

Tutorial Letter 107/0/2012

Applied Taxation (CTA Level 2)

TAX4862
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Year module

Department of Taxation

This tutorial letter contains study units 14 to 18 as well as self-assessment assignment 5.

Bar code

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ORIENTATION

I INTRODUCTION

This tutorial letter is divided into five study units:

- Study unit 14 deals with **individuals** (including deduction for individuals), **ring-fencing of assessed losses** and **partnerships**.
- Study unit 15 deals with various aspects relating to **individuals** (this includes **fringe benefits** and **retirement benefits**).
- Study unit 16 deals with **employees' tax** and **provisional tax**.
- Study unit 17 deals with **tax avoidance, objections and appeal**.
- Study unit 18 deals with **tax and estate planning**.

The goal of this tutorial letter is to assist you in making the most of the time available to master the topics in this tutorial letter. Follow the guidelines and keep to the time limits (remember that these limits are based on the fact that certain topics have already been covered in your undergraduate studies).

II TIME FRAME



Your time should be divided into two parts:

- Obtaining the required knowledge (15 hours)
This would entail working through the tutorial letter, the text book (SILKE: South Africa Income Tax **2012**) (underlining and making summaries) and familiarising yourself with the Income Tax Act – Section A of this tutorial letter; and
- Application of knowledge (15 hours)
This would entail the completion of the integrated example and the self-assessment assignment – Sections B and C of this tutorial letter.

III PROPOSED WORKING METHOD

Start of by reading the tutorial letter. The tutorial letter will guide you in obtaining the knowledge from the textbooks and the Act. After you have obtained the knowledge, it should be easier to apply your knowledge when attempting the questions.

IV INSTRUCTION ICONS (LEGENDS) AND ABBREVIATIONS

In this tutorial letter, the following instruction icons are used:



Time allocation



Work program or Instruction or Activity



Important or Additional information
Examples or Exercises
Information relating to changes in legislation
Abbreviations used in the study unit
Outcomes of the study unit

The following abbreviations are used in this tutorial letter:

Abbreviation	Meaning of abbreviation
CGT	Capital Gains Tax
SAICA Legislation Handbook	SAICA Legislation Handbook 2011/2012 Volume 2
par	Paragraph
QSAT	Questions on SA Tax 2012, Roeleveld J, <i>et al.</i>
SAICA	The South African Institute of Chartered Accountants
SILKE	SILKE: South African Income Tax 2012, Stiglingh M, <i>et al.</i>
SU	Study unit
the Act	The Income Tax Act, No. 58 of 1962 (as amended)
TL	Tutorial letter
VAT	Value-Added Tax

V WEEKLY STUDY PROGRAM

Monday	11 June	Study unit 14: Individuals, ring-fencing of assessed losses and partnerships
Tuesday	12 June	Study unit 15: Individuals - fringe benefits and retirements benefits
Wednesday	13 June	Study unit 15: Individuals - fringe benefits and retirements benefits
Thursday	14 June	Study unit 16: Employees' tax and provisional tax
Friday	15 June	Study unit 17: Tax avoidance and objections and appeal Study unit 18: Tax and estate planning
Weekend	16 & 17 June	Study unit 18: Tax and estate planning (continued) Section B & C of this tutorial letter

VI BEANCOUNTER SCENARIO

We'll be continuing our investigation of the Beancounter family's tax problems and financial affairs. Refer to previous tutorial letters to meet the Beancounter family and to update yourself on what has happened to the family so far.

VII LECTURERS

The following lecturers compiled this tutorial letter:

Prof AJJ van Wyk
Ms M Ungerer
Ms MM Pretorius

Please contact **any** of the tax lecturers should you have questions regarding this tutorial letter. You can also send your queries (regarding administrative and academic matters) and comments via e-mail to TAX4862-12-Y1@unisa.ac.za.

Queries regarding **academic** matters can also be asked by calling the taxation cellular phone (082 666 0099) weekdays from 8:00 to 16:00 or by calling the hunting line on 012 429 4135 (remember to let it ring so that the exchange can find a free extension).

You may also contact Marcia Monama at 012 429 4336 for all queries regarding **administrative** matters.

VIII IMPORTANT DATE FOR THIS TUTORIAL LETTER

Due date for self-assessment assignment 5:	17 June 2012
Date of test 4:	28 July 2012

IX OPEN-BOOK POLICY



VERY IMPORTANT:

- **UNISA's open-book policy:**
Please refer to Tutorial letter 301/0/2012 regarding the open-book policy approved by UNISA's top management.
- **SAICA's open-book policy**
Refer to www.saica.co.za ("SAICA Examinations", "Exam Information", "Open book policy for SAICA exams") for the extract from the SAICA examination regulations.

X DESCRIPTION OF SAICA'S LEVELS OF LEARNING

Throughout the tutorial letter, we will refer you to the SAICA levels of learning (ranging from level 1 to 3) for every topic that we study. These levels will assist you in your studies, giving you an indication of **how** a specific topic will be assessed.

The 3 levels of learning are summarised by SAICA as follows:

Level	Description	At this level the candidate should be able to:	Our interpretation of the approach students should have to SAICA levels:
1	Knowledge and comprehension	<ul style="list-style-type: none"> understand the terms and be able to describe what it is; identify what the problem is (but not be able to solve the problem); and know how to use it in a simple tax calculation (i.e. know what to do with it). 	<ul style="list-style-type: none"> Read thoroughly
2	Application and analysis	<ul style="list-style-type: none"> identify the underlying problem; and perform a simple calculation. 	<ul style="list-style-type: none"> Study
3	Integration	<ul style="list-style-type: none"> identify the underlying problem; perform complex calculations; and answer integrated questions. 	<ul style="list-style-type: none"> Study in detail



Interpretation notes

- Interpretation notes will be assessed on the same level as the applicable provision in the applicable Act.

SECTION A (GUIDELINES)

STUDY UNIT 14

INDIVIDUALS, RING-FENCING OF ASSESSED LOSSES AND PARTNERSHIPS

WORK PLAN FOR 11 JUNE 2012

TIME ALLOCATION FOR STUDY UNIT 14



A total of 3 hours of your study time during this week has been allocated to study unit 14.

The following time allocation is recommended:

Individuals	80 minutes
Ring-fencing of assessed losses	20 minutes
Partnerships	60 minutes
Outcomes for the Beancounter scenario	20 minutes
Total	180 minutes



Start your studies of study unit 14 by working through notes 14.1 –14.5. Thereafter you must work through each of the notes of this study unit.

14.1 BACKGROUND

The biggest problem student's face when dealing with the taxation of individuals is that they don't know how the different sections that is used to calculate the tax liability of an individual, fits together. It is important to remember that the normal tax framework is used to calculate the tax liability of an individual (see framework below). There are several specific inclusions (for example lump-sums and fringe benefits) and exempt income (for example the basic interest exemption – studied in TL104) that are applicable to individuals. Some deductions, for example pension fund-, retirement annuity fund- and medical aid deductions, are only available to individuals and will be discussed in this tutorial letter (refer to note 14.6 for a comprehensive framework for the calculation of the tax liability of an individual).

The income tax payable by any taxpayer is calculated on the taxpayer's taxable income. The following tax framework shows how we calculate the taxable income of a taxpayer and indicates how the topics covered in this study unit fit into this framework:

NORMAL INCOME TAX FRAMEWORK

GROSS INCOME (section 1)

LESS: Exempt income (section 10)

= *INCOME*

LESS: Deductions and allowances (mainly sections 11–17A, 22, 23, 24 and 24C)

LESS: Assessed loss brought forward (section 20)

ADD: Amounts to be included in taxable income including *TAXABLE CAPITAL GAINS*

LESS: Qualifying donations (section 18A)

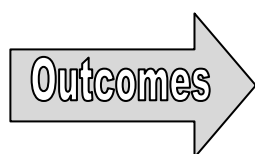
LESS: Qualifying medical expenses (only available to individuals) (section 18)

= *TAXABLE INCOME*

Use taxable income to calculate NORMAL TAX PAYABLE.

Study unit 14 deals with various aspects relating to the income tax payable by **individuals** (this includes **the order of deductions** (note 14.6) and **the ring-fencing of losses from certain trades** (note 14.6.6) when calculating taxable income). It also includes the taxation of **partnerships** (note 14.7).

14.2 OUTCOMES FOR THIS STUDY UNIT



After studying study unit 14, you should be able to meet the following outcomes:

- all the outcomes listed at the beginning of Chapters 10 (Individuals) and 15 (Partnerships) of SILKE;
- know how to deal with assessed losses and ring-fencing of assessed losses from certain trades (last bullet of SILKE chapter 8).

14.3 TABLE OF REFERENCE



In order to provide you with an overview of deductions regarding individuals and the ring-fencing of assessed losses, as well as being a useful study tool, we include the following table. Although this table provides you with a **summary of the sections** in the Income Tax Act and the **appropriate references to SILKE**, covered in this study unit, it should **not** be used in **isolation** to guide you through the study process. Proceed to the **daily work program** (see notes below) and follow the **specific study approach** stated there. This table should then be **used for revision purposes only**.

SAICA LEVELS:

Please pay attention to the **SAICA knowledge levels** (refer to “Orientation” note X in this tutorial letter for a description of the levels) while working through this table.

REFERENCE TO NOTES:

Where reference is made to **another tutorial letter**, you should **understand the principles** and be able to **apply** the principles for purposes of this study unit, but study the principles in **more detail** (according to the SAICA level) in that tutorial letter **referred to**.

Where reference is made to **previous tutorial letters**, you may be **tested** according to the **SAICA level** provided. In other words, study units may be **integrated** with knowledge acquired in **previous tutorial letters** as well as **other study units** in the same tutorial letter.

Reference to the Income Tax Act	Topics	SILKE	Notes in TL	SAICA Levels
Amounts received				
Section 1 – par (c) and (cA) of the definition of gross income	• Inclusion in gross income (services rendered)	4.4* & 4.5* 10.1 - 10.3		3
Sections 7(2) or 7(2A)	• Taxation of married couples	10.5		3
Sections 7(3) & 7(4)	• Minor children	10.7		3
Section 7(11)	• Divorce (after 1 March 2009 only)	10.6		2
Section 7A	• Anti-dated salaries	10.8		1
Section 10	• Exempt from tax	6.20*		3
Deduction for individuals				
Sections 6A, 11(k), 11(n), 11(nA), 11(nB) 18, 18A,	• Deductions	10.4 10.9 8.7 8.9.2	14.6.1 – 14.6.4	3
Section 11(a) & 23(m)	• Limitations of deductions	10.4		3
Interpretation Note 13: • Deductions: Limitation of deductions for employees and office holders (SAICA Legislation Handbook 2011/2012, pg 487)				3
Section 20	• Assessed losses	8.12.1 & 8.12.3	14.6.5	3
Section 20A	• Limitation on certain losses	8.12.6	14.6.6	3

* Already included in previous study units

14.4 IMPORTANT LAW AMENDMENTS

Before continuing with study unit 14, it is important that you take note of the following important amendments to the Income Tax Act which were promulgated in 2011/2012 (refer to the **Taxation Laws Amendment Act No.24 of 2011** and the **Taxation Laws Amendment Act No. 25 of 2011**).



PLEASE NOTE

For Part I of the 2013 SAICA Qualifying Examination, legislation promulgated prior to 31 January 2012 taking effect during the 2013 year of assessment for individuals and 2012 or 2013 years of assessment for corporate entities, will be examinable. Monetary amounts will be updated for such years of assessment as provided for in the Minister of Finance's budget speech of 2012. This has an impact on the above years of assessment and does not appear in the SAICA Legislation Handbook (SAICA 2012/2013 examinable pronouncements).

Since the latest legislation was only promulgated on 10 January 2012, some of the parts in SILKE are based on "old" legislation. Some of the legislative amendments applicable to the 2013 year of assessment have already been incorporated in SILKE and in most chapters these changes can be found at the end of the chapter. Please make sure that you study the latest legislation. We will draw your attention to sections which should be ignored and replaced with the updated legislation.

For this study unit you must IGNORE SILKE 10.4.3 and instead STUDY SILKE 10.9.



LAW AMENDMENTS:

- **Section 11(n)(i)(aa):** Severance benefits have been added in the calculation of the limitation. Therefore, the amount on which the 15% limitation for the RAF contribution is calculated, will be as follows:
 - Total amount of income *EXCLUDING*
 - Income derived from retirement funding employment, retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit and **severance benefit**.
- **Section 18 (medical expenses):** The deduction system for medical aid fund contributions will be converted into a credit system with effect from 1 March 2012. This includes the new Section 6A rebate. See note 14.6.3 in this study unit for a complete discussion.

MONETARY VALUES WITH REGARDS TO INDIVIDUALS' RATES OF NORMAL TAX, REBATES AND MONETARY THRESHOLDS AS ANNOUNCED BY THE MINISTER OF FINANCE IN THE BUDGET SPEECH 2012:

(Note that the 2013 monetary values will be provided in an addendum in tests and examinations)

Tax Thresholds (point at which tax becomes payable)		
	Taxable income (Rand)	
	2012	2013
Persons under 65	59 750	63 556
Persons 65 and under 75	93 150	99 056
Persons 75 and above	104 261	110 889

Tax Tables	
Tax Rates: Individuals, estates and special trusts - 2013	
Taxable income	Rates of tax
R0 – R160 000	18% of taxable income
R160 001 – R250 000	R28 800 + 25% of taxable income exceeding R160 000
R250 001 – R346 000	R51 300 + 30% of taxable income exceeding R250 000
R346 001 – R484 000	R80 100 + 35% of taxable income exceeding R346 000
R484 001 – R617 000	R128 400 + 38% of taxable income exceeding R484 000
Exceeding R617 000	R178 940 + 40% of taxable income exceeding R617 000

Tax Rebates		
	Rebates (Rand)	
	2012	2013
Persons under 65	10 755	11 440
Persons 65 and under 75	6 012	6 390
Persons 75 and above	2 000	2 130

Annual interest exemption for:	2012 & 2013 (Rand)
Persons under 65	22 800
Persons 65 and above	33 000

Subsistence allowance		
	2012	2013
Meals and incidental costs	R286	R303
Incidental costs only	R88	R93

Travel allowance			
Scale of values (2013 year of assessment)			
Where the value of vehicle is (incl VAT)	Fixed Cost (R)	Fuel cost (c/km)	Maintenance cost (c/km)
R0 – R60 000	19 492	73.7	25.7
R60 001 – R120 000	38 726	77.6	29.0
R120 001 – R180 000	52 594	81.5	32.3
R180 001 – R240 000	66 440	89.6	36.9
R240 001 – R300 000	79 185	102.7	45.2
R300 001 – R360 000	91 873	117.1	53.7
R360 001 – R420 000	105 809	119.3	65.2
R420 001 – R480 000	119 683	133.6	68.3
Exceeding R480 000	119 683	133.6	68.3

Monthly Medical Rebates/Credits

	2012	2013
Taxpayer	216	230
Taxpayer and one dependant	432	460
For each additional dependant	144	154

The above rates are only applicable to persons under the age of 65

Capital gains tax		
	2012	2013
Inclusion rate	25%	33.3%
Annual exclusion	R20 000	R30 000
Exclusion in year of death	R200 000	R300 000
Primary residence exclusion	R1 500 000	R2 000 000



Before you start studying the detailed provisions of the Income Tax Act in respect of individuals, read the following scenario relating to the Beancounter family. Then you should, as you study the different notes in study unit 14, identify areas of concern that should be brought to the attention of Barry Beancounter and his friends. Refer back to your study units for background information.

14.5 BEANCOUNTER SCENARIO



Bizzie Beancounter and her sister-in-law, Belinda Beancounter (a South African resident), had a discussion one day while drinking cappuccinos. Belinda wanted to know from Bizzie if she knew anything about deductions available to individuals, as she has been divorced from 1 December 2012 and has never done her own tax. As Bizzie knew neither, she referred her to you.

Belinda (35 years old) had been employed as a travel agent by Seconds travel agency. She left the employment of the travel agency at the end of June 2012 and started working as a general manager at a five star bush lodge on 1 July 2012.

The following information relates to her employment during the 2013 year of assessment:

	Note	R
<u>Seconds travel agency:</u>		
Salary (per month) (non-pensionable)		15 000
Total commission earned		20 000
Restraint-of-trade payment	1	10 000
<u>Bush Lodge:</u>		
Salary (per month)(non-pensionable)		25 000
Medical aid contributions by employer (per month)	2	500
Medical aid contributions by employee (per month)	2	1 000
Retirement annuity fund contributions (per month)		800
<u>Other:</u>		
Maintenance payments received from her ex-husband	3	30 000

Notes:

1. A restraint-of-trade payment was made to Belinda, prohibiting her from working for another travel agency located within a radius of 20 kilometres, for a period of two years.
2. The contributions to the medical aid only provided cover for Belinda. Her employer's contributions were paid for her benefit in terms of the rules of the fund. The medical aid fund has settled all of her claims submitted during the 2013 year of assessment in full. She therefore did not incur any medical expenses, apart from her own contributions made during the year.
3. Belinda also received maintenance payments of R10 000 per month from her ex-husband from the date of their divorce (1 December 2012).
4. During the year of assessment, she made a donation of R1 800 to an orphanage. The orphanage provided her with a section 18A certificate (receipt).
5. When she moved to the game lodge, she sold her primary residence for an amount of R2 600 000 (proceeds). When she inherited the house in 2004, it had a market value of R600 000.
6. She earned interest on her savings account of R5 000 and R30 000 from other investments during the 2013 year of assessment. All investments have been made in South Africa.

Belinda would like to know what her tax liability for the 2013 year of assessment will be.



Before attempting to help Belinda Beancounter with her query, you should work through and master study unit 14. After studying individuals, you will be ready to identify areas of concern that should be brought to the attention of Belinda Beancounter.

14.6 THE CALCULATION OF TAX PAYABLE BY INDIVIDUALS ACCORDING TO THE FRAMEWORK



Read through the proposed study method below, before you work through the framework to calculate the tax payable by individuals in more detail.

Proposed study method:

You have to review and master the sections of the Income Tax Act, as set out in the table in note 14.3. While you work through the sections in the Act and SILKE, bear in mind the SAICA knowledge levels as indicated in the table in note 14.3 of this study unit.

When working through the legislation in this study unit, apply the following study approach:

- Step 1: Read the relevant section in the Act. (You will probably still be able to grasp the essence of a section without looking at the Act, but we urge you to get familiar with the Act. This will be to your benefit as the tests, the final examination and the 2013 Qualifying Examination part 1, are all limited open book assessments).
- Step 2: Review the relevant part(s) in SILKE together with the additional notes in this study unit. Should it be indicated that a discussion of the relevant section is included in the additional notes of this study unit, look at the additional information **first** before working through the relevant part(s) in SILKE.

Before discussing the separate elements in the study unit, we first provide you with a comprehensive framework, in order to indicate where these elements will fit into the calculation of the taxable income of an individual. This is further emphasised in the integrated example in Section B.



Work through:

The framework below, pay special attention to the **ORDER OF THE DEDUCTIONS** as it is very important. The aim of the references in the framework to the Income Tax Act and tutorial letters, is to help you understand where each individual item, that has an effect on the calculation of the taxable income of an individual, fits into the framework and not to guide you through this study unit.

FRAMEWORK	Legislation	Reference to TL in which the topic is covered
<i>The proportional amount of the net income of the controlled foreign company</i>	Section 9D	TL 106
<i>Profit share from a partnership</i>	Section 24H, 66(15) and 77(7)	TL 107
<i>Distributions by a trust and other income deemed to accrue</i>	Section 7 and 25B	TL 106
LESS: DEDUCTIONS	Sections 11(a) & 11A	TL 105
<i>Expenditure and losses actually incurred in the production of income, provided such expenditure and losses are not of a capital nature</i> (Take into account limitations laid down by section 23 and specifically section 23(g), which only allows expenditure incurred for purposes of a trade and section 23(m) which limits amounts received by virtue of employment, as well as the possible application of section 11A)	Sections 11(a) and 23(m) and Interpretation note 13	TL 105
<i>Losses from different trades</i> (including losses made from a trade (not a company or CC – separate legal entity) and a share in a loss from a partnership (calculated in terms of section 24H) Remember : <ul style="list-style-type: none"> • Cannot set-off an assessed loss from non-RSA trade against SA income. Loss must be carried forward and used against non-RSA income in next year. • Trading loss from one foreign country can be set-off against taxable income from other foreign countries. • Can however utilise a RSA loss against non-RSA income. • Section 20A could be applicable (ring-fencing of assessed losses). 	Sections 20 Section 20A	TL 107
<i>Pension fund contributions</i> (Remember that the contributions to a provident fund are not deductible)	Section 11(k)	TL 107
<i>Entertainment expenditure</i> (Remember not allowed if expenditure incurred in connection with employment or the holding of an office unless received by agent or representative who derives more than 50% of total remuneration in form of commission based on their sales or the turnover)	Sections 11(a) and 23(m)	TL 107
<i>Assessed loss of previous year</i>	Sections 20 & 20A	TL 107
<i>Retirement annuity fund contributions</i>	Section 11(n)	TL 107
= SUBTOTAL (TAXABLE INCOME)		
<u>Add:</u> <i>Unexpended portion of allowances (e.g.: travel allowance and entertainment allowance)</i>	Section 8(1)	TL 107
<u>Add:</u> <i>Taxable capital gains</i>	Section 26A and the 8 th Schedule	TL 104
= SUBTOTAL (TAXABLE INCOME)		
<i>Donations to certain organisations</i>	Section 18(A)	TL 107
<i>Medical contributions and expenses</i>	Section 18	TL 107
= TOTAL (TAXABLE INCOME)		



Study Chapter 10, 8.7 and 8.9.2 in SILKE in addition to the following notes.
Remember to IGNORE SILKE 10.4.3 and instead study SILKE 10.9

In the following notes of this tutorial letter, we will study the various **deduction components** of the framework in more detail.

14.6.1 Limitations on deductions for individuals

Order of deductions	Limitation
Pension fund contributions (section 11(k))	
Current	Limited to the greater of:
Arrears	<ul style="list-style-type: none"> • R1 750; or • 7,5% × retirement funding income Limited to R1 800 per annum
Retirement annuity fund contributions (section 11(n))	
Current	Limited to the greatest of:
Reinstatement	<ul style="list-style-type: none"> • R1 750; • R3 500 – current pension fund contributions allowed; or • 15% × non-retirement funding income Limited to R1 800 per annum
Donations to public benefit organisations (section 18A)	
	Limited to 10% × taxable income before this deduction and the medical expenses deduction in section 18 (excluding any retirement fund lump sum benefit, retirement fund lump-sum withdrawal benefit and severance benefit)
Medical expenses (section 18)	
Over 65 years old	Deductible in full
Physically disabled	Amounts paid by the taxpayer but not recovered from the medical aid fund <i>plus</i>
Other	<ul style="list-style-type: none"> • total contributions to a medical aid fund <i>less</i> • four times the Section 6A tax credit. Total contributions made to a medical aid fund <i>less</i> <ul style="list-style-type: none"> • four times the S6A medical scheme fees tax credit <i>plus</i> • amounts paid by the taxpayer but not recoverable from the medical aid fund <i>less</i> • 7.5% of the taxpayer's taxable income before this deduction.

14.6.2 Deduction with regard to pension fund contributions (section 11(k))

Note that income from retirement funding employment excludes retirement fund lump-sum benefits. Retirement fund lump sum benefits are lump sums received from a fund in consequence of retirement, death, resignation or withdrawal.

14.6.3 Deduction with regard to medical expenses (section 18)

With effect from 1 March 2012, the deduction system for medical aid fund contributions will be converted into a credit system.

A new rebate (Section 6A) will be introduced that must be deducted from the normal tax payable by a taxpayer.

- The rebate does not apply to taxpayers 65 years or older.
- The taxpayer must be registered to a registered medical aid fund or scheme.
- The rebate will be for all taxpayers younger than 65 as well as a taxpayer (or a dependant) with a disability.

The amount of the medical scheme fees tax credit will be:

- R230, per month, if fees are paid in respect of the taxpayer
- R460, per month, if fees are paid in respect of the taxpayer and one dependant, or
- R460, per month, if fees are paid in respect of the taxpayer and one dependant plus R154 in respect of fees paid in respect of **each additional** dependant.

The medical scheme fees tax credit is not refundable and cannot exceed the tax payable.

The Section 18 medical deduction has subsequently been amended as follows for two types of taxpayers:

Taxpayers <65	Taxpayer (or dependant) with a disability
<ul style="list-style-type: none"> ❖ Total contributions made by the taxpayer to a medical aid fund ❖ <u>LESS</u>: Four times the section 6A medical scheme fees tax credit in respect of that taxpayer (limited to Rnil). ❖ <u>PLUS</u>: Amounts paid by the taxpayer (but not recoverable from the medical aid fund by the taxpayer or his or her spouse during the year of assessment to <ul style="list-style-type: none"> ➢ Doctors ➢ Hospitals ➢ Pharmacies (prescribed medicine) For expenditure incurred both locally and internationally for the taxpayer, his or her spouse, children and dependants ❖ <u>LESS</u>: 7.5% of the taxpayer's taxable income (excluding any retirement fund lump sum benefit, retirement fund lump sum withdrawal benefit or severance benefit) before this deduction. 	<ul style="list-style-type: none"> ❖ Total contributions made by the taxpayer to a medical aid fund ❖ <u>LESS</u>: Four times the section 6A medical scheme fees tax credit in respect of that taxpayer (limited to Rnil). ❖ <u>PLUS</u>: Amounts paid by the taxpayer (but not recoverable from the medical aid fund by the taxpayer or his or her spouse during the year of assessment to <ul style="list-style-type: none"> ➢ Doctors ➢ Hospitals ➢ Pharmacies (prescribed medicine) For expenditure incurred both locally and internationally for the taxpayer, his or her spouse, children and dependants including expenditure incurred and paid in consequence of any physical impairment or disability.



Remember:

The Section 6A rebate for both types of taxpayers mentioned above, will be similar. The medical scheme fees tax rebate (section 6A) is deducted after the primary rebate.

General notes:

- The deduction in terms of section 18 can be claimed in respect of all medical scheme beneficiaries that are dependants of the taxpayer, therefore including a family member **registered** as a **dependant** of the taxpayer in terms of the medical fund.
- Note that a medical fringe benefit (paragraph 12A(5) of the 7th Schedule) must be included in a taxpayers' gross income. This amount will be the contribution that an employer makes to a medical scheme for the benefit of an employee. Take note that paragraph 12A(5)(d) was deleted with effect from 1 March 2012. This means that the payment of contributions to benefit funds by an employer in respect of **employees over the age of 65 will now be treated as a fringe benefit**.

**Take note:**

The Taxation Laws Amendment Act 2011 failed to exclude 'severance benefits' from the amount on which the 7.5% is calculated. This is an oversight and SARS have indicated that this will be corrected.

**Example**

A married taxpayer under the age of 65 years has three dependants (his wife and two children). All four family members are members of his medical aid fund. Relevant details are as follows:

- Cash salary: R312 000
- Employer's contribution to medical aid fund: R34 000
- His own contribution to medical aid fund: R12 000
- Medical expenses paid by him and not recovered from the medical aid fund: R18 000

Calculate the taxpayers' taxable income and normal tax liability for the 2013 year of assessment.

Suggested solution:

Cash salary

Plus: Fringe benefit (par 12A of Seventh Schedule):

Employer's contribution

Taxable income before section 18 deduction

Section 18 - Medical aid deduction

Medical aid fund contributions as contemplated in Section 18(1)(a):

Employers contribution

Own contribution

Less: Section 6A rebate x 4

$(R460 + R154 + R154) \times 12 \text{ months} = R9\,216 \times 4$

Subtotal:

Plus: Medical expenses

Less: 7.5 % x R346 000

Section 18 deduction

Taxable income

Normal tax payable per the table:

$R51\,300 + [(R344\,814 - R250\,000) \times 30\%]$

Less: Primary rebate

Less: Section 6A rebate $(R460 + R154 + R154) \times 12 \text{ months}$

Normal tax liability

R	R
	312 000
	34 000
	346 000
34 000	
12 000	
46 000	
(36 864)	
9 136	
18 000	
27 136	
(25 950)	
	(1 186)
	344 814
79 744	
(11 440)	
(9 216)	
59 088	

14.6.4 Impact of taxable capital gains on allowable deductions

A taxable capital gain is included in taxable income in terms of section 26A (also refer TL104). Certain deductions are calculated as a percentage of, for example, taxable income and it raises the question of how the calculation of these deductions is influenced by a taxable capital gain. The following notes explain it:

- **Contributions to a pension fund (section 11(k))**

The deduction is limited to 7,5% of remuneration derived from retirement funding employment (excluding any retirement fund lump-sum benefit, lump sum withdrawal benefit and severance benefit) and is therefore not influenced by a taxable capital gain.

- **Contributions to a retirement annuity fund (section 11(n))**

The 15% is calculated on an amount that commences with income (excluding any retirement fund lump-sum benefit, lump sum withdrawal benefit and severance benefit) and will therefore also not be affected by a taxable capital gain.

- **Donations and medical expenses**

Both are calculated with reference to **taxable** income, but in terms of section 18A(1), the deduction in respect of qualifying **donations** must be calculated on taxable income (excluding any retirement fund lump-sum benefit) **before the medical deduction** has been taken into account. That provides the order – first section 18A, then section 18.

The “taxable income” for purposes of both the section 18A (donations) and section 18 (medical) deductions will therefore **include a taxable capital gain**.



Example

Mr Bennet is unmarried, 45 years old (with no other dependants) and is a full time employee of Bennetto Limited. His income for the 2013 year of assessment, before any deductions, amounted to R245 000. The following information still needs to be taken into account:

- Mr Bennet made a capital gain of R40 000 and a capital loss of R5 000 during the year.
- He contributed R1 200 per month to his pension fund. The R1 200 is calculated at 8% of his basic salary of R15 000 per month. All his contributions to a pension fund in previous years were allowed as a deduction in terms of section 11(k).
- His total retirement annuity fund contribution for the year of assessment amounted to R12 000.
- Mr Bennet’s monthly medical fund contributions that he paid amounted to R900. He also paid R13 000 for qualifying medical expenses not refunded or to be refunded by his medical scheme.
- He made a donation of R2 000 to an approved PBO and the necessary section 18A receipt was obtained.
- Mr Bennet was employed for the full year.

REQUIRED

Calculate Mr Bennet’s taxable income for the 2013 year of assessment.

Suggested Solution:

	R	R
INCOME		245 000
Pension fund contributions (section 11(k))	Actual: R1 200 x 12 = R14 400 Maximum: Greater of R1 750 or 7,5% x R180 000 (R15 000 x 12)	<u>(13 500)</u>
		231 500
RAF contribution (section 11(n))	Actual = R12 000 Maximum = greater of R1 750, [R3 500 – R13 500 = R0] or [15% x (R231 500 + R13 500 (a 11(k)) - R180 000 retirement funding employment (R15 000 x 12))] = R9 750 (or R245 000 – R180 000 = R65 000 x 15% = R9 750)	<u>(9 750)</u>
Taxable income before capital gain		221 750
Taxable capital gain	Net capital gain = R40 000 - R5 000 = R35 000 Annual exclusion = R35 000 – R30 000 = R5 000 Inclusion rate = R5 000 x 33.3% = R1 665	<u>1 665</u>
		223 415
Donations (section 18A)	Actual = R2 000 Maximum = 10% x R223 415 = R22342 Limited to actual, therefore, R2 000	<u>(2 000)</u>
		221 415
Medical expenses (section 18)	Medical aid fund contributions (section 18 (1)(a): R900 x 12 <u>Less:</u> 4 x section 6A rebate (4 x R230 x 12 months) Subtotal: (But limited to Rnil) <u>Plus:</u> Medical expenses <u>Less:</u> 7.5% x R221 415 Section 18 deduction	10 800 <u>(11 040)</u> (240) 13 000 <u>13 000</u> <u>(16 606)</u> -
Taxable income		<u><u>221 415</u></u>



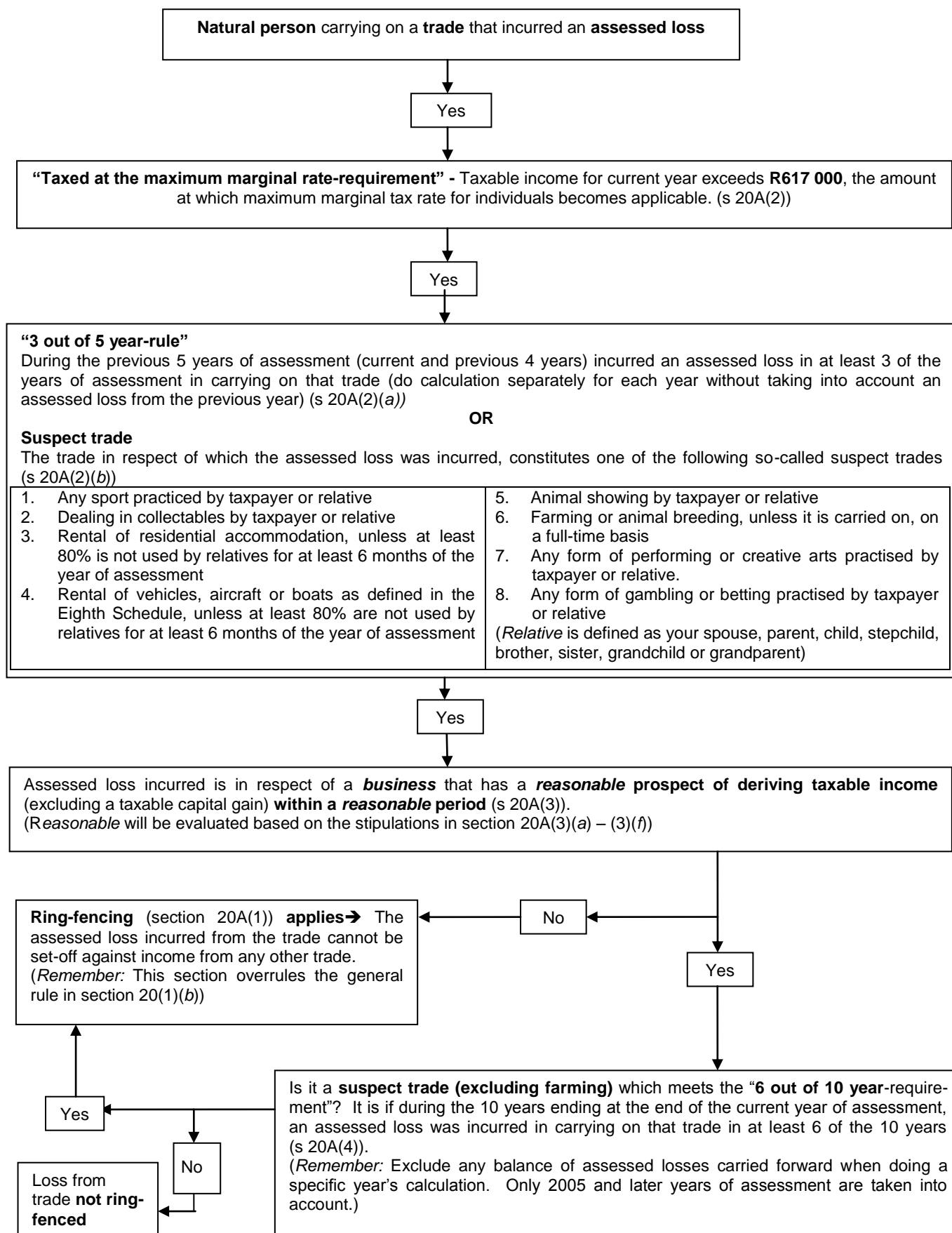
Study Chapter 8.12.1, 8.12.3 and 8.12.6 in SILKE in addition to the following notes.

14.6.5 Assessed losses of the previous year (section 20)

Note that an assessed loss may not be set off against any retirement fund lump sum benefit, lump sum withdrawal benefit and severance benefit.

14.6.6 Ring-fencing of assessed losses of certain trades (section 20A)

This section applies to individuals only. Remember that if a natural person carries on a trade in his own name, he will be taxed in his personal capacity. It is important to note that section 20 (set-off of assessed losses) is subject to the provisions of section 20A.



Notes:

- In terms of section 20A(2), the '**taxed at the maximum marginal tax rate-requirement**' should be tested for by comparing the following amounts:
 - **the sum of the taxpayer's taxable income** (as defined in section 20A(2)) (**determined without having regard to any other provisions of this section**) and **any assessed loss and balance of assessed loss which were set off in terms of section 20 in determining that taxable income** and
 - the amount at which the maximum marginal tax rate for individuals for the year under review becomes applicable (exceeding R580 000 (in 2012) and R617 000 (in 2013)).

Thus, we look at taxable income after deducting the current years and previous years' assessed losses. (If section 20A has however been applied to a certain trade in a previous year of assessment, such trade is then ring-fenced from that year onwards and such an assessed loss from that trade can only be set off against income derived from that trade. Assessed losses from that trade will then not be deducted from the current year's taxable income.) Assessed losses so deducted, are then added back again. Thus, the net effect is that losses from other trades are in essence ignored for the purposes of the "taxed at the marginal rate-requirement". It is however taken into account for the purposes of calculating deductions such as qualifying donations (section 18A) and qualifying medical costs (section 18).

This interpretation relates only to the "**taxed at the maximum marginal rate-requirement**". The "3 out of 5 year-rule" is tested by doing separate calculations for each trade *without* taking into account an assessed loss from a previous year.

- Note that once an assessed loss is ring-fenced, it stays ring-fenced even if the person is not taxed at the maximum marginal tax rate in a subsequent year of assessment (section 20A(5)).
- Any balance of an assessed loss carried forward, to which section 20A applied in any prior year of assessment, may not be set off against any income other *than income derived from that specific trade*. Income derived from any trade includes: recouplement's in terms of section 8(4) and any amount derived from the disposal, after the cessation of that trade, of any asset used in carrying on that trade (section 20A(6)).
- All farming activities carried on by a taxpayer shall be deemed to constitute a single trade (section 20A(7)).
- If the provisions of section 20A(2) (being "taxed at the maximum marginal rate-requirement") apply, the taxpayer must indicate the nature of the business in his tax return (section 20A(8)).
- It is our view that separate business activities (other than farming) will constitute separate trades.



Example: Section 20A

Assume for these examples that the maximum marginal tax rate becomes applicable if taxable income exceeds

- R490 000 for the 2009 year of assessment,
- R525 000 for the 2010 year of assessment;
- R552 000 for the 2011 year of assessment;
- R580 000 for the 2012 year of assessment; and
- R617 000 for the 2013 year of assessment.



Example A (Section 20A)

2012

The taxpayer is an accountant and started out as a part-time game farmer during 2012 year of assessment. In the 2012 year of assessment he has taxable income of R650 000 from his accounting practice and his game farm has generated an assessed loss of R30 000.

REQUIRED:

Indicate whether the assessed loss from the game farm will be ring-fenced in terms of section 20A(1) in the 2012 year of assessment.

Suggested Solution:

Section 20A(1) will be applicable and the assessed loss of R30 000 will be ring-fenced, unless it is a trade which constitutes a business in respect of which there is a reasonable prospect to derive taxable income (not a taxable capital gain) within a reasonable period (section 20A(3)), because:

- It is a natural person carrying on a trade (being farming) with an assessed loss.
- The taxpayer is taxed at the maximum marginal tax rate (taxable income of R650 000 – R30 000 + R30 000 = R650 000 compared to R580 000: note that assessed losses are not taken into account when such a taxable income is calculated) (section 20A(2)).
- Although the 3 out of 5 year-rule does not apply, part-time farming is a listed suspect trade (section 20A(2)(b)) and therefore section 20A(1) will apply.
- Thus taxable income for the 2012 year of assessment will be R650 000 and a ring-fenced assessed loss of R30 000 is carried forward to the 2013 year of assessment.

2013

Against all odds the 2013 year of assessment was a much better year for the game farm and the taxpayer generated taxable income of R2 000. He also generated taxable income of R600 000 from his accounting practice.

REQUIRED:

Calculate the taxpayer's taxable income for the 2013 year of assessment.

Suggested Solution:

The ring-fenced assessed loss from the game farm for the 2012 year of assessment, can only be set-off against the income earned from that trade (section 20A(5)) in any subsequent year of assessment. Taxable income will therefore be = R600 000 + (R2 000 – R2 000: assessed loss deducted from 2012 (R30 000 ring-fenced assessed loss brought forward) but can only be applied against income from the ring-fenced trade) = R2 000. The remaining R28 000 assessed loss is then carried forward to 2014.



