

# **Tutorial Letter 103/3/2018**

## **TAXATION OF SALARIED PERSONS**

**TAX1501**

**Both semesters**

**Department of Taxation**

**STUDY GUIDE 2 OF 2**

**This tutorial letter contains learning units 5 to 8 as well as additional questions to work through.**

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**IMPORTANT INFORMATION:**

Please register on myUnisa, activate your myLife e-mail address, and ensure that you have regular access to the TAX1501-18-S1 OR TAX1501-18-S2 module site on myUnisa, depending on which semester you are registered for.

**Note:** This is an **online module**; therefore, your module is available on myUnisa. However, in order to support you with your studies, you will also receive certain study material in printed format.

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## 1. GENERAL

This document contains learning units 5 to 8. It is the second part of your 'study guide'. Please use this document to guide you through the contents of this module.

**IN ADDITION, REFER TO TUTORIAL LETTER 102, WHICH CONTAINS IMPORTANT INFORMATION YOU NEED TO TAKE NOTE OF.**

We wish you every success with your studies in taxation. Make the most of your opportunity to learn about this dynamic and practical subject. If you work through the learning units diligently and practice the examples on your own, then you will be well on your way to successfully completing this module.

Regards

Your TAX lecturers

The following lecturers are available to assist you:	
Ms R Moosa	012 429 2883
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# LEARNING UNIT 5

# 5

## INTRODUCTION

## STUDY PROGRAMME

## LEARNING OUTCOMES

## PRESCRIBED STUDY MATERIAL FOR THIS LEARNING UNIT

## SECTIONS OF THE PRESCRIBED TEXTBOOK WHICH YOU MAY IGNORE

## CONTENTS

- 5.1 Background
- 5.2 Definition of gross income
- 5.3 Definition of resident
- 5.4 Summary of requirements for gross income
- 5.5 Specific inclusions in gross income
- 5.6 Exempt income

## POINT TO PONDER

## WRAP-UP

## e-TIVITY

## SELF-ASSESSMENT QUESTIONS

## ASSESSMENT CRITERIA

**Gross  
income  
and  
exempt  
income**

## INTRODUCTION

You will remember that the framework for taxable income starts with gross income. This is the starting point or foundation for taxation. The Act gives a definition of “gross income”, which is found in section 1 of the Act. In this learning unit, we will focus on the definition of gross income.

## STUDY PROGRAMME

You should complete this learning unit in **week 6** of the programme.

You should spend a minimum of **eight (8) hours** in **week 6** on this learning unit.

Refer to Tutorial Letter 102 for the study programme.

## LEARNING OUTCOMES

After completing this learning unit, you should be able to

- reproduce the requirements of the definition of gross income
- calculate and apply the physical presence test
- know the basic meaning of each requirement of the gross income definition as described in section 5.4 of the learning unit
- know and apply the exempt portion of interest paid to residents
- know and apply the income tax rules where a taxpayer is married in and out of community of property

## PRESCRIBED STUDY MATERIAL FOR THIS LEARNING UNIT

Chapter 4 in the prescribed textbook.

## SECTIONS OF THE PRESCRIBED TEXTBOOK WHICH YOU MAY IGNORE

Section 4.3

## CONTENTS

### 5.1 Background

*Textbook: section 4.1*

Income received is usually included in gross income and subject to taxation. However, the Act makes provision for certain types of income to be exempt from taxation. After income has been included in gross income, certain amounts may be deducted from gross income, as they are not subject to taxation. You must know what is meant by “gross income” and you must also know which income is classified as exempt. This learning unit will help you understand these two concepts.



Read section 4.1 in the prescribed textbook.

## 5.2 Definition of gross income

*Textbook: sections 4.2 and 4.2.1*

The definition of gross income differs for South African residents and for non-residents.



In this module, we will only focus on **residents**.

The five requirements for the definition of “gross income” are as follows:

- resident
- total amount in cash or otherwise
- year or period of assessment
- received by/accrued to
- excluding receipts or accruals of a capital nature



All of the above requirements must be present before income can be classified as gross income.



Study sections 4.2 and 4.2.1 in the prescribed textbook.

## 5.3 Definition of resident

*Textbook: section 4.2.2*

It is clear from the definition of a resident that a person can be classified as a South African resident either because

- he/she is ordinarily resident in South Africa or
- he/she meets the physical presence requirements



“Ordinarily resident” refers to where a person normally lives, where the person lives with a degree of permanence, and where he/she normally resides apart from temporary or occasional absences. Case law has also defined this term, but in this module, you do not have to know the case law. Look up the meaning of the word “ordinarily” in your dictionary.



Ignore the frame in this section of the prescribed textbook, in which the case-law meaning of “ordinarily resident” is given and only learn the above description of ordinarily resident.






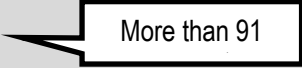
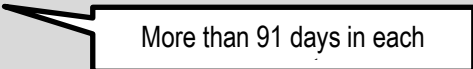
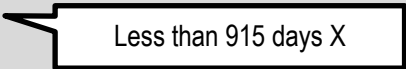

Study the section with the heading “Physical presence”, but don’t attempt example 4.1 yet.



You must know the three requirements of the physical presence test and be able to apply them in a practical situation, otherwise known as a case study.

If a person does not meet the first requirement in the physical presence test, you do not need to go on to the next requirement. The same applies if requirement 2 is not met; you will not have to test for requirement 3.

<p>Work through example 4.1 in the prescribed textbook. Work through parts A, B and C. Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook.</p>	

<p>Marcia works for a French company and she is not ordinarily resident in South Africa. The company sends her to South Africa to gain experience and to establish contacts there. She spent the following days in South Africa:</p> <p>2018: 92 days during the year of assessment  2017: 95 days during the year of assessment  2016: 97 days during the year of assessment  2015: 92 days during the year of assessment  2014: 98 days during the year of assessment  2013: 100 days during the year of assessment</p> <p><b>REQUIRED</b></p> <p>Determine whether Marcia is a resident of South Africa for income tax purposes for the 2018 year of assessment, based on the physical presence test.</p> <p>Cover the answer below and first see if you can do it on your own!</p>	
<p><b>SOLUTION</b></p> <p><b>Requirement 1:</b>  2018 (current year of assessment): 92 days </p> <p><b>Requirement 2:</b>  2013 to 2017 (previous five years): more than 91 days each year in the previous five years </p> <p><b>Requirement 3:</b>  2013 to 2017 (previous five years): total days (95 + 97 + 92 + 98 + 100 = 482 days) </p> <p>Marcia does not comply with the physical presence test; therefore, she is not a resident of South Africa for the 2018 year of assessment.</p>	



For purposes of this module, you can always assume a taxpayer is a resident, unless we ask you to discuss whether a person is a resident or not.



## 5.4 Summary of requirements for gross income

*Textbook: sections 4.2.3 to 4.2.6*

The first requirement of the gross income definition, namely “resident”, was dealt with in section 5.3. We will now briefly discuss each of the other requirements.

### 5.4.1 Year or period of assessment

Taxable income is calculated for 12 months. In the case of a salaried person, the year of assessment starts on 1 March and ends on 28/29 February. This is called the year of assessment or tax year. Income must have been received or accrued during a specific tax period for it to be included in the specific year of assessment.

### 5.4.2 Total amount in cash or otherwise



There must be an amount before it can form part of gross income. Cash means money. “Otherwise” means that instead of money, an asset is given as income. This means that it includes the value of every form of property that the taxpayer earns and it must have an ascertainable money value. An example is a person who buys a new car and trades his or her old car in as part of the selling price of the new car. The car dealer will include the value of the trade-in (old car) as part of the gross income of the sale of the new car. However, whatever is received must have a monetary value.

### 5.4.3 Received by/accrued to

*Received by:* the amount that is **actually received, which must be received to the taxpayer's own benefit**

*Accrued to:* the amount that the taxpayer **becomes entitled to**, even though it has not yet been received

Another important concept is that a taxpayer must be unconditionally entitled to an amount. This means that there must not be any condition attached to the amount.

<p>Work through example 4.2 in the prescribed textbook. This is an example of an amount that accrues to the taxpayer.</p> <p>Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook.</p>	

### 5.4.4 Excluding receipts or accruals of a capital nature

The capital nature of income is determined using two broad types of guidelines – subjective tests and objective tests. The first test, being the subjective test, refers to the intention of the taxpayer. The intention of the taxpayer is measured by looking at his or her actions and reasons as well as the facts of the case. The objective test can be used when the intention of the taxpayer is not clear or if SARS and the taxpayer differ regarding the nature of the income. Objective factors that can play a role in determining the capital nature of income could include the period for which the asset was held or whether the taxpayer was involved in similar transactions before.



Remember, you only need a basic understanding of the requirements and you do not have to know the detailed case-law principles in this module. In your further studies of taxation, you will have to apply the case-law principles to a case study.

## 5.5 Specific inclusions in gross income

*Textbook: none*

We have dealt briefly with the requirements of the gross income definition. You will deal with this definition in much more detail as you continue with your studies in taxation. This definition also includes a list of specific amounts that must always be included in gross income, no matter what the nature of the income is.



In this module, you do not have to know the complete list of special inclusions. However, you must take note that **dividends, fringe benefits and amounts for services rendered** are three of the specific inclusions in gross income.

## 5.6 Exempt income

*Textbook: section 4.4*

Go back to the framework and see where exempt income fits into it. Income could only be exempt if it was included in gross income.



Study section 4.4 in the prescribed textbook, but only the following headings:

- Table 4.1: Framework for calculating normal tax of a natural person
- South African interest paid to South African residents
- South African and foreign dividends





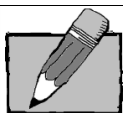



Listen to the podcast on the concept of income under **Additional Resources** on myUnisa.

Foreign dividends and South African dividends also qualify for an exemption. The following is a summary of how foreign dividends and South African dividends, which was received by or has accrued to the taxpayer, is treated.

Foreign dividends	Tax treatment						
Foreign dividends distributed by a company listed on the JSE Limited	<p><b>Full exemption</b></p> <p><i>Example:</i> Foreign dividends received amount to R5 000.</p> <p>Taxable income calculation:</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 80%;">Gross income</td> <td style="text-align: right;">R 5 000</td> </tr> <tr> <td><u>Less: Exemption</u></td> <td style="text-align: right;"><u>(5 000)</u></td> </tr> <tr> <td>Taxable portion</td> <td style="text-align: right;"><u>Nil</u></td> </tr> </table>	Gross income	R 5 000	<u>Less: Exemption</u>	<u>(5 000)</u>	Taxable portion	<u>Nil</u>
Gross income	R 5 000						
<u>Less: Exemption</u>	<u>(5 000)</u>						
Taxable portion	<u>Nil</u>						
Foreign dividends received from a foreign company in which the individual holds at least 10% of total equity shares and voting rights	<p><b>Full exemption</b></p> <p><i>Example:</i> Foreign dividends received amount to R5 000.</p> <p>Taxable income calculation:</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 80%;">Gross income</td> <td style="text-align: right;">R 5 000</td> </tr> <tr> <td><u>Less: Exemption</u></td> <td style="text-align: right;"><u>(5 000)</u></td> </tr> <tr> <td>Taxable portion</td> <td style="text-align: right;"><u>Nil</u></td> </tr> </table>	Gross income	R 5 000	<u>Less: Exemption</u>	<u>(5 000)</u>	Taxable portion	<u>Nil</u>
Gross income	R 5 000						
<u>Less: Exemption</u>	<u>(5 000)</u>						
Taxable portion	<u>Nil</u>						

