Fundamentals Level – Skills Module

# Taxation (South Africa)

Tuesday 2 December 2014

**Time allowed**
Reading and planning: 15 minutes
Writing: 3 hours

ALL FIVE questions are compulsory and MUST be attempted.
Tax rates and allowances are on pages 2–4.

**Do NOT open this paper until instructed by the supervisor.**

**During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.**

**This question paper must not be removed from the examination hall.**

**The Association of Chartered Certified Accountants**

# Paper F6 (ZAF)

ACCA

## SUPPLEMENTARY INSTRUCTIONS

1. Calculations and workings need only be made to the nearest R.
2. All apportionments should be made to the nearest month.
3. All workings should be shown.

## TAX RATES AND ALLOWANCES

**The following tax rates and allowances are to be used in answering the questions.**

**Year ending 28 February 2014/31 March 2014**

| | |
|---|---|
| **Rebates** | |
| Primary rebate | R12,080 |
| Secondary rebate (over 65) | R6,750 |
| Tertiary rebate (over 75) | R2,250 |
| **Interest exemption** | |
| Under 65 | R23,800 |
| Over 65 | R34,500 |

**Foreign dividend exemptions**

Fully exempt where 10% or more of the equity shares and voting rights are held.
Fully exempt where received by a company from a foreign company resident in the same country as the recipient.
To the extent of any controlled foreign company inclusions (net of applicable foreign tax)
To the extent that the foreign dividend is from a company listed on the JSE

To the extent that the above do not apply:
For individuals 25/40ths of the dividend is exempt
For companies 13/28ths of the divided is exempt

| | |
|---|---|
| **Medical rebate rates** | |
| Single member | R242 |
| Member plus one dependant | R484 |
| Each subsequent dependant | R162 |
| **Dividends tax** | 15% |
| **Companies** | |
| Normal tax rate | 28% |
| Official rate of interest (assumed) | 8% |

**Rates of normal tax payable by persons (other than companies)**
**for the year of assessment ended 28 February 2014**

**Where the taxable income:**

| | |
|---|---|
| does not exceed R165,600 | 18% of each R1 of the taxable income |
| exceeds R165,600 but does not exceed R258,750 | R29,808 plus 25% of the amount over R165,600 |
| exceeds R258,750 but does not exceed R358,110 | R53,096 plus 30% of the amount over R258,750 |
| exceeds R358,110 but does not exceed R500,940 | R82,904 plus 35% of the amount over R358,110 |
| exceeds R500,940 but does not exceed R638,600 | R132,894 plus 38% of the amount over R500,940 |
| exceeds R638,600 | R185,205 plus 40% of the amount over R638,600 |

**Tax rates for small business corporations**
for the year of assessment ended 31 March 2014

Where taxable income:

| | |
|---|---|
| does not exceed R67,111 | Nil |
| exceeds R67,111 but does not exceed R365,000 | 7% of the amount over R67,111 |
| exceeds R365,000 but does not exceed R550,000 | R20,852 plus 21% of the amount over R365,000 |
| exceeds R550,000 | R59,702 plus 28% of the amount over R550,000 |

**Turnover tax rates for micro business corporations**
for the year of assessment ended 31 March 2014

Where taxable turnover:

| | |
|---|---|
| does not exceed R150,000 | Nil |
| exceeds R150,000 but does not exceed R300,000 | 1% of the amount over R150,000 |
| exceeds R300,000 but does not exceed R500,000 | R1,500 plus 2% of the amount over R300,000 |
| exceeds R500,000 but does not exceed R750,000 | R5,500 plus 4% of the amount over R500,000 |
| exceeds R750,000 but does not exceed R1,000,000 | R15,500 plus 6% of the amount over R750,000 |

**Car allowance**

| | |
|---|---|
| Maximum vehicle cost for actual expenses | R480,000 |

**Fringe benefit (company car)**

| | |
|---|---|
| Benefit percentage (where no maintenance plan exists) | 3·5% |
| Benefit percentage (where a maintenance plan exists) | 3·25% |

