millicent Andrews is a disabled trainee project manager, registered under a 24-month 'Project Management' learnership that commenced on 1 November 2016. The learnership was successfully completed on 31 October 2018 and Millicent left Westin Front's employ on the same date. Millicent is paid a salary of R300 000 *per annum* throughout her employment with the company. She holds an NQF level 9 qualification.

YOU ARE REQUIRED TO: Calculate, insofar as the information above allows, the income tax effects for Westin Front's years of assessment ended 31 December 2016, 2017 and 2018. Assume that the current legislation applied throughout all relevant years of assessment.

SOLUTION 15.2

1. **Taxable income for Spectrum Interferometers (Pty) Ltd - Period 1 April 2016 to 28 February 2017**

Opening stock				(7 100 000)	(1)
Exchange loss on trading stock debt			(100 000 × (9.5286 − 9.7627))	(23 410)	(1)
Raw materials acquired			(75 000 × 9.5653)	(717 398)	(1)
Exchange gain/(loss) on debt			75 000 × (9.5653 − 9.8822)	(23 767)	(1)
Exchange gain/(loss) on FEC			75 000 × 50% × (10.767 − 9.8822)	(33 180)	(2)
Machine A					
s12C (year 2)			1 642 500 × $^{100}/_{114}$ × 20%	(288 158)	(1)
Finance charges (s24J)	***Initial amt/ AIA***	***Interest***	***Payment***		
January 2016 (1 642 500 − 20 000 deposit)	1 442 500	21 638	(20 000)		(1)
February 2016	1 444 138	21 662	(20 000)		(0.5)
March 2016	1 445 800	21 687	(20 000)		(0.5)
April 2016	1 447 487	21 712	(20 000)	(21 712)	(1)
May 2016	1 449 199	21 738	(20 000)	(21 738)	(1)
Settlement payment			1 444 000		(1)
Adjusted initial amount	1 449 199 + 21 738 − 20 000		1 450 937		(1)
Gain for issuer			6 937	6 937	
Disposal:					
Selling price		1 450 000			
Limited to cost	1 642 500 × $^{100}/_{114}$	1 440 789			
Tax value		576 316			
s8(4)(a) recoupment				864 474	(2)
Capital gains:					
Proceeds		1 450 000			(1)
less recoupment (see above)		(864 474)			(1)
		585 526			
Base cost:					
Expenditure	1 440 789				(1)
less allowances (see above)	(864 474)	(576 316)			(1)
Capital gain		9 211			
Machine B					
s12C			R3 000 000 × 20%	(600 000)	(1)
Disposal:					
Selling price		1 000 000			
Cost		3 000 000			
Tax value		1 200 000			
s11(o) loss (elected as reduces taxable income more than a capital loss)				(200 000)	(2)
Capital gains:					

SOLUTION 15.2 continued

Proceeds		1 000 000			(1)
Base cost:					
Expenditure	3 000 000				
less allowances (3 000 000 × 60% + 200 000)	(2 000 000)	(1 000 000)			(1)
Capital gain		0			
Machine Z					
Recoupment					
Selling price (187 000 × 9.099)		1 701 513			(1)
Cost		1 450 000			
Tax value*	1 450 000 × 20%	290 000			(1)
*Allowances over 3 years are 80% (40%:20%:20%)					
s8(4)(e) deferred recoupment (1 450 000 − 290 000)		1 160 000			(1)
Proceeds (converted to Rands at spot)		1 701 513			
less recoupment		(1 160 000)			(1)
		541 513			(1)
Base cost:					
Expenditure	1 450 000				(1)
less allowances	(1 160 000)	(290 000)			(1)
Para 66 capital gain deferred		251 513			
As machine B is sold, the remaining deferred recoupment and capital gain is released					
Remaining recoupment released in 2017 tax year	1 160 000 × 60%			696 000	(1)
Remaining capital gain released in 2017 tax year	251 513 × 60%		150 908		(1)
Sales of inventories				15 000 000	(1)
Investments					
Distribution deemed at market value		13 000 000			(1)
Base cost		(9 000 000)			(1)
Capital gain		4 000 000			
Total capital gains (9 211 + 150 908 + 4 000 000)			4 160 118		(1)
Total capital losses			0		
Aggregate and net capital gain			4 160 118		
Taxable capital gain (@ 80%)				3 328 095	(1)
Taxable income				10 866 142	
Tax payable @ 28%				3 042 520	(1)
					(39)

SOLUTION 15.2 continued

2. **Dividends tax liability of Spectrum**

Dividend *in specie* - investments		13 000 000		(1)
Dividends tax @ 15%			1 950 000	(1)
Liquidation dividend				
Method 1: Equity method*				
Opening retained earnings		23 849 653		(1)
less in specie dividend (book value)		(9 000 000)		(1)
less accounting loss on machines (R1 450 000 + R1 000 000 – R4 000 000)		(1 550 000)		(1)
Add: accounting profit on inventories (15 000 000 −7 100 000 – 717 398)		7 182 603		(1)
Exchange differences realised (accounting matches tax treatment)		(80 357)		(1)
Income tax liability		(3 042 520)		(1)
VAT liability has no impact on reserves		0		
Dividends tax (in specie dividend, therefore company liable)		(1 950 000)		(1)
Gain on realisation of Machine A debt		6 937		(1)
Settlement of liabilities and receipt of accounts receivable (no impact)		0		
		15 416 315		
Plus capital		12 000 000		(1)
less contributed tax capital:				
Share capital and share premium - 31 Dec 2010	5 000 000			(1)
Capitalised profits of R4m (excluded from contributed tax capital)				(1)
Additional consideration for shares	3 000 000	(8 000 000)		(1)
Available for dividend		19 416 315		

Dividend			
Dividend in specie - investments	*13 000 000*		(1)
No dividends accrued			
Dividends tax @ 15%		*1 950 000*	(1)
Method 2: Asset method*			
Cash opening balance	*14 000 000*		(1)
Proceeds on sale of machines (R1 450 000 + R1 000 000)	*2 450 000*		(1)
Proceeds on sale of inventories	*15 000 000*		(1)
Raw materials purchased	*(717 398)*		(1)
Exchange gains and losses	*(80 357)*		(1)
Liabilities settled (excluding loss on realisation of Machine A debt)	*(4 250 347)*		(1)
Gain on realisation of Machine A debt	*6 937*		(1)
Dividends tax liability	*(1 950 000)*		(1)
Income tax liability	*(3 042 520)*		(1)
Accounts receivable received	*6 000 000*		
Cash balance	*27 416 315*		
less *contributed tax capital*	*(8 000 000)*		(3)
Available for dividend	*19 416 315*		

SOLUTION 15.2 continued

*	*Note: The VAT consequences are irrelevant as the output VAT is collected from customers and the input VAT is claimed back from SARS resulting in no effect on reserves.*			
	Dividends tax payable by Michael, to be withheld by Spectrum		2 912 447	(1)
				(15)

3.	**Income tax effects - Michael Optic**				
	Dividend received – Investments	not gross income	0		(1)
	Liquidation dividend received		19 416 315		(1)
			19 416 315		
	s10(1)(k)(i)		(19 416 315)	0	(0.5)
	Proceeds on disposal of shares on liquidation		27 416 315		(1.5)
	less dividend on liquidation		(19 416 315)		(1)
			8 000 000		
	less base cost:				
	Expenditure	28 000 000			(0.5)
	Plus additional equity	3 000 000	(31 000 000)		(0.5)
	Capital loss		(23 000 000)		
	Para 19 - disregard loss				
	Para 19(1)(a) does not apply as the dividend was subject to dividends tax, i.e. is not an 'exempt dividend'				
	Loss does exceed extra-ordinary dividend				
	Capital loss to be aggregated		(23 000 000)		
					(6)
					(60)

SOLUTION 15.5

1.	**Calculation of taxable income - Jack Twosun**				
	Salary	25 000 × 3		75 000	(0.5)
	Motor car award		200 000		(0.5)
	Cash		310 000		(0.5)
			510 000		
	Excluded as this is a severance benefit		(510 000)	0	(0.5)
	Use of motor vehicle	R387 600 × 3.25% × 3		37 791	(2)
	Use of yacht	R800 × $^{5}/_{31}$ × 15% or exclusion para 6(4) of 7th Sch		19	(1.5)
	Entertainment allowance	2 000 × 3		6 000	(0.5)
	No reduction as not required to account to employer for expenditure				
	No deduction as salaried employee - s23(m)				
	Foreign trust S7(8)				
	Interest*		12 000		(0.5)
	less Sheila's distribution	2 000 × $^{12\,000}/_{17\,200}$	(1 395)	10 605	(1)
	Foreign dividend*		5 200		(0.5)

SOLUTION 15.5 continued

less Sheila's distribution	2 000 × $^{5\,200}/_{17\,200}$		(605)		(1)
			4 595		(0.5)
less s10B(3)(b) exemption*	(4 595) × $^{25}/_{40}$		(2 872)	1 723	(1)
Interest SA			5 200		(0.5)
less s10(1)(i) exemption	23 800 limited to		(5 200)	0	(0.5)
Dividend SA			520		(0.5)
less s10(1)(k) exemption			(520)	0	(0.5)
				131 138	
less retirement contributions s11(k) (R75 000 × 8%) =			6 000		(1)
limited to *lesser* of:					
*R350 000, or			350 000		(1)
*27.5% of the higher of remuneration			118 810		
or taxable income (including capital gains)			131 138		
		× 27.5% =	36 063		(1)
The full contribution is therefore allowed as a deduction.				(6 000)	(1)
No excess to be carried forward or used for the lump sum					
Capital gains/losses (all references are to the 8th Schedule)					
Domestic dwelling - para 40(1)(a) and para 67(2)9a) rollover			0		(0.5)
Shares					
Proceeds - para 40(1)		300 000			(0.5)
Base cost		(400 000)			(0.5)
Capital gain/capital loss			(100 000)		
Furniture and effects - para 40(1)(a) and para 67(2)9a) rollover			0		(0.5)
Private yacht > 10 metres, not a personal use asset - para 53					
Proceeds - para 40(1)		500 000			(0.5)
Base cost - para 20(1)(a)		(750 000)			(0.5)
Capital gain/capital loss		(250 000)			
Loss disregarded (paragraph 15)			0		(0.5)
			(100 000)		
less annual exclusion	R300 000 limited to		100 000		(0.5)
Net capital gain/assessed capital loss			0		
				0	
				125 138	
Pension lump sum	para (e)		490 000		(0.5)
RAF lump sum	para (e)		400 000		(0.5)
Severance benefit	para (d)		510 000		
less para 5 deduction for contributions not previously allowed:					
Brought forward from prior years		9 200			(0.5)
Current year disallowed	none	0	(9 200)		(1)
Retirement fund lump sum benefit (taxed in terms of separate table)			1 390 800		

SOLUTION 15.5 continued

The lump sum (part of taxable income although taxed separately)				1 390 800	(1)
Taxable income				1 515 938	

*Only Shelia's portion (being to a resident) is removed, as the amount retained in the foreign trust and the amounts distributed to Anthony and Marge are attributable to Jack in terms of section 7(8). Although Marge's distribution is an annuity, s10B(5) disallows a s10B(2) full exemption but not a s10B(3) partial exemption.

2. Calculation of taxable income - estate late Jack Twosun			0		
Domestic dwelling	rollover - no effect				(0.5)
Shares in listed companies	Proceeds	350 000			(0.5)
	less base cost	(300 000)	50 000		(0.5)
Private yacht	Proceeds	510 000			(0.5)
	less base cost	(500 000)	10 000		(0.5)
			60 000		
less annual exclusion			(40 000)		(0.5)
			20 000		
Taxable income inclusion @ 40%			8 000		(1)
					(28)

SOLUTION 15.6

Peter Bessick

Salary	R70 000 × 4	280 000	(1)
Use of laptop			
Rental value	R2 000 × $^{100}/_{114}$ × 4 months =	7 018	(1.5)
Gold watch	Value = cost to employer (excl. VAT)	40 000	(1)
	No R5 000 reduction as not 15 completed years of service		(1)
Royalty (gross)	$^{380\,000}/_{0.95}$ =	400 000	(1)
Will qualify for s6*quat* rebate in respect of tax withheld, as not from an SA source - s9(2)(c)/(d) and s9(4)(c)		(20 000)	(1)
Cession of interest s7(7)		50 000	(1)
s10(1)(i)(xv) exemption		(23 800)	(1)

The Onion's Trust

2016 Income		
Rental	R12 000 × 6 months	72 000
less expenses		(45 000)
		27 000
Tax in Peter's hands i.t.o. s7(5)	$^{1\ million}/_{2.5\ million}$ (40%) × 27 000	10 800
Balance taxed in trust's hands (SA source)		

SOLUTION 15.6 continued

2017 Income

s25B(2A) inapplicable as SA source income and taxed in 2016 in SA					(1)
Rental	R12 000 × 3 months		36 000		(1)
less expenses			(24 000)		(1)
			12 000		
Tax in Peter's hands i.t.o. s7(3)	R12 000 × 40% (donation ratio) × 50% (to minor child)			2 400	(1.5)
Dividend from Sunny Horizons LLC - taxed in Peter's hands i.t.o. s7(8) as David is not a resident					(1)
Gross amount					
s7(8)	£4 500 × $^{100}/_{90}$	5 000			(1)
Translated into Rands at ave - s25D(3)	5 000 × 15			75 000	(1)
It is submitted that notwithstanding that s7(8) does not use the word 'accrued' Peter would still be allowed the s10B(3) exemption.				(47 561)	(1)
s9D: Gold Dust Ltd					
Note that the question said to ignore the 75% rule in the further proviso to s9D(2A)					
Pre-tax profit	(£100 000 − £18 000) × 14 × 15%			172 200	(1)
The £20 000 dividend of Silver Linings, in which Gold Dust holds a 90% interest (i.e. £18 000 of the total dividend), would have been exempt under s10B(2)(a) if Gold Dust had been a resident, and therefore must be included from 'net income' i.t.o. s9D(2A)					(1)
s9D: Silver Lining Ltd					
More than 50% held indirectly					
Pre-tax profit	£50 000 × 90% × 15% × R14			94 500	(2)
Gold Dust Ltd dividend received	£35 000 × 15% × R15			78 750	(2)
s10B(2)(a)				(78 750)	(1)
s6*quat*:**					
Silver Lining	£10 000 foreign tax × 90% × 15% × R15 =		20 250		
Gold Dust	£30 000 foreign tax × 15% × R15 =		67 500		
				1 029 757	
less retirement contributions s11(k) =			22 400		(1)
limited to *lesser* of:					
*R350 000, or			350 000		(1)
*27.5% of the higher of remuneration			327 018		
or taxable income (including capital gains)			1 053 757		
		× 27.5% =	289 783		(1)
The full contribution is therefore allowed as a deduction.				(22 400)	(1)
No excess to be carried forward or used for the lump sum					

SOLUTION 15.6 continued

Capital gain					
Proceeds		3 200 000			(0.5)
Base cost	2 500 000				(0.5)
Selling costs	200 000				(0.5)
		(2 700 000)			
Capital gain		500 000			
Taxed in Peter's hands i.t.o. para 69:					
R500 000 × 40% (donation) × 50% (to child) − R40 000 (annual exclusion) =		60 000	× 40%	24 000	(2.5)

Taxed in Natalie's hands:		
R500 000 × 50% − R40 000 = R230 000 × 40% =	84 000	
Taxed in Matthew's hands:		
[R500 000 × 60% (non-donation) × 50% (distribution) − R40 000 (annual exclusion)] × 40% =		44 000

Taxable income before retirement lump sum benefit (RFLB)		1 031 357	
Lump sum from pension fund	6 000 000		(0.5)
less deductions previously not permitted (per s11(k)) - para 5 - 2nd Schedule:			
Brought forward from prior years	(42 000)		(1)
Taxable lump sum (to be taxed per retirement lump sum tax tables)		5 958 000	(0.5)
Total taxable income		6 989 357	
Tax per tables before rebate on ordinary taxable income		342 287	(1)
Tax payable on RFLB		1 897 380	(1)
Total tax payable before rebate		2 239 666	

s6quat:

Sunny Horizons LLC	£5 000 × 10% × R15	7 500	(2)
Gold Dust Ltd**	(see above)	67 500	(2)
Silver Linings Ltd**	(see above)	20 250	(2)
		95 250	

Note: The reference within s6quat to 'without regard to s10B(3)' means that the foreign tax in respect of the Sunny Linings dividend must not be apportioned to account for the fact that the dividend was partially exempt. It does not mean that the exemption must not be taken into account when determining foreign taxable income in the numerator of the limit calculation below.

SOLUTION 15.6 continued

Limited to [(R172 200 + R94 500 + R75 000 − R47 561)/R6989 357] × R2 239 666 =	94 254	(94 254)	(3)
Note: No rebate for foreign withholdings tax i.r.o. Gold Dust dividend, as was exempt from tax in SA.			
Rebate		(13 500)	(1)
*Note: Although the rebate cannot be offset against the retirement lump sum, it must be shown after the lump sum so as not to affect the s6*quat *apportionment.*			
Tax liability		2 131 913	
			(46)

**For s6*quat* purposes, the average exchange rate for the taxpayer would be used (R15). The average exchange for the foreign tax year is used for the s9D(2) inclusion (R14).

