Answers

Note: 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 Green Build (Pty) Ltd

The Directors
Green Build (Pty) Ltd
Address
Cape Town
South Africa

7 December 2012

Dear Directors

RE: SOUTH AFRICAN INCOME TAX EFFECTS ARISING FROM THE TRANSFER OF THE PATENT TO PATENT CO AND OTHER QUERIES

This letter serves to provide the explanations you have requested. Each question has been considered in turn below.

(i) Assuming that Patent Co is considered a 'foreign company', would any of the corporate rules apply to the transfer of the patent to Patent Co? If any rules appear like they might apply, are there any qualifying criteria?

The corporate rules in the Income Tax Act provide for the deferral of income tax consequences for a variety of corporate transactions. Many of the corporate rules are inapplicable to this proposed transaction, namely: amalgamation transactions (as no amalgamation of companies is taking place); unbundling (as no company is being unbundled); liquidation, deregistration or winding up (as no companies contemplated in this transaction are to be placed in liquidation, deregistered or wound up). The only two transactions that could be considered are: (a) asset-for-share; or (b) intra-group transactions.

As the asset, the patent, is being sold to Patent Co, consideration could take the form of shares. However, as Patent Co is considered a 'foreign company', the asset-for-share corporate rule is rendered inapplicable, as the asset must transfer to a resident company. Similarly, the intra-group transaction corporate rule may also not be applied, as the companies forming part of the same group must be resident.

It is our conclusion that the corporate rules are inapplicable to this transaction while Patent Co remains a foreign company.

(ii) Assuming the corporate rules do not apply, what would be the South African income tax implications to transfer the patent to Patent Co in Country X?

The sale of the patent to Patent Co, in the absence of the corporate rules, will result in a number of income tax implications. It should first be noted that Patent Co would be considered a connected person in relation to Green Build (Pty) Ltd ('Green Build'). This relationship arises by virtue of the large equity interest that Green Build would hold in Patent Co. Such a relationship directly affects all the income tax implications.

A recoupment will arise on disposal of the asset. The connected person relationship causes the recoupment to be determined using the market value as the sales price. However, as the market value (R15,000,000) is in excess of the original cost price of the asset (R7,000,000) the recoupment is limited to the allowances previously allowed (R5,000,000). This recoupment is added to taxable income and is subject to the company tax rate of 28%.

In addition, capital gains tax implications arise. The capital gains tax implications are also 'tainted' by the connected person relationship. Essentially, as the sales price contemplated is below market value, the market value is substituted as the proceeds value. The capital gains tax calculation would therefore be reflected as follows:

	R	R
Proceeds	15,000,000	
Less recoupment (see above)	(5,000,000)	10,000,000
Less: base cost		
Expenditure	7,000,000	
Less allowances previously allowed	(5,000,000)	(2,000,000)
Capital gain		8,000,000

The capital gain would be aggregated with Green Build's other capital gains and capital losses for the year of assessment. In the absence of any other such capital gains or capital losses and in the absence of any capital loss brought forward, 50% of such capital gain would be added to the taxable income of Green Build and subjected to the company tax rate of 28%.

(iii) What would the residence status of Patent Co be in relation to the definition of 'resident' in the South African Income Tax Act?

South Africa's taxation system is based on residence. Residence for non-natural persons (such as companies) for South African income tax purposes is achieved if a company is incorporated, formed or established in South Africa or has its place of effective management in South Africa.

It is clear from the advice supplied and the structure proposed that Patent Co would be incorporated outside South Africa (rendering 'formed' or 'established' irrelevant). However, it is less obvious that the place of effective management would be outside South Africa.

'Place of effective management' is not a defined term but is rather determined from a 'facts and circumstances' approach. From a South African tax perspective, should the facts and circumstances reflect that day-to-day management is conducted in South Africa, the entity so managed would be considered to have South Africa as its place of effective management. Factors indicating that the place of effective management is in Country X include: the majority of the directors are based in Country X; the directors' meetings take place in Country X. Factors indicating that the place of effective management is in South Africa include: the veto power of the South African director.

