Strategic Professional – Options

Advanced Taxation – South Africa (ATX – ZAF)

Tuesday 4 June 2019

ATX ZAF ACCA

Time allowed: 3 hours 15 minutes

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – BOTH questions are compulsory and MUST be attempted

Tax rates and allowances are on pages 2–5

Do NOT open this question paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

ATX – ZAF

Think Ahead ACCA

The Association of Chartered Certified Accountants

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances for the tax year 2019 will continue to 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 2019/31 March 2019

Rebates

Primary rebate	R14,067
Secondary rebate (over 65)	R7,713
Tertiary rebate (over 75)	R2,574

Interest exemption

Under 65	R23,800
Over 65	R34,500

Foreign dividend exemptions

Fully exempt where 10% or more of the equity shares and voting rights are held.
Fully exempt where received by a company from a foreign company resident in the same country as the recipient.
To the extent of any controlled foreign company inclusions (net of applicable foreign tax)
To the extent that the foreign dividend is from a company listed on the JSE

To the extent that the above do not apply:
For individuals 25/45ths of the dividend is exempt
For companies 8/28ths of the dividend is exempt

Medical aid contribution tax rebate rates

Single member	R310
Member plus one dependant	R620
Each subsequent dependant	R209

Additional medical expenses tax rebate

Persons 65 or older or persons younger than 65 if that person, his or her spouse or his or her child is a person with a disability:

((Medical contributions – (medical aid contribution tax rebate x 3)) + other qualifying medical expenses) x 33·3%

Persons younger than 65:

((Medical contributions – (medical aid contribution tax rebate x 4)) + other qualifying medical expenses) as exceeds 7·5% of taxable income x 25%

Trusts (other than a special trust)		45%
Dividends tax		20%
Companies		
Normal tax rate		28%
Value added tax (VAT) (standard rate) –	to 31 March 2018	14%
	from 1 April 2018	15%
Donations tax		20% (up to R30 million)
		25% (from R30 million)
Estate duty		20% (up to R30 million)
		25% (from R30 million)
Official rate of interest (assumed)		8%

Rates of normal tax payable by persons (other than companies)
for the year of assessment ended 28 February 2019

Where taxable income:	
does not exceed R195,850	18% of each R1 of the taxable income
exceeds R195,850 but does not exceed R305,850	R35,253 plus 26% of the amount over R195,850
exceeds R305,850 but does not exceed R423,300	R63,853 plus 31% of the amount over R305,850
exceeds R423,300 but does not exceed R555,600	R100,263 plus 36% of the amount over R423,300
exceeds R555,600 but does not exceed R708,310	R147,891 plus 39% of the amount over R555,600
exceeds R708,310 but does not exceed R1,500,000	R207,448 plus 41% of the amount over R708,310
Exceeds R1,500,000	R532,041 plus 45% of the amount over R1,500,000

Tax rates for small business corporations
for the year of assessment ended 31 March 2019

Where taxable income:	
does not exceed R78,150	Nil
exceeds R78,150 but does not exceed R365,000	7% of the amount over R78,150
exceeds R365,000 but does not exceed R550,000	R20,080 plus 21% of the amount over R365,000
exceeds R550,000	R58,930 plus 28% of the amount over R550,000

Turnover tax rates for micro businesses
for the year of assessment ended 28 February 2019

Where taxable turnover:	
does not exceed R335,000	Nil
exceeds R335,000 but does not exceed R500,000	1% of the amount over R335,000
exceeds R500,000 but does not exceed R750,000	R1,650 plus 2% of the amount over R500,000
exceeds R750,000 but does not exceed R1,000,000	R6,650 plus 3% of the amount over R750,000

Car allowance

Maximum vehicle cost for actual expenses	R595,000

Fringe benefit (company car)

Benefit percentage (where no maintenance plan exists)	3·5%
Benefit percentage (where a maintenance plan exists)	3·25%

General business reduction: Benefit value x business kms/total kms (as per logbook)
Private fuel reduction: Private fuel (R) x private kms/total kms (as per logbook)
Private maintenance reduction: Private maintenance (R) x private kms/total kms (as per logbook)

Subsistence allowances

Deemed expenditure for meals and incidental costs (per Government regulation) R416 per day (local travel)
Deemed expenditure for incidental costs only (per Government regulation) R128 per day (local travel)
Deemed expenditure for meals and incidental costs (foreign travel) – (per published tables) will be supplied in the question where relevant

