Strategic Professional – Options

Advanced Taxation – South Africa (ATX – ZAF)

Tuesday 3 December 2019

ATX ZAF ACCA EN

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:

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

$$P1 = R_1 \times B_1/(A_1 + B_1)$$

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 Joseph Matala is 56 years of age. He was the chief executive officer (CEO) of MCorp, a major corporation, until he decided to take early retirement with effect from 30 June 2018 to start up his own company CEO4U (Pty) Ltd (CEO4U). He is the sole director and shareholder of CEO4U, which provides advisory input (similar to the functions of a CEO) to start-up companies. CEO4U has a February year end and has no other employees.

A number of issues have arisen since his retirement for which Joseph requires your advice.

(a) Issue 1 – Early retirement

Until his retirement, MCorp paid Joseph an annual cash salary of R3,600,000. MCorp always contributed 10% of this amount to the MCorp pension fund. For the year of assessment 2019, the South African Revenue Service (SARS) reported an amount of R210,000 carried forward from prior years as excess retirement fund contributions. The pension fund reported that as at 30 June 2018, Joseph had accumulated R15,000,000. As Joseph took early retirement, he decided to extract the maximum amount tax-free and transfer the balance to a retirement annuity fund. The rules of the MCorp pension fund permit retirement from the fund after the age of 55.

Joseph also held shares in MCorp which he had acquired via the MCorp share scheme. On retirement, he was contractually obligated to return some of the shares over which a restriction to sell still applied. Joseph had acquired these shares for R500,000 when the market value was R800,000. These had to be resold to the share scheme trust at the acquisition cost of R500,000.

On 30 June 2018, other shares acquired for R400,000 (when the market value was R550,000), became free from a restriction to sell. Their market value at 30 June 2018 was R650,000. Joseph sold these shares on 10 December 2018 for R730,000.

Joseph would like to understand:

(i) The tax implications arising from his actions with respect to the pension fund, and confirmation of the amount which he should have taken as a tax-free lump sum from the pension fund.

(ii) The maximum amount he can contribute to a retirement annuity fund which would qualify for deduction in the 2019 year of assessment.

(iii) The tax implications arising from the share scheme transactions. (14 marks)

(b) Issue 2 – CEO4U transactions

As MCorp had not found a suitable candidate on Joseph's retirement, MCorp approached CEO4U to provide a freelance CEO service for a five-month contract (1 July–30 November 2018) paying a monthly retainer fee of R295,000. As the only employee of CEO4U, Joseph provided this service. MCorp appointed a new CEO on 1 December 2018. For the period 1 July to 1 November 2018, MCorp was CEO4U's only client.

On 1 November 2018, CEO4U obtained a contract with a company in Farland to provide CEO services. The contract value was a monthly payment of FAR500,000 (FAR = Farland currency). CEO4U was required to open a Farland bank account to receive payment. No funds were remitted to South Africa in the 2019 year of assessment. The services are performed from South Africa and meetings are held via video conferencing software.

By 1 January 2019, CEO4U had secured an additional three contracts, two in South Africa and an additional contract in Farland. These are smaller functions. Each of the South African contracts provides for monthly payments of R10,000 and the Farland contract for monthly payments of FAR20,000.

All monthly payments accrue at the month end. The following exchange rates are relevant:

Date	1 FAR = X ZAR
30 November 2018	0·3854
31 December 2018	0·4065
31 January 2019	0·3765
28 February 2019	0·3970

In respect of CEO4U, Joseph would like to understand:

(i) Whether or not South African income tax should have been withheld and/or other advance payments of tax should have been made to SARS in respect of the income received by CEO4U.

(ii) Whether CEO4U would be required to register for any other South African taxes.

(iii) Whether CEO4U would qualify for the South African micro business or small business corporation preferential regimes.

(iv) The tax implications arising in respect of the Farland contracts, including any subsequent remittance of funds from Farland in the year of assessment 2020. (12 marks)

(c) Issue 3 – Change of residence

Joseph is considering moving the residence of CEO4U to Farland and moving his own residence there.

