Professional Level – Options Module

Advanced Taxation (South Africa)

Monday 1 December 2008

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 2–3

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 year 2008 will continue to apply for the foreseeable future.
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 2008
Rebates	
Primary rebate	R7,740
Secondary rebate (over 65)	R4,680
Interest exemption	
Under 65	R18,000
Over 65	R26,000
Companies	
Normal tax rate	29%
STC rate	10%
Ordinary trusts	40%
Donations tax	20%
Estate duty	20%

Schedule 1

Rates of normal tax payable by persons (other than companies)
in respect of the year of assessment ended 29 February 2008

Where the taxable income	
does not exceed R112,500	18% of each R1 of the taxable income
exceeds R112,500 but does not exceed R180,000	R20,250 plus 25% of the amount over R112,500
exceeds R180,000 but does not exceed R250,000	R37,125 plus 30% of the amount over R180,000
exceeds R250,000 but does not exceed R350,000	R58,125 plus 35% of the amount over R250,000
exceeds R350,000 but does not exceed R450,000	R93,125 plus 38% of the amount over R350,000
exceeds R450,000	R131,125 plus 40% of the amount over R450,000

Tax rates for small business corporations for the
year of assessment ended 29 February 2008

R0 – R43,000	Nil
R43,001 – R300,000	10% of the amount over R43,000
R300,001 and above	R25,700 + 29% of the amount over R300,000

Rating formula

$$R = \left[\frac{F}{B + D - (C + L + G)}\right]$$

$$Y = \left[\frac{A}{B + D - (C + L)} \times (B - L)\right] + (L \times R)$$

Official interest rates

1 March 2007	10%
1 September 2007	11%

Travel allowance table

For years of assessment commencing on or after 1 March 2006

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 – 40,000	15,364	47·3	22·5
40,001 – 60,000	20,910	49·4	26·2
60,001 – 80,000	25,979	49·4	26·2
80,001 – 100,000	31,513	54·8	30·5
100,001 – 120,000	36,978	54·8	30·5
120,001 – 140,000	41,771	54·8	30·5
140,001 – 160,000	47,512	57·2	39·8
160,001 – 180,000	52,629	57·2	39·8
180,001 – 200,000	58,334	65·9	43·8
200,001 – 220,000	64,591	65·9	43·8
220,001 – 240,000	69,072	65·9	43·8
240,001 – 260,000	74,777	65·9	43·8
260,001 – 280,000	79,918	69·3	52·5
280,001 – 300,000	85,440	69·3	52·5
300,001 – 320,000	88,793	69·3	52·5
320,001 – 340,000	95,218	69·3	52·5
340,001 –	100,011	77·1	68·0

Note:
Where reimbursement is based on actual business kilometres travelled, no other compensation is paid to such employees and the kilometres travelled for business does not exceed 8,000, the prescribed rate is R2·46 per kilometre.

SECTION A – BOTH questions are compulsory and MUST be attempted

1 Spiros Mathei, a South African resident, who is 67 years of age, has various investments and assets. On good advice he is in the process of revising his will and it is therefore of the utmost importance that he fully understands all the tax implications regarding his income and assets.

Information regarding his interests is as follows:

(a) In June 1999 Spiros created the Mathei Family Trust and sold his portfolio of shares, listed on the Johannesburg Stock Exchange (JSE), to the trust for R3 million on loan account. The loan is interest free and no repayment date had been set.

On the same date, he donated a fixed residential property in South Africa to the trust. The market value of this residential property was R1·5 million in June 1999. The residential property has always been let out to tenants on long leases. The market value of this residential property on 1 October 2001 was R1·7 million.

In terms of the trust deed, Spiros receives an annuity of R20,000 out of the trust income on the last day of each month.

In June 2002 Spiros' father, Eric, died leaving a cash investment of R2 million, in a United States bank account, to the Mathei Family Trust. Eric had been resident in the United States for his entire life.

The beneficiaries of the Mathei Family Trust are Spiros, his wife Catalina, and their two children, Riana and Mira. Both children are majors; Riana is a resident of South Africa, while Mira is a resident of the United States. The income of the Mathei Family Trust for the year ended 29 February 2008 was as follows:

	R
Dividends – JSE shares	190,000
Interest – United States bank account	180,000
Rent – from residential property	325,000

The Mathei Family Trust is discretionary with regard to capital and income except for the annuity payable to Spiros. The trustees exercised their discretion and distributed R100,000 each to Riana and Mira on 29 February 2008 out of the total pool of income earned by the trust for the year.

(b) Spiros owns two other properties in South Africa in his personal name, his primary residence and a holiday house.

