Professional Level – Options Module

Advanced Taxation (South Africa)

Monday 7 June 2010

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 2–4

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 2010 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 ended 28 February 2010

Rebates	
Primary rebate	R9,756
Secondary rebate (over 65)	R5,400
Interest exemption	
Under 65	R21,000
Over 65	R30,000
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 ended 28 February 2010

Where the taxable income	
does not exceed R132,000	18% of each R1 of the taxable income
exceeds R132,000 but does not exceed R210,000	R23,760 plus 25% of the amount over R132,000
exceeds R210,000 but does not exceed R290,000	R43,260 plus 30% of the amount over R210,000
exceeds R290,000 but does not exceed R410,000	R67,260 plus 35% of the amount over R290,000
exceeds R410,000 but does not exceed R525,000	R109,260 plus 38% of the amount over R410,000
exceeds R525,000	R152,960 plus 40% of the amount over R525,000

Tax rates for small business corporations for the year of assessment ended 28 February 2010

R0 – R54,200	Nil
R54,201 – R300,000	10% of the amount over R54,200
R300,001 and above	R24,580 + 28% of the amount over R300,000

Turnover tax rates for micro business corporations for year of assessment ending 28 February 2010

R0 – R100,000	Nil
R100,001 – R300,000	1% of the amount over R100,000
R300,001 – R500,000	R2,000 + 3% of the amount over R300,000
R500,001 – R750,000	R8,000 + 5% of the amount over R500,000
R750,001 – R1,000,000	R20,500 + 7% of the amount over R750,000

Medical tax-free monthly contributions:

Single member	625
Member plus one dependent	1,250
Each additional dependent	380
SARS official rate (assumed)	12%

Capital gains tax:

Annual exclusion	R17,500
Primary residence exclusion	R1,500,000
Inclusion rate (natural persons)	25%
Inclusion rate (non-natural persons)	50%

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

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 lumpsum benefits
in respect of the year of assessment ending 28 February 2010

Not exceeding R300,000	0% of taxable income
Exceeding R300,000 but not exceeding R600,000	18% of each R1 of the taxable income exceeding R300,000;
Exceeding R600,000 but not exceeding R900,000	R54,000 plus 27% of the taxable income exceeding R600,000;
Exceeding R900,000	R135,000 plus 36% of the taxable income exceeding R900,000

Tax rates of normal tax withdrawal lumpsum benefits in respect of the year of assessment ending 28 February 2010

Not exceeding R22,500	0% of taxable income
Exceeding R22,500 but not exceeding R600,000	18% of each R1 of the taxable income exceeding R22,500;
Exceeding R600,000 but not exceeding R900,000	R103,950 plus 27% of the taxable income exceeding R600,000;
Exceeding R900,000	R184,950 plus 36% of the taxable income exceeding R900,000

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 The Local Company Ltd ('Localco') is a resident company in South Africa and offers a number of different products and services. Information concerning some of their activities is provided below for the year ended 31 March 2010.

Leasing activities
Localco leases manufacturing machinery (i.e. is the lessor). All leases are entered into with unconnected persons at arm's length.

One of the leases had the following terms: The cash value (including VAT) of the machine leased is R1,368,000. The monthly cash payment in terms of the lease agreement is R46,000 for three years. The residual value in terms of the lease is R200,000. If the lessee wishes to acquire the leased asset at the end of the lease, it is sold at such residual value. The market value of the machine at the end of the lease is R350,000.

The lessee has been using this machine for manufacturing purposes and the lease came to an end on 31 October 2009 on which date the lessee purchased the machine for its residual value in terms of the lease agreement.

Instalment sale
Some machinery is bought for immediate resale by Localco on instalment terms.

One of the sale contracts has the following terms: The machine has a cash selling price (including VAT) of R1,710,000. An initial deposit of R150,000 is payable by the purchaser on concluding the agreement and monthly instalments of R46,800 are payable for a period of three years. The monthly yield to maturity is 1·25%. The agreement was concluded on 1 February 2010 and the machine was immediately delivered by Localco to the purchaser.

Foreign company holding
Localco holds 15% of the participation and voting rights in Foreignco, a company resident for tax purposes in the country of Ruritania. Foreignco is not classified as a 'foreign business establishment'. The net income after all exemptions (if Foreignco was a controlled foreign company) amounts to the equivalent of R3 million. Non-residents hold the remaining 85% of the participation and voting rights and none of these non-residents are connected to Localco. Foreignco suffered Ruritanian corporation tax at an effective rate of 14% on its pre-tax profits. Foreignco earns no South African profits or dividends from South African companies and is not a listed company.