Joseph would like to understand:

(i) Whether or not CEO4U could become tax resident in Farland if Joseph remains resident in South Africa.

(ii) The South African tax implications arising if both Joseph and CEO4U become tax resident in Farland.

Farland has a tax treaty with South Africa which replicates the OECD Model Tax Convention on Income and on Capital. (5 marks)

Required:

Write a report to Joseph Matala, explaining the tax implications of each of the issues (1) to (3), addressing each of the matters raised by him.

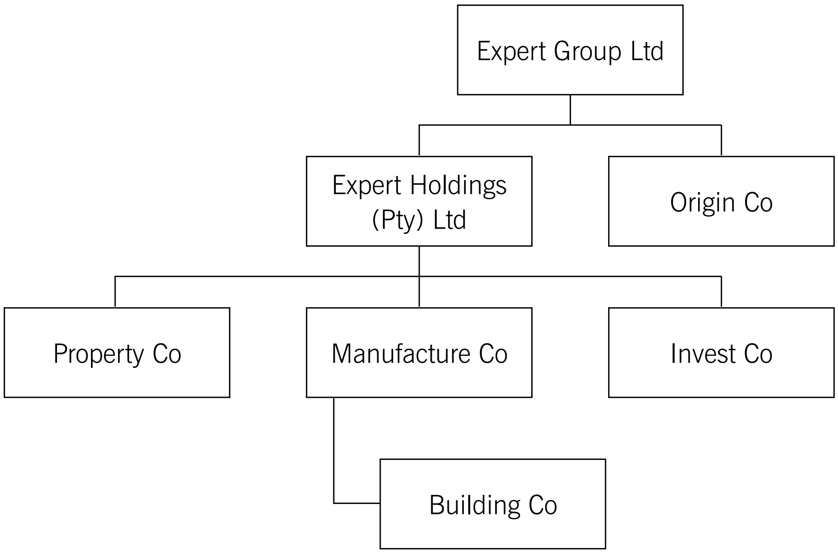
Notes:
1. **The split of the mark allocation is shown against each of the issues raised.**
2. **Where applicable, your answer should clearly set out any conditions which must be met for the tax implications you have identified to apply.**

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 The Expert Group of companies (the Group) has expanded over a number of years. As the structure is now unwieldy, the directors of the listed company, Expert Group Ltd, would like your advice on the proposed restructuring of the Group. Such restructuring would take place on or after 1 April 2020.

The current structure of the Group (comprising only 100% owned South African resident companies) may be illustrated as follows:



The directors of Expert Group Ltd would like a flatter structure. Some of the company acquisitions (such as Building Co) predated the incorporation of Property Co, resulting in some assets being inappropriately allocated. Further, Origin Co was purchased into the group of companies ten years previously, but no thought was given to its placement within the group operations at the time.

Substantial inter-group loans exist between Expert Holdings (Pty) Ltd and Invest Co. As Expert Holdings (Pty) Ltd receives dividends from its subsidiaries, it loans these receipts interest-free to Invest Co which then on-lends to the other subsidiaries for asset acquisitions.

Property Co owns various properties for rental to third parties and to other companies within the Group.

Building Co's only asset is an offshore building which is rented.

Manufacture Co runs a manufacturing operation requiring substantial machinery and other assets in a building rented from Property Co.

Invest Co is the financing company of the Group, on-loaning money from Expert Holdings (Pty) Ltd and other third party financial institutions.

Origin Co runs a manufacturing operation on a smaller scale than Manufacture Co and with different product lines. It also operates from a building rented from Property Co. Origin Co currently has a large assessed loss.

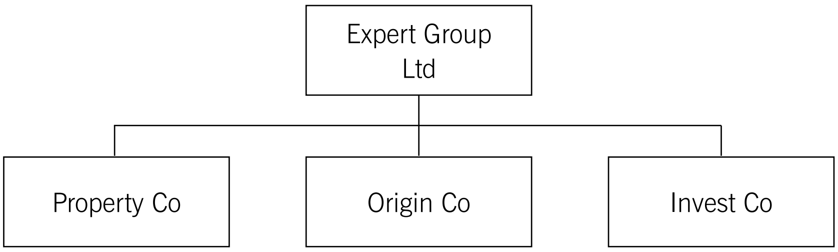
The directors would like to carry out the following steps:

(i) Transfer Building Co's single asset (a building located outside South Africa) to Property Co and subsequently liquidate Building Co.

