Professional Level – Options Module

Advanced Taxation (South Africa)

Monday 1 June 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.

Tax Rates and Allowances

Year ended 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	12·5%
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 ended 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 the year of assessment ended 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

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

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 R2·92 per kilometre.

Tax rates of normal tax retirement lumpsum benefits
in respect of the year of assessment ending 28 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

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

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

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Question 1 begins on page 5.

Section A – BOTH questions are compulsory and MUST be attempted

1 Joe van Gent, a South African resident, who is 56 years old, owns a number of rent–producing properties. In addition he owns the entire share capital of three private, South African resident, companies that own rent-producing properties.

Joe's gross income consists of rentals, dividends and interest and his taxable income is in excess of R490,000.

On 28 February 2008 he sold a block of flats, which had become dilapidated, for almost R3 million. Joe has in excess of R2·8 million available to invest in another property.

Joe has found a property he would like to purchase. The property is in a small shopping centre and is owned by Kap Enterprises (Pty) Limited. The property yields net rentals of R310,000 a year. The seller would prefer to sell Joe the shares in Kap Enterprises (Pty) Limited, but is prepared to sell him the property out of the company if this would be critical to the sale taking place.

Kap Enterprises (Pty) Ltd has a nominal share capital of 1,000 shares of R1 each and a 10% shareholder's loan account of R1,500,000. The rent-producing property is reflected at its original cost to Kap Enterprises (Pty) Ltd of R2,000,000. The only other asset of Kap Enterprises (Pty) Ltd is cash of R25,000.

Kap Enterprises (Pty) Ltd has no liabilities other than the shareholder's loan account and has retained revenue profits of R524,000.

The selling price of the property is R2·8 million before the payment of any duty. The selling price of the shares is R1,300 per share and the loan account is to be taken over at R1,500,000.

Joe would like to understand the tax implications of the two different methods of buying the property, as well as the tax implications for the seller as he might want to sell the property when he retires in the future.

Required:

Write a letter to Joe van Gent in your capacity as his tax advisor, explaining the following;

(a) All the tax effects of the sale of the property for R2·8 million for Kap Enterprises (Pty) Ltd. (6 marks)

(b) All the tax effects for the individual shareholder of Kap Enterprises Limited, for R1,300 each. (6 marks)

(c) The tax effects of the purchase of the property for R2·8 million for Joe van Gent. (3 marks)

(d) The tax effects of the purchase of the shares for R1,300 each for Joe van Gent. (5 marks)

(e) Which would be the better option? (7 marks)

Professional marks will be awarded in question 1 for the appropriateness of format and presentation of the letter and the effectiveness with which the information is communicated. (2 marks)

(29 marks)

2 Trimmings (Pty) Limited (Trimmings) is a client of your firm, and has provided information to your manager in advance of an upcoming meeting. Your manager has requested that you prepare meeting notes detailing the tax effects of the various transactions mentioned by Trimmings, and these notes will be used in the upcoming meeting. Trimmings is a Republic registered company. Trimmings designs and supplies various packaging materials, from ribbons and strings to boxes and paper, to consumers.

Trimmings acquires its stock directly from manufacturers or sub-contracts the manufacture of its new designs to a third party. Trimmings is registered for value added tax (VAT) and is not a small business corporation.

During Trimmings' year ending 31 December 2008 the following transactions are of note:

International purchase
On 1 December 2007 Trimmings concluded a contract to import a batch of corrugated cardboard from a supplier in Australia. The cost of the cardboard was AUS$21,000. The cardboard was shipped free-on-board on 1 December 2007. Because of the fluctuation of the exchange rate, Trimmings took out a two-month forward exchange contract on 1 December 2007 to cover the settlement to the creditor which took place on 31 January 2008. Trimmings complies with generally accepted accounting practice for its foreign exchange transactions but has not yet processed any accounting entries for this trading stock. Ruling rates of exchange are:

Date	Spot rate	Forward rate and period
1 December 2007	AUS$1 = R5·80	AUS$1 = R5·98 (two months)
31 December 2007	AUS$1 = R5·85	AUS$1 = R5·00 (one month)
31 January 2008	AUS$1 = R5·90	

The average exchange rate for the year of assessment ending on 31 December 2007 is AUS$1 = R5·75.

Loans and bad debts
In 2007 Trimmings lent R100,000 to one of its sub-contractors, Quickfit (Pty) Ltd, who was experiencing a cash flow problem. Quickfit repaid R50,000 of the loan in 2007, and went into liquidation on 1 June 2008. It was doubtful whether any of the R50,000 would be recovered and Trimmings wrote off the loan on 31 December 2008 as a bad debt.

Finance lease
A computer had been leased under a two-year financial lease from a financial institution. This lease was capitalised for accounting purposes. Depreciation of R5,700 and finance charges of R2,200 were expensed to the income statement in the year to 31 December 2008. The computer had cost R19,494 (R17,100 plus VAT of R2,394). The finance charges in the lease were R4,506. The final lease rental of R1,000 was paid on 30 September 2008. On 1 October 2008 the financial institution simply abandoned the computer to Trimmings without requiring the payment of any consideration. Its market value on 1 October 2008 was R11,400 (VAT inclusive). The computer was still in good working order and was used for the entire 2008 year of assessment. Practise note 19 provides a three year write off period for computers.

Broad based employee share plan
Trimmings decided to embark on a broad based employee share plan during the year in terms of the Companies Act. At least 90% of all its employees were eligible and entitled to participate in the scheme. The employees may not dispose of their shares for at least five years from the date of the grant.

The shares were offered on 1 June 2008 and 15 employees acquired 100 shares each at a par value of R1 each. The market value of a share at 1 June 2008 is R92. Some of the employees will be granted interest free loans from Trimmings to acquire the shares.

