Answers

Marks

1 Len Philander

(a) (i)

Tax payable for the period ended 31 July 2006		R	R	R	
Interest			18,000		
Less interest exemption			(16,500)	1,500	1
Dividend income (exempt)				0	0·5
Rentals				12,000	0·5
Travel allowance			42,000		
Less actual private travel 20%			(8,400)	33,600	1
Salary				270,000	
Provident fund (no deduction)				–	0·5
Mooring fees (not in production of income)				–	1
Partnership loss	$^{2,400}/_2 \times {}^5/_{12}$				
Note: it is possible that this could be ringfenced.				(500)	1
				316,600	
Medical contributions		8,500			
Limited to	500 × 2 × 5 = 5,000			(5,000)	1
Excess contributions	8,500 – 5,000	3,500			
Less	$7^1/_2$ % × 316,600	(23,745)			
No further deduction permitted				–	0·5
				311,600	
Capital gains					
Family house (roll over to spouse)			–		1
Holiday house	proceeds (MV)	1,500,000			
	base cost	(700,000)	800,000		0·5
Motor car (personal use asset)			–		0·5
Yacht > 10 metres (not personal use asset)					0·5
	proceeds (MV)	900,000			0·5
	base cost	(1,000,000)			
	Loss	(100,000)			
	Loss disallowed per para 15		–		1
Investment	proceeds (MV)	600,000			
	base cost	(200,000)	400,000		0·5
Share portfolio	proceeds (MV)	4,100,000			
	base cost	(2,900,000)	1,200,000		1
Aggregate gains			2,400,000		
Less exclusion on death			(60,000)		1
			2,340,000		
Taxable capital gain at 25%				585,000	0·5
Taxable income				896,600	
Tax payable				315,640	
Less rebate	7,200 × $^5/_{12}$			(3,000)	1
				312,640	
					15

Marks

(ii) Estate duty position

All property will be included in the estate at market value except for the listed shares, which, as they have been sold, must reflect the proceeds received. The aggregate of all the assets will represent the gross value of the estate. 1

Any liabilities owing by the deceased will be allowed as deductions from the gross value of the estate. 1

Certain additional deductions are permitted as follows:
- The market value of the house is deductible as it accrues for the benefit of Len's wife. 1
- Any taxes due in respect of Len's last tax return or due by his deceased estate are all deductible. 1
- Remuneration of the executor and mandatory estate fees are all deductible. 1
- Finally an abatement of R2,500,000 is allowed to be deducted. 1

After all the deductions and abatement the amount remaining is the dutiable estate on which estate duty of 20% is calculated. 1

Annexure

House	3,200,000
Holiday house	1,500,000
Motor car	300,000
Yacht	900,000
Investment	600,000
Shares	5,000,000
Cash	600,000
Gross estate	12,100,000
Less House	(3,200,000)
Taxes	
Expenses	
Abatement	(2,500,000)
Dutiable estate	
Estate duty at 20%	

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(b)

Tax consultant
Address

Date

Len Philander
Address

Dear Mr Philander

You have requested advice regarding the tax implications of the creation of an *inter vivos* trust for yourself and trust beneficiaries.

Please find below all the tax implications for the scenario that you have set out.

1. The transfer of the assets into the trust as a donation will be subject to donations tax on the market value of the asset. An annual exemption is allowed of R50,000. Donations tax is calculated at 20% of the market value after deducting the exemption. The donation of the assets will also be a disposal for capital gains tax purposes. A portion of the donations tax paid may be added to the base cost of the assets, which will reduce the capital gain. After aggregating all your gains and losses an annual exclusion of R12,500 is allowed before including 25% of the net capital gain with your other taxable income. 0·5 0·5 0·5 0·5 1
2. Income received by the trust will retain its nature as rental and dividends even if distributed to the beneficiaries. Distributions to the beneficiaries will vest in them and these amounts will be taxed in their own hands, as they are both major children. However, as your daughter is a non-resident the amount she receives will be taxed in your hands (s.7(8)). 1 1 1
3. Any income not distributed by the trust at the end of the tax year (retained income) will be taxed in your hands as the trust is discretionary, no one has a vested right to this income and you have made a donation to the trust (s.7(5)). 2
4. Any dividends included in the retained income or in the distributed amounts will, because it retains its nature, enjoy exemption if they are domestic dividends. 2

		Marks

Please refer to the annexure below, which illustrates how the income in the trust will be taxed.

