Use of a non-programmable pocket calculator is permissible
Closed book examination

This examination question paper remains the property of the University of South Africa and may not be removed from the examination venue.

This paper consists of seven (7) pages plus the annexures (pp i – ii)

**IMPORTANT INSTRUCTIONS:**

1. All amounts exclude VAT unless stated otherwise.
2. All persons mentioned are residents of the Republic of South Africa unless stated otherwise.
3. SARS = South African Revenue Service

The answering of this paper

1. This paper consists of four (4) questions
2. Answer all the questions
3. Start each question on a new (separate) page
4. Show all workings, where applicable. Where an amount is subject to a limitation, clearly indicate the application of the limitation. Where any item is exempt from tax or not allowable as a deduction, this must be indicated, and a brief reason provided. All amounts must be rounded to the nearest rand.
5. Please complete the cover page of the answer book in full
6. You are reminded that answers may NOT be written in pencil

7. Proposed timetable (try as far as possible not to deviate from this timetable):

<table>
<thead>
<tr>
<th>Question</th>
<th>Topic</th>
<th>Marks</th>
<th>Minutes</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Tax liability of a company</td>
<td>30</td>
<td>36</td>
</tr>
<tr>
<td>2</td>
<td>Micro business and small business corporation</td>
<td>22</td>
<td>26</td>
</tr>
<tr>
<td>3</td>
<td>Provisional tax and capital gains tax</td>
<td>23</td>
<td>28</td>
</tr>
<tr>
<td>4</td>
<td>General deduction formula and tax administration</td>
<td>25</td>
<td>30</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td></td>
<td><strong>100</strong></td>
<td><strong>120</strong></td>
</tr>
</tbody>
</table>
QUESTION 1  (30 marks, 36 minutes)

Guitar Hero (Pty) Ltd is **not a small business corporation** as defined in the Income Tax Act. The company manufactures all kinds of musical instruments, including guitars, pianos and drums and it sells these instruments to one retailer in South Africa, namely Music Moods CC. Guitar Hero (Pty) Ltd's financial year ends on 31 March. The accountant requested you to calculate the company's income tax liability for the year of assessment ended 31 March 2015. The following information is provided to you:

1. Sales to Music Moods CC amounted to R6 865 000
2. A donation of R150 000 was made to Lifeline, a registered public benefit organisation. The relevant section 18A certificate was obtained.
3. The company purchased raw materials amounting to R3 650 500 and also paid a transport company R8 600 to deliver the stock to its premises.
4. Guitar Hero created a new computer program that would simplify the manufacture process. Research and development expenses incurred in developing the computer program amounted to R375 000 and were incurred on 1 May 2014. Salaries paid to research staff amounted to R98 000 and were also incurred on the same date. Approval was obtained from the Minister, as well as the Department of Science and Technology for the development of the computer program on 15 April 2014.
5. Bad debts written off during the year of assessment amounted to R58 060.
6. The following table relates to the list of doubtful debts:

<table>
<thead>
<tr>
<th></th>
<th>01/04/2013 – 31/03/2014</th>
<th>01/04/2014 – 31/03/2015</th>
</tr>
</thead>
<tbody>
<tr>
<td>List of doubtful debts</td>
<td>R 112 000</td>
<td>R 97 000</td>
</tr>
</tbody>
</table>
7. The following information relates to the fixed assets:

- On 1 August 2013 the company purchased a range of new furniture for R36 000 for the distribution office. On 1 October 2014, the company relocated to a new distribution office and the furniture was moved on the same date. Moving costs amounted to R15 000.
- The old furniture was only sold on 1 August 2014 to a second-hand dealer for R18 000. This old furniture was originally purchased for R25 000 on 1 July 2013.
- Guitar Hero (Pty) Ltd purchased two manufacturing machines on 1 July 2014. Manufacturing machine A was bought new for R220 000 and manufacturing machine B was bought second-hand for R125 000.
- On 1 May 2014, the company purchased five new apartments in a residential building in Cape Town at a cost of R650 000 each. The company rented these apartments out at R3 500 each per month from 1 May 2014, solely for trade purposes.

8. Guitar Hero (Pty) Ltd paid an amount of R110 000 on 1 January 2015 to the local municipality for water and electricity for the period 1 January 2015 to 31 December 2015.