That the chairman of the board of directors of Patent Co is South African should not influence the facts and circumstances test, except in the current circumstances, where such director has veto power. If the power of veto is regularly exercised and is normally based on instructions given to the chairman by the directors of Green Build, arising out of discussions by those directors which take place in South Africa, then the place of effective management of Patent Co would be considered to be South Africa.

However, it is suggested that further investigations take place considering, in particular, the other guiding facts and circumstances that the South African Revenue Service may consider, such as:

– Where the centre of top level management is located;
– Location of and functions performed at the headquarters;
– Where the business operations are actually conducted;
– Where controlling shareholders make key management and commercial decisions in relation to the company;
– Legal factors such as the place of incorporation, formation or establishment, the location of the registered office and public officer;
– Where the directors or senior managers or the designated manager, who are responsible for the day-to-day management, reside;
– The frequency of the meetings of the entity's directors or senior managers and where they take place;
– The experience and skills of the directors, managers, trustees or designated managers who purport to manage the entity;
– The actual activities and physical location of senior employees;
– The scale of onshore as opposed to offshore operations;
– The nature of powers conferred upon representatives of the entity, the manner in which those powers are exercised by the representatives and the purpose of conferring the powers to the representatives.

Tutorial and marking note: *Not all factors are expected to be listed. This is the list based on the current (March 2002) Interpretation Note on place of effective management. The interpretation note is currently under review with a discussion paper having been released by SARS and suggesting the removal of certain factors and weighting of others.*

(iv) If Patent Co is not resident, what would the South African income tax implications be for Patent Co in relation to royalties received in respect of the patent?

The patent was developed in South Africa. As a direct result, the patent's development fixes the source of the income derived from the use of the patent in South Africa. This means that the worldwide royalties received by Patent Co for the use of the patent worldwide will be included in gross income for South African income tax purposes.

Any royalties received by Patent Co for use of the patent in South Africa would be subject to a 12% final withholdings tax on royalties. This would result in these royalties being exempted from gross income and not being subject to normal tax. The same would not be true of the other royalties received from elsewhere in the world. South African normal tax would therefore be levied on the other worldwide royalties (after any applicable deductions) at the company rate of 33% (the percentage applicable to foreign companies).

Tutorial note: *For 2013 years of assessment, the deemed source rules are changed. One of the implications of the new rules is an express provision that unless a royalty (as defined in the replaced s.9) is included as deemed source, it is deemed to not be of a South African source. This would mean that the other worldwide royalties (i.e. the non-SA royalties) would not be from a South African source and the 12% final withholding tax would be the only tax levied on the royalty income earned by Patent Co from the patent. In addition, with the introduction of Dividends Tax from 1 April 2012, the SA tax rate of foreign companies' SA source income drops to 28%. Candidates applying these new provisions will also receive credit.*

(v) If Patent Co is not resident, what, if any, would be the South African income tax implications for Green Build of paying Patent Co a royalty of R1,000,000 per annum?

Despite the payment being made to a connected person, a deduction would be considered in terms of the general deduction provision. This provision only requires that the expenditure be incurred in the production of income and not be of a capital nature. Recurring expenditure, such as royalty payments, are generally of a revenue nature. The provision does not limit ‘excessive’ expenditure. Limitations are provided in terms of separate provisions of the Income Tax Act. Particular to these circumstances as proposed is a provision considering the disallowance of deductions for intellectual property [s.23I]. As the patent was owned and developed by Green Build before its sale to Patent Co and now Green Build is paying Patent Co a royalty for use of the patent, such a deduction is disallowed unless the same amount is included as income for Patent Co (which it is not, as it is exempted from gross income due to the application of 12% South African withholding tax – see above) or the amount is included in the net income of Patent Co as a controlled foreign company to be included in the taxable income of Green Build (see possible controlled foreign company implications in (vi) below).

Assuming the above restriction does apply, where the amount paid is subject to the withholdings tax on royalties (see (iv) above), one-third of the expenditure is permitted as a deduction.

(vi) If Patent Co is not resident, will Patent Co be a controlled foreign company in relation to Green Build, and if so are there any implications of this?

