Professional Level – Options Module

Advanced Taxation (South Africa)

Friday 7 December 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 ended 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 ending 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 Green Build (Pty) Ltd ('Green Build') is a resident company with a financial year ending on 31 March each year, and is a value added tax (VAT) vendor. Green Build manufactures 'green' (that is, environmentally friendly) building products. Green Build is also engaged in building 'green' buildings. All amounts below exclude VAT unless otherwise stated. During the year of assessment ending 31 March 2012, the following transactions took place:

In a prior financial year, Green Build's research division produced a building brick impregnated with the seeds of an evergreen ground cover plant (the 'Green Brick'). This brick is used in the 'greening' of cities. Buildings built with these bricks are eventually covered by this plant, which survives on the seasonal rain. This technology has been patented and royalties are currently derived from all over the world.

The patent was developed at a total cost of R7,000,000 and has a current market value of R15,000,000. Allowances of R5,000,000 have been accepted by the Commissioner against the cost.

Green Build has received advice that the patent should be sold (at cost) to a company located outside South Africa (in Country X, which is considered to be a tax haven) to reduce its overall tax burden. The advice provides for a company (Patent Co) to be incorporated in Country X. Green Build (Pty) Ltd will hold 51% of the equity interest in Patent Co. The remaining 49% is to be held by non-resident investors whose capital will fund future investments by Patent Co. Only equity shares are to be issued and each share has one shareholder vote. The directors for Patent Co will also be from Country X and a director from Green Build will serve as the chairman of the board of directors. The chairman will have veto power over any decision made by the board of directors. All directors' meetings would be conducted in Country X. The chairman of the board is resident in South Africa.

The directors have the following questions regarding the South African tax implications of the above advice:

(i) Assuming that Patent Co is considered a 'foreign company', would any of the income tax 'corporate rules' on corporate transactions apply to the transfer of the patent to Patent Co? If any rules appear like they might apply, are there any qualifying criteria? (4 marks)

(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? (6 marks)

(iii) What would the residence status of Patent Co be in relation to the definition of 'resident' in the South African Income Tax Act? (10 marks)

(iv) If Patent Co is not resident, what would the future South African income tax implications be for Patent Co in relation to royalties received in respect of the patent? (3 marks)

(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? We do not need to know about any transfer pricing implications. (9 marks)

(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? (4 marks)

Country X does not have a Double Tax Agreement with South Africa.

Required:

In a letter, answer the questions (i) to (vi) raised by the directors of Green Build (Pty) Ltd. You should support your explanations with calculations where appropriate.

Note: The mark allocation is shown against each of the six questions above.

Professional marks will be awarded in question 1 for the overall presentation of the letter, the provision of relevant advice and the effectiveness with which the information is communicated. (4 marks)

(40 marks)

2 William Khumalo retired from employment on 30 June 2011, after reaching the age of 65. He would like to understand his tax implications for the year of assessment ending 29 February 2012 based on the information below.

Employment – 1 March 2011 to 30 June 2011
William had received a monthly cash salary of R40,000. From this amount, he contributed R3,200 per month to the company's pension fund and R1,500 to the company's authorised medical aid scheme. William has no dependants on his medical scheme. The company contributed an equal amount to the pension fund but did not contribute towards the medical aid scheme. Of William's contributions to the pension fund, R40,000 had been disallowed in terms of the Income Tax Act by 28 February 2011.

The company provided William with the use of a company car. On 30 June 2011, the company gave William the car, at which date the market value was R340,000. The company car had been originally purchased for R420,000 (including value added tax (VAT)) on 1 April 2009 from which date William had been granted use. The company paid all running costs in relation to the car, but from 1 July 2011, William took responsibility for the running costs. The costs incurred by the company amounted to R7,245 for fuel and R580 for the licence. William's costs were R8,900 for fuel and R9,000 to replace the tyres. No other maintenance costs were incurred as the car was acquired from the dealer with a five year maintenance plan. William kept a logbook, but only for the period 1 March 2011 to 30 June 2011 during which time he travelled 3,000 business kilometres out of a total of 7,000 kilometres. For the period 1 July 2011 to 29 February 2012, William travelled a further 8,000 kilometres.

The company also awarded William R150,000 as a long-service cash bonus in June 2011.