Common capital allowances

New and unused manufacturing plant and equipment	40%/20%/20%/20%
Used or leased manufacturing plant and equipment	20% each year for five tax years
New or unused plant or machinery used for research and development (where it does not qualify for the research and development accelerated allowance)	50%/30%/20%
Small business corporation manufacturing plant and equipment	100%
Small business corporation (other assets) – unless wear and tear provides a greater deduction	50%/30%/20%

Wear and tear (based on Binding General Ruling 7) will be supplied in the question where relevant

Manufacturing building allowance (unless seller's rate supplied)	5%
New or unused commercial building (not a manufacturing building)	5%

- No deduction where another section of the Act applies to the building
- Where part of a building is acquired, 55% of the acquisition price is 'cost'
- Where an improvement to the building is acquired, 30% of the acquisition price of the improvement is 'cost'

Research and development (R&D) expenditure	150%

Costs related to immovable property, machinery, plant, implements, utensils or articles (excluding any prototype or pilot plant created solely for the purpose of the process of research and development) are not claimed as research and development expenditure. Financing, and administrative or compliance costs may not be claimed as research and development expenditure.

Capital gains tax

Annual exclusion (while alive)	R40,000
Annual exclusion (in year of death)	R300,000
Primary residence exclusion	R2,000,000
(where proceeds are R2 million or less, the full gain is excluded for the portion of the property used for domestic purposes as a primary residence)	
Inclusion rate (natural persons)	40%
Inclusion rate (non-natural persons)	80%

Time apportioned base cost formulae:

$$Y = B + [(P - B) \times N/(T + N)]$$

$$P = R \times B/(B + A)$$

Where deductible enhancement expenditure has been incurred after the valuation date, the time apportioned base cost formulae change to:

$$Y = B + [(P_1 - B_1) \times N/(T + N)]$$

$$P_1 = R_1 \times B_1/(A_1 + B_1)$$

Travel allowance table
for years of assessment commencing on or after 1 March 2018

Value of the vehicle (including value added tax (VAT) but excluding finance charges or interest)	Fixed cost	Fuel cost	Maintenance cost
R	R p.a.	c/km	c/km
0 – 85,000	28,352	95·7	34·4
85,001 – 170,000	50,631	106·8	43·1
170,001 – 255,000	72,983	116·0	47·5
255,001 – 340,000	92,683	124·8	51·9
340,001 – 425,000	112,443	133·5	60·9
425,001 – 510,000	133,147	153·2	71·6
510,001 – 595,000	153,850	158·4	88·9
Exceeds 595,000	153,850	158·4	88·9

Note: Where reimbursement is based on actual business kilometres travelled and no other compensation is paid to such employees and the kilometres travelled for business does not exceed 12,000, the prescribed rate is R3·61 per kilometre.

Transfer duty rates
for the year of assessment ended 28 February 2019

Where the acquisition price:

does not exceed R900,000	Nil
exceeds R900,000 but does not exceed R1,250,000	3% of the amount over R900,000
exceeds R1,250,000 but does not exceed R1,750,000	R10,500 plus 6% of the amount over R1,250,000
exceeds R1,750,000 but does not exceed R2,250,000	R40,500 plus 8% of the amount over R1,750,000
exceeds R2,250,000 but does not exceed R10,000,000	R80,500 plus 11% of the amount over R2,250,000
exceeds R10,000,000	R933,000 plus 13% of the amount over R10,000,000

Tax rates of normal tax retirement lump sum and severance benefits
in respect of the year of assessment ended 28 February 2019

Where taxable portion of lump sum:

does not exceed R500,000	Nil
exceeds R500,000 but does not exceed R700,000	18% of the amount over R500,000
exceeds R700,000 but does not exceed R1,050,000	R36,000 plus 27% of the amount over R700,000
exceeds R1,050,000	R130,500 plus 36% of the amount over R1,050,000

Tax rates of normal tax withdrawal lump sum benefits
in respect of the year of assessment ended 28 February 2019

Where taxable portion of lump sum:

does not exceed R25,000	Nil
exceeds R25,000 but does not exceed R660,000	18% of the amount over R25,000
exceeds R660,000 but does not exceed R990,000	R114,300 plus 27% of the amount over R660,000
exceeds R990,000	R203,400 plus 36% of the amount over R990,000

Section A – BOTH questions are compulsory and MUST be attempted

1 Expand (Pty) Ltd (Expand) is a South African resident company wholly-owned by Uitbreiden NL, a company in the Netherlands. Expand is effectively managed in South Africa. It provides equity and debt capital to various start-up companies in Africa, including South Africa. Its year of assessment ends on 31 March each year.