Green Build in the absence of any other residents will hold more than 50% of the participation rights and/or voting rights of Patent Co (a foreign company). As a result, Patent Co will be a controlled foreign company in relation to Green Build. A proportional share of the ‘net income’ of Patent Co will be included in the taxable income of Green Build. As Patent Co will be located in Country X (a tax haven), the expected tax rate for Patent Co is likely to be less than 75% of the SA tax rate on the equivalent income and, as a result, the net income cannot be deemed to be nil. Because the royalty is included in the proportional net income of Patent Co which gives rise to a controlled foreign company tax charge in Green Build, the limitation of the deduction for Green Build as set out in (v) above is lifted.

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

Yours sincerely

Candidate

2 William Khumalo

(a) Employees’ tax

	R	R
Salary (4 x R40,000)		160,000
Less pension contributions:		
Actual R3,200 x 4 limited to the greater of:	12,800	
R1,750 or		
7·5% x R160,000	12,000	(12,000)
Company car use:		
R420,000 x 3·25% x 4 x 80%		43,680
Costs incurred by the company – no fringe benefit		
Medical contributions paid by the employee		
All permitted as employee turns 65 in the year of assessment: R1,500 x 4		(6,000)
Total		185,680
Annual equivalent of month amounts R185,680 x 12/4		557,040
Add: once-off bonus		150,000
Add: receipt of company car		420,000
Total		1,127,040
Tax on R1,127,040 (T1) less rebates (R10,755 + R6,012)		370,299
Tax on R557,040 (T2) per progressive table for individuals less rebates (R10,755 + R6,012)		142,758
Tax on annual amounts: T1 – T2		227,541
Tax on monthly amounts: T2 x 4/12		47,586
Total employees’ tax withheld by the company		275,127

(b) Lump sums and annuities from funds

Lump sums from pension, provident and retirement annuity funds are taxed in terms of separate tax tables on retirement or withdrawal from the fund. The retirement tax tables are more favourable than the withdrawal tables, due to government wishing to promote the retention of retirement savings rather than early withdrawal. The tables are cumulative in nature where multiple lump sums are concerned across all years of assessment. This also means that the tax-free portions in terms of those tables apply over the taxpayer’s life.

Where the fund must pay out a lump sum, a tax directive is requested from SARS by the fund. This tax directive will determine the tax to be withheld from the lump sum (and is treated as employees’ tax). The tax withheld will appear on an IRP 5 certificate issued to the ‘employee’. The fund is considered an employer as regards lump sums and annuities.

All annuities are taxed as gross income. The annuity from the pension fund is no exception. The pension fund will have to withhold employees' tax on the annuity paid and issue an IRP 5 certificate to the pensioner (the employee).

Both the lump sums received in a year of assessment and the annuities received are included in taxable income. However, the progressive tax table for individuals is only applied to the annuity and not the lump sums (as the tax is determined in accordance with separate tables – see above).

The tax to be withheld on lump sums received during the 2012 year of assessment would be determined as follows:

	R	R
Pension Fund retirement:		
Pension lump sum received (1/3 x R6,000,000)		2,000,000
Add previously taxable lump sum from RAF A:		
Lump sum from RAF A	2,000,000	
Less amount transferred to another qualifying fund	(1,000,000)	
Less contributions from any fund of which the taxpayer is or was a member, being the company pension fund at the time the taxpayer left RAF A	(37,000)	963,000
Less: unused portion of disallowed contributions (R40,000 – R37,000)		(3,000)
Total taxable lump sums		2,960,000
Tax per the retirement lump sum tables on the total		867,150
Less tax on previously taxed lump sums based on the retirement table		(148,230)
Tax on lump sum from the pension fund		718,920
Retirement Annuity Fund B:		
Retirement annuity lump sum received (1/3 x R1,200,000)		400,000
Add previously taxable lump sums:		
From RAF A (see above)	963,000	
Lump sum pension fund (R2,000,000 – R3,000)	1,997,000	2,960,000
Total taxable lump sums		3,360,000
Tax per the retirement lump sum tables on the total		1,011,150
Less tax on previously taxed lump sums based on the retirement table		(867,150)
Tax on lump sum from the pension fund		144,000