Pension annuity and lump sums
The total available credit for William in the company pension fund amounted to R6,000,000. William decided to take one-third of the credit in cash and convert the remaining portion into an annuity. The annuity began on 31 July 2011 and amounted to R20,000 per month.

William had previously withdrawn from a retirement annuity fund (RAF A) in October 2010. At that time, he chose to take R1,000,000 in cash and transfer the remaining R1,000,000 to another retirement annuity fund (RAF B). All contributions to RAF A had been allowed as a tax deduction, but the contributions to the company pension fund disallowed in October 2010 amounted to R37,000. The fund credits in RAF B on 1 September 2011 amounted to R1,200,000, at which date William decided to retire from that fund. Again, one-third to be taken in cash and two-thirds to be converted to an annuity paying R2,600 per month. All contributions to RAF B had been permitted as tax deductions.

Other information – 1 March 2011 to 29 February 2012
William earned interest of R35,000 for the year of assessment and R70,000 in rental (after allowable expenses) from a property he owned.

William did not dispose of any capital assets during the year of assessment.

Required:

(a) Calculate the total employees' tax withheld by the company in respect of William for the 2012 year of assessment. (8 marks)

(b) Explain the income tax effects arising from the lump sums from the pension and retirement annuity funds as well as the payment of the annuity by the pension fund. Support your answer by calculating the tax to be withheld from the lump sum payments in the 2012 year of assessment. (10 marks)

(c) Explain whether or not William would be subject to any other taxes, other than normal tax, for the 2012 year of assessment and what the registration requirements and payment dates for such tax/taxes would be. (2 marks)

(20 marks)

Section B – TWO questions ONLY to be attempted

3 Cameron, Callum and James, aged 56, 53 and 48 respectively, are partners in a bakery, trading as CCJ Baking ('CCJ'). They share profits and losses equally. They have no other business interests. CCJ provides services to a wide range of corporate customers. While most are regular customers, no client is considered larger than the others. The partners employ five pastry chefs and one bookkeeper/receptionist. The total partnership turnover is approximately R10 million per annum. The partnership is a registered value added tax (VAT) vendor.

The partners are considering selling their partnership interests to a private company, which would be called CCJ Baking (Pty) Ltd. The equity shares in the company would be held in the same proportions as the partners' profit sharing ratios in the partnership. The private company will continue to run the business along the same lines and with the same staff as the partnership. It is anticipated that the total income of CCJ Baking (Pty) Ltd will be R12 million per annum.

A second company, B's IT and Advertising Services (Pty) Ltd, would also be set up with Cameron's wife, Barbara, as the sole shareholder. Barbara has no other business interests. The company's sole object would be to provide IT and advertising services to CCJ Baking (Pty) Ltd. Cameron will be its only employee. It is anticipated that the total income of B's IT and Advertising Services (Pty) Ltd will be R2 million per annum.

An independent valuation has placed the current value of the partnership at R26 million. This valuation comprises: goodwill of R14 million; a building worth R4 million; cash in the bank of R5 million; and baking equipment of R3 million. There are no partnership liabilities. The building does not qualify for any capital allowances.

The partnership was started during 2008 when the partners each contributed R2 million in order to buy baking equipment which cost R1·2 million (and currently has a tax value of R200,000), the building which cost R3 million and to fund running expenses. Apart from drawing market-related salaries from the partnership, the partners have not drawn any profits out of the partnership.

The partnership interest would be sold to CCJ Baking (Pty) Ltd on interest-free loan for R26 million (allocated to assets as per the independent valuation above). The sale will qualify to be a zero-rated transaction for VAT purposes. Over time the partners would draw down on their loan accounts to pay off their personal bonds and would thereafter probably invest the balance.

Assume that any sale would become effective at the start of the 2012 year of assessment. Baking is not considered a process of manufacture.

Required:

Advise the partners of what the tax implications would most likely be for them and the companies referred to in the question, if they were to implement the above structure.

(20 marks)

4 Grace Trader has two portfolios of shares. The first portfolio is a trading portfolio and the second is an investment portfolio. The Commissioner for the South African Revenue Service has accepted that these classifications are correct for tax purposes. Grace maintains all her share portfolios on a first-in-first-out (FIFO) basis.