Foreign dividends	Tax treatment								
Other foreign dividends	<p><b>Exempt portion = 25/45 (ratio exemption)</b></p> <p><i>Example:</i>            Foreign dividends received amount to R5 000.            Taxable income calculation:</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 80%;"></td> <td style="text-align: right;"><b>R</b></td> </tr> <tr> <td>Gross income</td> <td style="text-align: right;">5 000</td> </tr> <tr> <td><u>Less: Exemption (R5 000 x 25/45) =</u></td> <td style="text-align: right;"><u>(2 778)</u></td> </tr> <tr> <td>Taxable portion</td> <td style="text-align: right;"><u>1 829</u></td> </tr> </table>		<b>R</b>	Gross income	5 000	<u>Less: Exemption (R5 000 x 25/45) =</u>	<u>(2 778)</u>	Taxable portion	<u>1 829</u>
	<b>R</b>								
Gross income	5 000								
<u>Less: Exemption (R5 000 x 25/45) =</u>	<u>(2 778)</u>								
Taxable portion	<u>1 829</u>								
<p><b>Note</b>            If the question states the taxable portion of foreign dividends, that amount should be included in the final taxable income.</p>									
Local dividends	Tax treatment								
South African dividends received or accrued to a taxpayer	<p><b>Full exemption</b></p> <p><i>Example</i>            South African dividends received amount to R5 000.            Taxable income calculation:</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 80%;"></td> <td style="text-align: right;"><b>R</b></td> </tr> <tr> <td>Gross income</td> <td style="text-align: right;">5 000</td> </tr> <tr> <td><u>Less: Exemption</u></td> <td style="text-align: right;"><u>(5 000)</u></td> </tr> <tr> <td>Taxable portion</td> <td style="text-align: right;"><u>Nil</u></td> </tr> </table>		<b>R</b>	Gross income	5 000	<u>Less: Exemption</u>	<u>(5 000)</u>	Taxable portion	<u>Nil</u>
	<b>R</b>								
Gross income	5 000								
<u>Less: Exemption</u>	<u>(5 000)</u>								
Taxable portion	<u>Nil</u>								

<p>Work through example 4.4 in the prescribed textbook.</p> <p>Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook.</p> <p>Note that the exemption for South African interest amounts to R23 800, as Mahindra is under the age of 65.</p>	
<p>Work through example 4.5 in the prescribed textbook.</p> <p>Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook.</p> <p>Note that the exemption for South African interest can only be R20 000, as it was the amount that was received. The exemption cannot exceed the amount received because only R20 000 was included in gross income.</p>	
<p>Work through example 4.6 in the prescribed textbook.</p> <p>Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook.</p> <p>Note that there is no exemption for foreign interest received.</p>	



Remember that if a taxpayer is married in community of property, interest, dividend and rental income will be split 50/50 between the husband and wife, and each spouse will be entitled to the full interest and dividend exemption. When we ask a question, we will indicate the type of marriage the taxpayer has.

Carl received South African interest (see amounts below) and South African dividends of R5 000. His wife earned interest of R9 000.

Calculate the **exemption** for interest and dividends received by Carl if

- Carl is 40 years old, earns interest of R11 500 and is married out of community of property
- Carl is 66 years old, earns interest of R36 000 and is married out of community of property
- Carl is 40 years old, earns interest of R11 500 and is married in community of property

Attempt the example without referring to the solution on the next page.



	R
a) Dividend exemption	5 000
Interest exemption	11 500
b) Dividend exemption	5 000
Interest exemption	34 500
c) Dividend exemption (R5 000 x 50%)	2 500
Interest exemption (note)	10 250

**Note**

Carl is married in community of property and he is taxed on 50% of his wife's interest (50% x R9 000) and 50% of his interest (50% x R11 500); thus, R4 500 + R5 750 = R10 250.



**POINT TO PONDER**



- Why are not all the terms used in the gross income definition, for example capital nature, defined in section 1 of the Act?

**WRAP-UP**

- Gross income definition
- Physical presence test
- Requirements of the gross income definition
- Specific inclusions in gross income
- Exempt income



Now that you have completed this learning unit, please revise the learning outcomes to make sure that you have attained all of them.



Visit the **Discussion Forum** and answer the online self-assessment questions.

Revise the learning unit on **gross income** and discuss any concepts that you do not understand, or if you do understand, then answer those students who have posted questions.

### SELF-ASSESSMENT QUESTIONS

Solutions are found at the end of this learning unit.

#### **QUESTION 5.1 (5 marks, 6 minutes)**

- (i) The gross income definition applies to South African residents only.
- (a) True  
(b) False
- (ii) Receipts of capital nature are included in gross income.
- (a) True  
(b) False
- (iii) For an amount to be exempt, it has to be included in gross income.
- (a) True  
(b) False
- (iv) South African dividends are exempt.
- (a) True  
(b) False
- (v) Interest exemption for a taxpayer, who is younger than 65 years, is R23 800 (2017 year of assessment).
- (a) True  
(b) False

REQUIRED	Marks
State whether each of the above statements is true or false.	5

**QUESTION 5.2 (10 marks, 12 minutes)**

Mr Giovanni is ordinarily resident in Italy and not ordinarily resident in South Africa. During a working holiday in 2012, he was in South Africa from 1 April 2012 to 15 February 2013. He enjoyed staying in South Africa so much that he returned and lived in Cape Town from 1 June 2013 to 31 December 2013. During the 2015 year of assessment, he again visited Cape Town from 1 June 2014 to 30 September 2014. During the 2016 year of assessment, he returned to Cape Town, where he lived from 1 October 2015 to 31 December 2015. During the 2017 year of assessment, he was in Cape Town for 100 days. He was in Johannesburg again from 1 September 2017 to 31 January 2018.

REQUIRED	Marks
Indicate if Mr Giovanni is a resident of the Republic for the 2018 year of assessment, based on the physical presence test.	10

**QUESTION 5.3 (10 marks, 12 minutes)**

Sipho, 22 years old, is married in community of property to Betty.

The following information relates to Sipho for the current year of assessment:

	R
Salary	150 000
Bonus (non-pensionable)	18 000
Local dividends	1 900
Local interest	26 000

Betty received local interest of R18 600 during the current year of assessment.

REQUIRED	Marks
Calculate Sipho's gross income and exempt income for the current year of assessment.	10

**QUESTION 5.4 (33 marks, 40 minutes)**

Nolan Richmond is 55 years old and married out of community of property to Suzanne Richmond. They have a ten-year old child, who is still at school. Neither Nolan nor any of his family members have a disability as defined. Nolan's wife and child are dependants on his medical aid.

The following information relates to the year of assessment ended 28 February 2018:

	R
Salary .....	342 000
Bonus .....	28 500
SA local interest received .....	21 110
Foreign interest received .....	4 000
Dividends received from South African companies .....	5 995
Donation made to a public benefit organisation (section 18A receipt received) .....	2 400
Current Pension fund contributions for the year .....	31 493
Medical aid contributions (fully paid by Nolan Richmond) .....	51 000
Qualifying medical expenses not refunded by the medical aid .....	9 125
Current Retirement annuity fund contributions .....	9 600
Repairs paid in respect of a personal computer .....	750
Provisional tax paid in respect of the current year of assessment .....	800
Employees' tax deducted during the year .....	60 500

**QUESTION 5.4 (continued)**

REQUIRED	Marks
(a) Calculate Nolan Richmond's taxable income for the 2018 year of assessment.	20
(b) Calculate Nolan Richmond's net tax liability/(refund) for the 2018 year of assessment.	13

**QUESTION 5.5 (25 marks, 30 minutes)**

Lucy Louw is 38 years old. She is married out of community of property to Jan Louw and has two children, five and eight years old. She had the following income and expenses for the 2018 year of assessment:

	R
<b>Income</b>	
Salary	240 000
Bonus	20 000
South African interest received .....	30 000
Foreign interest received from a foreign company .....	7 000
Foreign dividends received from a foreign company listed on the JSE Ltd.....	5 800
<b>Expenses</b>	
Current contributions to a retirement annuity fund .....	3 600
Contributions to a medical aid fund (note 1).....	?
Donation (note 2).....	27 000
Current contributions to a pension fund (note 3) .....	19 200

**Notes**

- Lucy contributed R400 per month to a medical aid fund for the full tax year and her employer contributed R2 100 per month for the full tax year. She also had other qualifying medical expenses of R13 200. Her husband and two children are dependants on her medical aid. None of them has a disability as defined.
- Lucy donated R27 000 to Unisa and received a section 18A certificate.
- Lucy contributed 8% of her salary to the pension fund each month throughout the full tax year.

REQUIRED	Marks
a) Calculate Lucy Louw's taxable income for the 2018 year of assessment.	17
b) Calculate Lucy Louw's net normal tax for the 2018 year of assessment.	8



Go to section 4.6 in the prescribed book and attempt answering all the questions.

The solutions are found at the back of the prescribed book.

**ASSESSMENT CRITERIA**

We could assess this learning unit in assignments or in the examination by asking you to

- recall and briefly explain the requirements of the gross income definition
- apply the physical presence test to a practical situation
- calculate the exempt portion of interest and dividends for taxpayers who are married in and out of community of property

**Solutions to self-assessment questions in learning unit 5**

**QUESTION 5.1 (5 marks)**

- (i) False
- (ii) False
- (iii) True
- (iv) True
- (v) True

**QUESTION 5.2 (10 marks)**

**Solution**

Requirement 1:

2018 (current year of assessment): 126 days More than 91 days✓ (1)

Requirement 2:

2013 to 2017 (previous five years): more than 91 days each year in the previous five years (2017: **100**; 2016: **92**; 2015: **122**; 2014: **214**; 2013: **321**) (3)

Requirement 3:

2013 to 2017 (previous five years): total days (100 + 92 + 122 + 214 + 321 = 849 days) Less than 915 daysX (5)

Mr Giovanni does not comply with the physical presence test and he is therefore not a resident of South Africa in the 2018 year of assessment. (1)

**QUESTION 5.3 (10 marks)**

Sipho's gross income is as follows:

	R	
Salary	150 000	(1)
Bonus	18 000	(1)
Local dividends (50% x R1 900)	950	(2)
Interest – himself (50% x R26 000)	13 000	(2)
– wife (50% x R18 600)	<u>9 300</u>	(2)
Gross income	191 250	

**Exempt income**

Dividends	(950)	(1)
Interest exemption of R23 800 limited to	<u>(22 300)</u>	(1)
	<u>168 000</u>	

**10**

**QUESTION 5.4 (33 marks)**

(a)	R	R	R	
Salary			342 000	(1)
Bonus			28 500	(1)
Foreign interest			4 000	(1)
Local interest	21 110			(1)
Less: Exemption of R23 800 limited to	<u>(21 110)</u>		Nil	(1)
Local Dividends	5 995			(1)
Less: Exemption	<u>(5 995)</u>		Nil	(1)
<b>Subtotal</b>			<u>374 500</u>	