Example B (Section 20A)

A natural person derives an annual taxable income of R560 000 from her job as a secretary for the years of assessments 2009 until 2013. She also sells flowers from her garage after hours. The flower business generated assessed losses as follows: R12 000 (2009), R5 000 (2010), R8 000 (2011), R2 000 (2012) and R3 000 (2013). She is unable to prove a reasonable prospect of taxable income within a reasonable period of time in respect of the flower business.

REQUIRED:

Indicate whether the provisions of section 20A(1) can be applied to the taxpayer. If so, from which year of assessment will the ring-fencing apply?

Suggested Solution:

Section 20A(1) will only be applicable from the 2011 year of assessment and from this year onwards the assessed losses (R8 000 (2011), R2 000 (2012) and R3 000 (2013)) will be ring-fenced. The following is the reasoning behind section 20A(1) being applicable:

- It is a natural person carrying on a trade with an assessed loss.
- The taxpayer is taxed at the maximum marginal rate of tax in the 2009 year of assessment - taxable income of R560 000 ($R560\,000 - R12\,000 + R12\,000$) which is above the R490 000 threshold, but in this year the "3 out of 5 year-rule" is not met (selling flowers is not a suspect trade). The same applies to the 2010 year of assessment with a R560 000 ($R560\,000 - R5\,000 + R5\,000$) taxable income which exceeds the R525 000 threshold.
- In 2011 the taxpayer is still taxed at the maximum marginal tax rate – taxable income of R560 000 ($R560\,000 - R8\,000 + R8\,000$) which exceeds the R552 000 threshold and the "3 out of 5 year-rule" is now met for the first time. Therefore section 20A(1) will apply from the 2011 year of assessment onwards. In the 2011 year the person's taxable income will therefore be R560 000, and the R8 000 assessed loss will be ring-fenced, only to be set-off against future income from the flower business.
- In the 2012 year of assessment the "taxed at the maximum marginal tax rate-requirement" will be tested for by using a taxable income of R560 000 against the threshold of R580 000. Note that although "the taxed at the maximum marginal tax rate" requirement is not met for the 2012 and 2013 year of assessments, the assessed losses of R2 000 (2012) and R3 000 (2013) is not set-off, as this trade has been ring-fenced from the 2011 year onwards (section 20A(5)). The R13 000 ($R8\,000 (2011) + R2\,000 (2012) + R3\,000 (2013)$) is available for set-off against future income earned out of the flower business.



Remember:

If her salary was only R400 000, this article would not apply as she is not taxed at the maximum marginal rate of tax for any of the said years. The fact that the 3 out of 5 year-rule is met, does not cause section 20A(1) to become applicable unless the "taxed at the maximum marginal rate-requirement" (in section 20A(2)) is also met.



You have now completed your studies of the deductions of individuals and assessed losses and should be ready to start with partnerships. Read note 14.7 below.

14.7 PARTNERSHIPS

14.7.1 Table of reference



In order to provide you with an overview of deductions regarding partnerships, as well as being a useful study tool, we include the following table. Although this table provides you with a **summary of the sections** in the Income Tax Act and the **appropriate references to SILKE**, covered in this study unit, it should **not** be used in **isolation** to guide you through the study process. Proceed to the **daily work program** (see notes below) and follow the **specific study approach** stated there. This table should then be **used for revision purposes only**.

SAICA LEVELS:

Please pay attention to the **SAICA knowledge levels** (refer to “**Orientation**” note X in this tutorial letter for a description of the levels) while working through this table. In instances where the levels of knowledge have changed from the prior year’s syllabus, the current level has been highlighted in the table below.

REFERENCE TO NOTES:

Where reference is made to **another tutorial letter**, you should **understand the principles** and be able to **apply** the principles for purposes of this study unit, but study the principles in **more detail** (according to the SAICA level) in that tutorial letter **referred to**.

Where reference is made to **previous tutorial letters**, you may be **tested** according to the **SAICA level** provided. In other words, study units may be **integrated** with knowledge acquired in **previous tutorial letters** as well as **other study units** in the same tutorial letter.

Reference to the Income Tax Act	Topics	SILKE	Notes in TL	SAICA Levels
<i>The taxation of persons other than companies</i>				
Section 24H Sections 66(15) and 77(7) Eighth Schedule, par 36	• Partnerships	Chapter 15 28.11.4	14.7.3	2 Excluded 1



Study Chapter 15 and 28.11.4 in SILKE in addition to the following notes.

14.7.2 Important law amendments

Before continuing with study unit 14, it is important that you take note of the following important amendments to the Income Tax Act which were promulgated in 2011/2012 (refer to the **Taxation Laws Amendment Act No.24 of 2011** and the **Taxation Laws Amendment Act No. 25 of 2011**).



LAW AMENDMENTS:

The requirement that a partnership may not be a registered vendor for VAT purposes in order to qualify as a micro business has been deleted with effect from the commencement of the year of assessment that commence on or after 1 March 2012.

14.7.3 Partnerships – important issues



Remember:

A partnership is not a separate tax entity, the profit of the partnership is taxed in the hands of the individual partners. Refer to the tax framework in note 14.6 to ensure that you know where in the order of the tax calculation the profit from the partnership should be included.

The tax treatment of a partnership's income has been discussed in detail in SILKE Chapter 15 and only a few important issues will therefore be highlighted.

- A partnership is not a person as defined for normal tax purposes and thus not a separate tax entity for income tax (and CGT). Individual partners are taxed on their profit-share, but if a partnership qualifies, the partnership and not the partners must register for purposes of VAT and for employees' tax purposes. If one of the partners withdraws or retires or a new partner is admitted, the partnership is dissolved as a result thereof. The VAT Act (in terms of section 51), deems the "old" partnership and the "new" partnership to be the same person or vendor for VAT purposes. VAT registration will therefore not be affected if the new partnership continues as a going concern.
- In terms of section 24H(2) each partner is deemed to be carrying on the trade or business of the partnership. The provisions of section 20A, if applicable, (discussed in note 14.6.6 of this study unit) should therefore be applied to partnership losses.
- Amounts received by the partnership are deemed to be received by partners on the same date (section 24H(2) and paragraph 36 of the Eighth Schedule for CGT).
- Expenditure and allowances are deemed to be that of the partners in their profit sharing ratio.
- Remember that certain amounts will be deductible (in profit share ratio's) and will then be taxable in the hands of the individual partners, such as interest earned on capital contributions by partners and salaries paid to partners.
- No employer/employee relationship exists between a partner and partnership, except for purposes of sections 11(k) (deduction for pension fund contributions) and 11(l) (any amount contributed by the employer to a pension fund on behalf of an employee), therefore no termination gratuities (par (d) of the "gross income" definition), no fringe benefits in terms of par (i) of the "gross income" definition and no key-man policies on lives of partners (s 11(w)).
- The definition of "retirement funding employment" distinguishes between partners that were previously employees of the partnership (before they became partners) and partners that were not. In relation to a partner who was an employee of the partnership and retained his membership of the pension fund, "retirement funding employment" is defined as the part of the partner's income from the partnership in the form of the partner's share of profit that does not exceed the partner's pensionable emoluments during the 12 month period that ended on the day the partner ceased to be an employee.
- In relation to any other partner, "retirement funding employment" is defined as the part of the partner's income from the partnership in the form of the partner's profits.
- A partner can only claim a bad debt (s 11(i)) if:
 - The debt is due to the partner;
 - The debt became irrecoverable during the year; and
 - It was included in the taxable income of the partner in the current or a previous year of assessment.

A new partner will not be able to claim a bad debt that became due before he became a partner, since it had never been included in his income. The original partners will only be entitled to a deduction in the new profit sharing ratio (see part 3 of the example below).



Example: Bad debt deduction (s 11(i))

Partners	<u>A</u>	<u>B</u>	<u>C</u>
Profit sharing ratio	1/3	1/3	1/3

- 1) A debtor of R300, which became due to the partnership during the previous year, is now irrecoverable and is written off as a bad debt:

Suggested Solution:

Partners	<u>A</u>	<u>B</u>	<u>C</u>
Included in gross income previously	100	100	100
Deduction (section 11(i))	(100)	(100)	(100)

- 2) If C left, and A and B share 50/50:

	<u>A</u>	<u>B</u>	<u>C</u>
Profit sharing ratio	$\frac{1}{2}$	$\frac{1}{2}$	
Included gross income previously	100	100	100
Deduction (section 11(i)) 50% of R300, but limited to	(100)	(100)	-

- 3) If a new partner D joins and all share equally:

	<u>A</u>	<u>B</u>	<u>C</u>	<u>D</u>
Profit sharing ratio	$\frac{1}{4}$	$\frac{1}{4}$	$\frac{1}{4}$	$\frac{1}{4}$
Included gross income previously	100	100	100	-
Deduction (section 11(i))	(75)	(75)	(75)	-



You have now completed your studies of partnerships and should be ready to provide outcomes for the Beancounter scenario.



Read through the Beancounter scenario again and make a rough summary of what your solution will be. Then read through the outcomes of the scenario to determine if your answer was correct.



14.8 OUTCOMES FOR THE BEANCOUNTER SCENARIO

You have done a calculation regarding the issues raised by Bizzie on behalf of Belinda Beancounter:

Normal tax liability of Belinda for the 2013 year of assessment:

	R	R
Income:		
Salary – Seconds travel agency (R15 000 x 4)		60 000
Commission		20 000
Salary – Bush lodge (R25 000 x 8)		200 000
Restraint-of-trade (paragraph (cA) of gross income definition) (The receipt is capital in nature, but specifically included in terms of paragraph (cA) of the gross income definition.)		10 000
Maintenance payments (R10 000 x 3)	30 000	
<u>Less: Exempt – section 10(1)(u)</u>	<u>(30 000)</u>	-
Medical aid contributions by employer (R500 x 8) (fringe benefit)		4 000
Interest received:		
- Savings	5 000	
- Other investments	30 000	
<u>Less: Section 10(1)(i)(xv) interest exemption</u>	<u>(22 800)</u>	12 200
Income		<u>306 200</u>
Deductions and allowances:		
Retirement annuity fund contributions (R800 x 8 = R6 400) (section 11(n)) Limited to the greater of: R1 750; or R3 500 – R0; or 15% x R306 200 = R45 930, but limited to actual		<u>(6 400)</u>
		299 800
<u>Add: Taxable capital gain (section 26A)</u>		
Proceeds	2 600 000	
<u>Less: Base cost</u>	<u>(600 000)</u>	
	2 000 000	
<u>Less: Primary residence exclusion (paragraph 45)</u>	<u>(2 000 000)</u>	-
		299 800
<u>Less: Donations - Actual of R1 800 limited to 10% x R299 800 (section 18A)</u>		<u>(1 800)</u>
Subtotal		298 000
Medical aid fund contributions (Section 18(1)(a)):		
Employer contributions (R500 x 8)	4 000	
Own contributions (R1 000 x 8)	8 000	
	<u>12 000</u>	
<u>Less: 4 x Section 6A rebate: ((R230 x 12 months) x 4)</u>	<u>(11 040)</u>	
Subtotal	960	
<u>Plus: Medical expenses</u>	<u>-</u>	
	960	
<u>Less: 7.5% x R298 000</u>	<u>(22 350)</u>	
Section 18 deduction	-	-
Taxable income		<u><u>298 000</u></u>

Normal tax payable per table:

R51 300 + (30% x (R298 000 – R250 000))

R51 300 + R14 400

R65 700

Tax per the tables:

Less: Primary rebate

Less: Section 6A rebate (R230 x 12)

R	R
	65 700
	(11 440)
	<u>(2 760)</u>
	<u>51 500</u>

Normal tax liability



After completion of the above study unit, please use the outcomes provided at the beginning of this study unit (refer note 14.2) to identify areas for improvement.

If you have met all the outcomes stated, you have finished your studies of relating to individuals, ring-fencing of assessed losses and partnerships.

SECTION A (GUIDELINES)

STUDY UNIT 15

FRINGE BENEFITS AND RETIREMENT BENEFITS

WORKPLAN FOR 12 & 13 JUNE 2012

TIME ALLOCATION FOR STUDY UNIT 15



A total of 6 hours of your study time has been allocated to study unit 15.

The following time allocation is recommended:

Background, Outcomes for this study unit, Beancounter scenario and Proposed study method	30 minutes
Allowances and fringe benefits	220 minutes
Retirement benefit funds and lump sums from employers	90 minutes
Outcomes of the Beancounter scenario	20 minutes
Total	360 minutes

15.1 BACKGROUND

There are several specific inclusions in Gross Income that are applicable to individuals. In this study unit we will mainly deal with **fringe benefits** and **retirement benefits**.

The income tax payable by any taxpayer is calculated on the taxpayer's taxable income. In the case of an individual we apply one tax rate (on a progressive scale) to calculate the tax payable on taxable income (excluding retirement benefits received from a fund), and a different tax rate to calculate the tax payable on the taxable amount of lump sums received from retirement benefit funds. These taxes are then added together to calculate the taxpayers total tax payable for the year of assessment. The following tax framework shows how we calculate the taxable income of a taxpayer and indicates how the topics covered in this study unit fit into this framework:

NORMAL INCOME TAX FRAMEWORK

GROSS INCOME (section 1) (NB: Lump sums in a separate column)

Less: Exempt income (section 10)

= *INCOME*

Less: Deductions and allowances (mainly sections 11–17A, 22, 23, 24 and 24C)

Less: Assessed loss brought forward (section 20)

Add: Amounts to be included in taxable income including *TAXABLE CAPITAL GAINS*

Less: Qualifying donations (section 18A)

Less: Qualifying medical expenses (only available to individuals) (section 18)

= *TAXABLE INCOME*

Follow the following three steps to calculate tax payable, once the taxable income was determined:

1. Apply the applicable rate of tax according to the tax rate table for natural persons and persons other than companies and trust (excluding special trusts) to the taxable income, excluding lump sums from retirement benefit funds, to calculate tax payable. Deduct the applicable rebates (primary, secondary and additional over 75 rebates, as well as the section 6A rebate).
2. Apply the applicable rate of tax according to the tax rate table for retirement lump sum benefits or retirement lump sum withdrawal benefits to the taxable amount of lump sums received from retirement benefit funds to calculate the tax payable on retirement lump sum benefits.
3. Add the amount calculated in step 1 to the amount calculated in step 2 to calculate the aggregate amount of NORMAL TAX PAYABLE.

15.2 OUTCOMES FOR THIS STUDY UNIT



After studying study unit 15, you should be able to conclude the following:

- all the outcomes listed at the beginning of chapter 11 (Fringe benefits) of SILKE;
- all the outcomes listed at the beginning of chapter 12 (Retirement benefits) of SILKE.

15.3 BEANCOUNTER SCENARIO



Before you start studying the detailed provisions of the Income Tax Act in respect of fringe benefits and retirement benefits, read the following scenario relating to the Beancounter family. Then you should, as you study the different sections in study unit 15, identify areas of concern that should be brought to the attention of Barry Beancounter and his friends. Refer back to your previous tutorial letters for background information.

Barry Beancounter has never had a good relationship with Bizzie's family. After an argument with Bizzie during which she accused him of being "horrible" to her family, he contacted you. In an attempt to restore his relationship with his in-laws, Barry has asked you to assist his brother-in-law (Mr. Bloke Boycott) with his tax affairs. Barry said he would pay your bill.

A meeting was set up and you, Barry and his bother-in-law attended. You obtained the following information from Bloke:

Mr. Bloke Boycott is 51 years old and has always been a South African resident. He had been employed by Medical Equipment Manufacturers (Pty) Ltd ("MEM") as sales manager up to 30 November 2012. He held the position for 13 years. Based on his excellent work performance, he was offered the position of sales director of Superior Equipment Ltd ("Superior"), the holding company of MEM.

Mr. Bloke Boycott resigned from MEM on 30 November 2012 and took up his new position as sales director of Superior on 1 December 2012. Superior offered Mr. Bloke Boycott the following remuneration package:

- A cash salary of R100 000 per month.
- Provident fund contributions at 10% of his cash salary. Mr. Bloke Boycott had to become a member of this provident fund and in terms of the rules of the fund he had to make monthly contributions amounting to 10% of his cash salary. In terms of the rules of the fund, Superior would contribute R1 for each R1 contributed by Mr. Boycott. Mr. Boycott will only be entitled to receive Superior's contributions when he retires at the age of 65.
- The option to acquire 100 000 shares in Superior at par value, which is R5 per share. In terms of the rules of Superior's share option scheme, all senior management personnel may participate in the scheme but they are not allowed to sell the shares within four years from the date of exercising the option. Mr. Boycott exercised his right on 31 December 2012 when the market value was R25 per share. The share option scheme is only open to senior management. Senior management comprises 5% of all permanent employees of the company.
- Mr. Boycott can choose either the right to use two company cars or a travel allowance of R20 000 per month. This offer will be effective on 1 February 2013, after a two-month probation period, applicable to all new appointments in senior management.
 - The two company cars that Superior will provide if Mr Boycott exercises this option, are a new BMW One series 120Di (cost price R230 000, inclusive of VAT) and a new Land Rover Discovery V6 DiHSE (cost price R570 000, inclusive of VAT). Superior will pay for all the fuel, licence, maintenance and insurance costs. Both these vehicles will be utilised primarily for business purposes. Ownership of these vehicles will never be transferred to Mr Bloke Boycott. Both the vehicles will be subject to a maintenance agreement of 60 000 km or 3 years. No logbook will be kept by Mr. Boycott is he exercises the company car option.
 - If Superior pays Mr. Boycott a travel allowance, he will purchase the two vehicles mentioned above for cash, and be able to treat the actual business expenditure as amounts expended against the travel allowance for tax purposes. Superior will not pay any costs other than the travel allowance. Mr. Boycott will keep a logbook.

The following is expected for any given year of assessment per vehicle:

Total distance travelled	23 000 km
Distance travelled for business use	12 000 km
Fuel	R7 000
Insurance, license fees, services and tyres	R20 000

Shortly before Mr. Boycott left MEM, a farewell party was arranged for him, at which he received a Panasonic Flatron television set as a long service award. MEM acquired the television set specifically for

Mr. Bloke Boycott on a sale at an independent retailer. The sale price was R15 000 (including VAT) while these television sets normally retail at R25 000 (including VAT) each.

Barry was clearly bored during the meeting and fell asleep twice. After you had woken him up he made it clear that you were to provide advice to Bloke regarding the following:

(a)	Advise Mr. Bloke Boycott on the current income tax implications arising from the cash salary and employer provident fund contributions paid by Superior.												
(b)	Advise Mr. Bloke Boycott on the income tax implications arising from the exercise of the share options granted to him by Superior and the subsequent vesting of these options. Ignore any tax implications arising after the date of vesting.												
(c)	<p>Advise Mr. Bloke Boycott, from an income tax perspective only (i.e. taxable income), whether he should opt for the two company cars or for the travel allowance from Superior.</p> <p><i>(Base your advice on the implications for a full year of assessment, using 2013 legislation and provide reasons for your answer.)</i></p> <p>For the purpose of claiming against a travel allowance, based on deemed expenditure for 2013, the applicable rates are:</p> <table border="1"> <thead> <tr> <th>Cost of vehicle</th> <th>Fixed R</th> <th>Fuel c</th> <th>Repairs c</th> </tr> </thead> <tbody> <tr> <td>Exceeds R180 001 but not R240 000</td> <td>66 440</td> <td>89,6</td> <td>36,9</td> </tr> <tr> <td>Exceeds R480 000 (2013 legislation)</td> <td>119 683</td> <td>133,6</td> <td>68,3</td> </tr> </tbody> </table>	Cost of vehicle	Fixed R	Fuel c	Repairs c	Exceeds R180 001 but not R240 000	66 440	89,6	36,9	Exceeds R480 000 (2013 legislation)	119 683	133,6	68,3
Cost of vehicle	Fixed R	Fuel c	Repairs c										
Exceeds R180 001 but not R240 000	66 440	89,6	36,9										
Exceeds R480 000 (2013 legislation)	119 683	133,6	68,3										
(d)	<p>Advise Mr. Bloke Boycott on the current income tax implications that will arise as a result of the receipts and accruals received from MEM at the farewell party.</p> <p style="text-align: right;"><i>(Source: QE 2006 adapted)</i></p>												

The day after the meeting Mr. Beancounter phoned you to apologize for falling asleep during the meeting and once again thanked you for your willingness to assist him in restoring his relationship with his in-laws. You in turn gave him the number of a close friend of yours, a psychologist.

Before attempting to sort out Mr. Beancounter's family matters, work through studyunit 15.



- The examinable taxation pronouncements of the qualifying examination part I that will be written in January 2013 will test individuals with a 2013 year of assessment and non-natural persons with either a 2012 or 2013 year of assessment.
- Monetary amounts updated for such years of assessment as impacting the above years of assessment and not appearing in the SAICA Legislation Handbook will be provided in an addendum in tests and examinations.

15.4 PROPOSED STUDY METHOD

You have to review SILKE chapters 11 and 12 together with the relevant sections in the Income Tax Act. You will notice that reference to the Income Tax Act is provided next to the heading of each paragraph in SILKE. As you study these chapters in SILKE, bear in mind the required level of knowledge of the SAICA tax syllabus as indicated in the table in point 15.5.1 and below.

When working through the legislation applicable to this study unit, apply the following study approach:

- Step 1: Read the relevant section in the Act. (You will probably still be able to grasp the essence of a section without looking at the Act, but we urge you to get familiar with the Act. This will be to your benefit as the tests, the final examination and the 2013 SAICA Qualifying Examination part 1, are all limited open book assessments).
- Step 2: Review the relevant section(s) in SILKE together with the additional notes in this study unit. Should it be indicated in the table in point 15.5.1 and below that a discussion of the relevant section is included in this study unit, look at the additional information **first** before working through the relevant section(s) in SILKE.

15.5 ALLOWANCES AND FRINGE BENEFITS

The benefits received from employers can be divided into three categories, namely cash received (section 1 – par (c) and (cA) of the gross income definition), benefits received other than in cash for example fringe benefits (section 1 – par (i) of the gross income definition read with the Seventh Schedule) and allowances for example travel allowance (section 8). Lump sums received from an employer will be dealt with later in this study unit.

In this section the different allowances and fringe benefits received from an employer will be studied. Remember the **Seventh Schedule** contains the rules on how to value the different fringe benefits. You must take special notice of when will the value of a fringe benefit will be Rnil.

15.5.1 Table of reference



In this section of the study unit, Chapter 11 in SILKE will mainly be studied. The table below provides a summary of the SAICA syllabus, sections in the Income Tax Act and the appropriate references to SILKE that is covered in this section of the study unit. The aim of this table is to guide you through the study process.

SAICA LEVELS

Please pay attention to the **SAICA knowledge levels** (refer to “**Orientation**” note X in this tutorial letter for a description of the levels) while working through this table. In instances where the levels of knowledge have changed from the prior year’s syllabus, the current level has been highlighted in the table below.

REFERENCE TO NOTES

Where reference is made to **another tutorial letter**, you should **understand the principles** and be able to **apply** the principles for purposes of this study unit, but study the principles in **more detail** (according to the SAICA level) in that tutorial letter **referred to**.

Where reference is made to **previous tutorial letters**, you may be **tested** according to the **SAICA level** provided. In other words, study units may be **integrated** with knowledge acquired in **previous tutorial letters** as well as **other study units** in the same tutorial letter.



Immediately after this table, indicating the topics to be covered, will follow important changes in legislation since 2011. Before you study the sections in the Act, we suggest that you first read the law amendments (15.5.2) applicable to the section to be studied, especially if you studied taxation in a previous year.

Where we refer to “Notes in this tutorial letter”, study that paragraph together with the paragraph in SILKE.

Reference to the Income Tax Act	Topics	SILKE	Notes in TL	SAICA Levels
<i>Taxable benefits and allowances</i>				
S 1 definition of “gross income” special inclusion (i)	Inclusion in gross income (fringe benefits)	11.1,11.4		3
S 8(1)	Certain amounts to be included in income or taxable income	11.2, 11.3, 11.3.1 & 11.3.2	15.5.3	3
S 8(1)(a)-(c)				1
S 8(1)(d)-(f)		11.3.3		1
S 8A	Excluded			Excluded
S 8B	Taxation of amounts derived from broad based employee share plans and vesting of equity instruments	11.6	15.5.4	2
S 8C	Taxation of directors and employees on vesting of equity instruments	11.7	15.5.4	
S 8C(1) to (4) and Eighth Schedule par 20(1)(h)(i)				3
S 8C(5) – (6)				Excluded
S 8C(7)				3
Section 10(1)(nA), (nB), (nC), (nD), (nE)	Exemptions from tax	6.20.1 tot 6.20.5 (TL 104/2012)	-	3
Seventh Schedule	Benefits or advantages derived by reason of employment or the holding of any office (official interest rate will be given)	11.4	15.5.5 – 15.5.7	3
	Par 2(k) & 12C			Excluded



When working through chapter 11 in SILKE you can IGNORE paragraph 11.5 (Right to acquire marketable securities (s 8A) as it is **excluded** from the SAICA syllabus:

15.5.2 Important law amendments

Before you continue your studies of study unit 15, it is important that you take note of the following important amendments to the Income Tax Act that were promulgated during 2011/2012 (refer to the **Taxation Laws Amendment Act No.24 of 2011** and the **Taxation Laws Amendment Act No. 25 of 2011**).



PLEASE NOTE

For Part I of the 2013 SAICA Qualifying Examination, legislation promulgated prior to 31 January 2012 taking effect during the 2013 year of assessment for individuals and 2012 or 2013 years of assessment for corporate entities will be examinable. Monetary amounts will be updated for such years of assessment as provided for in the Minister of Finance's budget speech of 2012. This has an impact on the above years of assessment and does not appear in the SAICA Legislation Handbook (SAICA 2012/2013 examinable pronouncements).

Since the latest legislation was only promulgated on 10 January 2012, some of the parts in SILKE are based on "old" legislation. Some of the legislative amendments applicable to the 2013 year of assessment have already been incorporated in SILKE and in most chapters these changes can be found at the end of the chapter. Please make sure that you study the latest legislation. We will draw your attention to sections which should be ignored and replaced with the updated legislation.

For this study unit you must STUDY SILKE 11.8



LAW AMENDMENTS:

- **Section 8(1)(b)(iiiA):** In the case of a travel allowance where the expenditure claimed is based on accurate data, the cost of the vehicle is limited to **R480 000** (2011: R400 000) and the finance charges must also be limited to an amount as if the original debt had not exceeded **R480 000** (2011: R400 000).
- **Section 8B:** The definition of "broad-based employees share plan" in paragraph (c) was amended to require that employees who obtain equity shares must be entitled to all dividends, foreign dividends and full voting rights in respect of equity shares.
- **Section 8C:** The wording of section 8C(1A) was amended due to the new definitions of "shares" and "equity shares" as well as the new dividends tax.
- **Seventh Schedule, paragraph 7,** has been amended with the insertion of subparagraph (8A). This subparagraph states that if the employee is a "judge" or a "Constitutional Court judge" the kilometres travelled between the judge's place of residence and the court over which the judge presides will be deemed to be business kilometres and not private.
- **Seventh Schedule, paragraph 9:** Residential accommodation formula – The value of B in the formula has been amended to **R63 556** (2012: R59 750).
- **Seventh Schedule, paragraph 12A(5)(d):** This subparagraph has been deleted with effect from 1 March 2012. This will have the effect that the payment of contributions to benefits funds (medical aid), by an employer in respect of employees over the age of 65 will now be taxed as a fringe benefit.

15.5.3 Travel allowance (section 8(1))

Remember that from the 2011 year of assessment **actual** records of kilometres travelled (logbook) must be kept indicating private and business travel. The tariff for the reimbursive allowance will be given in the exam (2013: 316 cents per km) if the travelling distance is 8 000 km or less per annum.



SCALE OF VALUES (2013 year of assessment)			
Where the value of vehicle is (incl VAT)	Fixed Cost (R)	Fuel cost (c/km)	Maintenance cost (c/km)
R0 – R60 000	19 492	73.7	25.7
R60 001 but does not exceed R120 000	38 726	77.6	29.0
R120 001 but does not exceed R180 000	52 594	81.5	32.3
R180 001 but does not exceed R240 000	66 440	89.6	36.9
R240 001 but does not exceed R300 000	79 185	102.7	45.2
R300 001 but does not exceed R360 000	91 873	117.1	53.7
R360 001 but does not exceed R420 000	105 809	119.3	65.2
R420 001 but does not exceed R480 000	119 683	133.6	68.3
Exceeding R480 000	119 683	133.6	68.3



Take note:

The “value” of the vehicle used in calculating the taxable portion of a travel allowance **INCLUDES VAT**.

15.5.4 Sections 8B and 8C

Note that the provisions of both sections 8B and 8C of the Act overrule the provisions of section 9C (circumstances in which certain amounts received or accrued from disposal of shares are deemed to be of a capital nature). Further note that paragraph 2(f) of the Seventh Schedule (low interest loans – SILKE 11.4.11) excludes loans to enable employees to purchase qualifying equity shares in terms of section 8B, or to pay securities transfer tax or uncertificated securities tax on such shares (i.e. no fringe benefit).

Also take note that section 8C(7) defines what constitutes a restricted equity instrument (11.7 in SILKE).

15.5.5 Right of use of a motor vehicle (paragraph 7)

The following explains the calculation to determine the cash equivalent of the taxable benefit for the use of a company car.

Cash equivalent of the benefit

The cash equivalent of the taxable benefit will be the difference between the value of the private use of the motor vehicle and the consideration given by the employee (if any).

The value of the benefit will be the following:

- For each month during which the employee is entitled to use the vehicle for private purposes, the value of the taxable benefit will be 3,5% per month of the “determined value” of the motor vehicle.
- Where the vehicle (at acquisition by the employer) is the subject of a maintenance plan, the value of the taxable benefit will be 3.25% per month of the determined value of the motor vehicle (a maintenance plan must be for at least three years and/or 60 000 km).

- When the vehicle is used for a shorter period and not for a full month by the employee, the value will be reduced according to the ratio of the number of days in the period to the number of days in the month. The purpose of the reduction is to provide for the right of use of the motor vehicle commencing in the middle of a month. No reduction in the value determined will be made by reason of the fact that the vehicle in question was during any period (for any reason) temporarily not used by the employee for private purposes.

The “**determined value**” of a motor vehicle will be:

- *where the vehicle was acquired by the employer under a bona fide sale or exchange agreement at arm’s length,*

the original cost (excluding finance charges or interest payable). REMEMBER that VAT is now **included** in the determined value.

- *where the vehicle was supplied by a motor vehicle manufacturer to his employee, the cost of manufacturing the vehicle.*
- *where the vehicle was held by the employer under a lease and the ownership thereof was acquired by the employer on the termination of the lease or where the vehicle was held by the employer under a lease agreement only,*

the retail market value at the time when the employer first obtained the right of use of the vehicle or where the lease is a financial lease, the cash value (excluding finance charges).

- *in any other case,*

the market value at the time when the employer first obtained the vehicle or right of use thereof. This value should also exclude finance charges.



Remember:

Where the employer has granted an employee the right of use of a motor vehicle and a limit was placed on the value of such vehicle by the employer, and the employee makes a contribution towards the purchase price of a more expensive vehicle, the contribution made by the employee must be deducted from the cost price of the more expensive vehicle. For example, the employee’s status is such that he qualifies for the use of a motor vehicle of which the cost does not exceed R120 000. The employee, however, wishes to obtain the use of a vehicle costing R150 000 and therefore, makes a contribution of R30 000 towards the purchase of the vehicle. The “determined value” to be used in calculating the benefit will be R120 000 (R150 000 – R30 000) excluding VAT. The determined value will thus be R120 000 + VAT.

The “**determined value**” of a motor vehicle must be **reduced** if:

- The employer acquired the vehicle or the right of use of the vehicle 12 months or more before the date on which the employee is granted the right of use of the vehicle. (Seventh Schedule paragraph 7 proviso to the subpar (1)(a)). A depreciation allowance must be deducted from the determined value as determined above. The allowance is calculated at 15% on the reducing-balance method for each completed period of 12 months, calculated from the date on which the employer first obtained such vehicle or the right of use thereof to the date on which the employee was first granted the use of the vehicle.

In order to be clear what amount needs to be calculated, we will make use of the following terms:

- o **Cash equivalent of the value of the taxable benefit** or the value of the taxable benefit or the taxable benefit refers to the amount as determined in par 7(2) and (4), i.e. the value of the benefit less any amount contributed by the employee. Either 80% or 20% of this amount will be included in remuneration for employees' tax purposes.
- o **The taxable benefit (on assessment)** refers to the amount as determined in par 7(2) and (4) above, less any par 7(7) and (8) reductions.

The value of the **taxable benefit** must be **reduced** if:

- The employee pays an amount to the employer for the use of that vehicle. This reduction is not applicable in respect of payments for the cost of the license, insurance, maintenance or fuel for that vehicle (paragraph 7(2)).

The value placed on the private use of the vehicle, may be reduced (**ONLY ON ASSESSMENT**) by the following:

- The employee proves to the satisfaction of the Commissioner that accurate records of distances travelled for business purposes in such vehicle are kept (paragraph 7(7)). The benefit is then reduced pro rata with the ratio of kilometres driven for business to the total number of kilometres. **This reduction is only calculated on assessment and not with the monthly calculation of employees' tax.**
- The employee proves that accurate records of the distances travelled for private purposes are kept and the employee pays the full amount of license, maintenance, and/or insurance. This amount is adjusted annually in the ratio applicable to private use (paragraph 7(8)(a)).
- The employee proves that accurate records for the distances travelled for private purposes are kept and that the employee pays the full amount for fuel for private purposes. This reduction is also calculated on assessment and is calculated on the number of kilometres travelled for private purposes at the rate per kilometre, by the rate for fuel which applies in the "travel allowance" table, as announced for the use of the travel allowance (paragraph 7(8)(b)).



EXAMPLE:

If the employee does not receive a travel allowance but has the private use of a company vehicle with a purchase price of R285 000 (including VAT).

- and she is responsible to bear all the costs of maintenance (R45 000) with regard to the vehicle (the company bears all fuel expenses),
- and she has accurate records of distances travelled for business purposes and she use 25 000 km of her total 40 000 km for private purposes
- the taxable fringe benefit (on assessment) for the year will be calculated as follows:

	R	
R285 000 × 3,5%	= 9 975	
<u>Less: Business travelled</u> : $\frac{15\,000}{40\,000} \times R9975$	<u>(3 741)</u>	
	<u>6 234</u>	

Therefore taxable fringe benefit (on assessment) for the year: 12 x R6 234 = R74 808.

The employer is deemed to have granted his employee the right to use a motor vehicle if he has hired the motor vehicle under a lease and has transferred his rights and obligations under the lease to the employee. The employee's deemed right of use will then extend for the remainder of the lease. The rentals payable by the employee under the lease will in time be deemed a consideration to be paid by him for the right of use of the motor vehicle, and the "determined value" of the vehicle will be the retail market value at the time when the employer first obtained the right of use of the vehicle, or the cash value (excluding finance charges) where the lease is a financial lease.



TAKE NOTE:

- Where more than one motor vehicle is made available to an employee at the same time and the Commissioner is satisfied that each vehicle is used during the year of assessment primarily for business purposes, the value of the private use of all the vehicles will be determined using the value of the vehicle having the highest "determined value" (unless the Commissioner directs otherwise). In addition, no further reductions on assessment will be available to the taxpayer.
- Note further that if an employee receives an employer-owned vehicle and a travel allowance on the same vehicle, the travel allowance will be fully taxable (no reductions).



EXAMPLE 1

Ronel de Witt was granted the use of a company vehicle from 1 March of the 2013 year of assessment. In addition, the company (her employer) bears the full cost of fuel used for both business and private travelling as well as the full cost of maintaining the vehicle. The vehicle, which was purchased by the company on 30 June two years ago, cost R78 700. The cost price included VAT amounting to R7 700 and finance charges of R16 000. Ronel pays R200 a month to the company for the use of the vehicle.

You are required to calculate the **cash equivalent** of the benefit for the 2013 year of assessment.

SUGGESTED SOLUTION: Example 1

	R
2013 year of assessment	
Determined value of the vehicle	
Cost price (R78 700 excluding finance charges (R16 000))	62 700
<u>Less:</u> Depreciation for one completed period of 12 months (15% on R62 700)	<u>(9 405)</u>
Determined value	<u>53 295</u>
Taxable fringe benefit:	
3,5% per month of R53 295 (value of the private use)	1 865
<u>Less:</u> Consideration paid by Ronel	<u>(200)</u>
Cash equivalent per month	<u>1 665</u>
Cash equivalent of the benefit for the current year of assessment (R1 665 × 12 months)	<u>19 980</u>



EXAMPLE 2

Assume the same facts as in Example 1 above, except that Ronel de Witt kept accurate records (to the satisfaction of the Commissioner) of private kilometres travelled during the current year of assessment. She travelled 8 000 of the total 20 000 kilometres during the year of assessment for private purposes

You are required to calculate the taxable fringe benefit (on assessment) for the 2013 year of assessment.

SUGGESTED SOLUTION: Example 2

	R
2013 year of assessment	
Cash equivalent of the benefit as calculated in example 1	19 980
Reduction as a result of business use of 12 000km	
$\frac{12\ 000}{20\ 000}$ km x R19 980	(11 988)
The taxable fringe benefit (on assessment) (8 000/20 000 km x R19 980)	<u>7 992</u>



You can either reduce the cash equivalent of the benefit with business use by deducting the business use ratio, or you can multiply the cash equivalent of the benefit with the private use ratio.



EXAMPLE 3

Jan has the use of a company car which his employer purchased on 1 March 2012 for R342 000 (VAT included) from that date. He paid a monthly amount of R200 for the use of the car.

You are required to calculate the cash equivalent of the benefit of the company car, which has to be included in Jan's taxable income for the 2013 year of assessment and/or the amount to be included in Jan's remuneration for purposes of employees' tax:

1. Jan did not keep records and did not pay any costs of the vehicle himself, what is the amount to be included in remuneration for the calculation of employees' tax?
2. Jan did not keep records and did not pay any of the vehicle costs, what is the taxable fringe benefit (on assessment) for the year to be included in his taxable income?

3. Jan keeps record of his business travel and he drove 10 000 of his annual 40 000 kilometres for business, what is
- the monthly amount to be included in remuneration for purposes of employees' tax and
 - what amount must be included in his taxable income as the taxable fringe benefit (on assessment)?
4. Jan records his business kilometres as in 3 above and he paid the following costs himself:
- | | |
|------------------------|---------|
| Licence of the vehicle | R200 |
| Insurance | R12 000 |
| Maintenance | R25 000 |
| Fuel | R26 000 |
- What amount will be included in his taxable income as the taxable fringe benefit (on assessment)?
5. The vehicle was bought with a 3 year/60 000 kilometres maintenance plan and it cost R399 000 (VAT included) and he did not keep any records or paid any amounts in respect of the expenses of the motor vehicle (apart from the R200 per month paid to the employer). (a) What is the amount to be included in remuneration for purposes of calculating the monthly employee's tax and, (b) What amount will be included in his taxable income as the taxable fringe benefit (on assessment)?

SUGGESTED SOLUTION: Example 3



NOTE:

Unless it is proven or stated otherwise with the use of an employer owned motor vehicle, it is deemed that:

- All travel is private travel.
- All costs are paid by the employer.
- Adjustments for deductions (actual business kilometres and costs borne by the employee relating to private use of the vehicle) are only done on **assessment**.
- VAT are now **included** in the determined value of the vehicle.
- No maintenance plan on the vehicle.