[TURN OVER]
9. The following employee expenses were paid:

- Salaries and wages (approved by the Commissioner) $1,200,000
- Contribution to medical aid fund in respect of all employees $155,000
- Leave pay to Lucinda Marshall $54,000

10. On 1 February 2015, there was a robbery at the distribution office and five guitars with a cost price of R5,500 each were stolen. In an attempt to recover the stolen items, the company paid a bribe of R1,500 to a security officer to try and find the culprits. The insurance company paid an amount of R20,000 to Guitar Hero (Pty) Ltd for the theft of the guitars.

11. Additional information:

Binding general ruling No. 7 allows for the following write-off periods for assets (where applicable):

- Furniture and fittings 6 years

Guitar Hero (Pty) Ltd has elected to use the section 11(o) scrapping allowance, where applicable.

| REQUIRED: Calculate the tax liability of Guitar Hero (Pty) Ltd for the year of assessment ended on 31 March 2015 | MARKS |
QUESTION 2  (22 marks, 26 minutes)

PART A  (7 marks, 8 minutes)

Fly Away With Me (Pty) Ltd (FAWM) provides hot air balloon trips over the Drakensberg mountains. FAWM is a registered microbusiness. FAWM has a February year-end. The following is a summary of the transactions that took place during the 2015 year of assessment:

<table>
<thead>
<tr>
<th>Notes</th>
<th>R</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td></td>
</tr>
<tr>
<td>3</td>
<td></td>
</tr>
</tbody>
</table>

Notes:

1. The fee for a hot air balloon ride is R2 500 per person per trip. Trips are only done on Saturdays. All customers need to pay an upfront deposit of 50% of the fee for a booking to be confirmed. The balance of the fees levied for the trip is to be paid within two days after the trip.

During the 2015 year of assessment, 320 persons went on hot air balloon trips. The persons who enjoyed the trip on 28 February 2015 (the last Saturday of the year of assessment), is not included in this figure. On 28 February 2015, 10 persons went on the hot air balloon trip and none have paid the remaining portion of the fee still due. Another 40 persons have already booked and paid their deposits on 28 February 2015 for the trips to be done in the 2016 year of assessment.

2. FAWM has a registered trademark for the phrase "Up, up and away!" A company, UK Farming, approached FAWM to use the phrase for a product. FAWM agreed to this and UK Farming pays FAWM a royalty (investment income) every year.

3. FAWM sold one of its hot air balloons to another company for R50 000.

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**REQUIRED:**

<table>
<thead>
<tr>
<th>MARKS</th>
</tr>
</thead>
<tbody>
<tr>
<td>(a) Calculate the taxable turnover of Fly Away With Me (Pty) Ltd for the year of assessment ended on 28 February 2015</td>
</tr>
<tr>
<td>(b) Assume the taxable turnover is R970 000 for the 2015 year of assessment. Calculate the tax liability of Fly Away With Me (Pty) Ltd on 28 February 2015</td>
</tr>
</tbody>
</table>

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PART B  (5 marks, 6 minutes)

Minora CC is in the process of applying to SARS to be recognised as a small business corporation for income tax purposes. Mr Sharp Blade, the sole member of Minora CC approached you to outline the requirements set by SARS to be regarded as a small business corporation for income tax purposes.

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**REQUIRED:**

<table>
<thead>
<tr>
<th>MARKS</th>
</tr>
</thead>
<tbody>
<tr>
<td>List the requirements set in the Income Tax Act in order to qualify as a small business corporation for income tax purposes</td>
</tr>
</tbody>
</table>

[TURN OVER]
QUESTION 2 (continued)

PART C (10 marks, 12 minutes)

Minora CC is a small business corporation as defined in the Income Tax Act. Minora CC manufactures blades and other cutting products for three South African supermarkets. Minora CC’s year of assessment ends on 31 March 2015. Mr Sharp Blade has provided you with the following information to calculate the tax liability of Minora CC for the year of assessment ended on 31 March 2015.

1. Total sales to South African supermarkets: R12 250 000

2. Purchase of raw materials: R 9 188 000

3. On 1 July 2013, Minora CC purchased a delivery vehicle for R251 500 and brought it into use on the same date. The delivery vehicle was still in use at 31 March 2015.

4. On 2 February 2015 Minora CC purchased a new manufacturing machine at a total cost of R855 000 to be used directly in its process of manufacture. The new machine was brought into use on 5 February 2015.

5. Minora CC sold a computer on 15 January 2015 for R8 000 to a second-hand trading company. The computer was originally purchased on 25 August 2012 for R14 500.

6. During the 2010 year of assessment Minora CC erected a new factory building at a total cost of R12 750 000 and brought the building into use on 1 July 2009.

7. Minora CC experienced a lack of office space and decided to purchase a part of a new commercial building to be used mainly for office space. Minora CC paid R2 230 725 for part of this commercial building and brought it into use on 1 September 2014.

