Answers

Professional Level – Options Module, Paper P6 (ZAF)
Advanced Taxation (South Africa) **June 2012 Answers**

Note: The ACCA does not require candidates to quote section numbers or other statutory or case references as part of their answers. Where such references are shown below [in square brackets] they are given for information purposes only.

1 John Craft

(a) The worldwide royalties of R1,300,000 (R500,000 + R800,000) will be included in gross income. However, an exemption may arise for all or part of the foreign royalties of R800,000 if tax is shown to have been paid in Country X, as John is the first owner of the copyright in this publication [s.10(1)(m)]. Any expenses incurred in the production of any income remaining may qualify for deduction, should such expenses meet the requirements of any deduction provision.

The pension annuity is from a source outside South Africa. While the source classification has no bearing on the inclusion of the annuity in gross income, it is relevant for the exemption that may be applied in the case of annuities from foreign pension funds. Essentially, the pension annuity will be exempt to the extent that it relates to foreign services rendered. In this case 35 out of 40 years, i.e. 35/40 of the pension annuity, is exempt from tax in South Africa.

Despite the lump sum being from a foreign fund, the lump sum is included in gross income. As a result of the foreign service, it is submitted that the portion pertaining to that foreign service (as for the annuity) will be exempt in the determination of the amount to be included in gross income. This means that only R625,000 of the R5 million lump sum will be included in gross income. However, this R625,000 will be taxed in terms of separate tax tables. The tax to be withheld by the pension fund should amount to R55,800 ((R625,000 – R315,000) x 18%). This amount is not subject to any rebates.

The property acquired and placed into his spouse's name will not be subject to donations tax as they are only informally separated and not separated by judicial order or notarial deed, resulting in the donations tax exemption between spouses being effective. The roll-over provision applies, placing the base cost of R1·75 million in his wife's hands. He will recognise no capital gain or capital loss as the roll-over provision results in a disposal at base cost.

(b) John Craft
Address
Cape Town
South Africa

15 June 2012

Dear John

RE: South African Income Tax Effects Arising from Emigration and the Future

In your correspondence, you have raised two separate queries. These are addressed separately in this response.

Query (i) – South African income tax effects on emigration to Country X
South Africa's taxation system is based on residence. While you are currently resident in South Africa (based on the legal subjective test of 'ordinarily resident'), on emigration such status as a resident will cease and you will be considered, for South African income tax purposes, to be a non-resident.

Non-residents are only taxed in South Africa on income arising from a South African source. Such source may be true source (where the originating cause of the income is located in South Africa) or deemed source (income that as a result of a legislative provision is deemed to have its source located in South Africa). In addition, capital gains tax is only applicable to immovable property located in South Africa or to assets of a permanent establishment in South Africa. You would not have a permanent establishment in South Africa.

The effect on emigration to Country X will be that revenue items will only be liable to South African tax if such income is from a South African source. Only expenditure directly relating to such income will be deductible. Capital gains tax will also be levied on emigration as emigration is a deemed disposal. However, capital gains tax will only arise on assets other than immovable property in South Africa or assets of a permanent establishment in South Africa. As you have no such permanent establishment, most assets will be deemed to be sold, with the deemed proceeds being the market value on the date of emigration. It should also be noted that the bulk of your assets, for example, motor vehicles, furniture etc, will be classified as 'personal use assets' for capital gains tax purposes. The result of such classification is that any capital gain or capital loss on such disposal will be disregarded (i.e. results in no capital gain or capital loss to be aggregated). The ultimate capital gains effect on your emigration is likely to be minimal.

Subsequent to your emigration, your South African source income remains taxable in South Africa. Based on the income types supplied for the 2012 tax year, you should take note of the information that follows. Firstly, as your book was written while in South Africa, the worldwide royalties are considered to have South Africa as the location of that originating cause (the originating cause being where you exercised your wits and skills in writing the book rather than where the sales take place). Thus the royalties from South Africa and Country X will be considered gross South African income. However, only those for sales in South Africa would be subject to a final withholding tax of 12% (levied on royalties paid to non-residents for the use of a copyright (in your case) in South Africa). However, as both the South African and Country X royalties arise from the copyright that you, as author, hold over the book, such royalties may be exempt from South African tax to the extent that such royalties have been subjected to income tax in another country. Should Country X apply an income tax to your worldwide royalties on the basis of residence there, no South African tax may be levied on the royalties. Should this 'first owner' copyright exemption not apply, the Country X royalties (treated as South African true source) will be subject to normal tax in South Africa.

