Professional Level – Options Module

Advanced Taxation (South Africa)

Friday 15 June 2012

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

This paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – TWO questions ONLY to be attempted

Tax rates and allowances are on pages 2–5

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 P6 (ZAF)

ACCA

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances for the tax year 2012 will continue to apply for the foreseeable future unless you are instructed otherwise.
2. Calculations and workings need only be made to the nearest R.
3. All apportionments should be made to the nearest month.
4. All workings should be shown.

TAX RATES AND ALLOWANCES

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

Year ended 29 February 2012/31 March 2012

Rebates	
Primary rebate	R10,755
Secondary rebate (over 65)	R6,012
Tertiary rebate (over 75)	R2,000
Interest exemption	
Under 65	R22,800
Over 65	R33,000
Of which the first R3,700 may be used for foreign dividends or foreign interest	
Medical contribution rates	
Single member	R720
Member plus one dependant	R1,440
Each subsequent dependant	R440
Companies	
Normal tax rate	28%
STC rate	10%
Trusts (other than a special trust)	40%
Donations tax	20%
Estate duty	20%
Official interest rate (assumed)	8%

Rates of normal tax payable by persons (other than companies)
In respect of the year of assessment ended 29 February 2012

Where the taxable income	
does not exceed R150,000	18% of each R1 of the taxable income
exceeds R150,000 but does not exceed R235,000	R27,000 plus 25% of the amount over R150,000
exceeds R235,000 but does not exceed R325,000	R48,250 plus 30% of the amount over R235,000
exceeds R325,000 but does not exceed R455,000	R75,250 plus 35% of the amount over R325,000
exceeds R455,000 but does not exceed R580,000	R120,750 plus 38% of the amount over R455,000
exceeds R580,000	R168,250 plus 40% of the amount over R580,000

Tax rates for small business corporations
for the year of assessment ending 31 March 2012

R0 – R59,750	Nil
R59,751 – R300,000	10% of the amount over R59,750
R300,001 and above	R24,025 plus 28% of the amount over R300,000

Turnover tax rates for micro business corporations
For the year of assessment ended 29 February 2012

R0 – R150,000	Nil
R150,001 – R300,000	1% of the amount over R150,000
R300,001 – R500,000	R1,500 + 2% of the amount over R300,000
R500,001 – R750,000	R5,500 + 4% of the amount over R500,000
R750,001 and above	R15,500 + 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 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) R286 per day (local travel)
Deemed expenditure for incidental costs only (per Government regulation) R88 per day (local travel)
Deemed expenditure for meals and incidental costs (foreign travel) – per published tables therefore 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 5 tax years
Small business corporation manufacturing plant and equipment	100%
Small business corporation (other assets) – unless wear & tear provides a greater deduction	50%/30%/20%

Wear & tear (based on Interpretation Note 47 and supplied in the question)

Manufacturing building allowance (unless seller's rate supplied)	5%
New or unused commercial building (not 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 'revenue nature' expenditure	150%
Research and development 'capital nature' expenditure	50%/30%/20%

Capital gains tax

Annual exclusion (while alive)	R20,000
Annual exclusion (in year of death)	R200,000
Primary residence exclusion	R1,500,000

(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)	25%
Inclusion rate (non-natural persons)	50%

Time apportioned base cost formula: $Y = B + \left[\frac{(P - B) \times N}{(T + N)}\right]$

Travel allowance table

for years of assessment commencing on or after 1 March 2011

Value of the vehicle (including VAT but excluding finance charges or interest)	Fixed cost	Fuel cost	Maintenance cost
R	R p.a.	c/km	c/km
0 – 60,000	19,492	64·6	26·4
60,001 – 120,000	38,726	68·0	29·2
120,001 – 180,000	52,594	71·3	31·9
180,001 – 240,000	66,440	77·7	35·0
240,001 – 300,000	79,185	87·0	44·7
300,001 – 360,000	91,873	93·9	54·2
360,001 – 420,000	105,809	100·9	65·8
420,001 – 480,000	119,683	113·1	67·6
Exceeds 480,000	119,683	113·1	67·6

Notes:

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 R3·05 per kilometre.

