Tutorial Letter 102/3/2018

Taxation of Individuals

TAX3702

Both semesters

Department of Taxation

STUDY GUIDE 1 OF 2

This tutorial letter contains learning units 1 – 6 and additional questions you should work through

Bar code

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Please note:

Due to Unisa's print schedule, this tutorial letter had to be submitted by a certain date so that you would receive it in time. Unfortunately, the 2017/2018 Income Tax Act has not yet been promulgated, which means that **this tutorial letter** was based on a draft Income Tax Act. This however should not affect the content of this module. Should there be any major differences between the draft Act and the final Act we will communicate them to you through an announcement on myUnisa.

The other issue is that the **prescribed book** was not finalised at the time of writing this tutorial letter, because of the Act not having been promulgated: therefore, some of the paragraph/section references in **this tutorial letter** may be incorrect. When the prescribed book is finalised we will compare it with this tutorial letter and advise you of any changes to paragraph/section numbering. We apologise for any inconvenience this may cause you and wish to state that we want to offer the most up-to-date study material to you. Unfortunately, the combination of having to have this tutorial letter available for you when registering and the fact that the South African Parliament was very late in promulgating the Income Tax Act resulted in this unfortunate situation. We would like to emphasise that at undergraduate level these issues should not negatively affect your taxation studies or the content presented to you.

ORIENTATION

1 GENERAL

We would like to welcome you as a student of the module *Taxation of individuals*. We hope you will find your studies constructive and that it will ultimately also have practical value. Please read through this introduction very carefully as it could save you very valuable time and help avoid unnecessary queries.

The study of taxation forms an integral part of your accounting or business degree, as taxation affects many aspects of daily commercial activities. This module specifically involves investigating the effects of taxation on individuals as opposed to legal/business entities.

This module will have practical applications for every student who is employed. Upon completion of the module, you should be able to make decisions concerning the taxation implications of salary structuring, resigning from employment, retiring, investments, and so on.

The purpose of this module is to equip learners with a basic knowledge of the Income Tax Act 58 of 1962 (as amended) and the Estate Duty Act 45 of 1955 (as amended) as it applies to individuals (natural persons), as well as the application of these principles, in order to determine the income tax/estate duty liability.

2 SUGGESTED APPROACH TO THE MODULE

We suggest that you set specific times aside for study. Depending on how many modules you are attempting, you will need to draw up a programme for the semester, making time for each module as well as a revision period just before the exams.

Once you know on which days you will study taxation, decide which learning units you plan to work through on each date. Remember that you need to be flexible as some learning units may take longer than others to work through.

We suggest that you approach each learning unit as follows:

- Use the study guide and see which chapter in the prescribed book is dealt with in the learning unit that you plan to study, then read the applicable portions (as per the study guide) of the chapter. By “read”, we mean just that: read, without taking notes. At this stage, you merely need to get an idea of what is being discussed. If possible, do this reading exercise just before you are due to study the section.

- Now follow the specific instructions in the study guide. Work through the learning unit, summarising from the prescribed book and working through the explanatory examples. Remember that you will take in more information if you make notes at the same time. You might want to add to the notes later as you discover what is important. Alternatively, you might want to make new notes at a later stage, but we have found that it helps you to keep focused if you write as well as read.

  It is important to attempt the explanatory examples on your own **and then** to refer to the answer, as this helps you to ascertain what you’ve understood. It is also important to take short breaks every now and then.

- Once you have worked through the entire learning unit, you can attempt the examination preparation questions at the end of the chapter in the prescribed textbook. Again, it is important to attempt these **without referring to the solutions**, so that you can see how much you have understood.

- Once you have attempted the question, work through the solution in conjunction with your answer. If you have made some mistakes (which you most probably will have) do not worry because this is an important part of the learning process. You can then refer back to that section of the chapter and re-study the topic to help you understand why you went wrong.

