Professional Level – Options Module

Advanced Taxation (South Africa)

Monday 7 December 2009

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 tax year 2009 will 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 ending 28 February 2009

Rebates	
Primary rebate	R8,280
Secondary rebate (Over 65)	R5,040
Interest exemption	
Under 65	R19,000
Over 65	R27,500
Companies	
Normal tax rate	28%
STC rate	10%
Donations tax	20%
Estate duty	20%
Trusts (other than a special trust)	40%

Rates of normal tax payable by persons (other than companies)
In respect of the year of assessment ending 28 February 2009

Where the taxable income	
does not exceed R122,000	18% of each R1 of the taxable income
exceeds R122,000 but does not exceed R195,000	R21,960 plus 25% of the amount over R122,000;
exceeds R195,000 but does not exceed R270,000	R40,210 plus 30% of the amount over R195,000;
exceeds R270,000 but does not exceed R380,000	R62,710 plus 35% of the amount over R270,000;
exceeds R380,000 but does not exceed R490,000	R101,210 plus 38% of the amount over R380,000;
exceeds R490,000	R143,010 plus 40% of the amount over R490,000

Tax rates for small business corporations for
year of assessment ending 28 February 2009

R0 – R46,000	Nil
R46,001 – R300,000	10% of the amount over R46,000
R300,001 and above	R25,400 + 28% of the amount over R300,000

Medical tax-free monthly contributions:

Single member	570
Member plus one dependent	1,140
Each additional dependent	345
SARS official rate	12%

Capital gains tax:

Annual exclusion	R16,000
Primary residence exclusion	R1,500,000
Inclusion rate (natural persons)	25%
(non-natural persons)	50%

Time apportionment formula: Y = B + [(P – B) x N/(T + N)]

Travel allowance table

For years of assessment commencing on or after 1 March 2008

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	14,672	58·6	21·7
40,001 – 80,000	29,106	58·6	21·7
80,001 – 120,000	39,928	62·5	24·2
120,001 – 160,000	50,749	68·6	28·0
160,001 – 200,000	63,424	68·8	41·1
200,001 – 240,000	76,041	81·5	46·4
240,001 – 280,000	86,211	81·5	46·4
280,001 – 320,000	96,260	85·7	49·4
320,001 – 360,000	106,367	94·6	56·2
360,001 – 400,000	116,012	110·3	75·2
Exceeds 400,000	116,012	110·3	75·2

Notes:

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 R2·92 per kilometre.

Tax rates of normal tax retirement lump sum benefits in respect of the year of assessment ending 29 February 2009

Not exceeding R300,000	18% of each R1 of the taxable income
Exceeding R300,000 but not exceeding R600,000	R54,000 plus 27% of the taxable income exceeding R300,000;
Exceeding R600,000	R135,000 plus 36% of the taxable income exceeding R600,000;

Rating formula

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

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

Section A – BOTH questions are compulsory and MUST be attempted

1 Andy Jones inherited a portfolio of shares from his late father. In order to reorganise the portfolio into shares which he wished to trade with and shares which he wanted to keep for the long term, as investment, he placed the appropriate shares with two different brokers. Unfortunately because of the depressed economic climate in the past two years he has made losses in the trading portfolio. Andy has become aware of the new s.9C requirement that where shares are held for a certain period of time they have to be treated as capital.

Andy's trading portfolio had an assessed loss in the previous year which he could set off against his other income reducing his tax considerably. He is concerned that he will be denied this set off in future when he makes losses as he has held many shares for longer than three years.

Andy has an aggregate capital loss brought forward from the previous year.

Required:

Write a letter to Andy Jones as his tax adviser addressing his concerns as follows:

(i) Set out the criteria under which the rule in s.9C will apply. (8 marks)

(ii) Inform Andy of how s.9C will affect his situation and the normal tax and capital gains tax consequences for him. (9 marks)

(iii) Advise Andy whether transferring his trading portfolio to a close corporation would be more beneficial than his current situation. (4 marks)

Professional marks will be awarded to question 1 for the format, presentation, clarity and effectiveness with which the information is communicated. (3 marks)

(24 marks)

2 Your Tax Manager has provided some information regarding a client of the firm you are working for.

Organic Products (Pty) Limited holds all the shares in Bath Time (Pty) Limited, Beautify (Pty) Limited, Spa Products (Pty) Limited and Aroma (Pty) Limited.

All companies are residents of the Republic of South Africa and have a year of assessment ending 28 February 2009. You must ignore the corporate rules.

The following four queries need your attention in finalising the audit of the group, and your Tax Manager has requested that you prepare a memo explaining the tax consequences of these queries, as detailed below. All amounts are VAT exclusive.

1 **Bath Time (Pty) Limited (Bath)**
Bath owned a vacant piece of land and entered into a 25 year lease agreement with Aroma (Pty) Limited (Aroma). Aroma was obliged under the terms of the agreement to spend at least R1 million on the building. Aroma built an office block on the property at a cost of R1·2 million. The lease agreement commenced on 30 June 2008 at which date building work commenced. The office block was completed on 31 January 2009 and immediately occupied.

2 **Beautify (Pty) Limited (Beautify)**
Beautify had purchased a five year patent for R100,000 on 1 July 2006. On 31 July 2008 Beautify sold this patent to Spa Products (Pty) Limited (Spa) for its market value of R120,000 for the remainder of its patented life period.