Please do not hesitate to contact me if you require any further information.

Yours faithfully

Tax consultant

Annexure

Taxable income of the trust		R	
Rental income		6,000	
Dividends		61,000	
		67,000	
Less distribution	10,000 × 2	(20,000)	
		47,000	

Amount taxed in Len's hands per s.7(5).

Len			
Dividend and rent s.7(5) – the retained income in the trust (as above)		47,000	
Less dividend exemption	$^{61}/_{67}$ × 47,000	(42,791)	
		4,209	
Daughter's distribution – s.7(8) (as she is non-resident)		10,000	
Less dividend exemption	$^{61}/_{67}$ × 10,000	(9,104)	
		5,105	
The son will be taxed on the distribution to him as he is a major.			
Son's distribution		10,000	
Less dividend exemption (retains its nature)		(9,104)	
		896	2
			12
Format and presentation of letter			1
Effectiveness with which information is communicated			2
			3
			37

2 Argon Optical (Pty) Ltd

(a)

Tax Accountant
Argon
Date

Memorandum to the financial director

You have requested a report from me to advise on the VAT and income tax implications for Argon in respect of three options which are being considered. This report is based on information supplied to me by yourself and I deal with each of the options below.

Option 1

VAT

As the seller is not a vendor, Argon will pay transfer duty on the acquisition of the building. 2

Argon can claim a deemed VAT input of $^{14}/_{114}$ of the consideration but limited to the transfer duty paid of R1,945,000. 1·5

Income tax

Argon will be able to claim a building allowance of 5% of the cost less the input VAT claimed provided no allowance has ever previously been claimed on the building. 2

Option 2

VAT

VAT input is claimable on the purchase consideration of R3,684,210 (R30 million × $^{14}/_{114}$). 0·5

VAT input is claimable on improvements made of R245,614 (R2m × $^{14}/_{114}$) 0·5

Marks

Income tax

No connected person rule for buildings	1
A 5% building allowance will be deductible in respect of the building, calculated as R30 million × $^{100}/_{114}$ × 5% = R1,315,789	1
A 5% building allowance will be deductible in respect of the improvements calculated on R2 million less the actual VAT input (R2m – 245,614) × 5% =R87,719.	1

Option 3

VAT

VAT input is claimable on the lease payments R90,000 × $^{14}/_{114}$ = R11,053 per month	0·5
VAT input is claimable on the building costs of R35 million. 35m × $^{14}/_{114}$ = R4,298,245	0·5
VAT input is claimable on the premium paid of R50,000. 50,000 × $^{14}/_{114}$ = R6,140	0·5

Income tax

Lease rentals net of VAT are fully deductible.	0·5
The lease premium of R50,000 × $^{100}/_{114}$ is deductible over the term of the lease of 25 years. i.e. 1,754 (43,859/25)	1
The lease improvement of R35 million net of VAT is deductible as follows: The amount of R30 million net of VAT is divided by the number of months left in the lease term from the date of completion of the building.	2
30 million × $^{100}/_{114}$ divided by 24 years 3 months	0·5
The excess expenditure of R5 million × $^{100}/_{114}$ is subject to a building allowance of 5%	1
	16

Format of memorandum	1
Effectiveness of communication	1
	2

(b) The lessor will have to include the following in gross income in the year(s) the income accrues to him:

– The lease premium R50,000 × $^{100}/_{114}$	1
– The amount stipulated in the lease agreement for improvements R30 million × $^{100}/_{114}$ on completion of the building	1·5
– Lease rentals of R90,000 × $^{100}/_{114}$ per month	0·5
The lessor could get relief in respect of the improvements value included in income in terms of s.11(h). This relief is subject to the commissioner's discretion.	1
	4

(c) The VAT treatment will differ depending on whether the branch is fully independent or not.