Tax rates of normal tax retirement lump sum benefits
in respect of the year of assessment ended 29 February 2012

Not exceeding R315,000	0% of taxable income
Exceeding R315,000 but not exceeding R630,000	18% of each R1 of the taxable income exceeding R315,000
Exceeding R630,000 but not exceeding R945,000	R56,700 plus 27% of the taxable income exceeding R630,000
Exceeding R945,000	R141,750 plus 36% of the taxable income exceeding R945,000

Tax rates of normal tax withdrawal lump sum benefits
in respect of the year of assessment ended 29 February 2012

Not exceeding R22,500	0% of taxable income
Exceeding R22,500 but not exceeding R600,000	18% of each R1 of the taxable income exceeding R22,500
Exceeding R600,000 but not exceeding R900,000	R103,950 plus 27% of the taxable income exceeding R600,000
Exceeding R900,000	R184,950 plus 36% of the taxable income exceeding R900,000

Rating formulae

$$Y = \left[\frac{A}{B + D - C}\right]$$

Section A – BOTH questions are compulsory and MUST be attempted

1 John Craft was a resident of Country X but immigrated to South Africa three years ago, settling in Cape Town. He was permitted to hold dual citizenship (i.e. he was a national of Country X and South Africa). There is no double tax agreement between South Africa and Country X. He continued to work for his Country X employer, a retail company. John retired on 30 June 2011. The employees tax has already been determined, but John has queries regarding selected events. These are considered below.

During the year of assessment ended 29 February 2012, the following occurred:

(i) Since arriving in South Africa, John had written a novel that was a best-seller. The book was sold in South Africa and Country X by the publishers for which John received royalties. Royalties for sales of the book in South Africa amounted to R500,000 and royalties for sales in Country X amounted to R800,000 (once converted to Rands at the appropriate exchange rate).

(ii) On retirement, John received a lump sum from the employer's pension fund (situated in Country X). The rules of the pension fund are similar to those required by the Pension Funds Act for South African funds. The lump sum amounted to R5 million (once converted to Rands). The monthly pension annuity from the fund amounted to Euro 4,000 per month, beginning 31 July 2011. During his service with his employer, John had spent a total of five of his 40 years of service in South Africa, with the last three years (apart from the occasional business trip) exclusively in South Africa.

(iii) On 1 June 2011, he purchased a flat in Cape Town for R1·75 million (including all relevant costs), putting his spouse's name exclusively on the title deed.

John had moved to South Africa three years previously as a result of an informal separation from his spouse (i.e. this separation was not in terms of a judicial order or notarial deed of separation). His spouse remained in Country X. John and his spouse reconciled their differences in January 2012 and John plans to emigrate back to Country X on 30 June 2012. From that date, John will remain non-resident for South African tax purposes.

Required:

(a) Explain the South African income tax effects arising from the events (i) to (iii) above for the year of assessment ended 29 February 2012. Support your explanations with calculations, where possible. If any of the events do not give rise to South African income tax effects you must indicate this, supporting your answer with reasons. (11 marks)

(b) In a letter to John Craft:

(i) explain the South African income tax implications of John emigrating to Country X on 30 June 2012 assuming the royalty income, pension annuity and ownership of the Cape Town flat will continue; and (16 marks)

(ii) discuss the potential South African tax consequences for his spouse if she decides to sell the Cape Town flat on 1 November 2012 at an anticipated market value of R2·5 million. (6 marks)

Professional marks will be awarded in part (b) for the presentation and effectiveness of the communication. (4 marks)

(37 marks)

2 Bottlers (Pty) Ltd is a company that processes and bottles olive oil for sale in retail stores. Their business is considered a process of manufacture. The company has a 31 March year end. The company does not qualify as either a micro-business or a small business corporation (i.e. is a standard resident company).

During the year, the directors recognised the need to raise R50 million to finance a five-year project of machinery acquisition. All machines will be acquired as new and unused. They are aware of the following available options:

(i) Borrow the money from the local bank. The yield-to-maturity on the loan will be 9% per annum with 60 equal payments of R1,037,918; or

(ii) Enter into a sale and leaseback arrangement with the bank in terms of which identified assets currently owned by Bottlers (Pty) Ltd will be sold for market value (representing approximately R50 million) and this market value would be the value of the assets in terms of the lease. These existing assets originally cost R38 million (excluding VAT) and have a tax value of R7,600,000. The assets will remain on the premises of Bottlers (Pty) Ltd, but ownership will be transferred by notarial deed. At the end of the sale and leaseback, the machinery will revert back to Bottlers (Pty) Ltd for a payment of R5 million (representing the estimated residual value and estimated market value of the assets). The monthly payments in terms of the lease will be R1,000,000.

Bottlers (Pty) Ltd will choose the most tax efficient option.

Unless otherwise stated, all figures include value added tax (VAT) where appropriate.

Required:

Explain the tax consequences of the above two options and advise Bottlers (Pty) Ltd as to which option is the most tax efficient and/or provides a better cash flow over the five years. You must provide calculations as to the tax savings and cash flows over the five years to support your answer.

(23 marks)

Section B – TWO questions ONLY to be attempted

3 Braedon Harris, aged 50, is married and has two children. He has been told by his friends that he should set up an estate plan involving the sale of assets to a Trust. Braedon has numerous assets, but the assets he would like specifically addressed are provided below. Braedon is married to his wife out of community of property, but subject to the accrual system.