<table>
<thead>
<tr>
<th>REQUIRED</th>
<th>MARKS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Calculate the tax liability of Minora CC for the year of assessment ended on 31 March 2015</td>
<td>10</td>
</tr>
</tbody>
</table>

[TURN OVER]
QUESTION 3  (23 marks, 28 minutes)

PART A  (8 marks, 10 minutes)

Happy Feet CC is a shoe manufacturer, located in Cape Town, South Africa. The close corporation is not a small business corporation as defined in the Income Tax Act. Its year of assessment ends on 28 February 2015. The following information is presented to you:

<table>
<thead>
<tr>
<th>Year of assessment</th>
<th>Date of ITA34 income tax notice of assessment</th>
<th>Taxable income</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012</td>
<td>7 July 2012</td>
<td>R2 999 775</td>
</tr>
<tr>
<td>2013</td>
<td>19 August 2014</td>
<td>R3 258 215</td>
</tr>
<tr>
<td>2014</td>
<td>25 November 2014</td>
<td>R3 687 421</td>
</tr>
<tr>
<td>2015</td>
<td>Estimated – not yet assessed</td>
<td>R4 125 374</td>
</tr>
</tbody>
</table>

REQUIRED:  

(a) Calculate the first provisional tax payment of Happy Feet CC for the 2015 year of assessment  

(b) Calculate the second provisional tax payment of Happy Feet CC for the 2015 year of assessment  

PART B  (15 marks, 18 minutes)

Sit-sit (Pty) Ltd manufactures and sells plastic chairs and its year of assessment ended on 28 February 2015.

The company's factory building was destroyed in a fire on 15 June 2014 and Sit-sit (Pty) Ltd received an indemnity payment of R3 850 000 from its insurance company on 30 June 2014.

The building was acquired on 1 January 2001 for R2 600 000. Valuation costs of R12 000 were paid to a sworn appraiser on 15 February 2002 who determined the market value of the building to be R600 000 as at 1 October 2001. The time apportionment base cost on 1 October 2001 is R736 828 and the total capital allowance claimed on the factory building up to the date it was destroyed, was R1 950 000.

REQUIRED:  

Calculate the taxable capital gain or assessed capital loss for the year of assessment ended on 28 February 2015  

MARKS  

15
QUESTION 4 (25 marks, 30 minutes)

PART A (15 marks, 18 minutes)

Big Slam Pro Shop (Pty) Ltd (Big Slam) sells golfing equipment and golfing clothes at its pro shop and is also responsible for renting golf carts to golfers playing golf at Blue Gum Country Club near Durban in South Africa. Its year of assessment ends on 28 February 2015.

On 28 December 2014, Big Slam hosted a golfing day and all the golf carts were rented out to the participating players.

On 3 January 2015, Big Slam received a claim from John Best, a participant in the golf day hosted on 28 December 2014, for injuries sustained as a result of a golf cart accident on 28 December 2014. The brakes failed and John Best ended up in the dam.

Big Slam and John Best settled the claim out of court on 31 January 2015. Big Slam agreed to pay John Best an amount of R10 500, which was paid on 10 March 2015.

REQUIRED: | MARKS
---|---
(a) Discuss, with reference to case law, whether Big Slam Pro Shop (Pty) Ltd will be able to claim the payment made to John Best as a deduction in terms of the general deduction formula (section 11(a)) for the 2015 year of assessment. | 12
(b) Discuss what the principle "received by" a taxpayer means in the gross income definition by referring to case law. | 3

PART B (10 marks, 12 minutes)

Boxing Gloves (Pty) Ltd is a large retailer of boxing equipment. The company is a resident of the Republic for tax purposes and its year of assessment ends on 28 February 2015. Boxing Gloves (Pty) Ltd has a subsidiary company, Brand New (Pty) Ltd.

REQUIRED: | MARKS
---|---
(a) Discuss how Brand New (Pty) Ltd, a newly registered South African company, will register as a taxpayer for the first time (referring to the formal registration form applicable to companies). In addition, list three types of information the company will need to complete on the form. | 4
(b) Boxing Gloves (Pty) Ltd does not agree with the tax assessment issued by SARS for the 2015 year of assessment. A doubtful debt allowance was disallowed in the assessment process. The tax assessment issued by SARS reflects an amount of R26 450 due and payable to SARS. Boxing Gloves (Pty) Ltd submitted an objection against the tax assessment, but the objection was declined.
Discuss the process that Boxing Gloves (Pty) Ltd can follow to lodge an appeal against the disallowed objection. You do not need to mention any court cases. | 4
(c) Boxing Gloves (Pty) Ltd declares a dividend of R100 000 to Mr Money, its only shareholder.
Calculate the net dividend amount that Mr Money will receive from Boxing Gloves (Pty) Ltd. | 2
ANNEXURE A: EXTRACT FROM THE INCOME TAX ACT (ACT 58 OF 1962, AS AMENDED) – EIGHTH SCHEDULE