CHAPTER 16: FOUNDATIONS
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QUESTION 16.1 (Solution at end of chapter) (35 Marks)

PART A (7 Marks)

Manley Blaine, a South African resident, owns a block of flats situated in Wynberg, Cape Town.

He inherited the block of flats in terms of his father's (Mr Blaine Senior) will, executed in the United Kingdom. Mr Blaine Senior was, at date of death and throughout his adult life, ordinarily resident in the United Kingdom.

Manley received rentals of R700 000 for the year of assessment ended 28 February 2017.

YOU ARE REQUIRED TO:

1. State what is the source of these (the R700 000) rentals. State whether the source is determined in terms of s9 or in terms of common law principles with appropriate explanations and reference to case law.
2. If the block of flats that Manley inherited were situated in the United Kingdom, how would your answer differ from that in (1)?

PART B (5 Marks)

Adrie Spaans, ordinarily resident in the Netherlands, designed a model pattern that was used to teach the art of tailoring. She had developed this pattern in the Netherlands. Due to its popularity in the Netherlands she visited South Africa and marketed her product here.

In the current year of assessment Adrie received payments amounting to R120 000 from various design schools in South Africa that used the pattern as a teaching aid.

YOU ARE REQUIRED TO: Discuss whether the R120 000 received would be taxed in South Africa or not, indicating the source of the income with reference to s9 of the Income Tax Act or common law principles as appropriate.

PART C (12 Marks)

A leading lung specialist (a SA resident) in private practice in the Republic of South Africa was flown to a central African state to perform an operation on one of their top ministers. The president (of the African state) sent his private jet to fetch and return the specialist. All his expenses were paid and, although he did not wish to be paid for his services, the government of the African state insisted on paying him the equivalent of R100 000.

YOU ARE REQUIRED TO:

1. Explain where the source of the income would be.
2. Explain with reasons whether the lung specialist will be taxed on the amount in the Republic of South Africa.

PART D (11 Marks)

Chancer, a SA resident, occupied a position that required him to be entrusted with funds to be used for secret operations. Over a number of years he appropriated funds to himself and, in total, took about R450 000 from the trust fund. Chancer was ultimately caught, charged and ordered to repay the whole amount, which he subsequently did.

Chancer was then assessed to tax on the amount he had stolen. Chancer objected to this assessment on the grounds that the amount was not 'received' by him and was therefore not gross income.

YOU ARE REQUIRED TO: Discuss whether the R450 000 was or was not 'received by' Chancer. Refer to case law where appropriate.

QUESTION 16.2 **(24 Marks)**

You have been approached by Mrs Good for tax advice regarding the sale of fixed property that she owns.

In 1991 Mrs Good inherited a large sum of money from her late father. She used the money to purchase a block of flats in Durban.

The flats were acquired in 1993 at a cost of R1.5 million. Mrs Good has derived rental income from the flats for the past 23 years.

Mrs Good has now decided to sell the block of flats because she is getting old and is in poor health. She has consulted a prominent estate agent who has advised her that she could sell the property in one of two ways. She could sell the entire block as one property in its present condition. Alternatively, she could divide the block into sectional title units and sell the flats individually. The estate agent estimates that the selling price of the block as a single property will be R10 million. He has told her that if she spends R1 million on upgrading the building and opening a sectional title register she can expect to sell the flats for R15 million.

Mrs Good is a South African resident and is not a VAT vendor.

YOU ARE REQUIRED TO: Advise Mrs Good on the income tax consequences of the sale of the property either as a single property or as sectional title units.

QUESTION 16.3 **(30 Marks)**

PART A (4 Marks)

1. Jason Limited is a company involved in the manufacture of wooden fencing. On 1 February 2017 it completed a wooden fence for erection around a cricket field at a cost to itself of R12 000. At its financial year-end of 28 February 2017, the fair market value of this fence was R15 000. On 10 March 2017 the fence was sold and delivered to a cricket club for R15 000.

2. Robyn Limited carries on the business of a building contractor specialising in the construction of sports pavilions. On 31 January 2017 it completed the building of a pavilion for the Oval Cricket Club. In terms of the building contract, 90% of the contract price is due and payable on completion of the pavilion and 10% of the contract price is to be retained as 'retention monies' until a final certificate is issued by the engineer six months after the completion of the building. The contract price of the Oval Cricket Club contract is R1 125 000. Robyn Limited's year of assessment ends on the last day of February each year.

YOU ARE REQUIRED TO: Apply the 'entitlement' principle to each of the above two cases to determine the date of accrual of the amount in question.

PART B (10 Marks)

1. Peter Morkel, a SA resident, has recently formed his own security business. The Small Business Development Corporation has agreed to assist Peter with his new business venture. It has approved a medium-term loan that will be used by Peter to finance the costs of setting up his new business. On 1 March 2016 Peter Morkel received a loan of R800 000 from the Small Business Development Corporation.
2. Errol Wander, a SA resident, is fulfilling a lifelong ambition by walking along the entire coastline of South Africa. In order to do this, he had to take leave of absence from Second National Bank where he has worked for some years. He had been earning R15 000 a month from the bank. The bank has agreed to pay Errol R12 000 a month throughout the period he is on his walk subject to the condition that he must work for the bank for a similar period after his walk and must also wear the logo of the bank on his backpack. Should he break this agreement, Errol will be required to repay to the bank an amount calculated by multiplying R12 000 by the number of months that he failed to work for the bank in terms of his agreement. During the current year of assessment Errol received R144 000 from the bank. He did not spend this R144 000 but deposited it into a separate savings account in a bank in order to be able to repay it should the occasion arise.
3. Glencairn Estate Agents CC collects rentals on behalf of a number of property owners. During the current year of assessment Glencairn Estate Agents CC received R216 000 from the tenants occupying the flats and houses belonging to property owners. It kept R10 800 being its commission on the rentals collected and paid over R205 200 to the property owners.

YOU ARE REQUIRED TO: Discuss whether or not the amounts referred to in the above three cases constitutes gross income in the hands of the respective recipients.

PART C (16 Marks)

Ivan Schafer, a SA resident, has been receiving a reasonable return from the letting of a block of 15 flats which he had purchased in 1982. He does not have any history of property dealing.

Ivan is now aware that he can make a substantial profit by selling the flats individually and has made application for a sectional title register to be opened.

To make the flats more attractive to would-be purchasers he is also considering the possibility of developing the flats by making certain improvements.

YOU ARE REQUIRED TO: Discuss, giving reasons, whether you consider the receipts and accruals arising from the sale of the flats to be included in Ivan Schafer's gross income or not. Deal with the position where the flats are sold individually, without any development work being done and the position where the flats are first developed, then sold.

QUESTION 16.4 **(29 Marks)**

PART A (7 Marks)

Andrew Stein, a SA resident, runs a new and second-hand furniture shop. During the current year of assessment, he sold a dining-room suite to a customer for R15 000. It was agreed that Andrew would accept the customer's antique sideboard in settlement of the purchase price. The market value of the sideboard at the time was R20 000. Andrew had desired the sideboard as a birthday gift for his wife

and had therefore agreed to the transaction. Before Andrew could transport the sideboard to his home a regular customer offered him R25 000 for the sideboard. Andrew could not resist the offer and sold it to the customer for R25 000 cash.

YOU ARE REQUIRED TO: Determine Andrew's gross income as a result of the above transactions. Give reasons for each inclusion or exclusion from gross income. (Ignore VAT.)

PART B (5 Marks)

Michael Lang, a SA resident, was interested in purchasing 15 hectares of land for his retirement. He intended to live there and grow flowers and herbs for sale to local markets. He found a suitable area that was for sale, but the seller was only interested in selling 20 hectares or nothing. Mr Lang felt this was the ideal site and purchased the 20 hectares.

He thereupon immediately sold five hectares for R2 million, making a profit of R500 000 and proceeded with his retirement plan in respect of the remainder of the property. At the end of the same year he received R45 000 in respect of flowers and herbs sold.

YOU ARE REQUIRED TO: Discuss the inclusion or exclusion of the R2 million and R45 000 in Michael Lang's gross income. (Ignore VAT.)

PART C (14 Marks)

Mr Zeller invented an ingenious and efficient structure to support bicycles on the back of a car without using a tow hitch and which was permanently attached to the car's boot. Mr Zeller was not a resident of the Republic. Mr Zeller took part in the Cape Town Cycle Tour two years ago. Whilst in Cape Town he developed the ideas and plans for his structure.

Various firms were interested in selling and fitting this structure to cars. Mr Zeller registered his patent and subsequently received gross royalties of R4 million from firms in South Africa and R1 million from companies registered and managed in Europe who used this structure in Europe (from 1 July 2016 to 28 February 2017).

Before the end of the 2017 year of assessment, a South African firm offered to buy the patent outright from Mr Zeller for R20 million. Mr Zeller accepted this offer and all legal formalities for the sale went through before the year-end. Mr Zeller received the R20 million on the first day of the next year of assessment.

YOU ARE REQUIRED TO: Determine what amounts will be included in Mr Zeller's gross income in the 2017 year of assessment. Give brief reasons for each amount whether included or excluded. (Ignore VAT.)

PART D (3 Marks)

Jane Murray is a SA resident who retired from a South African employer on 29 February 2016. She had also worked for an American firm AmerCo for 30 years.

Jane headed the South African branch of AmerCo (in Johannesburg) from 1 January 2008 to 31 December 2009. She retired from AmerCo on 31 December 2009. On retirement, Jane was informed that AmerCo would pay her a pension of R400 000 *per annum* in respect of her 30 years' service to the company. Jane had become ordinarily resident in the Republic from 1 January 2012. In addition to her pension, Jane received interest on a deposit in an American bank. This amounted to R200 000 for the 2017 year of assessment.

YOU ARE REQUIRED TO: Determine the amount (if any) to be included in Jane Murray's gross income for the 2017 year of assessment.

QUESTION 16.5 (Solution at end of chapter) (23 Marks)

The following five case studies relate to exempt income:

1. Marco Lothario is employed by Cape Shipping Ltd as a member of their crew. Cape Shipping Ltd's ships are all used for the international transportation of passengers. During his 2017 year of assessment, Marco was outside South African territorial waters for a total of 200 days. He was paid a salary of R20 000 per month.

2. Dickey Bird is employed as a pilot by South African Airways. During his 2017 year of assessment, he was paid R65 000 per month. He was physically outside South Africa for a total of 190 days during this period. At no stage was he outside South Africa for a continuous period of more than 60 days.

3. ThembaNjalo, a SA resident, is employed as a mineworker, while his wife Valencia, to whom he is married out of community of property, works as a marketer for the mine. During his 2017 year of assessment his employer gave him a miner's uniform with a market value of R400. From 1 March 2016 they also gave his wife a clothing allowance of R500 per month.

4. Mr and Mrs Fred Couple, married out of community of property and both South African residents, are both employed by the same company. During April 2016 they were both advised that they would be transferred from the Johannesburg branch of the company to the Cape Town branch. Mr Couple was transferred on 1 August 2016. He commenced work and moved into the Cape Town Holiday Inn from that date. The company paid the cost of his flight, R4 200 and also the costs of his accommodation at the hotel, for which the hotel charges him R12 000 per month. Mrs Couple flew down to join him in the hotel and at work on 15 January 2017. The company paid for the cost of her flight, R3 800 and the costs of both Mr and Mrs Couple's accommodation in the hotel, for which the hotel charges R24 000 per month. The company also paid all costs relating to the transportation of the household effects to Cape Town, which cost R81 500 and the estate agent's commission on the sale of their Johannesburg house, which amounted to R150 000. Mr and Mrs Couple purchased a house on 20 January 2017 and moved into it on 15 February 2017.

5. Ian Vester deposited R100 000 in a South African financial institution (a 'bank' as defined in s50A) on a fixed deposit at 8% *per annum* with interest payable monthly from 1 July 2016. Ian is not resident in South Africa, having immigrated to Australia in 2014. During his 2017 year of assessment, he also earned royalty income of R120 000 from sales of a book in South Africa which he had written in Australia.

YOU ARE REQUIRED TO: Discuss which amounts will constitute income for the taxpayers named in the above cases, in respect of their 2017 years of assessment.

QUESTION 16.6 (10 Marks)

For purposes of this question, ignore VAT.

Nashleen Dilrajh, a SA resident, 66 years old, is a purchasing manager for YDE clothing stores. She is in charge of all inventory purchases for the clothing chain and must pre-purchase the clothes before each new fashion season.

For her 2017 year of assessment Nashleen had the following income and expenditure:

1. She earned a salary of R30 000 per month from YDE. The company was extremely impressed with her selection of the summer sales collection and they decided to award her an additional bonus of R40 000 and to promote her to head of retail operations. She used the R40 000 to purchase an annuity from Sanlam. The annuity was to pay out R800 per month over six years commencing on 1 June 2016.
2. Her boyfriend in England gave her shares in non-SA resident companies based in Europe, which earned her taxable dividends of R8 000. She also received an annuity, as a beneficiary, from her family trust, which comprises local South African dividends of R5 000 and interest of R16 000. She also has savings in a high yielding money market fund in South Africa that earned interest of R30 000.
3. Nashleen has converted her spare bedroom into a home office to enable her to do YDE work on Wednesdays (when she does not have to work in YDE's offices). She incurred a total of R102 500 in rental, electricity and water (combined) on her house for the 2017 year of assessment. The floor area of the home office is 25 square metres and the floor area of the entire house is 200 square metres.

YOU ARE REQUIRED TO: Calculate Nashleen's taxable income for her 2017 year of assessment.

QUESTION 16.7 (Solution at end of chapter) (25 Marks)

The following question consists of case studies relating to expenditure incurred by the taxpayer.

YOU ARE REQUIRED TO: In respect of each scenario to state, with reasons, whether or not the expenditure in question is deductible:

1. R200 000, being the best estimate at year end of the likely damages to be paid by McBurgers Ltd to one of its customers who purchased a cup of coffee which was too hot and, as a result of which, the customer suffered damage to his mouth. McBurgers Ltd has agreed to a settlement, but is taking advice as to the amount thereof.
2. R100 000, being a 'provision for returnable containers' included in the balance sheet of Billy's Biscuits Ltd in respect of the likely amount which the company would have to refund to customers who return their biscuit tins in the following year.
3. R1 000 000, being damages to be paid by Happy Homes Ltd, a firm of building contractors, who failed to install a lightning conductor in a home built by them. Lightning struck the home and killed a resident.
4. R2 000, being the cost of a replacement suit that Tip-Top Drycleaners had to give to a customer when they lost the suit that he had given them to dry-clean.
5. Travel expenses for the year of R4 000 incurred by Fred Sharpe, an attorney, in respect of travel between his home and practice. He conducts his professional activities partly at home and partly at his practice.

QUESTION 16.8 (38 Marks)

Listed below are ten different sets of circumstances in which the taxpayer concerned would like to claim a tax deduction for certain expenses incurred.

1. Big race jockey Wizard Whipp was fined R6 000 for failing to keep his mount, Postcrasher, on a straight course during the running of a feature race. Wizard Whipp and Postcrasher had been first past the post, but ended up being placed third after a successful objection had been lodged by the owners of the second and third horses across the line on the ground of interference from

the winner. Wizard Whipp now wishes to claim the fine of R6 000 he has paid as a deduction for tax purposes from his earnings consisting of riding fees and prizes (commissions).

2. Mr Rice-Taxfree successfully campaigned for a seat in parliament in a recent general election. In his return of income for the current year of assessment he has claimed as a deduction from his salary, earned as a member of parliament, the campaign and election expenses he had incurred.

3. Betty Baker is the author of *The Cookery Page* that appears in a local newspaper each week. Betty Baker states that at least half the meals she prepares at home are experimental-type meals which she may use in her cookery article at some stage. Betty Baker now wishes to deduct R20 000, being half the amount she has paid to the supermarket, for purchases during the current year of assessment. She is of the opinion that this is part of her business expenses while trading as a cooking correspondent.

4. Cluster Homes (Pty) Ltd constructed a block of duplex flats with the intention of deriving income in the form of rentals. It borrowed R40 million at 15% per year in order to finance the cost of building. During its current year of assessment, it paid R6 million interest. The flats were let to tenants for the first time, three months before the end of its year of assessment. Cluster Homes (Pty) Ltd would like to claim the R6 million as a deduction for normal tax purposes.

5. MahaMoodley is one of the directors of Moodley's Manufacturing Co (Pty) Ltd. In terms of his employment contract with the company, he is entitled to take a trip abroad every five years, at the company's expense. His employment contract further provides that he may take a companion with him, also at the company's expense. During the current year of assessment, MahaMoodley completed his fifth year of service to the company. Accompanied by a friend, he proceeded on a six-week trip to India at the company's expense. Moodley's Manufacturing Co (Pty) Ltd paid his expenses amounting to R60 000 and the friend's expenses of R55 000 and have claimed the R115 000 paid as a deduction for normal tax purposes.

6. George Bacon carries on farming operations both in the Republic and in Zambia. Five years ago, George left Zambia and moved to the Republic, where he purchased a farm on the KwaZulu-Natal North coast. When he discovered that he was unable to sell his farm in Zambia, he appointed a farm manager to control and continue his farming operations there. George returns to Zambia once every three months in order to supervise the farming operations there. He has incurred travelling expenses in this regard of R50 000 during the current year of assessment and wishes to deduct them from the farming profits he has made in the Republic.