**QUESTION 5.4 (continued)**

	R	
<u>Less: Expenses</u>		
Repairs to computer (not allowed ito sec 23)	-	(1)
<u>Less: Contributions to retirement funds</u>		
Actual contributions R31 493 + R9 600 = R41 093		(2)
<b>STEP 1: Percentage limit</b>		
27.5% of greater of remuneration or taxable income before this deduction		
- Remuneration: R342 000 + R28 500 = R370 500		(2)
- Taxable income before this deduction: R374 500		(1)
The greater of the two amounts is the taxable income		
Therefore: 27.5% x R 374 500 = R102 988		(2)
<b>STEP 2: Limited to the lessor of:</b>		
1) <b>R102 988</b> or		(1)
2) <b>R350 000</b>		
The lessor of the two amounts is R102 988 and would be the limitation.		(1)
The contributions was however less than the limit and all of the contributions can therefore be deducted	(41 093)	(1)
	<hr/>	
	333 407	
<u>Less: Donations – R2 400</u>		
Limited to 10% x R333 407 <b>(1)</b> = R33 341, therefore	<hr/>	(2)
	(2 400)	
Taxable income	<hr/>	
	331 007	
		<b>Total: 20 marks</b>
<b>(b)</b>	R	R
Tax per tables – 2018 = [(R331 007 – R296 540) x 31%] + R61 910		72 595
		(2)
<u>Less: Rebates</u>		(13 635)
		(1)
<u>Less: Medical scheme fees tax credit [(R303 x 2) + R204] x 12 months</u>		(9 720)
		(2)
<u>Less: Medical expense tax credit</u>		-
		(1)
Medical aid contributions	51 000	(1)
<u>Less: 4 x medical scheme fees tax credit (4 x R9 720)</u>	<hr/>	(2)
	(38 880)	
Excess	12 120	
<u>Plus: Other qualifying expenses</u>	<hr/>	(1)
	9 125	
	21 245	
<u>Less: 7.5% of taxable income (7,5% x R331 007)</u>	<hr/>	(1)
	(24 826)	
	0	
Net normal tax	<hr/>	49 240
<u>Less: Provisional tax</u>		(800)
Employees tax deducted	<hr/>	(1)
	(60 500)	(1)
SARS owes Nolan Richmond <b>(1)</b>	<hr/>	(12 060)
		<b>Total: 13 marks</b>

**QUESTION 5.5 (25 marks)****Part A (17 marks)**

	R	R	
Salary		240 000	(1)
Bonus		20 000	(1)
SA interest received	30 000		
<u>Less: Exemptions</u>	<u>(23 800)</u>	6 200	(1)
Foreign interest received		7 000	(1)
Foreign dividends received	5 800		
<u>Less: Exemption</u>	<u>(5 800)</u>	0	(1)
Medical – fringe benefit			
– employer contribution: R2 100 x 12 = R25 200		<u>25 200</u>	(1)
		298 400	
<u>Less: Retirement fund contributions</u>		<u>(22 800)</u>	(1)
Actual contributions: R3 600 (1) + (8% x R240 000) (1)			
= R22 800			

**Step 1: Calculate the percentage limit:**

27.5% of the greater (1) of remuneration or taxable income before this deduction

- Remuneration: R240 000 + R20 000 = R260 000 (1)
- Taxable income before this deduction: R298 400 (1)

The greater of the two amounts is the taxable income

Therefore R298 400 x 27.5% = **R82 060** is the first limit

**Step 2: Limited to the lessor (1) if:**

- 1) **R82 060** or
- 2) **R350 000 (1)**

The lesser of the two amounts is R82 060 and would be the limitation.

The contributions < limit, therefore all of the contributions can be deducted

	<u>275 600</u>		
<u>Less: Donation</u>	<u>(27 000)</u>	(1)	
R27 000, but limited to 10% (1) x R275 600 (1) = R27 560			
<b>Taxable income</b>	<u>248 600</u>		
			<u><u>17</u></u>

**Part B (8 marks)**

	R	
<b>Taxable income</b>	248 600	
Normal tax [(R248 600 – R189 880) x 26% + R34 178]	49 445	(1)
<u>Less: Rebate</u>	<u>(13 635)</u>	(1)
<u>Less: Medical scheme fees tax credit [(R303 x 2) + (R204 x 2)] x 12</u>	<u>(12 168)</u>	(1)
<u>Less: Medical expense tax credit</u>		
Medical aid contribution (R4 800 (1) + R25 200)	30 000	
<u>Less: 4 x medical scheme fees tax credit (4 (1) x R12 168)</u>	<u>(48 672)</u>	
Excess	0	
<u>Plus: Qualifying medical expenses</u>	<u>13 200 (1)</u>	
	13 200	
<u>Less: 7,5% x taxable income (7,5% x R248 600) (1)</u>	<u>(18 645)</u>	
	0	(1)
<b>Net normal tax</b>	<u><u>23 642</u></u>	

**Total: 8 marks**

## LEARNING UNIT 6

# 6

### INTRODUCTION

### STUDY PROGRAMME

### LEARNING OUTCOMES

### PRESCRIBED STUDY MATERIAL FOR THIS LEARNING UNIT

### SECTIONS OF THE PRESCRIBED TEXTBOOK WHICH YOU MAY IGNORE

### CONTENTS

- 6.1 Background
- 6.2 Definition of general deduction formula
- 6.3 Carrying on a trade
- 6.4 Summary of the requirements for the general deduction formula
- 6.5 Prohibited deductions

### POINT TO PONDER

### WRAP-UP

### e-TIVITY

### SELF-ASSESSMENT QUESTIONS

### ASSESSMENT CRITERIA

## General deduction formula

## INTRODUCTION

Take a look again at the framework at the beginning of chapter 5 in the prescribed textbook. We are now at the point of the framework where general deductions may be deducted from the income. In this learning unit, we will look at what expenses a person earning a salary is allowed to deduct from taxable income. In taxation, we refer to expenses, which are allowed to reduce taxable income, as “deductions”. In this learning unit, we will look at deductions of a general nature.

## STUDY PROGRAMME

You should complete this learning unit in **week 6 and 7** of the programme.

You should spend a minimum of **two (2) hours in week 6 and six (6) hours in week 7** on this learning unit.

Refer to Tutorial Letter 102 for the study programme.

## LEARNING OUTCOMES

After completing this learning unit, you should be able to

- list and briefly explain each of the requirements for the definition of the general deduction formula
- explain the definition of trade and be able to explain what is meant by “carrying on a trade”
- list the prohibited deductions
- list the deductions that a salaried person may claim in terms of section 23(m)

## PRESCRIBED STUDY MATERIAL FOR THIS LEARNING UNIT

Chapter 5 in the prescribed textbook.

## SECTIONS OF THE PRESCRIBED TEXTBOOK WHICH YOU MAY IGNORE

Sections 5.4, 5.5 and 5.6

## CONTENTS

### 6.1 Background

*Textbook: section 5.1*

The Act allows certain deductions against the income from a taxpayer. These deductions can be specific, for example, retirement contributions and donations, or they may be of a general nature. We need to combine a couple of sections in the Act to see if an expense is deductible for income tax purposes.

Refers to trade (we need to look at the definition of trade). This is found in section 1 of the Act, with all the other definitions.

Requirements for deducting expenses are found in section 11. Sections 11 to 19 list all the deductions from income. Section 11(a) specifically lists the requirements for deducting general expenses.

This could mean that many expenses may be deducted. The Act gives us a list of deductions that are **not** allowed (prohibited) – this may be found in section 23.

The workings of these three sections are referred to as the “general deduction formula”. In this learning unit, we will consider the requirements for deducting an expense of a general nature, the meaning of trade, and lastly some of the expenses that may **not** be deducted for income tax purposes.



Read section 5.1 in the prescribed textbook.

**6.2 Definition of the general deduction formula**

***Textbook: section 5.2***



Study section 5.2 in the prescribed textbook.

The requirements of the general deduction formula are as follows:

- carrying on a trade
  - expenditure and losses
  - actually incurred
  - in the production of income
  - not of a capital nature
  - partially or fully expended for the purposes of trade
- ← } Definition of trade

Section 11(a) requirements

← Section 23(g)



**All** of the above requirements must be present before an amount can be deducted.

### 6.3 Carrying on a trade

*Textbook: section 5.2.1*



Study section 5.2.1 with the heading “Carrying on a trade” in the prescribed textbook.

It is clear from the definition that

- it has a very wide meaning and **includes** earning a salary
- it **includes** rental
- it **excludes** interest and dividend income.



If the taxpayer is not carrying on a trade (as defined), he or she will not be allowed to deduct general expenses from income received.

A person who speculates in shares is carrying on a trade, but a person who incurs expenses related to his or her hobby (e.g. stamp collecting) is not carrying on a trade.

As “employment” is defined as a trade, a person earning a salary may deduct expenses of a general nature in terms of section 11(a) requirements. However, section 23(m) would limit the deductions available to a salaried individual.

### 6.4 Summary of the requirements for the general deduction formula

*Textbook: section 5.2.2*

For expenses of a general nature to be deductible for income tax purposes by a person earning a salary, there must be a trade (as we saw above). We also saw that earning a salary is defined as a trade for income tax purposes. We will now briefly consider each of the other requirements for an expense to be deducted for income tax purposes. Remember that if the taxpayer has an expense, it must comply with **all** the requirements.

#### 6.4.1 Expenditure and losses

There is no significant difference between the two concepts. An expense is payment in return for goods or services. A loss is an expense of an involuntary nature, for example stock that was burned in a fire.

#### 6.4.2 Actually incurred

The taxpayer has to pay the amount of the expense and no condition may be attached to the liability.

#### 6.4.3 In the production of income

The expense must have the purpose of producing income. This is usually a difficult requirement to test. The test deals with whether the expense can be closely linked to the activities that produce the income that will be taxed.

#### 6.4.4 Not of a capital nature

This means that the expense cannot be expended to contribute to the taxpayer’s income-producing “structure”. The expense must be in terms of the running of the trade. Expenses that are expended in respect of a taxpayer’s structure normally result in creating something that will benefit the taxpayer’s trade for a long period (enduring benefit), for example, buying a building or machinery. This type of expense is of a capital nature and it is therefore not deductible for income tax purposes. On the other hand, the purchase of stationery does not create an enduring benefit (stationery is used as soon as it is purchased). We call that kind of expense a revenue expense and it is deductible for income tax purposes, as long as all the other requirements are met.

### 6.4.5 Partially or fully expended for the purposes of trade

This means that the expense can be apportioned (divided) into the part of the expense that relates to trade and the part that does not relate to trade. For example, if stationery is purchased and some of it is used for private purposes, only the portion of the stationery used in the trade will be deductible.



Remember you only need a basic understanding of the requirements and you do not have to know the names and details of case law in this module. In your further studies of taxation, you will have to apply the case law to a case study.

### 6.5 Prohibited deductions

**Textbook: section 5.3**

The Act provides a list in section 23 of the amounts that cannot be deducted (prohibited deductions) from income.



In this module, you do not have to know the complete list of prohibited deductions. You do have to know that the following deductions are prohibited:

- **domestic and private expenses**, for example groceries, cellphone expenses, etc.
- **finances**, for example traffic fines
- **expenses relating to employment** (Section 23(m) in the Act gives a list of expenses relating to employment, which are deductible.)

Section 23(m) is the most important section for the purposes of this module. Section 23(m) states that a person earning income from employment **only**, may **not** deduct any expenses, except the ones that are listed in this section (see below). Therefore, unlike the other prohibited deductions, subsection (m) first prohibits all deductions for persons earning salaries and then lists the deductions that a salaried person **can** deduct from his or her salary income.



In this module, you must know that the following deductions are allowable for a salaried person (in terms of section 23(m)):

- legal expenses relating to salary/employment issues (CCMA proceedings)
- wear and tear on an asset that is used regularly for the job (This is calculated using the cost of the asset and dividing it by the useful life of the asset. This allowance is apportioned for the number of months the asset was used in the year of assessment.)
- home office expenses if the job requires a home office
- retirement fund contributions (remember the order of deductions)
- donations



Study the applicable prohibited deductions and section 23(m) in section 5.3 of the prescribed textbook.

### POINT TO PONDER

- Why may a salaried person not deduct school fees as a deduction?



