Answers

1 Tax Advisor
Firm's Address

Joe van Gent
Client's Address

1 June 2009

Dear Joe

Please find below explanations in respect of your questions regarding the purchase of the property directly or purchasing the shares in the company owning the property.

(a) Sale of the property by Kap Enterprises (Pty) Ltd

Value added tax (VAT)
VAT output would be payable on the sale of R343,859 (R2,800,000 x $^{14}/_{114}$) unless Kap Enterprises and Joe van Gent agreed that it was a sale of a going concern. If this was the case the VAT would be 0%.

Income tax
The sale of the property will give rise to capital gains tax. The capital gain will be calculated by deducting the base cost of R2 million plus any selling costs from the proceeds of R2,800,000. 50% of the gain will be included in taxable income and be taxed at the company rate of 28%.

(b) Sale of the shares in Kap Enterprises (Pty) Ltd

VAT
There is no VAT on shares.

Uncertificated securities tax
Securities transfer tax at a rate of 0·25% of the consideration, or market value (whichever is greater) is payable on transfer.

Income tax
The sale of the shares will give rise to capital gains tax. The capital gain will be calculated by deducting the original base cost of the shares to the shareholder (plus any selling costs) from the selling price of R1,300,000 (1,300 x 1,000).

The capital gain will be aggregated with any other capital gains or losses of the shareholder. Any aggregate capital gain or loss remaining will be reduced by the annual exclusion of R16,000. 25% of the capital gain will be included in taxable income to be taxed at the shareholder's marginal tax rate.

The sale of the loan account will have no tax effect as it is sold for its base cost.

(c) Purchase of property

VAT
VAT will be payable at either the standard rate, R343,859 or the zero rate as discussed in (a) above.

Income tax
There will be no immediate income tax effects. The base cost of the property for capital gains tax purposes will be the R2·8 million plus any other acquisition costs incurred e.g. legal costs, commission. Rentals will be included in your income.

(d) Purchase of the shares

Uncertificated securities tax will be payable as discussed in (b) above.

VAT
No input VAT is payable on shares.

Income tax
No immediate income tax effects.

The base cost of the shares for capital gains tax purposes will be the cost of the shares of R1,300,000 plus any acquisition costs e.g. legal expenses, uncertified securities tax. As the property is held in the company, the company will recieve rental income and no income will fall to be taxed in your hands.

If the company declares a dividend, you will have dividend income. Currently domestic dividends are exempt from tax.

The company will pay secondary tax on companies of 10% on net dividends declared until such time as the withholding tax applies.

(e) The initial cash outlay is the same for both options, therefore one has to consider the future tax implications.

If you purchase the property directly, you will have additional rentals included in your taxable income of R310,000 per year which will be taxed at 40%.

If you purchase the shares in the company you will have no additional income unless the company declares a dividend on which you will pay only 10% tax.

The company will only be paying tax at 28% on rental income.

While the purchase of shares seems more tax efficient it must be borne in mind that on the sale of the property, one day 50% of the gain will be taxed at the company rate of 28% with no annual exclusion. This is an effective rate of 14%. If the property is in your name the effective tax rate of the gain made on sale is only 10% (40% x 25%).

From a capital gains tax perspective it is better to purchase the property in your own name.

For income tax purposes buying the shares option seems better but as property prices increase the advantage in respect of the capital gains tax could outweigh the income tax advantages.

If you need any further information please do not hesitate to contact me.

Yours sincerely,
Tax Advisor

2 Trimmings (Pty) Limited

(a) International transaction

The trading stock was accounted for at the ruling exchange rate when the transaction was concluded, R121,800 (21,000 x 5·80) and added to closing stock if unsold.

The stock unsold at 31 December 2007 is included in opening stock.

Exchange gains or losses must be calculated at the settlement date.

The debt of R121,800 gives rise to a loss of R1,050 (21,000 x (5·90 – 5·85)) (year end translation date).

The loss of R1,050 must be deducted from income.

The forward exchange contract also gives rise to an exchange loss or gain at the settlement date.