	R	R
1. Monthly amount to be included in "remuneration"		
Taxable benefit: 3,5% of determined value of R342 000		11 970
<u>Less:</u> Consideration paid by employee		(200)
Cash equivalent of fringe benefit (per month)		11 770
Remuneration in respect of fringe benefit: 80% x R11 770		9 416
2. Cash equivalent of the fringe benefit of free use of motor vehicle:		
Cash equivalent (per month) as in (1) above		11 770
Annual amount: R11 770 x 12		141 240
No reduction in terms of par 7(7) and 7(8) as no logbook was kept		

	R	R
3. Monthly amount included in "remuneration"		
(a) Cash equivalent of the fringe benefit – same as in (1) above		9 416
(b) Annual amount of taxable fringe benefit on assessment:		
Taxable benefit: 3,5% of determined value of R342 000		11 970
<u>Less:</u> Consideration paid by employee		(2 400)
Monthly cash equivalent of the fringe benefit		11 770
Annual amount of taxable fringe benefit: 12 x R11 770		141 240
<u>Less:</u> Par 7(7) reduction (on assessment)		
R141 240 x 10 000km/40 000km		(35 310)
Taxable fringe benefit (on assessment)		105 930
4. Annual amount of cash equivalent (as calculated in (3) above)		105 930
<u>Less:</u> Par 7(8) reduction for private costs:		
Licence	200	
Insurance	12 000	
Maintenance	25 000	
	37 200	
Reduced by private use: 30 000/40 000km x R37 200		(27 900)
Fuel – per table: 30 000km x 117.1c		(35 130)
Taxable fringe benefit (on assessment)		42 900
5. (a) Amount to be included in "remuneration":		
Taxable benefit: 3,25% x R399 000		12 968
<u>Less:</u> Contribution paid by employee		(200)
Cash equivalent of fringe benefit (per month)		12 768
"Remuneration" in respect of fringe benefit: 80% x R12 768		10 214
(b) Taxable fringe benefit of free use of motor vehicle (on assessment):		
Taxable benefit for the year: 3,25% x R399 000 x 12		155 610
<u>Less:</u> Paid by Jan (R200 x 12)		(2 400)
Taxable fringe benefit (on assessment)		153 210

15.5.6 Medical scheme contributions (paragraph 12A)

Since 1 March 2010, the full amount paid by the employer on behalf of an employee (younger than 65) towards a medical aid scheme, is included in the taxable income of the employee as a fringe benefit.

From 1 March 2012, a taxpayer 65 years or older, will now also be taxed on any fringe benefit if his employer contributes to a medical fund on his behalf.

Although a taxpayer or a dependent of the taxpayer being physical impaired or disabled, can claim all medical costs (including contributions), the contributions paid by the employer will still be a fringe benefit. This taxpayer will be able to claim all his qualifying medical expenses as a deduction. In terms of section 18(2)(b) he will also be able to claim the total contributions to a medical aid fund less four times the section 6A medical scheme fees tax credit.

**Take note:**

If the employer makes a contribution to the medical aid fund, which is taxed as a fringe benefit in the hands of the employee, the employee is deemed to have made the contribution for the purposes of the medical tax credit.

**Take note:**

SILKE 11.4.14 list 4 situations where the value of the fringe benefit has no value. TAKE NOTE that the last bullet, (“a person entitled to the 65-or-older rebate...”), is no longer applicable as section 12A(5)(d) has been deleted with effect from 1 March 2012. Thus, only the first three bullets under this section are for fringe benefits where the benefit has no value.

15.5.7 Costs relating to medical services (paragraph 12B)

Please take note of the 4 cases in SILKE 11.4.15 where no value is placed on this fringe benefit.

15.6 LUMP SUMS RECEIVED FROM RETIREMENT BENEFIT FUNDS AND LUMP SUMS RECEIVED FROM EMPLOYER

A person can either receive a lump sum from a fund, before or on retirement, or the person can receive a lump sum from an employer. A lump sum received from an employer may be either just a lump sum or it can be a severance benefit.

15.6.1 Table of reference



In this section of the study unit, Chapter 12 in SILKE will mainly be studied. The table below provides a summary of the SAICA syllabus, sections in the Income Tax Act and the appropriate references to SILKE that is covered in this section of the study unit. The aim of this table is to guide you through the study process.

SAICA LEVELS

Please pay attention to the **SAICA knowledge levels** (refer to “**Orientation**” note X in this tutorial letter for a description of the levels) while working through this table.

REFERENCE TO NOTES

Where reference is made to **another tutorial letter**, you should **understand the principles** and be able to **apply** the principles for purposes of this study unit, but study the principles in **more detail** (according to the SAICA level) in that tutorial letter **referred to**.

Where reference is made to **previous tutorial letters**, you may be **tested** according to the **SAICA level** provided. In other words, study units may be **integrated** with knowledge acquired in **previous tutorial letters** as well as **other study units** in the same tutorial letter.

Immediately after this table, indicating the topics to be covered will follow important changes in legislation since 2011. Before you study the sections in the Act, we suggest that you first read the law amendments applicable to the section to be studied, especially if you studied taxation in a previous year. Where we refer to “Notes in this tutorial letter”, study that paragraph together with the paragraph in SILKE.

Reference to the Income Tax Act	Topics	SILKE	Notes in TL	SAICA Levels
Employment lump sums				
S 1 definition of “gross income” special inclusions (d) and (f)	Services – compensation for loss of office and	12.1 – 12.2	See note below	3 3
	Services – commutation of amount due	4.6 4.8		
S 7(A)(4A)	Excluded			Excluded
S 5(10)	Excluded			Excluded
Retirement benefits				
S 1 definition of “gross income” special inclusion (e) and (eA)	Fund benefits	4.7 and 12.3	15.6.3.1	3
Second Schedule Par 1	Definitions	-	15.6.3.1	3
Par 2(1)(a), 3,5 and 6	Retirement or death	12.3.1	-	3
Par 2(1)(b), 4 and 6	Withdrawal or resignation	12.3.2	-	3
Par 2A	Public sector funds	12.3.3	-	3
Par 2(1)(b)(iA)	Divorce (only after 1 March 2009)	12.3.4	-	2

15.6.2 Important law amendments

Before you continue your studies of retirement benefits, it is important that you take note of the following important amendments to the Income Tax Act that were promulgated during 2011/2012 (refer to the **Taxation Laws Amendment Act No.24 of 2011** and the **Taxation Laws Amendment Act No. 25 of 2011**).



PLEASE NOTE

For Part I of the 2013 SAICA Qualifying Examination, legislation promulgated prior to 31 January 2012 taking effect during the 2013 year of assessment for individuals and 2012 or 2013 years of assessment for corporate entities will be examinable. Monetary amounts will be updated for such years of assessment as provided for in the Minister of Finance’s budget speech of 2012. This has an impact on the above years of assessment and does not appear in the SAICA Legislation Handbook (SAICA 2012/2013 examinable pronouncements).

Since the latest legislation was only promulgated on 10 January 2012, some of the parts in SILKE are based on “old” legislation. Some of the legislative amendments applicable to the 2013 year of assessment have already been incorporated in SILKE and in most chapters these changes can be found at the end of the chapter. Please make sure that you study the latest legislation. We will draw your attention to sections which should be ignored and replaced with the updated legislation.

For this study unit you must STUDY SILKE 12.5.



LAW AMENDMENTS:

- The concept “severance benefit” was introduced with effect from 1 March 2011 and includes any amount (other than a lump sum benefit from a fund) received by or accrued to a person by way of a lump sum from the person’s employer in respect of the relinquishment, termination, loss, repudiation of the person’s appointment, if;
- Such person has attained the age of 55 years; or
 - The loss of employment is due to sickness, accident, injury or incapacity through infirmity of mind or body; or
 - Such termination or loss is due to the employer having ceased to carry on the trade or the person having become redundant (general personnel reduction).
- Severance benefits are included in gross income (in terms of par (d)) if it is received/accrued by way of a **lump sum AND one** of the above requirements are met.
- **Second Schedule, paragraph 6(1)(a)** has been amended and the funds to which transfers can be made in order to qualify for paragraph 6(1)(a) deductions will now be as follows:

Funds from which pre-retirement lump sum is received	Fund to which specific transfer may be made
Pension fund	<ul style="list-style-type: none"> ☞ Pension fund ☞ Pension preservation fund ☞ Retirement annuity fund
Pension preservation fund	<ul style="list-style-type: none"> ☞ Pension fund ☞ Pension preservation fund ☞ Retirement annuity fund
Provident fund	<ul style="list-style-type: none"> ☞ Pension fund ☞ Pension preservation fund ☞ Provident fund ☞ Provident preservation fund ☞ Retirement annuity fund
Provident preservation fund	<ul style="list-style-type: none"> ☞ Pension fund ☞ Pension preservation fund ☞ Provident preservation fund ☞ Retirement annuity fund
Retirement annuity fund	<ul style="list-style-type: none"> ☞ Retirement annuity fund

Rates of tax for lump sum benefits (2012/13)

RETIREMENT FUND LUMP SUM BENEFITS	
The taxable portion of a lump sum received from a pension, provident or retirement annuity fund on retirement or death is the lump sum less any contributions that have not been allowed as a tax deduction plus the taxable portion of all lump sums and severance benefits previously received. This amount is subject to tax at the following rates less the hypothetical amount of tax on lump sums previously received:	
Taxable portion of lump sum	Rates of tax
Not exceeding R315 000	0% of taxable income;
Exceeding R315 001 but not exceeding R630 000	R0 plus 18% of the amount by which the taxable income exceeds R315 000
Exceeding R630 001 but not exceeding R945 000	R56 700 plus 27% of the amount by which the taxable income exceeds R630 000
Exceeding R945 001	R141 750 plus 36% of the amount by which the taxable income exceeds R945 000.

RETIREMENT FUND LUMP SUM WITHDRAWAL BENEFITS

The taxable portion of a pre-retirement lump sum (withdrawal benefit) from a pension or provident fund is the withdrawal amount less any transfer to a new fund plus all withdrawal lump sums or severance benefits previously received. This amount is subject to tax at the following rates less the hypothetical amount of tax on lump sums previously received:

Taxable Income from benefits	Rates of tax
Not exceeding R22 500	0% of taxable income;
Exceeding R22 500 but not exceeding R600 000	R0 plus 18% of the amount by which the taxable income exceeds R22500
Exceeding R600 000 but not exceeding R900 000	R103 950 plus 27% of the amount by which the taxable income exceeds R600 000
Exceeding R900 000	R184 950 plus 36% of the amount by which the taxable income exceeds R900 000.



Take note:

The taxable lump sum cannot be off-set against any assessed loss of the taxpayer.

15.6.3 Lump sums from a retirement fund and severance benefits received (Second Schedule)

LUMP SUM TABLE	Situation that give rise to lump sum:	Reduce by deductions under
RETIREMENT BENEFIT TABLE (par 2(1)(a)):	Retrenchment (Termination of services)	Paragraph 6 of the Second Schedule
	Death/Retirement	Paragraph 5 of the Second Schedule
	Severance benefit	
WITHDRAWAL BENEFIT TABLE (par 2(1)(b)):	Withdrawal (resignation)	Paragraph 6 of the Second Schedule
	Divorce on/after 1/3/2009	Paragraph 6 of the Second Schedule
	Fund transfers	Paragraph 6 of the Second Schedule



REFER TO SILKE EXAMPLE 12.6

15.7 OUTCOMES FOR THE BEANCOUNTER SCENARIO

You have drafted a reply to the issues raised by Barry Beancounter on behalf of Bloke Boycott:



(a) Income tax implications arising from the cash salary and employer provident fund:

The monthly salary that Mr Boycott receives will be included in his gross income in terms paragraph (c) of the gross income definition.

The provident fund contributions paid by the employer will not be a fringe benefit (par 12A (contributions by employer to a benefit fund) is not applicable as this is not a benefit fund (Par 12 (A)(5)) and par 13 (medical services) is not applicable as this is not the release of an obligation).

Furthermore, Mr Barry Boycott will also not be taxed on Superior's contributions to the Provident Fund, as he is not unconditionally entitled to the contributions yet. He does not receive these contributions for his own immediate benefit; he will only be entitled to these contributions on retirement.

The salary will, however, be regarded as retirement-funding employment income, which is relevant when calculating the allowable section 11(n) (contributions to RAF) deduction in respect of the retirement annuity fund contributions.

(b) Income tax implications arising from the exercise of the share options:

Current tax implications

The 100 000 shares acquired will not be taxed as part of a broad-based employee share plan (section 8B) as the share option scheme is not open to at least 80% of all permanent employees, but only senior management.

- The 100 000 shares acquired will also not be taxed in terms of section 8B as it is not a "qualifying equity share" as defined. A qualifying equity share is defined as shares where the market value of equity shares acquired do not in aggregate for the current and the four immediately preceding years of assessment exceed R50 000. The market value of the 100 000 shares clearly exceeds this R50 000 (being R2 500 000 (100 000 shares x R25)). Because it is not a "qualifying share" in terms of section 8B, section 8C(b)(ii) cannot exclude it from the provisions of section 8C (vesting of equity instruments).
- As Mr Barry Boycott was granted the option to acquire the shares after 26 October 2004, he will be subject to tax in terms of section 8C. No tax implication will arise during the 2013 year of assessment when Mr Barry Boycott exercises the option to acquire the 100 000 shares in Superior. The benefit obtained (being R25 less R5) will be included in gross income but will be exempt in terms of section 10(1)(nD) as the shares have not yet vested in Mr Boycott.

Future tax implications

- Tax implications will be triggered by the date of vesting i.e. four years later when the restriction on selling the shares is lifted. Thus, tax implications will arise during the 2017 year of assessment.
- The gain will be the *difference* between
 - o the market value on the date of vesting (2017); and
 - o the consideration paid, being the par value of R5 per share.
- If shares vest at a loss then a deduction in terms of section 8C will be obtained.

(c) Company cars vs. travel allowance from Superior:Company cars

A value needs to be placed on the private use of the two vehicles. The fringe benefit value will be calculated on the determined value, being original cost including VAT (par. 7(1) of the 7th Schedule):

- Only the vehicle with the highest value (**paragraph 7(6)**), the Land Rover Discovery, the value will be (paragraph 7(4)(a)(i)): $3.25\% \times R570\,000 = R18\,525$ p.m.
- Mr Boycott will include in his taxable income on an annual basis $R18\,525 \times 12 = R222\,300$

Travel allowance

If Mr Boycott receives a travel allowance he will be taxed on the amount of the travel allowance remaining after deducting his business expenditure (section 8(1)(b)).

The actual expenditure incurred for tax purposes will be:

	<i>Land Rover Discovery</i>	<i>BMW</i>
Wear and tear (cost limited to max R480 000)	480 000	230 000
	/ 7 yrs	/ 7 yrs
	= 68 571	= 32 857
Fuel	7 000	7 000
Insurance, services, tyres	20 000	20 000
Total	<u>95 571</u>	<u>59 857</u>
Multiply by 12 000/23 000	49 863	31 230

[Alternative $R95\,571 + R59\,857 \times 24\,000/46\,000 = R81\,093$]

Included in the calculation of Mr Boycott's taxable income will be the value of the annual travel allowance, being an allowance of R20 000 per month

240 000

Less: The actual expenditure claimable by Mr Boycott against the travel allowance (R49 863 + R31 230)

(81 093)

Resulting in an inclusion in taxable income of

158 907

Therefore, based solely on the Income Tax consequences, Mr Boycott should elect the travel allowance.

(d) Tax implications of receipts and accruals at farewell party from MEM:Television set

- Where the asset was acquired specifically by the employer to dispose of to the employee, the fringe benefit value will be the cost thereof to the employer (par. 5(2) of the 7th Schedule).
- Mr Boycott will therefore have a fringe benefit value of R13 158 ($R15\,000 \times 100/114$) which will be included in gross income.
- Mr Boycott will not be entitled to a R5 000 long service award deduction against the fringe benefit value as his number of years service is only 13 years, and therefore it does not qualify as a long service as defined in par. 5(4) of the 7th Schedule. Long service is defined as an initial unbroken period of service of not less than 15 years (par. 5(4) of the 7th Schedule).

SECTION A (CONTINUED)

STUDY UNIT 16

EMPLOYEES' TAX, PROVISIONAL TAX AND SECTION 6quat

WORKPLAN FOR 14 JUNE 2012

TIME ALLOCATION FOR STUDY UNIT 16



A total of 3 hours of your study time has been allocated to employees' tax, provisional tax and section 6quat.

The following time allocation is recommended:

Background notes, Outcomes for this study unit and Beancounter scenario	5 minutes
Employees' tax	75 minutes
Provisional tax	75 minutes
Section 6quat	15 minutes
Outcomes of the Beancounter scenario	10 minutes
Total	180 minutes



Start your studies of study unit 16 by reading through notes 16.1 – 16.5.

16.1 BACKGROUND

This study unit deals mainly with **employees' tax** and **provisional tax**. These payments do not relate to a different or additional type of tax. It is the pre-payment of normal tax.

TAX FRAMEWORK

TAXABLE INCOME

↪ Calculation of normal tax due / (refundable):

- ① **Separate tax tables** (for natural persons, deceased and insolvent estates, and special trusts AND small business corporations) **OR**
- ② **Flat rates** for companies (other than a small business corporation) and other trusts, based on taxable income

= Normal tax payable (section 5)

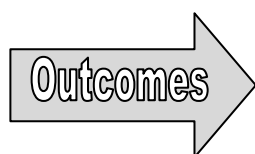
Less: Rebates (section 6 (only natural persons), section 6A (only to natural persons under the age of 65) and section 6quat (all resident taxpayers))

= Normal tax liability

Less: Prepaid tax (employees' tax (only natural persons) and/or provisional tax- **4th Schedule**)

= Normal tax due / (refundable)

16.2 OUTCOMES FOR THIS STUDY UNIT



After studying study unit 16, you should be able to meet all the outcomes listed at the beginning of chapters 13 (Employees' tax) and 14 (Provisional tax) of SILKE, but excluding the following outcome listed in chapter 13:

- "... by calculating the SITE liability of a taxpayer in a case study" (second part of bullet 1 should therefore be deleted) as SITE is excluded from the SAICA syllabus.

You should also be able to meet the following outcome:

- Understand the rebate and deduction in terms of section 6quat and treat it correctly for income tax purposes.

16.3 TABLE OF REFERENCE

The following table provides a summary of the sections of the Income Tax Act that are covered in this study unit.



In order to provide you with an overview of employee's tax, provisional tax and section 6quat and a useful study tool, we include a table which refers to SILKE, your prescribed textbook, as well as to the applicable sections in the Income Tax Act. Although this table provides you with a **summary of the sections** in the Income Tax Act and the **appropriate references to SILKE** that is covered in this study unit, it should **not** be used in **isolation** to guide you through the study process. After reading through notes 16.3.1 and 16.4 proceed to note 16.5 in this study unit. This table should then be **used for revision purposes only**.

SAICA LEVELS:

Please pay attention to the **SAICA knowledge levels** (refer to "Orientation" note X in this tutorial letter for a description of the levels) while working through this table.

Reference to the Income Tax Act	Topics	Reference to SILKE	Reference to notes in TL 107	SAICA LEVELS
Section 5 Section 5(1), 5(2), 5(7)	Levy of normal tax and rates thereof:	1.1.1	16.6	3
Section 6(5)	SITE – EXCLUDED			Excluded
Section 6	Normal tax rebates (amounts will be provided)	1.1.1		3

Reference to the Income Tax Act	Topics	Reference to SILKE	Reference to notes in TL 107	SAICA LEVELS
Section 6A	Medical scheme fees tax credit	10.9		3
Fourth Schedule	Amounts to be deducted or withheld by employers and provisional payments i.r.o. normal tax and provisional tax		16.7	
Part I	Definitions	13		3
Part II paragraph 11B	Employees' tax SITE - EXCLUDED	13 13.6	16.6	2 Excluded
Part III	Provisional tax (including penalties and interest)	14.1 – 14.6 & 14.7.4 – 14.7.5	16.7	2
Section 89bis	Payment of employees' tax and provisional tax and interest on overdue payment of such taxes	14.7.1		1
Section 89quat	Interest on underpayments and overpayments of provisional tax	14.7.2		1
Section 6quat	Rebate or deduction in respect of foreign taxes on income (amount of foreign tax will be provided)	19.9	16.8	2

16.3.1 Sections in SILKE you may ignore



When working through SILKE, chapters 13 and 14, you may ignore:

- SILKE chapter 13.6 (SITE), (excluded from SAICA syllabus)

16.4 IMPORTANT LAW AMENDMENTS

Before you continue your studies of study unit 16, it is important that you take note of the following important **amendments** to the Income Tax Act that were promulgated in **2011/2012** (refer to the **Taxation Laws Amendment Act, No. 24 of 2011** and the **Taxation Laws Second Amendment Act, No. 25 of 2011**):



PLEASE NOTE

For Part I of the 2013 SAICA Qualifying Examination, legislation promulgated prior to 31 January 2012 taking effect during the 2013 year of assessment for individuals and 2012 or 2013 years of assessment for corporate entities will be examinable. Monetary amounts will be updated for such years of assessment as provided for in the Minister of Finance's budget speech of 2012. This has an impact on the above years of assessment and does not appear in the SAICA Legislation Handbook (SAICA 2012/2013 examinable pronouncements).

Since the latest legislation was only promulgated on 10 January 2012, some of the parts in SILKE are based on "old" legislation. Some of the legislative amendments applicable to the 2013 year of assessment have already been incorporated in SILKE and in most chapters

these changes can be found at the end of the chapter. Please make sure that you study the latest legislation. We will draw your attention to sections which should be ignored and replaced with the updated legislation.

For this study unit you must STUDY SILKE 13.12.



LAW AMENDMENTS:

- **Fourth Schedule, Paragraph 9(6)** was inserted and provides that the employer must deduct from the amount to be withheld or deducted by way of employees' tax the amount of the medical scheme fees tax credit that applies in respect of that employee in terms of section 6A if
 - the employer effects payment of the medical scheme fees, or
 - the employer does not affect payment of the medical scheme fees, but proof of payment of those fees has been furnished to the employer.
- The tax rate for personal service provider **companies** has been reduced to **28%** (previously 33%).



Before you commence studying the detailed provisions covered in this study unit, first read the following scenario relating to the Beancounter family. The scenario provided requires you to first read through the information carefully. As you study the different sections in study unit 16, you should identify areas of concern that should be brought to the attention of Barry Beancounter and his friends.

16.5 BEANCOUNTER SCENARIO



You received a phone call from Mr Bloke Boycott this morning. He was very friendly and said that he could not talk for long, as he was about to leave on a hunting trip with his brother-in-law. He wanted you to consider the employees' tax consequences of the 100 000 share options in Superior (his current employer), which he exercised on 31 December 2012. (Refer to the Beancounter scenario under study unit 15.)

Before ending the conversation, Bloke mentioned to you that he was very much looking forward to this hunting trip. He said, for the first time in thirty years he is really "connecting" with his brother-in-law.



Before attempting to advise Mr Boycott on the above, you should work through and master study unit 16. Start with note 16.6.

16.6 EMPLOYEES' TAX



Review SILKE chapter 13 (excluding SILKE 13.6) and read the following additional notes. You can also exclude Chapter 13.2.4 and 13.9 in SILKE, as it will be dealt with later on in the tutorial letter.

16.6.1 General

The Fourth Schedule (as far as employees' tax is concerned) is divided as follows:

Fourth Schedule:		
Part I: Definitions	Paragraph 1	Definitions used in the Schedule
Part II: Employees' tax	Paragraphs 2 - 11	Duty to deduct and the way in which it is calculated. Exemption certificates, directives, penalties, tables and lump sums.
	Paragraph 11A	Deals with the employees' tax where an employee acquired marketable securities, equity shares or equity instruments.
	Paragraph 11B	Standard Income Tax on Employees (SITE). (Excluded from SAICA syllabus)
	Paragraph 11C	Employees' tax payable in respect of directors of private companies. (Refer note 16.6.3)
	Paragraphs 12 -16	Administrative provisions.



Please note that the tax rate for

- personal service provider **companies** is **28%** and
- personal service provider **trusts** is **40%** (SILKE page 1142).

16.6.2 Summary of the calculation of employees' tax

The following provides a summary of the method in which **employees' tax** is calculated:



Take note:

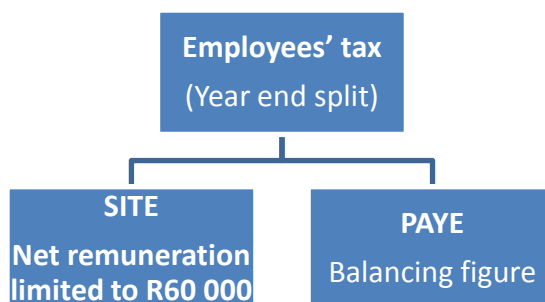
Paragraph 2(4)(e) of the Fourth Schedule has been deleted, therefore the sixth bullet on page 428, (SILKE 13.5) is no longer valid and should be ignored in the determination of remuneration.

DETERMINE THE AMOUNT OF **REMUNERATION** (paragraph 1 of the Fourth Schedule).
(Refer to SILKE 13.2).

LESS: CONTRIBUTIONS OR PREMIUMS AS COVERED IN PARAGRAPH 2(4)(a) – (f)
(Refer to SILKE 13.5)

= **BALANCE OF REMUNERATION**

EMPLOYEES' TAX is calculated on the "**balance of remuneration**". At year end, employees' tax is then split between SITE (calculated on **net remuneration** only) and PAYE.



Note that you only have to be able to calculate the employees' tax and not the split between PAYE and SITE, as SITE is **excluded** from the SAICA syllabus.

16.6.3 Directors of private companies



Study paragraph 11C of the Fourth Schedule and work through SILKE Chapter 13.9 together with the note below. Sub-paragraphs (a) and (g) of the definition of employee in paragraph 1 of the Fourth Schedule are also relevant.

You will now understand that employees' tax with respect to a director of a private company is calculated on the **greater** of:

- remuneration that actually accrued to the director in the relevant month (**actual remuneration**) or
- "remuneration" that is determined according to the formula in paragraph 11C (**deemed remuneration**).

Relief is granted in respect of the above (study paragraph 11C(6) of the Fourth Schedule in this regard). The result is that the director will not be deemed to have received a deemed remuneration (that is calculated in accordance with the formula) where **more than 75%** of the **balance of remuneration** in respect of the preceding year of assessment is **represented by fixed monthly payments**.



Examples to calculate deemed remuneration

Example 1:	Solution:																		
Amounts received or receivable during the previous year of assessment (2012) from a private company: <ul style="list-style-type: none"> • Annual salary of R250 000 • Annual bonus of R40 000 • Retirement annuity fund contribution of R20 000 	<table style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th></th> <th style="text-align: right;">R</th> </tr> </thead> <tbody> <tr> <td>Salary</td> <td style="text-align: right;">250 000</td> </tr> <tr> <td>Bonus</td> <td style="text-align: right;"><u>40 000</u></td> </tr> <tr> <td>Remuneration</td> <td style="text-align: right;">290 000</td> </tr> <tr> <td>Less: RAF</td> <td style="text-align: right;"><u>(20 000)</u></td> </tr> <tr> <td>Balance of remuneration</td> <td style="text-align: right;"><u>270 000</u></td> </tr> <tr> <td>Apply formula: $Y = T/N$</td> <td></td> </tr> <tr> <td></td> <td style="text-align: right;">$= 270\,000 / 12$</td> </tr> <tr> <td>Deemed remuneration =</td> <td style="text-align: right;">R22 500 per month</td> </tr> </tbody> </table>		R	Salary	250 000	Bonus	<u>40 000</u>	Remuneration	290 000	Less: RAF	<u>(20 000)</u>	Balance of remuneration	<u>270 000</u>	Apply formula: $Y = T/N$			$= 270\,000 / 12$	Deemed remuneration =	R22 500 per month
	R																		
Salary	250 000																		
Bonus	<u>40 000</u>																		
Remuneration	290 000																		
Less: RAF	<u>(20 000)</u>																		
Balance of remuneration	<u>270 000</u>																		
Apply formula: $Y = T/N$																			
	$= 270\,000 / 12$																		
Deemed remuneration =	R22 500 per month																		
Example 2:	Solution:																		
Same information as in example 1, but the bonus is based on performance and could only be finalised and paid on 15 March 2012.	The deemed remuneration would still be R22 500, because when the employees' tax calculation is done on 31 March 2011, the bonus amount (which accrued in the 2012 tax year) had been finalised and can be taken into account to calculate the deemed remuneration.																		

Example 3:	Solution:																																				
Same information as in one, but the bonus was based on performance and could only be calculated and paid during June 2012. Assume that an amount of R220 000 was received by the director from the company for the 2011 year of assessment and that his RAF contributions amounted to R20 000.	<p><i>Deemed remuneration from March 2012 until May 2012</i></p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td></td> <td style="text-align: right;">R</td> </tr> <tr> <td>Remuneration from 2011</td> <td style="text-align: right;">220 000</td> </tr> <tr> <td>Less: RAF</td> <td style="text-align: right;"><u>(20 000)</u></td> </tr> <tr> <td>Remuneration</td> <td style="text-align: right;">200 000</td> </tr> <tr> <td>Add: 20% (par 11C(1)(c)(ii))</td> <td style="text-align: right;"><u>40 000</u></td> </tr> <tr> <td>Balance of remuneration</td> <td style="text-align: right;"><u>240 000</u></td> </tr> <tr> <td>Apply formula: $Y = T/N$</td> <td></td> </tr> <tr> <td></td> <td style="text-align: right;">$= 240\,000 / 12$</td> </tr> <tr> <td>Deemed remuneration = R20 000 per month</td> <td></td> </tr> </table> <p><i>Deemed remuneration from June 2012 until February 2013 (same as in example 1):</i></p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td></td> <td style="text-align: right;">R</td> </tr> <tr> <td>Salary</td> <td style="text-align: right;">250 000</td> </tr> <tr> <td>Bonus</td> <td style="text-align: right;"><u>40 000</u></td> </tr> <tr> <td></td> <td style="text-align: right;">290 000</td> </tr> <tr> <td>Less: RAF</td> <td style="text-align: right;"><u>(20 000)</u></td> </tr> <tr> <td>Balance of remuneration</td> <td style="text-align: right;"><u>270 000</u></td> </tr> <tr> <td>Apply formula: $Y = T/N$</td> <td></td> </tr> <tr> <td></td> <td style="text-align: right;">$= 270\,000 / 12$</td> </tr> <tr> <td>Deemed remuneration = R22 500 per month</td> <td></td> </tr> </table>		R	Remuneration from 2011	220 000	Less: RAF	<u>(20 000)</u>	Remuneration	200 000	Add: 20% (par 11C(1)(c)(ii))	<u>40 000</u>	Balance of remuneration	<u>240 000</u>	Apply formula: $Y = T/N$			$= 240\,000 / 12$	Deemed remuneration = R20 000 per month			R	Salary	250 000	Bonus	<u>40 000</u>		290 000	Less: RAF	<u>(20 000)</u>	Balance of remuneration	<u>270 000</u>	Apply formula: $Y = T/N$			$= 270\,000 / 12$	Deemed remuneration = R22 500 per month	
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- Directives can be issued by the Commissioner to employers to alleviate hardship in certain circumstances. Ensure that you study these as set out in paragraph 11(b) of the Fourth Schedule.

16.6.4 Share schemes



Study paragraph 11A of the Fourth Schedule and work through Chapter 13.2.4 in SILKE. You will note that paragraphs (b), (d) and (e) of the definition of remuneration in paragraph 1 of the Fourth Schedule include certain amounts in remuneration.

16.7 PROVISIONAL TAX AND ADDITIONAL TAX, PENALTIES AND INTEREST



Review SILKE chapter 14. Pay special attention to the summary in Chapter 14.8. Also, refer to paragraph 17 – 27 of the Fourth Schedule.

16.7.1 General

The Fourth Schedule (as far as provisional tax is concerned) is divided as follows:

Fourth Schedule:		
Part III: Provisional tax	Paragraph 17	Payment of provisional tax
	Paragraph 18	Exemptions
	Paragraph 19	Estimates to taxable income by provisional taxpayers
	Paragraph 20, 20A	Additional tax payable
	Paragraph 21, 23, 23A, 24, 25 and 27	Payment of provisional tax (including penalties and interest)

16.7.2 Notes to the summary in Chapter 14.8

Note 1: Note that taxable capital gains are only excluded when the “basic amount” is used as an estimate. If a taxpayer uses his **actual** taxable income (as the estimate) for a specific year of assessment, taxable capital gains should be included in taxable income according to section 26A (second and third payment). The final taxable income for a specific tax year would also include taxable capital gains.

The taxable portion of any lump sum award from any pension fund, pension preservation fund, provident fund, provident preservation fund, retirement annuity fund and severance benefit, is excluded in determining the “basic amount.”

Note 2: The “basic amount” is the taxable income reflected on the most recent assessment received by the taxpayer on such date that the estimate is being made. The taxable income must be reduced by

- any taxable capital gain (in the case of companies and other taxpayers) and
- in the case of an individual, the taxable portion of a lump sum from an employer (paragraph (d) to gross income) as well as a retirement fund lump sum benefit or retirement fund lump sum withdrawal benefit (paragraph (e) to gross income), included therein.

If the most recent assessment was received less than **60 days** before the estimate is submitted, the “basic amount” per the previous assessment may be used. It might happen that a taxpayer has received a provisional tax return (form IRP6) with the “basic amount” printed thereon, but subsequently receives an assessment indicating a higher taxable income (see also par 19(3) of the Fourth Schedule). He then has the option to use the (lower) amount printed on the IRP6 form as the “basic amount”.

The “basic amount” is only used for the first payment.



- Work through SILKE Chapter 14.7 and the relevant sections of the Act (sections 89*bis*, 89*quat*, 89*ter* and paragraphs 20, 20A and 27 of the Fourth Schedule).



Note the following:

- Section 23(d) of the Income Tax Act prohibits the deduction of interest, penalties and additional tax paid in respect of the late payment of provisional tax for normal tax purposes. Interest received on any overpayment will however be taxable in the hands of the taxpayer.
- Section 89*ter* of the Income Tax Act (discussed in Chapter 33.6.3 in SILKE) provides that where a taxpayer owes tax, as well as a penalty imposed plus interest, and he makes payment of part of the amount due by him, the payment will *first* be set off against the penalty, *then* against the interest and *finally* against the tax and additional tax due by him.
- Paragraph 20 of the Fourth Schedule provides for a basis for calculation of penalties relating to the underestimation of provisional tax. This basis distinguishes between taxpayers whose taxable income exceeds R1 000 000 and taxpayers whose taxable income is less than this amount.

16.8 SECTION 6quat



Review SILKE chapter 19.9.



- Section 6quat was discussed in TL106/2012 study unit 11.
- Remember that this section can also be applicable to individuals.
- Work through the examples in SILKE Chapter 19.9. (*Per SAICA syllabus – amounts will be provided in the questions as this topic is on a level 2*)



You should now read the Beancounter scenario again and attempt to think of all the tax consequences. Plan your answer before working through the solution.

16.9 OUTCOMES FOR THE BEANCOUNTER SCENARIO



You have drafted the following reply to Mr Bloke's query:

Tax implications will arise on the date when the restriction on selling the shares is lifted (section 8C). Thus, during the 2017 year of assessment, the difference between the market value on that date less the R5 paid per share will be the gain that needs to be included in your income.

This gain is included in the definition of *remuneration* for the purposes of employees' tax (paragraph 11A of the Fourth Schedule) and is deemed to be an amount paid by the employer to the employee. On the vesting date, you would have to inform Superior of the fact that you have made a gain on the exercising of the share options.

Employees' tax must be withheld from your salary on such gain, unless the Commissioner grants authority to the contrary. Superior would have to approach the Commissioner for the amount to be deducted. The employees' tax so deducted will be PAYE and not SITE.

SECTION A (CONTINUED)

STUDY UNIT 17

TAX AVOIDANCE AND OBJECTIONS & APPEAL

WORKPLAN FOR 15 JUNE 2012

TIME ALLOCATION FOR STUDY UNIT 17



A hour and a half of your study time have been allocated to study tax avoidance, objections and appeal, other administrative matters.

The following time allocation is recommended:

Background notes, Outcomes for these study units and Beancounter scenario	20 minutes
Tax avoidance	30 minutes
Objections and appeal and other administrative matters	20 minutes
Outcomes of the Beancounter scenario	20 minutes
Total	90 minutes

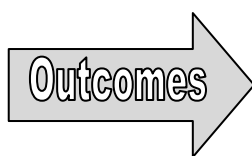


Start by reading notes 17.1 to 17.3 (the background in note 17.1, outcomes for this study unit and the Beancounter scenario) in this study unit.

17.1 BACKGROUND

You have acquired the necessary knowledge on tax matters at this stage and should be able to interpret, discuss, calculate and analyse the major tax consequences of a transaction. If you are not aware of the anti-tax avoidance provisions, you will not be able to evaluate any suggestions regarding the avoidance of tax. Furthermore, if you do not know the procedure to be followed in the case of objections and appeals, then your tax knowledge will be wasted to a large extent in practice.

17.2 OUTCOMES FOR THIS STUDY UNIT



After studying study unit 17, you should be able to meet all the outcomes listed at the beginning of Chapter 25 (Tax avoidance) of SILKE, as well as have:

- An understanding of the meaning and implications of the burden of proof as set out in section 82;
- Knowledge of the administrative provisions as contained in the Income Tax Act.



Before you commence studying the detailed provisions covered in this study unit, you should first read the following scenario relating to the Beancounter family. As you study the different sections in study unit 17, you should then identify areas of concern that should be brought to the attention of Barry Beancounter's family.

17.3 BEANCOUNTER SCENARIO



One day Barry Beancounter's cellular phone rang. It was his two cousins Mike and Bernard, with a tax problem. Due to his limited knowledge regarding taxation matters, Barry referred them to you.

On 1 April 2011, Mike Mechanic and Bernard Bulldozer received the following e-mail from their employer, Plant Hiring (Pty) Ltd. Plant Hiring (Pty) Ltd is a small business corporation and is regarded as carrying on a process similar to a process of manufacturing.

Dear staff member

Due to the company experiencing financial difficulties, we are forced to liquidate the company. We thank you for your support and wish you well.

Regards

Wise-guy Cats and Sleepy Sam
Directors and shareholders

It has always been the view of Mike and Bernard that the company was "mismanaged". Due to their age, (at that stage Mike was 50 years and Bernard 40 years old) they realised that finding a new job in the market, will be difficult.

Mike and Bernard made an appointment to see Wise-guy Cats and Sleepy Sam in order to discuss the possibility of acquiring their shares in Plant Hiring (Pty) Ltd. They also approached all the creditors and informed them of their intention to acquire the shares in the company and provided them with a business proposal. The creditors found this to their liking and they agreed to provide the company further extension to settle their debts, provided that the shares were transferred to Mike and Bernard.

The purchase price of the shares was based on the market value of the assets, current contracts and creditors of R2 900 100. Mike and Bernard registered second bonds over their private properties to finance the purchase price of the shares and to provide working capital for the company. Within 12 months they turned around the company's overall financial position and profitability.

On 2 December 2013 Plant Hiring (Pty) Ltd received its assessment relating to the year of assessment ended 28 February 2013. The set-off of the assessed loss of R3 000 800 against taxable income was disallowed by SARS in terms of section 103(2).

Indicate whether you agree with the 2013 assessment received from SARS (disallowing the assessed loss in terms of section 103(2)) and provide reasons for your answer.



Before attempting to assist Mike and Bernard, you should first work through and master the avoidance and evasion of tax in the Income Tax Act, after which you should be able to identify the important areas that should be brought to their attention.

17.4 TAX AVOIDANCE

In this section, the different sections influencing tax avoidance will be discussed.