General business reduction: Benefit value x business kms/total kms (as per logbook)
Private fuel reduction: Private fuel (R) x private kms/total kms (as per logbook)
Private maintenance reduction: Private maintenance (R) x private kms/total kms (as per logbook)

**Subsistence allowances**

Deemed expenditure for meals and incidental costs (per Government regulation) R319 per day (local travel)
Deemed expenditure for incidental costs only (per Government regulation) R98 per day (local travel)
Deemed expenditure for meals and incidental costs (foreign travel) – (per published tables) will be supplied in the question where relevant

**Common capital allowances**

| | |
|---|---|
| New and unused manufacturing plant and equipment | 40%/20%/20%/20% |
| Used or leased manufacturing plant and equipment | 20% each year for five tax years |
| Small business corporation manufacturing plant and equipment | 100% |
| Small business corporation (other assets) – unless wear and tear provides a greater deduction | 50%/30%/20% |

**Wear and tear (based on Binding General Ruling 7) will be supplied in the question where relevant**

| | |
|---|---|
| Manufacturing building allowance (unless seller's rate supplied) | 5% |
| New or unused commercial building (not a manufacturing building) | 5% |

– No deduction where another section of the Act applies to the building
– Where part of a building is acquired, 55% of the acquisition price is 'cost'
– Where an improvement to the building is acquired, 30% of the acquisition price of the improvement is 'cost'

| | |
|---|---|
| Research and development (R&D) expenditure | 100% |

Additional 50% on expenditure incurred if R&D project is approved by the Minister of Science and Technology and incurred for R&D after such approval

**Capital gains tax**

| | |
|---|---|
| Annual exclusion (while alive) | R30,000 |
| Annual exclusion (in year of death) | R300,000 |
| Primary residence exclusion | R2,000,000 |

(where proceeds are R2 million or less, the full gain is excluded for the portion of the property used for domestic purposes as a primary residence)

| | |
|---|---|
| Inclusion rate (natural persons) | 33·3% |
| Inclusion rate (non-natural persons) | 66·6% |

Time apportioned base cost formulae:

$$Y = B + [(P - B) \times N]/(T + N)$$

$$P = R \times B/(B + A)$$

Where deductible enhancement expenditure has been incurred after the valuation date, the time apportioned base cost formulae change to:

$$Y = B + [(P_1 - B_1) \times N]/(T + N)$$

$$P_1 = R_1 \times B_1/(A_1 + B_1)$$

**Travel allowance table**
for years of assessment commencing on or after 1 March 2013

| Value of the vehicle (including value added tax (VAT) but excluding finance charges or interest) | Fixed cost | Fuel cost | Maintenance cost |
|---|---|---|---|
| R | R p.a. | c/km | c/km |
| 0 – 60,000 | 19,310 | 81·4 | 26·2 |
| 60,001 – 120,000 | 38,333 | 86·1 | 29·5 |
| 120,001 – 180,000 | 52,033 | 90·8 | 32·8 |
| 180,001 – 240,000 | 65,667 | 98·7 | 39·4 |
| 240,001 – 300,000 | 78,192 | 113·6 | 46·3 |
| 300,001 – 360,000 | 90,668 | 130·3 | 54·4 |
| 360,001 – 420,000 | 104,374 | 134·7 | 67·7 |
| 420,001 – 480,000 | 118,078 | 147·7 | 70·5 |
| Exceeds 480,000 | 118,078 | 147·7 | 70·5 |

**Note: Where reimbursement is based on actual business kilometres travelled and no other compensation is paid to such employees and the kilometres travelled for business does not exceed 8,000, the prescribed rate is R3·24 per kilometre.**

**This is a blank page.**
**Question 1 begins on page 6.**

**ALL FIVE questions are compulsory and MUST be attempted**

**1** Cement Brick Co Ltd (CBC) is a company engaged in the manufacture of cement blocks and bricks for the building industry. The Commissioner for South African Revenue Service (SARS) accepts that these activities are processes of manufacture for the purposes of the Income Tax Act. CBC manufactures two different brick strengths, namely 7 MPa and 14 MPa (14 MPa bricks being stronger than 7 MPa bricks).