Required:

Prepare the meeting notes for your manager. Your notes should specifically cover the following:

(a) All the tax effects of the international transactions for the year ended 31 December 2008. (9 marks)

(b) All the tax effects and adjustments to the income statement in respect of the loan written off. (5 marks)

(c) All the adjustments to the income statement and tax effects of the finance lease. (8 marks)

(d) The tax effects of the broad-based employee share plan for the year ended 31 December 2008 for:

(i) The employer;
(ii) The employees. (4 marks)

(e) The tax effects for an employee who sells his share after five years. (2 marks)

(f) Your opinion on the firm's responsibility as tax advisers if Trimmings refused to include any recoupment in respect of the computer in its income. (1 mark)

Professional marks will be awarded in question 2 for the appropriateness of format and presentation of the meeting notes and the effectiveness with which the information is communicated. (2 marks)

(31 marks)

Section B – TWO questions ONLY to be attempted

3 Paul Setter, a resident of South Africa, retired from Transford Limited on 31 May 2008, after 40 years service. Paul is 61. For the first ten years of his employment with Transford Limited, Paul had been employed at its branch in Zimbabwe. The remaining 30 years were spent in South Africa at the head office of Transford Limited.

Paul was a member of the Transford Limited provident fund for all his years of employment with Transford Limited. Of his total contributions of R240,000, R51,000 were in respect of the period he spent in Zimbabwe.

On Paul's retirement, the provident fund paid him a lumpsum of R2·2 million and Transford Limited paid him a lumpsum of R100,000 in respect of his past loyal service. It is not the usual policy of Transford Limited to make such payments and the payment was not provided for in Paul's contract of employment.

At the time of his retirement Paul had considered commuting half of his retirement lumpsum from Transford Limited into a pension annuity.

Required:

(a) Explain how the lumpsum from the provident fund is taxed assuming Paul takes the whole amount as a cash lumpsum. (8 marks)

(b) Explain how the lumpsum and pension annuity would be taxed if Paul had taken this option. (5 marks)

(c) Explain the tax effects of the lumpsum from Transford Limited for Paul. (3 marks)

(d) Explain the tax effects for Transford Limited of the lumpsum payment made by them. (4 marks)

(20 marks)

4 Professor Connolly left the University of Cape Town on 30 June 2008 when he emigrated to take up a position at an Australian university. He has not returned to South Africa.

While in South Africa Professor Connolly had invented an environmentally friendly and cost effective lamp fuel substitute. This substance is now manufactured in South Africa and in China under a royalty agreement with Professor Connolly.

For the 2009 year of assessment Professor Connolly earned the following royalties:

– from the South African manufacturer R84,000. Of these royalties R32,000 was earned up to 30 June 2008.
– From the Chinese manufacturer the equivalent of R106,000 gross. Non-refundable withholding tax the equivalent of R5,300 was levied on this amount by the Chinese authorities. Included in the R106,000 gross is R15,000 relating to the period up to 30 June 2008. The tax paid up to 30 June 2008 amounts to R800.

A South African manufacturer of a similar substance brought an infringement of a copyright action against Professor Connolly but was unsuccessful. Professor Connolly incurred legal expenses of R9,200 on 25 June 2008 in this regard.

The professor also incurred non-capital expenditure of R22,000 in respect of his South African royalties.

Professor Connolly left certain funds in the Republic and did not sell his former primary residence. Since his emigration he has rented the residence out, earning net rentals of R62,100.

On 30 June 2008 Professor Connolly lent his excess funds of R50,000 to his son to start a new business in South Africa. Interest is payable monthly at the rate of 5% per year.

Required:

(a) Explain and illustrate how Professor Connolly will be taxed in respect of his royalty income for the year of assessment ended 28 February 2009. (10 marks)

(b) Explain how the non-capital expenditure in respect of the South African royalties will be dealt with if expended evenly throughout the year. (2 marks)

(c) Explain the tax effects of the rentals and interest received after 30 June 2008. (4 marks)

(d) Discuss, in general terms, the deductibility of expenses paid to defend copyright actions. (4 marks)

(20 marks)

5 Alison Tate has inherited cash and property from her recently deceased parents. She is contemplating forming a trust for her husband, Leon and their two children and would like to understand all the tax consequences of such an arrangement.

Alison has provided the following information:

Inherited property	Market value on inheritance date
House in Constantia, Cape Town	R5 million
Shares listed on the Johannesburg stock exchange	R3 million
Cash	R1·5 million
Artworks	R800,000

Alison now lives in the Constantia house with her husband as their primary residence, but also runs a successful consultancy practice from their home. Alison is 58 years old and is taxed at the highest marginal rate. Barry and Laura, Alison's two children, are both married and Laura has two small children.

Barry lives in the United Kingdom and is no longer a tax resident of South Africa.

The trust to be formed will be entirely discretionary except for an annuity of R10,000 per month payable to Leon equally out of the interest and dividends accruing to the trust.

The trustees will be Alison, Laura and an independent lawyer and the beneficiaries will be Alison's children, grandchildren and Leon. Alison will not be a beneficiary.

Required:

(a) Explain the tax consequences of donating the Constantia house to the trust. (9 marks)

(b) Explain the tax consequences of donating the cash to the trust. (2 marks)

(c) If the shares and cash were donated to the trust and the trust receives interest and dividends, explain how the annuity to Leon will be taxed and indicate in whose hands it is taxed. (5 marks)

(d) State who would be taxed and on what amount, if the shares and cash were donated to the trust and the trust distributed an amount of R100,000 to Barry equally out of the dividend and interest income. (4 marks)

(20 marks)

End of Question Paper