3 **Organic Products (Pty) Limited (Organic)**
Organic is the holding company of the group and does not trade. Its only income is dividends distributed by all its subsidiaries in the group. Organic has a managing director who is paid a remuneration package of R600,000 for services rendered to the group. Dividends received from the companies amounted to R2,000,000 for the 2009 year of assessment.

In addition Organic made donations of R200,000 to qualifying Public Benefit Organisations for which it received s.18A receipts.

4 Organic has one non-resident shareholder, T Rex. T Rex holds 40% of the shares in Organic.

The equities side of Organic's balance sheet at 31 January 2009 is as follows:

	R
Share capital	200,000
Share premium	400,000
Retained income	1,000,000
	1,600,000

T Rex is considering lending Organic R4,000,000 at an interest rate of 18%. The prime interest rate is 11%. Organic will use this cash to invest in a new venture which will bring in additional income.

Required:

Prepare a memo to your Tax Manager explaining the tax consequences of the four situations above, covering the following:

(i) the current and future tax consequences of the lease agreement and the construction of the building for both Bath and Aroma. (8 marks)

(ii) the normal tax consequences of the transactions at 2 above for both Beautify and Spa. (11 marks)

(iii) whether Organic can get a deduction for the director's remuneration and the donations made. (6 marks)

(iv) how this loan at 4 above and the interest charged will be dealt with in 2010 if T Rex makes the loan on 1 February 2009. (9 marks)

Professional marks will be awarded to question 2 for the format, presentation, clarity and effectiveness with which the information is communicated. (2 marks)

(36 marks)

Section B – TWO questions ONLY to be attempted

3 Mr Laroc invented an ingenious and efficient structure to support bicycles on the roof of a car which was permanently attached to the car roof. Mr Laroc was not a resident of South Africa. Mr Laroc took part in an Argus Cycle Tour in Cape Town (South Africa) two years ago. Whilst in Cape Town he developed the ideas and plans for his structure.

Various firms were interested in selling and fitting this structure to cars. Mr Laroc registered his patent and subsequently received royalties of R800,000 from firms in South Africa and R100,000 from companies registered and managed in Europe who used this structure in Europe (during the 2009 year of assessment).

Before the end of the 2009 year of assessment a South African firm offered to buy the patent outright from Mr Laroc for R2 million. Mr Laroc accepted this offer and all legal formalities for the sale went through before the year-end. Mr Laroc received the R2 million on the first day of the next tax year.

Required:

(a) **Explain what amounts will be included in Mr Laroc's gross income in the 2009 year of assessment, and consider any capital gains tax implications. Deal separately with the royalties and the sale of the patent.** (17 marks)

(b) **Explain the tax consequences of the sale of the patent if Mr Laroc was always a South African resident.** (3 marks)

(20 marks)

4 Harold and his wife Drew created a trust in 2004 for their two children, Dirk and Len. Both children are majors, Dirk is a resident in the United Kingdom and Len is a resident in South Africa.

Harold sold a block of flats to the trust in 2004, leaving the consideration outstanding on an interest free loan account. Drew donated listed South African shares to the trust on the same date.

The trust is discretionary and the trustees may make distributions to the two children as they deem necessary.

The income of the trust for the year ended 28 February 2009 was as follows:

	R
Dividends from South African listed shares	50,000
Net rentals	250,000
Proceeds from shares sold	200,000

The trustees made the following distributions:

To Dirk – out of rental and dividends	200,000
Len – out of rental and dividends	100,000
Proceeds of shares distributed to Len	100,000

The base cost of the shares sold was R120,000.

Required:

(a) **Briefly explain the difference between a donation and an interest free loan to the trust and its effect on income received by the beneficiaries.** (3 marks)

(b) **Discuss how the R200,000 received by Dirk will be taxed and in whose hands. Illustrate your discussion by means of calculations.** (9 marks)

(c) **Discuss the tax consequences of the sale of shares and the distribution of part of the proceeds to Len.** (8 marks)

(20 marks)

5 Lupin (Pty) Limited (Lupin) is a resident of South Africa. During its year of assessment ended 31 March 2009, Lupin expanded its operations and formed a new unlisted company (Legume) in Thailand. Lupin acquired 48% and Mr Swail (a South African resident and a 5% shareholder of Lupin) acquired 18% of Legume's equity share capital. The remaining 34% was taken up by a resident of Thailand. The effective management of Legume is in Thailand and it has a 31 March year end.

For the 2009 year of assessment, Legume made a profit of R19,070,000. Income tax of R5,721,000 was paid to the Thailand government in respect of this income.

All transactions were at arm's length prices with foreign clients. On 1 February 2009 Lupin received a net dividend of R420,000 and Mr Swail received R157,500. This was the first dividend paid by Legume and was subject to Thailand withholding tax of 5%.

Mr Swail is 38 years old and has other taxable income from South Africa of R650,000 for the 2009 year of assessment.

Required:

Explain the effect which the financing arrangements adopted for Legume are likely to have on the normal tax liabilities of both Lupin and Mr Swail in respect of their 2009 year of assessment. Support your explanations with calculations where necessary and assume any favourable elections which are possible are made.

(20 marks)

End of Question Paper