CBC is not classified as a small business corporation. The company is registered as a value added tax (VAT) vendor but all amounts are stated excluding VAT.

The following information relates to CBC's financial year ended 31 March 2014:

(i) CBC issues their invoice to the customer for the full value of the blocks or bricks being delivered at the time when the delivery vehicle is loaded and dispatched. Customers pay within 60 days. However, it is anticipated that approximately 10% of the 7 MPa bricks and 6% of the 14 MPa bricks will be broken during the delivery process. Credit notes in respect of any broken bricks are then issued to the customer. The delivery drivers are responsible for documenting the number of bricks broken per delivery.

Total invoices issued for the year amounted to R183,000,000 against which credit notes of R6,500,000 had to be issued. In addition to the above amounts, at 31 March 2014, deliveries of R4,000,000 worth of 7 MPa bricks (with a cost of R2,700,000) and a further R6,000,000 of 14 MPa bricks (with a cost of R5,000,000) were underway but not complete. Invoices had been issued but no credit notes in respect of any broken bricks. No bricks were in transit at 1 April 2013.

(ii) Mrs A, an employee of CBC, has worked for the company for many years, but had not contributed to the company pension fund. On Mrs A's retirement from CBC on 31 March 2013, CBC's directors decided to award Mrs A R5,000 paid monthly for 12 months. This was in recognition of her loyal service to CBC during the years she had been an employee.

(iii) A newly installed kiln (used for hardening the bricks) ruptured. The kiln (Kiln B) was insured for full replacement value. The insurance company paid an amount of R1,000,000. The kiln had originally cost R990,000 and had only been used by CBC for two months. A new kiln (Kiln C) was purchased and installed on 14 December 2013 at a cost of R1,100,000. Kiln B had previously replaced Kiln A. Kiln A was taken out of service on 30 September 2013 and sold for R55,000. It had originally cost R650,000 in June 2009.

(iv) None of the other machines used by the company were replaced during the year. These other machines, all used in the process of manufacture, comprise the following:

1. Moulding machines (to form the bricks) purchased for R1,250,000 on 1 August 2012.
2. Mixing machines (mixing the components of the cement brick) purchased for R1,300,000 on 1 January 2013.
3. A cuber (a machine which receives the moulded blocks and stacks them onto pallets for delivery) purchased for R2,600,000 on 1 June 2009.

(v) The land and factory from which CBC operates had been acquired by the company in May 2007 for R11,000,000 (inclusive of acquisition costs). R10,200,000 of the purchase price was in respect of the factory building.

(vi) Other tax deductible expenses (including purchases of inventory) for the year amounted to R132,678,000.

(vii) CBC has an assessed capital loss brought forward of R2,500.

(viii) CBC's first provisional tax payment was R5,500,000. The company's second provisional tax payment has been estimated as R6,000,000.

**Other information:**

(ix) CBC will apply any provision which reduces its liability for income tax, without incurring penalties.

(x) The Commissioner for SARS permits any qualifying asset for wear and tear to be written off over five years in terms of Binding General Ruling 7.

**Required:**

**(a) Explain whether or not any amounts in respect of deliveries underway at the year end should be included in Cement Brick Co Ltd's gross income for the year of assessment ended 31 March 2014.** (5 marks)

**(b) With respect to Mrs A's pension arrangements, explain whether the monthly payments of R5,000 would be deductible by Cement Brick Co Ltd, setting out the conditions which would apply in order for the payments to be deductible.** (5 marks)

**(c) Calculate the income tax liability of Cement Brick Co Ltd for the year of assessment ended 31 March 2014.**

Notes:

1. Your treatment of the items in points (i) and (ii) should be consistent with the conclusions stated in your answers to parts (a) and (b).
2. Indicate clearly any items of income which are exempt or amounts which are not deductible by the use of a zero. (20 marks)

**(30 marks)**

**2** Joe Moffet (aged 66) is a citizen of the United Kingdom. During 2008 his only child, a daughter, moved to South Africa with her husband. Joe has retired but occasionally provides consulting services in the UK to his former employer. Joe would like to spend as much time as possible with his daughter in South Africa and is considering spending six months of the year in South Africa and six months in the United Kingdom.