The gain or loss is the difference between the forward rate in terms of the contract and the spot rate on settlement.

The loss of R18,900 (21,000 x (5·00 – 5·90)) must be deducted from income.

(b) Loans and bad debts

The bad debt of R50,000 will not be allowed to be deducted from income and will have to be added back. It was never previously included in income.

The loan write off will, however, be subject to capital gains tax.

The loan is an asset which has been disposed of for no consideration, creating a capital loss of R50,000.

The loss must be aggregated with any other capital gains and losses and if any net capital gain remains, 50% thereof must be included in taxable income.

(c) Finance Lease

The finance lease is not capitalised for tax purposes. The R5,700 depreciation and R2,200 finance charges must be added back to income.

The lease rental of R1,000 less the applicable VAT is allowed as a deduction from income. The VAT is calculated as follows:

R2,394 x $^{1}/_{24}$ = R99

The deduction will be R8,109 (1,000 – 99) x 9.

At the end of the lease, Trimmings has a recoupment of the deemed fair market value as it is allowed continued use for no consideration.

The deemed fair market value is calculated by taking the original tax cost of the computer and reducing it by 20% for each completed year on the reducing balance method.

This amount of R13,680 (R17,100 – 20%) is added to income.

It could be agreed that the inclusion should only be R11,400 which is the market value on that date.

From 1 October 2008 a wear and tear allowance is claimed on the R13,680 included in income. The deduction is R1,140 ($^{R13,680}/_{3}$ x $^{3}/_{12}$).

(d) Broad based employee share plan

Trimmings (Pty) Ltd
Trimmings can deduct up to R3,000 per employee per annum.

The deduction for the year end 31 December 2008 is:

R9,100 ((92 – 1) x 100)

Limited to R3,000 per employee

The balance of R6,100 per employee can be deducted at R3,000 per year for the next two years and R100 in the year thereafter.

The employees
The receipt of the shares is exempt from tax, provided they do not sell them in the next five years.

Any loans granted to them to acquire the shares are also not treated as fringe benefits.

(e) If the shares are sold after five years any gain or loss made on the sale will be subject to capital gains tax. The gain or loss will be calculated by deducting the base cost of R1 (the consideration paid) from the selling price.

(f) I would inform Trimmings (Pty) Ltd that I have to inform and disclose the omission to the Commissioner of the South African Revenue Services (SARS).

3 Paul Setter

(a) The lumpsum of R2·2 million is taxed at special rates.

The first R300,000 is exempt as well as any contributions not permitted as deductions in the past. All the contributions plus interest will be allowed to increase the exempt portion as it is a provident fund and none of his contributions would have been allowed as deductions.

Paul has had years of service in South Africa of at least two out of the previous ten years.

This means that his taxable lumpsum is only the portion relating to his years of service in South Africa.

Lumpsum		2,200,000
Less	(300,000)	
Less	(240,000)	(540,000)
		1,660,000

As only 30 years were spent in South Africa the taxable portion is R1,245,000 (1,660,000 x $^{30}/_{40}$)

The tax payable on this amount is R367,200 ((1,245,000 – 600,000) x 36% + 135,000)

(b) The same rules would apply as in (a) above but the lumpsum would only be R1·1 million, therefore:

Lumpsum	1,100,000
Less	(540,000)
	560,000
Apportioned 560,000 x $^{30}/_{40}$	420,000

The tax on R420,000 would be R86,400 (27% x (420,000 – 300,000) + 54,000)

The pension annuity that Paul received from the fund will be taxed according to the ordinary/normal tax tables for individuals on a monthly basis.

(c) The lumpsum of R100,000 from Transford Limited will be included in Paul's gross income. Paul will be allowed an exemption of R30,000 against this amount as he is retiring and is over 55 years old. The net of R70,000 will be taxed according to Paul's highest average rate of tax in the current and previous years of assessment.

(d) Transford Limited will only be allowed a deduction for the R100,000 if it is in the production of income. This could be if it was normal policy for Transford Limited to make payments of this nature or in terms of employment contracts.