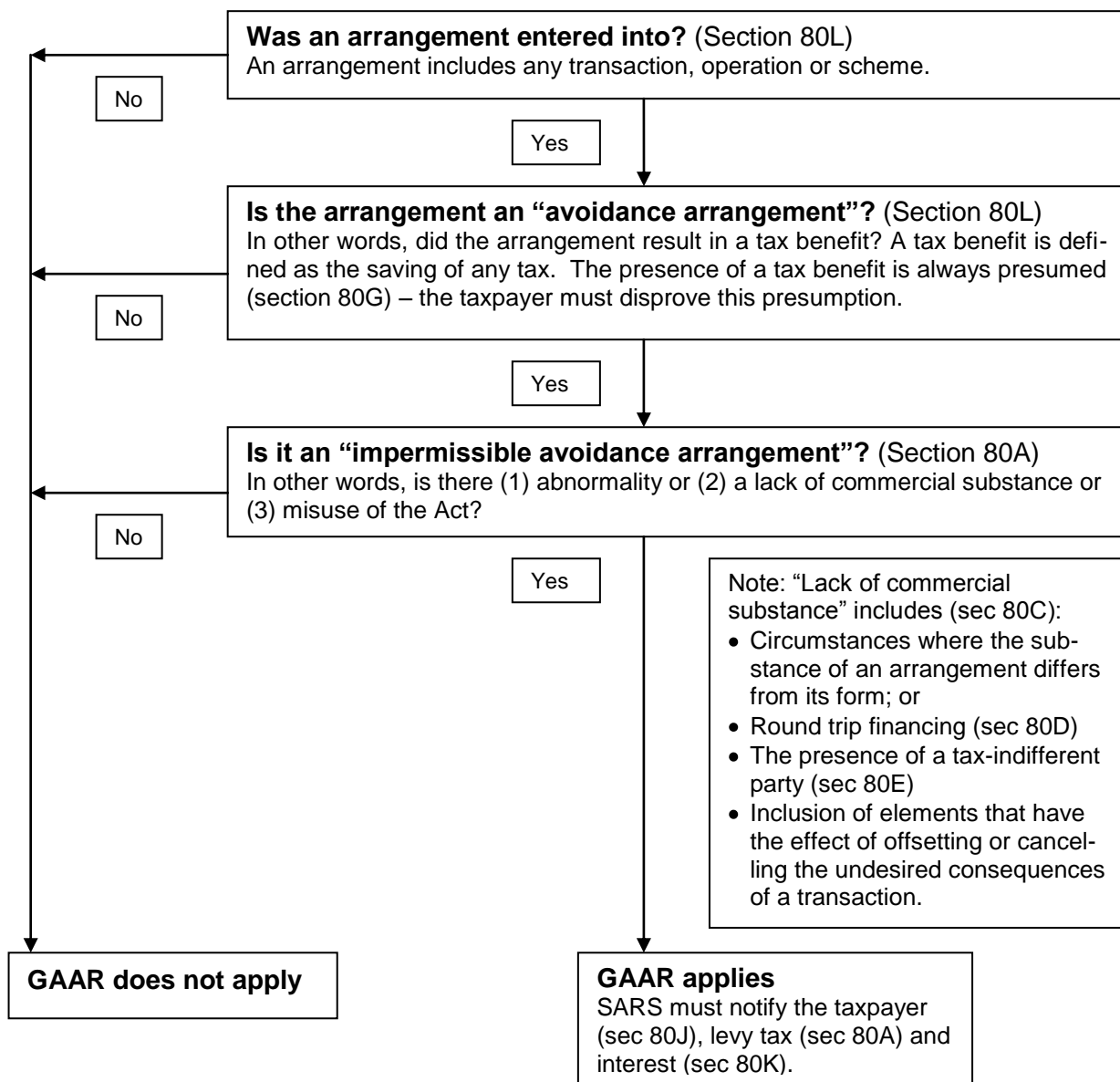
In this section of the study unit, Chapter 25 of SILKE will mainly be studied. The table below provides a summary of the SAICA syllabus, sections in the Income Tax Act, additional notes and the appropriate references to SILKE that is covered in this study unit. The purpose of the table is **not** to lead you through the study process but to be used as a helpful study tool.

Legislation	Topics	SILKE	SAICA Level
S 80A	Impermissible tax avoidance arrangements (excluding commercial substance) <i>(question will state that the transaction does not lack commercial substance)</i>	25.2	3
S 80B	Tax consequences of impermissible tax avoidance	25.2	3
S 80C	Lack of commercial substance <i>(question will state that the transaction does not lack commercial substance)</i>	25.2	1
S 80D	Round trip financing <i>(question will state that round trip financing is not applicable)</i>	25.2	1
S 80E	Accommodating or tax-indifferent parties	25.2	1
S 80F	Treatment of connected persons and accommodating or tax-indifferent parties	25.2	1
S 80G	Presumption of purpose	25.2	3
S 80H	Application to steps in or parts of an arrangement	25.2	1
S 80I	Use in the alternative	25.2	1
S 80J	Notice	25.2	1
S 80K	Interest	25.2	3
S 80L	Definitions	25.2	3
S 80M – 80T	Excluded		Excluded
S 103(2), (4) and (6)	Transactions, operations or schemes for purposes of avoiding or postponing liability for or reducing amounts of taxes on income	25.4 & 25.7	3
S 103(5)	Income dividend swaps	25.6 & 25.7	1



- Study SILKE Chapters 25.1, 25.2, 25.4 and 25.7 together with the following diagram.
- Read through Chapter 25.6 with comprehension.
- Note that the case law discussed in Chapters 25.3 and 25.5 are not part of the SAICA syllabus. We recommend that you ignore Chapter 25.3 but that you read through Chapters 25.5 and 25.8 to obtain a better understanding of the topic.
- Ignore Chapter 25.9 as it is excluded from the SAICA syllabus.

The following diagram provides an overview of the rules of sections 80A to 80L (general anti-avoidance rules – “GAAR”):



Source: Taxflash, BDO Spencer Steward Taxation Services

17.5 OBJECTIONS AND APPEAL AND OTHER ADMINISTRATIVE MATTERS

In this section, the different sections influencing objections and appeal and other administrative matters will be discussed.



In this section of the study unit, Chapter 33 of SILKE will mainly be studied. The table below provides a summary of the SAICA syllabus, sections in the Income Tax Act, additional notes and the appropriate references to SILKE that is covered in this study unit. The purpose of the table is **not** to lead you through the study process but as a helpful study tool.

SAICA LEVELS:

Please pay attention to the **SAICA knowledge levels** (refer to “Orientation” note X in this tutorial letter for a description of the levels) while working through this table.

Legislation	Topics	SILKE	SAICA Levels
Sections 65 to 76	<ul style="list-style-type: none"> Returns, return of information, books, accounts and records, administrative penalty 	Excluded	Excluded
Sections 76B – 76S	<ul style="list-style-type: none"> Advance tax rulings 	Excluded	Excluded
Sections 77 to 80	<ul style="list-style-type: none"> Assessments 	Excluded	Excluded
Section 81	<ul style="list-style-type: none"> Objection against assessment 	33.11 (Step 2)	3
Section 82	<ul style="list-style-type: none"> Burden of proof 	33.12	3
Sections 83 to 87	<ul style="list-style-type: none"> Dispute resolution 	Excluded	Excluded
Section 88	<ul style="list-style-type: none"> Payment of tax pending objection and appeal 	33.6.2	1
Sections 88A – 88H	<ul style="list-style-type: none"> Settlement of dispute 	Excluded	Excluded
Sections 89 to 94	<ul style="list-style-type: none"> Payment, recovery and refund of tax 	Excluded	Excluded
Sections 95 to 101	<ul style="list-style-type: none"> Representative taxpayers 	Excluded	Excluded
Sections 102 & 102A	<ul style="list-style-type: none"> Refunds 	Excluded	Excluded
Section 104	<ul style="list-style-type: none"> Offences 	33.12	1
Section 105	<ul style="list-style-type: none"> Jurisdiction of courts 	Excluded	Excluded
Section 105A	<ul style="list-style-type: none"> Reporting of unprofessional conduct 	1.3	1
Section 106	<ul style="list-style-type: none"> Authentication and service of documents 	Excluded	Excluded
Section 107	<ul style="list-style-type: none"> Regulations 	Excluded	Excluded
Section 107A	<ul style="list-style-type: none"> Rules of tax court 	Excluded	Excluded
Section 108	<ul style="list-style-type: none"> Prevention of relief from double taxation 	19.3.2	1



- Study SILKE Chapter 33.12 (Onus of proof).
- Study SILKE Chapter 33.11 (Step 2 - Objection against the assessment).



You should now read the Beancounter scenario again and attempt to think of all the tax consequences. Plan your answer before working through the solution.



17.6 OUTCOMES FOR THE BEANCOUNTER SCENARIO

You should now be able to answer Mike Mechanic's and Bernard Bulldozer's (cousins of Barry Bean-counter) query. In formulating your answer you should have identified the following:

Before section 103(2) can be applied, **all three** of the following requirements must be present:

- 1) There must be an agreement affecting the company or a **change in shareholding** of the company;
- 2) The above must have a direct or indirect result of which **income has been received** by or accrued to the company; and
- 3) The purpose of the agreement or change has been effected **solely or mainly** for the purpose of **utilizing the assessed loss**.

When these requirements are met, the use of the assessed loss is denied.

Reasons why the transaction was not affected solely or mainly for the purpose of utilising the assessed loss:

- Mike and Bernard bought the shares for their own job security, believing the sole reason for the company's downfall was its "mismanagement".
- They were not formerly part of top management and it appears that they realised the potential of the business. The fact that they requested further extension to pay the debts rather than enter into a compromise with creditors indicate that they had bona fide business reasons to buy the company and not solely or mainly to utilize the loss.
- They carried on the same business and did not change the type of business operations.
- They registered second bonds over their private properties, thereby increasing the risk of their personal financial stability in order to secure the future of the business.

Conclusion:

You should disagree with SARS and lodge an objection. Section 103(2) is not applicable as all three of the requirements are not present.

SECTION A (CONTINUED)

STUDY UNIT 18

TAX AND ESTATE PLANNING

WORKPLAN FOR 15 JUNE 2012 (continued)

TIME ALLOCATION FOR STUDY UNIT 18



A total of 3 hours of your study time for this week has been allocated to study unit 18.

The following time allocation is recommended:

Tax and Estate planning	180 minutes
Total	180 minutes



Start your studies of study unit 18 by reading through the following notes on tax planning.

18.1 TAX ADVICE

Please note that in this study unit there are no specific references to the Income Tax Act, VAT Act or the Estate Duty Act, or to study units or to SILKE, which needs to be studied. This is because this study unit encompasses your whole syllabus. This study unit is, in effect, an application of all your tax knowledge in the situation of an advisor.

Questions requiring you to provide tax advice will normally entail a comparison of different alternatives (for example, should a taxpayer accept a travel allowance or utilise the right to use an employer-owned vehicle). The tax implications of these alternatives and the after-tax cash flows, in particular, would have to be calculated in coming to any conclusion (and advice) in this regard.

18.1.1 Tax planning

The following notes are based on "Tax Strategy" by EB Broomberg & Des Kruger, (third edition), Butterworth's, 1998, Durban. The notes have been updated for subsequent changes to legislation.

18.1.1.1 Tax planning in general

There is virtually no economic act or agreement, which is devoid of tax implications. Accordingly, if tax planning is done timeously, positive tax savings can be achieved. The failure to plan timeously leads to

catastrophe. Signing contracts or agreements retrospectively is definitely not tax planning. Usually it would constitute fraud. A tax advisor must have a competitive level of ability. If the tax advisor does not have a good theoretical knowledge of the Income Tax Act and other related taxes, he will not be able to identify the tax saving opportunities. Accordingly, he will not be able to ensure that his clients find themselves in a position of honestly and legitimately paying less tax than their fellow taxpayers in like circumstances.

18.1.1.2 Approach to tax planning

Parties to an agreement often find themselves in an adversary position - the agreement may totally favour one person from a tax perspective, for example, the one party may obtain a capital gain (subject to CGT) whilst the other party may not be able to obtain a corresponding deduction, which increases the "cost" of the acquisition. Ideally, the tax benefits (and disadvantages) of both parties must be identified and quantified and be shared equally. This is achieved by hard bargaining between the parties.

The (adverse) tax considerations must never be allowed to distort a sound commercial bargain. However, adverse tax considerations may compel the scuttling of a proposed transaction.

In effect, the approach to tax planning involves the isolation and identification of the factors that give rise to a tax liability and, thereafter, the neutralisation of these factors as far as is possible.

18.1.1.3 Factors that determine tax liability

- **Factor of incidence**

The factor of incidence means identifying the person or legal entity upon whom the liability for tax will fall. Is it an existing company, a company to be formed, a partnership, an individual or a trust?

The method to decrease the tax liability entails the varying of the incidence of taxation from a highly taxed person or legal entity to a lower taxed person or entity.

- Consider the normal tax rates of individuals (maximum 40%), companies (rate of 28%) for years of assessment ending on or after 1 April 2008), and trusts (flat rate of 40%). (Refer to TL105 p62 for the different company rates for the 2012/2013 year of assessment. Remember that Dividends tax replaced STC as from 1 April 2012 at a rate of 15%).
- Consider the effective capital gains tax rates for individuals (maximum 13.3% (40% x 33.3%)), companies (18.6% (28% x 66.6%)) and trusts other than a special trust for the benefit of a disabled person (26.6% (40% x 66.6%)) for the 2013 year of assessment.
- Consider the tax disadvantages of companies:
 - i) Hostile legislation (personal service provider companies).
 - ii) Share-dealing companies (not individuals) are precluded (section 22(1)) from writing down the value of shares which are trading stock, to their market value).
 - iii) Assessed losses. Section 20(1) precludes a company with an assessed loss from carrying forward that assessed loss if the company ceased to trade in any tax year. This restriction is not applicable to individuals (or trusts). Section 20A, however, ring-fences certain trade losses for individuals.
 - iv) Refusal to recognise groups of companies. There is no group relief (except for Part III in the Income Tax Act) and intra-group transactions are closely scrutinised for non-arms length inter-company charges.

- v) Business tendency of company. Assets purchased by a company and later sold, are more likely to be regarded by the Revenue Authorities as revenue in nature. The onus on the taxpayer is greatly increased in these circumstances.
 - vi) Extraction of capital profits from a company. A company is subject to an effective 18.6% (66.6% x 28%) capital gains tax as opposed to a maximum of 13.3% (33.3% x 40%) for an individual.
 - vii) Also note that certain exclusions from CGT would only apply in the case of natural persons and special trusts, e.g. annual exclusion.
 - viii) Furthermore, section 64E (loans to shareholders, deemed to be dividends in certain circumstances) could present a problem.
- Consider the advantages of companies:
- i) Non-fiscal considerations
 - limited liability
 - perpetual succession
 - status
 - ii) Utilisation of assessed losses but be careful of trading in assessed losses - section 103(2).
 - iii) Able to change the year-end of the company (to take advantage of new tax rates, etc).
- The use of business trusts:
- i) Non-fiscal considerations:
 - limited liability
 - can have perpetual succession
 - assets of trust are distinct from the personal assets of the trustee and founder
 - control and administration may be unwieldy
 - it is difficult to dispose of a beneficial interest in a trust as opposed to the sale of shares in a company - however, a trust deed can make a provision for beneficiaries to be substituted
 - the loss of control and/or freedom of action by the founder of the trust
 - ii) Anti-avoidance provisions aimed at preventing a taxpayer from diverting income to another, less heavily taxed taxpayer - see sections 7(2) to 7(8) and section 25B. (The attribution rules in the Eighth Schedule should also be taken into account).
 - iii) Taxed at a flat rate of 40% which is higher than normal tax for a company (but the same rate as the maximum rate of an individual). The inclusion rate of the net capital gain is double that of any natural person (66.6% versus 33.3%).
 - iv) No loss of the identity of income received by a trust (Armstrong's case – conduit pipe principle) and distributed to a beneficiary, but where distributed in the form of an annuity, the sections 10(1)(h) and 10(1)(k) exemptions will not be available.
 - v) Potential savings in estate duty by:
 - freezing the value of growth assets - this is still the case even with the introduction of CGT
 - taxing, in terms of section 7, the donor rather than the beneficiary who actually receives and retains the income. With the donor paying the tax it will further reduce his (the donor's) estate.

➤ Partnerships:

- i) Non-fiscal considerations:
 - no limit on liability;
 - no perpetual succession. The introduction of a new partner results in a new partnership being formed (possibly with adverse tax effects on dissolution of old partnership);
 - control and administration of partnership and the rights and liabilities of the partners amongst themselves, could give rise to difficulties.
- ii) A partnership is not a person for normal tax purposes (except for VAT purposes!). However, it is or can be an employer for employee's tax purposes, except in the case of the partners. The partnership does not qualify as an employer of the partnership, except for purposes of sections 11(k) and 11(l). The partners are treated as separate taxpayers in their own right.
- iii) A partner who trades in a partnership can qualify as a micro business (but not the partnership itself). Refer to SILKE 15.2.12 for specific rules that apply to a partner who wants to elect turnover tax for micro businesses (turnover tax is excluded from the syllabus for the 2013 tax year).
- iv) Unless with special permission (that is difficult to obtain), the year-end of the partnership is fixed at the last day of February each year (section 24(H)(5)).
- v) Can form an *en commandite* or limited partnership which gives limited liability to the partners, but their share of losses is "ring-fenced" to the amount of the investment.
- vi) Assessed losses of the individual partners can be carried forward indefinitely.
- vii) If a share dealer, the individual partners may write down the value of their trading stock of shares to their market value, if lower than cost.
- viii) The maximum rate of tax for an individual is 40% as opposed to a rate of 28% for a company for years of assessment ending on or after 1 April 2008. Remember that from 1 April 2012, STC is replaced by dividends tax.

• **Factor of timing**

For tax years ending on or after 1 April 2008, the maximum tax rate for companies has been reduced to 28%. As from 1 April 2012, STC has been replaced with dividends tax.

The effective CGT rate dropped from 14,5%(29% x 50%) in the 2008 year of assessment to 14% (28% x 50%) for the tax years ending on or after 1 April 2008. The effective CGT rate was however increased for the 2013 year of assessment. The new effective rate will be 18.6% (66.6% x 28%).

The status of the taxpayer may alter (from resident to non-resident or vice versa).

Tax provisions may change (e.g. ring-fencing of losses from a secondary trade for individuals).

The method to decrease the tax liability is to defer the recognition of income to a later period (discounted cash flow and time-value of money considerations) or to speed-up the claiming of a deduction or allowance.

- **Factor of residence**

Where is the person resident?

The method to decrease the tax liability is to change, if possible, the residence of a person or prevent a person from becoming resident in South Africa. Remember to take the existence of any double tax agreement into account. Manipulate the circumstances so that the exemptions for income earned from a source outside South Africa, can be utilised (section 10(1)(o)(i)).

- **Factor of nature**

Is the amount received or accrued of a capital or revenue nature? Does the amount fall within the definition of a dividend?

The method to decrease the tax liability is to attempt to re-characterise an amount into a capital receipt which may then be taxed at a far lower rate of tax than ordinary income (e.g. effective rate applicable to capital gains of individual is 13.3% and to companies it is 18.6%) due to the inclusion rate applicable to calculate the taxable capital gain or re-characterise (but do not cede) interest into a dividend, which will be subject to dividends tax at a rate of 15%.

18.1.2 General and specific considerations in tax planning

18.1.2.1 Tax rates

- Normal tax (company rate of 28% versus individual maximum marginal rate of 40%);
- Natural persons also qualify for a rebate, and companies not, therefore the threshold for an individual < 65 years of age = R63 556.
- New dividends tax of 15%;
- CGT (company 18.6% versus individual maximum 13.3%);
- Withholding tax (royalties - 12%, fixed property acquired from a non-resident - ranging between 5% and 10% and non-resident sportspersons and entertainers – 15%);
- Donations tax - 20%;
- Estate Duty - 20%;
- VAT - 14% or zero-rated or exempt;
- Transfer duty at rates ranging from 0% to a maximum rate of 8%. Be careful of certain property owning companies or close corporations which in terms of legislation, can give rise to transfer duty on the value of the property in the entity on a change in shareholding or members' interest; Natural persons may be exempt from transfer duty in respect of a primary residence transferred from a trust or company up to 31 December 2012.
- Securities transfer tax – from 1 July 2008 - 0,25% of the greater of the consideration or market value of any listed or unlisted share or members' interest in a CC transferred, cancelled or redeemed and to the cession of a right to receive distributions from a company or CC. Security transfer tax is not applicable to foreign companies not listed on the South African stock exchange. No securities transfer tax is payable if the consideration is less than R40 000.



**Integrated Example:
Maximum marginal rate for individuals**

You are a tax manager in an accounting firm, and you have received some tax queries from one of your main clients. The client, Vision Manufacturing Limited ('Vision'), is a South African resident company, and its business is the manufacture of ceramic tiles. Vision has a December year-end, and is a registered category C VAT vendor. Mr Angus Jacobs took over the running of Vision on 1 March 2012.

The following information is relevant a query you have received from the company:

As part of Angus's remuneration package (from 1 March 2012), Vision expects to spend R14 000 per month on motor vehicle costs. It has two options in this regard:

- (a) Vision acquires the motor vehicle in terms of a lease and grants the free use to Angus. The cash cost of the car is R456 000 (VAT inclusive). The lease payments on a three-year lease will be R14 000 per month, inclusive of VAT and maintenance; or
- (b) Vision pays Angus a travel allowance of R14 000 per month. Angus then leases the vehicle on precisely the same terms as those outlined in (a) above. Angus will maintain an accurate logbook of kilometres travelled for business purposes. He expects to travel a total of some 28 000 km per annum, of which the private component is expected to be 21 000 km. The total cost of petrol for the private travel component is expected to be about R25 000 per annum, which Angus will pay himself. All other costs, including the cost of petrol for the business travel component, will be covered by Vision.

REQUIRED:

Advise Angus, based on tax cash flows, which of the two options will be better for him – compare the monthly PAYE amounts as well as the additional payment or refund upon assessment.

- Assume that there is no maintenance plan on the vehicle.

(16 marks)

(QE 2012 – Adapted)

SUGGESTED SOLUTION

	Company Car R	Travel Allowance R	
Monthly taxable amount:			
Company Car (R456 000 x 3.5% x 80%)	12 768		1
Travel Allowance (R14 000 x 80%)		11 200	1
PAYE @ 40% (i.e. monthly cash OUTflow)	5 107	4 480	1
x 12 months	<u>61 284</u>	<u>53 760</u>	
 Annual taxable value			
<i>Company Car</i>			
Annual value of usage (R456 000 x 3.5% x 12)	191 520		1
<u>Less: Business travelling proportion</u> <u>[x 7 000/28 000 km]</u>	<u>(47 880)</u>		1
	143 640		
<u>Less: Cost of private fuel (21 000km x R1.336)</u>	<u>(28 056)</u>		1
Annual Taxable Value	<u>115 584</u>		
 Monthly taxable amount:			
Company Car (R456 000 x 3.5% x 80%)	12 768		1
Travel Allowance (R14 000 x 80%)		11 200	1
PAYE @ 40% (i.e. monthly cash OUTflow)	5 107	4 480	1
x 12 months	<u>61 284</u>	<u>53 760</u>	
 Annual taxable value			
<i>Company Car</i>			
Annual value of usage (R456 000 x 3.5% x 12)	191 520		1
<u>Less: Business travelling proportion</u> <u>[x 7 000/28 000 km]</u>	<u>(47 880)</u>		1
	143 640		
<u>Less: Cost of private fuel (21 000km x R1.336)</u>	<u>(28 056)</u>		1
Annual Taxable Value	<u>115 584</u>		



Take note:

When you are requested to provide tax advice, you should always use the maximum marginal tax rate (i.e 40%) and not the tax tables applicable to individuals.

18.1.2.2 **Specific issues relating to either purchase the shares of a company or rather to purchase the assets of such company**

- Recoupment's (sections 8(4) and 22(8));
- Assessed losses (sections 20 & 103(2));
- Income for dividend swaps (section 103(5));
- Hybrid instruments (sections 8E and 8F);
- Deeming of income to have accrued to a donor (sections 7(2) - 7(8));
- VAT issues;
- Deductibility of interest on borrowed funds (purchase shares of company versus purchase of assets out of a company);
- Lock, stock and barrel sales; *CIR v Niko*, 11 SATC 124: The purchase price received by the seller of a business, even if expressed as a lump sum, must be allocated to the individual items making up the business, including goodwill, stock, etc. The price received and allocated to items of a revenue nature (for example, stock) remains revenue in nature even if purchased under a lock, stock and barrel sale. Similarly, the price allocated to an item of a capital nature (for example, goodwill, trade receivables (debtors), fixed assets) remains capital in nature (but CGT may be payable and recoupment's can come into play). See TL 102/2012.

18.1.2.3 **Other considerations**

- Tax skeletons of the company versus the cost of forming a new company. Assessments only remain open for three years after the date of assessment (section 79(1)), provided that there was no fraud, misrepresentation or non-disclosure of material facts.
- Connected persons (always be careful when transactions take place between connected persons - *prima facie* such transactions are not seen to be arms length transactions). Where connected persons are involved, there is specific legislation to prevent misuse of allowances. In this regard refer especially to section 1 and section 23J. Also, refer to TL 105/2012 in this regard.
- Cost of agreement and legal fees. Who will bear the cost? Usually the contract stipulates who will bear the cost of the agreement. From a tax planning point of view, the person who can obtain a tax deduction for the cost of the agreement should bear the total cost of the agreement with a corresponding adjustment to the purchase price. For example, in a lease agreement, if the lessee must bear the cost of the lease agreement, he will not be able to obtain a deduction for such expense, as such expense is regarded as capital in nature. On the other hand, should the lessor bear the cost of the agreement, he would be able to obtain a deduction for such expense as it is revenue in nature and is incurred in the production of income.
- Commercial considerations. Always take into account the present as well as the possible future commercial considerations which may outweigh the immediate potential tax benefits.
- Time value of money. This aspect is very important in evaluating a transaction and must be taken into account in deciding which route to follow. This is especially so in cases of evaluating alternatives, for example, whether to purchase or lease equipment, whether to invest an amount in a retirement annuity fund or in collective investments schemes or shares quoted on a stock exchange or in property.
- An important point to note is that the comparison must be made at the after-tax cost level. As the cash outflows (or inflows) are likely to vary under different options, tax implications must be taken into account. The time value of money should also be taken into account - although many tax questions require candidates to ignore this aspect.

18.1.3 Investment decisions

18.1.3.1 General comment regarding the answering of questions relating to investment decisions

An investment decision usually involves a comparison between two or more options. Therefore, a uniform base needs to be selected in order to make a realistic comparison - usually it would be the after-tax returns that should be compared.

If a corporate taxpayer is the investor, a tax rate of 28% is usually used. If it is an individual taxpayer, one would usually use the maximum marginal rate of tax of 40% unless the circumstances indicate otherwise. In the case of a trust, a rate of 40% is used.

In the case of an individual (natural person), the starting point is the R22 800 basic interest exemption for a person under the age of 65 and R33 000 for a person of 65 and older. One should always endeavour to ensure that the taxpayer earns at least interest equal to the exemption in order to obtain the maximum benefit. For example, an investment by a person (older than 65 years) of R250 000 in interest bearing securities earning 12% per annum will yield R30 000 in interest which will be a tax free investment. In order to earn an equivalent amount from some other type of taxable investment, the individual would need to earn a 20% (12% / 60%) yield before tax.

Although merely earning passive interest income is not included in the definition of carrying on a "trade", which means that interest paid will not be allowed as a deduction in terms of section 11(a) (general deduction formula), the Revenue Authorities follow Practice Note 31 which provides for interest paid to be allowed as a deduction provided that more interest is received than is paid or the amounts of interest paid and received are the same. No loss can be created.

Be conscious of whether the taxpayer is resident or non-resident in the Republic. If the investor is non-resident in the Republic, then in terms of section 10(1)(h), the interest which he receives on investments in the Republic may be tax free provided that the provisions of that section are met.

If the investor is resident in South Africa, then he is taxed on his world-wide income with a foreign tax rebate. Dividends received from a foreign company might be taxable in South Africa.

The after-tax returns on other investments may not be the same each year. This can occur, for example, if an initial or higher tax allowance is granted on assets purchased in the first year.

18.1.3.2 Specific investments

General

The tax treatment of income from investments depends upon various factors but the most important factor is whether the amount is tax free (for example, natural persons are exempt from tax on the first R22 800 interest if under the age of 65, R33 000 if older than 65 years. Furthermore, the residence of a taxpayer is also important in determining whether an amount is tax free or not. In addition, one should consider the tax deductions that may be claimed.

What is an investment?

An investment is not an asset which is purchased for resale at a profit but an asset purchased to hold and earn a return. It is the proverbial capital tree which bears the fruit (*CIR v Visser*). Generally, the intention of the taxpayer would determine its status (*Natal Estates*).

Typical investments are interest-bearing securities, dividend-yielding shares, rent-producing properties and assets generating leasing income. Assets such as Kruger Rands or diamonds not set in jewellery, which do not produce income, generally present a problem. But this aspect will be covered in greater detail below.

Tax entity to be utilised

The tax entity to be utilised will influence the rate at which the income from the investment will be taxed. The various tax entities and their effective tax rates have already been discussed above. Also remember that the basic interest exemption is only available to natural persons.

There is a great temptation for an investor to operate through a company in view of the fact that the corporate tax rate is 12% lower than the maximum marginal rate (40%) of an individual taxpayer. However, the company's income after tax still has to be diverted to the individual by way of:

- dividends on which an additional 15% dividends tax will be borne by the shareholders.
- a salary, provided that the individual provides a legitimate service to the company and that the company can deduct the salary for tax purposes, that is, it is carrying on a trade, etc (the salary, in turn, is taxable in the recipient's hands).

Be careful of the potential excessive remuneration practice of the Revenue Authorities. The excessive remuneration practice of the Revenue Authorities, however, should not be a problem especially where the individual taxpayer is already paying tax at the maximum marginal rate of 40%.

Types of investment

The tax treatment of an investment will depend on the type of investment, as the returns on different investments are treated differently in the Act, for example, certain expenses are tax deductible for certain types of investment income; an investor holding qualifying shares for at least three years (section 9C), will be deemed to have disposed of a capital asset, etc. Note that if an amount is received on or after 1 July 2009 in respect of the sale of shares in a venture capital company, it will not be deemed to be capital in nature up to the amount of expenditure allowed as a tax deduction for income tax purposes in respect of those shares (section 9C(2A)). (VCC's are excluded from the syllabus for the 2013 tax year).

Dividends

Dividends received from local South African companies are subject to a 15% dividends tax that will be borne by the shareholder.

Section 9C provides that the disposal of qualifying shares held for three years or more on or after 1 October 2007, will be deemed to be of a capital nature.

Interest and income instruments

Interest earned is normally taxable but refer below for any deductions and the interest exemption already mentioned.

Income instruments

Not all taxpayers receiving interest under instruments, will necessarily be affected by the provisions of section 24J. As far as the accrual of interest is concerned, and only in the case of non-corporate taxpayers, the ambit of this section is limited to instruments defined as "income instruments". Included in the definition of instruments are instruments, the term of which will or is likely to exceed one year and which are issued or acquired at a discount or premium or which bear deferred interest.

Examples of instruments, which **do not** fall within the scope of section 24J, are:

- savings accounts;
- call accounts;

- fixed deposits not exceeding one year;
- fixed deposits (the term of which is longer than one year, but the rate of interest is fixed and paid annually).

For a company, an “income instrument” is any “instrument” (irrespective of its period).

Interest does not accrue from day-to-day (unless it is deemed to do so because it is an “income instrument” as defined (see above)) but only when it becomes payable in terms of the contract. Therefore, various types of interest-bearing securities will have different terms and conditions as to when interest accrues.

- In the case of fixed-deposit investments, the interest only accrues when the fixed deposit matures, unless any other conditions have been provided for in the investment contract.
- In the case of mortgage and other bonds, the interest accrues on the dates provided for in the bond.
- The interest earned from Government or municipal stocks or debentures accrues according to the terms of the issue.

Rental and leases

Rental income from fixed property and lease income from the leasing of certain movable assets are taxable but certain deductions can be set-off against it.

Hard assets

These are assets like paintings, works of art, stamps, jewellery, antiques and coins. As the only “income” from them could arise when sold/disposed of at a profit, it would be up to the taxpayer to prove that these assets were of a capital nature to prevent the proceeds from falling into gross income. The intention of the taxpayer in acquiring and holding these assets and his conduct in relation to them, rather than the mere nature of the assets, will determine the taxability of any profit.

The proceeds on the sale of assets of this nature bought as part of a collection, to be used as ornaments, jewellery, for interior decoration or for the personal enjoyment of the taxpayer, will generally not be taxable (not even subject to CGT (personal-use asset) unless they are coins made of gold or platinum).

Kruger Rands

There have been decided court cases determining whether the proceeds from a sale of Kruger Rands were revenue or capital in nature. Read these decisions in SILKE Chapter 3 (also refer to Tutorial Letter 102/2012) - however, they may appear confusing but we recommend that Kruger Rands should be subjected to the same “tests” as other assets for determining a capital or revenue classification.

Collective investment schemes (Unit trusts)

Note that a distinction is made between the tax treatment of the distribution by a collective investment scheme in property and a collective investment scheme in securities.

18.1.4 Deductions available against investment income

Section 11(a) allows the deduction of expenditure incurred (as defined) in the production of income in the carrying on of a trade.

The passive earning of interest, dividends, pensions and annuities do not form part of the definition of carrying on a trade.

Practice note 31 has, however, been issued, which relaxes the prohibition of deductions somewhat.

In terms of **Practice Note 31** interest paid on funds borrowed for the purposes of lending them out at a higher rate of interest will, in terms of section 11(a) of the Act, constitute an admissible deduction from the interest so received by virtue of the fact that this activity constitutes a profit-making venture.

While it is evident that a person (not being a money lender) earning interest on capital or surplus funds invested does not carry on a trade and that any expenditure incurred in the production of such interest cannot be allowed as a deduction, it is nevertheless the practice of Inland Revenue to allow only interest incurred in the production of the interest to the extent that it does not exceed such income. The above practice is allowed even where funds are borrowed at a certain rate of interest and then invested at a lower rate.



Integrated Example: Purchase of assets or shares

Steve Willmot retired on 28 February 2013 and received R600 000 cash (after tax) from a pension fund. Due to the ill health of his brother Ben, Steve is considering taking over the manufacturing business of his brother. The business was valued at R550 000 and consists of:

	R
Manufacturing equipment	475 000
Trade receivables	75 000
	550 000

The **tax value** of the new manufacturing equipment at 28 February 2013 amounted to R160 000. The equipment qualified for a section 12C allowance. It was purchased and brought into use on 1 January 2012.

The statement of financial position of the business is as follows:

STATEMENT OF FINANCIAL POSITION OF WILLMOT MANUFACTURING (PTY) LTD AS AT 28 FEBRUARY 2013

	R
Capital employed	
Share capital	100
Loan account - Ben Willmot	349 900
Accumulated loss	(75 000)
	275 000
Employment of capital	
Manufacturing equipment	200 000
- At cost	400 000
- <u>Less</u> : Accumulated depreciation	(200 000)
Trade receivables	75 000
- At book value	78 750
- <u>Less</u> : Allowance for credit losses	(3 750)
	275 000

The company is registered as a VAT vendor. The assessed loss amounts to R115 000. Of the trade receivables of R78 750, R15 000 will have to be written off as irrecoverable at the end of the 2014 tax

year due to an event after year end. Steve is positive that the business will be profitable from day one. The purchase price will be settled in cash. Assume that Steve is already at the maximum marginal rate of tax of 40%.

The company is not a small business corporation.

REQUIRED	
(a)	Calculate the net cash flow for each of the two options (namely to buy the shares and loan account or to buy the assets and to trade in his own name) for the 2013 year of assessment. He will register as a VAT vendor and the transaction will qualify as a zero-rate supply (going concern). Use 28% as the tax rate for the company.
(b)	Advise Steve on all other tax matters that he must consider in year one and in future years that may be applicable to him and that might have an impact upon the option that he elects.

SUGGESTED SOLUTION: Example 2

Part (a)

Buy the business:

Tax implications for 2013 year of assessment

	Option 1 Buy shares and loan account R	Option 2 Buy assets R
Share capital	-	-
Loan account	-	-
Assessed loss	(115 000)	-
Equipment (20% section 12C) - 20% x R400 000	(80 000)	-
<u>Section 23J applicable:</u>		
Lowest of		
- 20% (not new asset (section 12C)) x R475 000 or		
- 20% x R449 950 (R400 000 – R240 000 (R160 000 + R80 000) (allowance) + R240 000 (recoupment) + R49 950) (R75 000 x 66.6% capital gain)	-	(89990)
Trade receivables – capital	-	-
Credit losses	(15 000)	-
	<u>(210 000)</u>	<u>(89 990)</u>
Net saving in tax (28% company; 40% individual)	<u>(58 800)</u>	<u>(35996)</u>
Net cash outflow:		
- Purchase price	550 000	550 000
<u>Less: Tax saving</u>	<u>(58 800)</u>	<u>(35 996)</u>
Net cash outflow	<u>491 200</u>	<u>514 004</u>

Advice

Based on the net cash outflow as well as the potential tax saving in 2013, it appears as if it would be better to buy the shares and loan account. However not all the factors have been taken into account and other potential negative aspects should be considered before making a final decision.

Part (b)**i) Accumulated loss/assessed loss**

Section 103(2) must be considered (should he buy the shares and loan account): The company has an assessed loss. There will be a change in shareholding. Income will accrue to the company as a result of the change in shareholding. For the Commissioner to rely on section 103(2), the agreement to purchase the shares must have been solely or mainly for the purpose of utilizing any assessed loss in order to avoid a liability for the payment of any tax. In the case of Steve, the company has an assessed loss and there will be a change in shareholding. Income will accrue to the company if Steve manages to make profits. To buy shares and the loan account in a company cannot be deemed to be abnormal.

The only real issue is whether the purchase of the shares was solely or mainly for the purpose of utilizing the assessed loss. As the purchase of the shares was because of his brother's ill health, this fact seems to be the main reason.

He should thus be able to steer clear of the Commissioner invoking section 103(2).

ii) Capital allowances on equipment

The company can claim tax allowances of R80 000 ($R400\,000 \times 20\%$) each in the 2013 and 2014 years of assessment before the assets are written-off for tax purposes. If Steve buys the assets, he can claim R87 500 in each of the next 5 years. A recalculation should be done, not only taking into account the tax benefit for one year. The tax effect of the 2 options now looks different as the tax saving operating through a company is now $R160\,000 \times 28\% = R44\,800$ while the cash flow benefit is $R449\,950 \times 40\% = R179\,980$ in the case of operating in his own name.

(iii) Trade receivables

Should he purchase the trade receivables and recover any amounts written-off as bad, such recoveries would be regarded as being capital in nature and will be a capital gain.

iv) Capital profits

If any capital gains are made by the company, CGT would amount to 18.6% ($66.6\% \times 28\%$) as opposed to 13.3% ($33.3\% \times 40\%$) if he was operating in his own name.

v) Loan account

The fact that the company has a loan account of R349 900 could be advantageous in that the first R349 900 paid out to Steve from any cash generated by the company can take the form of a repayment of the loan account and will not attract any tax.

vi) Fringe benefits

Utilisation of a company could mean that Steve could award himself certain fringe benefits which may be taxed more favourably than if he operated in his own name.

vii) VAT and securities transfer tax

Transfer of shares are subject to 0,25% securities transfer tax; while the transfer of a business will be at the zero rate for VAT purposes as it is a supply of a going concern (given).

Tax implications year of assessment 2013 to 2017	Option 1 Buy shares R	Option 2 Buy assets R
Share capital	-	-
Loan account	-	-
Assessed loss (if not allowed)	-	-
Equipment (20% section 12C)		
- 20% x R400 000 x 2	(160 000)	
- 20% x R449 950 (connected persons, section 23J)	-	(449950)
Bad debts	<u>(15 000)</u>	-
	<u>(175 000)</u>	<u>(449 950)</u>
Net saving in tax (28% company; 40% individual)	<u>(49 000)</u>	<u>(179980)</u>
Net cash outflow:		
- Purchase price	550 000	550 000
<u>Less: Tax saving</u>	<u>(49 000)</u>	<u>(179980)</u>
Net cash outflow	<u>501 000</u>	<u>370 020</u>

Advice

The picture looks different if one takes all the factors into account. It appears that it would be the best to buy the assets out of the company.

18.2 ESTATE PLANNING



For a discussion on the objectives and legal considerations of Estate Planning **read** SILKE chapters 31.1 to 31.2.3. Thereafter study SILKE chapters 31.3 to 31.4.



You have now completed study unit 18.

You should now be ready to attempt the integrated question in Section B.

SECTION B (INTEGRATED EXAMPLE)

STUDY UNITS 14 - 18

INDIVIDUALS, FRINGE BENEFITS, RETIREMENT BENEFITS,
PARTNERSHIPS, EMPLOYEES AND PROVISIONAL TAX,
TAX AVOIDANCE AND TAX PLANNING

SECTION B – INTEGRATED EXAMPLE



1,8 hours (108 minutes) have been allocated to work through the integrated example. This example will give you an indication at which level you need to apply your knowledge in the tests and examinations.

PURPOSE STATEMENT:

SECTION B contains an integrated example and is based on prior year's examinations or test papers. The goals with this section are firstly, to assist you to integrate knowledge and to vest a way of thinking in order for you to answer the assignment, tests and exams and secondly, to give you the opportunity to apply the assessment criteria stated in TL101 in order to prepare for the formative assessments (tests) and the final summative assessment (examination).