In January 2009, on his first visit to South Africa, Joe bought a house in a suburb of Durban, South Africa where his daughter had settled. Since 1 March 2009, Joe has spent approximately six months each year in South Africa and the remaining six months in the United Kingdom. Joe still maintains his house in the United Kingdom and apart from some online consulting, all physical consulting services are performed in the United Kingdom.

**Required:**

**(a) Explain whether or not Joe Moffet can be considered to be resident in South Africa for income tax purposes for the 2014 year of assessment.** (8 marks)

Sigi Manual is a South African resident who was employed by Firelighters Limited for over 20 years until 31 December 2013 when she retired having reached the age of 60. Sigi was not an agent or a representative for Firelighters Limited. The company is registered as a value added tax (VAT) vendor. All amounts are stated excluding VAT unless otherwise indicated.

The following information relates to Sigi for the year of assessment ending 28 February 2014:

Employment

On Sigi's retirement, Firelighters Limited made her a lump sum payment of R100,000 in recognition of her long years of service. To fund this anticipated payment, Firelighters Limited had taken out an insurance policy which matured on Sigi's retirement date. The policy premiums had been treated as a fringe benefit for Sigi, with the amount from 1 March 2013 to 31 December 2013 resulting in a fringe benefit of R12,000. The sum of the premiums from the inception of the policy until 28 February 2013 amounted to R50,000 and these were all treated as a fringe benefit for Sigi. Firelighters Limited also gave Sigi a long service award of a gold watch on her retirement. The watch had been purchased by the company for R6,500.

Sigi had always contributed 7·5% of her cash salary to the company provident fund. Her contributions to the provident fund ended on 31 December 2013. Sigi's cash salary at retirement was R20,000 per month.

Sigi had been granted the use of a BMW 3 series car owned by Firelighters Limited. The BMW car cost Firelighters Limited R190,000 (inclusive of VAT) when it was purchased second-hand on 1 June 2010. The car was only made available to Sigi on 30 November 2011. Firelighters Limited paid for all maintenance and all business fuel in respect of the car, as the car had no maintenance plan as it was acquired second-hand. The costs incurred by the company amounted to R5,900 for maintenance and R13,000 for business fuel for the year of assessment ended 28 February 2014. Sigi returned the car to Firelighters Limited on her retirement.

In anticipation of her retirement, Sigi purchased a home in a retirement village on 1 December 2012. As Sigi did not have sufficient cash at the time for the deposit, she asked Firelighters Limited if it would subsidise part of the purchase price until her retirement date. Firelighters Limited agreed and advanced an amount of R200,000 to Sigi on 1 December 2012. Firelighters Limited agreed to charge Sigi interest at an annual rate of 3% payable monthly. The R200,000 advanced by Firelighters Limited was in excess of that required for the property purchase, so Sigi invested R50,000 of the capital in a fixed deposit account earning interest of 6·5% per annum (simple interest). On her retirement on 31 December 2013 Sigi repaid the full R200,000 to Firelighters Limited.

Sigi belongs to Firelighters Limited's medical aid scheme and contributed R13,000 to the fund for the year ended 28 February 2014. Sigi chose to remain a member of the medical aid fund after her retirement. In addition to her regular contributions, Sigi underwent a serious operation during the year of assessment and paid an additional R45,000 in medical expenses of which only R15,000 was recovered from the medical aid fund. She is the only member (i.e. Sigi has no dependants) of the medical aid fund.

Firelighters Limited paid Sigi's mobile phone bill in full. From March 2013 to 31 December 2013 this amounted to R4,500. The mobile phone was used by Sigi for business purposes only. The mobile phone contract was in the company's name. The mobile phone had to be returned to Firelighters Limited on Sigi's retirement.