The pension annuity is paid from a foreign pension fund. The pension annuity is considered to be derived from the services rendered during the years in which contributions were made. A South African deemed source provision will apply which will apportion the source of the annuity on this basis so that 5/40ths will remain liable to South African income tax. The monthly pension annuity is denominated in foreign currency. This amount will have to be translated on the accrual date at the spot rate unless you elect for the amounts to be translated at the average exchange rate.

Tutorial note: *Reference to the 2/10 year rule in s.9(1)(g) has been avoided as the source rules in the Acts of 2011 will be rewritten and will no longer make reference to this rule, leaving only the above form of apportionment. No marks are therefore allocated to this rule to allow for candidates applying the new legislation (effective for 2013 years of assessment).*

As the Cape Town flat was acquired and placed in your spouse's name, you have no legal ownership of such property, nor any recognisable interest in such property. The result of that ownership in this flat will have no bearing on your South African income tax liability.

Query (ii) – Disposal of the Cape Town flat on 1 November 2012
As the flat is owned by your spouse (as the person with legal title over the property), the disposal must be for her account. Despite being a non-resident, capital gains tax in South Africa applies on disposals of immovable property in South Africa. Furthermore, being a disposal by a non-resident natural person, the purchaser (or the agent or conveyancer as representatives for the purchaser) has a duty to withhold 5% of the proceeds to be paid for the property. Such withholding is paid over to the South African Revenue Service. Unlike the withholding tax on your royalty, this withholding is not final, but a pre-emptive collection pending the outcome of the determination of the final normal tax liability when your spouse files a South African tax return. The 5% withholding may be reduced on application to the Commissioner for a directive in four circumstances. As the anticipated capital gain (ignoring any selling costs which would serve to further reduce such gain) would be R750,000 (R2·5 million less the cost of R1·75 million), the inclusion in taxable income after the annual exclusion would only be R182,500 ((R750,000 – R20,000) x 25%); and as your spouse has no other taxable income in South Africa, the tax to be levied per the progressive tables applicable to individuals after the rebate (for 2012 as indicative of 2013) would be R24,370 ((R182,500 – 150,000) x 25% + R27,000 – R10,755), whereas the withholdings tax would be R125,000. On this basis, a directive may be obtained for the withholdings tax to be reduced to the tax payable on the actual capital gain.

Should you require any further information in relation to these or any other queries, please do not hesitate to contact me.

Yours sincerely

Student

2 Bottlers (Pty) Ltd

Option 1: Loan from the bank
The capital sum borrowed from the bank will be utilised to acquire machinery. Such machinery (net of VAT) will qualify for capital allowances and be written off over four years at the rate of 40% in the first year and 20% in each of the successive years.

Each repayment to the bank comprises capital and interest. For example, the first payment of R1,037,918 will comprise interest of R375,000 (9%/12 months x R50,000,000) and capital of R662,918 (R1,037,918 – R375,000).

Tutorial note: *Each payment will comprise less interest and more capital. The capital portion of the repayment is not deductible (being an amount of a capital nature). The interest is deductible on a yield-to-maturity basis (i.e. is incurred on that basis for the purposes of deduction). However, all that is needed for the purposes of this answer is the excess of total payments over the capital cost of the machinery over the whole five-year term. It would only be necessary to work out the split between interest and capital repayments if the tax position for each year was needed.*

Over the period of the loan, interest of R12,275,080 (1,037,918 x 60 – R50,000,000) will be deducted.