(c) Other taxes

As William has taxable income other than from remuneration, being taxable rentals and taxable interest (R35,000 – R32,000 interest exemption = R3,000 taxable interest), and taxable income in excess of R120,000, William should be registered for provisional tax. This would require a first payment and submission of a return on 31 August 2011, a second payment and return on 29 February 2012. A voluntary third payment to avoid interest may be made by 30 September 2012. Payments would only be made if the estimates made indicate that payment is required. Additional taxes are levied in the event that the second provisional payment is based on a low estimate.

3 CCJ Baking

Individual partners:
Partnerships are transparent entities for South African income tax purposes. This means that, for tax purposes, the individual partners are liable for South African income tax for their proportional share of the partnership income after deducting their proportional share of the deductible expenses. However, for value-added taxation (VAT) purposes, the partnership is seen as a person. In this scenario, the sale will take place at the zero rate (as provided in the supplied facts).

The sale
The income tax implications of the sale of the partnership to CCJ Baking (Pty) Ltd must therefore be considered for the individual partners. As the South African Income Tax Act looks through the partnership, it is not the partnership interest that is considered sold, but their share of each of the underlying assets. Each of the assets is therefore considered in turn below:

The goodwill is a generated asset. As most expenditure is attached to other assets, generated goodwill is considered to have a base cost of nil. This means that the proceeds represent a capital gain. Each partner will recognise one-third of R14 million as a capital gain.

The building will generate a total capital gain of R1 million, being proceeds of R4 million less the cost of R3 million. Each partner will recognise one-third of R1 million as a capital gain.

The baking equipment is a depreciable asset. In the first instance, the partners will have to recognise the recoupment of the tax allowances previously allowed. As the selling price is greater than the original cost, all the previous allowances granted will be recouped, being R1 million (R1·2 million less tax value of R200,000). One-third of the R1 million recoupment will be included in the gross income of each partner. The equipment will then be subject to capital gains tax. The total capital gain will be R1·8 million (being proceeds, net of the recoupment, of R1 million less the base cost of R200,000, which is the expenditure of R1·2 million less the allowances to date). This capital gain of R1·8 million is again split between the partners in their profit sharing ratio.

Cash is not considered an asset for the purposes of the capital gains tax provisions of the Income Tax Act and therefore generates no capital gain or capital loss.

Each partner will have aggregated capital gains in respect of the disposal of partnership assets totalling R5,600,000 (R14 million + R1 million + R1·8 million)/3. Cameron, Callum and James will have to aggregate these capital gains with any other capital gains or capital losses before applying the annual exclusion and, if a positive result remains and no assessed capital losses are created, will include 25% of such net result in taxable income. Despite Cameron being over 55 years of age, he does not qualify for the small business asset exclusion as the market value of the businesses assets are in excess of R5 million.

Post-sale income tax effects

Instead of being taxed on their portion of the partnerships profits or losses, the partners will be taxed on salaries accruing to them from the company.

In the partnership, no employees' tax had to be withheld from salaries accruing to partners. This is because the partners are not 'employees' of their partnership. In respect of salaries accruing to them from the company, however, employees' tax will have to be withheld as the former partners are now directors.

Once they have paid off their personal bonds, any investment income accruing to each may be taxable depending on the type of income.

CCJ Baking (Pty) Ltd:

This company could qualify as a 'Small Business Corporation' and receive accelerated allowances. The company qualifies as it will not be a 'personal service provider', none of its shareholders holds any equity interest in any other private company or close corporation throughout the relevant year of assessment and its turnover is less than R14 million. The company is not a 'personal service provider', as it will have no regular or major clients and employs more than three unconnected full time employees.

Therefore, the company would benefit from the lower graduated tax rates for Small Business Corporations as well as the accelerated capital allowance of 50/30/20 on its assets. For manufacturing assets, the write-off is 100% in the year the manufacturing asset is brought into use into the company for the first time.