Sigi was not liable to account to Firelighters Limited for any entertainment expenses. She received an allowance for entertaining of R4,000 up to the date of her retirement. She incurred entertainment expenses of R5,600.

Other information

The following information is also relevant for the year of assessment ended 28 February 2014:

| | |
|---|---|
| Interest received on fixed deposit at 6·5% (see above) | 2,708 |
| Interest received on other cash deposits | 32,000 |

Sigi also contributed to a retirement annuity fund. Her contributions were R3,500 per year.

Sigi is a widow with two adult children.

**Required:**

**(b) Calculate the taxable income of Sigi Manual for the year of assessment ended 28 February 2014.**

**Note: Indicate clearly any items of income which are exempt or amounts which are not deductible by the use of a zero.** (17 marks)

**(25 marks)**

**3** **(a)** AB Furniture Co Ltd (AB) entered into a number of transactions involving assets in its year of assessment ended 31 March 2014. AB sells wood supplies as well as furniture which it manufactures from its inventory of wood. The manufacture of furniture is considered by the Commissioner for South African Revenue Service (SARS) to be a process of manufacture for the purposes of the Income Tax Act.

AB is registered as a value added tax (VAT) vendor but all amounts are stated excluding VAT. The transactions entered into in the year of assessment ended 31 March 2014 are detailed below:

(1) One of AB's factories had fallen into disrepair and the directors decided to sell the factory and move the plant and machinery to new premises. New premises were acquired on 1 October 2013 for a total cost of R5,600,000 (R1,200,000 representing the cost of the land and R4,400,000 representing the cost of the factory). The old factory and land were sold for R350,000 and had originally cost R2,600,000 when purchased in August 2002. The factory had been depreciated at 5% per annum based on the factory value of R2,000,000 at the time of purchase.

(2) AB owned a plot of vacant land on which it had planned to build a new factory. However, the land was appropriated by the Government to use as a military base during the year. The land had been acquired for R3,400,000 in 2011. Compensation received from the Government amounted to R2,500,000.

(3) An old drill press was sold for proceeds of R3,500. The drill had originally been purchased for R4,800 five years previously and had been fully depreciated for tax purposes.

(4) An industrial sanding machine was acquired for R25,000. This machine replaced the fully tax depreciated older machine, which had originally been acquired for R15,000. The older machine was sold for scrap for proceeds of R2,350. Both the disposal of the old machine and the acquisition of the replacement machine took place in the 2014 year of assessment. Both machines were used in the manufacture of furniture.

AB has an assessed capital loss of R17,200 brought forward from the 2013 year of assessment. The Commissioner for SARS permits wear and tear of 20% per annum on all qualifying assets.

**Required:**

**Calculate the effect of the above transactions on the taxable income of AB Furniture Co Ltd for the year of assessment ended 31 March 2014.**

**Note: Briefly explain the use of any elective provision to minimise the company's taxable income.**

(17 marks)

**(b)** Mologodi Mayaba disposed of some assets during the year of assessment ended 28 February 2014, as follows:

(1) Mologodi sold a collection of paintings to a gallery for R155,000 in June 2013. The aggregate base cost of the paintings was R100,000.

(2) Mologodi sold a Cessna 162 light aircraft, weighing 600 kilograms, for R1,150,000 in August 2013. He had inherited the aircraft from his father in May 2010, when it had a market value of R1,450,000.

**Required:**

**Explain the tax treatment of each of Mologodi Mayaba's disposals and determine his aggregate capital gain or capital loss for the year of assessment ended 28 February 2014.** (3 marks)

**(20 marks)**

4 Runner (Pty) Ltd ('Runner') is a registered value added tax (VAT) vendor with two-month tax periods ending on the last day of February, April, June, and so on. Runner is a wholly-owned subsidiary of Sports Ltd ('Sports'). Sports is not a VAT vendor.

Runner's business comprises the manufacture and sale of a line of sporting goods, which are sold both locally and exported to overseas customers.