In this case it is for past loyal services and he will no longer be active in producing income for Transford. In the absence of any other information this could not be in the production of income and therefore a deduction would be disallowed.

4 Professor Connolly

(a) 1 March 2008 to 30 June 2008 – resident in South Africa

Professor Connolly is ordinarily resident in South Africa from 1 March 2008 to 30 June 2008 and will be taxed on his worldwide income.

Royalties from South African manufacturers and Chinese manufacturers will be included in gross income for the period to 30 June 2008.

A deduction will be permitted of the foreign tax paid of R800 as it is in respect of South African source income.

1 July 2008 to 28 February 2009 – not resident in South Africa

For the period after 30 June 2008 Professor Connolly is non-resident.

The royalties are still from a true South African source and non-residents are taxed on South African source income.

The Chinese royalty of R91,000 (106,000 – 15,000) and the South African royalty of R52,000 (84,000 – 32,000) is included in gross income.

However, an exemption will be granted for the South African royalty as it will be subject to withholding tax.

The withholding tax on the use of a copyright in South Africa by a non-resident is taxed at 12% on the gross amount 6,240 (52,000 x 12%).

It is submitted that Professor Connolly will still be entitled to the foreign tax paid in respect of the Chinese royalty.

(b) The portion of expenditure prior to 30 June 2008 will be allowed as a deduction.

The portion of expenditure incurred after 30 June 2008 will not be allowed as a deduction as the South African tax from that date will take the form of a royalty computed on the gross amount of the royalties rather than on a net income basis.

(c) The rentals and interest are from a South African source and Professor Connolly must include these in gross income.

Any expenditure relating to the rentals will be allowed as deductions.

The interest received however, will be exempt from tax as Professor Connolly is not carrying on business in South Africa and has not been in the country for more than 183 days.

(d) The legal expenses will be deductible if they are so closely related to the earning of income that they are an inevitable concomitant of the production of income.

If the expenses were incurred in respect of a claim, or dispute at law which would result in less royalties being received, then they would be deductible. However, if the action was successful and the South African manufacturing of the product had to be totally terminated, then it is submitted no deduction would be allowed as the legal expenses would relate to capital expenditure.

5 Alison Tate

(a) Donation of house to the trust

Transfer duty will be payable by the trust on the transfer of the property at 8% as it transfers to a non-natural person.

Donations tax will be payable by the donor on the market value at donation date at 20% after deducting an exemption of R100,000

Capital gains tax will be payable.

The gain will be calculated by taking the market value at donation date less the base cost. The base cost is the market value on inheritance date.

A portion of the donations tax payable can be added to the base cost. Capital gain/market value x donations tax.

The capital gain will have to be apportioned as part of the house is used for business purposes. The R1·5 million exemption will only be deductible from the non-business use portion.

An annual exclusion of R16,000 will be allowed against aggregate capital gains (gains minus losses) and 25% of the net capital gain will be included in taxable income and taxed at 40%.

If the house is sold by the trust in the future no primary residence exclusion will be permitted.

(b) Donations tax would be payable at 20%. There will be no capital gains tax effects as it is currency which is an excluded asset.

(c) The annuity to Leon vests in him and he will be taxed.

The income will retain its nature and Leon will receive interest and dividends.

The dividend exemption is not permitted as it is paid as an annuity.

The interest exemption for natural persons will be allowed against the interest portion of the annuity. If the interest exemption is not fully utilised it can be used against 'otherwise not exempt domestic dividends'.

(d) A distribution is made to a non-resident in consequence of a donation to the trust.

Alison will be taxed on the R100,000.

The amount will retain its nature because of the conduit pipe principle laid down in the case law. Alison will therefore include R50,000 interest and R50,000 dividends in gross income.

The dividends will be fully exempt.

The interest exemption of R19,000 will be allowed against the R50,000 interest.