There would be no write-off on the goodwill purchased. In the case of the baking equipment, the 50% rate would be applied on the lower of cost (R3 million) and connected person cost, being R1·65 million (R1·2 million less allowances for the connected person (R1 million) add the recoupment recognised by the connected person (R1 million) and add the result of the connected person's inclusion rate multiplied by the capital gain on the asset (25% x R1·8 million)). Thus the first year's write-off would be R825,000.

The company would also get deductions against income for its expenses, including the salaries paid to the shareholders/directors and the R2 million IT and advertising fee paid to B's IT and Advertising Services (Pty) Ltd (provided that this amount is not excessive; if it is excessive, it would probably not be in the production of income).

As long as the loans were outstanding, the shareholders would be able to draw down on these loans free of STC. STC would, however, be payable on dividends declared (or deemed to be declared) by the company. In the future, dividends tax would have to be withheld by the company on the dividends paid. This would be a tax on the shareholders and not the company.

As mentioned above, employees' tax would have to be withheld on salaries paid to the shareholders/directors.

B's IT and Advertising Services (Pty) Ltd:

This company would fall into the definition of a 'personal service provider', as services would be rendered personally by Cameron who would be a connected person in relation to the company, since Cameron, together with his wife Barbara, hold more than 20% of the share capital of the company. CCJ Baking (Pty) Ltd would be its only client and therefore more than 80% of the income of the company would come from one client. Furthermore, it would not have any employees other than Cameron.

CCJ Baking (Pty) Ltd would have to withhold employees' tax at the rate of 33% from payments made to the company. This employees' tax would be refundable to B's IT and Advertising Services (Pty) Ltd on assessment.

It would not qualify as a small business corporation because it would be a 'personal service provider'.

Deductions would be limited to payments to employees, legal expenses, bad debts, employer contributions to pension, provident and benefit funds, rental of premises, finance charges, insurance, repairs, fuel and maintenance in respect of assets if the premises and assets are used wholly and exclusively for the purposes of trade.

4 Grace Trader

(a) Shares in a trading portfolio are held with a revenue intention, that is, 'in a scheme of profit-making'. As a result, the entire portion of the proceeds should be included in gross income. The acquisition cost would be allowed as a deduction and, if unsold by the year end, treated as closing stock at the end of a year of assessment and as opening stock at the start of the next.

(b) **(i)** **Transaction 1**

For transaction 1, the above would hold true for the second acquisition (31 August 2010), but not the first (1 May 2008). The first acquisition of shares has resulted in a 'qualifying share' being held for a period of more than three years. A qualifying share is any equity share held by the taxpayer that has been held for a continuous period of at least three years and which was not at any time:

1. A share in a share block company;
2. A share in a non-resident company (unless that non-resident company has a listing on the JSE); or
3. A hybrid equity instrument.

The impact of this classification and period of holding is that the Income Tax Act deems the holding to have always been of a capital (i.e. investment) nature. Clearly this provision only affects shares held with a revenue intent as those held with a capital intent would not have qualified for any deduction. The impact of such a determination for shares previously held as trading stock is that the expenditure previously allowed (the acquisition cost now reflected in opening stock) is reversed. The disposal is then considered in terms of the capital gains tax provisions.

The effects may be illustrated as follows:

	R	R
Opening stock (45,000 + 70,000)		(115,000)
Reversal of expenditure for holding held for more than three years		45,000
Proceeds on disposal of shares held for less than three years (500 x R200)		100,000
Capital gains tax:		
Proceeds (500 x R200)	100,000	
Less base cost	(45,000)	
Capital gain	55,000	

The capital gain would have to be aggregated with any other capital gains or capital losses for the year of assessment.

(ii) **Transaction 2**

The disposal in transaction 2 does not trigger the deemed capital intent as the shares are held in a non-resident company and no mention is made of a listing on the JSE.

This disposal would have the following effect:

	R
Opening stock	(36,000)
Proceeds on disposal of shares	90,000

(iii) **Transaction 3**

Preference shares are, by their nature, restricted in some way in terms of the participation in the profits or capital of the company. As a result, preference shares are not considered to be 'equity shares' for the purposes of the Income Tax Act.