The following transactions relate to March and April 2014. All amounts are stated inclusive of VAT, where appropriate, unless stated otherwise. Where applicable, tax invoices are available to facilitate any reclaims of input tax.

(i) Sales of goods to customers in the United Kingdom amounted to R1,832,000.

(ii) Sales to local customers in South Africa amounted to R12,524,830.

(iii) Runner ran a competition to find the member of its sales department who achieved the highest monthly sales figure for March 2014. The prize was an overseas trip. Flights cost R11,400 for the international part of the journey and R3,800 for the local transfer flight. The local flight was purchased as a separate booking from the international flight. Foreign hotel accommodation costs paid by Runner amounted to R15,000. All other costs (such as personal expenditure and meals) had to be paid by the winning employee. The prize was awarded and paid in April.

(iv) Purchases of new inventory from small suppliers, which were not registered VAT vendors, amounted to R250,000.

(v) Purchases of raw materials for manufacturing inventory from various VAT registered local suppliers amounted to R7,945,254.

(vi) On 5 March 2014, there was a break-in at Runner's warehouse and various items of inventory were stolen. The company's insurer assessed the loss as being R90,000. As the factory was fully insured, a claim which covered the loss in full was received on 22 April 2014.

(vii) On 10 April 2014, Runner acquired a small building, which was located adjacent to its factory. The premises were purchased from a VAT vendor, Big Props, for R4,570,000. Runner planned to use part of the ground floor of the new building as a recreational club for its factory workers, and the rest of the premises as storage space for its range of sporting attire. The portion allocated to the club was 40% of the total area of the premises. Runner paid Big Props in full on 17 April, on the same date that registration of the title deeds took place.

(viii) Runner owned a piece of vacant land which it had acquired in 2010 for a cost of R970,000 (excluding VAT). This land was sold on 22 April 2014 to its holding company Sports. Immediately before the sale, the land was held in Runner's accounts at book value and the sale to Sports took place for proceeds of book value (excluding VAT). The open market value of the land on 22 April 2014 was R1,050,000 (including VAT).

(ix) A second-hand shoe manufacturing machine was purchased from Smiley's Footwear, a registered VAT vendor for R90,300.

(x) Runner entered into an instalment sale agreement for the purchase of a delivery van from a registered VAT vendor on 31 March 2014. The aggregate amount of the instalments over the 60-month agreement period is R237,360. This includes finance charges of R59,520. The first instalment of R3,956 was paid on 31 March 2014, when Runner took possession of the van. The second instalment was paid on 30 April 2014.

(xi) Runner purchased a new car for the company's marketing manager for R370,200 on 1 March 2014. The marketing manager was given use of the vehicle immediately. The company pays all fuel and maintenance costs of the car.

(xii) Runner donated a number of rugby jerseys (trading inventory) to a local high school on 14 April 2014. The jerseys had originally been purchased for a cost of R3,420, and the open market value of the jerseys on 14 April 2014 was R3,306.

(xiii) Salaries and wages amounting to R650,000 were paid during March 2014 and R680,900 during April 2014.

**Required:**

**Calculate the input and output VAT effects of Runner (Pty) Ltd's transactions (i) to (xiii) above, giving brief explanations for your treatment of each item.**

**Note: Indicate clearly any transaction which does not give rise to a VAT effect by the use of zero.**

**(15 marks)**

**5** **(a)** In 2001 in a presentation to the Finance Committee of Parliament, a firm presented the following statement: 'The trouble with the word 'evasion' is that linguistically it is too close to 'avoidance' and even leads to such portmanteau hybrid terms as 'avoision', thereby blurring a distinction which should really be quite clear.'

**Required:**

**Explain the difference between 'evasion' and 'avoidance' for tax purposes, giving an example of each.** (4 marks)

**(b)** **Briefly explain the main purpose of taxation in the modern economy.** (2 marks)

**(c)** **Explain the difference between direct tax and indirect tax, giving an example of each.** (4 marks)

**(10 marks)**

**End of Question Paper**