## WRAP-UP

Order	Gross income	
	Less: Exempt income	
	Income	
	Less: General deductions	
	Less: Retirement fund contributions	
	Taxable income before donations	
	Less: Donations to PBOs	
	Taxable income	

- Trade requirement
- Section 11(a) requirements
- Section 23(m) – allowable deductions for salary earners



Now that you have completed this learning unit, please revise the learning outcomes to make sure that you have attained all of them.



Visit the **Discussion Forum** and answer the online self-assessment questions. Revise the learning unit on the **general deduction formula** and discuss any concepts that you do not understand, or if you do understand, answer those students who have posted questions.

## SELF-ASSESSMENT QUESTIONS

Solutions are found at the end of this learning unit.

### QUESTION 6.1 (5 marks, 6 minutes)

- (i) Which of the following is **not** one of the requirements for the general deduction formula?
- a trade
  - expenditure or losses
  - in the production of income
  - in the production of exempt income
- (ii) Trade does **not** include income earned from ...
- rentals.
  - salary.
  - dividends.
  - speculation in shares.
- (iii) Alice Wonder is a salaried person and incurred the following expenses during the year of assessment:

	R
Income protection premiums	800
Contributions to a retirement funds	6 200
Expenses relating to her house	2 300
Donation to a public benefit organisation (section 18A receipt obtained)	5 000



**QUESTION 6.1 (continued)**

Which of the expenses she incurred will be allowed as deductions (although some might be subject to limitations) by Alice in the calculation of her taxable income?

- (a) contributions to retirement funds and donation made
  - (b) expenses relating to her house and retirement fund contributions
  - (c) income protection premiums and retirement fund contributions
  - (d) income protection premiums, retirement fund contributions and donation made
- (iv) A salaried person is allowed to deduct the following when calculating taxable income:
- (a) retirement fund contributions
  - (b) medical aid fund contributions
  - (c) personal loan repayments
  - (d) private expenses
- (v) A salaried person is allowed to deduct ...
- (a) wear and tear on assets used regularly for personal use.
  - (b) wear and tear on assets used regularly for business use.
  - (c) wear and tear on private assets.
  - (d) wear and tear on assets owned by the employer.

**QUESTION 6.2 (9 marks, 11 minutes)**

Mike Baker owns a bakery and coffee shop. A customer lost a finger when he used the bread-slicing machine that is available to customers who purchase bread at the bakery. Mike was liable for the compensation that was paid to the customer. He would like to claim the compensation as a tax deduction.

<b>REQUIRED</b>	<b>Marks</b>
Discuss whether Mike will be able to claim the expense in terms of the general deduction formula.	<b>9</b>

**QUESTION 6.3 (9 marks, 11 minutes)**

Tessa Hardwork is a personal assistant to the financial director of a company. She would like to deduct the cost of dresses that she bought to wear to work. She feels that she would not have purchased these dresses if she did not go to work.

<b>REQUIRED</b>	<b>Marks</b>
Discuss whether Tessa will be able to claim the expense in terms of the general deduction formula.	<b>9</b>

**QUESTION 6.4 (11 marks, 13 minutes)****Company:** Jennifer's CATERING**Section:** Tax deduction of expenses

I incurred the following costs relating to my business, which, I suppose, will be deductible.

I am a caterer who works from home. I use my existing kitchen, which occupies 10% of the floor area of my home, to prepare the food for my catering business. I have also built an additional storeroom in which to store the crockery and groceries used for my catering activities. Two thirds of my account at the local supermarket relates to my catering business, and the account is always settled at the end of the month following the month in which the purchases are made. My total account is R22 400 a month.

I pay R6 800 a month to a full-time assistant in my catering business. I also paid my teenage son R3 000 during the year of assessment for assisting as a waiter at functions. Had I hired a waiter, it would have cost me R4 000.

REQUIRED	Marks
<p>For each of the following expenses, indicate if it will be deductible in terms of the general deduction formula (section 11(a), read with section 23).</p> <ul style="list-style-type: none"> <li>• grocery account at the local supermarket <b>(3)</b></li> <li>• salary of assistant <b>(2)</b></li> <li>• salary of teenage son <b>(1)</b></li> </ul> <p><b>Note:</b> Provide the general deduction formula requirements. <b>(5)</b></p>	<b>11</b>

**QUESTION 6.5 (20 marks, 24 minutes)****PART A**

During the year of assessment, Mavis Tau (a South African resident) lost her job and as a result, she decided to sell her car. She bought the car in 2012, and sold it for R80 000 cash during the year of assessment.

REQUIRED	Marks
<p><u>List</u> the requirements of the definition of gross income in terms of section 1 of the Income Tax Act and apply the information provided to determine whether Mavis should include the R80 000 in her gross income.</p>	<b>10</b>

**PART B**

John Blanc was employed by the South African Police Service for the **full year**. During the year of assessment, John Blanc paid R6 000 for his DSTV subscription for personal use.

REQUIRED	Marks
<p><u>List</u> the requirements of the general deduction formula <u>and apply the information provided</u> to determine if John will be allowed to deduct the DSTV subscription for the 2018 year of assessment.</p>	<b>10</b>



Go to section 5.8 in the prescribed book and attempt answering all the questions. The solutions are at the back of the prescribed book.

### ASSESSMENT CRITERIA

We could assess this learning unit in assignments or in the examination by asking you to

- list and briefly explain each of the general deduction formula requirements
- explain the meaning of “carrying on a trade”
- list some of the prohibited deductions
- identify and list the deductions that a salaried person may deduct (section 23(m))  
(You could also be asked to apply these rules in a practical case study.)

### Solutions to self-assessment questions in learning unit 6

#### QUESTION 6.1 (5 marks)

- (i) d
- (ii) c
- (iii) a
- (iv) a
- (v) b

#### QUESTION 6.2 (9 marks)

The requirements of the general deduction formula are as follows:

- A trade must be carried on. **(1)**
- There must be an expense or a loss. **(1)**
- It must be actually incurred. **(1)**
- It must be in the production of income. **(1)**
- It must not be of a capital nature. **(1)**
- It must be expended partially or fully for the trade. **(1)**

In order for Mike to claim the expense, all requirements must be met:

- Mike carries on a trade, as he owns a bakery and coffee shop. **(1)**
- Compensation was paid and therefore, there was an expense. **(1)**
- The compensation was paid and therefore, it was actually incurred. **(1)**
- The expense needs to be closely connected to the activities that produce income. The compensation for the injury is not closely connected to the income produced by the selling of bread. **(1)**
- The expense does not create an income-producing structure and no enduring benefit is created. **(1)**
- The expense was fully incurred for trade. **(1)**

Compensation is not deductible, as it does not comply with all the requirements.

**(1)**

**Max: 9**

**QUESTION 6.3 (9 marks)**

The requirements of the general deduction formula are as follows:

- A trade must be carried on. **(1)**
- There must be an expense or a loss. **(1)**
- It must be actually incurred. **(1)**
- It must be in the production of income. **(1)**
- It must not be of a capital nature. **(1)**
- It must be expended partially or fully for the trade. **(1)**

All five requirements must be met.

For Tessa to claim the expense, all requirements must be met:

- She carries on a trade because she earns a salary. **(1)**
- She incurred an expense when she purchased the dresses. **(1)**
- She paid for the dresses and she would have actually incurred the expense. **(1)**
- It is not closely connected to the activities that produce income because she can wear the dresses for private purposes. **(1)**
- It is not of a capital nature since it is not part of her income-producing structure and no enduring benefit is created. **(1)**
- It is partially expended (she could wear it for other purposes and not only at work). **(1)**

Purchases of dresses are not deductible, as they do not comply with all the requirements. **(1)**

**Max: 9**

**QUESTION 6.4 (11 marks, 13 minutes)**

An expense is deductible in terms of the general deduction formula if the following requirements are met:

The preamble of section 11 requires that the expense must be laid out for the purposes of a trade. Jennifer is **carrying on a trade, (1)** as she is in the business of providing catering.

- expenditure or losses **(1)**
- actually incurred **(1)**
- in the production of income **(1)**
- during the year of assessment **(1)**
- not of a capital nature **(1)**

**Maximum marks: 5**

**Grocery account at the local supermarket**

- The expenses were actually incurred and are deductible **(1)** in the year of assessment when they were incurred, not in the year of assessment in which they were paid.
- Furthermore, they were incurred in the production of her income and are not of a capital nature. **(1)**
- As only a the portion of her expenses relating to her trade may be deducted, two thirds **(1)** of her total grocery account expenses were incurred during the year of assessment and are deductible in terms of section 11(a) read with section 23(g).

**Maximum marks: 3**

**Salary of assistant**

- The amount of R6 800 a month paid to the catering assistant is deductible **(1)** in terms of section 11(a), as it is an expense or a loss, actually incurred in the production of Jennifer's income and not of a capital nature. **(1)**

**Maximum marks: 2**

**QUESTION 6.4 (continued)****Salary of teenage son**

- The R3 000 Jennifer paid and incurred for her teenage son during the year of assessment for his assistance as a waiter at functions is also deductible **(1)** in terms of section 11(a), as it is an expense, actually incurred, in the production of income, not of a capital nature.

**Maximum marks: 1****QUESTION 6.5 (20 marks)****PART A**

Gross income:

- *In the case of a resident (1)* – Mavis is a South African resident. **(1)**
- *Total amount in cash or otherwise (1)* – Mavis received an amount of R80 000 in cash. **(1)**
- *Received by or accrued to (1)* – The money was actually received by Mavis. **(1)**
- *During the year of assessment (1)* – The money was received during the year of assessment. **(1)**
- *Excluding receipts and accruals of a capital nature (1)* – The car was capital in nature (it was an investment and not kept for speculative purposes). **(1)**

**Conclusion**The amount **cannot** be included in gross income because it is **capital in nature**. **(1)****Total: 10 marks****PART B**

General deduction formula:

- *Carrying on a trade (1)* – Expenditure was not incurred for trade purposes but for personal use. **(1)**
- *Expenditure or losses (1)* – Paying the DSTV subscription is an expense. **(1)**
- *Actually Incurred (1)* – The amount (money) was paid, therefore it was incurred. **(1)**
- *In the production of income (1)* – This is for his personal use and not in the production of income. **(1)**
- *During the year of assessment (1)* – He paid the amount during the year of assessment. **(1)**
- *Not of a capital nature (1)* – Paying the subscription is not like buying an asset (it does not create an enduring benefit); therefore, it is not capital in nature. **(1)**

**Conclusion**

The amount will not be allowed as a deduction for the year of assessment.

**(1)****Total 13 marks  
Maximum of 10 marks**



# LEARNING UNIT 7

**INTRODUCTION**

**STUDY PROGRAMME**

**LEARNING OUTCOMES**

**PRESCRIBED STUDY MATERIAL FOR THIS LEARNING UNIT**

**SECTIONS OF THE PRESCRIBED TEXTBOOK WHICH YOU MAY IGNORE**

## **CONTENTS**

- 7.1 Background
- 7.2 Right of use of motor vehicle
- 7.3 Meals, refreshments and vouchers
- 7.4 Residential accommodation
- 7.5 Low-interest loans
- 7.6 Contributions to medical and retirement funds
- 7.7 Travel allowance
- 7.8 Subsistence allowance

**POINT TO PONDER**

**WRAP-UP**

**e-TIVITY**

**SELF-ASSESSMENT QUESTIONS**

**ASSESSMENT CRITERIA**

# 7

**Fringe  
benefits**

## INTRODUCTION

In this learning unit, we will consider the different fringe benefits and allowances and how they are taxed. A fringe benefit arises between an employer and employee and it is a form of payment for work done by the employee for the employer.

## STUDY PROGRAMME

You should complete this learning unit in **week 7 and 8** of the programme.

You should spend a minimum of **four (4) hours in week 7 and ten (10) hours in week 8** on this learning unit.