Any capitalisation shares received are deemed to have been received for a nil cost unless the capitalisation issue qualified as a 'dividend'. The issue by a company of its own shares is generally not considered a dividend with the result that the additional 500 shares in Teto Ltd did not generate any further tax deductions.

This disposal would have the following effect:

	R
Purchase on 1 March 2011	(43,000)
Receipt of capitalisation shares	0
Proceeds on disposal of shares	55,000

(iv) **Transaction 4**

Income on investments managed by a collective investment scheme are deemed to accrue directly to the taxpayer holding the participatory interest where the income is distributed within 12 months. Where income is not so distributed, the income is deemed to have been received by or accrued to the collective investment scheme and is taxable in its hands. The subsequent distribution of such income would not be taxable in the hands of the taxpayer holding the participatory interest.

For Grace, the above implies the following effects on her taxable income:

	R
South African dividends received (on-distribution within 12 months)	15,000
Dividend exemption	(15,000)
South African dividends received (on-distribution outside 12 months)	
Not deemed received by or accruing to Grace	
Foreign dividends received within the last 12 months	6,000
First R3,700 of the interest exemption	(3,700)
Interest earned by CIS within 12 months and on-distributed	560
Interest exemption of R22,800 less R3,700 (used above) limited to actual interest	(560)

That Grace has elected that such income distributions are reinvested has no bearing on the fact that the income is still deemed to have accrued to her.

(c) Shares are considered financial instruments. For the 2012 year of assessment, the trading stock provisions were amended to indicate that no person holding financial instruments as trading stock may write down such instruments. This has the additional impact that any instrument written down in the 2011 year of assessment and unsold at the end of the 2012 year of assessment must be written back up to cost (irrespective of the market value of that instrument).

5 Tax Services Inc

(i) Query 1

Gross income for income tax purposes includes all amounts received by or accruing to a person. However, case law has limited these wide words and any amount is only considered to have been 'received by' a person where such amount is received for that person's own benefit. For the Coastal Estate Agents Ltd, this clarification is important as the Agency receives money on behalf of clients. While they do 'receive' such amounts, these amounts are not for their own benefit and therefore do not form part of their gross income. In addition, as accruals are considered only to take place when the person is 'unconditionally entitled' to such money, the amounts collected on behalf of the clients also cannot be considered to 'accrue' to the Agency. The commission earned, however, does constitute gross income.

While the supply of residential accommodation is an exempt supply for VAT purposes, the Agency is not the person supplying such accommodation. The Agency renders a service to manage and collect rentals with respect to both residential and commercial property. This is a fully taxable supply for VAT purposes. However, the VAT charged and 'received' by the Agency is also not gross income for income tax purposes as such amounts are not received by the Agency for its own benefit. The output VAT is collected on behalf of the South African Revenue Service.

(ii) Query 2

For gross income to arise there must be:

- An amount
- Received or accrued
- In cash or otherwise
- Which amount is not of a capital nature.

In this case, the issue is whether or not there is an 'amount' for the purposes of gross income. An 'amount' is money or money's worth, i.e. something capable of being valued. In this case, the life right is granted in exchange for the right to use the funds received free of interest. That right has value (essentially in the interest not charged). Such right in this instance is of a revenue nature – the business of Village Retirement Ltd being the supply of retirement village homes life rights in exchange for such loans, i.e. their stock in trade. As such, the right must be valued and that value is to be included in gross income.

Tutorial notes:
1. *This concept does not extend to 'notional' amounts, for example, if money is held in a safe and not in a bank account, the interest that could have been earned on the money is not added to gross income.*
2. *This scenario is based on the decision of* CSARS *v* Brummeria *(69 SATC 205) [name shortened].*

(iii) Query 3

Mr Rich, apart from any other donations tax exemptions, may make donations of up to R100,000 exempt from donations tax. As this is insufficient to avoid donations tax, Mr Rich should donate R200,000 to his wife. Donations to non-separated spouses are free of donations tax. Mrs Rich can retain her R100,000 and then donate R50,000 to each of the children. As these donations do not exceed her R100,000 donation exemption limit, they would not be subject to donations tax. Mr Rich can then donate the remaining R100,000 by donating R50,000 to each of his children. Again, as for Mrs Rich, as this does not exceed the R100,000 exemption limit, these donations would be free of donations tax.

