Answers

Marks

1 Cement Brick Co Ltd

(a) Accrual of deliveries

	Marks
The definition of gross income requires the inclusion of all amounts which are received or accrued in cash or otherwise in the particular year of assessment, other than amounts of a capital nature.	1
The amounts under consideration in this part are clearly not of a capital nature, being the sale of Cement Brick Co Ltd's (CBC) trading inventory.	½
The issue is therefore whether or not the amounts billed can be considered to be 'accrued' for the purposes of the gross income definition. As no amount has been received for the invoices issued, receipt is not considered.	½
For the amount to have 'accrued', CBC must be unconditionally entitled to the amount.	½
With respect to the bricks being delivered, it is submitted that the taxpayer is not yet unconditionally entitled	½
to the amounts. Delivery would be required in order to conclude the sale contract and thus the accrual.	1
In conclusion, the amounts will not be included in gross income of the 2014 year of assessment. Furthermore, the cost price of the blocks being delivered would be included in closing inventory (as the inventory is still	½
'held and not disposed' by the taxpayer – albeit that the inventory is 'held' on the delivery truck).	½
	5

(b) Pension payment

	Marks
For an amount to be deductible, the amount must be expenditure actually incurred, in the production of income, other than an amount of a capital nature (the general deduction). Alternatively, a specific deduction provision must apply.	½
Specific deduction	
Should the R5,000 paid in equal instalments be classified as an annuity, CBC would qualify for a deduction of the annuity amounts in terms of a specific deduction provision for annuities to former employees. However,	1
annuities are amounts chargeable against some person. As this payment to Mrs A may be viewed as voluntary on CBC's part, it may not qualify as an annuity.	½
Therefore, the general deduction rules must be considered.	
General deduction	
It is clear that the amounts have been paid to Mrs A during the year and are therefore actually incurred.	½
Furthermore, the compensation paid to Mrs A arises effectively from her past employment services rendered and it is therefore submitted to be of a revenue nature.	1
To meet the 'in the production of income' requirement, there must be an intention for the incurred expenditure	1
to give rise to income. In this case the payment is in recognition of Mrs A's prior services. There is no intent for this expenditure to give rise to future income and as such cannot be classified as 'in the production of income' [*WF Johnstone* & *Co* v *CIR*]. Accordingly, the payment is unlikely to be deductible.	½
	5

				Marks
(c)	**Income tax liability for the 2014 year of assessment**			
		R	R	
(i)	Sales (as per conclusion in part (a)) – R183,000,000 – R6,500,000		176,500,000	1
(i)	Goods in transit (closing inventory) (R2,700,000 + R5,000,000)		7,700,000	1
(ii)	Pension payment (as per conclusion in part (b)) – no deduction		0	½
(iii)	Kilns			
	Kiln A: Impact for 2014 year of assessment			
	Recoupment of allowances:			
	Selling price (R55,000) limited to cost price (R650,000)	55,000		1
	Less tax value R650,000 less R650,000 (allowances claimed 40%:2010; 20%:2011; 20%:2012; 20%:2013)	0		1
	Recoupment to be deferred	55,000		
	Capital gain or capital loss:			
	Proceeds	55,000		½
	Less recoupment	(55,000)		½
		0		
	Less base cost:			
	Expenditure less allowances permitted (650,000 – 650,000)	0		1
	Capital gain to be deferred	0		
	Allowance on Kiln B: R990,000 x 40%		(396,000)	½
	Recognised portion of recoupment of Kiln A: 40% x R55,000		22,000	1
	However, as Kiln B had to be replaced, the remaining recoupment of Kiln A must be immediately recognised (R55,000 – R22,000)		33,000	1
	Kiln B: Impact for 2014 year of assessment			
	Recoupment of allowances:			
	Insurance proceeds	1,000,000		½
	Limited to cost price	990,000		½
	Less tax value R990,000 less R396,000 (2014)	(594,000)		1
	Recoupment to be deferred	396,000		
	Capital gain or capital loss:			
	Proceeds	1,000,000		½
	Less recoupment	(396,000)		½
		604,000		
	Less base cost:			
	Expenditure less allowances permitted (990,000 – 396,000)	594,000		1
	Capital gain to be deferred	10,000		
	Allowance on Kiln C: R1,100,000 x 40%		(440,000)	½
	Recognised portion of recoupment of Kiln B: 40% x R396,000		158,400	1
(iv)	Moulding machines: (Year 2): 20% x R1,250,000		(250,000)	½
	Mixing machine: (Year 2): 20% x R1,300,000		(260,000)	½
	Cuber: Fully depreciated in prior year		0	½
(v)	Manufacturing building allowance: 5% x R10,200,000		(510,000)	½
(vi)	Other tax deductible expenses – given		(132,678,000)	½
(vii)	Capital gain from deferral to be recognised: 40% x R10,000	4,000		1
	Sum of current year capital gains and capital losses	4,000		
	Less assessed capital loss brought forward	(2,500)		
	Net capital gain	1,500		
	Taxable capital gain inclusion 66·6% x R1,500		999	½
	[**Tutorial note:** *A figure of R1,000 is incorrect and the legislation makes the inclusion 66·6% and not two-thirds*]			
	Taxable income		49,880,399	