Assets to be considered:

(i) A share investment portfolio with a current market value of R3 million and a dividend yield of R100,000 per annum.
(ii) A rental property with a current market value of R5 million and net rental income of R240,000 per annum.
(iii) A controlling equity interest of 55% in a private company, Braedon Consulting (Pty) Ltd. The equity holding is currently valued at R25,000,000, represented by only 550 shares each of which carries a single vote. Braedon is the managing director of the company and the majority shareholder. This company pays a dividend of approximately R300,000 to Braedon each year.

One of Braedon's friends has recently set up an estate plan and has suggested that Braedon sell all of the above assets on loan account, which will bear no mention of interest or repayment terms. However, Braedon is concerned about losing control over his consulting company.

Any trust set up will have at least three Trustees, two of which will be independent. The beneficiaries will be Braedon's wife, Mikaela and their two children (both of whom are currently minors).

Required:

(a) Advise Braedon how control could be retained in Braedon Consulting (Pty) Ltd (see his question (iii)) while still including the equity shares in the disposals to the Trust. Any structure proposed must not result in the shares being deemed property for Estate Duty purposes. (4 marks)

(b) Assuming the assets are sold to the Trust on loan account, explain the immediate and future income tax and estate consequences for Braedon and the immediate and future income tax implications for the Trust. Your answer should include the implication for both fully vested or fully discretionary trusts, explaining where possible the advantages and disadvantages of each. (12 marks)

(c) Explain the income tax and estate duty implications for Braedon should he bequeath the loan account to the Trust on his death. Include in your explanations the impact for the Trust. (4 marks)

(20 marks)

4 Stewart Forlee runs a successful sports-good shop as a sole proprietor. He is VAT registered as the annual turnover is in excess of R1 million. Stewart is concerned that employees providing customers with incorrect advice may place him at risk for legal action. He would like to ensure that his personal wealth is less susceptible to legal action by incorporating the business. Stewart would therefore like advice as to the best method of transferring the business into a private company, Sport-Gear (Pty) Ltd. He will initially be the sole shareholder in the business.

Stewart's business has capital assets, allowance assets, trading stock and goodwill (as the only intangible asset).

Required:

(a) Briefly explain which of the corporate rules could apply to the transfer of the business from Stewart into Sport-Gear (Pty) Ltd and the rule's requirements. You are not required to consider the anti-avoidance provisions of the rule in detail, but must make reference to the time-frame to prevent the anti-avoidance provision applying. (7 marks)

(b) Assuming the corporate rules do not apply, advise Stewart on the VAT consequences of such a sale. Your answer should include any requirements of any mechanism to reduce the VAT to be levied on Stewart. (6 marks)

(c) Stewart also had a rental trade. The entire trade was conducted from a hotel he owned in France. He had originally acquired the hotel from a United States business for an amount in US Dollars. He paid contractors from the United Kingdom to refurbish the hotel (settling in pounds sterling (GBP)). He has decided to sell the hotel to a French hotelier for an amount in Euro. The hotel is considered by the South African Revenue Service to be a permanent establishment in France with a chosen functional currency of 'Euro'. The French government will tax the capital gain derived in terms of its laws.

Required:

Discuss the implications that the above sale may have on Stewart's income tax liability in the year of disposal. You are not required to consider the impact of Double Tax Treaties but should consider the matter of double tax relief as it may be available to Stewart in general terms. (7 marks)

(20 marks)

5 Adam Croft has been offered a senior executive position in a company, beginning 1 March 2011. He has approached you for advice concerning an aspect of the package offered.

Adam has the following vehicle options:

(i) A travel allowance of R10,000 per month for his own vehicle.
(ii) A company car, for which the company will be responsible for all running costs

For all of the above options, Adam is expected to travel a total of 40,000 kms per year, of which 25,000 kms will be for business purposes. He will maintain a logbook as evidence of these trips. Should Adam choose option (i), he will buy a car costing R520,000 including VAT. The company would purchase a car of the same value should he choose option (ii). For any vehicle acquisition, it may be assumed that the vehicle will come with a maintenance plan and will be bought for cash. For either party, fuel is considered to total R37,800 for the year and additional maintenance (not covered by the maintenance plan) a further R5,000. Licensing and insurance amounts to R9,000.

You must assume that Adam is taxed at the maximum marginal rate and that legislation as applies to the 2012 year of assessment continues for the next five years.

Adam has no particular option preference, but would like to establish the minimum value for which the car must be sold to make the options' cash effect the same over five years.

You may ignore time value of money effects and may assume that the costs as above are constant for five years.

Required:

Explain the tax consequences for Adam Croft of each of the above options and advise Adam as to which option provides a better cash flow over the life of the car. You must provide calculations to support your answer.

(20 marks)

End of Question Paper