MONETARY AMOUNTS APPLICABLE TO THE 2013 YEAR OF ASSESSMENT

The 2013 SAICA examinable pronouncements cover legislation promulgated until 31 December 2011 effective on/before 1 April 2012. This means that for individuals the 2013 year of assessment and for corporate entities the 2012 or 2013 years of assessment will be examinable.

As we base the questions for individuals on the 2013 year of assessment, we will make use of the new monetary amounts as announced by the Minister of Finance in the budget speech given during February 2012. These new monetary amounts does not appear in the SAICA Legislation Handbook, but is provided in this tutorial letter.



After completing the question in the time limit you should be able to identify:

your competency to pass the formative assessments and summative assessment relating to the topics you have already covered so far. You have to identify your shortcomings in order to rectify it before the tests and examination for example:

- Time management problems;
- Shortcoming in knowledge base;
- Shortcomings in handling of data, for example: identifying the problem, distinguishing between relevant and irrelevant information, analysing data, integrating data, evaluate alternatives and the ability to propose practical solutions;
- Problems with communicating your findings etc.



Proposed self-assessment method

Read the information given in the question carefully. Do not read the REQUIRED yet. (This is the method that will be followed in tests and the examination (15 minutes for every 40 marks).)	17 minutes
Attempt the Question, but commence with reading the REQUIRED.	68 minutes
Assess your answer with the help of the proposed solution. Note where you made an error and refer back to the legislation and/or SILKE by making use of the references provided in the solution in order to affirm your knowledge and understanding of the application of the legislation. (0.5 minute per mark).	23 minutes
	108 minutes



EXAMPLE

45 marks

Mr and Mrs Willard are married in community of property. Mr Willard is 59 years and Mrs Willard 65 years old. Mr and Mrs Willard are the only registered dependants of Mr Willard's medical aid fund.

Information relating to Mrs Willard:

The following amounts accrued to her during the 2013 year of assessment:

Salary	R50 000
Rental	R12 000 (not excluded from the joint estate)
Interest	R50 000 (not excluded from the joint estate)

She contributed 5% of her salary to a provident fund and R5 000 to a retirement annuity fund during the 2013 year of assessment.

Information relating to Mr Willard:

Mr Willard was employed by Wonder (Pty) Ltd until his retirement on 31 December 2012.

From 1 January 2013 he entered into a partnership with an old friend, Mr Mac, repairing electronic equipment.

Income accrued during the 2013 year of assessment:	Notes	R
Basic salary per month (received from employer)		8 000
Annual bonus (received from employer)		29 198
Entertainment allowance	1	9 250
Use of company vehicles (from 1 May 2012)	2	?
Briefcase received in recognition of 35 years service – cost to employer	3	8 383
Lump sum received from pension fund	4	800 000
Monthly pension received	4	6 500
Dividends received from South African companies		4 000
Monthly annuity received	5	6 000
Proceeds on sale of boat	6	103 000
Partnership income	7	?
Expenses incurred during the 2013 year of assessment:		
Monthly pension fund contributions (based on basic salary only – contributed until retirement on 31 December 2012)	4	640
Total annual retirement annuity fund contributions		12 000
Monthly medical aid fund contributions (paid by Mr Willard and continued contributing after retirement)		2 000
Qualifying medical expenses not refunded by the medical aid fund		8 500
Donation to an approved Public Benefit Organisation, a relevant receipt in terms of section 18A was obtained		5 000
Purchase price of boat	6	65 000

Notes:

1. Mr Willard was required to entertain clients on a regular basis and incurred entertainment expenses of R6 120 (he can produce proof thereof) for the period until his retirement.
2. As from 1 May 2012 until 31 December 2012, Mr Willard enjoyed the use of two company cars, none of which was subject to a maintenance plan:
 - 2.1 Mrs Willard used the one vehicle with a determined value of R80 000, for private purposes. Mrs Willard paid for all the fuel herself. No record was kept of kilometres travelled or the cost of the fuel used.
 - 2.2 Mr Willard used the other vehicle. The company purchased this vehicle on 1 March 2009 for R108 300 (including VAT). His employer paid all maintenance and fuel for his private and business travel. He kept a detailed logbook from 1 May 2012, which revealed that his private use of this company car until his retirement on 31 December 2012 amounted to 5 333 km and his business use amounted to 6 777 km. The total distance travelled for the period was 12 110 km.
3. After 21 year of service this was the first time Mr Willard received any reward for long service. The amount of R8 383 excludes VAT.
4. On 30 November 2011 Mr Willard purchased pensionable years of service retrospectively for R3 000. On retirement, a lump sum payment from the pension fund to the amount of R800 000 was paid to

him. During the 2012 year of assessment, a total amount of R16 500 in respect of contributions to the pension fund had not been allowed as a deduction, before this all the amounts were allowed as deductions. The pension fund deducted R103 437 employees' tax from the lump-sum payment made to Mr Willard.

On 1 March 2010 Mr Willard received a retirement fund lump-sum of R400 000 from a retirement annuity fund, all the contributions relating to this amount were allowed as deductions. Mr Willard paid R18 000 income tax on this lump-sum received.

Mr Willard's membership of the pension fund was a condition of his employment. After retirement he is also receiving a monthly pension of R6 500.

5. A monthly annuity of R6 000 is paid to Mr Willard by ABC Insurance Company. He purchased this annuity for R800 000 and it is payable from 1 March 2009 until the date of death. Mr Willard's life expectancy at the date of purchase was 17,18 years.
6. Mr Willard, thinking he would have more time at his disposal subsequent to his retirement, purchased a 14 meter boat on 1 November 2012 for R65 000. On 15 February 2013, Mr Willard, after realising that he had no spare time now that he was in partnership with Mr Mac (see note 7), sold this boat, which he had never used to a collector, for R103 000.
7. From 1 January 2013 Mr Willard and Mr Mac have been repairing electronic equipment in partnership. The partnership agreement states that profits and losses are shared in the ratio of 60% (Mr Willard): 40% (Mr Mac). The total income (all of it taxable) of the partnership amounted to R45 000 for the two months ending 28 February 2013 and the tax deductible expenses amounted to R25 600. Each of the partners is paid a monthly salary of R4 000 (included in the tax deductible expenses mentioned above).
8. Employees' tax of R30 947 was deducted from Mr Willard's salary during the year. He did not make a first provisional tax payment but he did make a second provisional tax payment of R2 000 on 28 February 2013.

REQUIRED	Marks
Calculate Mr Willard's third provisional tax payment to be made for the 2013 year of assessment in order to avoid any interest liability. Show all your calculations and indicate when this amount is payable.	45



Understanding the REQUIRED part in questions

Once you have read the required part of a question, you need to establish **what you have to do**. If you are required to either calculate or discuss the **tax** consequences, it means that you have to calculate/discuss all of the following (if applicable), namely:

- VAT
- Estate duty and
- Income tax.

If you are required to calculate or discuss the **income tax** consequences, then you only have to deal with all the parts in the Income Tax Act, namely normal tax, donations tax and dividends tax.

If you are required to calculate or discuss the **normal tax** consequences, remember that the inclusion of taxable capital gains in taxable income should form part of your answer.

Exam technique (How to make the most of information provided in the allowable time):**1. Read the required part**

After reading the information provided, but before commencing the question, you have to carefully read the required part. At this stage, you should be able to identify the following:

- **Type of question:** Long calculation question. Note the verb “calculate”. Income and expenses with notes are provided. Normally such a question can be answered by starting at the top and working your way down, i.e. tick each item listed and each note as you go along. Be careful not to miss any of the items or notes. Remember that any taxable capital gain is included in taxable income last, i.e. before the deduction of qualifying donations in terms of section 18A.
- **Outcome expected:** The amount of the third provisional tax payment of Mr Willard for the 2013 year of assessment, as well as an indication when this amount is payable. Until you have calculated such an amount and specified the date it is payable, you have in essence not answered the question. This is therefore the equivalent of a conclusion in a discussion question.
- **Scope of the question (borders):** It is the normal tax calculation of an individual. Only the calculation of Mr Willard’s third provisional tax payment is required, although information regarding Mrs Willard is also provided. In order to calculate Mr Willard’s third provisional tax payment, you first have to calculate his actual tax liability for the 2013 year of assessment. After calculating this amount, you will have to deduct any provisional tax payments and employees’ tax deducted during the year of assessment in order to calculate the outstanding liability payable by way of the third provisional tax payment. You therefore only have to consider normal tax consequences, which would of course include CGT consequences. Ensure that you do the calculation of the deductions relating to an individual in the correct sequence (refer to the framework given in Section A).

Note that, although no reference is made to VAT in the “required” part, you are not permitted to ignore VAT (unless stated otherwise) and, therefore, you have to address the VAT issues evident from the information provided which will have an effect on the normal tax liability of Mr Willard (although he is not a registered vendor). Remember that you are also required to indicate when the third provisional tax payment is due – do not forget this part of the question as it is one easy mark.

- **Time allocation:** It is always important to establish the time you have available to answer the question before you start with a question and of course to adhere to that limit. In the case of a long calculation question, only the total mark is usually indicated.

2. Analyse and interpret the information given

Keep in mind that sometimes unnecessary information is also provided. Read carefully if you attempt to answer a question on individuals, as some important information can be provided in the first and last paragraphs. As you start working through the question you should be able to identify the following:

- Mr Willard and Mrs Willard are married **in** community of property – passive income as well as rent received on property which forms part of the communal estate will therefore be included in equal portions in the taxable income of the spouses. This is the reason why the information relating to Mrs Willard is provided (do not waste time in calculating her tax liability, it is not required).

- Mr Willard has not yet attained the age of 65 and will therefore only qualify for the basic interest exemption of R22 800 and the primary rebate of R10 755.
- Mr Willard retired during the year, which indicates that there will possibly be lump sums from employers or retirement funds (remember that the lump sums must be kept in a separate column and taxed according to either the retirement fund lump sum withdrawal benefit table or the retirement fund lump sum benefit table).
- Mr Willard entered into a partnership. There will therefore be taxable income (or a loss) from a separate trade that needs to be considered. Remember to calculate the taxable income (or loss) from the trade separately, and then to include the taxable income from that trade before considering the allowable deductions (for example pension fund contributions) for an individual.

As the partnership is an independent trade and there was a loss for the year the provisions of section 20A must be considered to determine if the loss may be claimed.

- A boat was sold during the year – this indicates possible capital gains tax consequences in terms of the Eighth Schedule.
- The employees' tax and the provisional tax payments made to date are provided in order to assist you to calculate the third provisional tax payment.

3. Start answering the question now

You can now start working through the question from the top. Tick off amounts and notes as you go along. Remember that you have to read, think and then write. Ensure that you answer the question, namely what is the amount of the third provisional tax payment to be made by Mr Willard for the 2013 year of assessment and when is it payable?

EXAMPLE - SUGGESTED SOLUTION

Normal tax liability of Mr Willard for the 2013 year of assessment

	R	R Retirement fund lump- sum	R Other	
Salary				
(R8 000 x 10m) (par (c) of the gross income definition)			80 000	(1)
Bonus				
(par (c) of the gross income definition)			29 198	(1)
Use of company vehicle (2.1)				
R80 000 x 3.5% x 8m = R22 400 (As no record of kilometres travelled was kept, the value of the fringe benefit cannot be reduced.) (Par 7(7) and (8) of the Seventh Schedule.)			22 400	(2)
Use of company vehicle (2.2)				
R108 300 x 85% x 85% x 85% = R66 510 x 3.5% x 8m	18 623			(2)
<u>Less: Business use R18 623 x 6 777km / 12 110km</u>	<u>(10 422)</u>		8 201	(2)
(Par 7(7) and (8) of the Seventh Schedule.)				
Briefcase				
R8 383 – R5 000 (long service - Par 5 of 7th Schedule)			3 383	(1)
Lump-sum payment from Pension fund				
Total amounts received (par (e) of the gross income definition)	800 000			(1)
<u>Less: Deductions par 5 of 2nd Schedule - Allowances not claimed previously = R16 500 + ((R640 x 10) – (R8 000 x 10) x 7,5% (current year))</u>	<u>(16 900)</u>	783 100		(2)
Pension received				
R6 500 x 2m (Jan & Feb 2013) – par (a) of ‘gross income’			13 000	(1)
Rental received (wife)				
50% x R12 000 (married in c.o.p.)			6 000	(1)
Interest received (wife)				
50% x R50 000 (married in c.o.p.)	25 000			(1)
<u>Less: Basic interest exemption</u>	<u>(22 800)</u>		2 200	(1)
Dividends received				
50% x R4 000 (married in c.o.p.)	2 000			(1)
<u>Less: Exempt - sec 10(1)(k)</u>	<u>(2 000)</u>		-	(1)
Annuities received				
Amount received (R6 000 x 12m) (par (a) of gross income definition)	72 000			(1)
<u>Less: Capital portion thereof (exempt in terms of s 10A)</u> (R800 000/(R6 000 x 12m x 17,18) x R72 000) (the capital amount will be provided in the examination)	<u>(46 566)</u>		25 434	(2)

	R	R	R
Salary received from partnership			
R4 000 x 2m			8 000 (1)
Profit share from partnership			
(R45 000 - R25 600) x 60% profit share ratio			11 640 (1)
INCOME		783 100	209 456
Current pension fund contribution deduction (s 11(k))			
Actual contributions = R640 x 10 = R6 400, limited to the greater of R1 750 or 7,5% x R80 000 = R6 000			(6 000) (1)
Arrear pension fund contribution deduction (s 11(k))			
R3 000 - R1 800 (claimed previous year)			(1 200) (1)
RAF contribution deduction (s 11(n)) (Actual = R12 000)			
Actual contributions = R12 000			
Deduction limited to greatest of R1 750; R3 500 - R6 000 = R2 500 or 15% x NRFI = R19 418, but always limited to actual. NRFI = R209 456 - R80 000 = R129 456 (Refer to the comprehensive framework in Silke on page 330, together with note 3 on page 331.)			(12 000) (2)
Taxable income before capital gains and unexpended portion of allowances		783 100	199 506
Entertainment allowance (section 8(1))			
Nothing allowed as a deduction in terms of sections 11(a) and 23(m), since employee earns fixed remuneration – allowance included in taxable income. Company should consider reimbursing employee for specific entertainment expenses incurred.			9 250 (1)
Capital gain on sale of boat			
(not personal use asset > 10 metres)			
Proceeds	103 000		
Less: Base cost	(65 000)		
Capital gain	38 000		(1)
Less: Annual exclusion	(30 000)		(1)
Nett capital gain	8 000		
Taxable capital gain = R8 000 x inclusion rate of 33.3%			2 664 (1)
Taxable income after taxable capital gains		783 100	202 170
Deduction for qualifying donation (s 18A)			
Actual = R5 000. Limited to 10% of R202 170 = R20 217 limited to actual, therefore			(5 000) (1)
Taxable income after donations		783 100	197 170
Medical expense deduction (s 18)			
Actual contributions: R2 000 x 12 = R24 000	24 000		(1)
Less: 4 x the s 6A tax credit (R460 x 12 = R5 520 x 4) = R22 080	(22 080)		(1)
(Note: this subtotal must be limited to Rnil if it is negative)	1 920		
Plus: Qualifying medical expenses	8 500		(1)
	10 420		
Less: 7.5% of subtotal (R197 170)	(14 788)		(1)
Taxable income			<u>197 170</u>
Taxable retirement fund lump-sum income		<u>783 100</u>	

Calculation of the normal tax liability on retirement fund lump sum benefits:

	R
Normal (lump sum) tax liability on all retirement fund lump sum benefits received (R400 000 + R783 100 = R1 183 100)	
Tax on R1 183 100: (R1 183 100 – R945 000) x 36% + R141 750	227 466 (2)
Hypothetical normal (lump sum) tax liability on retirement fund lump sum benefits previously received (R400 000): (R400 000 – R315 000) x 18% + Rnil	<u>(15 300) (1)</u>
Normal tax liability on retirement fund lump sum benefits	<u>212 166</u>

Calculation of the third provisional tax payment:

	R
Normal tax per tax tables on R197 170	
(R197 170 – R160 000) x 25% + R28 800	38 092,50 (1)
<u>Less:</u> Primary rebate	(11 440,00) (1)
<u>Less:</u> Section 6A rebate (R460 x 12)	<u>(5 520,00) (1)</u>
Normal tax liability on taxable income excluding retirement fund lump sum benefits	21 132,50
<u>Add:</u> Tax liability in respect of retirement fund lump-sum benefit (refer below)	<u>212 166,00 (1)</u>
Total normal tax liability	233 298,50
<u>Less:</u> Employees tax deducted	(30 947,00)
<u>Less:</u> Employees tax deducted	(103 437,00) (1)
<u>Less:</u> First provisional tax payment	-
<u>Less:</u> Second provisional tax payment	<u>(2 000,00) (1)</u>
Third provisional tax payment due on or before 30 September 2013	<u>96 914,50</u>

SECTION C

Self-assessment assignment 5/2012

STUDY UNITS 14 - 18

INDIVIDUALS, FRINGE BENEFITS, RETIREMENT BENEFITS,
PARTNERSHIPS, EMPLOYEES AND PROVISIONAL TAX,
TAX AVOIDANCE AND TAX PLANNING

SECTION C – SELF-ASSESSMENT ASSIGNMENT



QUESTIONS AND SUGGESTED SOLUTIONS



We have provided you with 14 hours of questions.

PURPOSE STATEMENT

In **SECTION C**, you will find the self-assessment assignment, which you have to mark yourself. You have to assess your own knowledge and competencies and take responsibility for your own learning experience.

Outcomes

After completing the questions in the self-assessment assignment in the time limits provided, you should be able to:

- Identify if you had rectified the shortcomings identified in the previous sections; and
- Demonstrate that you are competent to pass the formative assessments and summative assessment relating to the topics you have already covered so far.
- Your assignment integrates your knowledge on under-graduate work as well as work done in TL103 and TL104. Work through the questions in the assignment and then assess yourself against the suggested solutions provided below in this section.

Question	QSAT / provided	Topic	Marks / Minutes
1	provided	Mr Simba Chips. Taxable income of an individual, remuneration, fringe benefits, deductions, lump sums received, investment income, donations and employees' tax	47/71
2	provided	Virus McAfee. Taxable income of an individual, remuneration, fringe benefits, allowances, rent received and capital gains.	46/69
3	provided	Alistair Murphy. Normal tax liability of an individual, business income, lump sums received, capital gains and VAT.	62/93
4	provided	Dr Botha. Divorce, partnership, fringe benefits and provisional tax.	37/56
5	provided	James Wills. Taxable income of an individual, partnership, investment income, travel allowance and capital gains.	26/39
6	provided	Wilhelmina Slater . Normal tax liability of an individual, gross income definition, emigration, income received from a trust, fringe benefits, deductions, capital gains and lump sums received.	86/129
7	provided	Zannon Botha and Zannon (Pty) Ltd. VAT and employees' tax.	32/48
8	provided	Slimy Success. Employees' tax and provisional tax liability of an individual.	21/32
9	provided	Budgie Bird. Employees' tax liability of a member of a CC and provisional tax liability of a CC.	28/42
10	provided	Anti-Smoking Ltd. Employees' tax which had to be withheld from the remuneration paid to employees' and fringe benefits.	36/54
11	13.5	Theresa Strydom. Employees' tax and normal tax liability of an individual.	26/39
12	14.6	Gabor Brablink. Normal tax liability of an individual, remuneration received, pension received, lump sums received, foreign years of service and deductions.	23/35
13	21.10	Aloevale (Pty) Ltd. Section 103(2) and deductions.	15/23
14	21.11	Holding Ltd. Tax avoidance. Section 80A – 80L.	12/18
15	14.10	Mr Sasha Distell. Tax planning - normal tax consequences of retirement lump sum withdrawal benefits and retirement fund lump sum benefits.	40/60
16	12.10	Eric Clapton. Tax advice. Company car vs. travelling allowance.	20/30
			557/836



The questions in PART C is mostly integrated questions, on a level that we expect from you, as a CTA 2 student. You have to integrate previous knowledge of your undergraduate studies with the previous tutorial letters done. Take your time in doing a question thoroughly instead of just looking at the proposed solution. We thus recommend:

Read the information given in the question carefully. Do not read the REQUIRED yet. (This is the method that will be followed in tests and the examination.)	15 minutes for every hour
Attempt the question (Remember to commence with reading the REQUIRED).	14 HOURS
Assess your answer with the help of the proposed solution. Note where you made an error and refer back to the legislation and/or SILKE by making use of the references provided in the solution in order to affirm your knowledge and understanding of the application of the legislation.	0.5 minute for every mark allotted

QUESTION 1**47 marks****BACKGROUND INFORMATION**

- Mr Simba Chips is the marketing manager of Chips (Pty) Ltd.
- Chips (Pty) Ltd is a vendor for VAT-purposes.
- Both Mr Simba Chips and Chips (Pty) Ltd are residents of the Republic.
- Mr Simba Chips is 66 years old and a widower.
- His wife died in April 2012. They were married out of community of property.
- The company persuaded him to stay on as a full-time employee for a further three years after the normal retirement age, which is 65 years. However, he had to resign from the board of directors when he attained the age of 65 years.

FURTHER INFORMATION AND NOTES

Information pertaining to Mr Simba Chips' income, expenditure, donations, capital gains and capital losses for the year of assessment ending 28 February 2013, follows:

1. Salary

He received a monthly basic cash salary of R40 000 per month for the period 1 March 2012 to 28 February 2013.

2. Company car and travelling allowances

- **Company car**

The right of use of a company car was granted to him (for private and business use) for the period 1 March 2012 until 30 June 2012 (four months). The determined value of the car was R450 000. The company provided Mr Simba Chips with the option to buy the car at its market value less 15% discount on 1 July 2012. The market value of the car was R380 000 (including VAT) on 1 July 2012. Mr Simba Chips exercised this right and paid the company the agreed purchase price of R323 000. This is currently the only car that he owns.

- **Travelling allowances**

From 1 July 2012 he received a travelling allowance of R15 000 a month for the remaining eight months of the year of assessment. In addition to this, he is also reimbursed at R2 a kilometre for actual business travelling undertaken by him. He submitted the following claims based on dates travelled and destination in kilometres from the office to customers or suppliers:

Summary of the claims submitted to Chips (Pty) Ltd for business travel:

Month	Kilometres
July 2012	1 951
August 2012	775
September 2012	1 563
October 2012	2 895
November 2012	2 368
December 2012	1 375
January 2013	872
February 2013	1 369
Total business kilometres	13 168

QUESTION 1 (continued)

Mr Simba Chips does not keep accurate records of actual costs incurred. The odometer reading of the car was 62 328 km on 1 July 2012 and 80 122 km on 28 February 2013. He travelled 17 794 kilometres in total during the 244 day period that he received these allowances during the 2013 year of assessment.

3. Medical and retirement benefits provided by employer

The company does not have a medical aid scheme or any retirement fund for the benefit of the employees. Senior personnel are encouraged to join a medical aid scheme. The company does not contribute on behalf of any employee to such a medical aid scheme, but the individual employee is required to sign an agreement for the deduction and payment of the relevant amounts to the medical aid scheme. The company deducted R1 200 a month from Mr Simba Chips' remuneration and paid it over to the medical aid scheme.

The company operates a clinic on its premises and a medical doctor visits the clinic every morning from 7:00 to 9:00 at a fixed fee. Prescribed medication is purchased from a local wholesale pharmacy and delivered directly to the relevant employee. Mr Simba Chips visited the clinic once a month to have his blood pressure monitored and to have the prescribed medication for his high blood pressure placed on order. If Mr Simba Chips consulted a general practitioner, each appointment would have resulted in a consultation fee of R170 (including VAT). The normal retail price of his monthly medication amounted to R125,40 (including VAT), but the company only paid R87,78 (including VAT).

4. Shares allotted by employer

Mr Simba Chips qualified for free shares in Chips (Pty) Ltd in terms of a broad-based employee share plan that was implemented on 1 December 2012. All employees were allotted 100 shares of R1 each. The market value, as calculated by an independent valuer, was R64,00 a share on that date. The employees are only allowed to sell these shares to the employees share incentive trust and then only after a minimum period of five years have elapsed or if they have resigned or died, whichever occurs first. The trust must, in terms of the rules, buy these shares at a value not lower than R64,00, but also not higher than the value of the shares at the most recent financial year end of the company.

5. Amounts received from retirement funds

He received a pension of R6 500 a month for ten months (thus R65 000 for the year of assessment) from his late wife's pension fund and an annuity from his personal retirement annuity fund amounting to R25 000 a month (thus R300 000 for the year of assessment).

6. Investment income

The following investment income was received by or accrued to Mr Simba Chips during the 2013 year of assessment:

- R18 900 from a collective investment scheme in securities. The amount consists of:
 - R1 700 foreign dividends (not exempt in terms of section 10(2)(B)) and
 - R17 200 local dividends;
- Interest from a local bank to the amount of R52 000; and
- R20 000 dividends from Chips (Pty) Ltd on 31 March 2012.

QUESTION 1 (continued)**7. House donated to his daughter**

On 25 November 2012 he donated his primary residence in Johannesburg to his only child, Niknaks. Niknaks divorced her husband in May 2012 and had to find a home for her and her children.

Mr Simba Chips bought himself a unit in a retirement village in June 2012 and moved to his new home on 1 December 2012.

The following information relates to the donated property:

He bought the house on 1 November 2006 for R1 200 000 (including all costs). The market value of the property was R3 200 000 on the effective date of donation. The valuations were obtained from his bank at no charge.

8. Shares sold

On 1 April 2012 Mr Simba Chips sold his 10% share, comprising of 10 000 shares of R1 each, in Chips (Pty) Ltd to the management of Chips (Pty) Ltd in terms of a management take-over scheme, at the market value of R60,40 a share. These shares were allotted to him at R1 a share in November 2004. The market value thereof on the date he had exercised his option to buy the shares was R50 a share and in terms of the option he only paid R2 a share. He was taxed in terms of section 8A in 2006 on the market value of the shares (on the date he exercised his option) less the amount he paid for the shares. At the end of the year of assessment Mr Simba Chips now only holds the 100 shares in Chips (Pty) Ltd, which was allotted to him in terms of the broad-based employee share plan (refer to note 4).

9. Assessed capital loss brought forward

An assessed capital loss of R6 000 was carried forward to the 2013 year of assessment. The assessed loss does not include any transactions with a connected person.

10. Donation to public benefit organisation

He made a cash donation of R10 000 on 15 February 2013 to a registered public benefit organisation. He obtained the required section 18A receipt.

11. Medical cost paid by Mr Simba Chips

Mr Simba Chip's only paid the contributions of R1 200 a month which were deducted by his employer from his salary and paid over on his behalf to the medical aid scheme (refer to note 3) as well as R2 600 for an eye test and a pair of spectacles during the 2013 year of assessment.

12. Information regarding employees' tax for February 2013

Mr Simba Chips received the following salary and benefits for February 2013 and the company only deducted his own medical contribution of R1 200 a month to his own medical aid scheme:

	R
Salary	40 000,00
Travelling allowance	15 000,00
Reimbursive travelling allowance at R2 a kilometre (R2/km x 1 369 km)	2 738,00
Medical benefits at market value (R170 per visit and R125,40 for medication (refer note 3))	295,40

QUESTION 1 (continued)

REQUIRED		Marks
(a)	Calculate the donations tax, if any, payable in respect of the only two donations made by Mr Simba Chips. (Refer to notes 7 and 10.)	4
(b)	Calculate Mr Simba Chips' taxable income for the year of assessment ending 28 February 2013.	33
(c)	Calculate Mr Simba Chips' balance of remuneration earned from Chips (Pty) Ltd for employees' tax purposes in respect of February 2013. (Refer to note 12.)	5
(d)	Calculate the total employees' tax for the year of assessment ending 28 February 2013 that the pension fund and the retirement annuity fund had to deduct from the pension and the annuity payments respectively. (Refer to note 5.)	5
TOTAL MARKS		47

QUESTION 1 - SUGGESTED SOLUTION
--

(a) Donations' tax payable by Mr Simba Chips

The cash donation of R10 000 to an approved PBO is exempt from donations tax in terms of section 56(1)(h). (1)

House donated to daughter is a donation at market value
 R3 200 000 – R100 000 (annual exemption) (2)
 = R3 100 000 x 20% (1)
 = R620 000 donations tax payable

[4]

(b) Taxable income of Mr Simba Chips for the 2013 year of assessment

	R	R	
Salary (R40 000 x 12)		480 000	(1)
Fringe benefit - use of company car (R450 000 x 3,5% x 4 months)		63 000	(1)
Fringe benefit - acquisition of car at less than market value (R380 000 - R323 000)		57 000	(1)
Fringe benefit – medical aid fund contributions. No fringe benefit as employer did not contribute anything.		-	
Fringe benefit - Medicine (R87,78 x 100/114 x 12 months)		924	(1)
In terms of paragraph 12B(3)(c) no value will be placed where the employer renders the medical services to its employees in general at the place of work for the improved performance of their duties (or to employees entitled to the over 65 rebate). The medicine is however not regarded as a medical service.		Nil	(1)
Shares allotted in a broad based employee share plan (s 8B)	6 400		(1)
<u>Less: Exempt (s 10(1)(nC))</u>	(6 400)	Nil	(1)
Pension received from late wife's pension fund		65 000	(1)
Annuity received from retirement annuity fund		300 000	(1)
Foreign dividend received from CIS in securities	1 700		(1)
Less: Section 10B(3)(b) exemption – 30/40 x R1700	(1 275)	425	(1)
Local dividend received from CIS in securities	17 200		
<u>Less: Exempt (s 10(1)(k)(i))</u>	(17 200)	Nil	(1)
Local interest received	52 000		
<u>Less: Exempt (s 10(1)(j)(xv)) R33 000</u>	(33 000)	19 000	(1)
		985 349	
Dividend received from - Chips (Pty) Ltd	20 000		
<u>Less: Exempt (s 10(1)(k)(i))</u>	(20 000)	Nil	(1)

QUESTION 1 – SUGGESTED SOLUTION (continued)

	R	R	
Travelling allowance: R15 000 x 8	120 000		(1)
Reimbursive allowance: 13 168 km x R2/km	26 336		(1)
	<u>146 336</u>		
<u>Less:</u> Used for business purposes:			
Fixed cost: R380 000 (market value includes VAT)			
<u>R 105 809</u> x 244/365	397,51c		
17 794 km			(1)
Fuel	119,30c		
Maintenance	<u>65,20c</u>		
Total deemed cost	<u>582,01c</u>		
<u>Less:</u> 582,01c x 13 168 km (actual km)	<u>(76 639)</u>		(1)
Taxable portion of travelling allowance		69 697	(1)
Taxable Capital Gains:			
<u>Primary residence</u>			
Proceeds - deemed disposal at market value	3 200 000		(1)
Base cost (R1 200 000 + R387 500)	(1 587 500)		(1)
Portion of donations tax which may be included in base cost (R3 200 000 - R1 200 000) / R3 200 000 x R620 000 = R387 500 (refer (a))			(2)
	<u>1 612 500</u>		
<u>Less:</u> Primary residence exclusion	<u>(2 000 000)</u>		(1)
Capital gain	<u>Nil</u>		
<u>Shares</u>			
Proceeds 10 000 x R60,40	604 000		(1)
<u>Less:</u> Base cost 10 000 x R50	<u>(500 000)</u>		(1)
Capital gain	<u>104 000</u>		
Capital gain - primary residence	Nil		
Capital gain – shares	<u>104 000</u>		
Total capital gains	104 000		(1)
<u>Less:</u> Annual exclusion	<u>(30 000)</u>		(1)
Total capital gain	<u>74 000</u>		
<u>Less:</u> Assessed capital loss	<u>(6 000)</u>		(1)
Net capital gain	<u>68 000</u>		
Taxable capital gain (x 33,3%)		<u>22 644</u>	(1)
		1 077 690	
<u>Less:</u> Donations made to public benefit organisation R10 000, but limited to 10% x R1 077 690 = R 107 769 thus actual		<u>(10 000)</u>	(1)
		1067 690	
<u>Less:</u> Medical expense deduction for persons older than 65			
Contributions (R1 200 x 12)	14 400		(1)
<u>Plus:</u> Medical costs paid	<u>2 600</u>	(17 000)	(1)
TAXABLE INCOME		<u>1 050 690</u>	

QUESTION 1 – SUGGESTED SOLUTION (continued)**(c) Balance of remuneration of Mr Simba Chips for February 2013**

	R	
Salary	40 000	(1)
Travelling allowance (R15 000 x 80%)	12 000	(1)
Reimbursive allowance: R2 738 x 0% (received together with travelling allowance, but does not exceed appropriate rate per kilometre fixed by the Minister of Finance (currently 305c per km))	-	(1)
Medical benefit (R87,78 x 100/114)	77	(1)
Remuneration	<u>52 077</u>	
<u>Less:</u> Medical aid fund contributions deductible for persons older than 65	<u>(1 200)</u>	(1)
Balance of remuneration	<u><u>50 877</u></u>	

[5]

(d) Employee's tax to be deducted by the pension fund and the retirement annuity fund

	R	R	
Monthly pension received			
Annual equivalent R65 000 x 12/10		<u>78 000</u>	(1)
Normal tax at 18%		14 040	(1)
<u>Less:</u> Rebates			
Primary	11 440		
Secondary	<u>6 390</u>	<u>(17 830)</u>	(1)
		Nil	
Employees' tax for period (Rnil x 10/12)		<u><u>Nil</u></u>	
Annuity received form retirement annuity fund			
Annual equivalent		<u><u>300 000</u></u>	
Normal tax on R300 000 (R300 000 – R250 000) x 30% + R51 300		66 300	(1)
<u>Less:</u> Rebates (R11 440 + R6 390)		<u>(17 830)</u>	(1)
Employees' tax for year		<u><u>48 470</u></u>	

[5]

QUESTION 2**46 marks**

Virus McAfee, 45 years old, has been ordinarily resident in the Republic since 1 December 2009. Before this date Virus was an Australian resident. Whilst living in Australia, Virus worked at AVG Limited as a marketing and sales manager. When he immigrated to South Africa, AVG Limited agreed to transfer him to the South African branch of their company in Johannesburg. Virus is married out of community of property to Avast and has two children, Karspersky and Norton.

Virus received the following amounts and incurred the following expenses during the year of assessment ended 28 February 2013:

	Note	R
AMOUNTS RECEIVED:		
Basic salary		540 000
Annual bonus – non-pensionable		45 000
Commission – based on his sales		250 000
Free use of motor vehicle	1	?
Loan received	1	200 000
Travel allowance	2	66 000
Subsistence allowance	3	9 400
Long-service award	4	8 000
Use of 3G internet card	5	3 750
Bursary paid to Karspersky	6	15 000
Rent received	8	70 000
Proceeds on sale of residences	8	5 700 000
EXPENSES:		
Acquisition of laptop	5	2 000
Entertainment expenses incurred	7	2 300
Acquisition of new residence	8	3 650 000
Expenses incurred in respect of the residence in Australia	8	28 000
Contributions made to a provident Fund	9	43 200
Contributions made to a Retirement Annuity Fund	9	24 000
Medical expenses	10	45 800

- Virus had the exclusive use of a BMW 320i, a motor car, purchased by AVG Limited for R273 600 (including VAT) on 1 March 2012. He used the motor car for private and business purposes from 1 March 2012 up to 31 March 2012. On 31 March 2012 he purchased the motor car from AVG Limited for R200 000 on an interest-free loan. The market value of the motor car was R240 000 (including VAT) on 31 March 2012. Virus used R20 000 of his bonus that he received on 31 December 2012 to repay part of the loan. This was the only capital repayment made during the year of assessment. On 28 February 2013 AVG Limited informed Virus that they had decided to waive the outstanding amount on the loan due to his exceptional performance during the company's 2013 financial year. AVG Limited was responsible for the payment of all expenditure in relation to the use by Virus of the motor car for the period 1 March 2012 till 31 March 2012.
- From 1 April 2012 up to 28 February 2013, Virus received a travel allowance of R6 000 a month. He used the BMW 320i that he had purchased from AVG Limited (refer note 1 above) to travel in his capacity as marketing and sales manager of AVG Ltd as well as for private purposes.

QUESTION 2 (continued)

He kept an accurate logbook of all his business trips. The vehicle's odometer reading was 35 000 kilometres on 31 March 2012 and 62 000 kilometres on 28 February 2013. The official business kilometres for the 2013 year of assessment were 15 500. Virus decided to use the actual business kilometres travelled during 2013 to calculate the cost of his business travelling. He did not keep accurate records of the actual costs to keep his car on the road.

3. During September 2012, Virus was sent to Cape Town for business purposes for a period of five days and four nights. An advance of R6 400 was paid to him to cover his costs in respect of accommodation, meals and incidental costs. His costs amounted to:

	R
Accommodation	3 200
Meals	815
Incidental costs	285
Total	4 300

Virus could present documentary evidence of all his costs and no amount was refunded to AVG Limited.

During December 2012 Virus was asked to follow up on his previous visit to Cape Town. An advance of R3 000 was paid to him to cover all his costs during his visit of three days and two nights. Virus, however, fell sick and had to postpone his visit to Cape Town. At year-end, the visit had not taken place; neither had he repaid the advance that he received.

4. A set of platinum coins was presented to Virus during a company function held on 15 January 2013. He had just completed an initial period of 18 years of service at AVG Limited. The company paid R8 000 (excluding VAT) for the set of platinum coins. After the function, a colleague of Virus approached him with an offer to purchase the set of platinum coins for R12 000. Virus who experienced a cash flow problem (refer note 8) immediately saw the opportunity to address this problem and agreed to sell the set of platinum coins to his colleague for R12 000. The colleague paid him the amount in cash on 16 January 2013.
5. AVG Limited granted Virus the right to buy a laptop with a market value of R3 000 (excluding VAT) for R2 000 on 1 October 2012. The company trades in computers and the specific computer was purchased as trading stock at a cost of R3 500 (excluding VAT). Virus will use the laptop mainly for purposes of planning his marketing strategies in respect of his duties as marketing manager at AVG Limited. The Commissioner allows a write-off on computers (including laptops) in terms of Practice Note 47 over 3 years on the straight-line method.

Virus was also provided with a 3G internet card giving him access to the internet and the ability to download information (up to 4 gigabytes per month) from 1 October 2012. AVG Limited pays an amount of R750 per month for this service. Virus will use the internet service exclusively for the purpose of research to help him with his duties as marketing and sales manager of AVG Limited.

6. During the 2013 year of assessment, a *bona fide* bursary of R15 000 was awarded to Karspersky (Virus' son) to study at the University of Pretoria.
7. Virus entertained clients and prospective clients of AVG Limited as he saw fit. He spent R2 300 (including VAT) on entertainment during the 2013 year of assessment. Assume that Virus has the invoices to support these expenses. AVG Limited did not reimburse Virus for these expenses.

QUESTION 2 (continued)

8. On the date that Virus and his family immigrated to South Africa, he still owned the following assets:

Assets	Date acquired	Cost price R	Market value on 1 December 2009 (Date of immigration) R
House in Australia – his primary residence up to date of immigration – refer note below	1 December 2003	2 000 000	2 500 000
House in South Africa – acquired as an investment but his primary residence since his arrival in South Africa up to date of disposal – refer note below	1 December 2007	900 000	1 200 000

On 1 September 2012, Virus and his wife Avast were shocked but at the same time overcome with joy, when they were informed by Avast's gynaecologist that she was expecting twins and that her due date was March 2013. They realised that the house that they were living in (refer table above) would be too small for them. Virus immediately contacted estate agents to sell both the houses in Australia and South Africa. Both houses were registered in the names of the new owners on 1 December 2012. A bigger house was acquired on 1 December 2012 for R3 650 000.

The proceeds received on disposal were as follow:

	R
House in Australia	3 500 000
House in South Africa	2 200 000
	5 700 000

Since December 2009 (date of immigration), the house in Australia was let through an agency. For the period 1 March 2012 to 30 November 2012, rental income, the equivalent of R70 000 (before commission the equivalent of R10 000 paid to the letting agent), had accrued to Virus for the letting of the house. Virus spent the equivalent of R18 000 on repairs and maintenance during this period. Assume that no Double Tax Agreement exists between South Africa and Australia and that tax to the equivalent of R10 500 had been paid by Virus in Australia.