(ii) Manufacture Co to be consolidated into Origin Co.

(iii) The Expert Holdings (Pty) Ltd shareholdings in Property Co and Invest Co to be transferred to the Expert Group Ltd and Expert Holdings (Pty) Ltd to be liquidated.

The planned revised structure would end as:



The directors understand that there are special corporate rules to reduce, defer or minimise the income tax consequences for asset-for-share, substitutive share-for-share, amalgamation, intra-group, unbundling transactions and liquidation distributions. However, they are unclear as to the qualifying criteria, restrictions on use, which rule is applicable for each action and any future restrictions arising from the use of such rules.

Required:

(a) Explain each of the following special corporate rules, clearly explaining any qualifying criteria for each of the rules to apply:

- **Asset-for-share transactions**
- **Substitutive share-for-share transactions**
- **Amalgamation transactions**
- **Intra-group transactions**
- **Unbundling transactions**
- **Liquidation distributions** (11 marks)

(b) Based on your explanations in part (a), identify which of the special corporate rules could be applicable in respect of the directors' planned actions in each of steps (i), (ii) and (iii), explaining any restrictions which may be imposed in terms of the applicable rule. If no special corporate rule is applicable to a step, explain why. (10 marks)

(c) Discuss whether or not use may be made of the assessed loss in Origin Co against profits from the trade of Manufacture Co after its consolidation into Origin Co. (4 marks)

(25 marks)

Section B – BOTH questions are compulsory and MUST be attempted

3 With effect from 1 April 2018, the value added tax (VAT) rate changed from 14% to 15%. A number of vendors have approached you with queries in respect of this VAT rate change.

PropDev Ltd

PropDev Ltd sold a commercial property to Build Ltd, charging VAT at 14%. The contract for sale was signed on 1 March 2018 and the invoice was issued on the same day for R5,000,000. The property transfer was registered in the Deeds Office on 15 May 2018. When the contract was signed, Build Ltd paid a deposit of 10% of the purchase price to the transferring attorneys to be held in trust until the transfer took place, at which point the purchase consideration was transferred to PropDev Ltd.

PropDev Ltd had also entered into a number of sales contracts in respect of a new residential property development, again charging VAT at 14%. The purchasers (all non-VAT registered vendors) had signed the contracts during March 2018 and all buyers had paid the required deposits to the transferring attorneys.

Selling Ltd

Selling Ltd entered into a contract with a long-term customer on 15 January 2018 for the supply of goods over a six-month period at a set price of R50,000 per month. The agreement states 'the amount specified to be payable per month shall be inclusive of all relevant taxes and duties'.

Consult Ltd

Consult Ltd provided various consulting services to its clients in March. In accordance with its business practice, most client invoices are raised mid-month following the service for payment by the month end.

However, for one client (Client A), Consult Ltd agreed to invoice only once every two months as an exception to its usual invoicing practice. The last invoice to Client A was raised on 28 February 2018 in respect of services provided in January and February 2018. In April 2018, Consult Ltd invoiced Client A for services provided in March and April 2018.

Growth Ltd

Growth Ltd is a registered VAT vendor operating in Cape Town and Johannesburg selling standard rate VATable goods. While the operations have been mainly run from Cape Town, the expansion of the Johannesburg office has meant that many of the administrative functions now need to be performed on a decentralised basis. Growth Ltd is also considering opening a new branch in Zambia, which would also follow the decentralised model.