7. Fanny Fairlady, the well-known and beautiful photography and fashion model, gave birth to a son during March 2016. During the months of May and June, Fanny spent many hours in a local gymnasium in order to ensure her figure would return to the shape it was before she fell pregnant. She paid R2 000 to the gymnasium for the use of its facilities. Fanny started modelling again on 1 July 2016. She still attends the gymnasium once a week in order to preserve her current figure. She pays R250 per month for this service. Fanny would like to deduct the R2 000 and the R250 per month from the gross modelling fees she earns to arrive at her taxable income from this source.

8. Dr Norman Longwaite, a general practitioner, subscribes to the *Republic Geographical Journal.* He paid an annual subscription of R350 during the current year of assessment for this journal, which is published once a month. The monthly issues are posted directly to Dr Norman Longwaite at his rooms. As he is of the opinion that the journal is of educational value, he immediately takes the said issue home, upon which it is read by all three of his children. Two weeks later he brings the journal back to his rooms where it is placed in the waiting room for

the use of his patients. Dr Norman Longwaite would like to claim a tax deduction in respect of the annual subscription he paid.

9. Mary Moonsamy carries on the business of buying and selling second-hand newspapers. She buys the papers from housewives who reside in the housing suburbs of the town and then sells them to certain industrialists. She uses a trailer drawn by two donkeys to transport the second-hand newspapers. Mary owns four donkeys and uses them on an alternate daily basis to pull the trailer as a team comprising two donkeys. Mary would like to deduct the expenses she has incurred in relation to the donkeys from the profits she has made from her business of selling second-hand newspapers.

These expenses are as follows:	**R**
Cost of the four donkeys	3 000
Cost of feeding them	14 400
Cost of stabling them	5 400
Farrier's fees (farriers fit horse-shoes)	1 800
Veterinary expenses	1 900

10. Heavy Haulers CC carries on a transport business. During its current year of assessment, it was fined on a number of occasions for overloading its transport vehicles. In this regard, it incurred fines amounting to R23 000 in total, during the current year of assessment. Customers of Heavy Haulers CC often insist on larger loads than that which a vehicle is permitted to carry. These customers are charged a surcharge to cover the risk of a possible fine. The amounts of these surcharges have been included in the gross income of Heavy Haulers CC. Is the company entitled to a tax deduction of the R23 000 it has incurred on fines for overloading?

YOU ARE REQUIRED TO: Set out, with supporting reasons, the extent to which the expenditure in each of the above cases would be deductible from income.

QUESTION 16.9 **(26 Marks)**

Listed below are eight case studies. The expenses which have been incurred by the taxpayer may or may not be tax deductible.

1. Messrs Smith and Jones, the managing director and production manager respectively of Fruit Products Ltd, travelled to the USA for the purpose of purchasing new machinery for the company's factory. They found that the machinery was not suitable and returned to South Africa without making any purchases. The entire amount of travelling expenses incurred (R125 000) was claimed as a deduction from income by Fruit Products Ltd in its current year of assessment.
2. Quick Sell Ltd entered into an advertising contract with an advertising agency. The contract was for a period of five years but, in terms of the agreement, the entire amount of R240 000 was payable in the first year. During its current year of assessment (being the first year) the company claimed as a deduction from its income the entire amount of R240 000.
3. Anne Boyle, aged 23 years, is a divorcee who was awarded custody of her infant daughter. She received no maintenance for herself or her minor child from her former husband. In order to support herself and her child, she took up a position as a full-time typist and placed her child in a day nursery. Had it not been possible to place her child in the day nursery she would not have been able to go out to work. She claimed as a deduction from income an amount of R3 600, being the day-nursery fees.
4. Percival Caster, a chartered accountant in public practice, claimed, as a deduction from income, subscriptions to an income tax service amounting to R14 800 a year.
5. Travelling expenses of R6 000 incurred by David Cotton, an attorney practising in one town, who travels to another town to attend a board meeting of a company of which he is a director.

6. Expenses of R14 800 incurred by an advocate, Oscar Nylon, in travelling between his residence and his chambers. The advocate conducts his professional activities partly at his chambers and partly at his home.
7. After a number of burglaries at his business premises, Brutus Alert decided to purchase a watchdog. He paid R3 000 for an Alsatian dog. It costs Brutus Alert R600 a month to feed the dog. During the current year of assessment, he also paid the veterinary surgeon's account of R3 400 for treating the dog after the dog had been stabbed by an intruder.
8. Flora Bloom, trading as Flora's Florist Shop, incurred expenditure of R13 500 in respect of medical treatment and compensation for her driver, Simon, who was bitten by a bull terrier when delivering flowers to a customer of Flora's Florist Shop. The R13 500 she paid was in respect of doctor's accounts amounting to R2 200, hospitalisation cost of R2 800, theatre fees of R5 000 and anaesthetist fees of R2 500. The balance was towards new clothing, as his original trousers had been torn to pieces. Flora Bloom now wishes to deduct the R13 500 for normal tax purposes, as she feels it was one of her business expenses while trading as a florist.

YOU ARE REQUIRED TO: Set out, with supporting reasons, the extent to which the expenditure in each of the above cases would be deductible from income in terms of the general deduction formula.

QUESTION 16.10 **(17 Marks)**

'Lawn Ltd' (Lawn) is a local manufacturer of lawnmowers. Lawn is renowned for developing good quality Lawnmowers that can be adjusted to suit various grass types and terrains. The company has a 31 March year end.

Lawn had a bumper year due to an increased interest in gardening maintenance in South Africa and made sales of R336 000 during the year. Purchases of materials and parts to manufacture its lawnmowers totalled R147 000.

On 1 January 2017, a fatal accident occurred and one of Lawn's key employees, Mrs Gardener, was killed by a drunk driver whilst returning home from her New Year's party. Lawn paid the family of Mrs Gardener the amount of R150 000 as a goodwill gesture.

During March 2017, Lawn paid for expenses (R184 000) that were in connection with a cleaning service. Clean Ltd will clean Lawn's factory and machines in September 2017. Assume that the R184 000 was 'actually incurred' in Lawn's year of assessment ended 31 March 2017.

During the year, Lawn incurred penalties on its late VAT payments to the amount of R19 000.

During January 2017, a fire in the factory destroyed lawnmowers which had a cost of R8 000. By the end of the year, R6 000 had been received from insurance pay-outs. No other amounts are expected to be paid out.

During the current year, Lawn sued a competitor for an amount of R460 000, as Lawn felt that the competitor had copied a number of his unique lawnmower designs. Lawn won the case in January 2017, but received only R412 000, as the judge felt that this was fair compensation. R180 000 of the receipt was due to lost sales and the remainder for bad publicity brought upon Lawn because the competitor denied the allegations.

YOU ARE REQUIRED TO:

1. Calculate the taxable income of Lawn Ltd for the year ended 31 March 2017. Mention any applicable case law. Ignore VAT and give full reasons for the inclusion or exclusion of each item given. (12 Marks)

2. State whether the two statements below are true or false. Give full supporting reasons for your answers, including any relevant Income Tax Act references. These statements are independent of (1) above.
   i. If a taxpayer sometimes uses her lounge as an office to prepare work for her salaried income, she will be able to claim a deduction of expenses incurred relating to the lounge. (3 Marks)
   ii. The *New State Areas* case was concerned with the issue of whether an amount of income was capital in nature. (2 Marks)

QUESTION 16.11 (Solution at end of chapter) (13 Marks)

Ziton Motors Ltd carries on business as a second-hand car dealer and also repairs and services motor vehicles.

During the previous year of assessment, the company's delivery vehicle was borrowed by one of its employees without permission and was damaged in an accident. The company incurred expenses of R10 000 (in the current year of assessment) in repairing the vehicle. The employee agreed to repay this amount to the company if he had sufficient funds, but subsequently absconded without having repaid any of the amount incurred by the company. During the current year of assessment, the company incurred legal fees amounting to R2 000 in an attempt to recover the amount owing by the employee. As a result, half of the total debt outstanding was recovered by the end of the year of assessment.

Ziton Motors Ltd incurred further legal expenses amounting to R5 000 in resisting a R60 000 claim for damages by a customer who claimed that faulty brakes caused him to have an accident. Although the customer lost the case, Ziton Motors was obliged to pay the customer R1 500 under the warranty previously given on the service carried out by the company on the customer's car in 2016.

Amounts received from customers for repairs and services rendered during the year amounted to R800 000. In addition, Ziton Motors received R4 500 as a deposit from a customer whose car is to be repaired during January 2018.

In the prior year, Ziton had made provision for the following debts, which in the current year were proved to be irrecoverable and were written off in the company's books:

Amount owing in respect of a car sold at cost to Mr Marsh, an ex-employee, in a previous year of assessment	R15 000
Trade debtors	R50 000

Legal costs of R3 500 were incurred in an attempt to recover the R15 000 owing by Mr Marsh. R12 000 was incurred in the attempt to collect outstanding trade debtors.

Of the total outstanding debts of R450 000 at 31 December 2017, R240 000 was considered to be doubtful. At 31 December 2016, R85 000 of total debts outstanding of R300 000 were considered to be doubtful.

Included in the list of doubtful debts outstanding at 31 December 2017, is an amount of R40 000 owing by an ex-employee in respect of a cash loan granted to him while he was still in the employ of Ziton Motors.

Ziton Motors claims 25% of its qualifying doubtful debts as a doubtful debt allowance, in accordance with the criteria as set out in a public notice issued by the Commissioner.

YOU ARE REQUIRED TO: Calculate Ziton Motors Ltd's taxable income for its year of assessment ended 31 December 2017. (Ignore VAT.)

QUESTION 16.12 **(9 Marks)**

Framers (Pty) Ltd, a registered VAT vendor, is a company engaged in the business of picture framing. Its annual turnover for its financial year ended 31 December 2017 amounted to R3 500 000.

All amounts are exclusive of VAT, unless stated otherwise or the context indicates otherwise.

For the financial year ended 31 December 2017 its income statement and balance sheet included the following:

Income statement	**R**
Bad debts and increase in doubtful debt provision (note 1)	61 000
Legal expenses (note 2)	24 500
Damages claim (note 2)	100 000
Balance sheet	
Current assets	
Accounts receivable	200 000
Current liabilities	
Provision for bad debts (note 3)	30 000

Notes

1. Bad debts of R61 000 includes an increase in the provision for doubtful debts of R10 000.

2. Legal expenses consisted of an amount of R2 500 for debt collection and R22 000 in respect of resisting an action for damages against the company. A customer's painting, which was waiting to be framed, fell off a shelf and was damaged. The company was ordered to pay R100 000 in damages. Framers were insured and the insurer agreed on 15 December 2017 to pay out R70 000 in respect of the damages incurred.

3. The provision for bad debts is based on the total of doubtful debts at the end of the year of assessment. The company claims 25% of its qualifying doubtful debts as a doubtful debt allowance, in accordance with the criteria as set out in a public notice issued by the Commissioner.

   Included on the doubtful debt list at 31 December 2017 was a loan to an employee of R5 000. This amount included interest of R200 on the loan. No provision had been made in respect of this amount in the prior year.

YOU ARE REQUIRED TO: Determine the tax effect of all transactions and amounts for the year of assessment ended 31 December 2017.

QUESTION 16.13 **(15 Marks)**

PART A (4 Marks)

In June 2015 Joan Amm decided that she was going to operate a business (of selling cakes) through a new company. The company, Cookie Cakes (Pty) Ltd, was registered in October 2015. Trading did not commence until 1 March 2016, but Cookie Cakes did incur expenditure up to 29 February 2016.

The expenditure incurred during this period was:

–	one-month rental of premises	R20 000
–	staff salaries (staff were employed in February 2016)	R30 000
–	electricity and water	R2 000

During the year ended 28 February 2017 Cookie Cakes had gross income of R820 000 and tax deductible expenditure of R800 000. Joan does not own shares in any other companies and does not hold equity shares of any other company.

YOU ARE REQUIRED TO: Calculate Cookie Cakes' taxable income for the year ended 28 February 2017.

PART B (3 Marks)

Investico (Pty) Ltd borrowed R1m in 2016 to enable it to purchase shares in foreign companies. For the year of assessment ended December 2017 and 2018 Investico had the following dividend income from foreign companies and incurred the following interest on the loan:

	2017	**2018**
Dividend income received/accrued on 31 December	70 000	120 000
Interest paid on loan	90 000	80 000

Note that none of the dividend income is exempt in terms of section 10B(2).

YOU ARE REQUIRED TO: Calculate Investico's taxable income from its foreign dividend activities for the 2017 and 2018 year of assessment. You may assume that all applicable legislation remains unchanged for the 2018 year of assessment.

PART C (6 Marks)

Advance (Pty) Ltd acquired land from a private seller in 2017. Advance is a land-dealing company, i.e. land is its trading stock.

The land had a market value of R10 million at the time that it was acquired by Advance. The purchase consideration was settled by means of a share issue. Advance issued shares to the seller which had a nominal value of R2 million and a market value of R9 million.

YOU ARE REQUIRED TO: Explain whether Advance can claim a tax deduction in respect of the acquisition of the land and, if it can, how much it can deduct in its year ended 31 December 2017.

PART D (2 Marks)

In 2017 Been (Pty) Ltd issues shares to its employees in terms of a 'broad-based employee share plan'.

Been issued 5 000 of its shares to each of its 200 employees. Each share has a nominal value of R1.00 and a market value (at the time of issue) of R8.00.

YOU ARE REQUIRED TO: Calculate the deduction (if any) which Been may claim in respect of the shares issued, for its year of assessment ended 31 December 2017.

QUESTION 16.14 **(20 Marks)**

Carrymore (Pty) Ltd carries on business as a retailer of household goods. The company operates solely in Cape Town. Carrymore sells most of its goods on credit.

The following information is provided in respect of the company's year ended 31 December 2017:

1. Sales – cash 900 000
   – credit 4 200 000

2. Interest on debtors' accounts 210 000

3. Bad debts recovered 362 500

   Carrymore's attorneys were successful in collecting R325 000 of trade debts previously written off by the company. The attorneys were also successful in collecting two amounts owing by two ex-employees. These amounts had been written off as irrecoverable during 2016.
   - One amount of R12 500 had remained outstanding by an ex-employee in respect of goods purchased from Carrymore in November 2015. Carrymore had sold the stock to the ex-employee at cost. It was a policy of the company to sell obsolete or damaged stock to staff members at cost.
   - The other amount of R25 000 had been owing by another ex-employee in respect of a loan granted to him by Carrymore for the purpose of assisting the employee to purchase a plot of land. The employee intends to build a house on the land, but has not yet commenced building.

4. Trading stock on hand at cost was as follows:
   31 December 2016 450 000
   31 December 2017 700 000
   Purchases of trading stock during the year amounted to R3 500 000.

5. Included in the amount of R450 000, representing stock on hand at 31 December 2016, is an amount of R32 000 in respect of goods which were donated to a local charity in January 2017. The company made the donation anonymously and accordingly did not receive any public recognition for its generosity. The market value of the goods donated was R31 920. The charity is not permitted to issue receipts in terms of section 18A.

6. The list of doubtful debts drawn up for accounting purposes at 31 December 2017 amounted to R920 000. The balance at 31 December 2016 was R650 000. Carrymore claims 25% of the list of qualifying doubtful debts as a deduction in accordance with the criteria as set out in a public notice issued by the Commissioner.

7. Staff costs:
   - Salaries of employees 1 200 000
   - Contributions to pension and medical aid funds on behalf of employees 150 000
   - Annuity paid to ex-employees who retired due to old age during 2016 300 000
   - Annuity paid to dependants of an ex-employee who was fatally injured in the performance of his work duties 50 000

8. Legal expenses
   - Cost of collecting trade debtors (refer note 3 above) 25 000
   - Cost of collecting amount owing by ex-employees (refer note 3 above) 2 000
   - Cost of drawing up a restraint of trade agreement in respect of an employee who resigned on 1 June 2017 to set up his own business. The restraint was for a period of two years. 5 000

   It may be assumed that the cost of collecting the amounts owing by the ex-employees is proportional to the debts collected in respect of each employee.

9. Advertising and publicity

• Cost of advertising in local newspaper	37 000
• Cost of stock given as gifts to customers (the market value of the stock was R55 000)	60 000

10. Carrymore leases the premises from which it operates for R28 000 per month. During the current year, Carrymore experienced a sharp decline in its sales and took the decision to sub-let a section of its premises. Carrymore was fortunate to find a suitable tenant and it was agreed that the prospective tenant would occupy the premises with effect from 1 January 2018. The tenant paid three months' rental in advance amounting to R18 000 on 1 December 2017. The tenant also agreed to pay a premium of R50 000, but had not paid it by 31 December 2017.

YOU ARE REQUIRED TO: Calculate the taxable income of Carrymore (Pty) Ltd, if any, in respect of its year of assessment ended 31 December 2017. (Ignore VAT and CGT.)

QUESTION 16.15 (Solution at end of chapter) (24 Marks)

'Asquith (Pty) Ltd' (Asquith), a registered VAT vendor, purchased a second-hand machine for R1.4 million (excluding VAT) on 1 April 2016 and brought it into use directly in a process of manufacture on 15 May 2016. In addition to the R1.4 million, it incurred transport costs of R5 000 (excluding VAT) and installation costs of R45 000 (excluding VAT) in respect of the machine. The open market value of the machine (including direct costs of transport and installation) fluctuated as follows over this period. On 1 April 2016 the open market value was R1.7 million, while on 15 May 2016 it was R1.3 million and on 1 August 2016 (refer below) it was R2 million.