- If you do not know why your solution is wrong or why the solution in the prescribed book differs from yours, it would be a good idea to contact one of your lecturers. Please see *Tutorial Letter 101* for particulars of how to contact your lecturers.

- This is the time to attempt the assignment questions on the topic that you have studied. Once you receive the solution, you can mark your answer to see where and why you went wrong.

Once you have studied the entire syllabus, set aside three hours and attempt the exam paper that is included in Assignment 3. It is important that you approach this under exam conditions so that you can see where your weak points are. Once you have identified the topics you need to spend more time on, you can draw up a revision programme.

Refer to the information about tutorial classes in the brochure *Study @ Unisa* for additional assistance in your area.

3 CONTACT WITH LECTURERS

The lecturers who are available to assist you:	
Mr A Swanepoel	012 429 4313
Mr M van Dyk	012 429 4918
Ms M Bernard	012 429 4002
Ms C Stedall	012 429 4301
Ms MSI Wentzel	012 429 4876
Ms C Cass	012 429 8992
Ms I Kretzschmar	012 429 4394
Ms R Matenche	012 429 4752
Ms R Moosa	012 429 2883

Departmental secretary: Ms S Brecher 012 429 4494

You are welcome to contact any of your lecturers about the content of the module. Please remember to e-mail any questions via myUnisa to the relevant e-mail addresses:

TAX3702-18-S1@unisa.ac.za (first semester) or

TAX3702-18-S2@unisa.ac.za (second semester)

Course cell/mobile phone number is 079 365 1124

4 ADMINISTRATIVE ENQUIRIES

For any other enquiries, we refer you to *Tutorial Letter 101* and the *Study @ Unisa* brochure for all the contact details. Bear in mind that lecturers cannot assist you with queries regarding tutorial matter not received or assignments submitted.

5 TIMETABLE

Please refer to the study programme as set out in *Tutorial Letter 101/3/2018*, section 6.

We do not know how many courses you are attempting this semester, therefore we suggest that you calculate how much time you will have available for this module.

Then take the time that you have available and spend it as follows on each of the topics:

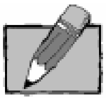
	Proposed time schedule for learning units in module:	% time spent
1	Introduction to taxation and calculation of net tax payable	5%
2	Gross income (residents) and special inclusions	10%
3	Fringe benefits and allowances	15%
4	Exempt income	5%
5	Deductions: general, prohibited and specific	15%
6	Capital gains tax for individuals	15%
7	Lump sum benefits	5%
8	Non-residents	3%
9	Prepaid taxes	10%
10	Donations tax	4%
11	Estate duty	10%
12	Farming income	3%

This is only an indication of how you should spend your time on this taxation module.

6 KEY TO SYMBOLS USED IN THE LEARNING UNITS

This symbol represents us, your lecturers, talking to you about what you can expect in the exam.

This symbol is used when we refer you to the prescribed book and a specific section of work that you need to **study**. This means that you should work through the text that we refer you to, making notes and working through any of the examples that are included in that section. **Remember**, when you work through an example, first attempt it on your own to see if you have understood the reading and only then check your answer against the solution. The **most** important step is therefore to understand where you went wrong (if you did)!



This symbol denotes an activity – these are extra activities that will help you to remember what you have learnt.

These are electronic activities. These activities are not compulsory, but will assist you to reinforce the topic that you are busy with.

7 CONCLUSION

We wish you every success with your studies in taxation. Please make the most of this **opportunity** to learn about this dynamic and practical subject.

LEARNING UNIT 1

INTRODUCTION
STUDY PROGRAMME
LEARNING OUTCOMES
PRESCRIBED STUDY MATERIAL FOR THIS LEARNING UNIT
SECTIONS OF PRESCRIBED BOOK THAT YOU MAY IGNORE

CONTENTS OF LEARNING UNIT

WRAP UP
ASSESSMENT CRITERIA
LITERATURE CONSULTED

Learning unit

1

Introduction to taxation and calcula-tion of net tax payable

INTRODUCTION

Tax is a reality most South Africans are faced with whether they are earning a salary or running their own business. Most transactions and activities are subject to some form of taxation. If you earn a salary, you pay income tax on the salary earned at the end of each month, provided that your salary is above the tax threshold; and if you buy goods, you normally pay value-added tax (VAT) on the purchases. In addition, if you are required to register as a taxpayer, you may be required to submit an annual income tax return.

