GENERAL DEDUCTION FORMULA EXAMPLE

AAA Ltd has a 31 December year end.

For the following expenditure, calculate the deductions available for a company that has a profit of R10,000,000 before taking into account the items mentioned below

**Carrying on a trade**

- The company bought shares in A Ltd, a company listed on the JSE, for R100,000 as an investment. The company paid R10,000 interest on a loan specifically taken out to buy these shares. They received R5,000 dividends from these shares.

**Expenditure and losses**

- The company wrote off depreciation of R120,000 during the year.

**Actually incurred**

**Caltex case application**

- The company promised to give the sales manager a new BMW 7 series if he exceeded sales targets for the year. The BMW would be given on 31 January of the next year. The sales target was exceeded in September when the cost of the car would be R600,000. At year end, the car price was R625,000.
- In the previous year, a similar competition was held. The car cost R400,000 at year end. The company eventually paid R420,000 for the car before giving it to the top salesman.

**Edgars case application**

- The company had a lease at Sandton City shopping centre. In March of each year, the company pays a top up of rent. The company has an annual rental of R480,000 for the shop. If the company turnover for the shop is greater than R10,000,000, the company pays 5% of turnover for each R1 of turnover above R10,000,000 for the year March to February. At the end of December, turnover was R9,800,000 for the Sandton shop. By the end of February, turnover was R11,500,000.
- The company had a lease at Eastgate shopping centre. In March of each year, the company pays a top up of rent. The company has an annual rental of R360,000 for the shop. If the company turnover for the shop is greater than R7,000,000 for the year, the company pays 5% of turnover for each R1 of turnover above R7,000,000 for the year March to February. At the end of December, turnover was R8,000,000 for the Eastgate shop. By the end of February, turnover was R10,800,000.
• The Eastgate shop pays a bonus to its manager. Turnover from 1 January till 31 December was R11,000,000 for the year. The manager is paid a bonus of 4% of turnover above R10,000,000 for the year January to December. The company only established turnover for the year on 15 January, 15 days after year end.

**Nasionale Pers case application**

• The company has a manufacturing division. The division pays a bonus at the end of June each year the equivalent of a 13\(^{\text{th}}\) cheque. If an employee is not working for the company in June, they do not qualify for a bonus. The provision at 31 December was correctly calculated at R100,000.
• The company has a sales division. The division pays a bonus at the end of June each year the equivalent of a 13\(^{\text{th}}\) cheque. If an employee leaves, the employee is paid pro rata his bonus for the number of months worked until the date of leaving. The provision at 31 December was correctly calculated at R120,000.

**Golden Dumps case application**

• The company was involved in legal dispute 1. If they lose the dispute, R1,000,000 in damages would be paid out. (This R1,000,000 would be tax deductible). The lawyer considers that the company has a fair chance of winning the case.
• The company was involved in a legal dispute 2. If they lose the dispute, R1,500,000 in damages would be paid out. (This R1,500,000 would be tax deductible). The lawyer considers that the company has no chance of winning the case and has recommended to management to settle out of court. Management has ignored the lawyers advice to date.

**Other application of unconditionally actually incurred**

• The company asked a security company to guard their business premises from 15 December till 8 January. They promised to pay an amount of R100,000 to ADT Ltd, a security company should no stock be stolen over this period. If stock is stolen, the market value of stock stolen will be taken off the R100,000 price. As at 31 December, no stock had been stolen.

**During the year of assessment**

• The company forgot to claim a R20,000 consulting fee in the previous tax year.
In the production of income

Sub Nigel v CIR

- The company received R80,000 income last year in advance from B Ltd. The company incurred R34,000 of expenditure in rendering the services for B Ltd in the current year. All R80,000 was recognised as gross income in the previous tax year.
- The company incurred R42,000 in expenditure in terms of a new product line that the company started. The new product line has not yet started producing income from the new product line.

PE Tramway case

- A bus driver was transporting company staff to the factory. There was an accident due to driver error and 3 staff members were killed and 12 people were injured. The company paid R132,000 in compensation to employees in respect of the accident. The bus driver had the correct license and the bus was roadworthy.

Joffe case

- The company was involved in the digging of a tunnel. The tunnel was reinforced with an inferior grade of concrete. The tunnel collapsed killing 2 people. The company paid R120,000 in compensation to the families of the 2 people.

Not of a capital nature

New State areas case

- The company started a new factory. Sewerage points needed to be connected to the municipal sewerage points. The council paid for the sewerage work and to recover amounts paid from 1 November:
  - Charged R2,000 a month to the company for 60 months to recover costs of sewerage laid down on the company premises,
  - Charged R1,600 a month to the company indefinitely for sewerage provision outside the property.

BPSA V CSARS

- The company obtained the right to open fast food stores from “Taco Hell”, a successful USA fast food chain. Royalties of R100,000 were paid during the year.
**Rand Mines v CIR**

- The company paid R5,000,000 to take over a contract to manage 72 franchise stores for a fast food chain. The contract was for 6 years and was estimated to earn approximately R3,000,000 a year for the company.

**To the extent of trade**

**Warner Lambert v CSARS and Nemojim v CIR**

- The company donated a BMW 325i car (costing R400,000) to St Sthithians school as a prize in the school raffle. They had a dual reason for doing this. They wanted to advertise the name of the company and they also had a philanthropic reason. Neither reason was more dominant than the other. The company did not have an established track record donating to third parties.

**Deductions not allowed**

**Insured losses**

- The company incurred R400,000 in a compensation claim for an employee injured in an accident at work. This accident happened from time to time at work and was usually unavoidable. The claim had been insured against. R300,000 was received from the insurance as compensation for the payment to the employee.

**Tax paid**

- The company paid R400,000 in tax during the year.

**Reserve transfers**

- The company transferred R300,000 from retained income to general reserve

**Expenses used to produce exempt income**

- The company incurred R20,000 in expenditure to generate local dividend income.

**Expenses deductible to the extent of trade**

- The company paid R20,000 expenses for something that was 40% for the company and 60% for a shareholder of the company that did not work for the company.
Corrupt activity or break the law

- The company received R30,000 in fines for overloading trucks. The overloading of trucks meant that the company could deliver more product thereby increasing profitability.
- R230,000 was paid as a bribe to generate business.

For each item, indicate the amount of expenditure or income attributed to them.