An associate company of Asquith's, Baldwin (Pty) Ltd, a registered VAT vendor in which Asquith holds a 51% shareholding, urgently needed this type of machine and Asquith therefore donated the machine to Baldwin on 1 August 2016. Asquith agreed to pay all transport and installation costs in relocating the machine to Baldwin's factory building. These costs amounted to R40 000 (excluding VAT) and the machine was brought into use directly in Baldwin's manufacturing process on 1 August 2016. Asquith did not replace the machine.

On 1 October 2016 the machine was removed from use since a fire had damaged it beyond repair. Baldwin's insurance company paid out R2 223 000 in respect of the claim. A new replacement machine, costing R1 950 000 (excluding VAT), with an open market value of R1.9 million was brought into use by Baldwin in its manufacturing process on 15 November 2016. Assume that Baldwin wishes to defer its liability for taxation wherever possible and elects to apply para 65 of the 8th Schedule (if applicable).

Assume that for the purpose of section 11(e) allowances, the Commissioner allows a straight-line write-off over five years on qualifying assets. Assume that all companies have a February year-end.

YOU ARE REQUIRED TO:

1. Show the income tax effects of the above transactions for Asquith (Pty) Ltd in respect of its year of assessment ended 28 February 2017. (13 Marks)
2. Show the income tax effects of the above transactions for Baldwin (Pty) Ltd in respect of its year of assessment ended 28 February 2017. (8 Marks)
3. Assume that Baldwin will use the above replacement machine in its manufacturing process until 1 January 2021, on which date it will be sold in the ordinary course of Baldwin's trade for R1.85 million (excludingVAT) and not replaced. Calculate the income tax effects of the machine for Baldwin (Pty) Ltd in respect of its year of assessment ending 28 February 2021 (assuming no changes in the current legislation). (3 Marks)

QUESTION 16.16 **(28 Marks)**

Avalon Adhesives (Pty) Ltd, a South African resident company with a financial year ending in February, manufactures a range of adhesives for sale to a variety of local customers.

The company is a registered VAT vendor. All figures are exclusive of VAT where applicable unless otherwise stated or shown by the context.

For the year of assessment ended 28 February 2017, the company's comprehensive statement of income reflected net profit of R1 250 000, after a total depreciation charge of R500 000 and before taking the items below into account:

On 30 June 2015, the company acquired a piece of land in Montague Gardens, Cape Town, at a cost of R1 000 000 and built a new factory building at a cost of R4 000 000 that was brought into use on 1 December 2015. On 1 April 2016, an extension to this building was commenced. This comprised an enlargement of the factory floor area at a cost of R400 000 and an increase in the size of the administration office costing R300 000. The entire extension was completed and brought into use on 1 November 2016.

When it commenced trading on 1 October 2015, Avalon acquired new manufacturing machinery at a cost of R900 000.

It also acquired a machine from its sole shareholder, Mr van Wyk, by way of donation on 1 November 2015. The machine had cost the shareholder R250 000, but had an open market value of R300 000 on the date of the donation. The shareholder had acquired the machine new, but had never used it before donating it to Avalon.

Avalon also purchased a five-ton bakkie for deliveries at a cost of R228 000 (including VAT) on 1 November 2016 and a motor car for the use of the managing director which cost R342 000 (including VAT) on 1 December 2016. Both vehicles were brought into use immediately on acquisition.

On 1 July 2016, the company installed a conveyer belt to move materials from one stage of the production process to the next in order to avoid problems that had occurred due to chemicals being spilled. The cost of this conveyer belt was R350 000. On 1 May 2016, the company acquired a new packing machine in its dispatch area at a cost of R80 000. A new stand-alone personal computer was acquired on 1 September 2016 at a cost of R6 000, for purposes of inventory control.

On 1 March 2016 Avalon distributed an asset that had a cost of R200 000 and a tax value of R150 000 to its shareholder by way of a dividend *in specie*. The market value of the asset on the date of the distribution was R220 000.

On 15 January 2017, one of the machines it had acquired on 1 October 2015 at a cost of R120 000 was destroyed in a fire caused by an electrical fault. The insurance company deposited an amount of R142 500 to the company's bank account as compensation for the loss on 16 February 2017.

Trading stock at 29 February 2016 had a cost of R300 000 and a net realisable value of R290 000 and an impairment was recognised in the 2016 financial statements. At 28 February 2017 closing stock on hand had a cost of R350 000, but due to changes in supply and demand in the market, the net realisable value was R400 000.

It can be assumed the Commissioner allows 20% a year straight-line for all assets qualifying for the section 11(e) allowance.

YOU ARE REQUIRED TO: Calculate the taxable income of Avalon for the year of assessment ended 28 February 2017. Start your calculation with the accounting net profit given and make whatever adjustments are required to arrive at taxable income. Where no adjustment is required, you should state this and provide an explanation.

QUESTION 16.17 **(12 Marks)**

Balfour Cellars CC is a small business enterprise, which is wholly owned by Horatio, a South African resident. Balfour Cellars CC is involved in the wine-making industry, which is considered a process of manufacture. Horatio has invested his life savings into Balfour Cellars and owns no other shares or members' interests.

For the year of assessment ended 31 March 2017 Balfour Cellars had the following receipts, accruals and expenses:

1. Purchase of one additional stainless steel tank for R100 000 on 1 June 2016. Balfour had purchased its first tank on 1 June 2015 for R95 000 and brought it into use in production on that date.
2. Purchase of ten wooden display cabinets for the equivalent of R10 000 each on 1 June 2016 to expand its wine-tasting facilities. R95 000 had been spent on similar display cabinets in the prior year of assessment.
3. Sales of wine to other cellars amounted to R500 000.
4. Tax-deductible expenditure amounted to R56 000.

You may assume that any qualifying assets may be written off over six years under section 11(e).

YOU ARE REQUIRED TO:

1. Briefly explain the requirements for a close corporation or private company to be classified as a small business corporation. (6 Marks)
2. Calculate the tax payable by Balfour Cellars CC for the year of assessment ended 31 March 2017 assuming it qualifies as a small business corporation. (Ignore VAT.) (6 Marks)

QUESTION 16.18 (Solution at end of chapter) **(16 Marks)**

Elwood is engaged in the manufacture of high quality furniture using exotic hard woods. This process is carried on in a factory in Cape Town.

The following information is provided for the year ended 28 February 2017.

1. Elwood's taxable income before taking the information below into account was R10 million.

2. In June 2014 Elwood (Pty) Ltd acquired a vacant piece of land at a cost of R800 000 for the purposes of constructing a second factory. This second factory, which Elwood had intended building, was never built, because of a downturn in the economy. On 1 March 2016 Elwood changed its intention and decided to subdivide the vacant land (acquired in 2014) and sell it off as small industrial plots in a scheme of profit-making. The property was subdivided at a cost of R500 000 and all of the plots were sold for R3 800 000. On 1 March 2016 the market value of the land was R1 600 000.

3. Opening stock (at cost) comprised:

– timber	R2 000 000
– consumable stores	R100 000
– work in progress	R400 000

Included in opening stock was some very high quality yellow wood. The directors decided that the wood would be taken out of stock and used to manufacture a boardroom table. On the date that wood was removed from stock, it had a market value of R25 000. The cost of the wood was R20 000. The cost of manufacturing the boardroom table was R10 000, which excludes the cost of the wood used. The boardroom table was brought into use on 1 June 2016. The Commissioner allows wear and tear of 20% per annum on office furniture.

4. Closing stock (at cost) on 28 February 2017 comprises:

– timber	R1 800 000
– consumable stores	R150 000
– work in progress	R600 000

YOU ARE REQUIRED TO: Calculate Elwood's taxable income for the year ended 28 February 2017. (Ignore VAT.)

QUESTION 16.19 **(28 Marks)**

'He Man Ltd' (He Man), a registered VAT vendor, is a local manufacturer of action figurines. Dexter, the financial accountant, is confused as to how to calculate taxable income, as he did not pay attention in his undergraduate tax lectures. He has approached you for advice and provided you with the following information:

1. Prior year closing stock (at cost, i.e. before any writedowns) was R2 250 000 (excluding VAT). Stock which had cost R500 000 (excluding VAT) had decreased in value and was written down to R300 000. The write down was permitted by SARS. None of the written down stock was sold during the year. By the end of the current year of assessment the written down stock had a market value of R600 000.

2. Sales for the year totalled R22 800 000 (including VAT), with 80% being on credit. 10% of credit sales were written off as bad. In addition, the provision for bad debts, excluding VAT, was R600 000 (2016: R800 000). Included in the current and prior year provision is a loan to an employee of R30 000 which has not yet been written off as bad in the current year. CSARS allows a 25% deduction on qualifying doubtful debt balances.

3. The company purchased R17 100 000 (including VAT) worth of trading stock.

4. Skeletor Ltd, a subsidiary of He Man, donated stock with a market value of R150 000 to He Man. None of this stock has been sold at year-end.

5. He Man removed stock with a cost of R171 000 (including VAT) and distributed it to shareholders as a dividend *in specie*. South African dividends of R484 000 were received by He Man.

6. He Man donated stock with a cost of R57 000 (including VAT) and open market value of R70 000 to a customer as part of a marketing campaign.

7. He Man made a donation of stock with a cost of R798 000 (including VAT) and an open market value of R900 000 to a registered PBO. Dexter has shown you the PBO's receipt evidencing this donation.

8. Stock costing R1 000 000 (excluding VAT) is on hand at the end of the year. This was calculated before any write downs or write backs and before adjusting for point (4) above.

9. The company pays an annuity of R4 000 at the end of each month to Mr X-man, a former employee who had retired due to old age in the prior tax year. Mr X-man passed away on 1 January 2017 after a New Year's Eve party. He Man continued to pay the annuity to Mr X-man's wife, Xena.

10. He Man purchased a delivery truck under a suspensive sale agreement on 1 October 2016. The cash cost of the truck was R200 000 (excluding VAT) and total instalments equalled R300 000. Only five of the 30 monthly instalments had been paid by year-end. The finance charges for the year per s24J amounted to R12 000. The Commissioner allows wear and tear of 25% *per annum* on delivery vehicles.

11. The company incurred research and development expenditure of R500 000 (excluding VAT) after 2 November 2016 on developing a prototype for the new Rambo action figure to be released in the following year. The research and development is approved in terms of s11D(9). Included in the amount of R500 000 is R50 000 paid to a sales representative involved in conducting a market survey.

    On 1 October 2016 a new building was purchased for commercial rental income and research and development activities. The purchase price was R1 000 000 (excluding VAT). 40% of this building is specifically equipped for research and the remainder of the building is let out for R3 000 per month (including VAT) to commercial tenants who did not conduct research and development in their portion of the building. Tenants took occupation on 1 October 2016.

YOU ARE REQUIRED TO: Calculate the taxable income for He Man Ltd for the year of assessment ended 28 February 2017.

QUESTION 16.20 (Solution at end of chapter) (30 Marks)

Ron and Shirley Baxter (née Taylor) were married on 30 June 2016, out of community of property, at the ages of 45 and 42 years respectively.

Ron's previous wife Joan had died in 2013 and he has two children from that marriage – Grant (22) and Janet (12). Neither is married and both are dependants on Ron's medical aid (as well as Mrs Baxter after her marriage to Ron).

Ron had inherited shares with a market value of R70 000 and an interest-bearing investment of R100 000 on his first wife's death. He donated the shares and interest investment to his two children in equal shares on 1 January 2014. Ron also received an annuity of R2 000 per month since 1 January 2014 from Joan's retirement annuity fund (RAF).This was to continue for five years. The income received from the donated investments for the year ended 28 February 2017 was R7 000 in dividends and R10 000 in interest. The total investment income was shared equally between Grant and Janet.

Shirley resigned from her employment on 30 June 2016 in order to get married. She received accumulated leave pay of R2 100 as well as a lump sum of R32 000 from her employer, as she had not belonged to a pension fund. Her salary had been R5 000 per month up to 30 June 2016. She had, from 1 March 2004, and still does, contribute R1500 per month to a RAF (which her employer took into account for employees' tax on a monthly basis). She did not belong to a medical aid before resigning.

Ron earned a basic salary of R17 000 per month. His monthly contributions to a pension fund (based on his basic salary) were R2 000. Ron also belonged to the firm's medical aid scheme and contributed R17 800 for the year. The excess of his medical costs not refunded by the medical aid fund amounted

to R2 300. Shirley joined Ron's medical aid as a dependant after their marriage. He also contributed R13 500 to a RAF for the year. All of his RAF contributions in previous years of assessment were fully deductible.

Ron was required, in terms of his employment package, to entertain clients. He received an entertainment allowance of R4 000 per month and incurred entertainment expenses of R15 300 for the year in this regard. He is not required to account to his employer for his entertainment expenditure.

Ron also did some private consulting, for which he received R15 000 for the year. This was mainly in respect of advice given and the only expenses he incurred were travelling costs of R250, stationery and printing of R410 and R500 in entertaining his clients, which was necessarily incurred to earn the R15 000 income.

Janet was chosen to do an advert on TV during the year and was paid an amount of R9 000. This amount was net of Pay-As-You-Earn (PAYE) of R3 000 withheld.

Grant was in the army and received army pay of R58 000 for the year. He was still partly financially dependent on his father and was therefore allowed to remain as a dependant on his father's medical aid.

YOU ARE REQUIRED TO: Calculate the following for the year of assessment ended 28 February 2017:

1. Shirley Taylor/Baxter's tax liability
2. Ron Baxter's normal tax liability
3. Janet Baxter's tax liability or tax refundable
4. Grant Baxter's normal tax liability

Use only the tax credits provided in the above in determining tax liabilities.

QUESTION 16.21 **(20 Marks)**

Mrs Jones is 34 years old and works for Happy Homes (Pty) Ltd as an estate agent in the Cape Town Atlantic Seaboard area. She receives a basic salary of R3 000 per month. The majority of her earnings come from commission on the properties she sells. Mrs Jones also has the use of a company car – a BMW 3 series which the company acquired for cash at its retail market value of R325 000 (including VAT) and of which she has had the use since then. Mrs Jones is required to pay for all fuel costs, amounting to R12 000. Mrs Jones keeps a logbook and travelled 20 000 kilometres for business and 10 000 kilometres for private use. The BMW has a maintenance plan.

For the tax year ended 28 February 2017, she earned R200 000 commission on house sales.

She also received an entertainment allowance of R2 000 per month, which she uses to entertain prospective customers. She is not required to account for expenditure to her employer, but she does keep accurate records of her expenditure, which amounted to R25 000 for the year ended 28 February 2017.

Mrs Jones contributes 10% of her basic salary to the company's pension fund. Because this is unlikely to meet her future financial needs she also joined a retirement annuity fund, to which she contributes R2 000 per month. She also belongs to a medical aid fund, to which she contributes R1 500 per month for medical cover for herself and her husband. She also incurred medical expenses of R20 000 that were not covered by her medical aid.

Mrs Jones also runs her own interior decorating business in her spare time. During the year she earned R45 000 and incurred deductible costs of R22 000. In addition she estimates that, of the amounts owing to the business, R5 000 will not be collectable. This includes R2 000 that she lent to a supplier whose business was undergoing cash-flow difficulties. She also wrote off a debt of R1 000 as 'bad' which she had identified as doubtful in the previous year. She is not a VAT vendor.

YOU ARE REQUIRED TO: Calculate Mrs Jones's normal tax payable (after any rebates) for the year of assessment ended 28 February 2017.

QUESTION 16.22 (20 Marks)

T.J. Mouton (TJ) is employed by 'Zenith Holdings Limited' (Zenith). During his 2017 year of assessment Zenith made contributions to a medical fund in respect of TJ as follows:

March to August 2016	R600 per month	
September to December 2016	R1 200 per month	(TJ's wife Hildegard was added as a dependant during this period)
January to February 2017	R1 250 per month	(TJ's son Brett, aged 18 was added as a dependant during this period)

TJ made additional contributions to the medical fund as follows:

March to August 2016	R900 per month
September to December 2016	R1 000 per month
January to February 2017	R1 250 per month

TJ incurred the following qualifying medical costs during his 2017 year of assessment:

June 2016	R2 500 (in respect of himself)
October 2016	R5 700 (in respect of Hildegard)
January 2017	R3 300 (in respect of Brett)

A total of R3 200 of these expenses was recoverable from the medical aid.

Hildegard is unemployed and paid R2 000 towards medical costs incurred in July 2016 in respect of TJ.

Assume that TJ's taxable income before taking into account the above information was R100 000 for his 2017 year of assessment.

YOU ARE REQUIRED TO:

1. Calculate TJ's 2017 normal tax payable (after rebates) assuming that he is 50 years of age.
2. Calculate TJ's 2017 normal tax payable (after rebates) assuming that he is 50 years of age and that Brett is 'disabled' as contemplated in the Income Tax Act.
3. Calculate TJ's 2017 normal tax payable (after rebates) assuming that he is 76 years of age.