In summary, over the five years, the tax effects would be:

	R
Allowances claimed (R50,000,000 x 100/114)	43,859,649
Interest claimed	12,275,080
	56,134,729
Income tax saving (28% x R56,134,729)	15,717,724
VAT input claim	6,140,351

Cash flow over the five years:

	R
Loan amount received	50,000,000
Amount paid for new machinery (including VAT)	(50,000,000)
VAT input claim on acquisition of new machinery	6,140,351
Loan repayments made (R1,037,918 x 60)	(62,275,080)
Income tax saving	15,717,724
Net cash inflow/(outflow)	(40,417,005)

Option 2: Sale and leaseback

The sale and leaseback comprises two elements: the sale and the subsequent finance lease. Each of these elements has tax consequences.

(i) The sale

The sale of the machinery for R50 million will result in output VAT of R6,140,351 (R50,000,000 x 14/114). From an income tax perspective:

– A recoupment of R30,400,000 (R38,000,000 – R7,600,000) arises.

– A capital gain also arises being proceeds of R13,459,649 (R50,000,000 – R6,140,351 (VAT) – R30,400,000 (recoupment)) less base cost R7,600,000 (R38,000,000 – R30,400,000 (allowances to date)) which equals R5,859,649.

– The immediate consequences of the recoupment and capital gain may be deferred as replacement machinery is acquired. The recoupment and capital gain will, however, be released into the taxable income calculation over the five-year period and so is largely irrelevant to overall impact.

Tutorial note: *As the machinery was replaced with another allowance asset, the recoupment and capital gain are 'released' on the basis of allowances granted to the new asset. For example, if the replacement machinery is a new machine to be used in a process of manufacture, the allowance on that asset would be 40% in year 1 and 20% in each of the three successive years. The recoupment on the previous (replaced) machine would be included in taxable income in each of those years of assessment on the same basis (i.e. 40%, 20%, 20%, 20%). Similarly, the capital gain would be released on the same basis for aggregation with any other capital gains or capital losses of the particular year of assessment.*

(ii) The leaseback

The lease will result in an input VAT claim on the asset value in terms of the lease as the finance lease is an instalment credit agreement, i.e. R6,140,351 (R50,000,000 x 14/114).

Each lease payment includes a portion of the VAT and reduced by such portion (despite the full VAT input being claimed at the start of the lease). As each payment is R1,000,000 over the 60 months, the monthly deduction to be claimed for income tax purposes will be R897,661 (being R1,000,000 less R6,140,351/60). The payment of R5,000,000 at the end of the lease to reacquire the machinery sold in terms of the sale and leaseback has no further VAT effects (being part of the lease arrangement). The R5,000,000 will be available for a wear and tear allowance in future years (despite being used in a process of manufacture) as it will not be the first time Bottlers (Pty) Ltd is bringing such machinery into use in its trade. The R5,000,000 paid at the end of the lease would represent the market value of the machinery at the end of the lease, so no recoupment of the lease payments arises.

In summary, over the five years, the tax effects would be:

VAT:

	R
Output on sale of existing machinery	(6,140,351)
Input VAT claimed in terms of finance lease	6,140,351
Input VAT claimed in terms of acquisition of new machinery (for which the finance was obtained)	6,140,351
Net input claim	6,140,351

Income Tax:

	R
Allowances (as per option 1 on new machinery acquired)	43,859,649
Lease payments claimed over five years (R1,000,000 x 60 – R6,140,351)	53,859,649
Recoupment in terms of sale (of the sale and leaseback)	(30,400,000)
Capital gain ultimately recognised in taxable income (if viewed in isolation) 50% x R5,859,649 (see bullet 2 under (i) The sale)	(2,929,825)
	64,389,473
Income tax saving (28% x R64,389,473)	18,029,052
Future (beyond the five years) additional tax saving is 28% x R5,000,000 (the saving on the wear and tear claimed on the machinery reacquired)	1,400,000
Ultimate income tax saving	19,429,052

Cash flow over the five years:

	R
Proceeds received for sale of machinery	50,000,000
VAT output on sale	(6,140,351)
Amount paid for new machinery (including VAT)	(50,000,000)
VAT input claim on acquisition of new machinery	6,140,351
VAT input on leaseback	6,140,351
Lease payments	(60,000,000)
Income tax saving	18,029,052
Net cash inflow/(outflow)	(35,830,597)

Option 2 would therefore appear more tax efficient and better in terms of the cash flow of the business.