Clearly, tax has an impact on everybody's life and, as a result, it is important for taxpayers to have an understanding of the overall tax system, as well as having the ability to calculate how much tax they may owe.

STUDY PROGRAMME

Refer to the study plan contained in *Tutorial Letter 101*.

LEARNING OUTCOMES

After working through this learning unit, you should be able to:

- show that you comprehend and can identify, on a basic level, the various types of taxation, the budget process, and the more important rules for interpreting the Income Tax Act
- describe the income tax framework that is used for the calculation of taxable income and net tax liability
- show that "gross income" less "exempt income" equals "income"
- describe the difference between "income" and "taxable income"
- explain how being married in community of property affects the calculation of taxable income
- calculate normal tax
- identify what the normal tax rebates and tax credits are
- calculate the net normal tax
- calculate the net normal tax liability
- explain the basic process for submitting tax returns, obtaining assessments and objecting to those assessments
- identify the tax status of an insolvent person

PRESCRIBED MATERIAL FOR THIS LEARNING UNIT

Chapters 1 and 5 and Appendix A in the prescribed book.

SECTIONS OF PRESCRIBED BOOK THAT YOU MAY IGNORE

Section 1.7 in chapter 1

CONTENTS OF LEARNING UNIT

1.1 BACKGOUND

Prescribed book section: 1.1

This learning unit will firstly provide a brief overview of the workings of the income tax system. The learning unit then proceed to look at the framework that is used to calculate how much income tax an individual has to pay. It is essential for you to always bear this framework in mind, because the majority of a person's income and some of his or her expenses will be included, at some point, within this framework. An example of the framework is provided on page 18 of this study guide.

In each of the learning units that follow, the different components of the framework will be discussed in more detail. You will know that you understand the content of this learning unit when you are able to answer the questions in section 1.1 of the prescribed book.

1.2 INTRODUCTION TO TAXATION

Prescribed book sections: 1.2 and 1.3

First, **read** through section 1.2, "Taxation in perspective", in your prescribed book. The methods used to classify tax often feature in the media. A news report may refer, for example, to the fact that "indirect tax" has increased; or it could discuss the relative merits of "wealth" versus "consumption" taxes. Being familiar with these concepts and classifications will enable you to better understand media coverage of tax-related matters. It will also be easier to understand certain principles relating to tax planning if you understand the concepts in this section.

Then **read** sections 1.3.1 and 1.3.2, on **the budget process**. The budget is the process that government follows to determine how much money it needs and therefore how much tax must be collected.

The budget is an important annual event as it determines the tax rates and the rules that will apply in the following year. Remember that the tax rates and rules change on an annual basis. It is therefore important to make sure that you are using the correct version of the Income Tax Act when you calculate a person's tax liability.

After reading the above sections, **read** section 1.3.3 on the **Income Tax Act 58 of 1962**. You will notice that the language of the Act does not provide absolute certainty in all situations. It is important that you understand how to go about interpreting the Act, as set out in this section. Remember that where a practice exists, it has no legal authority and can be opposed in a court of law. Under normal circumstances, however, interpretation notes help with the interpretation of the Act and are often the result of a playoff between SARS and taxpayers.

1.3 CALCULATION OF TAXABLE INCOME

Prescribed book section: 1.4

The first step in calculating how much tax a person must pay to SARS is to calculate the taxable income. Normal tax is then calculated on the basis of the person's taxable income.