Foreignco declared a dividend of the equivalent of R500,000 and there was no withholding tax applied in Ruritania.

Required:

Draft a letter to the directors of The Local Company Ltd (Localco) in which you:

(a) Explain the VAT, income tax and capital gains tax effects of the lease of manufacturing machinery (14 marks)

(b) Explain the VAT and income tax effects of the instalment sale (6 marks)

(c) Explain whether or not Localco could reduce its South African tax liability by making an election to have Foreignco treated as a controlled foreign company in relation to Localco. (13 marks)

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

(35 marks)

2 You are a junior tax consultant and have just received the following e-mail from your manager:

> **TO: you@afirm.co.za**
> **FROM: manager@afirm.co.za**
> **SUBJECT: Client Henry MacPheresen and family trust**
> **DATE: 31 May 2010**
>
> I attach a memorandum setting out information which has been supplied to me by Henry MacPheresen, whom I met briefly at an official function last week. He has made an appointment to see me here in the office in a week's time to discuss the tax position of his family trust. Can you please prepare some notes for the meeting setting out the South African income tax implications of the distributions made by, and the income retained by, the Trust for the donor and for each of the beneficiaries for the year of assessment ended 28 February 2010?
>
> The Trust is officially called the Donald MacPheresen Trust and it was formed in the Isle of Man by the late Donald MacPheresen, Henry's father. Henry is a resident of South Africa and one of the trustees of the Trust. The remaining trustees are currently sourced from a Trust management company incorporated in the Isle of Man.
>
> There are a couple of other points we will need to deal with. At the meeting, Henry would like to discuss a potential change in the trustees. Specifically, he wants to understand the South African tax implications of the Isle of Man Trust Company resigning as trustee and being replaced as trustees by his wife, Rachael, and his family's South African resident attorney. Please make sure your notes cover this issue.
>
> From what he has said to me I am not sure he wants to report this change in the Trustees to SARS. Could you find out what the disclosure requirements are and how, as a professional firm, we should deal with him if this is the case? You can put this in the notes as well.
>
> **Thank you**

The memorandum prepared by your manager is set out below

To: The files
From: Tax Manager
Date: 29 May 2010

Trust assets

The Trust has the following assets from donors:

(a) A rental property in South Africa donated by the late Donald MacPheresen
(b) A rental property in the United Kingdom donated by Henry
(c) South African interest-bearing investments donated by Henry's wife, Rachael
(d) South African shares donated by Henry's mother, Mary, who is aged 66 and is now resident in South Africa.

Trust beneficiaries

The Trust's beneficiaries are: Mary, Henry, Rachael, Joseph (Henry and Rachael's non-resident major son) and Janine (Henry and Rachael's minor South African resident daughter).

Trust income for the year ended 28 February 2010

The Trust earned the following from the various assets (all amounts have been translated into South African Rand at the appropriate rate):

(a) South African rental income – R300,000
(b) Foreign rental income – R450,000
(c) South African interest – R150,000
(d) South African dividends – R100,000

The Trust has no retained income.

Distributions of trust income in the year ended 28 February 2010

The following distributions were made:

(a) An annual annuity to Mary in terms of the Trust Deed of R250,000 (pro-rata from all income)
(b) A discretionary distribution to Joseph from the foreign rentals of R200,000
(c) A discretionary distribution to Janine from the interest income to pay for her schooling and board at the school, of R200,000

All distributions were made on the last day of the tax year of the Trust, being 31 December 2009.

Asset values at the end of the Trust's tax year

The asset values at the end of the Trust's tax year are as follows:

(a) South African property – R7,500,000 (R1,000,000 when donated on 1 April 1985)
(b) Foreign property – R12,000,000 (R4,500,000 when donated on 1 October 2000)
(c) South African interest bearing investments – R1,875,000 (also R1,875,000 when donated on 1 October 2003)
(d) South African shares – R5,000,000 (R1,500,000 when donated on 15 May 1999)

Required:

Prepare notes for the meeting as requested by your manager:

(a) Explaining the South African income tax implications of distributions made and income retained by the Trust for the donors and beneficiaries for the year of assessment ended 28 February 2010; (14 marks)

(b) Explaining the consequences of the changes in Trustees; (5 marks)

(c) Discussing the issue of Henry's reluctance to report the change in Trustees. (4 marks)

Professional marks will be awarded in question 2 for the format and presentation and the clarity of the notes. (2 marks)

(25 marks)

Section B – TWO questions ONLY to be attempted

3 You have been approached for advice by John Walker, a resident of South Africa, who runs his own business through a close corporation of which he is the sole member. He is also employed as an accountant at a large packaging corporation. John is married to Jenny, who is not employed and does not operate any form of business.