Required:

(a) Explain which value added tax (VAT) rate will apply to the sale of the commercial property and residential properties by PropDev Ltd and any associated implications. (5 marks)

(b) Explain the implications of the VAT rate change in respect of Selling Ltd's contract and who bears responsibility for any additional VAT due. (3 marks)

(c) Explain which VAT rate Consult Ltd should have applied to its invoices issued to monthly billed clients and Client A in April 2018. (3 marks)

(d) (i) Explain why Growth Ltd is able to register its Johannesburg operation separately for VAT purposes and how it should do so. (4 marks)

(ii) Assuming Growth Ltd registers the Johannesburg branch separately for VAT, explain the VAT implications in respect of any transfers of inventory and capital assets from Growth Ltd (Cape Town head office) to the Johannesburg branch. (2 marks)

(iii) Assuming Growth Ltd opens the new branch in Zambia and registers it as separate branch for VAT purposes, explain the VAT implications of supplies to and subsequent sales made by the Zambian branch. (3 marks)

(20 marks)

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Question 4 begins on page 12.

4 Jason Lang was in the process of emigrating from Austria to South Africa with his spouse, Eva. By the end of March 2018, Eva had already moved into their new house in Durban. They had purchased this house jointly for R5,000,000 on 1 March 2018 using R3,000,000 cash and a mortgage of R2,000,000.

Eva started her new job in Durban on 1 April 2018 and had registered as a South African resident taxpayer having concluded the formal emigration processes. Jason was in the process of selling his share of the Lang family company based in Austria and so had not yet concluded his emigration, when he unexpectedly died on 8 April 2018.

Jason and Eva were married in community of property. Jason and Eva also had a family trust managed by them and one other trustee. The trust earns dividends from various European companies (all holdings are less than 5% and none of the other shareholders are South African) from which an annuity was payable to each of Jason and Eva. The trust is resident in Mauritius and has remained tax resident there. The assets and income are denominated in Euros and had been contributed jointly by Jason and Eva.

Events prior to 8 April 2018

(i) Each of Jason and Eva received monthly annuities of €4,000 from the Mauritian trust.

(ii) Eva stopped working at her previous job in the 2018 year of assessment in anticipation of her move to South Africa. Since 1 April 2018, she has earned a salary of R80,000 per month from her South African employer.

(iii) Jason was drawing a monthly salary of €10,000 from the Lang family company.

Events after 8 April 2018

(i) Eva continued to work in South Africa for a monthly salary of R80,000.

(ii) The remaining directors of the Lang family company decided to pay Eva an amount of €100,000 in recognition of Jason's time at the company and leading the sale negotiations.

Assets

(i) Jason held shares in the Lang family company valued at €900,000 on 8 April 2018, the date of his death. The price realised by the executor of Jason's estate when the business sale was concluded was €950,000.

(ii) Jason and Eva jointly owned their family home in Austria. Jason had lived in it as a primary residence until his death. From 1 March 2018, Eva's primary residence was the home in Durban. The Austrian home was valued at €1,250,000 at the date of Jason's death. It had been purchased for €500,000 in October 2002 and was valued at €1,200,000 at the date Eva became resident in South Africa.

(iii) Jason and Eva had both bought motor cars in South Africa valued at R500,000 and R350,000 respectively.

(iv) Eva received the proceeds from a life policy (on Jason's life) in Europe amounting to €1,000,000 and a new policy in South Africa for R6,000,000.

(v) While Jason's will provided that his share of the family home in Austria and South Africa would pass to Eva on his death, she has confirmed with the executor that Jason's share must be transferred directly to the Mauritian trust. In addition, Eva sold her portion to the Mauritian trust for cash of €625,000 after which it is to be rented to third parties by the trust. The value of the sale was the same as the market value of Jason's share on death.

(vi) On 12 August 2018, the trust sold foreign shares for €2,000,000 which had been acquired for R1,500,000 on interest free loan account from Jason and Eva. The loan account was repaid and the capital gain retained by the trust.

Required:

(a) Explain the South African tax implications for Jason, Eva and his estate as a result of Jason's death. (5 marks)

(b) Explain the South African tax implications of Jason and Eva's acquisition of their new home in Durban. (2 marks)

(c) Explain the South African tax implications for Eva for the 2019 year of assessment. (9 marks)

(d) Explain how the income received from the Mauritian trust could be better structured for Eva from an income tax perspective. (4 marks)

(20 marks)

End of Question Paper