Grace has some queries regarding the tax treatment of selected transactions, detailed below:

(i) Transaction 1

Grace sold her holding in Zeebo Ltd, a company listed on the JSE, on 1 June 2011. The shares were held in the trading portfolio. The shares sold had been acquired in two separate transactions. The first acquisition of 500 shares occurred on 1 May 2008 for R45,000. The second acquisition, also for 500 shares, was on 31 August 2010 for R70,000. The sales price achieved was R200 per share. (8 marks)

(ii) Transaction 2

The holding in Yannis Ltd, a foreign company, was sold on 1 August 2011. These shares were held in the trading portfolio. The shares had been acquired for a Rand equivalent of R36,000 on 1 April 2007 and were sold for the Rand equivalent of R90,000. The holding was less than 10% of the participation rights in the company. (2 marks)

(iii) Transaction 3

1,000 preference shares in Teto Ltd, a resident company, had been acquired on 1 March 2011 for R43,000. The company had issued a further 500 shares in terms of a capitalisation issue funded from profits on 1 June 2011. The company reacquired all the preference shares on 1 November 2011 for R55,000. (3 marks)

(iv) Transaction 4

Grace has, as part of her investment portfolio, a participatory interest in a collective investment scheme in securities. This participatory interest was acquired for R60,000. The collective investment scheme has indicated on a transactional statement for her participatory interest for the year:

	R
South African dividends received within the last 12 months	15,000
South African dividends received outside the last 12 months	4,000
Interest on cash holdings of the portfolio earned within 12 months	560
Foreign dividends received within the last 12 months	6,000

Grace has elected that all income received from the collective investment scheme is to be reinvested (i.e. further units are acquired in the collective investment scheme). (5 marks)

Required:

(a) **Explain the general income tax consequences of a share 'trading' portfolio with respect to the acquisition and disposal of the shares in that portfolio.** (1 mark)

(b) **Advise Grace as to the income tax impact of each of the above transactions (i) to (iv) on her taxable income for the year of assessment ending 29 February 2012. Your answers should include computations where appropriate.**

Note: The mark allocation is shown against each of the four transactions above.

(c) Some of the shares in the trading portfolio have market values below the acquisition cost incurred.

Required:

Briefly explain whether these shares can be written down to that market value. (1 mark)

(20 marks)

5 You have received a memorandum from your manager at Tax Services Inc requesting that you prepare answers to the following independent client queries.

(i) Query 1:
Coastal Estate Agents Ltd ('the Agency') is a resident company and value added tax (VAT) vendor. The Agency collects rental income from a variety of commercial properties along the coast of South Africa on behalf of their clients. In addition, a number of residential property rentals are also collected. The Agency receives 10% of the rentals collected as a commission and pays the balance to the clients.

Required:

Explain the South African tax implications of the transactions for Coastal Estate Agents Ltd. (7 marks)

(ii) Query 2:
Village Retirement Ltd develops retirement village estates. The company does not sell the units to the retirees, but rather provides a 'life right' to the unit, being the right to remain in the property for the rest of the occupant's natural life, in exchange for an interest-free loan. The loan is only repayable by the company on the death of the retiree/occupant to that person's estate and the life right ends. The company then obtains a new loan from the new occupant.

Required:

Explain whether or not the life rights exchange for a loan from the holder of that right has any gross income implications for Village Retirement Ltd. (5 marks)

(iii) Query 3:
Mr Rich has R300,000, of which he would like to donate R100,000 to each of his wife, his son and his daughter. Each will invest their share in a fixed deposit account which will provide interest of R9,000 per annum for each investment of R100,000. His son is 19 and his daughter 17. Mr Rich would like to avoid donations tax, if possible, and would like to understand if any other income tax consequences may arise for him as a result of these donations. Mr Rich has interest income, in his personal capacity, exceeding R22,800 per annum and is not yet 65 years of age.

Required:

Advise Mr Rich as to the manner in which he may avoid donations tax and explain the income tax consequences that may arise for Mr Rich as a result of the donations. Also advise Mr Rich as to the circumstances required before the Commissioner could apply the general anti-avoidance rules to any scheme suggested. (8 marks)

(20 marks)

End of Question Paper