The framework for calculating taxable income (see page 18) is of critical importance, as you will use it during the rest of your taxation studies. The different components of the tax framework will be dealt with in later learning units, as indicated next to each component. At this stage, you must be able to list the different components of the framework in the correct order.

"Gross income" less "exempt income" equals "Income"

When dealing with income tax issues, always consider whether or not an amount fits into the framework, and if so, where? Ask yourself questions such as:

- Does the receipt of this amount fall into gross income?
- If the amount received falls into gross income, is it partially or fully exempt from tax?
- Is this expense deductible? And, if so, where in the framework is it deducted?
- If the expense is deductible, are there limitations to the deduction?

"Income" less "allowable deductions" equals "Taxable Income"

In the following learning units, the individual components of the framework will be discussed in more detail. When starting with a new learning unit, always refer back to the framework to ensure that you know which component of the framework you are busy with.

As you work through the examples, you will note certain gross income amounts that are subject to **exemptions** as well as certain **deductions** that are made against income. As yet, you have not studied these specific topics. They will be dealt with in later learning units. At this stage, you must accept the material as being correct.

While working through the section and examples 1.1 and 1.2 you should have noted the following:

- ✓ For an amount to be exempt from income tax, it must first be included in gross income.
- ✓ For couples married in community of property it is deemed that rental income and/or passive income were received in an equal share by both spouses and that both spouses will receive their own interest exemption on their share of the interest (i.e. each spouse is taxed on 50% of total investment income).
- ✓ Passive income includes dividend income and interest income.
- ✓ Expenses that relate to passive income and/or rental income, for example rental expenses, are also shared (50%) by persons married in community of property.

Always carefully note what the question requires: the examples asked for **taxable income**, but some questions ask only for **gross income**. If you calculate **taxable income** where **gross income** is asked for, you will waste precious time in an exam situation and receive no marks for your extra efforts. It is therefore very important that you know the meaning of all terms and follow the instructions in the question.

At this stage, it is important to point out that you are not expected to be able to recite the sections of the Act for this module. However, you must bear in mind that the Act is the authority, therefore when teaching you about tax, you need to be told why we do certain things - and this often means that we will refer to sections of the Income Tax Act. By the end of the module, you will find that you are familiar with some of the more common sections of the Act.

ACTIVITY 1.1

Before you continue with the next section, ensure that you can write down the framework for calculating taxable income. Thereafter compare your attempt to the framework on page 18 of this tutorial letter. Is yours accurate?

1.4 CALCULATION OF NET NORMAL TAX LIABILITY

Prescribed book sections: 1.5 and 5.5

The calculation of the net normal tax liability (net normal tax payable less pre-paid taxes) is the process that is used to determine how much tax has to be paid to SARS for the year of assessment. Most of the concepts dealt with in this section are discussed in more detail in later learning units. However, it is important that you understand the basic concepts as this will make your future studies much easier.

"Normal tax" less the rebates & tax credits equals "Net normal tax payable"

ACTIVITY 1.2

List the steps to follow when calculating the net normal tax liability.

While working through the section you should have noted the following:

- ✓ Normal tax is calculated for a year, which we refer to as a year of assessment.
- ✓ For a natural person, the year of assessment runs from 1 March of one year to 28/29 February of the following year.
- ✓ There are certain cases where a person will be assessed (taxed) for a period that is shorter than a full year. Where none of these cases applies, the person will be assessed for a full year.

While working through examples 1.3 to 1.5 you should have noted the following:

- ✓ If a person commences work during the year he will still qualify for the total rebate, as his tax year will be deemed to be for a period of 12 months, although he only worked for a couple of months.
- ✓ All taxpayers are entitled to a rebate. Taxpayers who are 65 years or older on the last day of the year of assessment are entitled to the primary rebate **as well as** the secondary rebate. Taxpayers who are 75 years or older on the last day of the year of assessment are entitled to an **additional** tertiary rebate. Persons younger than 65 years are only entitled to the primary rebate.
- ✓ The rebate must be deducted from normal tax and not from taxable income.
- ✓ The terms **normal tax**, **normal tax rebates, tax credits**, **net normal tax** and **tax liability** are important terms and have specific meanings. Ensure you know these.
- ✓ **The tax tables are contained in Appendix A of the prescribed textbook.**

We will now study tax credits and tax rebates that could reduce the normal tax further.