9. Virus contributes 8% of his basic salary to the AVG Provident Fund. Apart from his contributions to the Provident Fund, Virus contributed R2 000 a month to a Retirement Annuity Fund.
10. The monthly contribution to the Medibest Medical Aid Fund for Virus, his wife and their two children, amounts to R4 500. For the period 1 March 2012 to 28 February 2013, AVG Limited paid R2 500 per month to the medical aid fund and Virus paid the remaining R2 000. In addition to the contributions to the fund, qualifying medical expenses for Virus and his dependants amounted to R21 800 for the 2013 year of assessment. Virus has proof of payment for the full amount and none of the qualifying medical expenses were recovered from the medical aid fund.

REQUIRED	Marks
Calculate the taxable income of Virus McAfee for the 2013 year of assessment. Show all calculations and where any item has no effect on taxable income, provide reasons. Assume an official interest rate of 7% and round off all amounts to the nearest rand.	46

(UNISA 2008 – adapted)

QUESTION 2 – SUGGESTED SOLUTION
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Taxable income of Virus McAfee for the 2013 year of assessment

Note	R	R	
Basic salary received		540 000	(1)
Annual bonus received		45 000	(1)
Commission received (note: remuneration is not mainly derived in the form of commission)		250 000	(1)
<hr/>			
1	Fringe benefit - free use of motor vehicle (par 2(b) of 7 th Schedule) R273 600 x 3.5% x 1 month		9 576 (2)
	Fringe benefit - vehicle acquired for consideration less than market value (par 2(a) of 7 th Schedule) (R240 000 – R200 000 (section 8(14) of the VAT Act))		40 000 (1)
	Fringe benefit - interest free loan – (par 2(f) of 7 th Schedule) (R200 000 x 7% x 9/12) + (R180 000 x 7% x 2/12)		12 600 (2)
	Fringe benefit - waiver of loan – (par 2(h) & par 13 of 7 th Schedule) (Capital gain determined below together with other capital gains)		180 000 (1)
<hr/>			
4	Fringe benefit - long service award - (par 2(a) of 7 th Schedule) Cost to AVG Limited of platinum coins (par 5(2) of 7 th Schedule) <u>Less:</u> (par 5(2)(b) of 7 th Schedule) (Capital gain determined below together with other capital gains)	8 000 <u>(5 000)</u>	 3 000 (1)
<hr/>			
5	Fringe benefit - laptop (trading stock) acquired at less than actual value (par 2(a) & 5(2) of 7 th Schedule) Trading stock – market value less than cost, thus market value - (par 2(a) & 5(2) of 7 th Schedule) <u>Less:</u> Consideration - (par 5(1) of 7 th Schedule)	3 000 <u>(2 000)</u>	(1) (1)
	Fringe benefit - 3G card – free services - (par 2(e) of 7 th Schedule) A telephone or computer communication service has a nil value if used mainly for employer's business - (par 10(2)(bA) of 7 th Schedule)		- (1)
<hr/>			
6	Bursary to relative of employee No section 10(1)(g) exemption as Virus received remuneration exceeding R100 000 during the year of assessment		15 000 (1)
<hr/>			

QUESTION 2 – SUGGESTED SOLUTION (continued)

8	Rent received (resident taxed on world-wide income – gross income definition) <u>Less:</u> Commission to letting agent Repairs and maintenance Taxable income from rent received	R 70 000 (10 000) (18 000) <hr/> 42 000	R 42 000	(1) (1) (1)
10	Fringe benefit - medical contributions (par 12A of 7 th Schedule) (R2 500 x 12)		30 000	(1)
<hr/> <u>Less: expenses and deductions</u>				
5	Acquisition of laptop Acquisition is a capital expense. Consider section 11(e) allowance. Section 11(e) allowance is available in terms of section 23(m) as remuneration is not mainly derived in the form of commission. Section 11(e) based on value. Value (R2 000 + R1 000 = R3 000) < R7 000, thus write off in full to R1.		(2 999)	(1)
7	Entertainment expenses Section 23(m) is applicable, therefore no deduction is available.		-	(1)
8	Acquisition of new residence – capital expense Expenses in respect of residence in Australia – dealt with above		-	
9	Contributions to provident fund – not deductible. (Note that basic salary will be retirement funding income (RFI)) INCOME		-	(1)
			1 165 177	
9	Less: RAF contributions Actual = R24 000, limited to the greatest of: R1 750; or R3 500 – R0 = R3 500; or 15% x (R1 165 177 – R540 000 (RFI)) = R93 777, limited to actual. Portion not deducted during this year may be carried forward to the following year of assessment.		(24 000)	(2)
			1 141 177	
1,4 & 8	Taxable capital gains <i>Waiver of loan:</i> Proceeds <u>Less:</u> Included in taxable income – (par 2(h) of 7 th Schedule) <u>Less:</u> Base cost Capital gain <i>Platinum coins:</i> Proceeds <u>Less:</u> Base cost (R8 000 – R5 000) – see 4 above. Capital gain	180 000 (180 000) - <hr/> - <hr/> - 12 000 (3 000) <hr/> 9 000		(1) (1) (1) (1)

QUESTION 2 – SUGGESTED SOLUTION (continued)

	R	R	
<i>Residence – Australia:</i>			
Proceeds	3 500 000		
<u>Less: Base cost – market value on date of immigration</u>	<u>(2 500 000)</u>		
Capital gain	<u>1 000 000</u>		(1)
 <i>Residence – South Africa:</i>			
Proceeds	2 200 000		
<u>Less: Base cost – cost on date of acquisition</u>	<u>(900 000)</u>		
	1 300 000		(1)
<u>Less: Primary residence for 3 out of 5 years</u>	<u>(780 000)</u>		(1)
Capital gain	<u>520 000</u>		
 Part held as primary residence	780 000		
<u>Less: Primary residence exclusion R 2 000 000 limited to</u>	<u>(780 000)</u>		(1)
	<u>-</u>		
 Aggregate capital gain (R9 000 + R1 000 000 + R520 000)	1 529 000		
<u>Less: Annual exclusion</u>	<u>(30 000)</u>		(1)
Net capital gain	<u>1 499 000</u>		
 Inclusion rate 33,3%		499 167	(1)
		<u>1 640 344</u>	

2	Travel allowance received – (section 8(1)(b))			
	<i>Actual business kilometres – 15 500km</i>			
	<i>Total kilometres travelled 62 000 – 35 000 = 27 000km</i>			
	<i>Actual expenses - not available – use deemed cost</i>			
	<i>Determined value: R240 000 (market value as not an arm's length transaction) - (Table of rates – Government Gazette)</i>			(1)
	Fixed cost: $R79\,185/27\,000 \times 335/365$	269.17c		(1)
	Fuel cost	102.70c		(1)
	Maintenance cost	45.20c		(1)
	Total cost per km	<u>417.07c</u>		
	 Travel allowance received (R6 000 x 11)	66 000		
	<u>Less: Business expenses – 15 500km x 417.07c</u>	<u>(64 646)</u>	1 354	(1)
			<u>1 641 698</u>	

3	Subsistence allowance – section 8(1)(c)			
	<i>September 2012:</i>			
	Allowance received	6 400		
	<u>Less:</u>			
	Accommodation – actual cost	(3 200)		(1)
	Meals and incidental cost (5 x R303) – (R303 allowed per day or part of a day) (R1 515: more than actual of R1 100)	<u>(1 515)</u>		(1)
	Unexpended portion of allowance	<u>1 685</u>	1 685	

QUESTION 2 – SUGGESTED SOLUTION (continued)*December 2012:*

Virus has not by the last day of the end of the month following the payment of the allowance spent a night away from his usual place of residence or paid the allowance back to AVG Limited, therefore it will be deemed that he has received a payment for services rendered and not a subsistence allowance – (proviso subparagraph (bA) of the definition of “remuneration” in the Fourth Schedule)

R

R

		3 000	(1)
		<u>1 646 383</u>	
10	Medical expense deduction:		
	Contributions to medical aid fund – fringe benefit	30 000	(1)
	<u>Plus:</u> Contributions to medical aid fund - own contributions	24 000	(1)
	<u>Less:</u> 4 x section 6A credit		
	(R460 + R154 + R154) x 12 = R9 216 x 4	<u>(36 864)</u>	(2)
		17 136	
	<u>Plus:</u> Qualifying medical expenses incurred	<u>21 800</u>	(1)
		38 936	
	<u>Less:</u> 7.5% x R1 646 383	<u>(123 479)</u>	(1)
	Taxable income	<u><u>1 646 383</u></u>	[46]

QUESTION 3**62 marks**

Alistair Murphy studied medicine and qualified as a general practitioner (GP). He then worked abroad for two years to enable him to repay his study debt of R180 000. On his return to South Africa he took up employment at a hospital where he worked for 15 years. With the approval of the hospital he also performed some locum (contract) work for a GP.

When the GP reached retirement age, he offered to sell his practice to Dr Murphy, who was 44 years old at that stage. The terms of the agreement between Dr Murphy and the practitioner were that Dr Murphy would register as a vendor for value-added tax (VAT) and acquire the practice of the GP on 1 March 2001 as a going concern in his own name.

The following values were agreed between Dr Murphy and the GP:

	R
Goodwill	600 000
Debtors	165 000
Office and medical equipment	75 000
Residential property (60% utilised as consulting rooms)	1 250 000
Total purchase consideration (VAT included at 0%)	2 090 000

In terms of the agreement Dr Murphy paid the goodwill portion of the purchase price off over a period of five years, the outstanding debtor amounts were paid once collected and Dr Murphy financed the balance of the purchase consideration by raising a bond over the property.

Dr Murphy transferred the accumulated benefit of his pension fund to an approved pension preservation fund when he resigned from his employment at the hospital in 2001.

The accruals and expenses of Dr Murphy for the period 1 March 2012 to 28 February 2013 and the period 1 March 2013 to 30 April 2013 were as follows:

Details	12 months ended 28 February 2013	2 months ended 30 April 2013
	Excluding VAT levied	Including VAT levied (where applicable)
	R	R
Professional fees received	3 200 000	558 201
The annual value of professional fees received has been in excess of R2 500 000 since 2010. The amount excludes the overpayments and fees for Zambian medical services (see below).		
Overpayment by funds and/or patients	10 000	
Overpayments arise regularly when patients pay an account that the medical scheme subsequently also pays directly to Dr Murphy. Dr Murphy's staff is normally able to identify the particular patient and a refund is generally made within a period of two months after the date of receipt.		

QUESTION 3 (continued)

Details	12 months ended 28 February 2013	2 months ended 30 April 2013
	Excluding VAT levied R	Including VAT levied (where applicable) R
In December 2012 Dr Murphy received an overpayment of R11 400 (including VAT), but his accountant was unable to identify the patients to whom this amount related. The patients to whom refunds were due were identified in May 2013 and the amounts were refunded in that month.		
Fees for Zambian medical services Dr Murphy occasionally provides medical services in Zambia. In November 2012 he spent a week in Zambia and received US \$2 500 for services performed there (spot rate on transaction date = R7,47687). South Africa has sole taxing rights on this amount in terms of a double tax agreement with Zambia. Dr Murphy did not elect to apply the average exchange rate. <ul style="list-style-type: none"> • The amount (US \$2 500) converted at spot rate • The amount converted at the bank rate (realised value) • Exchange difference 		
Fees from public benefit organization Dr Murphy also offers his services to an approved local public benefit organisation free of charge. These services are rendered in January of each year. If Dr Murphy charged his normal rates for these services, he would have been entitled to an amount of R5 700.	0	
Interest received	112 500	12 500
Assets used for trade purposes <ul style="list-style-type: none"> • Computer equipment: Acquired and brought into use on 1 May 2012 at a cost of R6 000 plus VAT of R840 • Generator: Acquired and brought into use on 1 June 2010 at a cost of R36 000 plus VAT of R5 040 <p>Interpretation Note 47 allows for a three-year write-off period on computer equipment and five years on generators.</p>		
Municipal account on Dr Murphy's residential property <ul style="list-style-type: none"> • Property rates • Water, electricity and sanitation <p>In terms of a binding private ruling obtained by Dr Murphy he is entitled to claim 60% of the monthly input tax on this account. The balance is considered to be for private use and not acquired for purposes of making taxable supplies.</p>	50 400 39 000	8 700 7 926

QUESTION 3 (continued)

Details	12 months ended 28 February 2013	2 months ended 30 April 2013
	Excluding VAT levied R	Including VAT levied (where applicable) R
Communication expenses	45 600	
Office and cellular phone (96% of the calls were for business purposes)		
Conferences and staff training expenses		
Dr Murphy spent R12 000 on training of staff and recovered R8 000 from the Skills Fund.	12 000 8 000	
Locums (contractors)	120 000	
Dr Murphy makes use of locum GPs when he is on leave or working in Zambia. These doctors are all independent practitioners and invoiced Dr Murphy for the services rendered. None of these GPs are VAT vendors.		
Medical supplies		
Dr Murphy used these medical supplies in his medical practice and procured them from a single supplier who sold them to him at a discount of 20% on their market value.		
<ul style="list-style-type: none"> Total expense incurred on acquisition of medicines Supplies on hand at year end – valued at cost 	55 000 22 000	7 980
Insurance expenditure		
<ul style="list-style-type: none"> Office and medical malpractice Personal life 	68 000 32 000	13 680
Staff related costs		
15% of the approved remuneration may be used for the deduction in terms of section 11(l)		
<ul style="list-style-type: none"> Salaries paid to staff members (net of amounts below) Contributions to medical scheme Retirement annuity fund contributions paid by Dr. Murphy on behalf of his staff members Unemployment insurance fund contributions (UIF) – the employer's contribution Employees' tax Skills development levies (SDL) 	800 000 216 000 80 000 8 000 144 000 8 000	
Retirement annuity	150 000	12 000
Dr Murphy's contributions to a South African retirement annuity fund for himself. An amount of R220 000 was not allowed as a deduction in previous years. You may assume that the R12 000 will be allowed as a deduction in terms of section 11(n) in the 2014 year of assessment.		

QUESTION 3 (continued)

Details	12 months ended 28 February 2013	2 months ended 30 April 2013
	Excluding VAT levied R	Including VAT levied (where applicable) R
<p>Retirement funding</p> <p>Dr Murphy and his wife had always intended to move to the coast when he reached normal retirement age on 1 May 2013. While they were on their annual holiday, they made an offer to purchase a residence. The offer was accepted.</p> <p>The total price of the residential property (inclusive of transfer duty) was R2 750 000 and was paid on 12 February 2013, the day of the transfer.</p> <p>To finance this he withdrew an amount of R950 000 from his pension preservation fund on 1 February 2013.</p> <p>The balance of the purchase price was funded from his savings.</p>		
<p>Sale of medical practice</p> <p>After 28 February 2013 Dr Murphy put his practice up for sale and received an offer from a newly qualified GP with an effective date of 30 April 2013, which he accepted. As the transaction met all the requirements of section 11(1)(e) of the VAT Act, the total purchase consideration included VAT at a rate of 0%.</p> <p>The purchase price was allocated as follows:</p> <ul style="list-style-type: none"> • Goodwill: The goodwill was valued at R900 000 on 1 October 2001 and Dr Murphy will adopt this value as his valuation date value for capital gains tax (CGT) purposes • Accounts receivable: The accounts receivable comprise trade debtors, which were not transferred. The new GP will pay the amounts collected over to Dr. Murphy as they are collected • Computer, office and medical equipment (sold for less than original cost) • Generator • Residential property (60% utilised as consulting rooms) not valued on 1 October 2001 (assume that the section 18A output adjustment on acquisition equaled the section 16(3)(h) input adjustment on the sale of the property). The TAB value of the residential property amounted to R1 637 500. • Medical supplies 		<p>750 000</p> <p>450 000</p> <p>120 000</p> <p>30 000</p> <p>2 800 000</p> <p>14 000</p>

QUESTION 3 (continued)

Details	12 months ended 28 February 2013	2 months ended 30 April 2013
	Excluding VAT levied R	Including VAT levied (where applicable) R
Lump-sums On 1 May 2013 Dr Murphy retired from both retirement funds and received the following: <ul style="list-style-type: none"> • From the pension preservation fund, a lump sum of R20 000 and a monthly pension of R10 000. • From the retirement annuity fund, a lump sum of R1 100 000. Two-thirds of the amount received from the fund was used to acquire a living annuity in terms of which Dr Murphy will receive a monthly annuity of R40 000. 		

Dr Murphy did not have any assessed capital loss carried forward from the 2012 year of assessment.

REQUIRED		Marks
(a)	Calculate (supported with reference to legislation) Dr Murphy's normal tax liability for the year of assessment ended 28 February 2013. Where you are of the opinion that an accrual or expense has no tax effect, provide brief reasons to support your answer.	35
(b)	Calculate Dr Murphy's tax due on the withdrawals from the retirement funds for the 2014 year of assessment. Assume that the legislation for the 2014 year of assessment will be the same as that of the 2013 year of assessment.	8
(c)	Calculate the capital gain or loss resulting from the sale of goodwill and the residential property when Dr Murphy sold his medical practice.	8
(d)	Calculate the VAT due to the South African Revenue Service in respect of the tax period 1 March 2013 to 30 April 2013. Assume that the legislation for the 2014 year of assessment will be the same as that of the 2013 year of assessment. Your solution should include brief reasons for the inclusion / exclusion of accruals or expenses from the VAT calculation, even in instances where there is no tax effect.	11
Total marks		62

(SAICA 2011 QE1 Paper 1 Question 1 - adapted)

QUESTION 3 – SUGGESTED SOLUTION
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(a) Dr. Murphy's normal tax liability for the 2013 year of assessment				
	Reason	R	R	
Professional fees	"Gross income" (s 1)		3 200 000	(1)
Overpayment by funds / patients	Not "Gross income" (s 1) - not received or accrued, not for own benefit (Geldenhuys/MP Finance)		0	(1)
Income earned in Zambia:				
- Realised on transaction date	S 25D - at spot rate on transaction date		18 692	(1)
- Exchange rate loss	Exchange loss - no section 24I where a natural person does not hold the item as trading stock.		0	(1)
Work done for PBO	Not "Gross income" (s 1) - no amount received or accrued		0	(1)
Interest received	"Gross income" (s 1)	112 500		(1)
Less: Interest exemption	Section 10(1)(j)(ii)	(22 800)	89 700	(1)
Computer	S 11(e) - less than R7 000		(5 999)	(1)
Generator - over 5 years	S 11(e) - R36 000/5		(7 200)	(1)
Municipal rates and taxes	S 11(a), s23(g) and s23(a):			
	60% business use - 60% x R50 400		(30 240)	(1)
Electricity	60% business use - 60% x R39 000		(23 400)	(1)
Office and cellular phone	S 11(a) - R45 600 x 96% (Note: you could have argued that the 4% non-business use is incidental and consequently deducted the full amount of R45 600.)		(43 776)	(1)
Training of staff	S 11(a)		(12 000)	(1)
Skills claim	"Gross income" (s 1)		8 000	(1)
Locums	S 11(a)		(120 000)	(1)
Medical supplies:				
- Cost of acquisition	S 11(a)		(55 000)	(1)
- Closing stock	S 22(1)		22 000	(1)
Insurance - office and malpractice	S 11(a)		(68 000)	(1)
Insurance - personal	Personal expense: s 11(a) read with s 23(a) and s 23(b)		0	(1)
Salaries paid to staff members	S 11(a)	800 000	(800 000)	(1)
RAF contributions paid on behalf of staff	S 11(a)	80 000	(80 000)	(1)
Employees' tax	S 11(a)	144 000	(144 000)	(1)
Contributions to medical scheme	S 11(a)	216 000	(216 000)	(1)
"Approved remuneration"		1 240 000		(1)
Section 11(l) adjustment i.r.o. medical scheme	S 11(l) limited to: 15% x R1 240 000 (thus R216 000 – R186 000 = R30 000)	186 000	30 000	(1)
UIF contributions	S 11(a)		(8 000)	(1)

QUESTION 3 – SUGGESTED SOLUTION (continued)

		R	R	
Skills development levies (SDL)	S 11(a)		(8 000)	(1)
Lump sum inclusion	Par (e) of gross income def. - keep in separate column	950 000		(1)
Taxable income from practice			1 746 777	
RAF contributions:	S 11(n)			
- Carried forward from previous year		220 000		(1)
- Current contributions		150 000		(1)
Limited to greater of:		370 000		
R1750	R1 750			
(R3 500 - R0)	R3 500			
R1 746 777 x 15% (See Note)	R262 017	(262 017)	(262 017)	(1)
Carried forward to the next year (R370 000 – R262 017)	*	107 983		
Taxable income			1 484 760	
Normal tax thereon (See Note)	$R178\,940 + [(R1\,484\,760 - R617\,000) \times 40\%]$		526 044	(1)
Rebates	S 6		(11 440)	(1)
Tax payable			514 604	
Lump sum withdrawal benefit		950 000		
Contributions net yet deducted	*	(107 983)		(1)
Net		842 017		
Tax on withdrawal benefit	$R103\,950 + (27\% \times (R842\,017 - R600\,000))$		169 295	(1)
Total normal tax liability			683 899	
				[35]



Note that the lump sum of R950 000 must be excluded.

(b) Dr. Murphy's tax due on withdrawals from retirement funds for the 2014 year of assessment

		R	
Lump-sum withdrawal benefit received		950 000	(1)
Lump-sum received from preservation fund		20 000	(1)
Note: the annuities are included in normal gross income			
Lump-sum received from retirement annuity fund		1 100 000	(1)
Contributions not previously allowed - See Part (a) for calculations 11(n)		(107 983)	(1)
		1 962 017	
Tax thereon	$= R141\,750 + 36\% \times (R1\,962\,017 - R945\,000)$	507 876	(2)
Tax on previous withdrawal	$= R56\,700 + 27\% \times (R842\,017 - R630\,000)$	(113 945)	(2)
Tax on withdrawal benefits		393 931	
			[8]

QUESTION 3 – SUGGESTED SOLUTION (continued)

(c) Capital gain or loss resulting from the sale of goodwill and the residential property			
	Reason	R	
Goodwill:			
- Proceeds	Par 35	750 000	(1)
- Base cost limited to proceeds	R900 000 limited to R750 000, par 26(3)	(750 000)	(2)
		0	
House:			
- Proceeds	Par 35	2 800 000	(1)
- Base cost (TAB) par 30	Higher of:		(1)
	- MV on 1/10/2001: Not provided		(1)
	- 20% x proceeds = R560 000		(1)
	- TAB – R1 637 500	(1 637 500)	(1)
		1 162 500	
			[8]

(d) VAT due to SARS for the VAT period 1 March 2013 to 30 April 2013				
	Reason	Total amount	VAT amount	
		R	R	
Output tax				
Professional fees	Standard rated supply	558 201	68 551	(1)
Overpayments	Lapse of 4 months in VAT period result in output tax (s 8(27))	10 000	1 400	(2)
Interest received	Exempt supply / Financial service / not in furtherance of enterprise	0		(1)
Going concern sale - include trading stock	S 11 (1)(e), zero-rated supply	0		(1)
Input tax				
Municipal rates and taxes	Zero rated supply	0	0	(1)
Electricity	S 16 input tax (R7 926 x 60% x 14/114)	7 926	(584)	(1)
Medical supplies	S 16 input tax	7 980	(980)	(1)
Insurance	S 16 input tax	13 680	(1 680)	(1)
Retirement annuity	Personal, not in furtherance of enterprise (not a taxable supply)	0	0	(1)
Adjustment on personal residence:				
- The acquisition of the property was a zero rated supply and Alistair had to do a section 18A adjustment				
- This can now be claimed - S 16(3)(h) [1 250 000 x 40% x 14/114]				
			(61 404)	(1)
Amount due			(5 303)	
				[11]

QUESTION 4**37 marks**

You are an articled clerk, employed in the tax department of ABC Auditors. On 30 September 2013, your audit partner handed you the file of Dr BJ Botha.

The file consists of financial statements, various notes as well as tax and legal documents. The partner asked you to carefully read through the various documents and to draw up your reply to the queries of Dr Botha.

The Botha family are all residents for South African tax purposes, except where specifically stated otherwise.

Part 1: Divorce of Dr and Mrs Botha**9 marks**

On 26 February 2013, Dr Botha (52 years old) and Mrs Botha (50 years old) were divorced after 27 years of marriage, on grounds of irreconcilable differences. They were married out of community of property. They have two unmarried sons: William (25 years old and working full-time as a motor car dealer) and Nicholas (14 years old and attending boarding school at Grey College, Bloemfontein). Dr Botha is a medical doctor and an astute businessman with interests in various investments, trusts and businesses. Mrs Botha has been a housewife for the past 27 years.

The following information was extracted from the final divorce order (made by the Order of the High Court on 26 February 2013):

1. Dr Botha is a member of and contributes only to the Midas Retirement Annuity Fund. Mrs Botha is entitled to a once-off lump-sum payment equal to one third of the surrender value of the Midas Retirement Annuity Fund, payable out of the minimum individual reserve available in the fund. Total surrender value of the fund was R3.9 million on 26 February 2013. This amount is not at all related to the maintenance obligation of R25 000 per month (refer to point 3 below). Mrs Botha duly elected that she will become a member of the fund and that the amount due would remain in the Midas Retirement Annuity Fund (RAF). Neither Dr Botha nor Mrs Botha has ever received any lump sum from any retirement fund. The normal retirement age for the Midas Retirement Annuity Fund is the date on which a member attains the age of 55 years of age.
2. Mrs Botha will be entitled to their primary residence in Sandton (market value of R4.8 million on 26 February 2013), held by BJ Botha (Pty) Ltd.
3. Mrs Botha will be paid a monthly amount (alimony) of R25 000 for 36 months as final settlement of any other claims. This amount will be paid directly by Dr Botha and will not be a deduction from the minimum individual reserve of the Midas Retirement Annuity Fund.

REQUIRED	Marks
Discuss the following:	
(a) The normal tax implications of the transfer of one third of the surrender value of the RAF to Mrs Botha, arising from note 1, for both Dr and Mrs Botha, for their 2013 years of assessment;	6
(b) The normal tax implications, arising from note 3, for both Dr and Mrs Botha, regarding the payment of the alimony to Mrs Botha.	3

QUESTION 4 (continued)**Part 2: Medical Practice of Dr. Botha****28 marks**

Dr Botha is one of the four partners of Health and Wellness, a medical practice (a registered VAT vendor) that provides medical services and health advice to the general public. The partners share profits and losses equally but each partner is firstly paid a monthly salary in line with services rendered. The partnership agreement also provides for the payment of interest (at prime rate less 2%) to partners on amounts owing to partners and payment by partners at prime rate (9% for the 2013 year of assessment) on loan account owed by partners.

Part of their business is a flourishing practice in Armenia. There is currently no double tax agreement in place between Armenia and the RSA. Partners take turns to manage the practice on a rotating basis.

The following is an extract from the pro-forma Statement of comprehensive income for the partnership for the year ended 28 February 2013 (all amounts exclude VAT unless specifically stated otherwise):

	Notes	R	R
Medical fees received (Locally)			8 148 290
Net profit from medical practice situated in Armenia (correctly translated to Rands)	1.		6 456 210
Interest received from money market account (RSA)			230 000
Dividends received from MEDINVEST Plc (after deducting 10% withholding tax)	2.		396 000
Interest received on capital accounts	3.		90 000
Total income			15 324 500
Less:			
Operating expenses (all tax deductible)		6 129 800	
Compensation paid	4.	1 000 000	
Personnel cost	5.	366 000	
Salaries of partners	6.	2 220 000	
Interest on capital account	7.	34 000	
Donations	8.	120 000	(9 869 800)
Net profit			5 454 700

Notes

- The partnership paid R80 000 for a air ticket and accommodation for the former wife of Dr Botha, who visited him in Armenia, in a desperate attempt to rescue their marriage. This amount was deducted from the net profit from the medical practice situated in Armenia. All other expenses included in the net profit from the medical practice situated in Armenia, were tax deductible in terms of the RSA Income Tax Legislation.
- In 2011, the four partners decided to invest R750 000 each, offshore. They consequently invested in MEDINVEST Plc (formed and incorporated outside South Africa and its place of effective management is outside South Africa). 60% of the shares of MEDINVEST Plc are held by South African residents. The company is not a foreign business establishment. The partners each hold 15% of the equity share capital of MEDINVEST Plc. MEDINVEST Plc has a net income of R2 500 000, calculated in terms of the South African Income Tax Act (none of it is from a South African source), for the financial year ended 28 February 2013.

QUESTION 4 (continued)

3. The following interest was received on amounts owing by partners:

- Dr MN Mans R40 000
- Dr BJ Botha R50 000

The loan accounts are in debit due to the partnership paying the private expenses for the above-mentioned doctors.

4. A patient, Mrs WA Kloof was badly burned by a botched laser technique as a result of negligence. The partners settled out of court to save their good name as well as that of the practice and paid an amount of R1 million immediately. The partners were insured but are still waiting for the R1 million pay-out from the insurance company.
5. The partners provided their 10 employees with Blue Bulls T-shirts, free of charge, to wear to rugby games and on every Friday prior to a match. The partners paid R600 (including VAT) for each T-shirt. The expenditure (excluding VAT) was included in the personnel costs and thus deducted from income. The partners bought their own T-shirts and paid out of their own pockets.
6. The three senior partners (Drs MN Mans, BJ Botha and TJ Velse) each earn a monthly salary of R50 000 while the junior partner, SL Oppy (who was also responsible for the burns suffered by Mrs WA Kloof), earns R35 000 per month.
7. Interest paid on amounts due to partners are as follows:
- Dr TJ Velse..... R12 000
 - Dr SL Oppy..... R22 000
8. The partnership made a donation of R100 000 to “Doctors without Borders”, an approved public benefit organisation. The partnership duly received a section 18A receipt. The balance of R20 000 was donated to the beautiful daughter of the receptionist, Cindy Relly, to enable her to pay for her ticket and accommodation to New York to participate in the La Belle modelling competition.

REQUIRED	Marks
(a) Calculate the amount, in respect of the Health and Wellness partnership that should be included in the taxable income of Dr Botha for his 2013 year of assessment. Consider only the income accrued/received from the partnership and commence your answer with the R8 148 290 medical fees received by the partnership.	17
(b) Explain to the partners all the tax implications (if any), for the partnership and the employees of the Blue Bulls T-shirts provided to the employees (refer to note 5). Assume that the provision of Blue Bull T-shirts will not be “entertainment” as defined in the VAT Act.	6
(c) Dr Botha paid his first and second provisional tax payments for the 2013 year of assessment on time, estimated on his basic amount of R1 500 000 (his taxable income for the 2012 year of assessment (for both payments)). On 31 July 2013, you estimated that his taxable income for the 2013 year of assessment to be R2 400 000. Discuss if any penalties will be levied by SARS on the under-estimation of his income. Assume that no additional administrative penalties will be levied under section 75B.	5

(UNISA 2010 – adjusted)

QUESTION 4 – SUGGESTED SOLUTION
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Part 1: Divorce order**(a) Transfer of 1/3 of surrender value of RAF**

- Section 7(11) will not apply as the amount is not a maintenance liability, which is specifically excluded from the definition of a 'lump sum benefit' in the Second Schedule. (1)
- In terms of par 2(1)(b)(iA) of the Second Schedule the lump sum from the RAF is a withdrawal benefit in the hands of Mrs. Botha. (1)
- The value must be determined in terms of the Second Schedule and be included in gross income of Mrs. Botha in terms of the gross income definition in section 1 of the Income Tax Act (par (e)).
R3.9m x 1/3 = R1.3m. (1)
- The amount that must be included is the amount i.t.o the divorce order less deductions permitted in par 6 of the Second Schedule. (1)
- Dr Botha is the member of the fund but because the RAF transfer takes place on/after 1/3/2009 it will not be taxed in the hands of Dr. Botha. (1)
- Par 6 of the Second Schedule allows a deduction for the amount that is transferred to another similar RAF or stricter fund. As the amount is transferred to the same RAF, no amount will be taxed under the Second Schedule. R1.3m less R1.3m = Rnil. (1)
- In terms of par 54 of the Eighth Schedule a person must disregard capital gains and losses in respect of a disposal of a lump-sum benefit as defined in the Second Schedule. (1)

Max $\frac{7}{6}$

(b) Maintenance paid to Mrs. Botha

- In terms of par (b) of the definition of gross income the R25 000 per month alimony should be included in the gross income of Mrs. Mary-Jane Botha. (1)
- The maintenance (alimony) will however be exempt in terms of sec 10(1)(u). (1)
- Dr. BJ Botha will not be allowed any deduction in terms of section 11(a) read together with sections 23(a) and 23(b) for the maintenance paid to his ex-wife because it is not incurred in the production of income and it is a private expense (after 1962 ,thus section 21 not applicable) (1)

3

QUESTION 4 – SUGGESTED SOLUTION (continued)**Part 2: Taxable income of Dr. BJ Botha from the Health and Wellness partnership****(a) Partnership income**

	R	
Medical fees: Locally	8 148 290	(1)
Foreign income R6 456 210 + R80 000 (being a private/domestic expense)	6 536 210	(2)
Interest from money-market account – to partner's account	-	
Dividend received from MEDINVEST Plc – to partner account	-	
Interest received on loan account.....	90 000	(1)
	<u>14 774 500</u>	
Less: Operating expense	(6 129 800)	
Compensation paid (capital in nature)	-	(1)
Personnel cost (section 11(a)).....	(366 000)	(1)
Salaries of partners	(2 220 000)	(1)
Interest paid on capital account.....	(34 000)	(1)
	<u>6 024 700</u>	
Donation: to partners to deduct	-	
	<u><u>6 024 700</u></u>	
Each partner received 25%, thus R6 024 700 x 25% =.....	<u><u>1 506 175</u></u>	(1)
Amounts which needs to be included in the taxable income of Dr. BJ Botha		
Profits from partnership	1 506 175	(1)
Interest from money-market account (25% x R230 000).....	57 500	(1)
Exempt in terms of section 10(1)(i)(xv) – if not already utilised.....	(22 800)	(1)
MEDINVEST Plc: Foreign dividend received (25% x R440 000 (100/90 x R396 000))	110 000	(2)
Exempt: sec 10B(2)(a).....	(110 000)	(1)
15% x R2 500 000: sec 9D	375 000	(1)
Salary received.....	600 000	(1)
Interest paid to partnership - not deductible.....	-	(1)
Subtotal	<u>2 515 875</u>	
Donation to PBO: 10% x subtotal of his taxable income (not required by question), limited to 25% of R100 000 (R25 000)	(25 000)	(1)
Donation to Cindy Relly not allowed as not a PBO and no s 18A receipt.....	-	(1)
	<u><u>2 490 875</u></u>	<u>20</u>
	max	<u><u>17</u></u>

(b) T-shirts

- The expense is part of salary cost and deductible in terms of section 11(a) for the partnership (1)
- There is an employee employer relationship and it will qualify as a “taxable” fringe benefit in terms of paragraph 5 of the Seventh Schedule (an asset acquired at less than actual value) (1)
- The T-Shirts are not required as a condition of employment, thus it is not exempt in the hands of the employees as a uniform allowance in terms of s10(1)(nA) (1)
- The amount that must be included in the employee's gross income is the cost thereof to the employer, thus $R600 \times 100/114 = R526,32$ (1)
- This amount is also subject to employees' tax. (1)
- VAT of R736,84 ($14/114 \times R600 \times 10$) was claimed as an input tax by the partnership (1)
- In terms of section 18(3) of the Value-added Tax Act, an output tax of R646,36 ($14/114 \times R526,32 \times 10$) must be paid over to SARS (1)

Max 6

QUESTION 4 – SUGGESTED SOLUTION (continued)**(c) Provisional tax payment – Dr. BJ Botha**

- Dr. Botha's taxable income exceeds R1 million for the current year of assessment. That means that his second provisional tax payment must be based on his own estimation of his taxable income on the last day of assessment and not on the basic amount. (1)
- His first provisional tax payment may be based on his basic amount, thus no extra penalty will be imposed. (1)
- In terms of par 20 of the Fourth Schedule a discretionary penalty of up to 20% can be levied by SARS because his second provisional tax payment is less than 80% ($R1\,500\,000/R2\,490\,875 \times 100 = 60,2\%$) of his actual taxable income. (1)
- The additional tax will be calculated at 20% on the difference between normal tax calculated on the R1,5 million income he disclosed and normal tax on 80% of his actual taxable income for the year, at applicable rates. (2)
- To reduce this liability Dr. Botha can make a third additional ("topping-up") provisional tax payment in terms of par 23A of the Fourth Schedule. (1)

Max 6
5

QUESTION 5**26 marks**

During the 2010 year of assessment, three long-time university friends decided to consolidate their respective engineering consulting businesses into a partnership. James Wills, Peter Cassim and Able Mathemba all traded as sole proprietors in the past, but due to work pressure and a lack of capacity, they decided to form an equal partnership (profits and losses were shared equally between the three partners).

The partnership was called WCM Consulting Engineers and operated from 1 September 2009. On 1 February 2013, Able Mathemba indicated that he would like to resign from the partnership on 1 March 2013 due to ill health. James Wills and Peter Cassim decided to continue their relationship in a partnership and would change the partnership's name to WC Consulting Engineers. In the new partnership, James would have a 60% interest and Peter a 40% interest. Profits and losses will be shared in the ratio 60/40 between James and Peter.

WCM Consulting Engineers partnership is registered for VAT and all amounts **exclude** VAT unless otherwise stated.

James Wills is 58 years old and married out of community of property. Peter Cassim is 45 years old and unmarried. Able Mathemba is 49 years old and divorced.

The following information was made available by the bookkeeper of WCM Consulting Engineers as at 28 February 2013:

Pro-forma Income Statement for the year ended 28 February 2013		
	Notes	R
Income		
Turnover	1	1 350 000
Interest received	2	12 500
Sundry income	3	23 500
Total income		1 386 000
Less: Expenditure		1 101 570
Interest paid	4	35 250
Salaries and wages	5	687 400
Bad debts	6	15 870
General partnership expenses – all deductible		250 950
Travel allowance	7	38 350
Insurance	8	18 600
Subscriptions and membership fees	9	9 400
Removal costs	10	10 500
Depreciation	11	22 000
Goodwill written off		5 250
Rent paid to Able Mathemba	12	12 000
Net profit for the year		284 430

Notes:

- Included in the turnover of R1 350 000 is an amount of R50 000 being the proceeds on the disposal of partnership equipment. The equipment was originally purchased during the 2010 year of assessment for R45 000 (excluding VAT) and had a tax value of R25 000 on the date of the disposal. Depreciation for the 2013 year of assessment is included in the amount reflected under Note 11.

QUESTION 5 (continued)

	R
2. The interest received consists of the following:	
Interest received on a money-market account	9 500
Interest received on outstanding debtors accounts	<u>3 000</u>
	<u>12 500</u>
3. The sundry income consist of the following:	
Dividends from RSA companies	10 000
Loan repayment from an employee	5 500
Commission received from a foreign company	8 000
(the amount was not subject to tax in the foreign country)	
	<u>23 500</u>
4. Interest paid consists of the following:	
Interest on capital account: James Wills	9 000
Interest on capital account: Peter Cassim	9 000
Interest on capital account: Able Mathemba	9 000
Interest on bank overdraft	3 250
Interest paid to the South African Revenue Service	<u>5 000</u>
	<u>35 250</u>
5. Salaries and wages consist of the following:	
Salaries and wages – personnel	267 400
Salary: James Wills	140 000
Salary: Peter Cassim	140 000
Salary: Able Mathemba	<u>140 000</u>
	<u>687 400</u>
6. Bad debts consist of the following:	
Mr X – a normal trade debtor that was declared insolvent during June 2012 (excluding VAT - see below)	9 870
Mr Y – a loan granted to an employee who passed away on 19 September 2012	<u>6 000</u>
	<u>15 870</u>
The trade debtor originated during October 2011 when WCM Consulting Engineers provided consulting services to Mr X.	
7. Travel allowance	
A travel allowance of R38 350 was paid to James Wills for the 2013 year of assessment.	
On 1 January 2012, James Wills bought a vehicle on a 60-month suspensive sale agreement for his business and private use. The cash cost of the vehicle was R205 200 (including VAT). James Wills kept a log of his business travelling for the 2013 year of assessment, which amounted 9 385km for the year of assessment. The vehicle had an odometer reading of 25 871 kilometres on 1 March 2012 and a closing reading of 53 256 kilometres on 28 February 2013.	
8. Insurance expenditure consists of the following:	R
Premium for loss of profits due to fire	12 000
Life insurance paid on behalf of James Wills	<u>6 600</u>
	<u>18 600</u>

QUESTION 5 (continued)

9. Subscriptions and membership fees include the following:	R
Engineering Council of South Africa	2 400
SA Engineer – Monthly journal	2 800
Royal Bowls Club – Peter Cassim	1 800
Golden Golf Club – James Wills	<u>2 400</u>
	<u>9 400</u>

10. Removal costs include the following:

Transport cost to relocate equipment to new rental premises (see below)	7 500
Removal of rubbish from James Wills private residence	<u>3 000</u>
	<u>10 500</u>

The transport cost to relocate the partnership equipment to the new rental premises was paid on 1 November 2012. The equipment qualifies for a wear-and-tear allowance over 5 years in terms of Interpretation Note 47. The equipment was purchased new on 1 March 2010 for R37 500 (excluding VAT).