John earns a salary of R500,000 from his employer (before employee's tax).

The information pertaining to John's close corporation is as follows:

	R
Sales of merchandise	850,000
Sales of capital assets (proceeds)	200,000
Base cost of assets sold	125,000
Cost of sales	550,000
Other qualifying deductions	100,000

John earns interest from investments inherited from his late parents of R150,000 per annum. John wants to donate half the interest-bearing investments to Jenny with the express purpose of reducing his tax liability.

Required:

(a) Explain whether John CAN register the close corporation as a micro business. (3 marks)

(b) Explain whether John SHOULD register the close corporation as a micro business. (7 marks)

(c) Explain the normal tax consequences of the donation of the interest-bearing investments by John to Jenny. (2 marks)

(d) As John will only donate half the interest-bearing investments just before the end of the tax year, he has told you to disclose only half the interest on his tax return.

Explain whether John's instruction is the correct treatment, and how you should respond to this instruction. (4 marks)

(e) The sale of capital assets relate to a plot of vacant land (with certain building supplies) on which John had intended to build and rent a commercial rental building. John received an offer from one of his customers to purchase the plot and building supplies for R200,000 (when the original cost had been R50,000. This is a high return for a plot that was only purchased one year before.

Explain whether the proceeds from the sale will be treated as being of a capital or revenue nature. (4 marks)

(20 marks)

4 Liz operates a coffee shop as a sole proprietor from rented premises. Liz is registered for value added tax (VAT).

She is looking to close down the coffee shop and is concerned about the tax and VAT implications

Two options have arisen:

Option 1
Gert would like to buy all the furniture, namely the tables and chairs, for use in his restaurant which is in the same shopping centre as the coffee shop. Gert is also a VAT vendor. Liz will have to sell the equipment and any stock on hand to third parties.

Option 2
Joanne, who intends to start running a coffee shop of her own, would like to take over all the furniture and equipment and stock on hand, if any, at an agreed price.

Required:

(a) (i) For option 1, explain the VAT implications in respect of the furniture, equipment and stock on hand, and consider the impact of Liz deregistering for VAT both before and after the sale; (5 marks)

(ii) Explain the VAT implications in respect of the furniture, equipment and stock on hand for option 2. (7 marks)

(b) Explain the income tax implications in respect of the furniture, equipment and the stock on hand. (5 marks)

(c) If Joanne purchases the business, she would like to pay her waiters in cash. She has said that she will then not register as an employer.

Briefly explain whether Joanne's view is correct. (3 marks)

(20 marks)

5 Patricia Ngula has a share investment portfolio. All the shares are recorded on a first-in-first-out (FIFO) basis for tax purposes.

Prior to 1 March 2009, the following events took place regarding one of the share investments held in the portfolio:

(a) On 1 March 1999 an initial investment was acquired of 10,000 shares for R13 per share.
(b) On 1 July 2000 the company repaid its shareholders R1 per share from the original share premium.
(c) On 1 October 2001 the shares were valued at R14 per share.
(d) On 16 September 2003 the company made a distribution of R5 per share paid, 50% from revenue reserves and 50% from the original share premium.

During the year of assessment ended 28 February 2010, the following occurred:

(a) On 3 June 2009, the company reduced the par value of the shares in issue from R1 par value to R0·50 par value. In doing so, it paid R1·50 per share to shareholders, being R1 from revenue reserves and R0·50 from share capital. The market value of the shares before the transaction was R18 per share.
(b) On 5 December 2009, Patricia sold her 10,000 shares for R21 per share when the market had a sudden upswing.

Patricia has adopted the market value on 1 October 2001 as the valuation date value for all her shares held as capital (investment) assets.

Required:

(a) Explain the income tax consequences for Patricia of the receipt of R1·50 per share on 3 June 2009. (11 marks)

(b) Explain the income tax consequences of the sale of the shares on 5 December 2009. (9 marks)

(20 marks)

End of Question Paper