Medical tax credits (sections 6A and 6B):

From 1 March 2014, there is no longer a deduction from income for qualifying medical expenses. A medical scheme fees tax credit (section 6A) and an additional qualifying medical expense tax credit (section 6B) are available as a rebate against normal tax, in respect of taxpayers who qualify.

The calculation could be difficult for students, but it is actually quite straightforward once you understand the basic concepts involved.

First, it is important to understand how medical aid fund **contributions** differ from medical **expenses**:

- A person who is a member of a medical aid scheme (fund) makes monthly **contributions** to that fund (regardless of whether or not he or she visited a doctor or hospital during that month). In return for being a member of the fund, most (but not necessarily all) of the member's medical accounts are paid by the medical aid fund.
- Medical **expenses**, on the other hand, are all amounts that a medical aid fund has not covered (i.e. has not paid), or if the individual is not a member of a medical aid fund and pays for all the medical expenses him/herself. The individual is then obliged to pay for those expenses out of his or her own pocket. Consequently, if someone does not belong to a medical aid fund, then all his or her allowable medical costs will fall into this particular category.

Secondly, there are three categories of taxpayers for the purposes of the medical credit calculation:

1. *Taxpayers 65 years and older*

   Medical scheme fees tax credit

   These taxpayers are entitled to a medical scheme fees tax credit when they contribute to a medical aid scheme (section 6A).

   The medical scheme fees tax credit is calculated as follows:

   R303 per month each for the taxpayer and the first dependant; plus
   R204 per month for each additional dependant

   These taxpayers are also entitled to an additional qualifying medical expense tax credit when they incurred qualifying medical expenses (section 6B).

   Additional qualifying medical expense tax credit

   The additional qualifying medical expense tax credit is calculated as follows:

   Step 1: Add up all medical aid contributions (including contributions paid by an employer) for the year of assessment.
   Step 2: Deduct 3 x the annual medical scheme fees tax credit, from above total.
   Where the calculation results in a negative amount, the answer is limited to nil.
   Step 3: Add all qualifying medical expenses to the answer derived in step 2.
   Step 4: Multiply the total in step 3 by 33.3% = additional qualifying medical expense tax credit.

   Steps 1 and 2 are unnecessary if a taxpayer is not a member of a medical aid fund.

2. *Taxpayers of any age who have a disability (or dependant with a disability)*

   These taxpayers are entitled to the same tax credits as for persons 65 years or older, as under point 1 above. The calculations are the same as for taxpayers 65 years or older, as under point 1 above.

Bear in mind that the taxpayer's annual medical scheme fees tax credit, as well as the additional qualifying medical expense tax credit, will *be deducted as rebates from normal tax*.

3. Taxpayers under 65 years (no disability)

Medical scheme fees tax credit

These taxpayers are entitled to a medical scheme fees tax credit when they contribute to a medical aid scheme (section 6A).

The medical scheme fees tax credit is calculated as follows:

R303 per month each for the taxpayer and the first dependant; plus
R204 per month for each additional dependant.

These taxpayers are also entitled to an additional qualifying medical expense tax credit when they incurred qualifying medical expenses (section 6B).

Additional qualifying medical expense tax credit

The additional qualifying medical expense tax credit is calculated as follows:

Step 1: Add up all medical aid contributions (including contributions paid by an employer) for the year of assessment.
Step 2: Deduct 4 x the annual medical scheme fees tax credit, from above total.
Where the calculation is a negative amount, the answer is limited to nil.
Step 3: Add all qualifying medical expenses to the answer derived in step 2.
Step 4: Calculate 7.5% of taxable income.
Step 5: If the answer derived in step 3 **exceeds** the answer derived in step 4, the excess is multiplied by 25% = additional qualifying medical expense tax credit.