11. Depreciation	R
Depreciation on equipment (5 years straight-line method)	7 500
Depreciation on disposed equipment	9 000
Depreciation on furniture (5 years straight-line method)	<u>5 500</u>
	<u>22 000</u>

The Commissioner will allow wear and tear over 5 years on equipment and over 6 years on furniture.

All the furniture was purchased on 1 September 2009 for a total cost of R27 500 (excluding VAT).

12. Rent paid

The rent paid of R12 000 to Able Mathemba is for the use of office equipment, which he did not want to bring into the partnership when it was formed on 1 September 2009.

REQUIRED	MARKS
(a) Calculate the net profit/(loss) for WCM Consulting Engineers partnership for income tax purposes in order to determine the taxable income of the three partners. Commence your calculation with the accounting profit of R284 430 for the 2013 year of assessment.	16
(b) Calculate the taxable income of James Wills for the 2013 year of assessment. If a specific item (income or expense) should be excluded or ignored from the calculation of the taxable income, full reasons should be provided.	10

(Unisa October 2008 – adapted)

QUESTION 5 - SOLUTION

(a) Calculation of net profit of WCM Consulting Engineers Partnership for the 2013 year of assessment

	R	R
Net profit as per the income statement		284 430
<u>Less:</u> Proceeds from disposal of equipment – capital in nature	(50 000)	(1)
Interest received – allocated to partners	(12 500)	(1)
Dividends from RSA companies – (allocated to partners)	(10 000)	(1)
Loan repayment from an employee – capital in nature.....	(5 500)	(1)
Wear and tear – removal cost of equipment (R7 500 x 4 / 28) – written off over remaining life of equipment (28 months)	(1 071)	(2)
Wear and tear on furniture (R27 500 /6)	(4 583)	(1)
		200 776
<u>Add:</u> Interest paid to SARS – non-deductible – s23(d).....	5 000	(1)
Bad debts – loan Mr Y – capital in nature	6 000	(1)
Life insurance paid on behalf of James Wills – s23(b)	6 600	(1)
Subscription – Royal Bowls Club – s 23(b)	1 800	(1)
Subscription – Golden Golf Club – s 23(b).....	2 400	(1)
Removal cost of equipment – capital in nature.....	7 500	(1)
Removal of rubbish from James Wills private residence – s23(b)	3 000	(1)
Recoupment on sale of equipment (R45 000 – R25 000) S 8(4).....	20 000	(1)
Goodwill written off – non-deductible – capital in nature	5 250	(1)
Depreciation on furniture	5 500	(1)
		263 826
Net profit of the partnership		263 826
Apportioned as follows:		
James Wills (33,33% x R263 826).....		87 942
Peter Cassim (33,33% x R263 826)		87 942
Able Mathemba (33,33% x R263 826).....		87 942

max 16 ^[17]

Note: No adjustment need to be made for the wear-and-tear on the equipment and disposed equipment, as the amounts for depreciation and wear-and-tear will be the same.

QUESTION 5: SUGGESTED SOLUTION (continued)**(b) Calculation of the taxable income of James Wills for the 2013 year of assessment**

	R	R	
Profit share from partnership (33.33% x profit)		87 942	(1)
RSA interest received in partnership – 33,33% x R12 500	4 167		(1)
Interest received on capital account in partnership	<u>9 000</u>		(1)
	13 167		
<u>Less:</u> Interest exemption (under 65 years – first R22 800 exempt) limited to actual amount received	<u>(13 167)</u>	-	(1)
Dividends (local) received in partnership ($\frac{1}{3}$ of R10 000) (exempt i.t.o. s 10(1)(k))		-	(1)
Salary received from partnership		<u>140 000</u>	(1)
		227 942	
<u>Plus:</u> Travel allowance received			
Travel allowance received from partnership	38 350		
Total kilometres travelled	<u>27 385km</u>		
Actual business kilometres travelled	<u>9 385km</u>		
Fixed cost component on vehicle with a value of R205 200 = R66 440			
Fixed cost per kilometre (R66 440 / 27 385km)	242,61c		(1)
Fuel cost per kilometre	89,60c		
Maintenance cost per kilometre	<u>36,90c</u>		
Total cost per kilometre	<u>369,11c</u>		
Deduction for business use (9 385 km's x 369.11c per km)	<u>(34 641)</u>	3 709	(1)
		231 651	
<u>Add:</u> Taxable capital gain from partnership			
Proceeds on disposal of equipment (33,33% x R50 000)	16 667		
<u>Less:</u> Recoupment (Gross income) (33,33% x R20 000)	<u>(6 667)</u>		(1)
	10 000		
<u>Less:</u> Base cost (33,33% x (R45 000 – R20 000))	<u>(8 333)</u>		(1)
Capital gain	1 667		
<u>Less:</u> Loan written off of Mr Y (33,33% x R6 000)	<u>(2 000)</u>		(1)
Net capital loss – Carried forward to 2014	(333)		(1)
The net capital loss is reduced with the annual exclusion of (R30 000) – therefore no capital loss carried forward to the following year.	<u>333</u>	Nil	(1)
Alternatively, the capital gains could have been calculated in the partnership accounts and only one third brought over to James Wills.			
Taxable income for 2013		<u>231 651</u>	

max [13]
10

QUESTION 6**86 marks**

Wilhelmina Slater is a 57 year old widow and the Editor-in-Chief of the *Mode* fashion magazine. She is ordinarily resident in the Republic. Wilhelmina's husband, Bradford, passed away in September 2008. Bradford was a world-renowned shoe designer and bequeathed all his assets and cash on hand to the Slater Trust, his wife Wilhelmina, and to their children Marc and Amanda.

Wilhelmina Slater**Employment**

Wilhelmina received the following salary advice for February 2013:

Name: Wilhelmina Slater		Personnel No: 654321	
Position: Editor-in-Chief		Tax No: 12348903	
ID No: 531123 2345 089		Pay Date: 28 Feb 2013	
EARNINGS		DEDUCTIONS	
	Amount		Amount
Cash	40 000.00	PAYE	11 735.00
Cell phone allowance ❶	1 500.00	Medical aid fund deduction ❸	2 000.00
Travel allowance ❷	8 500.00	Pension fund contribution ❹	4 000.00
		UIF	125.00
Total Earnings	50 000.00	Total Deductions	17 860.00
NETT PAY		32 140.00	
STATISTICAL INFORMATION		MONTHLY PACKAGE	
	Year to date		Amount
Total cash salary	480 000.00	Cash	40 000.00
Bonus	36 000.00	Cell phone allowance	1 500.00
Cell phone allowance	18 000.00	Travel allowance	8 500.00
Travel allowance	102 000.00	Bonus provision	3 000.00
Medical aid fund paid on behalf of employee	24 000.00	Medical aid fund paid on behalf of employee	2 000.00
PAYE paid	140 780.00	Total Package	55 000.00

- ❶ Wilhelmina uses her cell phone only for the purposes of *Mode*'s business as she has a separate cell phone for private use. She purchased her "business" cell phone for R3 500 cash (including VAT) on 1 March 2012 and her "business" cell phone account, which she paid for calls made, amounted to R17 000 for the 2013 year of assessment.
- ❷ Wilhelmina used her Toyota Land Cruiser which she purchased in 2011 for R690 000 (including VAT) for business trips. She kept a detailed logbook and travelled 9 430 km for business purposes. The total kilometres that Wilhelmina travelled during the 2013 year of assessment, were 14 540km. She did not keep accurate record of her actual expenses.
- ❸ Amanda is the only other dependant apart from Wilhelmina registered as a dependant of the medical aid fund.
- ❹ One of the conditions of Wilhelmina's employment is that she is required to belong to the Daniel Pension Fund and is required to contribute 10% of her total cash salary to this fund. The required retirement age from the fund is stipulated as 60 years.

QUESTION 6 (continued)

As Wilhelmina Slater was part of top management, (only top management were allowed to obtain these shares), she was granted an option in the 2009 year of assessment to acquire 1 000 equity shares in Mode Fashion Magazine (Pty) Ltd, her employer, for an amount of R15 a share. The value of the option at the time was R20 a share. She may not sell the shares until after leaving the employment of Mode Fashion Magazine (Pty) Ltd. The shares and the option to acquire shares are therefore treated as restricted equity instruments. She exercised her option on 1 March 2012 when the shares had a market value of R30 a share. The market value of the shares was R35 per share on 28 February 2013 the same date as Wilhelmina retired on (see note below on retirement fund lump sums received by Wilhelmina).

Retirement and lump sums received

On 1 January 2012 Wilhelmina received a lump sum of R800 000 from a retirement annuity fund (RAF) after she retired from the fund (the retirement age for this RAF is 55 years) as well as R569 160 payable as an annuity of R5 000 per month for the rest of her life. The total expected return of all the annuities provided for in the annuity contract therefore amounted to R1 264 800. All the contributions she made to this fund were allowed as deductions. R450 000 of the lump sum was transferred directly for her benefit to an approved retirement annuity fund.

In the last week of February 2013, Wilhelmina suddenly decided to go on early retirement (effectively retiring from her pension fund on 28 February 2013). She decided that it was time for something new. The following are therefore not included in the above payslip:

- On retirement, a lump sum payment from the pension fund to the amount of R1 000 000 was paid to her. During the previous years of assessment an amount of R40 000 in respect of contributions to the pension fund had not been allowed as a deduction. The pension fund deducted R170 000 employees' tax from the lump-sum payment made to Wilhelmina.
- After retirement (from 1 March 2013) she will also receive a monthly pension of R40 000.

Slater Trust

Bradford Slater's mother, Claire, had set up an *inter vivos* trust (the Slater Trust) in January 2006. She made a cash donation of R1 000 to the trust on that date. This money was deposited in a bank account, but earns no interest. The trust has a February year-end.

Bradford bequeathed the following assets and investments, to the Slater Trust:

- R6 million cash that was subsequently invested by the trustees in a local money-market account, and
- The equivalent of a R2 million fixed term investment in the United Kingdom (UK).

On 1 March 2012 Wilhelmina sold her holiday house in Plettenberg Bay to the Slater Trust at the market value of R900 000. The purchase of the property by the trust was financed by a loan from Wilhelmina that carries interest at 6,567% per annum. This is considered to be a market-related interest rate. Bradford acquired this property on 1 October 2003 for R350 000 and bequeathed it to Wilhelmina when he passed away. The value of the property on the date of his death was R700 000. When the Slater-family is not using the holiday house, it is rented out.

Wilhelmina donated part of her listed share-portfolio in South African and foreign companies, the equivalent of R1 million (the market value at that date), to the Slater trust on 2 March 2012. This was her only donation for the year and she paid the relevant donations tax. She had purchased the shares for investment purposes for R850 000 on 31 December 2009.

QUESTION 6 (continued)**Extract from the Trust Deed of the Slater Trust:**

- Wilhelmina Slater will be an income beneficiary (with only a contingent right) until Amanda reaches the age of 21 years.
- The following persons are income and capital beneficiaries of the Slater Trust:
 - Marc, their son, aged 25. He is a full-time postgraduate student at the University of Cambridge in the UK (he is still a South African resident) and
 - Amanda, their daughter, aged 9. She is a full-time scholar and a resident of the Republic.
- The beneficiaries (Marc and Amanda), do not have any vested rights in respect of any of the income or capital of the trust.
- The trustees (Wilhelmina, Bradford's accountant and his attorney) have an absolute discretion whether to pay out some or all of the income or capital to the beneficiaries.
- An equal amount of trustee's remuneration is paid to the three trustees.

Income, expenditure and distributions of the Slater Trust for the year of assessment ended 28 February 2013

Asset	R2 million fixed term investment	R6 million cash	Shares in foreign companies	Shares in RSA companies	Holiday house	Total
Nature of receipt / accrual	Foreign interest (Refer Note)	Local interest	Foreign dividends (Refer Note)	Local dividends	Net rental income	
	R	R	R	R	R	R
Receipts / accruals	100 000	300 000	30 000	60 000	110 000	600 000
Municipal rates and water expenses	-	-	-	-	(30 000)	(30 000)
Trustee remuneration	(1 500)	(4 500)	(450)	(900)	(1 650)	(9 000)
Interest paid on loan for the purchase of the holiday house	-	-	-	-	(59 100)	(59 100)
University fees and maintenance paid to Marc Slater	(13 333)	(40 000)	(4 000)	(8 000)	(14 667)	(80 000)
School fees paid on behalf of Amanda Slater	(4 167)	(12 500)	(1 250)	(2 500)	(4 583)	(25 000)
Maintenance paid to Wilhelmina Slater	(6 939)	(20 816)	(2 082)	(4 163)	Nil	(34 000)
Income retained in the trust	74 061	222 184	22 218	44 437	Nil	362 900

Note - No foreign tax was paid on foreign interest and foreign dividends

QUESTION 6 (continued)**Other income and expenditure for the 2013 year of assessment**

	R
Royalties received from a book she wrote: "The Possibilities of being a Cougar" – she wrote the book during her last holiday in the United Kingdom(UK). The book was also published in the UK. No foreign taxes were paid on the royalties received.	66 900
Royalties received from patent (usufruct inherited from Bradford) – see note below	25 000
Additional medical expenses - she had cosmetic surgery during the year and insists that it is deductible for tax as she has to look good for her type of work.	(35 000)

Patent

Shortly before his death, Bradford developed a shoe patent, which was registered in terms of the Patents Act. He incurred qualifying capital costs in the development of the patent amounting to R250 000. He never claimed these expenses for tax purposes. In his will, he bequeathed the royalties (usufruct) of the patent to Wilhelmina and the ownership of the patent to his children, Marc and Amanda (50/50). Wilhelmina accepted the usufructuary benefits conferred upon her under Bradford's will.

With Wilhelmina's consent, Marc and Amanda decided to sell the shoe patent to Christian Louboutin for the equivalent of R625 000. The transaction was finalised on 31 March 2013 and the proceeds were deposited in Wilhelmina's bank account. All the parties involved (Wilhelmina, Marc and Amanda) agreed that the proceeds would be invested in an interest-bearing call account and that the same provisions of Bradford's will, will similarly apply to the new investment.

Possible Emigration

Wilhelmina considers emigrating to the United Kingdom. If she decides to emigrate, she will sell her primary residence in South Africa after emigration.

List of all Wilhelmina's assets on 28 February 2013:

DESCRIPTION	PURCHASE PRICE	MARKET VALUE ON 1/10/2001	MARKET VALUE ON 28/02/2013	MARKET VALUE ON 30/06/2013
ASSETS	R	R	R	R
Primary residence in Sandton, Johannesburg – inherited from Bradford	380 000	1 400 000	3 900 000	4 100 000
Toyota Land Cruiser 2011	690 000	-	480 000	430 000
Furniture and personal effects	100 000	-	90 000	120 000
100 Krugerrands – held as an investment, bought on 1 January 2004 – inherited from Bradford	240 000	-	780 000	870 000
Cash	-	-	-	280 000
1 000 shares in Mode Fashion Magazine (Pty) Ltd	-	-	R35 a share	R38 a share
Loan to trust	-	-	900 000	900 000

QUESTION 6 (continued)

REQUIRED:	Marks
(a) Calculate Wilhelmina Slater's normal tax due or payable for the 2013 year of assessment. Show all your calculations. Where any item is exempt from tax or not allowed as a deduction, this must be indicated and a short reason must be provided. All amounts must be rounded-off to the nearest Rand. Ignore the provisions of any double tax-agreement between South Africa and any other foreign country mentioned in the question.	54
(b) Discuss whether the proceeds on the disposal of the shoe patent paid into Wilhelmina's bank account should be included in Wilhelmina's gross income in the 2014- year of assessment. You can assume that the tax legislation will remain unchanged for the 2014 year of assessment.	10
(c) Discuss the tax implications for Wilhelmina Slater regarding her assets, if she decides to emigrate to the UK on 30 June 2013. Show all your calculations, where applicable. Assume that if she emigrates, she will sell her primary residence at its market value of R4 500 000 on 31 July 2013. Wilhelmina would like to minimise any possible capital gain but decided not to choose the time-apportionment base cost (TAB) method. You can assume that the tax legislation will remain unchanged for the 2014 year of assessment.	22

(Unisa Oct 2010 – adapted)

QUESTION 6 SUGGESTED SOLUTION

(a) Normal tax liability for Wilhelmina Slater for the year of assessment ended 28 February 2013

	R	Lump sum R	R	
Salary received (R40 000 x 12)			480 000	(1)
Annual bonus			36 000	(1)
Fringe benefit (par 12A of 7 th Schedule) – medical aid paid on behalf of employee (R2 000 x 12)			24 000	(1)
Annuities received				
Amount received (par (a) of GI def) – R5 000 x 12	60 000			(1)
No deduction in terms of sec 10A as it is not a purchased annuity	(-)		60 000	
Lump sum payment from pension fund				
Amount received (par (e) of GI def)	1 000 000			(1)
Less: Deductions – par 5 of 2 nd Schedule:				
Allowances not claimed previously	(40 000)			(1)
Allowances not claimed in 2013 (see below)	(12 000)	948 000		(1)
Interest received from trust (R59 100 (loan) + R20 816 (maintenance))	79 916			(2)
Less: Basic interest exemption (sec 10(1)(j)(xv))	(22 800)		57 116	(1)
Foreign dividend received from trust (R1 250 (sec 7(3)) + R2 082 (maintenance) + R22 218 (sec 7(5)))	25 550			(2)
Less: Ratio exemption (R25 550 x 30/40) s 10B(3)	(19 163)		6 387	(1)
Foreign interest received from trust (maintenance)			6 939	(1)
Local dividends received (from trust: R2 500 (sec 7(3)) + R4 163 (maintenance) + R44 437 (sec 7(5)))	51 100			(3)
Less: Dividend exemption (sec 10(1)(k))	(51 100)		-	(1)
Royalties received – book written – resident taxed on world-wide income			66 900	(1)
Royalties received – patent			25 000	(1)
Trustee remuneration received (R9 000/3): See note ①			3 000	(1)
Less: Pension fund contribution (R4 000 x 12) sec 11(k)	48 000			(1)
Limited to the greater of:				
R1 750 or				
(R40 000 x 12) x 7.5%	(36 000)		(36 000)	(1)
Not allowed as a deduction – carried forward to following year	12 000			
Vesting of share options Although the share options were exercised on 1 March 2012, the shares only vested with her retirement on 28 February 2013. The restriction then fell away (she retired) and she is liable for tax on the gain (vesting) of MV on vesting date less consideration paid – (R35 – R15) x 1 000 (sec 8C)			20 000	(1)
Cell phone allowance – used mainly for <i>Mode's</i> business	18 000			(1)
Less: Cell phone expenditure – denied sec 23(m)			-	(1)
Sec 11(e) allowance – permitted in sec 23(m) – cost of R3 500 deducted in full as it is a “small item” costing less than R7 000 – Interpretation Note: No 47	(3 499)		14 501	(1)

QUESTION 6 – SUGGESTED SOLUTION (continued)

Travel allowance received (R8 500 x 12) (sec 8(1))		R	R	R	(1)
		102 000			
Value of the vehicle: R690 000 (incl. VAT)					
Fixed cost R119 683/14 540 km	823,13 c				(1)
Fuel	133,60 c				
Maintenance	68,30 c				
	1 025,03 c				(1)
Business km: 9 430 km x 1 025,03 c		(96 660)		5 340	(1)
				769 183	
Taxable capital gains:					
<i>Holiday house</i>		R			
Proceeds	900 000				(1)
Less: Base cost (par 40 of 8 th Schedule)	(350 000)	550 000			(1)
<i>Listed shares donated</i>					
Proceeds	1 000 000				
Less: Base cost					
- Base cost excl donations tax	(850 000)				(1)
- Portion of donations tax i.t.o. par 22					
$Y = [(M - A)/M] \times D$					
$= \frac{(R1\,000\,000 - R850\,000)}{1\,000\,000} \times [(R1\,000\,000 - R100\,000) \times 20\%]$					
$= 0.15 \times R180\,000$	(27 000)	123 000			(2)
		673 000			
Annual exclusion		(30 000)			(1)
Net capital gain		643 000			
Taxable capital gain (33.3%)				214 119	(1)
				983 302	
Less: Sec 18 medical expense deduction					
Medical aid contributions by employer (R2 000 x 12) + R24 000 employers' own contribution		48 000			(2)
Less: 4 x the s 6A tax credit (R460 x 12 = R5 520 x 4)		(22 080)			(2)
		25 920			
Plus: Medical expenses not refunded by medical aid fund – deductible i.t.o s 18(1)(b) notwithstanding s 23		35 000			(1)
		60 920			
Less: 7,5% of R983 302		(73 748)		-	(1)
Taxable retirement fund lump sum			948 000		
Taxable income				983 302	

Note ①: If students added back the R450 and R900 trustee remuneration (foreign and local dividends), mark must still be awarded as the principle was laid down in a recent court case (funded by exempt income).

QUESTION 6 – SUGGESTED SOLUTION (continued)

	R	
Normal tax liability on retirement fund lump sum benefits:		
Normal tax liability on all retirement fund lump sum benefits received (R948 000 + R350 000 (R800 000 – R450 000 transferred) = R1 298 000)		(1)
Normal tax on R1 298 000: (R1 298 000 – R945 000) x 36% + R141 750	268 830	(1)
<u>Less:</u> Normal tax paid on retirement fund lump sum benefits previously received - R350 000: (R350 000 – R315 000) x 18% + Rnil	(6 300)	(1)
Normal tax liability on retirement fund lump sum benefits	262 530	
Normal tax liability:		
Normal tax on R983 302 (R983 302 – R617 000) x 40% + R178 940	325 460,80	(1)
<u>Less:</u> Primary rebate	(11 440,00)	(1)
<u>Less:</u> Section 6A rebate – R460 x 12	(5 520,00)	(1)
Normal tax liability on taxable income excluding retirement fund lump sum benefits	308 500,80	
<u>Add:</u> Tax liability in respect of retirement fund lump-sum benefit (refer above)	262 530,00	
Total normal tax liability	571 030,80	
<u>Less:</u> Employees tax deducted (R140 780 + R170 000)	(310 780,00)	(1)
Normal tax due for 2013	260 250,80	
		[51]
	max	50

(b) Disposal of patent

There are three assets that are disposed of namely: ① the usufruct (of Wilhelmina) and ② the two ownerships (<i>bare dominium</i>) (50/50) of the children.		(2)
Before an amount can form part of gross income, all of the elements (requirements) of the definition of gross income as defined in section 1 of the Income Tax Act, must be met.		(1)
One of these requirements is that there must either be a receipt or an accrual before an amount can be included in gross income		(1)
Wilhelmina Slater inherited the usufruct of the patent – she was thus unconditionally entitled to the royalties received in respect of the use of the patent (<i>Mooi v SIR</i>).		(1)
However, the ownership (<i>bare dominium</i>) of the patent was bequeathed to the children, Marc and Amanda Slater.		
The shoe patent was disposed of with Wilhelmina's consent, but the whole of the proceeds realised (R625 000), belonged to the heirs (the owners of the patent (<i>bare dominium</i>)) and did not form part of Wilhelmina's gross income although it was deposited into her bank account.		(2)
Wilhelmina disposed of her usufruct (royalties) but continued to earn interest on the investment (also a usufruct) which will be included in her gross income.		(1)
There was however, no value placed on the disposal of the royalties (the usufruct).		
Thus the proceeds on the sale of the patent were not received "on her own behalf and for her own benefit" (<i>Geldenhuys v CIR</i>), it was received on behalf of her children.		(2)
Conclusion: The amount deposited in Wilhelmina's bank account (by Wilhelmina as the usufructuary), does therefore not form part of her "gross income".		(1)
<i>Mention case law</i>	<i>Bonus</i>	(1)
		[12]
	max	10

QUESTION 6 – SUGGESTED SOLUTION (continued)**(c) Tax implications of the possible emigration of Wilhelmina Slater****Tax consequences of emigration:**

A natural person, who emigrates from the Republic to another country, will cease to be a resident as from the date that he or she emigrates (Interpretation Note 3 of the Act). (1)

In terms of paragraph 12(2)(a) of the Eighth Schedule there is a deemed disposal when a person ceases to be a resident and all assets will be treated as a disposal at market value, (1)
except immovable property situated in the Republic or any asset in a permanent establishment in the Republic or any qualifying equity share contemplated in section 8B, any equity instrument contemplated in section 8C or any right to acquire any marketable security contemplated in section 8A (if not vested).(1)

Primary residence

In terms of par paragraph 40 of the 8th Schedule, the assets of a deceased person are deemed to be disposed of at market value at the date of death. Excluded from this deemed disposal are assets transferred to the surviving spouse. The “roll-over relief” in terms of par 67 applies. (1)

Therefore, Wilhelmina will be treated as having:

- acquired the primary residence on the same date it was acquired by Bradford;
- acquired the primary residence for the same base cost (R380 000); and
- used the primary residence in the same manner it was used by Bradford for the period prior to disposal. (1)

At emigration:

The primary residence is immovable property situated in the Republic and not deemed to be a disposal in terms of paragraph 12(2)(i) on date of emigration. (1)

At disposal:

When she sells the residence on 31 July 2013 it will be immovable property of a non resident that is situated in the Republic. It will be a disposal of an asset and CGT will have to be calculated. (1)


Wilhelmina has to elect which valuation date value the base cost of the primary residence will be. She can choose either of the following:


- Market value of R1 400 000 on 01/10/2001
- 20% (Proceeds – allowable expenditure after valuation date) – thus (20% x R1 400 000) or
- TAB – not chosen. (2)

She would like to limit her capital gain and will therefore choose the market value of R1 400 000 as her valuation date value. (1)

QUESTION 6 – SUGGESTED SOLUTION (continued)

As the proceeds are more than R2 million, the capital gain or loss must be calculated. (1)

	R	
Proceeds	4 500 000	(1)
Less: Base cost - par 67	(1 400 000)	
	3 100 000	
Less: Primary residence exclusion 	(2 000 000)	(1)
Capital gain	1 100 000	

 Uninterrupted residence is required except where the resident is treated as being ordinary resident in the residence for a continuous period of up to two years if the resident does not reside in it for various reasons. If the residence is vacated due to the intended acquisition of a new primary residence, it is one of those reasons. Wilhelmina will thus qualify for the R2 million primary residence exclusion even if she was a non-resident on the date of disposal. (1)

Section 35A (withholding of amounts from the payments to non-resident sellers of immovable property) is merely an advance in respect of the seller's liability for normal tax for the year of assessment during which that property is disposed of by the seller (s35A(3)) and will apply as the selling price exceeds R2 million (sec 35A(14)(a)). (1)

The seller is a natural person thus the purchaser (or any other person on her behalf) must withhold 5% of the selling price of R4 500 000 and pay it over to SARS (sec 35A(1)). (1)

The date of payment to SARS is within 14 days after selling date if purchaser is a resident or 28 days if purchaser is a non-resident (sec 35A(4)). (1)

Motor vehicle: Toyota Land Cruiser 2011

There will be a deemed disposal in terms of paragraph 12(2)(a) on date of emigration at the market value of R430 000 but any gain or loss will be disregarded in terms of paragraph 53 as it is a personal-use asset. (1)

Furniture and personal effects

There will be a deemed disposal in terms of paragraph 12(2)(a) on date of emigration at the market value of R120 000 but any gain or loss will be disregarded in terms of paragraph 53 as it is personal-use assets. (1)

Krugerrands

Her Krugerrands will be deemed to be disposed of at market value in terms of par 12(2)(a) of the 8th Schedule.

	R	
Proceeds – Date of emigration	870 000	(1)
Less: Base cost	(240 000)	(1)
Capital gain	630 000	

Cash

Cash is currency and is excluded from the definition of an asset (paragraph 1(a)) in the Eighth Schedule. No capital gain or loss arises. (1)

QUESTION 6 – SUGGESTED SOLUTION (continued)**Shares in Mode Fashion Magazine (Pty) Ltd**

Her shares will be deemed to be disposed of at market value in terms of par 12(2)(a) of the 8th Schedule (vesting occurred at date of retirement).

	R	
Proceeds – Date of emigration (R38 x 1 000)	38 000	(1)
Less: Base cost – MV of shares on vesting date (R35 x 1 000)	(35 000)	(1)
Capital gain	3 000	

Loan to the trust

The loan to the trust is a financial instrument. A financial instrument is an asset, but the proceeds and base cost is the same and thus no capital gain or loss arises (refer par 28 of the 8th Schedule). No capital gain or loss arises. (1)

All the capital gains will be added together and will be reduced by any capital losses and then the annual exclusion of R30 000 will be deducted, after which the inclusion rate of 33.3% will be applied to calculate the taxable capital gain to be included in Wilhelmina Slater's taxable income. (1)

max 26
22

QUESTION 7**32 marks**

This question consists of two (2) related parts. Round-off all amounts to the nearest Rand.

Zannon Botha (40 years old and unmarried) is a well-known South African hairstylist and the only shareholder and director of Zannon (Pty) Ltd. Zannon Botha on behalf of Zannon (Pty) Ltd presents many television shows, workshops and “makeovers”, transforming “ugly ducklings” into beautiful “swans”.

Zannon (Pty) Ltd also manufactures and distributes a stunning range of hair products under the trademark “Zannon” and only uses the best ingredients (imported from the United Kingdom) in the local manufacturing process. These products are in high demand by international film stars.

Zannon (Pty) Ltd is a South African small business corporation (as defined) with a February year-end. The company is a registered VAT-vendor (on the invoice basis, with two-monthly tax periods) and 96% of the company’s assets are used to make taxable supplies. The company is not a labour broker or a personal service provider. No “professional service”, as defined in paragraph 1 of the Sixth Schedule, is rendered by the company. Zannon Botha does not invest in the stock-market and has never purchased any shares in another company. Likewise, no investment income is received by the company as it does not hold any shares or equity in any other company.

PART A**20 marks**

The following transactions occurred in Zannon (Pty) Ltd during **January and February 2013** (all amounts **INCLUDE VAT** where applicable):

	R
1. Income from television shows, workshops and “makeovers”	45 600
2. Sales	
(a) Local sales – various “Zannon” hair products.	32 832
(b) “Zannon” hair products directly exported to the United Kingdom (all the necessary documentary proof of goods that have been exported were obtained and all requirements regarding the export were met).	49 248
3. A new manufacturing machine was imported from France for the purpose of making taxable supplies (it will be used directly in a process of manufacture). The machine was released on 2 February 2013 from a Customs and Excise bonded warehouse. The customs value of the imported machine was R91 200 (excluding VAT) and customs duty payable thereon R8 000 (excluding VAT) . The French company, who supplied the machine, sent a technician from France to install the machine in Zannon (Pty) Ltd’s manufacturing plant on 4 February 2013. The French company issued an invoice for R15 960 for the installation services on the same day and Zannon (Pty) Ltd paid the amount directly via electronic fund transfer (EFT). The open market value for the installation service was R18 240 .	
4. From 2 January 2013, Zannon (Pty) Ltd provided its only shareholder, Zannon Botha with a company car (a “motor car” as defined in section 1 of the VAT Act), to enable him to travel to all the different locations where shows and makeovers are presented. This motor car was purchased new on the same date for R239 400 cash from Budget Cars (a registered VAT vendor) and registered in the name of Zannon (Pty) Ltd. Zannon (Pty) Ltd is entitled to a section 11(e) allowance of 20% per annum on the company car. Zannon Botha uses the same car for private purposes as well. Zannon (Pty) Ltd bears all the costs (including maintenance cost) of the car. Zannon Botha did not keep a detailed logbook.	

QUESTION 7 (continued)

	R
Zannon (Pty) Ltd incurred the following expenses in respect of the car: <ul style="list-style-type: none"> • Fuel of R900 per month • Vehicle license • Insurance of R570 per month 	1 800 245 1 140
5. On 31 January 2013 Zannon (Pty) Ltd purchased a 5-bedroomed house from a non-vendor at the open market value of R2 052 000 and paid the full amount of transfer duty of R164 160 on the same date. The house was purchased for <i>bona-fide</i> business purposes and not to obtain a tax advantage. Zannon Botha moved into the house with all his own furniture and pets on 1 February 2013. Only 15% of the total floor space of the house was used by Zannon (Pty) Ltd for the purposes of making taxable supplies. He contributed R420 per month towards his “rental” of the rest of the house. Market related rent for a similar house in the same area is R5 700 per month. Zannon Botha paid the total electricity bill that amounted to R1 254 for February 2013. The electricity paid is not included in the “rental” of R420 per month paid to Zannon (Pty) Ltd.	
6. Other costs incurred by Zannon (Pty) Ltd for the 2 month period, included: <ul style="list-style-type: none"> • Air ticket (Zannon Botha presented a workshop in London, United Kingdom) • Salary paid to Zannon Botha (R8 000 per month from 1 March 2012) 	9 120 16 000

REQUIRED	marks
Calculate the VAT payable or receivable by Zannon (Pty) Ltd for the two-month tax period ended 28 February 2013. (Provide brief reasons if any amounts are not subject to VAT.)	20

PART B**12 marks**

In addition to the information provided in Part A, Zannon Botha contributed R600 per month to a recognised retirement annuity fund since 1 March 2012 and provides his employer monthly with the proof of payment. He does not belong to a pension fund. Zannon Botha's remuneration remained unchanged from March 2012 (see Part A, note 6, for detail). Zannon Botha did not belong to a medical aid fund but qualified for the relief granted in respect of paragraph 11C(6) of the Fourth Schedule.

REQUIRED	marks
Calculate the employees' tax payable for March 2013 by Zannon (Pty) Ltd on behalf of Zannon Botha. You are not required to calculate the SITE payable for the month. You may assume that the legislation and monetary amounts for the 2014 year of assessment will be the same as for the 2013 year of assessment.	12

QUESTION 7 - SUGGESTED SOLUTION

PART A VAT payable or receivable by Zannon (Pty) Ltd for the two-month tax period ended 28 February 2013

	R	R	
1. Income from television shows, workshops and "makeovers" – R45 600 x 14/114		5 600	(1)
2. Local sales – R32 832 x 14/114		4 032	(1)
Hair products directly exported to the United Kingdom - zero rated supply (section 11(1)(a))		-	(1)
3. Imported machine - customs value	91 200		(½)
Plus: 10% of the customs value	9 120		(½)
Plus: All duties and surcharges	8 000		(½)
VAT customs value	108 320		
VAT levied (Input tax can be claimed)	x 14% =	(15 165)	(½)
Imported services – VAT chargeable in terms of section 7(1)(c) is not payable, as it will be used for the purposes of making taxable supplies – not subject to VAT in terms of section 14(5)(a)		-	(1)
4. Motor vehicle – input tax denied ("motor car" as defined)		-	(1)
The free use of the motor car – is a fringe benefit in terms of the 7 th Schedule to the Income Tax Act.			
It is a deemed supply under section 18(3) of the VAT Act and output tax must be accounted for:			
Determined value (excl VAT) = R239 400 x 100/114 = R210 000			(1)
R210 000 x 0.3% (input tax was denied on acquisition) = R630			(1)
x 2 months = R1 260			(1)
Deemed output tax for Jan & Feb 2013 = R1 260 x 14/114		155	(1)
Fuel – zero rated supply (section 11(1)(h))		-	(1)
Licence – input tax claimed on R245 x 14/114		(30)	(1)
Insurance – input tax claimed on R1 140 (R570 x 2) x 14/114		(140)	(1)
Wear and tear – an accounting provision – not a supply		-	
5. Second-hand property purchased from non-vendor: Notional input tax can be claimed on the lower of open market value or consideration in money (purchase price), limited to % used for taxable supplies (section 16(3)(a)(ii)(bb) and section 1, definition of input tax paragraph (b))			
R2 052 000 x 14/114 = R252 000			(1)
Apportioned for business purposes: R 252 000 x 15%		(37 800)	(1)
Electricity paid – February 2013 – R1 254 x 15% x 14/114		(23)	(1)
Rental received – residential accommodation – exempt supply			(1)
Free use of house: Is a fringe benefit in terms of the 7 th Schedule to the Income Tax Act. It could be a deemed supply under section 18(3) of the VAT Act. The supply of residential accommodation is, however, an exempt supply in terms of section 12(c) of the VAT Act and section 18(3) does not apply (proviso to section 18(3)) – thus no deemed output tax.		-	(1)
6. Airplane ticket (international transport) - zero rated supply (section 11(2)(a))		-	(1)
Salary paid – remuneration not part of the definition of an enterprise (sec 1)		-	(1)
Total VAT refundable		(30 195)	
			[22]
		max	20

QUESTION 7 – SUGGESTED SOLUTION (continued)**PART B**

A director of a private company qualifies as an employee under the definition of an employee in paragraph 1 of the 4th Schedule and paragraph 1 of the 7th Schedule and the cash equivalent of all fringe benefits must therefore be included in the calculation of Zannon Botha's "balance of remuneration" for purposes of the calculation of employees' tax.

As Zannon Botha (as the director of a private company) qualified for the relief granted in respect of paragraph 11C(6) of the 4th Schedule (more than 75% of his net remuneration was received in the form of fixed monthly payments), he will not be deemed to have received deemed remuneration and the **actual remuneration** must be used to calculate employees' tax.

	R	R	
Salary		8 000	(1)
Fringe benefit on company car (par 2(d) of the 7 th Schedule) (1 month):			
(R239 400 x 3,5% per month x 80%) (Part A note 4)		6 703	(2)
Residential accommodation (par 2(d) of the 7 th Schedule) (1 month):			
(A - B) x C/100 x D/12			
= ((R8 000 x 12) – R0 (employer is a private company and employee controls the company)) x 17/100 x 1/12 = Rental value	1 360		(1)
<u>Less:</u> Rent paid by Zannon Botha (Part A note 5)	(420)	940	(1)
		15 643	
<u>Less:</u> RAF contributions of R600 pm, limited to the greater of 15% x Non-RFI (R15 643) = R2 346,45 p/m, or R3 500 / 12 = R292 less pension contribution p/m, or R1 750 / 12 = R146 pm		(600)	(2)
Balance of remuneration		15 043	
Annual equivalent (x 12)		180 516	(1)
Normal tax per table (2014 = 2013) on R180 516			
(R180 516 – R160 000) x 25% + R28 800		33 929	(1)
<u>Less:</u> Rebate (2014 = 2013)		(11 440)	(1)
		22 489	
Employees' tax payable for March 2014 (R22 489 /12)		1 874,08	(1)
			[12]

QUESTION 8**21 marks**

Slimy Success retired at the age of fifty-five during the 2010 year of assessment. After two years of fishing, he became bored and started his own consulting business. He conducts this consultancy through a close corporation, Slip CC. He is the sole member of Slip CC. Slip CC's year-end is 31 March each year. From 1 March 2012, Slimy served on the board of directors of one of his former clients.

The following information relates to the 2013 year of assessment:

Private pension fund

A pension of R12 000 a month accrues to him.

O'Mutual retirement annuity fund

An annuity of R4 500 a month accrues to him.

Foreign retirement annuity fund

He received a retirement annuity of \$500 a month. No foreign tax was payable on this amount. The average exchange rate was \$1 = R7,70 for the year of assessment ending 28 February 2013. Slimy elected to use the average rate for the applicable year for the conversion of amounts received from the foreign retirement annuity fund.

Scheme (Pty) Ltd

Slimy Success became a director of Scheme (Pty) Ltd on 1 March 2012. His director's emoluments for the period 1 March 2012 to 28 February 2013 amounted to R2 000 a month. Slimy only attends monthly board meetings.

Slip CC

Slimy is the only member of Slip CC. He does consultation work through the CC. Slip CC is registered for VAT purposes. Slip CC secured a major contract with a telecommunication company. Due to the work involved, the CC could only service this client. Slimy had to refer all the other existing clients of Slip CC to one of his friends. The telecommunication company reimburses Slip CC for all the expenses paid on its behalf.