Refer to Tutorial Letter 102 for the study programme.

## LEARNING OUTCOMES

After you have completed this learning unit, you should be able to

- describe the meaning of the term “fringe benefit”
- calculate the cash equivalent of the following fringe benefits:
  - right of use of a motor vehicle
  - meals and refreshments or vouchers
  - residential accommodation
  - low-interest loans
  - Contributions paid by the employer on behalf of the taxpayer
- calculate the taxable value of the following allowances:
  - travelling allowance
  - subsistence allowance

## PRESCRIBED STUDY MATERIAL FOR THIS LEARNING UNIT

Chapter 6 in the prescribed textbook.

## SECTIONS OF THE PRESCRIBED TEXTBOOK WHICH YOU MAY IGNORE

Sections 6.2.1, 6.2.2, 6.2.6 and 6.2.9 to 6.2.12



## CONTENTS

### 7.1 Background

*Textbook: sections 6.1 and 6.2*

In this learning unit, we will look at how the different fringe benefits and allowances are taxed. A person can receive fringe benefits as well as cash, which together make up his or her salary received from the employer. Fringe benefits fall under gross income. Refer to the framework in previous learning units.



Read section 6.1 in the prescribed book.



For purposes of this module, we will only deal with the following fringe benefits and allowances:

- right of use of a motor vehicle
- meals, refreshments, and meal and refreshment vouchers
- residential accommodation (including holiday accommodation)
- low-interest loans
- contributions to funds
- travel allowance
- subsistence allowance



Study section 6.2 in the prescribed textbook.

### 7.2 Right of use of motor vehicle



*Textbook: section 6.2.3*





Study section 6.2.3 in the prescribed textbook.

This benefit arises when an employer gives an employee the use of a **company-owned** car for private use. A value must be placed on this private use.

<p>Work through example 6.4.</p> <p>Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook.</p> <p>Please note that the determined value of the vehicle <b>includes VAT</b> but <b>excludes</b> finance charges.</p>	

<p>Work through example 6.5 and 6.6.</p> <p>Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook.</p> <p>Did you see that the percentage used is 3.25% because the cost price of the vehicle includes a maintenance plan?</p>	

<p>Work through example 6.11.</p> <p>Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook.</p> <p>Did you see that the determined value is reduced by 15% for each completed period of 12 months?</p>	



The above calculation of the cash equivalent assumes that the vehicle is **not** used at all for business purposes **and** that the employer pays for **all** operating expenses of the vehicle.

In this module, this will always be the assumption and you **do not have to know the calculations in examples 6.7, 6.8, 6.9 and 6.10 (adjustments by the Commissioner on assessment)**.

However, you need to study the two paragraphs before example 6.11. If an employer gives the employee a vehicle that has already been used by someone else, provision has been made to reduce the determined value of the vehicle. The determined value is reduced by 15% for each completed 12-month period from the date that the vehicle was purchased until the date that the employee received the right of use. Please refer to example 6.11.



Listen to the podcast on the use of a motor vehicle under **Additional Resources** on myUnisa.


### 7.3 Meals, refreshments and vouchers

*Textbook: section 6.2.4*

The cash equivalent is the cost of the meal to the employer, less any amount paid by the employee.



Study section 6.2.4 in the prescribed textbook.

<p>Work through example 6.12.</p> <p>Try to complete it on your own without referring to the solution.</p>	
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The solution is available in the prescribed textbook.  
If these meals were provided in the employer's canteen, they would not be a fringe benefit.



#### 7.4 Residential accommodation

*Textbook: section 6.2.5*

The employee receives the use of residential accommodation. This accommodation may be owned by the employer or not owned by the employer or the employee may have an interest in the accommodation. For each of these circumstances, different rules will apply to calculate the cash equivalent of the benefit.

Holiday accommodation can also be provided to an employee, and then the cash equivalent of this benefit must also be calculated.



Study section 6.2.5 in the prescribed textbook.

Work through example 6.13.

Try to complete it on your own without referring to the solution.



The solution is available in the prescribed textbook.

This calculation is in respect of accommodation **owned by the employer**.



Work through example 6.14.

Try to complete it on your own without referring to the solution.



The solution is available in the prescribed textbook.

Kelly has an interest in the accommodation and the accommodation is not owned by the company; thus, different rules apply than those in example 6.13.



Work through example 6.15.

Try to complete it on your own without referring to the solution.



The solution is available in the prescribed textbook.

Holiday accommodation was provided to Ben. Ben did not pay anything for the use of the accommodation; therefore, no deduction is set off against the cash equivalent of R10 000.



## 7.5 Low-interest loans

*Textbook: section 6.2.7*







If an employee borrows money from his or her employer, a fringe benefit arises if the employer charges less interest than the official interest rate.



The official interest rate is available on the SARS website. When we ask a question, we will provide you with the official interest rate if necessary.



Study section 6.2.7 in the prescribed textbook.

<p>Work through example 6.16.</p> <p>Try to complete it on your own without referring to the solution.</p>															
<p>The solution is available in the prescribed textbook.</p> <p>Do you see that the fringe benefit is the difference between the interest rates of 6,5% and 6%?</p>															
<p>Work through example 6.17.</p> <p>Try to complete it on your own without referring to the solution.</p>															
<p>The solution is available in the prescribed textbook.</p> <p>Do you see that the fringe benefit is the difference between the interest rates of 6,5% and 4%?</p>															
<p>Betty Barbo's employer granted her a low interest loan on 1 April 2016. The initial loan was for R100 000 and the loan carries interest at 2,5%. She is required to repay R10 000 every six months. On 1 March 2017, the official interest rate was 8%. On 1 November 2017, the official interest rate changed to 7%.</p> <p>Calculate the taxable portion of the fringe benefit for the 2018 year of assessment.</p>															
<p>The following time line represents all of the changes to the outstanding loan balance as well as changes in the official interest rate. We must calculate the fringe benefit for the 2018 year of assessment and we therefore require the outstanding loan balance on 1 March 2017.</p> <table border="1" data-bbox="140 1749 1238 2007"> <thead> <tr> <th>1 April 2016</th> <th>30 September 2016</th> <th>1 March 2017</th> <th>31 March 2017</th> <th>30 September 2017</th> <th>1 November 2017</th> <th>29 February 2018</th> </tr> </thead> <tbody> <tr> <td>Loan granted of R100 000</td> <td>Repaid R10 000</td> <td>New year of assessment. Outstanding loan balance: R90 000</td> <td>Repaid R10 000. Balance R80 000</td> <td>Repaid R10 000. Balance R70 000</td> <td>Change in official interest rate</td> <td>End of 2017 year of assessment</td> </tr> </tbody> </table>	1 April 2016	30 September 2016	1 March 2017	31 March 2017	30 September 2017	1 November 2017	29 February 2018	Loan granted of R100 000	Repaid R10 000	New year of assessment. Outstanding loan balance: R90 000	Repaid R10 000. Balance R80 000	Repaid R10 000. Balance R70 000	Change in official interest rate	End of 2017 year of assessment	
1 April 2016	30 September 2016	1 March 2017	31 March 2017	30 September 2017	1 November 2017	29 February 2018									
Loan granted of R100 000	Repaid R10 000	New year of assessment. Outstanding loan balance: R90 000	Repaid R10 000. Balance R80 000	Repaid R10 000. Balance R70 000	Change in official interest rate	End of 2017 year of assessment									

<p>1 March 2017 – 31 March 2017  <math>R90\,000 \times (8\% - 2,5\%) \times 1/12 = R413</math></p> <p>1 April 2017 – 30 September 2017  <math>R80\,000 \times (8\% - 2,5\%) \times 6/12 = R2\,200</math></p> <p>1 October 2017 – 31 October 2017  <math>R70\,000 \times (8\% - 2,5\%) \times 1/12 = R321</math></p> <p>1 November 2017 – 28 February 2018  <math>R70\,000 \times (7\% - 2,5\%) \times 4/12 = R1\,050</math></p> <p>Total fringe benefit: R3 984 (R413 + R2 200 + R321 + R1 050)</p> <p>Remember, with every change in a variable, a new calculation needs to be performed.</p>	
--	--

## 7.6 Contributions to funds

*Textbook: section 6.2.8 and 6.2.13*

The total contributions paid by the employer on behalf of the taxpayer constitute a fringe benefit.



Remember, if you are over 65 and **not** retired, the contributions paid by your employer for medical aid constitute a fringe benefit.



Study section 6.2.8 in the prescribed textbook.

<p>Work through example 6.18.          Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook.</p>	

## 7.7 Travel allowance

*Textbook: section 6.3 and 6.3.1*



A travel allowance is an amount of **money** given to an employee to cover business-related travelling expenses. The taxable portion is determined by using the rules set out in the Act.







Read section 6.3 in the prescribed textbook.





Study section 6.3.1 in the prescribed textbook.

<p>Work through example 6.20.</p> <p>Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook.</p> <p>The business kilometres are used in the calculation of the taxable portion of the travel allowance.</p>	

<p>Work through example 6.21.</p> <p>Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook.</p> <p>Can you see the deemed cost figures are taken from the table above the example?</p>	

<p>Work through example 6.22.</p> <p>Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook.</p> <p>In this example, Gina keeps a record of actual cost. You must remember that Gina is entitled to use either the deemed cost or the actual cost, whichever gives the greater cost per kilometre. If actual cost is not available in a question, you can only use the deemed cost.</p>	

<p>Work through example 6.23.</p> <p>Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook.</p> <p>This example illustrates a situation where business kilometres for the year of assessment are fewer than 8 000 km. Remember, this is an exception to the general rule where you use the deemed cost table. You use a fixed cost per kilometre of 355c for the 2018 year of assessment.</p>	



Ignore example 6.24 because in this module, we test fringe benefits received for a full year of assessment.



Listen to the podcast on travel allowances under **Additional Resources** on myUnisa.

## 7.8 Subsistence allowance

**Textbook: section 6.3.2**

An employee receives an allowance when the employer requires the employee to be away from home for at least one night.



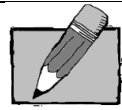
Study section 6.3.2 in the prescribed textbook.



Remember, you have to know that the deemed cost is **R115** per day for incidental costs and **R372** per day for meals and incidental costs (laundry, telephone costs, etc) if an employee receives a subsistence allowance and is away for business purposes in South Africa.

Work through example 6.25.

Try to complete it on your own without referring to the solution.



The solution is available in the prescribed textbook.

Note that Sue is entitled to deduct the greater of the actual cost or deemed cost, even though her actual cost is less than the deemed cost.



### POINT TO PONDER



- Is it fair that a person who receives a fringe benefit should be taxed on such a benefit?

### WRAP-UP

- The cash equivalent of fringe benefits is included in gross income.
- A fringe benefit is only possible between an employer and employee.
- A fringe benefit is part of the remuneration of an employee in a form other than cash.
- Different rules apply to calculating the cash equivalent of the different fringe benefits.
- Rules apply to calculating the taxable portion of cash allowances received by employees.



Now that you have completed this learning unit, please revise the learning outcomes and make sure that you have attained all of them.



Visit the **Discussion Forum** and answer the online self-assessment questions. Revise the learning unit on **fringe benefits** and discuss any concepts that you do not understand, or if you do understand, then answer those students who have posted questions.

**SELF-ASSESSMENT QUESTIONS**

Solutions are found at the end of this learning unit.