3 Braedon Harris

(a) The disposal of the equity shares in Braedon Consulting (Pty) Ltd will also result in the transfer of the voting rights in those shares to the Trust. Braedon cannot continue to exercise control over the voting rights of the equity shares in the Trust as this would be considered to be a retention of control of the asset (the equity shares) on death, with the result that the equity shares would be deemed to be Braedon's property for estate duty purposes (defeating the estate plan).

A standard planning mechanism used in such situations is to issue the current controlling shareholder non-participating preference shares. It is important that the shares are non-participating to ensure that no capital growth will occur for such shares (unlike equity shares where the value may increase or decrease as they are fully participatory in capital and revenue). The number of non-participating preference shares to be issued to the current controlling shareholder must be sufficient to ensure control is retained but insufficient for the shareholder to be able to pass special resolutions. Voting rights equivalent to those currently held by Braedon for the equity shares would meet such criteria. The number of preference shares needed to provide a 55% holding would be 1,222 (being the total current equity shares of 1,000 divided by a planned remaining 45% voting right). Each preference share would have a single vote and could be issued for a nominal sum.

As a result of the issue of the preference shares, control is retained, but growth is transferred to the Trust through the sale of the equity shares.

(b) **Braedon**
Braedon will sell his assets to the Trust on loan account. The loan account will, however, not bear any interest or provide for any repayments (i.e. will be repayable on demand). Such a loan account will effectively 'freeze' his estate in respect of these assets at their current market values. In addition, the disposal of each of the assets will result in an immediate capital gain or capital loss for Braedon. The market value disposal (treated as the proceeds) will become the base cost for the Trust.

As Braedon has disposed of the assets on 'interest-free' loan account, such disposal is considered a disposition for the purposes of the revenue and the capital attribution rules. Two critical revenue attribution rules apply in this scenario. Firstly, any income not vested by the Trustees in the beneficiaries and retained in the Trust will be deemed to be the income of Braedon. Secondly, any income vested in Braedon's minor children will be taxed in his hands and not the minor children's. Despite not receiving such income, the income tax liability will fall to Braedon. As Braedon appears to be in the highest tax bracket, the maximum marginal rate of 40% will apply to such income. However, much of the income is represented by local dividends and would be exempt from taxation as a direct result of the conduit pipe principle applicable to trusts. The rental income remains to be taxed. Income vested in major beneficiaries will pass the tax effects of the receipt of such income to such beneficiaries and will not return to Braedon or the Trust.

The capital attribution rules will only effectively apply to a discretionary Trust. The reason for the exclusion of the vested Trust is that the vesting in the beneficiaries has already taken place and for the attribution to take place, vesting must be about to occur. As a result, the capital gain or capital loss in a fully vested Trust to be attributed will be nil. For the discretionary Trust, on vesting an asset in a beneficiary or beneficiaries; or on disposal of the asset and the vesting of the capital gain in a beneficiary or beneficiaries; or on disposal of an asset and retention of the capital gain in the Trust, the capital attribution rules may apply. Any capital asset or capital gain vested in a major beneficiary will not trigger the capital attribution rules and neither Braedon or the Trust will be taxed on such capital gain.

A fully vesting Trust
As soon as the assets are received by the vesting Trust, such assets will be considered to have passed to the beneficiaries immediately. No capital gain or capital loss will arise in the Trust as the date of vesting in the beneficiaries will be the same as the date of receipt of the assets by the Trust. Such a vesting does, however, end the application of the capital attribution rules as vesting in the beneficiaries has taken place. Furthermore, as no capital gain or capital loss would have occurred (see earlier), the 'attributed' capital gain or capital loss to Braedon will be nil. The Trustees may continue to manage the assets for the vested beneficiaries, i.e. distribution of the assets is not necessary, merely vesting. While there is no advantage or disadvantage for the Trust, vesting the assets in the beneficiaries ensures that those beneficiaries' estates are grown by those assets and the future growth on such assets.