If the answer in step 5 is a negative amount, there will be no additional qualifying medical expense tax credit.

Steps 1 and 2 are unnecessary if a taxpayer is not a member of a medical aid fund.

Bear in mind that the taxpayer's annual medical scheme fees tax credit, as well as the additional qualifying medical expense tax credit, will *be deducted as rebates from normal tax*.

Section 6*quat* rebate:

Study sections 1.5.6 and 5.5, Foreign tax credit (s6*quat*).

It is not uncommon for a South African resident to pay foreign tax on foreign income, and then be obliged to include that foreign income in South African taxable income as well. Section 6*quat* provides relief against double taxation, by providing a rebate against South African normal tax, for any foreign tax paid.

The formula for the calculation of the section 6*quat* rebate is an important formula that you need to know and must be able to apply.

ACTIVITY 1.3

Write down and memorise

- the formula for the calculation of the section 6*quat* rebate

Prepaid taxes:

Study section 1.5.7, Prepaid taxes. In learning unit 9, this section of the content is dealt with in detail.

Visit the discussion forum on myUnisa. We would like you to introduce yourself by name and explain to the other students why you have chosen this module.

Remember to comment on other students' posts and to choose the correct discussion forum.

You should have chosen the "Introduction to taxation" discussion forum (if not, please delete your discussion and move it to the correct forum).

Visit the discussion forum **"learning unit 1"** and discuss any concepts that you don't understand,
or
if you do understand, answer those students who have posted questions.
Do the self-assessment in **learning unit 1** on myUnisa.

1.5 TAX RETURNS, ASSESSMENTS AND OBJECTIONS

Prescribed book section: 1.6

The process that should be followed when handing in tax returns is important for any future tax consultant, as this is normally the first aspect of tax that you are confronted with in practice. The rest of the procedures are discussed here to help you understand the process that should be followed when communicating with SARS.

You should have noted the following:

- ✓ Taxpayers may object to an assessment issued by SARS if they do not agree with it.
- ✓ There are strict procedures for the submitting of tax returns and if these are not adhered to, SARS may levy penalties and interest.

1.6 INSOLVENT PERSONS

No prescribed book section

When a natural person becomes insolvent, three different taxpayers have to be dealt with:

- the insolvent as a natural person for the period prior to sequestration (taxpayer one)
- the insolvent estate (taxpayer two)
- the insolvent as a natural person for the period subsequent to sequestration (taxpayer three)

When a natural person (taxpayer one) becomes insolvent, his current tax status is terminated on the day before his estate's date of sequestration. At the date of sequestration a new taxpayer, namely the insolvent estate (taxpayer two), comes into existence. The insolvent himself is regarded as a new taxpayer (taxpayer three) from the date of sequestration. From that date, he will be taxed on any income that he derives in his personal capacity.

In the case where a taxpayer voluntary surrender an estate, the date of sequestration is the date on which the estate is surrendered and the surrender is accepted by the court. In the case of compulsory sequestration, the date of sequestration is the date of the provisional court order, if such order is later made final. (Source: SILKE - South African Income Tax 2017: Volume 2)

You will not be examined on insolvent persons.

1.7 QUESTIONS

Prescribed book section: 1.9

At the end of every learning unit, we will refer you to practical questions (refer to part B of this tutorial letter). Remember the importance of attempting these questions on your own first, **without referring to the solutions**.

This will help you to ascertain whether you understood all the topics that were discussed.

Work through exam preparation questions 1.1 to 1.4 in the prescribed book as well as question 1.1 in part B of this tutorial letter. In these questions, you will have an opportunity to test your newfound knowledge. The questions also deal with situations that you will face in practice. The questions in the exam will also be based on practical applications. These questions will therefore help you to prepare for the exam.