**QUESTION 7.1 (5 marks 6 minutes)**

- (i) An employer may award a retired employee a fringe benefit.
- (a) True  
(b) False
- (ii) Fringe benefits are not included in gross income.
- (a) True  
(b) False
- (iii) A fringe benefit is cash given to an employee.
- (a) True  
(b) False
- (iv) The taxable portion of a fringe benefit is generally the portion used for private purposes.
- (a) True  
(b) False
- (v) An example of an allowance is a car given to an employee for private use.
- (a) True  
(b) False

REQUIRED	Marks
State whether each of the above statements is true or false.	5

**QUESTION 7.2 (27 marks, 32 minutes)**

Your cousin Bart Junior (25 years old) sends you an e-mail to ask for your assistance regarding the inclusion of fringe benefits to his salary package. Here is an extract from his e-mail:

I have been employed for two years and I have just received a new salary package because I have completed my studies. My new salary package includes certain fringe benefits.

First of all, can you explain to me what is meant by the term "fringe benefit"?

I will be receiving the following fringe benefits from 1 March 2017 and I would like you to calculate the taxable portion of each of these benefits for the year of assessment ended 28 February 2018. You can assume that I will receive the benefits for 12 months (except for the holiday accommodation).



**QUESTION 7.2 (continued)**Residential accommodation

I will have the free use of a flat that belongs to my employer. The flat consists of five rooms and it is furnished. I will have to pay the water and electricity. During the 2017 year of assessment, my remuneration amounted to R180 000. My remuneration for the 2018 year of assessment will amount to R250 000.

Meals at the canteen

I will be provided with 300 meals a year in the cafeteria situated on the business premises. The meals are valued at R60 per meal.

Holiday accommodation

During September, I will occupy the beach cottage on the West Coast for five days. The beach cottage belongs to my employer and in September, it is let to the public at a rate of R1 200 per day. I will pay R250 per day for the use of the cottage.

Medical contributions paid by the employer

The employer will contribute R1 000 per month to my medical aid fund.

Travel allowance

I will receive a monthly travel allowance of R3 800 per month. The cost of my vehicle excluding VAT amounts to R150 000. I expect that I will travel 15 400 kilometres for business purposes and a total of 26 500 kilometres for the 2018 year of assessment.

I expect my actual costs for the 12 months to be as follows:

	R
Fuel	12 000
Insurance premiums and licence fees	4 200
Maintenance	3 450

Use of motor vehicle instead of travel allowance

What would the taxable value of the fringe benefit be if my employer gives me the use of a motor vehicle instead of the travel allowance? My employer purchased the company car on 1 January 2017. The cost of the car is R195 000. This amount includes VAT and a maintenance plan. My employer pays for all operating expenses and the vehicle is not used for business purposes.

REQUIRED	Marks
(a) Explain the term "fringe benefit" to your cousin Bart Junior.	2
(b) Calculate the cash equivalent of each of the above fringe benefits and the taxable portion of any allowances for the 2018 year of assessment.	25

**QUESTION 7.3 (32 marks, 38 minutes)**

Gerald received the following benefits and allowance from his employer during the 2018 year of assessment:

**1. Right of use of employer's guesthouse (4 marks)**

Gerald's wife and two children were given the right to use a guesthouse, owned by Gerald's employer, for five nights. Although he could not go on holiday with his family due to work commitments, his wife and children spent five nights at the guesthouse. The guesthouse is situated in Cape Town. The company normally charges guests R950 per person per night. Gerald paid R5 000 in total for the entire period of use of the guesthouse.

**2. Travel allowance (20 marks)**

Gerald received a travel allowance of R20 000 per month for the full year of assessment. He travelled a total of 96 000 km for the full year, 42 000 km of which were private kilometres according to his logbook. The purchase price of the car was R500 000 (excluding VAT) on 1 March 2015. He had proof of the following expenses:

	<b>R</b>
Finance charges	41 000
Fuel costs	120 000
Licence fees	2 500
Maintenance	12 000

**3. Low-interest loan (5 marks)**

On 1 March 2017, Gerald received a loan of R30 000 from his employer. The interest on the loan was 2% while the official interest rate was 9%. On 31 August 2017, he repaid R15 000 to his employer.

<b>REQUIRED</b>	<b>Marks</b>
(a) Discuss whether the use of the employer's guesthouse would be included in Gerald's gross income for the 2018 year of assessment.	<b>3</b>
(b) Assuming the right of use of the employer's guesthouse is a taxable fringe benefit, calculate the taxable portion of all of Gerald's fringe benefits and of the travel allowance received for the 2018 year of assessment.	<b>29</b>

**QUESTION 7.4 (26 marks, 31 minutes)**

Mkhize Khoza is an employee of Zarro Ltd, an advertising company. He wants to complete his tax return for the 2018 year of assessment, but he does not understand certain tax issues. He therefore sent you an e-mail (see below) to assist him with his tax queries.

	<b>Marks</b>
<p><b>Tax queries</b> MkhizeK [mkhizek@mylife.ac.za] Sent: May 2017, at 08:00 To: Tax Student</p> <p>Dear Student</p> <p>Kindly assist me with the following queries:</p> <p><b>1. What is the difference between an allowance and a fringe benefit?</b></p> <p><b>2. Subsistence allowance</b> I received a subsistence allowance of R2 500 per month, for the full year, to cover the cost of meals and incidental costs. I was required to travel to clients and spent 26 days in total away from home during the year. I incurred, in total, R5 200 for meals and R4 700 for laundry and room service while I was on my business trips. I kept proof of all these expenses. What is the taxable portion of the allowance?</p> <p><b>3. Right of use of residential accommodation</b> I stayed in a house owned by my employer, for the full year. The house consists of four bedrooms, bathroom, kitchen and lounge and it is furnished by my employer. I did not pay anything towards the use of the house but only paid for electricity and water. My remuneration factor for the current year of assessment is R360 000 and for the previous year of assessment, it was R320 000. What is the cash equivalent of the benefit?</p> <p><b>4. Right of use of motor vehicle</b> I had the right to use a vehicle for the full year. The vehicle was not subject to a maintenance plan at the time of purchase. The company purchased the vehicle on 1 March 2017 for R240 000 (excluding VAT of R33 600 and interest of R80 000) What is the cash equivalent of the benefit?</p> <p><b>5. Travel allowance</b> Assume that I did not receive the right to use a motor vehicle, but that I used my own car for business purposes and received a travel allowance. My employer is willing to pay me a travel allowance of R6 000 per month. The cost of my car is R220 000 (including VAT). I will not keep any records for actual expenses incurred. I travelled a total of 24 000 km during the current year of assessment, of which 8 000 km were private kilometres. What is the taxable portion of the allowance?</p> <p><b>6. Low interest rate loan</b> On 31 August 2017, I obtained a loan of R15 000 from my employer. The interest rate charged by my employer was 3% per annum and the official interest rate is 8,5% per annum. At the end of the year, no portion of this loan was repaid. What is the cash equivalent of the benefit?</p>	<p></p> <p></p> <p></p> <p>2</p> <p>4</p> <p>4</p> <p>4</p> <p>9</p> <p>3</p>

**QUESTION 7.4 (continued)**

REQUIRED	Marks
Assist Mkhize Khoza with his queries by responding to each of the <b>six</b> queries.	<b>26</b>



Go to section 6.5 in the prescribed book and attempt answering questions 1 and 2. Only do the calculations of the fringe benefits that we deal with in this module. See the list at the beginning of the learning unit.

The solutions are at the back of the prescribed book.

<b>ASSESSMENT CRITERIA</b>
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We could assess this learning unit in assignments or in the examination by asking you to

- explain the term “fringe benefit”
- calculate the cash equivalent of the following fringe benefits as described in a practical case study:
  - right of use of a motor vehicle
  - meals and refreshments or vouchers
  - residential accommodation
  - low-interest loans
  - contributions paid by the employer on behalf of the taxpayer
- calculate the taxable value of the following allowances as described in a practical case study:
  - travel allowance
  - subsistence allowance

<b>Solutions to self-assessment questions in learning unit 7</b>
--

**QUESTION 7.1 (5 marks)**

- (i) False
- (ii) False
- (iii) False
- (iv) True
- (v) False

**QUESTION 7.2 (27 marks)**

A fringe benefit is **between an employer and employee**. It is a salary (remuneration) **in a form other than cash**. (2)

**Residential accommodation**

$$(A - B) \times C/100 \times D/12$$

$$A = R180\,000 \text{ (1)}$$

$$B = R75\,750 \text{ (1)}$$

$$C = 18 \text{ (1)}$$

$$D = 12 \text{ (1) (remember, must be 12/12)}$$

$$\text{Cash equivalent: } (R180\,000 - R75\,750) \times 18/100 \times 12/12 = R18\,765$$

**QUESTION 7.2 (continued)****Meals**

No taxable benefit: Rnil cash equivalent (1)

**Holiday accommodation**

	R
R1 200 (1) x 5 days (1)	6 000
Amount paid by Bart (R250 x 5 days)	<u>(1 250) (1)</u>
Cash equivalent	<u>4 750</u>

**Medical contributions**

R1 000 x 12 = R12 000 cash equivalent (1)

**Travel allowance**

Determined value: R150 000 x 114/100 = R171 000 (1)

Deemed cost

Fixed cost: R73 427 (1) /26 500 km (1)	277.1c
Fuel	100.6c (1)
Repairs	<u>45.4c (1)</u>
Deemed cost per km	<u>423.1c</u>

**R**Actual cost

Depreciation: R171 000 / 7 years (1)	24 429
Fuel	12 000 (1)
Insurance premiums and licence fee	4 200 (1)
Maintenance	<u>3 450 (1)</u>
	<u>44 079</u>
Actual cost per km: R44 079 /26 500 km (1)	166,3c

The greater of actual costs or deemed cost: Use deemed cost = 423.1c

Travel allowance received (R3 800 x 12 months) (1)	45 600
<u>Less:</u> Business travel (15 400 km (1) x 423.1c (1) /100 (1)) = R65 158 but limited (1)	<u>(45 600)</u>
Taxable portion of travelling allowance	<u>nil</u>

**Use of a motor vehicle**

R195 000 (1) x 3,25% (1) x 12 months (1) = R76 050

**Max: 27**

**QUESTION 7.3 (32 marks)****(a) Gross income**

- Gerald received the benefit by virtue of his employment. **(1)**
- This is therefore considered a taxable fringe benefit received by Gerald. **(1)**
- The taxable benefit will be included **(1)** in Gerald's calculation of taxable income in the 2017 year of assessment.