	R	Marks
Tax at 28%	13,966,511	½
Less provisional tax (R5,500,000 + R6,000,000)	(11,500,000)	1
Tax due	2,466,511	
		20
		30

2 Joe Moffet

(a) Residence

There are two tests for residence for natural persons, namely the legal subjective test of 'ordinarily resident' and the objective test of 'physical presence'. A person will be considered to be resident in South Africa if they meet either test. 1

Ordinarily resident

Case law has determined that a person will be ordinarily resident in South Africa if South Africa would be the place to which they would return to from their wanderings, despite absences of long or short duration. For a person to become 'ordinarily resident' in South Africa, there must first be the intention to become ordinarily resident and steps taken to indicate that the intention will be carried out. 1

While Joe has indicated an intention to be in South Africa for six months each year in order to see his daughter, there is no real indication that this is an intention to become ordinarily resident. The fact that all his work is still carried out in the United Kingdom and that Joe maintains a home in the United Kingdom is more indicative of an intention to remain resident in the United Kingdom. While Joe does maintain a property in South Africa, this single factor alone is likely to be insufficient to deem him ordinarily resident in South Africa. 2

Physical presence

The objective physical presence test is a mere count of days of presence in South Africa (where part of a day is counted as a full day and days in transit through South Africa where no formal entry is made via a port of entry into South Africa are excluded). 1

There are three parts to the test and if Joe does not meet any part of this test, he will be deemed to be non-resident in South Africa: (i) has the taxpayer been in South Africa for more than 91 days in the current year of assessment; (ii) has the taxpayer been in South Africa for more than 91 days in each of the five preceding years of assessment; and (iii) has the taxpayer been in South African for more than 951 days in aggregate in the five preceding years of assessment. 1

Joe only began to visit South Africa from January 2009. He could not have spent 91 days in South Africa in the 2009 year of assessment. The count therefore begins from the 2010 year of assessment. As only five years have passed and Joe did not spend more than 91 days in the 2009 year of assessment, he cannot yet be deemed to be ordinarily resident in South Africa. 2