While answering the examination preparation questions, note the following:

- The rebate should be deducted from the normal tax payable and not from the taxable income.
- In the case of persons married in community of property who received interest, the interest must be divided equally between both spouses before deducting the interest exemption.
- If a person is a resident of South Africa all interest received, even from a foreign source, is taxable in South Africa.
- A taxpayer is not allowed to claim any private costs for income tax purposes.
- Where the period of assessment is less than 12 months, only in cases of death, insolvency or birth is the rebate reduced pro rata.

1.8 SOLUTIONS TO ACTIVITIES

Activity 1.1: Refer to framework on page 18 of this tutorial letter.

Activity 1.2: Refer to sections 1.5.3 and 1.5.4 in the prescribed book.

Activity 1.3: Refer to section 5.5 in the prescribed book.

WRAP UP

In this learning unit, you were introduced to the basis on which tax is calculated. You must bear in mind that you will never be tested **directly** on this section of the work, but that it forms a **very** important foundation for the balance of the module. If you do not understand something at this point, it is important for you to resolve it before continuing with the next learning unit.

The remainder of this module will focus on the different components of the framework. If there are some of the components that you are unsure about, it's better to spend more time on becoming familiar with them at this stage, because it will save you a lot of time later on.

In this first learning unit, you learnt how to calculate a person's taxable income and the tax due for the year. In order to continue the general introduction to taxation, in the next learning unit we will look at **gross income**, the starting point of the framework used for calculating taxable income.

ASSESSMENT CRITERIA

We could assess your work on this learning unit in assignments or in the exam, by asking you to:

- calculate gross income
- calculate income
- calculate taxable income
- calculate normal tax
- calculate net normal tax
- calculate net normal tax liability

LITERATURE CONSULTED

Stiglingh, M, Koekemoer, AD, Van Zyl, L, Wilcocks, JS & De Swardt, RD. 2017. SILKE - South African Income Tax. Durban: LexisNexis

Bruwer, L, Coetzee, K, De Hart, KL, Koekemoer, AD & Stedall, C. 2017. *A student's approach to income tax: Natural persons.* Durban: LexisNexis.

INCOME TAX FRAMEWORK

		R	
	Gross income **- including special inclusions, fringe benefits and lump sums (lump sums are taxed separately)**	xxxxxxx	*(learning units 2, 3 & 7)*
less:	**Exempt income**	(xxxxx)	*(learning unit 4)*
gives:	**Income**	xxxxxx	*(learning unit 1)*
less:	**Allowable deductions**		
	- General deductions	(xxxx)	*(learning unit 5)*
	- "Other" allowable expenses	(xxxx)	*(learning unit 5)*
add:	**Taxable capital gain**	xxxx	*(learning unit 6)*
		xxxxx	
less:	**Retirement fund contributions**	(xxx)	*(learning unit 5)*
		xxxxx	
less:	**Donations**	(xxxx)	*(learning unit 5)*
gives:	**Taxable income**	xxxxx	*(learning unit 1)*
	Normal tax (per the tax tables)	xxxxx	*(learning unit 1)*
less:	**Rebates and credits**		
	- Primary	(xxxx)	*(learning unit 1)*
	- Age $\geq$ 65	(xxxx)	*(learning unit 1)*
	- Age $\geq$ 75	(xxxx)	*(learning unit 1)*
	- Medical scheme fees tax credits (section 6A)	(xxxx)	*(learning unit 1)*
	- Additional qualifying medical expense tax credits (section 6B)	(xxxx)	*(learning unit 1)*
	- Foreign tax (section 6*quat*)	(xxxx)	*(learning unit 1)*
gives:	**Net normal tax payable**	xxxxx	*(learning unit 1)*
less:	**Prepaid tax**		
	- Employees' tax	(xxx)	*(learning unit 9)*
	- Provisional tax	(xxx)	*(learning unit 9)*
gives:	**Tax liability**	xxxxx	*(learning unit 1)*