The telecommunication company was billed as follows:

	R
May 2012	114 000
August 2012	114 000
November 2012	114 000
February 2013	114 000

Slip CC did not incur any salaries or make any distributions during its 2013 year of assessment.

Further information relating to Slimy was as follows:

- He earned rentals of R82 000.
- Medical expenditure paid was R27 890 for the 2013 year of assessment. The amount comprises contributions of R1 500 a month to a medical scheme and R9 890 medical expenses paid and not reimbursed by the medical scheme. He and his wife (to whom he was married out of community of property) are members of the scheme.

QUESTION 8 (continued)

- He made the first and second provisional tax payments. The amounts due paid for the first and second periods were R24 600 and R27 200 respectively.

REQUIRED		Marks
(a)	Calculate the total employees' tax that the respective employers had to deduct from the above remuneration in the 2013 year of assessment.	9
(b)	Calculate the third provisional tax payment that Slimy has to make for the 2013 year of assessment to avoid any liability for interest.	12

(Tax Workbook – Nieuwoudt et al)

QUESTION 8 - SUGGESTED SOLUTION
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(a) Total employees' tax that the respective employers had to withheld from remuneration paid to Slimy Success.

Private pension fund

The pension fund is deemed to be an employer. The annual equivalent of the remuneration is R144 000 (R12 000 × 12). (1)

	R	
Normal tax on R144 000 at 18%	25 920	
<u>Less: Primary rebate</u>	(11 440)	
Total employees' tax	14 480	(1)

O'Mutual retirement annuity fund

The retirement annuity fund is deemed to be an employer. The annual equivalent is R54 000 (R4 500 × 12). (1)

	R	
Normal tax on R54 000 at 18%	9 720	
<u>Less: Primary rebate</u>	(11 440)	
Total employees' tax	Nil	(1)

Foreign retirement annuity fund

Not a resident employer. (1)

Scheme (Pty) Ltd

Directors of private companies are also subject to employees' tax. Employees' tax must be deducted from the higher of actual or deemed remuneration. There is no deemed remuneration because it is the first year that he serves on the board.

	R	
Normal tax at 18% on R24 000 (actual remuneration)	4 320	
<u>Less: Primary rebate</u>	(11 440)	
Employees' tax	Nil	(1)

Slip CC

Slip CC is a personal service provider. 28% employees' tax must be deducted from the remuneration of R100 000 (100/114 × R114 000) on all four dates.

	R	
R114 000 × 100/114	100 000	(1)
Tax @ 28%	28 000	(1)
Employees' tax (R28 000 × 4)	112 000	

QUESTION 8 - SUGGESTED SOLUTION (continued)

	R	
Pension fund	14 480	
O' Mutual RAF	-	
Overseas RAF	-	
Scheme (Pty) Ltd	-	
Slip CC (Important: NOT Slimy)	112 000	
Total employees tax	126 480	(1)
		[9]

(b) Calculation of the third provisional tax payment that Slimy had to make for the 2013 year of assessment

	R	R	
Pension		144 000	(1)
Annuity		54 000	(1)
Foreign annuity ($(\$500 \times 12) \times R7,70$)		46 200	(1)
Directors emoluments		24 000	(1)
Fees from Slip CC (CC paid no salaries and made no distributions)		-	(1)
Rentals		82 000	(1)
Income		350 200	
Less: Medical scheme contributions: $R1\ 500 \times 12$ months	18 000		(1)
Less: 4 x s 6A rebate $(460 \times 12 = R5\ 520) \times 4 = R22\ 080$	(22 080)	-	(1)
Taxable income		350 200	

	R	R	
Normal tax on R350 200			
$(R350\ 200 - R346\ 000) \times 35\% + R80\ 100$		81 570	(1)
Less: Primary rebate		(11 440)	(1)
Less: Section 6A medical rebate $(R460 \times 12)$		(5 520)	
Normal tax liability		64 610	
Less: Taxes pre-paid			
Employees' tax		(14 480)	(1)
First provisional tax payment		(24 600)	
Second provisional tax payment		(27 200)	(1)
Amount due to Slimy		(1 670)	
			[12]

QUESTION 9**27 marks**

Budgie Bird is fifty years old and has no children. Her husband died during the current year of assessment. She earned the following amounts during the year of assessment ending 28 February 2013:

(1) Amounts received from pension fund

She received a pension of R7 000 a month for ten months from her late husband's pension fund.

(2) Amounts and benefits received from her employer

Budgie was employed for the entire year and received a monthly salary of R25 000 and a non-pensionable travelling allowance of R10 000 a month. Her employer deducted monthly pension fund contributions at 7% of retirement funding employment from her salary. The company contributed R870 a month per employee to a medical scheme. She had to contribute R400 a month to the medical scheme. Her husband did not belong to the fund.

(3) Amounts received from Budgie CC

Budgie is a member of Budgie CC. Budgie CC is a "small business corporation" as defined. She has a 40% interest and her daughter has a 60% interest in the CC. The CC operates a floral shop in a large shopping mall. Budgie is actively involved in all operational and management decisions affecting the floral shop. She also does the books of the shop over weekends. Her daughter works full-time in the shop. Budgie's salary has been R10 000 a month and her daughter's salary R15 000 a month for the past three years. Budgie cannot keep an eye on her daughter and decided that the books should be audited on a yearly basis.

Annual bonuses are paid to the members after the financial statements have been audited by the auditors.

The following information related to the net income of Budgie CC:

Financial year end	Financial statements audited and bonuses approved (if any)	Estimated taxable income (after bonuses)	Daughter's bonus	Budgie's bonus
		R	R	R
28 February 2011	30 April 2011	130 000	None	None
28 February 2012	31 May 2012	280 000	30 000	26 000
28 February 2013	30 June 2013	285 000	32 000	28 000

(4) Provisional tax information relating to Budgie CC year of assessment ending 28 February 2013:

Financial year	Date assessed	Taxable income as assessed
2011	2011 year of assessment, assessed on 15 December 2011	R130 000
2012	2012 year of assessment, assessed on 1 December 2012	R270 000
2013	2013 tax year not yet assessed	None

QUESTION 9 (continued)

REQUIRED		Marks
(a)	Calculate the employees' tax for the year of assessment ending 28 February 2013 that the respective employers mentioned above had to withhold from Budgie Bird's remuneration (refer to notes 1 to 3).	20
(b)	Calculate the provisional tax that Budgie CC had to pay for the 2013 year of assessment.	8
TOTAL MARKS		28

(Tax Workbook – Nieuwoudt et al)

QUESTION 9 - SUGGESTED SOLUTION
--

- (a) **Employees' tax that the respective employers had to withhold from Budgie Bird's remuneration for the 2013 year of assessment**

Pension fund	R	
The pension fund is deemed to be an employer.		
The annual equivalent of the remuneration is R84 000 (R7 000 × 12).		(1)
Normal tax on R84 000 at 18%	15 120	
<u>Less:</u> Primary rebate	(11 440)	
Total employees' tax on annual equivalent	3 680	(1)
Total employees' tax for the period (R 3 680 × 10/12)	3 066,67	(1)

Employer	R	
Salary: R25 000 × 12 months	300 000	(1)
Travelling allowance: R10 000 × 12 months × 80%	96 000	(1)
Income	396 000	
Medical scheme contributions: R870 × 12 months – fringe benefit	10 440	(1)
Remuneration	406 440	
<u>Less:</u> Pension fund contributions – actual = R300 000 × 7% = R21 000		(1)
Limited to the greater of 7,5% × R300 000 = R22 500; or R1 750; thus R22 500		
But limited to actual contributions of	(21 000)	(1)
Balance of remuneration and annual equivalent	385 440	

	R	
Normal tax on R385 440		
(R385 000 – R346 000) × 35% + R80 100	93 904	
<u>Less:</u> Primary rebate	(11 440)	(1)
<u>Less:</u> Section 6A medical rebate (R230 × 12)	(2 760)	(1)
Total employees' tax on annual equivalent and for period which is 12 months	79 704	(1)

QUESTION 9 - SUGGESTED SOLUTION (continued)**Budgie CC**

Directors of private companies are also subject to employees' tax. Employees' tax must be deducted from the higher of actual or deemed remuneration.

There are two periods applicable:

1 March 2012 to 31 May 2012

The deemed remuneration

$$\begin{aligned}
 Y &= \text{deemed monthly remuneration} \\
 T &= \text{remuneration last year of assessment which is 2011. The 2012 bonuses have not yet been finalised.} \\
 T &= (R\ 10\ 000 \times 12) + (20\% \times (R\ 10\ 000 \times 12)) = R\ 144\ 000 \\
 N &= \text{months} \\
 Y &= R\ 144\ 000 / 12 = R\ 12\ 000. \qquad (2)
 \end{aligned}$$

If 75% of T consists of fixed monthly payments then use actual: $R\ 120\ 000 / R\ 144\ 000 = 83\%$.
Use actual remuneration. (1)

And

1 June 2012 to 28 February 2013

$$\begin{aligned}
 Y &= \text{deemed monthly remuneration} \\
 T &= \text{remuneration last year of assessment which is 2012.} \\
 T &= R\ 146\ 000 (R\ 120\ 000 + R\ 26\ 000 \text{ (bonus)}) \qquad (1) \\
 N &= \text{months} \\
 Y &= R\ 146\ 000 / 12 = R\ 12\ 167. \qquad (1)
 \end{aligned}$$

If 75% of T consists of fixed monthly payments then use actual: $R\ 120\ 000 / R\ 146\ 000 = 82\%$. Use actual remuneration. (1)

Actual remuneration in both cases is more than 75% of T. Therefore, use actual remuneration.

As the deemed remuneration will only change after 30 June 2013 the actual remuneration of R10 000 per month will be used for the whole of the 2013 year of assessment.

Total employees' tax withheld for the period 1 March 2012 to 29 February 2013		R	
Salary: R10 000 × 12 months		120 000	(1)
Annual bonus (approved on 31 May 2012)		26 000	(1)
Remuneration		146 000	
On R146 000 at 18%		26 280	
Less: Primary rebate		(11 440)	
Total employees' tax liability for the period 1/3/2012 – 28/2/2013		14 840	(1)
			[20]

QUESTION 9 - SUGGESTED SOLUTION (continued)**(b) Provisional tax that Budgie CC had to pay for the 2013 year of assessment**

2013 first provisional tax payment			
Due date not later than 31 August 2012	R		
Estimate = Basic amount = R130 000 + 8% = R140 400			
Normal tax payable = (R140 400 – R63 556) × 7% (small business corporation)	5 379,08		(1)
For half year	× 50%		(1)
Provisional tax payment (first)	2 689,54		
2013 second provisional tax payment			
Due date not later than 28 February 2013			
Actual estimate (2012) = R285 000 (Basic amount = R270 000 (2012 assessment))			
Use basic amount = R270 000			(1)
Normal tax payable on R270 000			
(R270 000 – 63 556) × 7%	14 451,08		(1)
<u>Less:</u> First provisional tax payment (see above)	2 689,54		(1)
Provisional tax payment (second)	11 761,54		
Note: To avoid additional tax on any underpayment, the difference between actual taxable income and the estimated taxable income must not be more than 90%.			
90% × actual estimate (R285 000) = R256 500 which is less than the estimated taxable income (R270 000) used to calculate the provisional tax for 2013.			
2013 third provisional tax payment			
Due date not later than 30 September 2013 (to avoid possible interest on underpayments)	R	R	
Actual estimate = R285 000			(1)
Normal tax payable on R285 000			
(R285 000 – R63 556) at 7%		15 501,08	(1)
<u>Less:</u> First provisional tax payment (see above)	2 689,54		
Second provisional tax payment (see above)	11 761,54	(14 451,08)	(1)
Provisional tax payment (third)		1 050,00	
			[8]

QUESTION 10**36 marks**

Anti-Smoking Ltd is a pharmaceutical company and a public company for tax purposes. All the full-time employees are members of the company's pension fund. The employees must make a 10% contribution and the company a 5% contribution of basic salary according to the rules of the fund. The company does not have a medical scheme but is willing to deduct the contributions from the employees' salaries and to pay the fund on behalf of its employees. The company is also willing to withhold any annuity fund contributions and to pay the contributions to the fund on behalf of the employees. The company is also willing to take the above-mentioned contributions into account when calculating the employees' tax liability.

You are busy with an audit on employees' tax for SARS. The following three employees were selected for verification purposes.

Vogue Slim

Vogue Slim is thirty years old and married. She is a full-time employee and a representative of the company. She spends most of her working time on the road and visits medical doctors in the Gauteng area. Vogue was in employment of her employer for the full year and her remuneration package and benefits for the 2013 year of were as follows:

- (1) Her pension fund contributions are calculated on her basic salary of R30 000 a month.
- (2) The company deducted her retirement annuity fund contributions of R1 000 a month from her salary and paid it over on her behalf.
- (3) Vogue had the use of the employer's vehicle for the entire year of assessment. The determined value of the vehicle is R250 000 and the employer carries all costs relating to the vehicle. Vogue uses this vehicle at least 80% for the business of her employer.
- (4) The employer awarded a bursary of R20 000 to her to enrol for a diploma in marketing at UNISA. If she does not complete the course, she has to repay the amount.

Camel Filter

Camel Filter is sixty-six years old and he was the chief executive officer of Anti-Smoking Ltd. Assume that he qualifies for the relief granted in paragraph 11C(6) of the Fourth Schedule (deemed remuneration of directors of private companies). He retired on 30 November 2012. Camel's remuneration package and benefits for the 2013 year of assessment were as follows:

- (1) His pension fund contributions were calculated on his basic salary of R120 000 a month.
- (2) He received an annual bonus of R100 000 on 1 October 2012.
- (3) The company deducted R3 500 per month from his salary and paid it over to the medical scheme on behalf of Camel. He and his spouse are members of the medical scheme.
- (4) Camel enjoyed both the use of the employer's vehicle and a travelling allowance until retirement.

The determined value of the vehicle was R750 000. Camel had to pay for the entire private fuel and the full maintenance of the vehicle. His employer paid a travelling allowance of R20 000 a month on the same vehicle up to 30 November 2012. The employer estimates that the employee will use the vehicle less than 80% for business purposes.

QUESTION 10 (continued)**Paul Revere**

Paul Revere is not married and twenty-five years old. He is employed on a temporary basis as security guard since December 2012. He earns R9 000 a month and enjoys the free use of a small flat consisting of four rooms on the premises of his employer. The flat is furnished and electricity and water is provided. The employer deducted R700 a month from his salary and paid it over on his behalf to his medical scheme.

REQUIRED	Marks
Calculate the employees' tax for each of the three employees that the employer had to withhold for the year of assessment ending 28 February 2013.	36

(Tax Workbook – Nieuwoudt et al)

QUESTION 10 - SUGGESTED SOLUTION

Vogue Slims

	R	
Net remuneration excluding the annual payment for the year of assessment ending 28 February 2013:		
Salary: R30 000 × 12 months	360 000	(1)
Employer's contribution to pension fund – (R30 000 × 12 × 5% = R18 000) not a fringe benefit	-	
Use of company vehicle: R250 000 × 3,5% × 12 months = R105 000 × 20%	21 000	(1)
Bursary (sec 10(1)(q), award by employer to employee, employee agrees to pay back if she does not complete the course.	-	(1)
Remuneration	381 000	
<u>Less:</u> Pension fund contributions of R36 000 (R3 000 (R30 000 × 10%) × 12 months)		(1)
Limited to the greater of 7,5% of retirement funding employment income of R360 000 = R27 000; or R1 750. Thus limited to R27 000	(27 000)	(1)
	354 000	
<u>Less:</u> Retirement annuity fund contributions		
Actual contributions of R12 000 limited to the greater of 15% × (R381 000 – R21 000 + R105 000) = R465 000 - R360 000 = R105 000 × 15% = R15 750 or R3 500 less R27 000 = Rnil or R1 750 ⇒ Thus R12 000	(15 750)	(2)
Note: The value of the fringe benefit is R105 000, which is the amount that would be included in Income in terms of the Seventh Schedule. Therefore we base the deduction for RAF contributions on the R105 000 and not the R21 000.		
Net remuneration	338 250	
Normal tax on R338 250:		
(R338 250 – R250 000) × 30% + R51 300	77 775	(2)
<u>Less:</u> Primary rebate	(11 440)	(1)
Total employees' tax	63 335	

QUESTION 10 – SUGGESTED SOLUTION (continued)

Camel Filter	R	R	
Net remuneration for the period 1 March 2012 to 30 November 2012:			
Salary: R120 000 × 9 months		1 080 000	(1)
Use of company vehicle: 3.5% × R750 000 × 9 months × 80%		189 000	(2)
Travelling allowance: R20 000 × 9 months × 80%		144 000	(1)
(Note: In terms of the Fourth Schedule, only 80% of this travelling allowance needs to be included in remuneration for employee's tax purposes. It must however be kept in mind that if a person receives a travelling allowance and a fringe benefit on the use of a company vehicle (the same vehicle), no expenses will be deductible from the travelling allowance in terms of section 8(1)(a)(i)(aa). This might create a problem for the taxpayer on assessment.)			
Remuneration		1 413 000	
<u>Less:</u> Pension fund contributions			
Actual contributions of R108 000 (R120 000 × 9 × 10%) limited to the greater of 7,5% of retirement funding employment income of R1 080 000 = R81 000; or R1 750/12 × 9 = R1 312,50. Thus		(81 000)	(2)
<u>Less:</u> Medical scheme contributions R3 500 × 9 (Camel > 65 years of age)		(31 500)	(1)
Net remuneration		1 300 500	
Annual equivalent: (R1 300 500 × 12/9)		1 734 000	(1)
Normal tax on R1 734 000:			
(R1 734 000 – R617 000) × 40% + R178 940		625 740	(2)
<u>Less:</u> Primary rebate		(11 440)	(1)
<u>Less:</u> Secondary rebate		(6 390)	(1)
Employees' tax liability on annual equivalent		607 910	
Employee's tax on remuneration for the period (R607 910 × 9/12)		455 932	(1)
Annual equivalent		1 734 000	
<u>Plus:</u> Annual payment (bonus)		100 000	(1)
		1 834 000	
Normal tax on R1 834 000:			
(R1 834 000 – R617 000) × 40% + 178 940		665 740	(2)
<u>Less:</u> Primary rebate		(11 440)	(1)
Secondary rebate		(6 390)	
		647 910	
Therefore, employees' tax on annual payment (R647 910 – R607 910)		40 000	(1)
Total employees' tax liability (R455 932 + R40 000)		495 932	(1)

QUESTION 10 – SUGGESTED SOLUTION (continued)

You can also do the calculation for the annual equivalent for 12 months from the start (instead of 9 months).

Paul Revere	R	
Net remuneration for the period 1 December 2012 to 28 February 2013:		
Salary: R9 000 × 3 months	27 000	(1)
Housing benefit: (R72 000 – R63 556) × 19/100 × 3/12	401	(1)
Net remuneration	27 401	
Annual equivalent: (R27 401 × 12/3)	109 604	(1)
Normal tax		
On R109 604 at 18%	19 728,72	(1)
Less: Primary rebate (per par 9(1))	(11 440,00)	(1)
Less: Section 6A tax credit (R230 × 12) (per par 9(6))	(2 760,00)	(1)
Annual tax liability on annual equivalent	5 528,72	
Employee's tax for the period R5 528,72 × 3/12	1 382,18	(1)

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You can also do the calculation for the annual equivalent for 12 months from the start (instead of 3 months for Paul Revere).

QUESTION 11**26 marks**

Question 13.5 in QSAT.

You need to answer this question according to the legislation applicable to the 2013 year of assessment. This has the effect that you need to adjust all the dates in the question with 1 year.

QUESTION 11 SUGGESTED SOLUTION**(1)(a) Employees' tax deductible from Theresa Strydom's salary for the period ended 30 June 2012**

	R	
Salary (R6 500 x 4)	26 000	(½)
<u>Less:</u> Pension fund contributions – actual – R26 000 x 7% = R1 820, but limited to the greater of R1 750 / 4 = R438 or 7.5% x R26 000 = R1 950, but limited to actual	(1 820)	(2)
	24 180	
<u>Less:</u> Retirement fund contributions – actual – R26 000 x 10% = R2 600, but limited to greatest of R1 750 / 4 = R438, or (R3 500 / 4) – R1 820 = Rnil, or 15% x R24 180 – R26 000 + R1 820 + R5 000 = R750, therefore limited to	(750)	(2)
Balance of remuneration before bonus	23 430	
Annual equivalent (R23 430 x 12/4)	70 290	(1)
Normal tax per table on annual equivalent – R70 290 x 18%	12 652,20	
<u>Less:</u> Rebate	(11 440,00)	
	1 212,20	(1)
Employees' tax for the period (excluding annual payments) – R1 212,20 x 4/12	404,07	(1)
Annual equivalent	70 290	
<u>Plus:</u> Bonus (annual payment)	5 000	(1)
	75 290	
Normal tax per table (R75 290 x 18%)	13 552,20	
<u>Less:</u> Rebate	(11 440,00)	
Total employees' tax for the year	2 112,20	(1)
Employees' tax on bonus (R2 112,20 – R1 212,20)	900	
Total employees' tax for the period (R404,07 + R900)	1 304,07	(1)
<u>Note:</u> The employees' tax that would have been deducted for June 2012 would have been (R1 212,20 / 12) + R900 = R1 001,01		[10½]

QUESTION 11 – SUGGESTED SOLUTION (continued)**(b) Employees' tax deductible from Theresa Strydom's salary for the period 1 July 2012 to 28 February 2013**

	R	
Salary (R7 000 x 8)	56 000	(½)
Entertainment allowance (R1 000 x 8)	8 000	(1)
Remuneration	64 000	
<u>Less:</u> Retirement fund contributions – actual – R56 000 x 12.5% = R7 000, but limited to greatest of R1 750 / 8 = R218,75, or (R3 500 / 12) – Rnil = R292, or 15% x R64 000 = R9 600, but limited to actual	(7 000)	(2)
Balance of remuneration	57 000	
Annual equivalent (R57 000 x 12/8)	85 500	(1)
Normal tax per table on annual equivalent (R85 500 x 18%)	15 390	
<u>Less:</u> Rebate	(11 440)	
Total employees' tax for the year	3 950	(1)
Employees' tax for the period (R3 950 x 8/12)	2 633,33	(1)
		[6½]

(2) The effect of the above on the final tax liability of Theresa Strydom for the 2013 year of assessment

	R	
Salary received employer 1	26 000	
Bonus received	5 000	
Salary received employer 2	56 000	
Entertainment allowance received	8 000	
	95 000	(2)
<u>Less:</u> Pension fund contributions – actual – R26 000 x 7% = R1 820, but limited to the greater of R1 750 or 7.5% x R26 000 = R1 950, but limited to actual	(1 820)	(1)
	93 180	
<u>Less:</u> Entertainment expenses – prohibited i.t.o. s 23(m)	-	(1)
	93 180	
<u>Less:</u> Retirement fund contributions – actual = R2 600 + R7 000 = R9 600, but limited to greatest of R1 750, or R3 500 – R1 820 = R1 680, or 15% x R93 180 – R26 000 + R1 820 = R10 350, but limited to actual	(9 600)	(2)
	83 580	
Normal tax per table (83 580 x 18%)	15 044,40	(1)
<u>Less:</u> Rebate	(11 440,00)	(1)
	3 604,40	
<u>Less:</u> Employees' tax paid (R1 360,23 + R2 633,33)	(3 993,56)	(1)
Normal tax refundable by SARS	(389,16)	
		[9]

QUESTION 12**23 marks**

Question 14.6 in QSAT.

You need to answer this question according to the legislation applicable to the 2013 year of assessment. This has the effect that you need to adjust all the dates in the question with 1 year.

QUESTION 12 SUGGESTED SOLUTION**(1) Gabor's normal tax payable for the 2013 year of assessment**

	R	R	
	Lump sums		
Salary received (R20 000 x 8)		160 000	(1)
<u>Less:</u> Pension fund contributions – actual – R160 000 x 8% = R12 800, but limited to the greater of R1 750 or 7.5% x R160 000 = R12 000, therefore limited to R12 000. (R800 carried forward)		(12 000)	(2)
Company contribution to pension fund – no fringe benefit		-	
Pension received (R8 000 x 4)		32 000	(1)
<u>Less:</u> Exempt portion i.t.o s 10(1)(gC) – R32 000 x 17/28 – see note 1 below (not part of SAICA syllabus)		(19 429)	(1)
Pension fund lump sum received from pension fund	500 000		(1)
<u>Less:</u> Contributions not allowed as deductions i.t.o s 11(k) – R27 000 (previous years) + R800 (2013) = R27 800	(27 800)		(2)
Severance benefit received from employer (Yaskia Ltd)	100 000		(1)
	572 200		
Taxable portion according to s 9(2)(i) (R572 200 x 11/28) - see note 2 below (not part of SAICA syllabus)	224 793		(1)
Interest received		56 500	(1)
<u>Less:</u> Interest exemption - >65 years		(33 000)	(1)
		184 071	
<u>Less:</u> Retirement fund contributions – actual = R2 000 x 12 = R24 000, but limited to greatest of R1 750, or R3 500 – R12 000 = Rnil, or 15% x R184 071 – R160 000 + R12 000 = R5 411, therefore limited to		(5 411)	(2)
Total taxable income	224 793	178 660	
Normal tax on taxable income (excluding lump sums received) (R178 660 – R160 000) x 25% + R28 800		33 465,00	(1)
<u>Less:</u> Rebates (R11 440 + R6 390)		(17 830,00)	(1)
		15 635,00	
Normal tax on retirement lump sum benefits and severance benefits:		9 430,74	
Current year lump sums received (calculated above)	224 793		
Previous year retirement annuity lump sum received less contributions not allowed i.t.o s 11(n) (R150 000 – R7 400)	142 600		
	367 393		(1)

QUESTION 12 – SUGGESTED SOLUTION (continued)

Normal tax on all lump sum benefits received – R367 393 - R315 000 = R52 393 x 18%	R 9 430,74	R	(1)
<u>Less:</u> Hypothetical tax on retirement lump sums previously received – R142 600 – R315 000 = Rnil x 0% = Rnil	-		(1)
Normal tax liability on retirement lump sum benefits	9 430,74		
Normal tax liability		25 065,74	
			[19]
<u>Note 1:</u>			
It is submitted that s 10(1)(gC) should refer to s 9(2)(i). Not part of SAICA syllabus.			
<u>Note 2:</u>			
It is submitted that par 2 of the Second Schedule should refer to s 9(2)(i) and not to s 9(1)(g). Not part of SAICA syllabus.			

(2) Calculation of the effect of the above transactions on the taxable income of Yaskia Ltd for the 2013 year of assessment, with brief reasons

- The R160 000 salary paid to Gabor is deductible i.t.o. section 11(a). (1)
 - The pension fund contributions (R160 000 x 8% = R12 800) contributed by the company is deductible i.t.o. section 11(l). (1)
 - Retirement lump sum (severance benefit) paid to Gabor, is for past services (*Johnstone*) therefore not deductible i.t.o. section 11(a). (2)
- [4]

QUESTION 13**15 marks**

Question 21.10 in QSAT. Ignore number 3 of the required as transfer pricing does not form part of the SAICA syllabus.

You need to answer this question according to the legislation applicable to the 2013 year of assessment. This has the effect that you need to adjust all the dates in the question with 1 year.

You may assume that the amounts paid for royalties in 2 represents net royalties.

QUESTION 13 SUGGESTED SOLUTION**(1) Explanation and calculation of the normal tax and VAT effects of the write-off of the loan in 1, for the 2013 year of assessment**Normal tax

Recoupment of R10 000 $(R25\ 000 \times 40\%) \times \frac{100}{114} = R8\ 772$ i.t.o section 8(4)(m) included in income as the purchase price would have been deducted i.t.o section 11(a). (1)

No compromise set off under s 20(1)(a)(ii) as the creditor did not definitely waived the claim, is is a prescription of a debt. (1)

VAT

No effect as the adjustment in the 2013 year of assessment as an adjustment would have been made after the first 12 months, probably in the 2010 year of assessment $(R10\ 000 - R8\ 772 = R1\ 228)$. (1)
[3]

(2)(a) Discussion whether Alin or Aloevale are at risk of an attack by SARS under s 103(2)

In terms of section 103(2) a change in shareholders and an agreement has been entered into. (2)

- Purchase of shares and agreement to buy all Alin's products. (1)
- Income for Alin will increase in the company with the assessed loss. (1)

If Alin and Aloevale can prove that they entered into the agreement in order to retain the patented manufactured products and not to utilise the assessed loss, it is possible they could avoid the application of section 103(2). (2)
[6]

(2)(b) Normal tax effects of the patent purchased and the royalties paid to the French creator

	R	
Patent purchased – wear-and-tear deductible i.t.o. s 11(gC) $(R42\ 000 \times 5\%)$	2 100	(2)
Royalties paid to non-resident- deductible i.t.o. s 11(a) $(R6\ 000 + R4\ 000) / 88\%$	11 364	(2)
Withholding tax i.t.o. s 35 paid to SARS $(R11\ 364 \times 12\%)$	1 364	(2)
		[6]

QUESTION 14**12 marks**

Question 21.11 in QSAT.

QUESTION 14 SUGGESTED SOLUTION**Discussion on whether the Commissioner could apply the general anti-avoidance provisions (sections 80A – 80L) to a transaction between Holding Ltd and Sub Ltd****Is there is an arrangement as defined in section 80L**

Yes. (1)

Is it an avoidance arrangement (is there a tax benefit)?

Yes, there is a tax benefit as the Hold group would be deducting the interest paid, but earning tax exempt dividends from the preference shares. (1)

Was the sole or main purpose to avoid tax?

There is a rebuttle presumption as to purpose in terms of section 80G. From the facts, it appears that the only reason for the structure of the transaction as proposed is to obtain a tax benefit. Hold could simply have sold a 26% stake in Sub to the BEE Co. (1)

The Commissioner can in any event apply the GAAR (General Anti-Avoidance Rule) to steps or parts of transaction, so even if it can be argued that the sole or main purpose was to facilitate the BEE deal, the particular steps or parts giving rise to the tax benefits can be attacked by the Commissioner. (1)

Context test:**(i) Does the transaction lack commercial substance?**

In terms of section 80E, one of the tests for lack of commercial substance is the inclusion or presence of an accommodating or tax indifferent person. (1)

It does not appear, however, as if any party meets the definition of an accommodating or tax indifferent party in section 80E. (1)

Round trip financing:

Funds are transferred among the parties resulting in a tax benefit and resulting in reducing the business risk of the bank's subsidiary. Therefore, roundtrip financing as defined in section 80D does exist. (1)

(ii) Does it create rights or obligations not normally created by persons dealing at arms-length or would it result in the miss-use or abuse of the provision of the Act?

It is submitted that no abnormal rights and obligations arise from the transaction, especially as the interest rate and preference dividend rate are both market related. (1)

However it is submitted that the arrangement might fall foul of the section 80A(c)(ii) misuse and abuse of section 45 of the Income Tax Act. (1)

The arrangement would appear to be abnormal as contemplated in section 80A. (1)

Conclusions

Because the arrangement is an avoidance arrangement, which in whole or in part has its sole or main purpose the avoidance of tax, it is an impermissible avoidance arrangement, to which the Commissioner can apply sections 80A to 80L. (2)

[12]

QUESTION 15**40 marks**

Question 14.10 in QSAT.

You need to answer this question according to the legislation applicable to the 2013 year of assessment. This has the effect that you need to adjust all the dates in the question with 1 year. Except for the date at the top of page 261 (1 April 2010), which should be adjusted with two years to 1 April 2012.

You may further assume that Sasha's "retirement" from XYZ Provident Fund (note 3) will be treated as a withdrawal as Sasha was under 55 years of age. We do not expect you to have known this.

QUESTION 15 SUGGESTED SOLUTION

Income tax consequences for Mr Sasha Distell for the 2013 year of assessment			
1.	A.	Since the fund in question is a pension fund, the maximum amount that Sasha can take as a lump sum is $\frac{1}{3}$ of R3 million = R1 million.	(1)
		Paragraph 5 (Second Schedule) provides that the lump sum benefit can be reduced by the deductions permissible in that paragraph. In this instance, those deductions are the contributions not previously ranking for deduction in terms of either s 11(k) or s 11(n) of R250 000.	(1)
		Therefore the retirement fund lump sum benefit = R1 million – R250 000 = R750 000	(1)
		Tax thereon, per retirement fund lump sum benefit (RFLB) table = R89 100 [(R750 000 - R630 000) x 27% + R56 700]	(1)
	B.	Transferring his interest from the pension fund is treated as a withdrawal from the fund. An amount is taxable unless deductions permissible against that lump sum in paragraph 6 (Second Schedule) can reduce the lump sum.	(2)
		In terms of paragraph 6, transfers from one fund to another fund are generally treated as deductions (see par 6(1)(a)(ii)). However, no deduction is granted for a move from a pension fund to a provident preservation fund. This is due to the fact that the provident preservation fund permits a full lump sum commutation on retirement or withdrawal as opposed to the pension fund (which on retirement only permits commutation of one-third of the benefit as a lump sum).	(2)
		The contributions that have not ranked for deduction in terms of s 11(k) or s 11(n) are, however, permissible deductions in terms of paragraph 6 (see par 6(1)(b)(i)). The taxable lump sum is therefore R3 million - R250 000 = R2 750 000. (Provided the pension fund permits the transfer of the full R3 million).	(1)
		Tax thereon, per the retirement fund lump sum withdrawal benefit (RFLWB) table = R850 950 [(R2 750 000 - R900 000) x 36% + R184 950].	(1)
	C.	Transferring his interest from the pension fund is treated as a withdrawal from the fund.	(1)
		In terms of paragraph 6, transfers from one to another fund are generally treated as deductions (see par 6(1)(a)(ii)). A deduction is granted for a move from a pension fund to a pension preservation fund (see par 6(1)(a)(ii)(aa)). As the deduction matches the lump sum, no tax is payable.	(2)

QUESTION 15 – SUGGESTED SOLUTION (continued)

2.	A.	Since the fund in question is a provident fund, Sasha can take the full amount of the fund value as a lump sum.	(1)
		Since he is older than 55 years on 28 February 2013, he can validly retire from the provident fund.	(1)
		Paragraph 5 would permit as a deduction against that lump sum the contributions that have not previously ranked for deduction in terms of s 11(k) or s 11(n).	(1)
		Therefore the retirement fund lump sum benefit is R3 million – R250 000 = R2 750 000.	(1)
		Tax thereon, per the RFLB table = R791 550 [(R2 750 000 - R945 000) x 36% + R141 750].	(1)
	B.	Transferring his interest from a provident fund to a provident preservation fund would be treated as a withdrawal.	(1)
		However, paragraph 6 would permit as a deduction against that lump sum the amount transferred from the provident fund to the provident preservation fund (see p6(1)(a)(ii)(cc)).	(1)
		As the deduction matches the lump sum, no tax is payable.	(1)
3.		Sasha's 'retirement' from the XYZ provident fund is treated as a withdrawal since he was under the age of 55 years on 1 April 2012.	(1)
		As the fund in question is a provident fund, he can take the full value in the fund as a lump sum.	(1)
		Paragraph 6 (Second Schedule) provides that the lump sum benefit can be reduced by the deductions permissible in that paragraph. In this instance, those deductions are the contributions not previously ranking for deduction in terms of either s 11(k) or s 11(n) of R235 000 of the pension contributions and the undeducted R300 000 of the provident fund contributions.	(2)
		Therefore the taxable portion is R2 million – R235 000 - R300 000 = R1 465 000.	(2)
		Tax thereon, per the RFLWB table = R388 350 [(R1 465 000 - R900 000) x 36% + R184 950].	(1)
		On retirement from the KWV pension fund he can take a maximum of 1/3 of R3 million as a lump sum benefit i.e. R1 million.	(1)
		Paragraph 5 then permits as a deduction against that lump sum, contributions not previously ranking for deduction in terms of s 11(k) or s 11(n). However, use cannot be made of amounts that have been previously applied in terms of the Second Schedule. The only remaining contributions are therefore R15 000 pension contributions (R250 000 less R235 000 used above).	(1)

QUESTION 15 – SUGGESTED SOLUTION (continued)

	Therefore the retirement fund lump sum benefit is R1 million – R15 000 = R985 000.	(1)
	The RFLB tax tables are cumulative, therefore, in calculating the tax attributable to the RFLB, we must add the RFLWB to the RFLB i.e. R1 465 000 + R985 000 = R2 450 000.	(2)
	The tax on this amount, per the RFLB table, is R683 550 [(R2 450 000 - R945 000) x 36% + R141 750].	(1)
	From this is subtracted the (hypothetical) tax that would be payable on the aggregate of previous RFLBs and RFLWBs.	(1)
	In this case the only previous lump sum received was in respect of the provident fund withdrawal, which amounted to R1 465 000. This aggregate lump sum must be applied against the RFLB table to determine the amount of tax to be applied against the cumulative tax above, namely R 328 950 [(R1 465 000 - R945 000) x 36% + R 141 750].	(2)
	Therefore the tax attributable to the RFLB is R683 550 – R 328 950 = R 354 600.	(1)
4.	In each case, after applying the deductions in terms of either paragraph 5 or 6 against the lump sum, the amount of the lump sum to be considered would first have to be determined in terms of Formula C.	(2)
		[40]

QUESTION 16**20 marks**

Question 12.10 in QSAT.

You need to answer this question according to the legislation applicable to the 2013 year of assessment. This has the effect that you need to adjust all the dates in the question with 1 year.

QUESTION 16 SUGGESTED SOLUTION**(1) Eric Clayton's annual nett cash flow for the 2013 year of assessment**

	R	R	
Company car:			
Fringe benefit (R214 000 x 3.5% x 12)		89 880	(1)
<u>Less:</u> Business kilometres travelled i.t.o par 7(7) of the Seventh Schedule (on assessment). R89 880 x 15 000km/40 000km		(33 705)	(1)
Net inclusion in taxable income		56 175	
Normal tax effect on amount included in taxable income at marginal rate of 40%		22 470	(1)
Travelling allowance:			
Travelling allowance (R3 000 x 12)		36 000	(1)
Fringe benefit – interest free loan (R214 000 x 8%)		17 120	(1)
		53 120	
<u>Less:</u> Travelling costs			
Option A – actual expenditure:			
Wear-and-tear on vehicle – s 8(1) (R214 000 / 7 years)	30 571		
Deemed interest – par 11(5) – deemed interest (R214 000 x 8%)	17 120		
Other expenses (provided)	13 460		
	61 151		(2)
Cost per kilometre in cents (R61 151 / 40 000km)	152,88c		(1)
Deduction (15 000km x 152.88c / 100)	22 932		(1)
Option B – deemed expenditure (per table):			
Fixed cost (R66 440 / 40 000km) x 100c	166,10c		
Fuel cost	89,60c		
Maintenance cost	36,90c		
Cost per kilometre in cents	292,60c		(2)
Deduction (15 000km x 292,60c / 100)	43 890		(1)
Option B provides a higher deduction, but must also be limited to the amount of the allowance received, therefore limit to		(36 000)	(1)
Net inclusion in taxable income		17 120	
Normal tax effect on amount included in taxable income at marginal rate of 40%		6 848	(1)

QUESTION 16 – SUGGESTED SOLUTION (continued)

	Company car	Travelling allowance	
	R	R	
Net cash inflow / (outflow):			
Normal tax	(22 470)	(6 848)	(1)
Plus: Travelling allowance received		36 000	(1)
Less: Actual costs incurred		(13 460)	(1)
Net cash inflow / (outflow)	(22 470)	15 692	
Therefore, the travelling allowance will provide the greatest annual cash flow for the 2013 year of assessment.			

(2) Greatest cash flow advantage at the end of 5 years

	Company car	Travelling allowance	
	R	R	
Net cash inflow / (outflow) over 5 years (R22 470 x 5years) (R15 692 x 5years)	(112 350)	78 460	(1)
Less: Repayment of loan		(214 000)	(1)
Plus: Value of car		20 000	(1)
Net cash outflow over 5 years	(112 350)	(115 540)	
Therefore, although the travelling allowance provides the greatest annual cash flow in the 2013 year of assessment, the company car provides the greatest net cash flow after 5 years.			
			[20]

END OF TUTORIAL LETTER