The income received from such assets in a fully vesting Trust is considered to pass immediately to the beneficiaries. While the income may be retained in the Trust, the tax consequences thereof fall to the beneficiaries. The Trustees may control the distribution of such income, but ownership would have passed to the beneficiaries. The Trust can have no income tax consequences for the receipt of such income.

A discretionary Trust
On receipt of the assets, a base cost is determined. On vesting of the assets in beneficiaries, or on disposal of the assets in the future, capital gains or capital losses will arise. The Trust may mitigate its effects by distributing the asset or the capital gains arising from the Trust disposing of an asset to the beneficiaries. The capital gain is effectively split between the beneficiaries (however, see the impact of the capital attribution rules above). Should the Trust retain the capital gain (and the creator, Braedon, has died) it would be taxed on such gain. As trusts have an inclusion rate of 50% and a flat tax rate of 40%, the effective taxation on capital gains retained in the Trust is 20%. Natural person beneficiaries, however, are only required to include 25% of net capital gains and such net amount is determined after an annual exclusion of R20,000 for each of the beneficiaries. Finally, the inclusion is added to the taxable income of such beneficiaries and taxed at their applicable marginal rate (which ranges between 18% and 40%). The maximum capital gains tax rate for individuals is therefore 10%. However, the advantage of retention of capital gains in a discretionary Trust, despite the tax disadvantage that may apply, is that the estate of the beneficiary is not grown and does not create a future estate duty problem for such beneficiaries.

Income received by a discretionary Trust is taxed in the Trust unless distributed to a beneficiary or attributed to the creator/donor (Braedon). The application of the attribution rules is considered above. Should the attribution rules not apply and income is retained in the Trust, it will be taxed at the flat rate of 40%. In the next tax year, such retained amounts are considered capital.

(c) Should Braedon bequeath the loan account to the Trust on death then, for income tax purposes, the loan amount will be deemed to be a waiver of a loan account. The result is that the Trust will be deemed to have a capital gain of the loan amount. Only once the waiver is recognised may the Trust then set off the amount owed by it to Braedon against the loan account received in terms of the bequest. Braedon's estate, not Braedon, will be deemed to have a capital loss. For estate duty purposes, the loan account will be an asset held on death and will be included as property in the estate. To the extent the loan account (with other assets and net of deductions) exceeds the abatement of R3·5 million, a 20% duty is levied.

4 Stewart Forlee

(a) As Stewart is a natural person and not a company, the only applicable corporate rule that may be applied is that of an asset-for-share. Stewart qualifies in terms of this corporate rule, as he would, at the end of the acquisition, have a qualifying interest in the company (being at least 20% of the equity shares and voting rights of the company). However, this corporate rule may not be applied to the goodwill asset. Should Stewart wish to dispose of this asset to the new business, it would have to be in terms of a standard disposal. In addition, Stewart and the company would be connected persons by virtue of the shareholding, so the transaction would have to be at market value for capital gains tax purposes or be deemed to be at market value.

Trading stock sold from the sole proprietorship must be acquired by the company as trading stock; however, the capital assets may be acquired by the company as either capital assets or trading stock as Stewart and the company are not part of the same group of companies (Stewart being a natural person).

As with most of the corporate rules, the disposals for Stewart will generate no tax consequences as the capital assets are required to be disposed of at base cost and the trading stock at the opening stock or deduction value. As the corporate rules override most of the Income Tax Act, such below arm's length prices do not trigger any of the connected person rules. For the allowance assets sold, no recoupment is recognised and the deductions are merely continued in the company as Stewart and the company are treated as one and the same taxpayer for this purpose.

As with the intra-group transaction, the company may not dispose of the assets (other than the trading stock) within a period of 18 months from the date of this transaction without anti-avoidance consequences. Stewart, similarly, may not dispose of the equity shares within 18 months without anti-avoidance consequences.