QUESTION 16.23 (17 Marks)

Daniel van Huys, a 42-year-old South African resident, is employed by Cartwright Wheels and Tyres as a sales representative. He has come to you with his shoebox of receipts, invoices etc. with the statement: 'Sort out my tax, I have no idea what is going on. And if you can, get some tax back!'

Since you are a busy individual, you have been fortunate to employ a clerk who has sorted out the information for you as summarised below:

	R
Monthly cash salary (net of employees' tax of R1 810)	3 190
Commission (for the year)	120 000
Travel allowance (per month) excluding garage card usage (see below)	3 000
Local subsistence (per day for 150 days for meals and incidentals and applied in the month that subsistence was paid)	400
Annual expenses	
Entertainment expenses	5 750
Expenses incurred on holiday in the company holiday house	5 000
Monthly grocery bill	2 500
Home office expenses (his home office is also used as a sewing room by his wife)	12 000
Speeding fines incurred on business trips	1 700

Because of all the travelling that Daniel does as a sales rep, the company fits new tyres to Daniel's car (market value of the tyres is R6 000) each year from their own premises as well as wheel alignment and balancing every 10 000 kilometres (a service with a value of R500 per service). They also pay for the car to be serviced by the local car dealership (a service for every 10 000 kilometres costs R600).

Daniel travelled a total of 52 000 kilometres in the current year of assessment. His car originally cost R180 000 including VAT. His car was serviced six times and the wheels were balanced five times. Daniel does not keep a logbook for his trips as it is 'too much hassle and most of my trips are business anyway'. The company gave Daniel a garage card to cover all tolls, oil and petrol. The bills charged to the card totalled R6 280. Cartwright Wheels and Tyres considers the R6 280 expensed on the petrol card to be a travel allowance.

Daniel spent 12 days at the company's Knysna holiday house (maintained for use by employees) with his wife and two children. When an employee has not booked the house, the house is rented at a market-related rate of R1 500 per day.

Daniel also has a South African interest bearing investment, yielding R30 000 *per annum*, that he had inherited from his late father in 2012.

YOU ARE REQUIRED TO: Calculate the normal tax liability for Daniel for the year of assessment ended 28 February 2017. Indicate, with a brief reason, where amounts are to be excluded from the calculation.

QUESTION 16.24 **(28 Marks)**

Mrs Lerato Mini, aged 60 (a South African resident and married out of community of property), is busy preparing her income tax return for the year of assessment ended 28 February 2017. On 31 October 2016 she retired from Berril (Pty) Ltd after many years of service as head of marketing. For the period 1 March 2016 to retirement, she earned pensionable salary of R30 000 per month, in respect of which she contributed 8% to the company's pension fund, and the company contributed a like amount. The pension fund consists solely of defined contribution components. All of her pension fund contributions in previous years of assessment were fully deductible.

In addition, Mrs Mini had the full use of a motor vehicle that the company had purchased for R228 000 (including VAT), at the time it made the vehicle available to her. The retail market value at that stage amounted to R235 000 (including VAT). The company paid for all business fuel and maintenance (as the car did not have a maintenance plan), but Mrs Mini paid the firm R300 per month against the private fuel costs. She was permitted to continue to use the car after retirement. For the full

year of assessment, Mrs Mini travelled 15 000 kilometres for business and 10 000 kilometres private. She maintained an accurate logbook of her travels.

On retirement Mrs Mini received a monthly pension of R18 000 with effect from November 2016. During April 2016 Berril awarded Mrs Mini a wide-screen television set in recognition of her long service (more than 15 consecutive years). She had not received any long service awards in the past. The company had acquired the TV set as trading stock for R13 680 (including VAT) and the market value on the date of the award was R11 000 (excluding VAT).

Being an energetic person, Mrs Mini was not ready to stop working when she retired from Berril and took up a position as marketing executive with Gadfly (Pty), where she received a salary of R32 000 per month with effect from 1 November 2016. In addition, she received a travel allowance of R5 000 per month from that date (relating to the car below) and an entertainment allowance of R2 000 per month. She was required to account to the company for entertainment expenditure and had supplied vouchers in the amount of R6 200 by 28 February 2017 and could not find any further vouchers. As the company was satisfied that she had actually used the full amount of the entertainment allowance for company entertainment, it did not require her to pay in the difference.

On 1 November 2016 Mrs Mini purchased a new motor vehicle for R285 000 (including VAT), which was partly used in carrying out her duties as marketing executive of Gadfly. Mrs Mini paid cash from her savings for the vehicle. During the period from acquisition to the end of February 2017 she travelled a total of 8 500 kilometres and her total running expenses amounted to R4 500. According to her detailed logbook, 3 400 kilometres represented business travel. Mrs Mini elected to use actual kilometres with deemed expenditure.

Mrs Mini did not qualify for membership of the Gadfly provident fund in terms of the rules of the fund, as she was over 60. From 1 November 2016 she increased her monthly contribution to a retirement annuity fund from the R2 000 per month it had been since 1 March 2016, to R4 000 per month. She will receive payments from this fund when she reaches the age of 65.

In addition to the above, Mrs Mini received the following amounts during the 2017 tax year:

• Dividends on South African listed shares	R10 000
• Interest on local savings accounts	R17 000
• Dividends on shares from Zimbabwe companies. The shares had been inherited from her aunt who was a Zimbabwe citizen. The dividends are not exempt under section 10B(2).	R4 000
• A lifetime achievement award from the Marketing Association. She had not even been aware that the association made such an award and was totally surprised by it.	R5 000

Neither Berril nor Gadfly had a medical aid scheme, but Mrs Mini contributed R2 000 a month throughout the year to a scheme in her private capacity. This was on behalf of herself (as the member) and her husband (the dependant). She had no additional medical expenses that were not covered by the medical aid scheme.

Mrs Mini donated R55 000 to the VW Charity on 28 February 2017, for which she obtained a s18A receipt. The charity is an approved public benefit organisation.

Mrs Mini had no other income, expenditure or capital gains or losses for the 2017 year of assessment.

YOU ARE REQUIRED TO: Calculate Mrs Mini's taxable income in respect of the year of assessment ended 28 February 2017.

QUESTION 16.25 **(31 Marks)**

Sarojini Naidoo, 39 years old, is married out of community of property to Aryan Naidoo. Sarojini is fresh produce manager at Foodworld Limited. In addition, to supplement their income, Sarojini and Aryan started a bed-and-breakfast operation in partnership from their home, sharing profits and losses equally. Sarojini's salary package for the year of assessment ended 28 February 2017 from Foodworld Ltd is as follows:

Salary	196 000
Pensionable bonus (paid in November)	16 000
Entertainment allowance	24 000
Pension contributions (contributions are based on salary and bonus)	16 960
Contributions to a retirement annuity fund	9 000
Medical aid contributions by employee (Aryan is a dependant)	24 000
Employee's tax deducted	24 560

Sarojini can spend her entertainment allowance as she pleases. During the year of assessment she could only produce proof for expenditure incurred of R4 800.

Sarojini is a qualified dietician and does occasional lecturing at the local University of Technology. For this she received a cheque for R7 500, which was after the university had deducted employee's tax of 25%.

The bed and breakfast operation commenced on 1 April 2016 and details are as follows:

Income statement for the period 1 April 2016 to 28 February 2017

	Note	**R**	**R**
Income	1		144 500
less: expenditure			
Purchases of food		12 200	
Cleaning materials		8 400	
Linen, towels, curtains	2	25 000	
Cleaning (allocation of cleaning lady's salary)		9 500	
Electricity and water		1 300	
Repairs and maintenance		755	
Depreciation – appliances	3	255	
Advertising		1 200	(58 610)
Net income			85 890
Sarojini 50%			42 945
Aryan 50%			42 945

Notes

1. Although turnover was not in excess of R1 million, Sarojini and Aryan registered the partnership voluntarily for VAT.
2. The Commissioner allows soft furnishings (linen, etc.) to be written off over five years.
3. Depreciation is in respect of the following:
   - A microwave purchased on 1 April 2016 for R2 500 (including VAT) from a dealer.
   - A fridge purchased on 1 April 2016 from Sarojini's father, who had moved into a retirement home and no longer needed the fridge. They paid him R3 000 for the fridge even though its market value (including VAT) was only R2 100. He is not a registered VAT vendor.
   - A toaster and kettle purchased on 1 April 2016 for R278 each (including VAT).

   Sarojini and Aryan calculate depreciation at 10% *per annum* on the cost of appliances. The Commissioner allows appliances to be written off over six years where appropriate.

In addition, Sarojini incurred medical expenses not recovered from the medical aid amounting to R24 200. Included in this amount is R22 000 in respect of the cost of a replacement artificial limb for her disabled husband, Aryan. Aryan also paid for additional qualifying medical expenditure amounting to R1 600.

Sarojini is a provisional taxpayer and made provisional payments of R3 000 for the year of assessment ended 28 February 2017.

All amounts exclude VAT unless otherwise stated.

YOU ARE REQUIRED TO:

1. Calculate Sarojini's tax liability for the 2017 year of assessment. (20 Marks)

2. Assuming the bed-and-breakfast business qualifies and is registered as a micro business from 1 April 2016 and assuming that all Sarojini's information remains the same for the 2017 year of assessment (including tax rates and rebates), calculate the tax payable by the micro business and Sarojini for the year of assessment ending 28 February 2017. (10 Marks)

3. By when must the micro business make payments of the turnover tax for the 2017 year of assessment? (1 Mark)

QUESTION 16.26 (Solution at end of chapter) (27 Marks)

'Kinshaw Trading (Pty) Ltd' (Kinshaw) is in the business of manufacturing fireworks. They sell to both the local market as well as the international market. Dee Colonel, who is founder and CEO of the company, is very proud of the company's growth. She started the company in her back yard five years ago and today her company is selling fireworks across the globe. She owns 100% of the company.

As business was taking off with a bang, new suppliers of raw materials were sought. Eventually, Dee decided to form 'Kinross Importers (Pty) Ltd' (Kinross), which imported the raw materials from China. Kinross is 100% owned by Dee, is VAT registered and makes only tax-able supplies. Kinshaw is on a two-month tax period ending March, May, July, etc.

The following is an extract taken from Kinshaw's management accounts for the two months ending May 2017. All amounts exclude VAT unless stated otherwise.

	Note	R
Sales (excluding VAT)	1	1 500 000
Purchase of raw materials (excluding VAT)	2	450 000
Purchase of goods and services	3	520 000
Profit from operations		530 000

Notes

1. The sales can be further analysed as follows:

Local sales	900 000
Foreign sales (directly exported)	600 000
Total sales	1 500 000

2. The purchase of raw materials is 80% from its sister company Kinross, and 20% from local suppliers. 50% of the local suppliers of raw materials are VAT registered.

   Kinross is able to sell raw materials at 10% below market value (market value in this instance excludes VAT) to Kinshaw due the fantastic bulk discounts it achieves from its suppliers.

3. An analysis of this figure provides the following purchases:
   a. Kinshaw purchased a second-hand computer from a VAT vendor for R3 000 (excluding VAT).
   b. Kinshaw paid salaries of R80 000 in the two-month period.
   c. Kinshaw purchased a second-hand bakkie from a friend, Mickey, for R20 000 and paid cash. Mickey is not a VAT vendor. The bakkie was used to deliver fireworks, as the last delivery vehicle had an unfortunate end when a 'golden flower' (a type of firework with a large explosive charge) accidentally went off in the back of the van.
   d. Dee travelled extensively to promote her business. In the two-month period she spent R12 000 on air travel to trade shows in Frankfurt, Germany and Nigeria. She spent R4 000 on travel to Parys, South Africa (excluding VAT).
   e. Petrol costs were R10 000.
   f. R40 000 (excluding VAT) relates to an invoice received from ABC Auditing Services. This was for the annual audit that took place in April. Payment of the invoice is only expected to be made in June 2017.
   g. The balance of these purchases of R351 000 are supplies of goods and services from VAT vendors.

YOU ARE REQUIRED TO:

1. Calculate the VAT payable to, or recoverable from, SARS by Kinshaw Trading at the end of their May VAT period.
2. Dee has other companies and businesses ranging from property rental, guesthouses to restaurants. She has asked you to clarify when the companies and/or businesses MAY and when they MUST register for VAT.

QUESTION 16.27 **(17 Marks)**

Toy World Ltd carries on business as a manufacturer of toys from its main branch in the Republic. The company also operates a depot in Harare, Zimbabwe, where sales are made to customers living in Zimbabwe. The Zimbabwean depot does not operate as an independent branch. Toy World Ltd has been registered as a category 'A' vendor. All amounts include VAT where appropriate.

The following information is provided:

Receipts	**February R**	**March R**
1. Cash sales		
– made by the republic branch to South African customers	193 800	176 700
– made by the Zimbabwean depot to Zimbabwean customers (these goods were forwarded to the depot on 10 January and were all sold by the end of March)	39 900	51 300
2. Insurance payment received on an insurance claim for trading stock stolen in the Republic		171 000
3. Interest received on a loan to a subsidiary company in the Republic		13 680
4. Cash received for the sale of an old machine to Mr Ball, the majority shareholder. Mr Ball is not a registered vendor. The machine originally cost R20 000 and had a book value of R5 000 on the date of sale. The open market value on the date of sale was R17 980.		11 400

Expenses

1.	Wages and salaries	63 840	57 000
2.	Property rates on the business property	1 710	1 710
3.	Electricity and water	1 083	855
4.	Telephone	912	570
5.	Raw materials purchased from other vendors	136 800	91 200
6.	Cost of entertaining important customers at various restaurants in Cape Town	1 368	912
7.	Purchase of a new single-cab bakkie for use as a delivery vehicle		
	– Cash cost	171 000	
	– Finance charges paid	8 550	
8.	Cash cost of a new motor car purchased for general use within the business	91 200	
9.	Petrol for delivery vehicles and the new motor car	912	1 026
10.	Maintenance of delivery vehicles and the new motor car	798	912

YOU ARE REQUIRED TO: Calculate the VAT payable by or refundable to Toy World Ltd in respect of its two-month tax period ended 31 March 2017. (Show detailed workings of how you would deal with each item.)

QUESTION 16.28 **(22 Marks)**

PART A (15 Marks)

Indumach (Pty) Ltd is a category 'C' vendor, i.e. it has a one-month VAT period. Indumach is a retailer of industrial machinery and makes only taxable supplies. The following information is given for March 2017.

1. Ten machines were purchased at a cost of R2 850 000 (including VAT); all machines have the same cost of R285 000 each (including VAT).
2. The standard mark up on cost (including VAT) is 50%, i.e. cost plus VAT is increased by 50% to derive selling price, which includes VAT.
3. Five machines were sold for cash.
4. One machine was sold in terms of an instalment credit agreement. The contract provides for 60 monthly payments of R8 900 (at the end of each month), beginning at the end of March.
5. One machine was leased in terms of a finance lease at a monthly rental of R8 000 (payable at the end of the month).
6. An old machine, which was held as opening stock and was reflected at R240 000 in the stock account of the ledger, was sold to Don Reece, at cost plus VAT. Don, who is a 20% shareholder of Indumach, is not a VAT vendor. The open market value of this machine was R175 000 at date of sale.
7. On 25 March a second-hand machine was purchased from a non-vendor for R180 000. Its open market value was R205 200. Indumach paid R100 000 immediately to secure the purchase and will pay the balance at the end of April.
8. The second-hand machine in point (7) above was immediately sold to a vendor (making only taxable supplies) who was a connected person in relation to Indumach, for R200 000.
9. On 1 March 2017 a fire in the warehouse totally destroyed two machines purchased in January for R319 200 (including VAT) each. Indumach's insurer paid out R280 000 for each machine as compensation on 25 March 2017.
10. The fire also totally destroyed a truck that had been bought second-hand from a non-vendor the previous year. The insurer paid out compensation of R80 000 in respect of this truck.

11. During March Indumach purchased two new water bottles for the cold water-dispensing machine in the staff canteen. These bottles cost R1 800 (including VAT) each and were paid for in March.

YOU ARE REQUIRED TO: Calculate all the VAT effects in respect of the above transactions for the month of March 2017. Prepare your answer in columnar format, i.e. have two columns, one for inputs and one for outputs.

PART B (7 Marks)

Indumach is considering expanding its operations and wishes to buy land adjoining its present warehouse. The land is owned by a local investor who is not a vendor. The purchase price will be R2.3 million, which is equal to the open market value of the land.

YOU ARE REQUIRED TO: Discuss the VAT and transfer duty implications for Indumach of buying this land.

QUESTION 16.29 **(12 Marks)**

1. John sells his 1998 Toyota by placing a classified ad in the local paper. His profit on the sale amounts to R10 000.

   Is John conducting an enterprise?

2. On 1 January 2016 Mary commences a real estate brokerage business. Working for Landco in the past, Mary typically earned commissions of R1.2 million per year. Mary's brokerage business generated commissions of R600 000 by 30 June 2016.

   Should Mary apply for VAT registration?

3. Mike operates a gardening business with an annual turnover of R900 000. Mike is not a vendor. During 2016 Mike sold old equipment for R200 000 and purchased new equipment costing R250 000.

   Must Mike register for VAT?

4. Feed (Pty) Ltd operates four restaurants in various towns in Gauteng. Schedules of income and expenditure are faxed by each restaurant to Feed (Pty) Ltd (head office) on a daily basis. Each restaurant maintains its own bank account and petty cash float. The annual turnover of each restaurant is R1.5 million.