Following the successful donations and investments by each of Mrs Rich and the two children, there are income tax consequences that may arise. Income generated by the daughter (a minor) would be attributed back to her parents in equal shares (having donated equal amounts) as the income arises as a result of the donation and the daughter is a minor [s.7(3)]. Furthermore, any income generated by Mrs Rich may, if the Commissioner considers the donation to have been made for the express purpose of avoiding tax, be attributed back to Mr Rich. The income generated on the investment by the son does not result in any specific attribution rule.

Whether or not the Commissioner can apply the General Anti-Avoidance Rules (GAAR) would depend on whether or not the following conditions are met, namely:

1. The scheme's sole or main purpose was to obtain a 'tax benefit', being an avoidance, postponement or reduction in the liability to taxation.
2. The scheme was entered into (being a transaction of a non-business context) in a manner or means that would not normally be employed for a purpose other than obtaining the tax benefit, or has created rights or obligations that would not normally be created between persons dealing at arm's length, or would result directly or indirectly in the misuse or abuse of the provisions of the Income Tax Act.

		Available	Maximum
1	**Green Build (Pty) Ltd**		
(i)	**Applicability of any corporate rules**		
	Dismissal of three of the rules (1 mark each)	3	
	Identification of two possible rules (1 mark each)	2	
	Inapplicability of rules and reason	2	
		7	4
(ii)	**SA tax implications to transfer the patent**		
	Connected person relationship and effect	1	
	Recoupment, link to market value and calculation	1	
	Capital gains proceeds linked to market value	½	
	Capital gains calculation	1½	
	Aggregation of gains and losses and addition to taxable income	1	
	Application of corporate tax rate to recoupment and gain	1	
			6
(iii)	**Residence status of Patent Co**		
	Rule for residence for non-natural persons	2	
	Identification of key consideration being place of effective management	1	
	Identification of facts and circumstances test and general rule	2	
	Factors in favour of POEM in Country X	1	
	Factors in favour of POEM in SA	1	
	Further investigations required	1	
	Factors to consider (Any four factors, ½ mark each)	2	
			10
(iv)	**Further SA income tax implications**		
	Identification of source and worldwide royalties attaching to SA	1	
	SA use royalties subject to final withholdings tax and rate	1	
	Exemption of SA use royalties from normal tax and applicable rate for normal tax	1	
			3
(v)	**Royalty payment to Patent Co by Green Build (Pty) Ltd**		
	Deduction per general deduction provision identified	1	
	Provision discussion and lack of limitation for 'excessive' expenditure	2	
	Limitation of deductions for intellectual property identified	1	
	When the limitation applies and exceptions to the limitation	4	
	One-third of deduction permitted where withholdings tax applied	1	
			9
(vi)	Identification of Patent Co as a controlled foreign company and application of definition	1	
	Inclusion of proportional share of net income in Green Build (Pty) Ltd's taxable income	1	
	Dismissal of application of 75% rule	1	
	Reference to permission of deduction for Green Build in light of application of controlled foreign company provision	1	
			4
	Format and presentation	1	
	Clarity of explanations	1	
	Logical flow	1	
	Quality of calculations	1	
			4
		Total	**40**

			Available	Maximum
2	**(a)**	Salary	½	
		Pension contributions and limits	1	
		Company car use for employees' tax	1	
		Medical contributions of employee all permitted as taxpayer over 65	1	
		Determination of annual equivalent for monthly amounts	1	
		Bonus and award of company car	1	
		Tax on two annual equivalents	1	
		Calculation for total employees' tax	1½	
				8
	(b)	Separate tables apply to lump sums	½	
		Tables are cumulative	½	
		Tax directive obtained	½	
		Treated as employees' tax	½	
		Annuity is gross income and subject to employees' tax	1	
		Progressive tables only applicable to annuity and not lump sums	½	
		Calculation of previously taxable RAF A lump sum	2	
		Calculation of pension fund taxable lump sum	1	
		Calculation of tax payable on pension fund lump sum	1½	
		Calculation of taxable RAF B lump sum	1	
		Calculation of tax on RAF B lump sum	1	
				10
	(c)	Taxpayer liable for provisional tax and reasons	1	
		Returns and payments due dates	½	
		Reference to additional taxes for under-estimate of second provisional payment	½	
				2
			Total	**20**