(b) Stewart could dispose of each asset to the company at the standard rate (as the disposal of each asset represents a taxable supply). However, as all the assets necessary for the business are being sold, the transaction could be classified as the disposal of a going concern. This is a disposal that is deemed to be the supply of a good, but VAT is charged at the zero rate. There are a number of requirements that must be met in order for the transaction to be classified and treated as the disposal of a going concern. These include:

- Both the company and Stewart must be registered as vendors (i.e. the newly formed company must apply for registration before the business is transferred)
- The supply must consist of an 'enterprise', which the business in this scenario does
- Stewart and the company must agree in writing:
    - that this is a supply of a going concern
    - that the enterprise will be an income-earning activity on the date of transfer
    - all assets necessary for the enterprise will be transferred
    - that VAT applies at the zero rate.

Such a disposal at the zero rate of the business as a going concern will minimise the VAT consequences on disposal of the business.

(c) The hotel represents an asset of a resident which is a permanent establishment outside South Africa. Furthermore, the permanent establishment has a functional currency of Euro. Despite such classification, the capital gain or capital loss falls to be included in Stewart's taxable income in South Africa.

As the asset's proceeds (and in fact the expenditure) are denominated in a foreign currency, translation rules are effective. The usual translation rules (of converting the proceeds and expenditure to Rands to determine the capital gain or capital loss) do not apply, as the asset is immovable property and/or is considered an asset of a permanent establishment outside South Africa for a resident.

The permanent establishment has a functional currency which is treated as 'local currency' to determine a capital gain or capital loss before converting such gain or loss to Rands. The proceeds are already in the functional (local) currency and so only the expenditure need be translated to that functional currency by applying the average rate of exchange for the expenditure for the years of assessment (of the resident) in which the expenditure was incurred. The gain or loss determined in the functional currency is then translated to Rands at the average exchange rate of the functional currency to Rands for the relevant year of assessment.

To the extent that a capital gain arises and is included in the taxable capital gain of Stewart, the French taxes levied may qualify as a credit against the South African taxes (as the capital gain arises from a source outside South Africa).

5 Adam Croft

Option 1: Travel allowance

Receiving a travel allowance has employees tax and normal tax implications. Of course, the payment of employees tax is a timing issue as the overpaid employees tax, if any, would be refunded on assessment. Time value of money would, however, be a consideration here. For the purposes of this analysis, the time value of money is excluded from the scope and therefore employees tax considerations are irrelevant to the analysis.

For normal tax purposes, the net inclusion value of the allowance is determined and the result added to taxable income. This net result would, based on the facts, be calculated as follows:

		R	R
Travel allowance R10,000 x 12 months			120,000
Reduced by the greater of actual costs or deemed costs:			
(a)	Actual costs: Wear and tear is only permitted over seven years for the purposes of reducing the travel allowance based on the vehicle's cost (which cost is further limited to a maximum of R480,000)		
	R520,000 limited to R480,000/7 years	68,571	
	Fuel	37,800	
	Maintenance	5,000	
	Licensing and insurance	9,000	
	Total actual costs	120,371	
	Estimated reduction is therefore 25,000 business kms/40,000 total kms x R120,371	75,232	
(b)	Deemed costs:		
	Fixed cost per the Gazetted table simulates wear and tear	R119,683	
	Costs per km, in cents, are therefore:		
	Fixed cost: R119,683/40,000kms	299·2	
	Fuel (per tables)	113·1	
	Maintenance (maintenance plan removes)	0	
	Total deemed cost per km	412·3	
	Estimated reduction is therefore 25,000 business kms x R4·123 =	R103,075	
	Best option selected		(103,075)
	Inclusion in taxable income		16,925

Marginal tax on such inclusion is 40% x R16,925 = R6,770

From an annual net cash perspective, excluding the acquisition and sale, the position is as follows:

	R
Travel allowance received	120,000
Fuel paid	(37,800)
Maintenance paid	(5,000)
Licensing and insurance	(9,000)
Final tax liability (as the employees tax effect is temporary)	(6,770)
Net cash inflow (annual)	61,430

Over five years, the inflows total 5 x R61,430 = R307,150

Option 2: Company car

Similar to the travel allowance, 80% of the gross fringe benefit would be included in remuneration for employees tax purposes. The ultimate fringe benefit (determined in the annual return) would be the true tax effect, therefore the employees tax considerations are irrelevant.