			Marks
1	**Joe van Gent**		
	(a)	VAT calculation	1
		Stating that the zero rate could apply	$1\frac{1}{2}$
		Stating that capital gains tax is payable	1
		Showing how the calculation must be done including only 50% of the gain	2
		Taxed at company rate 28%	$\frac{1}{2}$
			6
	(b)	No VAT on shares	1
		Mentioning uncertificated securities tax	1
		Stating sale will be subject to CGT	$\frac{1}{2}$
		Stating how the capital gain is calculated (proceeds less all base costs)	1
		Aggregation of gains and losses	$\frac{1}{2}$
		Annual exclusion	$\frac{1}{2}$
		25% of gain inclusion	$\frac{1}{2}$
		No effect for the loan account	1
			6
	(c)	VAT payable at R343,859 or the zero rate applies	1
		No income tax effect for purchase	$\frac{1}{2}$
		Make up of base cost of the property	$\frac{1}{2}$
		Net rentals will be included in income	1
			3
	(d)	No VAT payable	$\frac{1}{2}$
		Uncertified securities tax payable	$\frac{1}{2}$
		No income tax effect for the purchase	$\frac{1}{2}$
		Make up of base cost of the shares	$\frac{1}{2}$
		No income will fall into Joe van Gent's hands except if the company declares a dividend.	1
		Dividends are currently exempt from tax.	1
		The company will pay secondary tax on companies of 10% on dividends declared until such time as the withholding tax applies.	1
			5
	(e)	Comparison of rentals and dividends	2
		Mention of secondary tax on companies and withholding tax	1
		Discussion of the differences in the capital gains tax treatment for individuals and companies.	2
		Discussion of capital gains tax and normal tax advantages	2
			7
	Format and presentation of the letter		2
			29

		Marks
2	**Trimmings (Pty) Limited**	
(a)	International transaction	
	Trading stock must be accounted for at the ruling exchange rate when the transaction is concluded	1
	Calculation at correct rate	1
	Amount added to closing stock	1
	Exchange gains or losses must be calculated at settlement date in respect of the debt at year end	1
	Debt gives rise to a loss of R1,050	1
	Loss must be deducted from income	1
	Forward exchange contract also gives rise to an exchange loss or gain at settlement date	1
	Explanation of gain or loss	1
	The loss must be deducted from income, and correct calculation	1
		9
(b)	Loans and bad debts	
	The bad debt of R50,000 will not be allowed to be deducted from income	1
	It will have to be added back.	1
	Loan write off will be subject to capital gains tax	1
	Loan is an asset disposed of for no consideration and correct capital loss	1
	Loss must be aggregated with any other capital gains/losses and 50% of any net capital gain must be included in taxable income	1
		5
(c)	The finance lease is not capitalised for tax purposes.	$^1/_2$
	The R5,700 depreciation and R2,200 finance charges must be added back to income	$^1/_2$
	The lease rental of R1,000 less the applicable VAT is allowed as a deduction from income	1
	VAT calculation	$^1/_2$
	Correct deduction	$^1/_2$
	Recoupment of the deemed fair market value	1
	Calculation of deemed fair market value	1
	This amount is added income	1
	It could be agreed that the inclusion should only be the market value on that date	1
	From 1 October 2008 a wear and tear allowance is claimed	$^1/_2$
	Calculation	$^1/_2$
		8
(d)	Broad based employee share plan	
	Trimmings (Pty) Limited	
	Trimmings can deduct up to R3,000 per employee per annum	1
	Calculation of deduction for the year end 31 December 2008	$^1/_2$
	Limited to R3,000 per employee	$^1/_2$
	The balance can be deducted at R3,000 per year for the next two years and R200 in the year thereafter	1
	The employees	
	Exempt from tax provided they do not sell them in the next five years	$^1/_2$
	Any loans granted to them to acquire the shares are also not treated as fringe benefits	$^1/_2$
		4
(e)	If the shares are sold after five years any gain/loss will be subject to capital gains tax	1
	The gain/loss will be calculated by deducting the base cost from the selling price	1
		2
(f)	Disclose the omission to the Commissioner of the South African Revenue Services (SARS)	**1**
	Format of meeting notes	1
	Clarity of information	1
		2
		31