**Marks: 3**

R R

**(b)**1. Right of use of company guesthouse

Amount charged by company (R950 <b>(1)</b> x 3 <b>(1)</b> x 5 nights <b>(1)</b> )	14 250	
Amount paid	(5 000)	<b>(1)</b>
Taxable benefit	<u>9 250</u>	

**Marks: 4**2. Travel allowance

Travel allowance received R20 000 <b>(1)</b> x 12 months <b>(1)</b>	R 240 000	
<u>Less: Business use 54 000 km <b>(1)</b> x R4,016<b>(1)</b></u>	(216 864)	<b>(1)</b>

Determined value R500 000 x 1.14 **(1)** 570 000

Business kilometres travelled (96 000 km – 42 000 km) = 54 000 km **(1)**

Deemed cost

Fixed cost (R154 879 <b>(1)</b> / 96 000 <b>(1)</b> ) x 100	161.3	
Fuel	150.9 <b>(1)</b>	
Maintenance	89.4 <b>(1)</b>	
Total	<u>401.6</u>	

Actual costs

Wear and tear (R560 000 <b>(1)</b> / 7 <b>(1)</b> )	80 000	
Finance charges (R560 000 <b>(1)</b> / R570 000 <b>(1)</b> x R41 000) <b>(1)</b>	40 281	
Fuel costs	120 000 <b>(1)</b>	
Licence fees	2 500 <b>(1)</b>	
Maintenance	12 000 <b>(1)</b>	
Total	<u>254 781</u>	

Cost per km: R254 781 / 96 000 km **(1)** = R2, 654 per km

Taxable portion	<u>23 136</u>
-----------------	---------------

**Marks: 20**3. Low interest rate loan

R30 000 <b>(1)</b> x (9% – 2%) <b>(1)</b> x 6/12 <b>(1)</b>	R 1 050
(R30 000 – R15 000) = R15 000 <b>(1)</b> x (9% – 2%) x 6/12 <b>(1)</b>	525
Taxable portion	<u>1 575</u>

**Marks: 5**

**QUESTION 7.4 (26 marks)**

An allowance is the amount of cash given to you by your employer to use for business purposes. A fringe benefit is a benefit given to you by your employer in a form other than in cash. **(2)**

<b>Subsistence allowance</b>	<b>R</b>	<b>R</b>	
Subsistence allowance received (R2 500 x 12)		30 000	<b>(1)</b>
<u>Less:</u> Business expenses			
<b>The greater of</b>		(9 900)	<b>(1)</b>
– deemed cost (R372 x 26)	9 672		<b>(1)</b>
– actual costs (R5 200 + R4 700)	9 900		<b>(1)</b>
Taxable portion of the benefit		<u>20 100</u>	

**Right of use of residential accommodation**

$(A - B) \times C/100 \times D/12$

A = R320 000

B = R75 000

C = 18

D = 12

Taxable portion of the benefit (R320 000 **(1)** – R75 000 **(1)**) x 18/100 **(1)** x 12/12 **(1)** 44 100

**Right of use motor vehicle**

Determined value (R240 000 **(1)** + R33 600 **(1)**) = R273 600

Fringe benefit (R273 600 x 3,5% **(1)** x 12 months **(1)**) 114 912

**Travel allowance**

Travel allowance received (R6 000 x 12 months) 72 000 **(1)**

Determined value of the car 220 000 **(1)**

Deemed cost:

Fixed cost R68 684 **(1)** / 24 000 km **(1)** x 100 286,2 c

Fuel cost 100 c **(1)**

Maintenance cost 42,5 c **(1)**

428,7 c

Less: Business travel (24 000 km – 8 000 km **(1)** (or 16 000 km)) x (428,7c **(1)** / 100) (68 592) **(1)**

Taxable portion of the benefit 3 408

**Low interest rate loan**

Taxable portion of the benefit ((R15 000 **(1)** x (8,5% – 3% **(1)**)) x 6/12 months **(1)**) 413





# LEARNING UNIT 8

# 8

## INTRODUCTION

## STUDY PROGRAMME

## LEARNING OUTCOMES

## PRESCRIBED STUDY MATERIAL FOR THIS LEARNING UNIT

## SECTIONS OF THE PRESCRIBED TEXTBOOK WHICH YOU MAY IGNORE

## CONTENTS

- 8.1 Background
- 8.2 Calculation of a capital gain or loss on an asset
- 8.3 Taxable capital gain or loss
- 8.4 Proceeds
- 8.5 Base cost
- 8.6 Exclusions
- 8.7 Limitation of capital losses

## POINT TO PONDER

## WRAP-UP

## e-TIVITY

## SELF-ASSESSMENT QUESTIONS

## ASSESSMENT CRITERIA

# Capital gains tax

## INTRODUCTION

Capital gains tax is paid when a person transfers or disposes of his or her assets. It is not a separate tax. A separate calculation is done to calculate the taxable gain and then the taxable gain is added to the taxable income.

## STUDY PROGRAMME

You should complete this learning unit in **week 9 and week 10** of the programme.

You should spend a minimum of **ten (10) hours in week 9 and five (5) hours in week 10** on this learning unit.

Refer to Tutorial Letter 102 for the study programme.

## LEARNING OUTCOMES

After you have completed this learning unit, you should be able to

- calculate the capital gain or loss for each asset sold by applying the rules regarding the determination of proceeds and base cost for each asset
- apply the exclusions regarding the different types of assets
- calculate the aggregate capital gain or loss
- calculate the taxable capital gain or loss

## PRESCRIBED STUDY MATERIAL FOR THIS LEARNING UNIT

Chapter 7 in the prescribed textbook.

## SECTIONS OF THE PRESCRIBED TEXTBOOK WHICH YOU MAY IGNORE

Sections 7.3 to 7.5

## CONTENTS

### 8.1 Background

*Textbook: section 7.1 and 7.2*

In learning unit 5, we identified certain tests that can be used to determine which amounts should be included in gross income. One of the requirements we considered was whether the amount was a capital amount. As a general rule, if an amount is a capital amount for gross income purposes, the amount could relate to an asset and therefore, it is subject to capital gains tax.

The rules for calculating capital gains tax are found in the Eighth Schedule of the Income Tax Act.



Study section 7.1 and 7.2 in the prescribed book.



Look at the framework and see where the taxable capital gain is added to taxable income.

Remember that a capital loss cannot reduce taxable income. It is carried forward to the next year to reduce the capital gains of the next year.

## 8.2 Calculation of a capital gain or loss on an asset

*Textbook: sections 7.2.1, 7.2.2 and 7.2.3*

Before capital gains tax can be applied, an asset must have been disposed of.



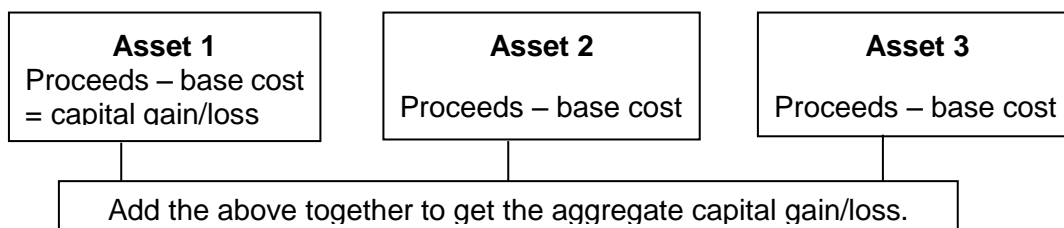
Study sections 7.2.1, 7.2.2 and 7.2.3 in the prescribed textbook.

Work through example 7.1.	
The solution is available in the prescribed textbook. Note that transactions, which are not classified as a disposal, do not result in any capital gain or loss. The term "disposal" includes more than just the sale of an asset.	

## 8.3 Taxable capital gain or loss

*Textbook: section 7.2.4*

The capital gains or losses from individual assets sold are added together to determine the aggregate capital gain or loss. The calculation of the aggregate capital gain or loss may be calculated as follows:



If there is an aggregate capital loss, the loss is reduced by R40 000 (i.e. R40 000 is added to the loss). The balance, if any, is **carried forward** to the following year of assessment. It does **not** reduce taxable income.

If there is an aggregate capital gain, **the taxable capital gain** (which is added to taxable income) is calculated as follows:

Aggregate capital gain

Less: Annual exclusion (natural person: R40 000)

Less: Assessed capital loss – previous year

= Net capital gain

Multiply: Inclusion rate – 40% (natural person)

= Taxable capital gain



INCLUDED IN TAXABLE INCOME



Study section 7.2.4 in the prescribed textbook.

<p>Work through example 7.2. Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook. The loss is reduced by the annual exclusion of R40 000.</p>	



Listen to the podcast on the capital gains tax framework under **Additional Resources** on myUnisa.

#### 8.4 Proceeds

*Textbook: section 7.2.5*

The proceeds are the amounts received by or accrued to the seller who disposed of the asset.



Study section 7.2.5 in the prescribed textbook.

<p>Work through example 7.3. Ignore (b) of the example. Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook. For purposes of this module, these adjustments are the only ones you have to know that can reduce the proceeds.</p>	

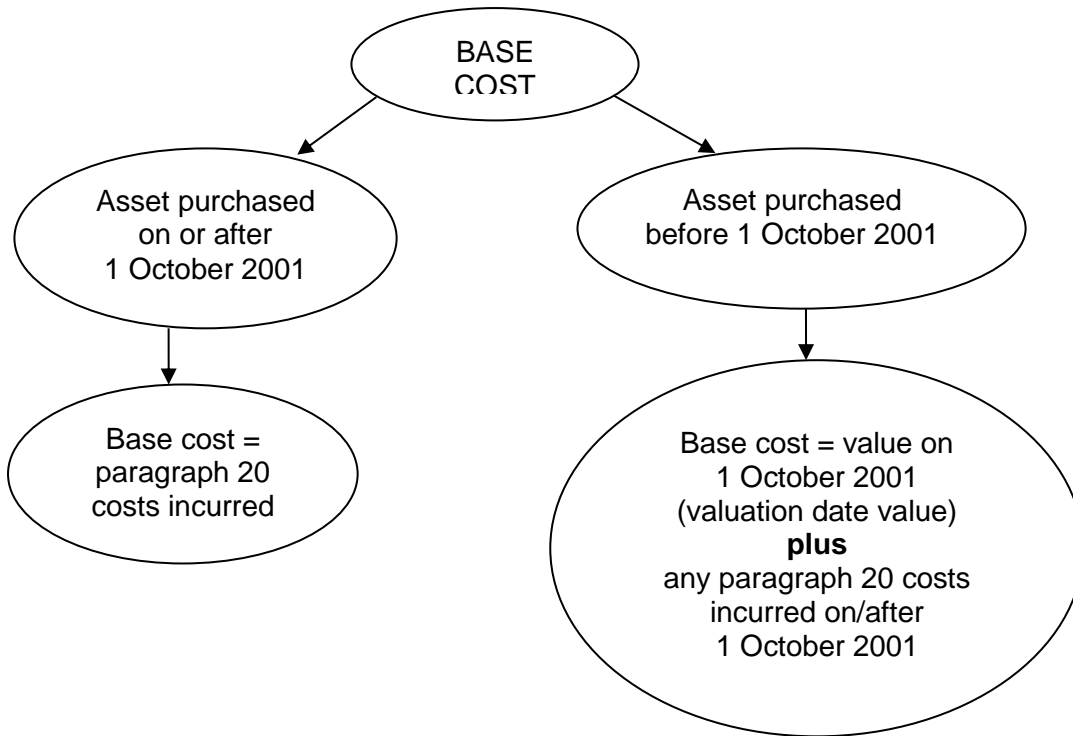


Remember the general rule that no adjustments are made to the proceeds.

#### 8.5 Base cost

*Textbook: section 7.2.6*

The base cost of the asset depends on when the asset was purchased. If the asset was purchased before 1 October 2001 – the date at which CGT was introduced for the first time – then we have to calculate a valuation date value before we can calculate a capital gain or loss.



Paragraph 20 of the Eighth Schedule provides a list of costs that may form part of the base cost.



Take note of the costs that are excluded from the base cost.





Study section 7.2.6 up to example 7.4 in the prescribed textbook.



<p>Work through example 7.4.</p> <p>Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook.</p> <p>This example deals with a situation where the assets were purchased <b>on or after</b> 1 October 2001.</p>	



Different rules apply when the asset was purchased before 1 October 2001. A recalculation of the base cost must be done so that it reflects the cost of the asset as on 1 October 2001. We refer to this recalculated base cost as the “valuation date value” of the asset.



Study section 7.2.6, from the heading “Assets purchased before 1 October 2001”, in the prescribed textbook.

<p>Work through example 7.5</p> <p>Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook.</p> <p>This example illustrates the calculation of the valuation date value when proceeds exceed total expenses.</p>	

<p>Work through example 7.6.</p> <p>Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook.</p> <p>This example illustrates the calculation of the valuation date value when proceeds are less than total expenses and the expenses exceed the market value. See the test (questions you should answer with a yes or no) before you proceed with your calculation of the valuation date value.</p>	

<p>Work through example 7.7.</p> <p>Try to complete it on your own without referring to the solution.</p>	
<p>The solution is available in the prescribed textbook.</p> <p>This example illustrates all the different scenarios to be taken into account to determine the valuation date value.</p>	



Remember that when you answer a capital gains tax question, you must carefully consider whether the asset was purchased prior to 1 October 2001 or on or after 1 October 2001, because that will determine how the base cost must be calculated.