   Can Feed register each restaurant separately?

5. a. ABC Ltd incorporates subsidiary XYZ (Pty) Ltd to carry out the distribution of ABC's merchandise. XYZ is expected to have turnover exceeding R1 000 000 in its first year of operation.

   b. Bigco carries out its various enterprises with six autonomous branches in different cities in the Republic.

   In (a) and (b) of (5) above, state which persons MUST register, MAY register or CANNOT register.

QUESTION 16.30 **(23 Marks)**

For the purposes of this question, assume that amounts are exclusive of VAT where appropriate. Note however that the term 'open market value' always includes VAT. Assume further that Asti is in possession of the necessary tax invoices, and that all purchases by or supplies to Asti are from registered VAT vendors.

'Asti Ltd' (Asti) owned the following assets on 1 March 2017 (all assets had been purchased from registered VAT vendors):

	Cost	**Open market value at 31 March 2017**
Trading stock, consisting of 20 000 units	R40 per unit	R75 per unit
Equipment	R40 000	R20 000
Computers	R30 000	R33 000
Patent	R15 000	R100 000
Motor car for the use of the MD	R320 000	R180 000

The following transactions occurred during March:	**R**
1. Sales to vendors (4 000 units)	280 000
2. Sales to non-vendors (1 500 units)	114 000
3. Rent paid	15 000
4. Insurance premium paid	3 000
5. Repairs	6 400
6. Insurance payment (amount received)	5 500

Notes

3. Asti rents the premises from a registered VAT vendor. The rental includes R1 500 for rates and R2 500 for electricity.

4. R600 of the insurance premium relates to the motor car. The balance is in respect of the remaining assets.

5 & 6. The repairs and the insurance payment relate to an accident that the MD was involved in while driving his car. Subsequent to the repair, the open market value of the car was reduced to R175 000.

Effective 31 March 2017, Asti entered into an agreement for the sale of its business as a going concern to Spumante Ltd, a registered VAT vendor. The agreement contained the following relevant clause:

'Clause 3: The subject matter of this sale is the purchase by the purchaser of the business of the seller as a going concern, which will be chargeable with VAT at 0%. In terms of this sale, the following assets will be acquired by the purchaser for the costs as stated: Trading stock 10 000 units at R55 per unit and all equipment for R18 000.'

Immediately after the sale, Asti was deregistered as a VAT vendor by the Commissioner. After deregistration, Asti sold its patent and computers to a third party for R80 000 and R12 000 respectively.

YOU ARE REQUIRED TO:

1. Discuss whether the sale of the business as a going concern will be zero-rated.
2. Assuming that the sale is zero-rated, calculate the net VAT payable by Asti Ltd arising out of the above transactions.

QUESTION 16.31 **(24 Marks)**

YOU ARE REQUIRED TO: Discuss the VAT effects of the transactions in each of the under mentioned cases. Unless otherwise specified, assume all parties are VAT vendors, and all amounts include VAT where appropriate.

CASE 1:

Propco CC is engaged in a business of letting houses, flats and offices. For the tax period ending 31 January 2017 the following information is provided:

Income		**R**
Rental from offices let		57 000
Rental from flats and houses let		90 000
(all flats and houses are let for six-month periods)		
Expenses		
Advertising	- offices	5 600
	- flats and houses	7 620
Staff	- salaries and wages	10 000
Painting	- flats	4 480
	- offices	11 200
Audit fees		2 240
Purchase of computer & printer to process all leasing business		8 960
Expenses relating to the rented offices	- electricity	336
	- water	112
Cleaning contract	- offices	3 360

CASE 2:

Rentco CC purchases a building comprising ten shops and six flats from a vendor at a cost of R1 120 000 (inclusive of R137 544 VAT), on 1 March 2017. During March it procures tenants for all the shops and flats. Rental on all leases is payable on the first day of the month. The first rents are all paid on 1 April 2017. Apart from the cost of the building, Rentco has the following income and expenses for the two months ended 30 April 2017:

Income		**R**
Rent	– flats	5 000
	– shops	17 100
Expenses		
	– painting flats (including VAT)	13 440
	– property rates	20 000
	– advertising (including VAT)	3 360
	– legal fees (including VAT)	4 480
	– employees' wages	6 000

Rentco has taxable supplies of less than R1 000 000 in any 12-month period and registration is not compulsory. Assuming that Rentco registered voluntarily on 1 March 2017 and has a two-month tax period ending on 30 April 2017, show the VAT return for this period.

QUESTION 16.32 (Solution at end of chapter) **(20 Marks)**

Suran Black and Judith Brown are about to set up an architectural practice. They believe that they can operate their business practice either in partnership or in a company.

If they form a company, they will each subscribe for 50% of the issued share capital. The company will then enter into an employment contract with each of them, which will provide for a cash salary as well as the use of a company car.

If they form a partnership they will share profits and losses equally. The partnership will pay them a pre-agreed salary and will give them each the use of a motor car.

They have been told by a friend that they must make certain that the company is not a personal service provider, because if it is, the tax position will be most unfavourable. Initially they will employ a draughtsman and a receptionist/bookkeeper. They are very fortunate in that they have recently been informed that their tender for a large assignment has a good chance of succeeding. If it is successful, they will work only on this project for the next three years.

YOU ARE REQUIRED TO: Prepare a report for Suran and Judith in which you explain:

1.	The definition of 'personal service provider'.	(7 Marks)
2.	All of the income tax implications in respect of a personal service provider.	(5 Marks)
3.	Whether, in your opinion, their company will be a personal service provider.	(2 Marks)
4.	How they and their partnership will be taxed if they do operate as a partnership.	(4 Marks)
	Format:	(2 Marks)

QUESTION 16.33 **(23 Marks)**

'Rackets (Pty) Ltd' (Rackets) carries on business as a wholesaler of sports equipment. The profit and loss account of the company for the year ended 31 December 2017 reflects the following:

		Note	**R**
	Sales	1	2 578 000
less	Cost of sales	2	(1 190 000)
			1 388 000
plus:	Profit on sale of fixed assets	3	9 000
	Dividends on local listed shares		28 000
less	Travelling expenses	3	(68 300)
	Bad debts	4	(15 000)
	Salaries and wages		(153 800)
	Other expenses	5	(117 500)
	Rental of premises	6	(508 800)
	Insurance premiums	7	(26 000)
			535 600
less	Provision for taxation		(146 000)
			389 600
less	Dividends paid 31/12/2017		(115 000)
Retained income for year			274 600

Notes

1. Sales comprise:

Cash sales	R1 388 000
Credit sales	R1 190 000

On 23 December 2016, Rackets received an amount of R7 500, being a partial payment in respect of goods supplied by Rackets. The total sales value of the goods supplied amounted to R15 000. Rackets had supplied the goods during December 2016 but had not yet issued an

invoice in respect of the sale of such goods. It intended to do so as soon as the 2017 year commenced. The company's accountant has ensured that the reported sales figure for 2017 includes the R15 000.

2. The cost of sales figure is derived as follows:

		R
Opening stock	– inventories	220 000
	– consumable stores	43 000
plus: purchases	– inventories	1 069 000
	– consumable stores	25 000
less closing stock	– inventories	(129 000)
	– consumables	(38 000)
		1 190 000

3.

	R
Fuel	7 500
Maintenance and repairs	20 000
Depreciation (33.33% straight line)	40 800
	68 300

The company owned a delivery vehicle (delivery vehicle 1) that was badly damaged in an accident on 30 June 2017. The vehicle was sold as scrap for R4 560 (including VAT) and the insurer paid out the claim of R65 550, no VAT has been accounted for on amounts received from the insurer. At 1 January 2017 the tax value of the vehicle was R78 750 and its book value was R70 000 (original cost was R105 000 (including VAT)).

On 1 January 2017 the company purchased a second-hand delivery vehicle (delivery vehicle 2) for R34 200 from a non-vendor. The purchase consideration was payable in two equal instalments of R17 100, the first instalment being paid on 1 January 2017. The final instalment was paid on 1 January 2018.

On 1 July 2017, the company purchased a new delivery vehicle (delivery vehicle 3) on suspensive sale. Payment is to be made in 36 equal monthly instalments of R5 000 each commencing on 31 July 2017. The cash value of the delivery vehicle on 1 July 2017 was R159 600 (including VAT). The yield to maturity is 7.98% *per annum.*

The Commissioner allows delivery vehicles to be written off over four years.

4. Although none of the company's debtors have actually been written off, provision for bad debts was made at 10% of total debtors outstanding at year-end. For income tax purposes, the accountant has prepared a list of doubtful debts that amounts to R60 000 (R45 000 – 2016). CSARS allows 25% of this list.

5. Other expenses are fully tax-deductible.

6. Rental in respect of the premises used by the company is R42 400 per month payable in advance.

7. Insurance premiums payable by Rackets in case of potential damage to its vehicles amounts to R2 167 per month and is payable in advance.

All amounts exclude VAT unless otherwise stated.

YOU ARE REQUIRED TO: Calculate the tax payable by Rackets (Pty) Ltd for its year of assessment ending 31 December 2017. Consider VAT only for the delivery vehicles. Note that Rackets (Pty) Ltd does not qualify as a 'small business corporation'.

SOLUTION 16.1

PART A - Manley Blaine

1. There is no specific source rule in terms of s9(2) for rent received on fixed property and also not a specific exclusion in terms of s9(4). The common law principles need therefore to be applied. The source of the rental income in terms of common law is South Africa. The originating cause of rentals being received is the block of flats located in Cape Town, i.e. where the taxpayer's capital is employed (*COT v British United Shoe Machinery*). (4)

2. The rent received from fixed property situated in the United Kingdom is not from a source in the Republic in terms of s9. The common law source of the rent is in the United Kingdom where the flats are situated. (2)

   Since Manley is a SA resident, in terms of the gross income definition he would include the rental income in gross income in both cases. (1)

(7)

PART B - Adrie Spaans

In terms of s9(2)(c) a royalty paid by a resident is from a source in the Republic (unless the royalty is attributable to a permanent establishment which is situated **outside** the Republic). In terms of s 9(2)(d) a royalty is from a source in the Republic if the intellectual property is used in the Republic. (1)

The R120 000 is therefore from a source in the Republic and is included in Adrie's South African gross income. (1)

In terms of s10(1)(*l*) the royalty will be exempt from normal tax unless Adrie is physically present in the Republic for > 183 days during the 12 months before the royalty is received or accrues OR if the royalty is attributable to a permanent establishment of Adrie in the Republic. (1)

The royalty received by Adrie from a source in the Republic is subject to a final withholding tax in terms of s49B(1). From 1 January 2015 the withholding rate is 15%. If s49B(1) is applicable, the royalty will be exempt from normal tax in terms of s10(1)(*l*). (1)

If Adrie is physically present in the Republic for > 183 days during the 12 months before the royalty is received or accrues OR if the royalty is attributable to a permanent establishment of Adrie **in the Republic** and Adrie is registered as a taxpayer in the Republic, then the royalty is exempt from withholding tax in terms of s49D and the s10(1)(*l*) exemption falls away. The royalty will then be subject to normal tax in SA. (1)

(5)

PART C - Lung Specialist

1. In order to establish the source of the income it is necessary to first apply s9. There is, however, no source rule in s9 for services rendered by an independent contractor. (1)

   The *CIR v Lever Brothers & Unilever Ltd (1946 AD)* case established the common law position that the word 'source' means the originating cause which requires an inquiry into two matters: (2)

   1. What is the originating cause of the income; and (1)
   2. Where is the originating cause located. (1)

SOLUTION 16.1 continued

When dealing with services rendered by an independent contractor, the Tax Court has consistently held that the originating source of income from services rendered, is the services, irrespective of the place where the contract or the payment is made. The source of the services are therefore the place where the services are rendered. (2)

The services are rendered by the specialist in the central African state and therefore the source of the services would be the foreign country and not South Africa where the specialist's practice is situated. (2)

2. Since the specialist is a SA resident, the gross income definition includes all amounts received in his gross income, irrespective of their source. (1)

A second issue concerns the capital or revenue nature of the receipt. It could be argued that because no payment was requested, the amount is fortuitous and therefore of a capital nature. However paragraph (c) of the gross income definitions includes any amounts received in respect of services rendered whether they are of a capital nature or not. (2)

(12)

PART D - Chancer

An amount is 'received by' for the purposes of the gross income definition in section 1 of the Income Tax Act, if the taxpayer received the amount on his own behalf and for his own benefit. (Geldenhuys) (2)

However, Chancer illegally appropriated about R450 000 of these funds for himself. This constitutes an illegal receipt. (1)

There are several conflicting judgements in respect of illegal income.

The *Delagoa Bay Cigarette Co. Ltd* ran an illegal lottery. This case introduced the principle that in determining whether an amount is 'income' or not, no account must be taken of the fact that the activity involved was illegal, immoral or ultra vires - the source of the income (whether legal or illegal) is immaterial. (2)

In *COT v G 1981 (4) SA 167 (2A)* it was held that amounts stolen by a thief are not 'received' by the thief within the meaning of the definition of 'gross income', since it was not willing given by the person from whom the money was taken. It was therefore a unilateral receipt. (1)

In *MP Finance Group CC (in liquidation) v CSARS (2007 SCA)* the taxpayer ran an illegal pyramid scheme, whereby it took money from 'investors' under false pretenses. It was held that an amount will be regarded as having been 'received' by the taxpayer for the purposes of the gross income definition if the taxpayer has intended to receive it for his own benefit, and these amounts were considered taxable. This is a subjective approach. (2)

Critics of the *MP Finance* decision note that the taxpayer failed to argue that in order for there to be a 'receipt', the intention of the person making the payment must be taken into account, which was central to the decision in COT v G. This is referred to as the 'objective approach' which means that the taxpayer must have been entitled to the amount.

SOLUTION 16.1 continued

It is, however, now assumed that the *MP Finance* decision does reflect the law correctly due to the fact that if the taxpayer must first be entitled to the amount, then the words 'received by' would be redundant. The position of the law is now that an illegal receipt is regarded as having been 'received by' the taxpayer if he/she intended to receive it for his/her own benefit. This is also the position of SARS as confirmed in Interpretation Note 80.	(2)
The amount of R450 000 has therefore been 'received by' Chancer.	(1)
	(11)
Total	(35)

SOLUTION 16.5

(1)	Since Marco was outside South Africa for a total exceeding 183 days during his 2017 year of assessment, the remuneration derived by him from Cape Shipping Ltd will be fully exempt in terms of section 10(1)(o)(i). As Marco is a crew member of a South African ship as defined in section 12Q(1), his remuneration to be exempted in terms of section 10(1)(o)(iA).	(2)
(2)	As a South African resident, the amount received forms part of his gross income. S10(1)(o)(ii) allows an exemption if the employee is outside the Republic for an aggregate of 183 full days in any period of 12 months, which must include a continuous period of 60 full days. This is not the case here therefore his salary is not exempt.	(2)
(3)	s10(1)(nA) would exempt the value of the uniform received in the case of Themba, but the exemption would not apply in the case of Valencia since her clothing is not a uniform (i.e. not separately distinguishable from everyday wear).	(2)
(4)	The exemption in s10(1)(nB) would apply to the costs of the flight, transporting their household and personal goods, costs of the sale of the previous residence and of hiring hotel accommodation (this latter exemption for a maximum period ending 183 days after the date from which the transfer takes effect). Although Fred's period of 183 days ends on 31 January 2017 (which is 183 days after 1 August 2016), from that date, Mrs Couples' accommodation exemption would cover him since the exemption is for the employee and members of his household. (During this period Mrs Couple is exempt on her portion of the costs as this is within 183 days of her appointment.) All costs would be exempt. Hence no taxable portion.	(5)
(5)	In terms of s9(2)(d), the use in South Africa has the effect that the royalty is from a source within the Republic and therefore 'gross income'. Royalties received by a non-resident from a source in the Republic are subject to a final withholding tax of 15%. Royalties is withheld i.t.o. s49B(1). However, if s49B(1) is applicable, the royalty should be exempt from income in terms of s10(1)*(l)*, as long as the person is not physically present in the Republic for > 183 days in aggregate during the 12 month period preceding the payment of the royalty and at no time during the 12 month period preceding the accrual of the royalty did the person carry on a business through a permanent establishment. It is submitted that the mere earning of royalty income does not constitute the carrying on of a business through a permanent establishment.	(5)

SOLUTION 16.5 continued

Ian is a non-resident. The interest received is from a source within the Republic (s9(2)(b)) and therefore falls into gross income. The interest is exempt in terms of s10(1)(h) if Ian is not physically present in the Republic for > 183 days during the 12 month period preceding the accrual of the interest nor carrying on a business through a permanent establishment. (2)

A final withholding tax on interest of 15% is levied in terms of s50B(1) for interest received by a non-resident from a South African source. This withholding tax is not be applicable to interest received from a Bank - s50D. (5)

(23)

SOLUTION 16.7

Case studies

1. As the test for the incurral of expenses 'in the production of income' was stated in *COT v Rendle*, one needs to examine whether the risk of the mishap occurring is an inevitable concomitant of the taxpayer's trade. It is submitted that the risk of making coffee which may be too hot would be an inevitable concomitant of the taxpayer's trade as an outlet selling coffee. As to the quantum of the expense which has been incurred, it was accepted in *Edgars Stores Ltd v CIR* at 885 that, where the existence of the liability is certain but the amount cannot be accurately determined at the tax year-end, that the liability is nevertheless regarded as having been incurred in the tax year in question. (5)