3 **CCJ Baking**

	Available	Maximum
Individual partners		
Transparency of partnerships for income tax	½	
Taxation of individual partners based on profit share	½	
Partnerships are persons for VAT	½	
Each asset considered sold by each partner and not the partnership interest	½	
Goodwill discussion and calculation of capital gain	½	
Capital gain calculation for the building	½	
Recoupment recognition, calculation and impact on partners	1½	
Capital gain calculation for baking equipment	1	
Recognition of cash not being considered an asset	½	
Effect for each partner and inclusion	1	
Consideration of small business exclusion for Cameron	1	
Partners (now as directors) taxed on salaries	½	
Employees' tax to be withheld	½	
Investment income impact	1	
CCJ Baking (Pty) Ltd		
Company is a small business corporation with reasons	2	
Effect of being a small business corporation (rates and allowances)	1	
Limitation of cost for allowance (connected person cost)	1	
No deduction for goodwill purchased	½	
Deduction for baking equipment	1½	
Deduction for all costs incurred	½	
Impact of draw down from loans	1	
Employees' tax withholding	½	
B's IT and Advertising Services (Pty) Ltd		
Company is a personal service provider plus reasons	2	
Obligation of CCJ Baking to withholding employees' tax and rate	1	
Does not qualify as a small business corporation and reason	1	
Limitation of deductions (with examples – max 2 examples)	1	
	23	**20**

				Available	Maximum
4	**(a)**	Impact of shares held with a revenue intention (income and expense)			1
	(b)	**(i)**	**Transaction 1**		
			Identification of deemed capital treatment	1	
			Explanation of a 'qualifying share'	2	
			Impact of a qualifying share disposal	2	
			Illustration of effects on taxable income	3	
					8
		(ii)	**Transaction 2**		
			Explanation why not treated as capital	1	
			Illustration of effect on taxable income	1	
					2
		(iii)	**Transaction 3**		
			Explanation why not treated as capital	1	
			Impact of capitalisation share issues	1	
			Illustration of effect on taxable income	1	
					3
		(iv)	**Transaction 4**		
			Discussion of taxation of distributions from collective investment schemes	2	
			Illustration of the effect on taxable income	2	
			Reinvestment of income distributed from a CIS still accrues and income tax effect must be recognised	1	
					5
	(c)	No write down permitted for financial instruments		½	
		Impact of previously written down financial instruments		½	
					1
				Total	**20**

			Available	Maximum
5	**(i)**	**Query 1**		
		General gross income rule	1	
		Explanation of receipt	1	
		Application to facts of the Agency	1	
		Explanation of accrual	1	
		Conclusion that commission earned is gross income	1	
		Consideration of VAT implications for residential v commercial accommodation	1	
		Impact for the Agency with respect to VAT on commission	1	
				7
	(ii)	**Query 2**		
		Gross income rule and identification of the critical issue	1	
		Explanation of the concept of 'amount'	1	
		Identification of the 'amount' in this context	1	
		Why such amount is of a revenue nature	1	
		Conclusion that the valued 'right' must be included in gross income	1	
				5
	(iii)	**Query 3**		
		Identification of the R100,000 exemption from donations tax	½	
		Identification of the spousal donations tax exemption	½	
		Explanation of the use of the exemptions to eliminate the donations tax	2	
		Effect of the income generated by the minor child on Mr Rich	1	
		Potential effect of income generated by Mrs Rich on Mr Rich	1	
		Identifying the lack of an attribution rule for income generated by the major child	1	
		Identification of the two critical components of the GAAR	2	
				8
			Total	**20**