25. Determination of base cost of pre-valuation date assets. - The base cost of a pre-valuation date asset (other than an identical asset in respect of which paragraph 32(3A) has been applied), is the sum of the valuation date value of that asset, as determined in terms of paragraph 26, 27 or 28 and the expenditure allowable in terms of paragraph 20 incurred on or after the valuation date in respect of that asset

26. Valuation date value where proceeds exceed expenditure or where expenditure in respect of an asset cannot be determined. - (1) Where the proceeds from the disposal of a pre-valuation date asset (other than an asset contemplated in paragraph 28 or in respect of which paragraph 32(3A) has been applied) exceed the expenditure allowable in terms of paragraph 20 incurred before, on and after the valuation date in respect of that asset, the person who disposed of that asset must, subject to subparagraph (3), adopt any of the following as the valuation date value of that asset-

(a) the market value of the asset on the valuation date as contemplated in paragraph 29,

(b) 20 per cent of the proceeds from disposal of the asset, after deducting from those proceeds an amount equal to the expenditure allowable in terms of paragraph 20 incurred on or after the valuation date, or

(c) the time-apportionment base cost of the asset as contemplated in paragraph 30

(2) Where the expenditure incurred before valuation date in respect of a pre-valuation date asset cannot be determined by the person who disposed of that asset or the Commissioner, that person must adopt any of the following as the valuation date value of that asset-

(a) the market value of the asset on the valuation date as contemplated in paragraph 29, or

(b) 20 per cent of the proceeds from disposal of the asset, after deducting from those proceeds an amount equal to the expenditure allowable in terms of paragraph 20 incurred on or after the valuation date

(3) Where a person has adopted the market value as the valuation date value of an asset, as contemplated in subparagraph (1) (a), and the proceeds from the disposal of that asset do not exceed that market value, that person must substitute as the valuation date value of that asset, those proceeds less the expenditure allowable in terms of paragraph 20 incurred on or after the valuation date in respect of that asset

ANNEXURE B: ADDITIONAL INFORMATION

The income tax rates applicable to a small business corporation are as follows

- 0% on taxable income not exceeding R70 700
- 7% on taxable income exceeding R70 700, but not exceeding R365 000
- R20 601 plus 21% on taxable income exceeding R365 000, but not exceeding R550 000
- R59 451 plus 28% on taxable income exceeding R550 000

[TURN OVER]
The income tax rates applicable to micro businesses:

<table>
<thead>
<tr>
<th>Turnover R</th>
<th>Rates of tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 – 150 000</td>
<td>Nil</td>
</tr>
<tr>
<td>150 001 – 300 000</td>
<td>1% of the amount over R150 000</td>
</tr>
<tr>
<td>301 000 – 500 000</td>
<td>R1 500 + 2% of the amount over R300 000</td>
</tr>
<tr>
<td>500 001 – 750 000</td>
<td>R5 500 + 4% of the amount over R500 000</td>
</tr>
<tr>
<td>750 001 – 1 000 000</td>
<td>R15 500 + 6% of the amount over R750 000</td>
</tr>
</tbody>
</table>

ANNEXURE C: INCOME TAX MONETARY THRESHOLDS SUBJECT TO PERIODIC LEGISLATIVE CHANGE (extract)

<table>
<thead>
<tr>
<th>Description</th>
<th>Reference to Income Tax Act, 1962</th>
<th>Monetary amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Small-scale intellectual property:</td>
<td>Paragraph (aa) of the proviso to section 11(gC)</td>
<td>R5 000</td>
</tr>
<tr>
<td>Intellectual property with a cost below the amount indicated is immediately deductible</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Prepaid expenses:</td>
<td>Paragraph (bb) of the proviso to section 23H(1)</td>
<td>R100 000</td>
</tr>
<tr>
<td>Limit of prepaid expenses that will not be deferred until delivery of goods, services or benefits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Small business corporations:</td>
<td>Section 12E(4)(a)(i)</td>
<td>R20 million</td>
</tr>
<tr>
<td>Corporations qualify for tax incentives if gross income does not exceed the amount referred to</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>