The annual tax effect would be:

	R
Gross fringe benefit:	
R520,000 x 3·25% (the inclusion rate applicable to company cars where the vehicle has a maintenance plan) x 12 months	202,800
Reduced by the general business reduction:	
R202,800 (above) x 25,000 business kms/40,000 total kms	(126,750)
Balance	76,050

As no other costs would be payable by the employee, the above total represents the final fringe benefit.

Tax on the benefit would amount to: 40% x R76,050	R30,420
As the only ‘cost’ to Adam, this annual cash outflow over five years amounts to: 5 x R30,420	R152,100

Five-year cash flow and conclusion

	Travel allowance	Company car
	R	R
Acquisition price	(520,000)	0
Annual cash effect x 5	307,150	(152,100)
Sub-total	(212,850)	(152,100)

A cash inflow of R60,750 (R212,850 – R152,100), representing the sale price of the car, would be required for the travel allowance option to result in the same net cash outflow as the company car option. If sold for more than R60,750, the travel allowance option would have better cash flow consequences over five years.

Note: *There is no capital gains tax on disposal of the car as it is a personal use asset (despite the partial business use) (see [paragraph 53(4) of the 8th Schedule to the Income Tax Act]). Capital gains tax therefore does not feature in the analysis.*

Professional Level – Options Module, Paper P6 (ZAF)
Advanced Taxation (South Africa) **June 2012 Marking Scheme**

				Marks
1	(a)		**Tax effects for 2012 year of assessment**	
			Worldwide royalties in gross income	1
			Exemption for first owner of copyright and tax required in another jurisdiction	1
			Deductibility of expenses to produce the income	½
			Pension annuity from source outside SA and impact	1½
			Exemption and ratio effective	1½
			Lump sum apportioned before inclusion in gross income	1
			Separate tax tables and tax withheld	1
			Property donation but no donations tax	1½
			Property effect with rollover	2
				11
	(b)		**Emigration and future effects**	
		(i)	Impact of emigration on residence status	½
			Taxation basis for non-residents	½
			Explanation of source (true and deemed)	1
			Impact of capital gains tax for non-residents	1
			SA source inclusion and deductions applicable	1
			Deemed disposal of assets for capital gains tax (excluding immovable property)	2
			Classification of most assets as personal use (with examples)	1
			Conclusion on immediate effects	1
			Impact of source on royalties	1
			Exemptions applicable and conditions	2
			Application of withholdings tax	1
			Implication for royalties not subject to withholdings tax	1
			Pension annuity source and deemed source	1
			Apportionment for inclusion in gross income	½
			Translation at the spot or average rates	½
			No impact for Cape Town flat (with reason)	1
				16
		(ii)	Disposal for spouse's account	1
			Non-resident – application of capital gains tax	1
			Withholdings tax implications	1
			Not a final tax and opportunity to reduce	1
			Calculation and explanation of reduction in withholdings tax that could apply to this disposal	2
				6
			Presentation and effectiveness of the communication	4
			Total	37

		Marks
2	Allowances for acquired machinery and rates	½
	Separating interest and capital repayment components	1
	Total interest	½
	Supporting summary tax calculations (2 x 1)	2
	Supporting cash flow summary (5 x ½)	2½
	Sale output	½
	Recoupment and calculation	1
	Capital gain and calculation	1
	Deferral possibility for recoupment and capital gain plus reason why it is not relevant to this comparison (½ each)	1
	Input VAT for finance lease as an instalment credit agreement	½
	Lease payments deductible and VAT impact (with calculation)	1½
	Payment of market value for machinery at the end of the lease having no VAT consequences	1
	Future wear and tear claim on reacquired machinery (and why not 'process of manufacture' capital allowance)	½
	No recoupment of lease payments at the end of the lease and why	½
	VAT in summary table (3 x ½)	1½
	Income tax effects for taxable income in summary table (4 x ½)	2
	Tax saving and future tax saving (2 x ½)	1
	Cash flow summary (7 x ½)	3½
	Conclusion	1
	Total	**23**