The directors of Expand have approached you for some advice with respect to the tax implications arising from some proposed and concluded transactions detailed as follows:

Issue 1 – Conversion of debt to equity in respect of Co A

Expand holds a 10% equity stake (2,000 shares) in Co A, a South African company with a 31 March year end. The current market value of the 2,000 shares is R200,000. Expand also provided debt finance of R300,000 to Co A. On 2 May 2017, Co A used half of the funds provided by Expand to acquire trading stock and the other half to acquire a machine. The machine was immediately brought into use in a process of manufacture.

Co A has not been performing well and is under financial strain. The company approached the directors of Expand with a proposal to convert the R300,000 debt from Expand into equity. The deal would effectively reduce this debt to nil, but the number of shares issued would increase by 2,100 with a projected market value per share of R80 immediately after the issue. Currently, only 5% of the trading stock acquired with the debt finance is on hand and the machine is still in use.

The directors of Expand would like to understand the income tax consequences for both Expand and Co A in respect of this proposed conversion of debt to equity. (10 marks)

Issue 2 – Interest on loans to Kenyan companies

Expand provides loans to various African companies to which it has provided equity finance. In most cases, the provision of both equity and debt finance is provided on the basis that Expand holds at least 20% of the equity share capital (but less than 50%) and that no other shareholder may individually hold a greater single equity share capital percentage than Expand.

For these companies which Expand lends to in Kenya, Expand levies interest at a rate of 17% (market lending rates are 13·5%). The corporate tax rate in Kenya is 30%. The total loans to Kenyan companies amount to R5,000,000.

The directors of Expand have become concerned as to whether any transfer pricing risk exists and would like to know of the implications if transfer pricing adjustments are necessary. (8 marks)

Issue 3 – Foreign exchange issues on borrowings from Uitbreiden NL

Uitbreiden NL lends money to Expand for onward lending to the African investment companies. The loans provided by Uitbreiden NL are denominated in Euro. These loans currently total EUR 1,000,000 on which interest has been charged at a market-related European rate of 3% per annum. At the time the loans were obtained by Expand, which was during the 2019 year of assessment, the exchange rate was EUR 1 = ZAR 15·50. However, at year end, the Rand had depreciated strongly against the Euro and the rate was EUR 1 = ZAR 17·20.

The directors of Expand are very concerned by this depreciation and the company's exposure to currency fluctuations. They have contacted local banks as they plan to enter into a currency hedge contract with respect to the loan capital only. The rates quoted are EUR 1 = R17·50 on settlement of the loans.

The directors of Expand would like to know the tax implications of the depreciation in the Rand and of the proposed currency hedge. (4 marks)

Issue 4 – Implications of electing to become a headquarter company

Expand focuses its investments outside South Africa and therefore holds very few interests in South African companies. 90% of its equity holdings are outside South Africa in other African companies. Equally, the interest and dividend income Expand receives on its investments are mainly from these foreign companies. While Expand restricts its equity shareholding to between 10% and 49%, frequently other unconnected resident companies also hold equity shares in these foreign companies.

Expand's assets include:

(i) R50,000,000 in equity shareholdings
(ii) R30,000,000 in debt financing to companies in which an equity interest is held

(iii) R2,000,000 in cash

The directors of Expand would like to understand:

(a) The potential tax benefits arising from an election to become a headquarter company.

(b) The key immediate income tax implications should such an election be made. (9 marks)

Required:

Write a report to the directors of Expand (Pty) Ltd, explaining the tax implications of each of the issues (1) to (4), addressing the matters raised by the directors.

Notes:

1. The split of the mark allocation is shown against each of the four issues above.
2. Where applicable, your answer should clearly set out any conditions which must be met for the tax implications you have identified to apply.

Professional marks will be awarded in Question 1 for the format and presentation of the report and for the effectiveness of communication. (4 marks)

(35 marks)

2 Wim Burgers is a Dutch national. He accepted a work contract with a large multinational organisation with a start date of 1 April 2018, and will be working for and be paid by the company's South African subsidiary, Cosmic (Pty) Ltd, for an initial period of five years with the possibility to extend for a further five years. Wim arrived in South Africa on 1 March 2018 in anticipation of the start date of the contract.