   In such a case, the best estimate of the liability must be made and would be deductible. Hence it is submitted that R200 000 would be deductible on the facts as given above. (2)

   Note that s24M which deems an expense not to be incurred in a tax year if the consideration cannot be quantified, only applies in the case of the acquisition of an asset. Section 24M does not apply in the case of expenditure such as damages. (2)

2. The facts in this case are different from those in (1) above in that in this case, the company has not actually incurred a liability at year-end. The liability is only incurred when the tins are returned (*Pyott*). Hence there would be no deduction. s23(e) would in any event preclude such a deduction. (3)

3. It would seem unlikely that the risk of an oversight of this importance occurring would be an inevitable concomitant of the taxpayer's trade, and hence the damages claim should not be deductible. It is submitted that it would still not be deductible, if it was in an area where installing lightning conductors was not the norm, as the event would then be too remote from the taxpayer's trade. (*Rendle*) (3)

4. In contrast with the case in (3) above, it would seem that the risk of clothing getting lost in a dry-cleaning business would be an inevitable concomitant of the taxpayer's trade, and hence that the cost of the suit should be deductible. (*PE Electric Tramway*) (3)

SOLUTION 16.7 continued

5. If a business requires a person to move from point to point, his travelling expenses may be deducted. See for example *SIR v Ineson*. However it must be clear that it is the exigencies of the business that compel him to move from point to point and not other factors. In the case of *CIR v de Villiers*, in which the taxpayer's decision to conduct the management of a farm at Pretoria was one made, as far as concerned the farming business, for private and domestic reasons. The travel expenses were disallowed. Hence in the given situation the taxpayer's motives for conducting his practice from home would need to be examined. (5)

   In terms of SARS practice expenditure incurred in travelling between home and one's place of work is treated as private expenditure and is therefore prohibited as a deduction by s23(b). (1)

   The only exception in the Act to the above, is para 7(8A) of the 7th Schedule, which states that the private kilometres travelled by a judge or constitutional court judge between the judge's place of residence and the court over which the judge presides will, with effect from 1 March 2011, be deemed to be kilometres travelled for business purposes and not private purposes. This is in relation to the fringe benefit on the right to use of motor vehicles. (1)

(25)

SOLUTION 16.11

Ziton Motors Ltd				
Amounts received	- s1 - gross income		800 000	(1)
Deposit received	- not repayable - s1 gross income		4 500	(1)
Repair to damaged vehicle	- s11(d)		(10 000)	(1)
Debt recovered - borrowed vehicle	- s8(4)(a)		5 000	(1)
Legal fees - borrowed vehicle	- s11(c)		(2 000)	(1)
Warranty expense	- s11(a)		(1 500)	(1)
Legal expenses - damages claim	- (s11(c)) (Note 1)		(5 000)	(1)
Bad debts	- Car sold to ex-employee (Note 2)		(15 000)	(1)
	- Trade debtors - s11(i)		(50 000)	(1)
Legal costs	- Car sold to ex-employee s11(c)		(3 500)	(1)
	- Trade debtors s11(c)		(12 000)	(1)
Doubtful debts	- Add back	2016 (25% × 85 000)	21 250	(1)
		2017 (25% × (240 000 − 40 000))	(50 000)	(1)
Taxable income			681 750	
				(13)

Note 1: Legal expenses for damages paid - the compensation relates to a risk which is inherent to the business. It is a necessary concomitant of its trading operations.

Note 2: The debt did arise from an amount which was included in income. The company is a second-hand car dealer, thus the sale of the car to the employee was the sale of trading stock.

SOLUTION 16.15

Asquith (Pty) Ltd

1. Cost of the machine would be: R 1 400 000 + R5 000 + R45 000 =		1 450 000		(1)
VAT @ 14% = 203 000				
Acquisition market value less actual VAT (R1 700 000 − R203 000) s23C		1 497 000		(1)
s12C(2) market value determined on the date of acquisition 1 April 2016				
use *lesser* s12C(2) therefore s12C(1) R1 450 000 × 20%			(290 000)	(1)
s12C allowances claimed from the date asset is brought into use.				
Transport and installation in respect of Baldwin It is submitted that these costs cannot be claimed in terms of S12C(6) since they were not incurred for the purpose of the continued use of the asset by Asquith.				
1/8/2016: tax value = R1 450 000 – 290 000 = R1 160 000				(1)
s8(4)(k) recoupment MV *less* VAT (R2m × $^{100}/_{114}$) limited to cost		1 450 000		(1)
VAT on change of use adjustment s18(1)				
Tax value 1 450 000 − 290 000		(1 160 000)		
			290 000	
Donations tax: R2m × 20%		400 000		(1)
Donations tax to be included in base cost p22				
* $Y = {}^{M-A}/_{M} \times D =$ 2 000 000 − $^{1\,200\,000}/_{2\,000\,000}$ × 400 000 =		160 000		(2)
Capital gains tax				
Proceeds para 38 (R2 000 000 × $^{100}/_{114}$) excl. VAT	1 754 386			
s18(1) VAT on MV				
less s8(4)(k)	(290 000)			
		1 464 386		(1)
Base cost para 20(1)(a)	1 450 000			
less 12C(1) para 20(3)(a)	(290 000)			(1)
Moving costs para 20(1)(c)(v)	40 000			(1)
	1 200 000			
Portion of donations tax para 22 (see * above)	160 000			(1)
Base cost		(1 360 000)		
Capital gain		104 386		
	× 80%		83 509	(1)
				(13)

SOLUTION 16.15 continued

2\. s11(e) used since no cost based on value R2m × R0 (no input VAT).

s11(e)	R2 000 000 × 20% × $^{2}/_{12}$		(66 667)	(1)
Proceeds limited to 'cost' proceed net of VAT	R2 223 000 × $^{100}/_{114}$	1 950 000		(1)
Tax value	R2 000 000 – R66 667	(1 933 333)		(1)
s8(4)(e) recoupment, deferred		16 667		
Release of deferred s8(4)(e) recoupment	40%		6 667	(1)

Section 8(4)(e) applies where the taxpayer has elected to apply para 65 of the Eighth Schedule, which may be done whenever proceeds equals or exceeds base cost, as is the case here (see below). The recoupment is therefore deferred and released in line with the capital allowances on the replacement asset.

Proceeds para 35	1 950 000			
less recoupment para 35(3)(a)	(16 667)			
		1 933 333		(1)
Base cost:				
Deemed base cost = MV para 38	2 000 000			
less s11(e) allowances para 20(3)(a)	(66 667)			
		(1 933 333)		
Capital gain		0		(1)
New replacement machine				
s12C(2) lower of cost and market value				
'cost' = R1 900 000 - actual VAT (R1 950 000 × 0.14) s23C =	1 627 000			(1)
s12C(1) allowance x 40%			(648 000)	(1)
				(8)

3\.

s12C allowance			0	
1/1/2021 Tax value = R0				
Recouped in terms of S8(4)(a) =			1 627 000	(1)

A capital loss of R150 000 would accrue on the disposal, calculated as follows:

Proceeds para 35(1)	1 850 000		
less recoupment para 35(3)(a)	(1 627 000)		
		223 000	(1)
Base cost para 20(1)(a)	2 000 000		
less s12C allowances para 20(3)(a)	(1 627 000)		
		(373 000)	(1)
		(150 000)	

The capital loss arises because the amount on which allowances was based was limited to the market value on acquisition, whereas the base cost is based on cost (without such a limit). (3)

(24)

SOLUTION 16.18

Elwood Pty (Ltd)			**R**	
Taxable income (before adjustments)			10 000 000	
- Sale of vacant land:				
CGT - change of use				
Deemed proceeds (MV) change of use para 12(1)		1 600 000		(1)
Base cost para 20(1)(a)		(800 000)		(1)
Capital gain		800 000		
Include in income 80% as this is the only CGT effect - para 10			640 000	(1)
Gross income (sale)			3 800 000	(1)
Cost of subdivision of land - s11(a)			(500 000)	(1)
Deemed opening stock s22(2)(b) and s22(3)(ii)			(1 600 000)	(1)
- Opening stock - s22(2)(a)				
Timber		2 000 000		(1)
Consumables		100 000		(1)
Work in progress		400 000	(2 500 000)	(1)
- Timber taken out of stock recoupment - s22(8) recoupment at market value			25 000	(1)
Labour costs of table - capital no s11(a)			0	(1)
Cost of table 25 000 + 10 000 (labour)				(1)
Wear and tear - s11(e)	R35 000 × 20% × $^{9}/_{12}$		(5 250)	(1)
- Closing stock - s22(1)(a)				
Timber		1 800 000		(1)
Consumables		150 000		(1)
Work in progress		600 000	2 550 000	(1)
Taxable income			12 409 750	(16)

SOLUTION 16.20

1. **Shirley Taylor/Baxter**	**R**	**R**	
Leave pay - gross income para (*d*) (not a severance benefit - see Note 2)	2 100		(0.5)
Lump sum - gross income para (*d*) (not a severance benefit - see Note 2)	32 000	34 100	(0.5)
Gross income para (*c*) salary R5 000 × 4		20 000	(1)
		54 100	
less retirement fund contributions - s11(*k*): R18 000 (R1 500 × 12) (RAF), limited to *lesser* of:			(0.5)
*R350 000, or			(0.5)
*27.5% of the higher of the remuneration (R2 100 + R32 000 + R20 000 = R54 100) or taxable income (R54 100), thus R54 100 × 27.5% = R14 878.		(14 878)	(2)
Note 1: The excess contribution of R3 122 (R18 000 − R14 878) may be carried over to the next year of assessment and added to that year's actual contributions. The deduction would again be limited per s11(k).			

SOLUTION 16.20 continued

Note 2: For the purpose of the 27.5% calculation, the 'remuneration' and 'taxable income' amounts exclude severance benefit payments - proviso (i) to s11(k). However, as the gratuity and leave pay do not meet the definition of a severance benefit in s1, these amounts are included in the calculation.

TAXABLE INCOME		39 222	
Normal tax per individual's tax table [R39 222 × 18%]		7 060	(0.5)
less primary rebate - s6		(13 500)	(0.5)
Normal tax liability (rebates may not result in a refund - limit to Rnil)		0	

2. **Ron Baxter**

Gross income para (a) annuity RAF R2 000 × 12		24 000	(0.5)
Note: The s10C exemption relates to the contributions that the member was unable to previously claim as a deduction. As Ron's RAF contributions were fully deductible in the past, the exemption does not apply.			
Janet's dividends from donated investment - s7(3) and para (*k*) gross income	3 500		(1)
Dividend exemption - s10(1)(*k*)(i)	(3 500)	0	(0.5)
Interest Janet - s7(3)	5 000		(0.5)
less interest exemption - s10(1)(*i*). R23 800 is limited to actual interest.	(5 000)	0	(0.5)
Salary gross income para (c) R17 000 × 12		204 000	(1)
Income		228 000	
Private consulting income	15 000		(0.5)
Travelling costs s11(*a*)	(250)		(0.5)
Stationery & printing s11(*a*)	(410)		(0.5)
Entertainment s11(*a*) - separate trade and so s23(*m*) not applicable	(500)	13 840	(0.5)
s8(1)(*a*)(i) Entertainment allowance R4 000 × 12 - see Note 2 No reduction in allowance as does not have to account to employer		48 000	(0.5)
Taxable income - subtotal		289 840	
less retirement fund contributions - s11(*k*): R24 000 (pension) + R13 500 (RAF) = R37 500, limited to *lesser* of:			(0.5)
*R350 000, or			(0.5)
*27.5% of the higher of the remuneration (R24 000 annuity + R204 000 salary + R48 000 entertainment allowance = R276 000) or taxable income (R289 840), thus R289 840 × 27.5% = R79 706. The full contribution is therefore allowed as a deduction.		(37 500)	(2)

Note 1: The income from Ron's private consulting is considered to be a separate trade, as he works as an independent contractor. As such, the income from that trade does not constitute 'remuneration' - see exclusion (ii) to the definition of 'remuneration' in para 1 of the 4th Schedule.

SOLUTION 16.20 continued

Note 2: An entertainment allowance is fully included in remuneration - see definition of 'remuneration' in para 1 of the 4th Schedule.

Note 3: An annuity is included in remuneration - see definition of 'remuneration' in para 1 of the 4th Schedule.

TAXABLE INCOME		252 340	

Note: The donation of the shares would have been subject to capital gains tax and donations tax in the relevant year of assessment.

Normal tax per individual's tax table [(R252 340 − R188 000) × 26% + R33 840]		50 568	(0.5)
less primary rebate - s6		(13 500)	(0.5)
less medical scheme fees tax credit - s6A [(R572 + R192) × 4] + [(R572 + R192 + R192) × 8]		(10 704)	(2)
less additional medical expenses tax credit - s6B		0	
Normal tax liability		26 364	

Note: As Ron is younger than 65 and there is no 'disability', the s6B(3)(c) additional medical expenses tax credit applies. This rebate does not affect the taxable income, but instead reduces the tax liability.

s6B credit = 25% × [Step 1 + Step 2 - Step 3]

Step 1: Excess medical scheme fees			
Ron's contributions		17 800	(0.5)
Reduced by 4 times the s6A medical tax credit	4 x R10 704	(42 816)	(1)
Step 1 'Excess contributions' Limit negative amount to Rnil		0	
Step 2: Other qualifying medical expenses		2 300	(0.5)
Step 3: Taxable income × 7.5%	R252 340 × 7.5%	18 926	(1)
s6B credit = 25% × [R0 + R2 300 − R18 926]	Limit to Rnil	0	(0.5)

3. Janet

Interest deemed to be Ron's - s7(3)		0	(0.5)
Dividends deemed to be Ron's - s7(3)		0	(0.5)
Advert - gross amount included into gross income para (*c*)		12 000	(0.5)

Note: It is possible for a minor child to earn income and be taxed thereon; it is only when that income is as a result of a donation from a parent that it is attributed to that parent.

TAXABLE INCOME		12 000	

SOLUTION 16.20 continued

Normal tax per individual's tax table [R12 000 × 18%]		2 160	(0.5)
less primary rebate - s6		(13 500)	(0.5)
Rebate cannot result in a refund - limit answer to Rnil		0	(0.5)
PAYE paid		(3 000)	(1)
Refund due from SARS to Janet		3 000	(0.5)
4. Grant			
Dividends - gross income para (*k*)	3 500		(0.5)
s10(1)(*k*)(i)	(3 500)	0	(0.5)
Interest - s24J(3)	5 000		(0.5)
less interest exemption - s10(1)(*i*). R23 800 is limited to actual interest.	(5 000)	0	(0.5)
Army pay - gross income para (*c*)		58 000	(0.5)
TAXABLE INCOME		58 000	
Normal tax per individual's tax table [R58 000 × 18%]		10 440	(0.5)
less primary rebate - s6		(13 500)	(0.5)
Normal tax liability - rebate cannot result in a refund.		0	
			(30)

SOLUTION 16.26

Kinshaw Trading (Pty) Ltd **1. VAT payable at the end of the May VAT period**		**Input** **R**	**Output** **R**	
Sales - local	R900 000 × 14%		126 000	(1)
Sales - foreign	Zero rated - s11(1)(a)		0	(1)
Purchase of raw materials from Kinross	R450 000 × 80% × 14%	50 400		(2)
Connected parties, but recipient (Kinshaw) would be able to claim full input tax, therefore no limit on input tax claimable (s10(4)).				
Purchase of raw materials from other suppliers				
- from vendors	R450 000 × 20% × 50% × 14%	6 300		(3)
- from non-vendors	Did not pay any VAT, therefore cannot claim any input tax	0		(1)
Other purchases				
a. Second-hand PC	R3 000 × 14%	420		(1)
b. Salaries paid	Employment excluded from definition of 'enterprise' in s1	0		(1)

SOLUTION 16.26 continued

c.	Second-hand bakkie purchased from non-vendor	R20 000 × $^{14}/_{114}$	2 456		(1)
d.	Local travel by air	R4 000 × 14%	560		(1)
	Foreign travel by air	zero rated - s11(2)(a)	0		(1)
e.	Petrol costs	zero rated - s11(1)(h)	0		(1)
f.	Auditing services	R40 000 × 14%	5 600		(1)
	- s9(1) - earlier of invoice or payment				
g.	Balance of purchases	R351 000 × 14%	49 140		(1)
			114 876	126 000	
VAT payable to SARS			11 124		(1)
					(17)

2. A person is required to register as a VAT vendor at the end of any month where the total value of taxable supplies in the course of carrying on **all enterprises** in the preceding 12 months has exceeded R1 million (s23(1)(a)). 'Value' excludes VAT. (2)

A person is also required to register as a VAT vendor at the beginning of any month where the total value of the taxable supplies to be made in terms of a contractual obligation in writing for the coming 12 months (reckoned from the beginning of the said month) will exceed R1 million (s23(1)(b)). Effective 1 April 2014. (2)

When a person (individual or company) carries on different businesses, but still within one legal entity, the total value of the taxable supplies of the different businesses are added together to determine the registration threshold. Separate branches or divisions of a person may, however, register separately, if certain conditions are met, but the taxable supplies of the different branches or divisions are still added together to determine the R1 million registration threshold (s50). (2)

A foreign supplier of electronic services is required to register at the end of the month where the total value of taxable supplies made by that person has exceeded R50 000 (s23(1A) - effective 1 April 2014). (1)

If a person supplies 'commercial accommodation' and the value of the supplies in respect of that enterprise or activity does not or are not expected to exceed R120 000 in a 12-month period, that person shall be deemed not to carry on an enterprise and therefore need not (and may not) register. (Proviso (ix) to the definition of 'enterprise' in s1). With effect from 1 April 2016 (before this date it was R60 000). (2)

If the taxable supplies of the person is more than R50 000 in a 12-month period, the person qualifies for voluntary registration, but then only on the payments basis (s23(3)(b)). (1)

(10)

(27)

SOLUTION 16.32

Suran Black and Judith Brown

Dear Messrs Black and Brown (2)

You have requested my advice on the tax aspects of your proposed business venture either as a partnership or in a company. You have asked me to deal with four specific issues.