The primary residence was purchased in 2000. The time apportioned base cost of this residence at 1 October 2001 is R800,000 and its market value on that date, R950 000.

The holiday house was purchased on 1 November 2001 for R500,000 and its current market value is R1·5 million.

Spiros is considering donating the holiday house to his two daughters.

Required:

Write a letter to Spiros Mathei in your capacity as his tax advisor:

(a) Explaining how the R20,000 monthly annuity from the Mathei Family Trust is taxed in the hands of Spiros. (5 marks)

(b) Explaining what other amounts from the Mathei Family Trust will be subject to tax in the hands of Spiros, Riana or Mira and, if so, to what extent. (10 marks)

(c) Explaining whether the Mathei Family Trust will itself be subject to tax on any of its income and, if so, at what rate. (3 marks)

(d) Explaining the tax implications if Spiros donates the holiday house to Riana and Mira equally. (7 marks)

(e) Explaining the tax implications if the trustees of the Mathei Family Trust sold the residential property for R3 million, in order to invest a larger proportion of the trust's assets overseas. (4 marks)

Note: you should support your explanations with relevant calculations.

Appropriateness of the format and presentation of the letter, and the effectiveness with which the information is communicated. (2 marks)

(31 marks)

2 Orbis (Pty) Limited (Orbis), a company which manufactures goods in a factory outside Cape Town, is currently planning to expand its manufacturing operations. The expansion will include the building of a new factory and the acquisition of new machinery. The old factory and certain machinery will be sold.

Orbis, who is a VAT vendor, has a year ended 31 December 2007 and is not a small business corporation.

Old factory building

Orbis had erected this building in 1989 at a cost of R1·5 million (VAT exclusive). The building was valued on 1 October 2001, at R1·8 million. In order to sell the building, certain renovations were undertaken at a cost of R284,000 (VAT exclusive). The building was sold for R15 million (VAT exclusive) in November 2007.

New factory building

Orbis signed a 30 year lease agreement on 1 December 2006 for the lease of some vacant land. In terms of the lease agreement, a lease premium of R500,000 was payable on 1 December 2006 and Orbis was required to build a factory on the land costing at least R50 million. Building commenced on 1 January 2007 and was completed on 1 November 2007 at a cost of R55 million. The building was brought into use immediately from 1 November 2007.

In order to fund some of the construction costs, Orbis borrowed R30 million from a South African lender. The loan agreement provides for the payment of interest of 10% annually for five years payable in arrears, and a final payment of R2 million at the end of the five years together with repayment of the R30 million. The loan agreement was entered into on 1 December 2006.

Old manufacturing machinery

A machine which had cost R1 million (VAT exclusive) in October 2005, was sold to a fellow subsidiary company for R200,000 (VAT exclusive) on 30 October 2007. The market value of the machine on 30 October 2007 was R1·5 million (inclusive of VAT).

New manufacturing machinery

A new machine is to be acquired, with a cash value of R7 million (excluding VAT), from a supplier.

The machine can be acquired in one of three different ways:

(i) Orbis can borrow the R7 million from a bank at an interest rate of 1% per month payable in arrears; or
(ii) Orbis can acquire the machine in terms of a suspensive sale agreement which provides for 60 monthly instalments of R198,334; or
(iii) The machine can be leased for 60 months in terms of a finance lease. The lease payments will be R148,000 per month. At the end of the lease, Orbis will pay R500,000 to acquire the machine from the lessor. The market value of the machine at the end of the lease is expected to be R600,000.

Required:

In preparation for a meeting with the production director of Orbis (Pty) Limited regarding the tax implications of the expansion programme, prepare a set of briefing notes on the following issues:

(a) The value added tax (VAT) and income tax implications of the sale of the old factory building. (9 marks)

(b) The tax allowances and deductions (if any) that will be available once the new factory is brought into use. (4 marks)

(c) The tax treatment of the interest on the loan of R30 million from the South African lender.

Note you should assume a yield to maturity of 11·06% per annum. (3 marks)

(d) If the fact that it was sold to a fellow subsidiary will adversely affect the income tax payable on the sale of the old machine. (4 marks)

(e) A comparison of the VAT and income tax implications of the three different ways of acquiring the new machine. (7 marks)

Appropriateness of the format and presentation of the notes and the style with which the information is communicated. (2 marks)

(29 marks)

Section B – TWO questions ONLY to be attempted

3 **(a)** Len Warren was ordinarily resident in South Africa for all of his life until 1 December 2006. On 1 December 2006 he emigrated to New Zealand. He returned to South Africa on 1 November 2007 and remained in South Africa until 15 June 2008. He then returned to New Zealand and has not been back to South Africa since this date.