		Marks
3	**Paul Setter**	
(a)	The lumpsum is taxed at special rates	1
	The first R300,000 is exempt as well as any contributions not permitted as deductions in the past	1
	All the contributions plus interest will be allowed to increase the exempt portion	1
	Paul has had years of service in South Africa of at least two out of the previous ten years	1
	This means that his taxable lumpsum is only the portion relating to his years service in South Africa	1
	Calculation	1
	Restriction for 30 years	1
	Calculation of tax payable	1
		8
(b)	Calculation based on lumpsum of R1·1 million	1
	Apportionment	1
	Calculation of tax	1
	Explanation of tax on pension annuity	2
		5
(c)	The lumpsum will be included in Paul's gross income	$^1/_2$
	Exemption of R30,000	$^1/_2$
	Reason	1
	Taxed at average rate of tax	1
		3
(d)	Transford Limited will only be allowed a deduction for the R100,000 if it is in the production of income	1
	Reference to policy or contract	1
	In this case it is for past loyal services	1
	In the absence of any other information this would be disallowed	1
		4
		20

		Marks
4	**Professor Connolly**	
(a)	Ordinarily resident from 1 March 2008 to 30 June 2008 and taxed on his worldwide income	1
	Royalties from South African and Chinese manufacturers will be included in gross income for the period to 30 June 2008	1
	Deduction of the foreign tax paid of R800 with reason	1
	Non-resident for the period after 30 June 2008	1
	The royalties are still from a true South African source and non-residents are taxed on South African source income	1
	The Chinese royalty with calculation included in gross income	1
	South African royalty with calculation included in gross income	1
	Exemption for the South African royalty with reason	1
	Withholding tax is taxed at 12% on the gross amount with calculation	1
	Entitled to the foreign tax paid in respect of the Chinese royalty	1
		10
(b)	The portion of expenditure prior to 30 June 2008 will be allowed as a deduction	1
	The portion of expenditure after 30 June 2008 will not be allowed as a deduction with reason	1
		2
(c)	The rentals and interest are from a South African source so must include these in gross income	1
	Any expenditure relating to the rentals will be allowed as deductions	1
	Interest received exempt from tax	1
	Reasons for exemption	1
		4
(d)	The legal expenses will be deductible with explanation	1
	Explanation of treatment if the expenses were incurred in respect of a claim	$1^1/_2$
	Explanation of treatment if the action was successful	$1^1/_2$
		4
		20

			Marks
5	Alison Tate		
	(a)	Donation of house to the trust	
		Transfer duty will be payable by the trust with rate and explanation	1
		Donations tax will be payable on the market value at donation date	1
		At 20% after deducting an exemption of R100,000	1
		Capital gains tax will be payable, with explanation of calculation	1
		A portion of the donations tax payable can be added to the base cost	1
		The capital gain will have to be apportioned as part of the house is used for business purposes	1
		The exemption will only be deductible from the non-business use portion	1
		Annual exclusion will be allowed against aggregate capital gains with explanation of treatment	1
		If the house is sold by the trust in the future no primary residence exclusion will be permitted	1
			9
	(b)	Donations tax would be payable at 20%.	1
		There will be no capital gains tax effects as it is currency which is an excluded asset	1
			2
	(c)	The annuity to Leon vests in him and he will be taxed	1
		The income will retain its nature and Leon will receive interest and dividends	1
		The dividend exemption is not permitted with reason	1
		The interest exemption for natural persons will be allowed against the interest portion of the annuity	1
		If the interest exemption is not fully utilised, can be used against 'otherwise not exempt domestic dividends'	1
			5
	(d)	A distribution is made to a non-resident in consequence of a donation to the trust.	
		Alison will be taxed on the R100,000	1
		Alison will include R50,000 interest and R50,000 dividends in gross income	1
		The dividends will be fully exempt	1
		The interest exemption of R19,000 will be allowed against the R50,000 interest	1
			4
			20