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Marks

(b) Taxable income for the 2014 year of assessment – Sigi Manual

	R	R	Marks
Lump sum amount received (funded by insurance policy)		100,000	½
Exemption for the premiums treated as a fringe benefit (R50,000 + R12,000)		(62,000)	½
Policy premiums fringe benefit		12,000	½
Long-service award – watch	6,500		½
Reduction for long service (lesser of R5,000 or the cost to the employer of all such awards given to the employee in the year of assessment)	(5,000)	1,500	1
Salary (R20,000 x 10)		200,000	½
Company car	190,000		½
Reduction for use granted after 12 months of ownership: 15% x R190,000	(28,500)		1
Value on which the company car use is based	161,500		
Fringe benefit for use of the company car: R161,500 x 3·5% x 10 months (no maintenance plan)		56,525	½
Low interest loan: R200,000 x (8% – 3%) x 10/12		8,333	1
Mobile phone (used exclusively for business purposes – no fringe benefit arises)		0	½
Entertainment allowance		4,000	½
No deduction against the entertainment allowance is permitted as Sigi is a salaried employee		0	½
Interest received (2,708 + 32,000)	34,708		1
Interest exemption for persons under 65	(23,800)	10,908	½
Included in the R10,908 taxable interest is R2,708 arising from the excess capital from the low interest loan as invested by Sigi. As a result of this income inclusion, the interest income may be reduced by that portion of the fringe benefit giving rise to the interest, i.e. R8,333 x R50,000/R200,000 as a deemed interest expense to generate this income.		(2,083)	1
Less interest paid on R50,000 portion of the loan used to generate interest income: R50,000 x 3% x 10/12		(1,250)	1
		327,933	
Contribution to provident fund (no deduction permitted)		0	½
RAF contribution – Actual of R3,500 limited to greater of:			
R1,750			½
R3,500 – 0			½
15% x (R327,933 – R200,000) – The cash salary of R200,000 was utilised to make contributions to the provident fund.		(3,500)	1
		324,433	
Medical expenses:			
Contributions	13,000		½
Reduced by = 4 x (R242 x 12)	(11,616)		1
	1,384		
Add other medical expenses	45,000		½
Less recovered from medical aid	(15,000)		½
Reduced by 7·5% x R324,433	(24,332)	(7,052)	½
Taxable income		317,381	
			17
			25

Tutorial note: *Sigi would be entitled to a rebate of R242 x 12 against her normal tax liability after the application of the primary rebate*

					Marks
3	**(a)** **AB Furniture Co Ltd**				
		R	R	R	
(1)	**Disposal of old factory**				
	Allowance on old factory: R2,000,000 x 5% (not apportioned)			(100,000)	½
	Scrapping allowance on factory:				
	Selling price		350,000		½
	Less tax value: R2,000,000 less (R2,000,000 x 5% x 12 years)		(800,000)	(450,000)	1
	Capital gains tax:				
	Proceeds		350,000		½
	Less base cost:				
	Expenditure	2,600,000			½
	Less allowances R2,000,000 x 5% x 12	(1,200,000)			1
	Less scrapping allowance	(450,000)	(950,000)		1
	Capital loss		(600,000)		
	Allowance on new factory building: R4,400,000 x 5%			(220,000)	½
(2)	**Appropriation of land**				
	Proceeds		2,500,000		½
	Base cost		(3,400,000)		½
	Capital loss		(900,000)		
(3)	**Sale of drill press**				
	Recoupment of allowances:				
	Selling price		3,500		
	Cost price		4,800		
	Tax value		0		
	Recoupment (R3,500 less R0)			3,500	1
	Capital gain or loss:				
	Proceeds		3,500		½
	Less recoupment		(3,500)		½
			0		
	Less base cost:				
	Expenditure		4,800		½
	Less allowances		(4,800)		½
	Capital gain		0		
(4)	**Sale of industrial sanding machine**				
	Recoupment of allowances:				
	Selling price		2,350		
	Cost price		15,000		
	Tax value		0		
	Recoupment to be deferred (R2,350 less R0)		2,350		1
	Capital gain or loss:				
	Proceeds		2,350		½
	Less recoupment		(2,350)		½
			0		
	Less base cost:				
	Expenditure less allowances permitted (15,000 – 15,000)		0		1
	Capital gain to be deferred		0		
	As the capital gain was R0 (i.e. not a loss), the capital gain and recoupment may be deferred. As the replacement asset is a depreciable asset, the recoupment and capital gain are effectively 'spread' over the tax useful life of the replacement asset.				
	Recoupment recognised: R2,350 x 40%			940	1
	Capital gain recognised: R0 x 40%		0	0	1

	R	R	*Marks*
Allowances on replacement industrial sanding machine			
R25,000 x 40%		(10,000)	1
Total capital gains and capital losses:			
From (1), (2), (3) and (4) above	(1,500,000)		½
Add assessed capital loss brought forward from 2013	(17,200)		½
Assessed capital loss carried forward	(1,517,200)		
Effect on taxable income		(775,560)	½
			17