Len spent the following number of days in South Africa in each of the years of assessment 2002 to 2007:

Year of assessment	Days in South Africa
2002	99
2003	120
2004	330
2005	180
2006	160
2007	195

Required:

(i) **Identify and briefly explain the factors which will be taken into account in determining whether a natural person is (or is not) ordinarily resident in South Africa.** (5 marks)

(ii) **Explain whether Len Warren will be a South African resident as defined for each of the years of assessment 2007 and 2008.** (8 marks)

(b) Mary Mostert is a resident of the Netherlands. While on holiday in South Africa, she invented and patented a process relating to a 'one size fits all pattern' which could be adjusted to any size.

During the year ended 29 February 2008, Mary received royalties of Euro 18,180 (equivalent to R200,000) relating to the use of the pattern in the Netherlands and royalties of R150,000 relating to the use of the pattern in South Africa.

Required:

Explain how the amounts received by Mary Mostert will be subject to tax in South Africa, clearly indicating the nature and amount of all taxes payable. (7 marks)

(20 marks)

4 A company had the following transactions in the year of assessment 2008:

(1) A motor vehicle purchased for R225,720 (VAT inclusive) was provided to an employee for both business and private use. The company pays for all fuel and maintenance.
(2) A television set purchased for R5,700 (VAT inclusive) was given to an employee as a long service award.
(3) A small pick-up truck purchased for R114,000 (VAT inclusive) was given to another employee as a long service award.
(4) Trading stock with a cost of R1,500 (VAT exclusive) and included in opening stock at the beginning of the year, was given anonymously to a local charity when its market value was R2,000.
(5) Trading stock with a cost of R10,000 (VAT exclusive) was given as a sponsorship to up and coming athletes when its market value was R12,000. The donation was given on the condition that the athletes wear clothing advertising the company.

Required:

(a) For each of the transactions (1), (2) and (3), state, giving reasons, whether and, if so, when input VAT on the acquisition of the asset may be claimed. (3 marks)

(b) For each of the transactions (1) to (5), calculate the output VAT giving brief explanations as to the basis of calculation. (8 marks)

(c) For each of the transactions (1) to (5), explain the income tax position of the company. (9 marks)

(20 marks)

5 **(a)** Libro (Pty) Limited (Libro), a South African registered company, is a registered value added tax (VAT) vendor. The following transactions relate to Libro's year of assessment ending 31 December 2007:

Transaction 1

On 1 July 2007 Libro acquired a second-hand machine (to be used in a manufacturing process) from Paul Cooper for R300,000 cash.

Paul Cooper owns 23% of the equity shares in Libro. The market value of the machine on 1 July 2007 was R280,000.

Paul Cooper had acquired the machine new on 1 April 2005 for R400,000. He had used the machine in a manufacturing process and claimed the section 12C allowance from the acquisition date.

Paul Cooper is not a VAT vendor.

Transaction 2

On 1 March 2007 Libro entered into a 19-year lease agreement with a lessor, who is exempt from income tax and is not a registered VAT vendor.

In terms of the lease agreement, Libro is required to:

– build a factory for the manufacture of paper products, which must cost at least R7,000,000 (VAT exclusive).

A lease rental of R13,000 per month is payable from 1 March 2007.

The factory building was completed on 1 November 2007 at a cost of R8,550,000 (VAT inclusive) and manufacturing commenced in the building on 1 December 2007.

Required:

(i) Explain the income tax effects of the purchase of the machine by Libro (Pty) Limited (transaction 1). Support your explanations with calculations where appropriate. (6 marks)

(ii) Explain the income tax effects of the lease of the building by Libro (Pty) Limited (transaction 2). Support your explanations with calculations where appropriate. (5 marks)

(b) Dido (Pty) Limited (Dido) is a fellow subsidiary company of Libro. Dido has an assessed loss of R800,000 at 31 December 2007 and does not have the cash resources to build a critically needed warehouse on land it owns adjacent to its existing factory. Libro could lend the cash to Dido at prevailing interest rates or enter into an alternative arrangement. The terms of the alternative arrangement will be as follows:

– Libro will lease the land from Dido for R40,000 per month.
– Libro will pay a lease premium of R130,000 on signing the lease agreement.
– Libro will erect a warehouse on the land at a cost of R700,000 (VAT exclusive) within six months of concluding the lease agreement.
– The warehouse will be used by Dido to store its products and Dido will pay a monthly rental of R40,000 to Libro.

Required:

Discuss whether the Commissioner could successfully apply the provisions of the specific anti-avoidance rule in section 103(2) against Dido (Pty) Limited so as to disallow the use of its assessed loss if it goes ahead with the alternative (lease) arrangement with Libro (Pty) Limited. (9 marks)

(20 marks)

End of Question Paper