If it is independent, then any goods supplied will be zero rated.	1
If it is not independent there is no effect when goods are supplied to the branch. However, at the point that	1
the branch sells to customers the zero rate will apply.	1
	3
	25

						Marks
3	**Sam Odis**					
(a)	2006:					
	s.12C allowance	$100,000 \times {}^{100}/_{114} \times 20\%$			(17,544)	1
	2007:					
	s.12C allowance (as above)				(17,544)	1
	Proceeds	$125,000 \times {}^{100}/_{114}$ limited to cost		87,719		1
	Less tax value		87,719			
	Less	$(100,000 \times {}^{100}/_{114} \times 40\%)$ 2005	(35,088)			
		2006	(17,544)			
		2007	(17,544)	(17,543)		
	Recoupment			70,176		1·5
	Recoupment deferred p66, s.8(4)(e)					1
	Recoupment deferred		$70,176 \times 40\%$		28,070	1
	Carried forward	R42,106 (70,176 – 28,070)				1
	Capital gain					
	Proceeds	$125,000 \times {}^{100}/_{114}$		109,649		0·5
	Less recoupment			(70,176)		0·5
				39,473		
	Base cost		87,719			
	Less allowances		(70,176)	(17,543)		1
				21,930		
	Capital gain chargeable	$21,930 \times 40\%$		8,772		1
	Less annual exclusion			(8,772)	0	1
	No inclusion					
	Capital gain carried forward	R13,158 (21,930 – 8,772)				1
	s.12C on new machine	$125,000 + 25,000 \times {}^{100}/_{114}$		131,579		
		$131,579 \times 40\%$			(52,632)	1·5
						14

(b) Sam will have an allowance of R26,316 ($150,000 \times {}^{100}/_{114} \times 20\%$) on the new machine which he may deduct from gross income. There will also be a recoupment included in gross income of: R14,035 ($70,176 \times 20\%$) 1·5

A capital gain of R4,386 ($21,930 \times 20\%$) will be aggregated with any other capital gains and losses, reduced by R12,500 and then included in taxable income at 25% 1·5

3

(c) Sam will have to include any balance remaining of the recoupment which has yet not been brought into account in his gross income as an amount recovered or recouped in that year. 1

Any portion of the capital gain not yet brought into account will have to be included as a capital gain in the year the machine is withdrawn from use. 1

2

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4 Jane Reilly

(a) Capital gains tax effects

1. Primary residence

On ceasing to be resident all assets are deemed to be disposed of at market value. An exception to this is immoveable property in South Africa. Thus there will be no disposal gain on emigration in this case. 1·5

When the property is eventually sold, Jane will be subject to capital gains tax. The gain will be calculated as the selling price less the original base cost of R950,000. 1·5

She will still be allowed the primary residence exclusion for the period that the property was her primary residence if she sells within two years after her emigration. 1

Marks

2. Dividend yielding shares
These shares will be deemed to be disposed of on 30 November 2006. If they are subsequently sold after Jane ceases to be resident there will be no further South African tax consequences. 1 0·5

The gain will be calculated as follows:

		R	Marks
Market value = proceeds		162,000	
Base cost	150,000 + [(162,000 – 150,000) × $^{1}/_{7}$]	(151,714)	
Capital gain		10,286	1·5

3. Personal use assets
As these are moveable assets there is a deemed disposal at 30 November 2006 at market value. 1
The capital loss would be R15,000 (35,000 – 50,000), but the loss would be disregarded as they are personal use assets. 1·5