Wim is a well-travelled individual, and also runs his own import and export business. He exports Dutch edible treats from the Netherlands to various countries, which he then sells in these countries to local retailers. Wim had not previously exported any goods to South Africa until he began working there. The following information pertains to Wim's 2019 year of assessment:

Employment
Wim is paid by Cosmic (Pty) Ltd in South African Rands. His annual cash salary is R2,000,000. Cosmic (Pty) Ltd will also contribute to his pension fund (registered in the Netherlands) on his behalf. In terms of the Netherlands pension fund rules, the full amount may be taken as a lump sum on retirement. No fund rules have been provided to the South African Revenue Service (SARS).

In addition, Wim participates in the group employee share scheme for shares in Global Holding Company (GHC) based in the Netherlands. The scheme provides for two options of acquiring the shares:

Option A
The GHC shares are acquired at a 5% discount on the current market value and the purchase price is funded from an employee share trust, set up for this purpose in the Netherlands. The loans to the employees from this trust are immediately repayable on disposal of the shares. The GHC shares may be sold at any time.

Option B
The GHC shares are acquired at a 10% discount on the current market value and the purchase price is again funded from the employee share trust (as in Option A). The loans from this trust are immediately repayable on disposal of the shares. The GHC shares can only be sold after one year has passed since the acquisition.

Dividends under each option may be paid to the employee share trust, at the request of the employee to acquire notional units linked to the value of the company shares. Units are acquired at the current market value of the shares. These units may be redeemed at any time.

Import and export business
On arrival in South Africa, Wim quickly secured contracts for the import of Dutch treats and sale to local retailers in South Africa. Local retail purchase contracts represented a combined promised acquisition of R1,100,000.

On 1 May 2018, Wim began to import the Dutch treats and imported treats to the value of R350,000 (before customs). The customs team accepted R350,000 as the customs value. Additional customs duties of R30,000 were raised.

Wim also began to source South African treats with a view to exporting such goods and, where possible, selling them locally. On 15 May 2018, Wim purchased South African treats from value added tax (VAT) registered vendors amounting to R200,000 (VAT inclusive).

Required:

(a) Discuss whether or not Wim is likely to be classified as a resident of South Africa for tax purposes under the physical presence test only. (2 marks)

(b) Assuming Wim is classified as non-resident for South African tax purposes, explain the tax implications arising in respect of the retirement fund contributions made by his employer and the employee share scheme under each of Options A and B. (11 marks)

(c) Explain the possible South African value added tax (VAT) and income tax implications of Wim's sole trader imports and exports business. (8 marks)

(d) Assuming Wim registers for VAT with effect from 1 June 2018, explain the VAT implications with respect to the pre-registration purchases of Dutch treats on 1 May 2018 and South African treats on 15 May 2018. (4 marks)

(25 marks)

Section B – BOTH questions are compulsory and MUST be attempted

3 Reginald Rich created a family trust on 1 March 2010. The trust has three trustees, being Reginald, Doris (his wife) and their accountant, Tim. The beneficiaries include Reginald, Doris and their two children, David and Beth. The trust is fully discretionary as to income and capital as well as the use of assets.

On creation of the trust, Reginald sold two properties into the trust on interest-free loan account. The first property (Prop A) is a large estate, used as Reginald and Doris's primary residence, which was sold to the trust for R14,000,000. The second property (Prop B) is a rental property near the beach in Cape Town, which was sold to the trust for R20,000,000. Prop B is rented on a long-term basis for R100,000 per month. Expenses on Prop B amount to R40,000 per month.

Reginald and Doris will emigrate to Cyprus on 1 November 2019. On 30 October 2019, they will invest EUR 2,000,000 in a residential property in Cyprus, in order to gain European Union (EU) citizenship. Cyprus grants citizenship to individuals purchasing residential property in Cyprus for a minimum value of EUR 2,000,000 six months after the date of purchase.

In addition to the EUR 2,000,000 property price, Reginald and Doris will incur legal and consultancy costs of EUR 100,000 in respect of the Cyprus purchase. In order to fund the Cyprus property purchase, Reginald will sell some foreign investments for EUR 1,000,000, which have a weighted average cost of EUR 700,000. No tax will be levied on this disposal in the relevant foreign jurisdictions. As they have no credit standing in Cyprus, Reginald and Doris will have to remit the remaining funds for the purchase from South Africa.