(b) Mologodi Mayaba

	R	R	
(1) The sale of the collection of paintings is a sale of personal use assets and therefore any capital gain or capital loss is disregarded.	0		½
(2) Proceeds	1,150,000		½
Base cost (market value when inherited)	(1,450,000)		½
Capital loss	(300,000)		
As the aircraft is greater than 450 kg in weight, it is not a personal use asset. However, the capital loss is to be disregarded [see p15 of the 8th Schedule to the Income Tax Act].		0	1
As no capital gains or capital losses remain to be aggregated, there is no amount to be reduced by the annual exclusion (which of itself cannot generate an assessed capital loss).			
Therefore, Mologodi's aggregate capital gain or capital loss is nil.			½
			3
			20

Marks

4 Runner (Pty) Ltd

Input/output value added tax (VAT) effects

		Input VAT R	Output VAT R	Marks
(i)	Sales to UK customers (exports are zero rated)		0	½
(ii)	Sales to local customers R12,524,830 x 14/114		1,538,137	½
(iii)	International flight (zero rated)	0		½
	Domestic flight R3,800 x 14/114 (as purchased separately)	467		1
	Overseas accommodation (service rendered outside of South Africa)	0		1
(iv)	Purchases from small suppliers: As the suppliers are not VAT vendors and the goods are new goods, no input VAT claim is possible	0		1
(v)	Purchases from VAT vendors R7,945,254 x 14/114	975,733		1
(vi)	Insurance receipt for inventory R90,000 x 14/114		11,053	1
(vii)	Acquisition of building			
	Input VAT relating to storage portion (recoverable) R4,570,000 x 14/114 x 60%	336,737		1½
	Input VAT relating to recreational club portion (input denied – entertainment purposes)	0		½
(viii)	Sale of land to Sports (connected person). However, consideration of R1,105,800 (R970,000 plus VAT of R135,800 (being 14% x R970,000)) was not less than open market value of R1,050,000. Therefore use actual consideration for output VAT calculation.		135,800	1½
(ix)	Purchase of second-hand machine from VAT vendor R90,300 x 14/114	11,089		
(x)	Instalment credit agreement. VAT input tax deductible in full up front.			½
	The consideration is the 'cash value', which is the cost of the goods, including VAT, but excluding finance charges.			½
	Input tax is therefore: (R237,360 – R59,520) x 14/114	21,840		1½
(xi)	Motor car purchased, input denied	0		
	Output tax on fringe benefit: R370,200 x 100/114 x 0·3% x 14/114 x 2m		239	1
(xii)	Inventory donated: Deemed supply. Market value is used as the deemed consideration. R3,306 x 14/114		406	1
(xiii)	Salaries and wages. No VAT. The rendering of employment services is not an enterprise.	0		½
		1,345,866	1,685,635	
				15

5 Theoretical questions

(a) The avoidance of tax encompasses the principle that no one is obliged to pay more tax than the law demands and that therefore taxpayers are entitled to structure their affairs in the way which will minimise their tax liabilities, provided that this is within the remit of the law. 1½

An example of tax avoidance would be a taxpayer in business claiming the capital allowances to which they are entitled, although frequently tax avoidance is much more complex and can involve artificial structures not originally intended by the Government. ½

Evasion on the other hand is where a taxpayer uses illegal means to intentionally avoid paying their true liability. Unlike tax avoidance, a reduction in tax is achieved only through a failure to comply with tax law and thus tax evasion is a criminal offence. 1½

An example of tax evasion would be the non-disclosure of income earned or the deliberate overstatement of deductible expenses. ½

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(b) The main purpose of tax in the modern economy is to fund government expenditure on the provision of services and benefits to the public (for example, to fund the costs of the police force, maintaining public roads, schools and hospitals, etc). Taxes can also perform other social functions such as wealth redistribution. 1 1

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		Marks
(c)	Direct tax is paid to the government by the same person (whether individual or corporate) on which it is imposed. Therefore, a direct tax is a tax on persons.	1½
	An example of a direct tax is income tax, which is calculated based on a taxpayer's taxable income.	½
	Indirect tax, on the other hand, is imposed on a transaction rather than a person. A person has the ability to engage in or refrain from taking part in a transaction in order to avoid the associated tax consequences.	1½
	An example of an indirect tax is value added tax (VAT).	½
		4
		10