4. Yacht
This is not a personal use asset as it is greater than 10 metres long, therefore, there will be a disposal at 30 November 2006. 1
The calculated gain or loss is:

	R	Marks
Proceeds = market value	750,000	
Less base cost	(850,000)	
Capital loss	(100,000)	0·5

This loss will also be disregarded under paragraph 15 of the Eighth Schedule 1

5. Holiday house
A capital gain or loss will have arisen on disposal on 1 November 2006, calculated as:

	R	R	Marks
Selling price		1,875,000	
Less base cost			
Market value 1 October 2001	900,000		
Selling costs	22,000	(922,000)	1
Capital gain		953,000	13

(b) **Income tax effect**

Capital gains		R		Marks
Shares		10,286		
Holiday house		953,000		
		963,286		1
Less annual exclusion		(12,500)		0·5
		950,786		
Less capital loss brought forward		(3,400)		1
		947,386		
Include in income	947,386 × 25%		R236,847	0·5
				3

(c) If Jane remained ordinarily resident by physically leaving the Republic of South Africa there would be no disposals for capital gains tax purposes as Jane would still be regarded as a resident for tax purposes. 1

A problem could arise, however, if she subsequently sold her primary residence in South Africa. It could then be argued that, as she had set up a home elsewhere, her South African home was no longer her primary residence. The result of this would be she would lose the primary residence exclusion. 1 1

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					Marks

5 Jamie Oldfield

(a) Jamie should take advantage of any available fringe benefits to the extent that their after-tax cost to him is less than the actual cost of provision to himself. 1

Accommodation

As the proposed accommodation is owned by Colt, the fringe benefit value is derived by means of the formula (A – B) × $^{C}/_{100}$ × $^{D}/_{12}$ i.e. 350,000 – 40,000 × 17% = R52,700 2

Travel allowance

As Jamie will not have accurate records for tax purposes he can only claim deemed kilometres × deemed rate. 1

					Marks
Total kilometres			27,000		
Less deemed private			(18,000)		
Business kilometres			9,000		1
Fixed rate		$^{41,771}/_{27,000}$	1·547		
Fuel			0·548		
Maintenance			0·305		
			2·400		
Business kilometres	9,000 × 2·4			21,600	2
Structure of package				R	
Total package				350,000	
Less cost of housing				(36,000)	
Less travel allowance				(21,600)	
				292,400	
Cash salary				292,400	1
Housing fringe benefit				52,700	0·5
Travel allowance	(21,600 – 21,600)			–	0·5
				345,100	
RAF contributions allowed	(max 15% × 345,100)			(4,700)	1
Taxable income				340,400	10

Colt pays 21,600 + 36,000 + 292,400 = R350,000

(b) Option 1

					Marks
				R	
Taxable income (as above)				340,400	
Tax payable	(340,400 – 300,000) × 38% + R79,000			94,352	
Less rebate				(7,200)	
Tax liability				87,152	1
Cash					
Salary			292,400		
Travel allowance			21,600		
			314,000		1
Expenditure (cash outflow)		R			
Car rental	3,650 × 12	43,800			
Fuel and oil	1,250 × 12	15,000			
Car maintenance	2,700 × 12	32,400			
Retirement annuity		4,700	(95,900)		2
			218,100		
Less tax payable			(87,152)		1
Disposable income			130,948		

Option 2

					Marks
Cash salary				400,000	
Tax payable	117,000 – 7,200			(109,800)	1
				290,200	
Expenses as above				(95,900)	1
Flat rental	5,000 × 12			(60,000)	1
Disposable income				134,300	

Marks

After the beneficial restructuring Option 2 is R3,352 per year better than the Colt package (Option 1) in disposable income terms. However, Jamie should also be advised to consider other non-cash factors such as his future prospects with each enterprise and the extent to which the cost of renting his own accommodation is likely to rise relative to his salary, and thus the accommodation benefit in future years. 1

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