(a) The Income Tax Act (the Act) defines a 'personal service provider' in the Fourth Schedule to the Act. In point form the following criteria define a personal service provider insofar as it is relevant to your situation.

- It is any company or trust, and: (1)
- Where any service rendered on behalf such company or trust to a client of such company is rendered personally by yourselves or any connected persons to you, and (1)
- Where as a result of the services you render on behalf of the company, in the absence of the company you would be regarded as an employee of such client if such service was rendered by you directly to such client; or (1)

  Where the duties or services provided must be performed mainly at the premises of the client, you (or the company) are subject to the control or supervision of such client as to the manner in which the duties are performed or are to be performed in rendering such service; or (1)
- Where more than 80% of the income of the company is, in any year, derived from one client (From what you have told me this will be the case for at least the first three years) (1)
- Except where the company employs three or more full time employees who are not shareholders and are not connected persons in relation to the shareholders. It should be noted that any relative of a person is a connected person of that person. (You are only going to employ two persons who will not be engaged in providing the service of the close corporation.) (2)

(9)

(b) You intimated that you believe that the income tax treatment of a personal service provider is not as favourable as for normal companies. The tax treatment of personal service companies is in fact so onerous as to make them unsuitable for your purposes. (1)

Briefly, the tax implication are:

- The rate of tax is 28%, as for all other companies. (1)
- All payments from clients are subject to a withholding tax at the rate of 28%. (1)

The deductions which a personnel services company may make in the determination of its taxable income are restricted to the following in terms of s23(k): (2)

- remuneration paid to employees
- legal expenses
- bad debts
- employer contributions to pension, provident and benefit funds
- expenses in respect of premises, finance charges, insurance, repairs, fuel and maintenance if such premises or assets are used wholly and exclusively for the purpose of trade.

(5)

SOLUTION 16.32 continued

(c) Based on the information provided your company will, at least for the first three years, be a personal service provider because you, the shareholders, render the services, on behalf of the company, to only one client (i.e. 100% of the company's income will be from one client) and the company will not employ more than two 'non-connected' employees who will be engaged in rendering the services of the company. (2)

(d) In South African tax law, a partnership is not recognised as a person, i.e. a partnership is not taxed. The individual partners are taxed on their share of the income from the partnership after deducting their share of tax deductible expenses. A partner is not an employee of a partnership in law and can therefore, not enjoy the tax benefits of fringe benefits. (2)

If the partnership buys motor cars for your use it is in fact you who are buying the cars. In your tax return you will be permitted to claim only those expenses relating to the cars that are business related. You should also note that travel from your home to your place of work is considered to be private travel. (2)

(6)

In conclusion, I would suggest that you operate the business as a partnership initially, until such time as you meet the exclusion requirements for a personal service provider.

Should you require any further information please contact me.

Yours faithfully

Taxman (20)

APPENDIX A: RATES AND MONETARY LIMITS

RATES OF NORMAL TAX PAYABLE BY PERSONS (OTHER THAN COMPANIES) IN RESPECT OF TAXABLE INCOME (EXCLUDING ANY RETIREMENT FUND LUMP SUM BENEFIT) FOR THE YEAR OF ASSESSMENT ENDING 28 FEBRUARY 2017

Taxable income	Rates of tax
Where the taxable income –	
Does not exceed R188 000……	18% of each R1 of the taxable income
Exceeds R188 000 but does not exceed R293 600	R33 840 plus 26% of the amount by which the taxable income exceeds R188 000;
Exceeds R293 600 but does not exceed R406 400	R61 296 plus 31% of the amount by which the taxable income exceeds R293 600;
Exceeds R406 400 but does not exceed R550 100	R96 264 plus 36% of the amount by which the taxable income exceeds R406 400;
Exceeds R550 100 but does not exceed R701 300	R147 996 plus 39% of the amount by which the taxable income exceeds R550 100;
Exceeds R701 300……	R206 964 plus 41% of the amount by which the taxable income exceeds R701 300

REBATES – INDIVIDUALS – 2017

Primary rebate	R13 500
Secondary rebate (over 65)	R7 407
Tertiary rebate (over 75)	R2 466

REBATES – MEDICAL – 2017

Taxpayer	R286
First dependant	R286
Each additional dependant	R192

INTEREST EXEMPTION – 2017

Individuals less than 65 years old	R23 800
Individuals 65 years and older	R34 500

RETIREMENT LUMP SUM OR SEVERANCE BENEFITS

Taxable income	Rates of tax
Not exceeding R500 000………	0%
Exceeding R500 000 but not exceeding R700 000	18% of the taxable income exceeding R500 000
Exceeding R700 000 but not exceeding R1 050 000	R36 000 plus 27% of the taxable income exceeding R700 000
Exceeding R1 050 000	R130 500 plus 36% of the taxable income exceeding R1 050 000

WITHDRAWAL LUMPSUM BENEFITS

Taxable income	Rates of tax
Not exceeding R25 000………	0% of the taxable income
Exceeding R25 000 but not exceeding R660 000	18% of the taxable income exceeding R25 000
Exceeding R660 000 but not exceeding R990 000	R114 300 plus 27% of the taxable income exceeding R660 000
Exceeding R990 000	R203 400 plus 36% of the taxable income exceeding R990 000

CAPITAL GAINS TAX

Annual exclusion (other than death)	R40 000
Annual exclusion on death	R300 000
Primary residence exclusion (paragraph 45)	R2 000 000
Small business lifetime exclusion (paragraph 57)	R1 800 000

Non-natural persons	80% of the net capital gain included in taxable income (Years of assessment commencing prior to 1 March 2016: 66.6%)
Natural persons	40% of the net capital gain (after annual exclusion) included in taxable income (Years of assessment commencing prior to 1 March 2016: 33.3%)
Deceased estate	40% of the net capital gain (after annual exclusion) included in taxable income (Years of assessment commencing prior to 1 March 2016: 33.3%)

TRUSTS (OTHER THAN A SPECIAL TRUST)

Rate of income tax 41%

COMPANIES

Normal tax (Financial years ending any date between 1 April 2016 and 31 March 2017)

- General companies (excluding mining, insurance, small business corporations, employment companies and foreign branches) 28%
- Small business corporation

Taxable income	*Rate of tax*
First R75 000	Nil
R75 000 to R365 000	7% of taxable income as exceeds R75 000
R365 001 to R550 000	R20 300 plus 21% of the amount by which taxable income exceeds R365 000
Exceeds R550 000	R59 150 plus 28% of the amount by which taxable income exceeds R550 000

TRAVEL ALLOWANCE For years of assessment commencing on or after 1 March 2016

Value of the vehicle (including VAT but excluding finance charges or interest)	**Fixed cost**	**Fuel cost**	**Maintenance cost**
R	**R p.a.**	**c/km**	**c/km**
0–80 000	26 675	82.4	30.8
80 001–160 000	47 644	92.0	38.6
60 001–240 000	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
Reimbursement based on actual business kilometres travelled and no other compensation is paid to such employee, kilometres travelled for business does not exceed 8 000, prescribed rate is R3.29 per kilometre.			

DONATIONS TAX

Natural person exemption	R100 000
Non-natural person exemption	R10 000
Rate	20%

ESTATE DUTY

Abatement	R3 500 000
Rate	20%

DIVIDENDS TAX **15%**
Section 10B(3) ratio: individuals, estates and special trust 26/41
Section 10B(3) ratio: other persons 13/28

WITHHOLDINGS TAX ON INTEREST (from 1 January 2015) **15%**

WITHHOLDINGS TAX ON ROYALTIES (from 1 January 2015) **15%**

VALUE-ADDED TAX
Standard rate 14%
Zero rate 0%

TRANSFER DUTY

Consideration	Rate
On the first R750 000	Nil
As exceeds R750 000 but not R1.25 million	3% of the value above R750 000
As exceeds R1.25 million but not R1.75 million	R15 000 plus 6% of the value above R1.25 million
As exceeds R1.75 million but not R2.25 million	R45 000 plus 8% of the value above R1.75 million
As exceeds R2.25 million but not R10 million	R85 000 plus 11% of the value above R2.25 million
As exceeds R10 million	R937 500 plus 13% of the value above R10 million

MICRO BUSINESS TURNOVER TAX FOR YEARS OF ASSESSMENT ENDING DURING THE 12 MONTHS ENDING 28 FEBRUARY 2017

Turnover	Rates of tax
Where the turnover –	
Does not exceed R335 000……	0%
Exceeds R335 000 but does not exceed R500 000	1% of the amount by which the turnover exceeds R335 000
Exceeds R500 000 but does not exceed R750 000	R1 650 plus 2% of the amount by which the turnover exceeds R500 000
Exceeds R750 000 but does not exceed R1 000 000	R6 650 plus 3% of the amount by which the turnover exceeds R750 000

APPENDIX B

LIFE EXPECTANCY TABLE (TABLE A)

The expectation of life and the present value of R1 per annum for life capitalised at 12% over the expectation of life of males and females of various ages.

Age	Expectation of Life		Present value of R1 per annum for life		Age	Expectation of Life		Present value of R1 per annum for life	
	Male	Female	Male	Female		Male	Female	Male	Female
0	64.74	72.36	8.327 91	8.331 05	46	24.58	30.14	7.819 24	8.059 56
1	65.37	72.74	8.328 28	8.331 14	47	23.79	29.27	7.771 09	8.031 19
2	64.50	71.87	8.327 76	8.330 91	48	23.00	28.41	7.718 43	8.000 26
3	63.57	70.93	8.327 14	8.330 64	49	22.23	27.55	7.662 36	7.966 17
4	62.63	69.97	8.326 44	8.330 33	50	21.47	26.71	7.602 01	7.929 50
5	61.69	69.02	8.325 67	8.329 99	51	20.72	25.88	7.537 13	7.889 67
6	60.74	68.06	8.324 80	8.329 61	52	19.98	25.06	7.467 48	7.846 46
7	59.78	67.09	8.323 81	8.329 18	53	19.26	24.25	7.393 87	7.799 65
8	58.81	66.11	8.322 71	8.328 69	54	18.56	23.44	7.316 31	7.748 34
9	57.83	65.14	8.321 46	8.328 15	55	17.86	22.65	7.232 34	7.693 55
10	56.85	64.15	8.320 07	8.327 53	56	17.18	21.86	7.144 14	7.633 63
11	55.86	63.16	8.318 49	8.326 84	57	16.52	21.08	7.051 78	7.568 96
12	54.87	62.18	8.316 73	8.326 08	58	15.86	20.31	6.952 25	7.499 27
13	53.90	61.19	8.314 80	8.325 22	59	15.23	19.54	6.850 04	7.423 21
14	52.93	60.21	8.312 65	8.324 27	60	14.61	18.78	6.742 06	7.341 35
15	51.98	59.23	8.310 29	8.323 20	61	14.01	18.04	6.630 10	7.254 57
16	51.04	58.26	8.307 70	7.322 03	62	13.42	17.30	6.512 32	7.160 20
17	50.12	57.29	8.304 89	8.320 71	63	12.86	16.58	6.393 01	7.060 46
18	49.21	56.33	8.301 80	8.319 26	64	12.31	15.88	6.268 22	6.955 37

Age	Expectation of Life		Present value of R1 per annum for life		Age	Expectation of Life		Present value of R1 per annum for life	
19	48.31	55.37	8.298 41	8.317 64	65	11.77	15.18	6.137 89	6.841 61
20	47.42	54.41	8.294 71	8.315 84	66	11.26	14.51	6.007 26	6.723 93
21	46.53	53.45	8.290 61	8.313 83	67	10.76	13.85	5.871 65	6.598 93
22	45.65	52.50	8.286 13	8.311 61	68	10.28	13.20	5.734 03	6.466 35
23	44.77	51.54	8.281 17	8.309 12	69	9.81	12.57	5.591 82	6.328 18
24	43.88	50.58	8.275 64	8.306 33	70	9.37	11.96	5.451 65	6.184 66
25	43.00	49.63	8.269 59	8.306 26	71	8.94	11.37	5.307 75	6.036 07
26	42.10	48.67	8.262 74	8.299 81	72	8.54	10.80	5.167 44	5.882 78
27	41.20	47.71	8.255 16	8.295 95	73	8.15	10.24	5.024 37	5.722 22
28	40.30	46.76	8.246 77	8.291 71	74	7.77	9.70	4.878 76	5.557 43
29	39.39	45.81	8.237 37	8.286 97	75	7.41	9.18	4.734 90	5.388 93
30	38.48	44.86	8.226 94	8.281 70	76	7.07	8.68	4.593 54	5.217 27
31	37.57	43.91	8.215 38	8.275 83	77	6.73	8.21	4.446 63	5.046 79
32	36.66	42.96	8.202 57	8.269 30	78	6.41	7.75	4.303 09	4.870 92
33	35.75	42.02	8.188 36	8.262 10	79	6.10	7.31	4.158 98	4.693 89
34	34.84	41.07	8.172 62	8.254 00	80	5.82	6.89	4.024 40	4.516 47
35	33.94	40.13	8.155 36	8.245 09	81	5.55	6.50	3.890 51	4.343 99
36	33.05	39.19	8.136 47	8.235 17	82	5.31	6.13	3.768 02	4.173 15
37	32.16	38.26	8.115 58	8.224 26	83	5.09	5.78	3.652 76	4.004 82
38	31.28	37.32	8.092 74	8.211 99	84	4.89	5.45	3.545 46	3.839 88
39	30.41	36.40	8.067 81	8.198 66	85	4.72	5.14	3.452 32	3.679 21
40	29.54	35.48	8.040 30	8.183 86	86	4.57	4.85	3.368 64	3.523 71
41	28.69	34.57	8.010 67	8.167 62	87	4.45	4.58	3.300 66	3.374 26
42	27.85	33.67	7.978 44	8.149 83	88	4.36	4.33	3.249 07	3.231 75
43	27.02	32.77	7.943 44	8.130 12	89	4.32	4.11	3.225 97	3.102 96
44	26.20	31.89	7.905 47	8.108 81	90	4.30	3.92	3.214 38	2.989 12
45	25.38	31.01	7.863 80	8.085 27					

APPENDIX C - ANNUITY TABLE (TABLE B)

Present value of R1 per annum capitalised at 12% over fixed periods

Years	Amount	Years	Amount	Years	Amount	Years	Amount	Years	Amount
1	0.892 9	21	7.562 0	41	8.253 4	61	8.325 0	81	8.332 5
2	1.690 0	22	7.644 6	42	8.261 9	62	8.325 9	82	8.332 6
3	2.401 8	23	7.718 4	43	8.260 8	63	8.326 7	83	8.332 6
4	3.037 4	24	7.784 3	44	8.276 4	64	8.327 4	84	8.332 7
5	3.604 8	25	7.843 1	45	8.282 5	65	8.328 1	85	8.332 8
6	4.111 4	26	7.895 7	46	8.288 0	66	8.328 6	86	8.332 8
7	4.563 8	27	7.942 6	47	8.292 8	67	8.329 1	87	8.332 9
8	4.967 6	28	7.984 4	48	8.297 2	68	8.329 6	88	8.333 0
9	5.328 2	29	8.021 8	49	8.301 0	69	8.330 0	89	8.333 0
10	5.650 2	30	8.055 2	50	8.304 5	70	8.330 3	90	8.333 0
11	5.937 7	31	8.085 0	51	8.307 6	71	8.330 7	91	8.333 1
12	6.194 4	32	8.111 6	52	8.310 4	72	8.331 0	92	8.333 1
13	6.423 6	33	8.135 4	53	8.312 8	73	8.331 2	93	8.333 1
14	6.628 2	34	8.156 6	54	8.315 0	74	8.331 4	94	8.333 1
15	6.810 9	35	8.175 5	55	8.317 0	75	8.331 6	95	8.333 2
16	6.974 0	36	8.192 4	56	8.318 7	76	8.331 8	96	8.333 2
17	7.119 6	37	8.207 5	57	8.320 3	77	8.332 0	97	8.333 2
18	7.249 7	38	8.221 0	58	8.321 7	78	8.332 1	98	8.333 2
19	7.365 8	39	8.233 0	59	8.322 9	79	8.332 3	99	8.333 2
20	7.469 4	40	8.243 8	60	8.324 0	80	8.332 4	100	8.333 2