To fund the remaining EUR 1,100,000, Reginald will sell local South African investments for R750,000 (weighted average cost of R500,000) and will also ask the trust to repay the loan of R14,000,000 on Prop A in full and repay R4,300,000 of the loan on Prop B. To fulfil this request, on 1 October 2019, the trust will sell Prop A for R17,000,000 and obtain a loan for R5,300,000 from a local South African bank secured over Prop B. For the period 1 October 2019 to 28 February 2020, it is forecast that the trust will make loan repayments to the South African bank amounting to R236,800 and pay interest amounting to R214,500.

The South African Reserve Bank has indicated that for exchange control purposes, it permits offshore investments by residents of up to R10,000,000 per person per annum.

When Reginald and Doris move to Cyprus, David and Beth will replace Reginald and Doris as trustees and the trust will remain resident in South Africa for tax purposes.

Reginald is subject to tax at the highest marginal rate and will continue to be up to the point of emigration. Doris paid no South African tax to the end of the 2019 year of assessment. Both Reginald and Doris are 68 years of age.

Assumed exchange rates:

	1 EUR = ZAR
Rate on date of sale of foreign investments	15·5
Rate on date of transfer of funds to Cyprus	16
Rate on date of purchase of Cyprus property	17·2

Required:

(a) Explain the income tax implications for Reginald in respect of the interest-free loans to the trust for Prop A and Prop B for the 2019 year of assessment. (4 marks)

(b) Explain the income tax implications for Reginald and the trust in respect of Prop B only for the 2020 year of assessment. (6 marks)

(c) Advise, with supporting calculations, how best Reginald and Doris could structure their export of capital to fund the Cyprus purchase prior to ceasing to be resident on 1 November 2019. (10 marks)

(20 marks)

4 On 1 April 2018, following a restructuring by his employer, Great Ltd, Nigil Job took early retirement at the age of 63. Normal retirement age under the terms of his company pension fund is 65.

On retirement, Nigil received a severance benefit of R1,000,000 from Great Ltd. His final cash salary was R90,000 for the month of March 2018. Nigil had contributed R1,500 to the medical scheme each month. After retirement, he received a 50% post-retirement medical subsidy on his medical contributions. Nigil had contributed 10% of his cash salary to the company pension fund. Under the terms of the pension fund, Nigil had to notify the fund of his intentions as regards his accumulation account within six months of termination of service. His accumulation account had built up to R6,000,000. Nigil notified the fund that he would withdraw R550,000 as a lump sum and the balance would be transferred to a retirement annuity fund (RAF).

Nigil had worked as Great Ltd's accountant for many years and was considered highly skilled. After retiring from Great Ltd, on 1 November 2018, he decided to buy into a partnership offering accounting services to small businesses. Nigil's capital contribution into the partnership was R1,500,000. Nigil's partnership share entitled him to 20% of profits and losses. The partnership prepared annual accounts for the year ended 28 February each year. The partnership does not provide medical benefits or pension benefits.

On 22 February 2019, Nigil suddenly and unexpectedly died. Nigil had no dependants and had never married. In accordance with his will, Nigil's estate was to be divided between his nephew, John, and niece, Juliet, after various donations to charities totalling R4,000,000. He had no life policies, deeming them to be unnecessary.

The partnership determined that Nigil's share of partnership profit for the 2019 year of assessment amounted to R100,000. This, together with Nigil's capital contribution (on which he had earned 5% interest from the partnership), was paid to the executor of his estate. The partnership profit was lower than expected due to the write-off by the partnership of a large client debt amounting to R1,000,000. The client had owed this amount since before Nigil became a partner. The partnership profit share was also net of interest on all partnership accounts. The other partners had taken out a life policy over Nigil's life to enable them to acquire his interest should he die. The partnership had been paid R1,500,000 by the insurer which was used to return the capital to Nigil.

Required:

(a) Explain, with supporting calculations, the income tax consequences of the severance benefit receipt and the lump sum withdrawn from Nigil's company pension fund accumulation account. (9 marks)

(b) Explain whether or not the post-retirement medical subsidy is taxable in Nigil's hands and the subsequent consequences, if any, on his medical aid rebates. (2 marks)

(c) Explain the income tax implications of the amounts received by the executor of Nigil's estate in respect of the partnership and the tax implications of the life policy held by the other partners over Nigil's life. (9 marks)

(20 marks)

End of Question Paper