The time apportioned base cost and market value will always be given in a question.


## 8.6 Exclusions

**Textbook: section 7.2.7**

The Act provides that in certain cases, certain capital gains or losses must be excluded before you calculate the aggregate (total) capital gain or loss for the year of assessment.



Study section 7.2.7 in the prescribed textbook.

<p>Work through example 7.8.</p> <p>Try to complete it on your own without referring to the solution.</p>	
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The solution is available in the prescribed textbook.  
This example shows the primary residence exclusion.



Take note of the limitations on the primary residence exclusion as well as the limitations applicable when the house was used for trade purposes.

## 8.7 Limitation of capital losses

*Textbook: sections 7.2.8 and 7.2.9*

Certain capital losses cannot reduce the aggregate capital gain or increase the aggregate capital loss to be carried forward, if they were not used for trade purposes.



Study sections 7.2.8 and 7.2.9 in the prescribed textbook.



**Take note:** If there is a gain on the specified aircraft or boat (see section 7.2.8), the gain will be taken into account. It is **only** a loss that is ignored.



There is **no** capital gains tax if assets are transferred between spouses.

### POINT TO PONDER

- Why must a taxpayer pay capital gains tax on a capital asset that he or she sells?



### WRAP-UP

- Capital gains tax is paid when an asset is sold.
- It is not a separate tax. The taxable gain is included in taxable income.
- A taxable capital loss does not reduce taxable income; it is carried forward to the following year to be set off against capital gains in that year.
- The capital gain or loss for each asset is calculated **separately**.
- Rules for the determination of proceeds and base cost apply.
- Certain exclusions apply.
- The capital gains and losses are combined to determine the aggregate capital gain/loss.
- The annual exclusion and assessed capital loss from the previous year are taken into account to determine the taxable capital gain or loss.



Now that you have completed this learning unit, please revise the learning outcomes to make sure that you have attained all of them.



Visit the **Discussion Forum** and answer the online self-assessment questions. Revise the learning unit on **capital gains tax** and discuss any concepts that you do not understand, or if you do understand them, then answer those students who have posted questions.

### SELF-ASSESSMENT QUESTIONS

Solutions are found at the end of this learning unit.

#### **QUESTION 8.1 (5 marks, 6 minutes)**

- (i) Capital gains are included in gross income.
- (a) True  
(b) False
- (ii) The annual exclusion for capital gains tax of an individual is R40 000.
- (a) True  
(b) False
- (iii) The primary residence exclusion applies to individuals and deceased estates only.
- (a) True  
(b) False
- (iv) Base cost for assets that are acquired both before 1 October 2001 and on or after this date is calculated in the same way.
- (a) True  
(b) False
- (v) An aggregate capital gain/loss must be calculated for all the assets disposed of.
- (a) True  
(b) False

REQUIRED	Marks
State whether each of the above statements is true or false.	5



**QUESTION 8.2 (8 marks, 10 minutes)**

Andile Baloi is 24 years of age and takes part in the National Lottery from time to time. In October 2016, he was very lucky to be the only one to select the correct numbers. His prize money amounted to R19,8 million. Andile immediately decided to move to St Helena Bay. He wanted to buy a piece of land with a six-bedroom house and all-round views of the ocean.

After a couple of weeks, he met Patricia Plaatjie, who owned just the property he was looking for. After some negotiations they agreed that Andile would buy the property from Patricia for R6 250 000.

Patricia is 68 years of age and has never been married. She bought the property in 1994 after she retired and has been living there ever since. The valuation date value (you can assume that it is correct) of the property was R2 830 000. During 2009, she built two swimming pools, one on either side of the house, both of them heated. She built these pools because she wanted to have a view of the sunrise and the sunset while sitting in a pool. The total cost of building these pools was R261 000. At the same time, she painted the house at a cost of R453 870. When she sold the house, the outstanding amount on her mortgage was R368 000.

REQUIRED	Marks
Calculate Patricia's taxable capital gain/loss for the current year of assessment, assuming that she did not have any other disposals for the year.	8

**QUESTION 8.3 (15 marks, 18 minutes)**

Betty Brave is 55 years of age and lives in KwaZulu-Natal. During the current year of assessment, she sold the following assets:

- Asset: Primary residence, situated in Margate  
 Date sold: 1 January 2017  
 Selling price: R5 000 000  
 Other information: Betty purchased the residence on 1 July 2007 for R2 520 000. The estate agent's commission on the sale was R45 000.
- Asset: Holiday home, situated in Umhlanga Rocks  
 Date sold: 15 February 2017  
 Selling price: R925 000  
 Other information: Betty purchased the residence on 1 January 2000 for R250 000. The house was sold privately. Improvements of R150 000 were made during 2008. The market value was R350 000 on 1 October 2001, while the time apportionment base cost was R222 222.
- Asset: Motor vehicle  
 Date sold: 20 November 2016  
 Selling price: R200 000  
 Other information: She purchased it on 1 March 2008 for R250 000.

REQUIRED	Marks
Calculate the taxable capital gain/loss for the 2018 year of assessment.	15

**QUESTION 8.4 (20 marks, 24 minutes)**

Roger Road is 59 years old and married out of community of property to Kirsten Road. Roger inherited R2 500 000 in cash and gold coins to the value of R100 000 from his late father's estate during May 1995.

Roger purchased a new house in Bedfordview in July 1998 for R2 000 000 and moved into it in the same month. He sold his previous house, situated in Johannesburg, for R500 000 in August 1998.

Roger decided to retire and sell all his assets, except his motor vehicles and some personal belongings. He and Kirsten purchased a house on the KwaZulu-Natal north coast for R3 000 000 in February 2017 and retired there.

Roger supplied you with the following information regarding the Bedfordview house and the other assets acquired and sold, as well as liabilities settled:

Asset	Cost	Selling price
	R	R
<b>1. Bedfordview house</b> Sold privately in January 2017 Purchased in July 1998 Improvements made in March 2009 Outstanding bond settled Market value was R2 400 000 on 1 October 2001 Time apportionment base cost was R1 600 000 on 1 October 2001	2 000 000 200 000 250 000	3 200 000
<b>2. Old furniture</b> Sold at a capital loss of R120 000		
<b>3. Listed shares</b> Purchased in January 2014 Sold in January 2017	200 000	310 000

REQUIRED	Marks
Calculate Roger's taxable capital gain/loss for the year of assessment ended 28 February 2018. Provide reasons where amounts are excluded or not taxed.	<b>20</b>



Go to section 7.6 in the prescribed book and attempt answering question 1.

The solutions are given at the back of the prescribed book.

## ASSESSMENT CRITERIA

We could assess this learning unit in assignments or in the examination by asking you to

- calculate the capital gain or loss on each asset sold by applying the rules regarding the determination of proceeds and base cost for each asset
- apply the exclusions regarding the different types of assets
- calculate the aggregate capital gain or loss
- calculate the taxable capital gain or loss



**In this module, we will not combine questions on capital gains tax with a taxable income question. We will ask about the capital gains tax in a separate question.**

## Solutions to self-assessment questions in learning unit 8

### QUESTION 8.1 (5 marks)

- (i) False
- (ii) True
- (iii) True
- (iv) False
- (v) True

### QUESTION 8.2 (8 marks)

	<b>R</b>	
Proceeds	6 250 000	(1)
<u>Less: Base cost</u>		
– Valuation date value	(2 830 000)	(1)
– Swimming pool	(261 000)	(1)
– Loan	nil	(1)
– Painting	<u>nil</u>	(1)
Capital gain	3 159 000	
<u>Less: Primary residence exclusion</u>	<u>(2 000 000)</u>	(1)
Gain on sale of house	1 159 000	
<u>Less: Annual exclusion</u>	<u>(40 000)</u>	(1)
Net capital gain	1 119 000	
<u>Multiply: Inclusion rate</u>	<u>x 40%</u>	(1)
Taxable capital gain	<u>447 600</u>	<b><u>8</u></b>

**QUESTION 8.3 (15 marks)**

	R	
<b>Asset: Primary residence</b>		
Proceeds	5 000 000	(1)
<u>Less: Base cost</u>	(2 565 000)	
– Purchase price	2 520 000	(1)
– Agent's commission	45 000	(1)
Gain	2 435 000	
<u>Less: Primary residence exclusion</u>	(2 000 000)	(1)
<b>Gain on sale of house</b>	435 000	
<b>Asset: Motor vehicle</b>	200 000	(1)
Proceeds	(250 000)	(1)
<u>Less: Base cost</u>		
Loss	(50 000)	
<b>Loss on sale of motor vehicle – personal use asset</b>	Nil	(1)
<b>Asset: Holiday home</b>		
Proceeds	925 000	(1)
<u>Less: Base cost</u>	(500 000)	
Valuation date value (note 1)	350 000	(1)
Cost after 1/10/2001	150 000	(1)
Gain on sale of holiday home	425 000	
<b>Taxable capital gain</b>		
Gain on sale of house	435 000	
Loss on sale of motor vehicle	Nil	
Gain on sale of holiday home	425 000	
	860 000	
<u>Less: Annual exclusion</u>	(40 000)	(1)
	820 000	
<u>Multiply: Exclusion rate</u>	x 40%	(1)
<b>Taxable capital gain</b>	328 000	

**Note 1**

The valuation date value is the greatest of (proceeds exceed all expenditure and therefore, par 26 applies)

- market value – R350 000 (1); or
- time apportionment base cost – R222 222 (1); or
- $20\% \times (R925\ 000 - R150\ 000) = R155\ 000$  (1)

**QUESTION 8.4 (20 marks)**Inheritance of cash and gold coins in May 1995 – no capital gains tax **(1)**Johannesburg house sold in August 1995 – no capital gains tax, prior to 1/10/2001 **(1)**

	R	R	
Bedfordview house		3 200 000	<b>(1)</b>
Proceeds			
<u>Less: Base cost</u>			
Valuation date value – the greater of			
– market value – R2 400 000 <b>(1)</b> ; or			
– 20% rule – (R3 200 000 <b>(1)</b> – R200 000 <b>(1)</b> ) x 20% <b>(1)</b>			
= R600 000; or			
TAB – R1 600 000 <b>(1)</b>			
Thus, market value		(2 400 000)	<b>(1)</b>
Outstanding bond – <b>not part of base cost</b>		Nil	<b>(1)</b>
Improvements		(200 000)	<b>(1)</b>
Profit		600 000	
<u>Less: Primary residence exclusion of R2 000 000 <b>(1)</b> – limited to gain</u>		(600 000)	<b>(1)</b>
		<hr/>	
Gain on sale of house		Nil	<b>(1)</b>
		<hr/>	
Other assets – old furniture ( <b>personal use asset</b> )		Nil	<b>(1)</b>
		<hr/>	
Listed shares			
Proceeds	310 000		<b>(1)</b>
Base cost	(200 000)		<b>(1)</b>
Capital gain	110 000	110 000	<b>(1)</b>
Aggregate capital gain		110 000	<b>(1)</b>
<u>Less: Annual exclusion</u>		(40 000)	<b>(1)</b>
		<hr/>	
Net capital gain		70 000	
		<hr/>	
Taxable capital gain (R70 000 x 40%) <b>(1)</b>		28 000	<b>(1)</b>
		<hr/>	

**22****Max 20**