3 Braedon Harris

(a)	Retention of control over voting rights results in inclusion in estate	1
	Use of non-participating preference shares	1
	Purpose for use and limitation on amount	1
	Number required and issue price may be nominal	1
		4
(b)	**Braedon**	
	Freezing of assets for disposal on loan account	½
	Capital gains tax on disposals to the Trust	½
	Revenue and capital attribution rules may apply	½
	Retention by Trust attributed to Braedon	½
	Income vested in minor children attributed to Braedon	½
	Tax rate applicable to Braedon	½
	Impact of dividends versus rentals	½
	Impact of Trust vesting income in major beneficiaries	½
	Impact of capital attribution rules for a vested Trust	½
	When capital attribution rules apply for discretionary trusts	½
	Impact of vesting capital assets or capital gains in major beneficiaries	½
	A fully vesting Trust	
	Impact of capital assets for vesting Trust	1
	Vesting not the same as distribution, i.e. trustees manage assets	½
	Impact that vesting has on beneficiaries' estates	½
	A discretionary Trust	
	Base costs created on receipt of assets	½
	Vesting of assets in beneficiaries or disposal triggers capital gains	½
	Splitting capital gain between beneficiaries	1
	Impact if retained in Trust (without attribution rules)	½
	Impact on beneficiaries if gain vested (and no attribution rules)	½
	No growth for beneficiaries' estates if no vesting	½
	Impact of income in a discretionary Trust	1
		12
(c)	Leaving loan account to the Trust is a waiver	1
	Capital gain for the Trust of the loan account before set-off	1
	Braedon's estate (not Braedon) recognises a capital loss	1
	Estate duty recognises loan account as property and duty is levied	1
		4
	Total	**20**

			Marks
4	**(a)**	Identifying the appropriate corporate rule	1
		Qualifying interest requirement	1
		Rule cannot apply to goodwill and consequence for goodwill	1
		Trading stock and capital asset disposal by Stewart and acquisition by the company	1
		Disposal tax consequences for Stewart	1
		No recoupment is recognised	½
		No connected person rules applicable	½
		18-month rule and consequences for the company and Stewart	1
			7
	(b)	Standard rate could be applied to each asset sold	1
		Classification as a going concern	½
		Deemed a supply but at the zero rate	1
		Requirements (7 x ½)	3½
			6
	(c)	Capital gain or loss falls to Stewart's taxable income	1
		Normal translation rules do not apply – with explanation of such rules	1
		Functional currency treated as 'local currency' to determine the gain or loss	1
		Translation of the expenditure at the relevant average rates	1
		Gain or loss then translated to Rands at the average exchange rate between the functional currency and Rands	1
		Inclusion in SA taxable income (and not SA-source)	1
		French tax qualifies for credit relief from SA tax	1
			7
		Total	**20**

5	**Travel allowance**	
	Identifying both employees tax and normal tax consequences	1
	Explaining the lack of relevance of employees tax to this exercise	1
	Addition of the net result to taxable income	½
	Travel allowance	½
	Actual costs:	
	Wear and tear	1
	Fuel, maintenance, licensing and insurance	1
	Estimated reduction for actual costs	½
	Fixed cost per table and per km	1
	Other table costs	1
	Estimated reduction for deemed costs	½
	Election of most beneficial option	1
	Annual cash flow calculation and over five years (excluding acquisition and sale)	2
	Company car	
	Explaining the lack of relevance of employees tax to this exercise	1
	Gross fringe benefit	1
	Business reduction	1
	Tax payable on annual assessment	½
	Effect over five years	½
	Final five-year consideration and effects	
	Table to determine effect including acquisition but excluding sale	2
	Determination of needed sale price to equate options	1
	Exclusion of capital gains tax	1
	Conclusion	1
	Total	**20**