LEARNING UNIT 2

Learning unit

2

Gross income (residents) and special inclusions

INTRODUCTION
STUDY PROGRAMME
LEARNING OUTCOMES
PRESCRIBED STUDY MATERIAL FOR THIS STUDY UNIT
SECTIONS OF PRESCRIBED BOOK THAT YOU MAY IGNORE

CONTENTS OF LEARNING UNIT

WRAP UP
ASSESSMENT CRITERIA
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LITERATURE CONSULTED

INCOME TAX FRAMEWORK

		R	
	Gross income	xxxxxxx	***(learning unit 2)***
	• **Special inclusions**	xxxxx	***(learning unit 2)***
	• **Fringe benefits**	xxxxx	*(learning unit 3)*
	• **Lump sums (lump sums are taxed separately)**	xxxxx	*(learning unit 7)*
less:	**Exempt income**	(xxxxx)	*(learning unit 4)*
gives:	**Income**	xxxxxx	*(learning unit 1)*
less:	**Allowable deductions**		
	- **General deductions**	(xxxx)	*(learning unit 5)*
	- **'Other' allowable expenses**	(xxxx)	*(learning unit 5)*
add:	**Taxable capital gain**	xxxx	*(learning unit 6)*
		xxxx	
less:	**Retirement fund contributions**	(xxxx)	*(learning unit 5)*
		xxxxx	
less:	**Donations**	(xxxx)	*(learning unit 5)*
gives:	**Taxable income**	xxxxx	*(learning unit 1)*
	Normal tax (per the tax tables)	xxxxx	*(learning unit 1)*
less:	**Rebates and credits**		
	- **Primary**	(xxxx)	*(learning unit 1)*
	- **Age ≥ 65**	(xxxx)	*(learning unit 1)*
	- **Age ≥ 75**	(xxxx)	*(learning unit 1)*
	- **Medical scheme fees tax credits (s 6A)**	(xxxx)	*(learning unit 1)*
	- **Additional qualifying medical expense tax credits (s 6B)**	(xxxx)	*(learning unit 1)*
	- **Foreign tax (section 6*quat*)**	(xxxx)	*(learning unit 1)*
gives:	**Net normal tax payable**	xxxxx	*(learning unit 1)*
less:	**Prepaid tax**		
	- **Employees' tax**	(xxx)	*(learning unit 9)*
	- **Provisional tax**	(xxx)	*(learning unit 9)*
gives:	**Tax liability**	xxxxx	*(learning unit 1)*

INTRODUCTION

Gross income is the first main building block of taxation. An amount must be included in gross income before it is subject to tax. An amount is included in gross income, either if it complies with the definition of gross income in the Act, or if it has been included in gross income in terms of one of the special inclusions that are also included in the definition.

In this learning unit, the different components of gross income will be discussed. This will enable you to determine whether an amount must be included in gross income because it complies with the definition of gross income or because of one of the special inclusions.

STUDY PROGRAMME

Refer to the study plan contained in *Tutorial Letter 101*.

LEARNING OUTCOMES

After working through this learning unit, you should be able to:

- state the requirements of gross income for residents
- determine whether an amount has to be included in gross income after analysing each component of the gross income definition
- calculate a person's gross income
- determine whether a person is a resident of the Republic as a result of being ordinarily resident or because they comply with the physical presence test
- determine why certain types of income do not meet the requirements of the general definition of "gross income" but are nevertheless specially included in gross income
- determine which amounts fall within the ambit of "received in respect of services rendered, employment or holding an office"
- list all the categories of receipts and accruals that are specially included in gross income
- demonstrate your ability to discuss whether a particular receipt or accrual should be specially included in gross income, even if it does not meet the "not of a capital nature" requirement of the general definition

PRESCRIBED MATERIAL FOR THIS LEARNING UNIT

Chapter 2 in the prescribed book and sections referred to in chapters 5 and 9.

SECTIONS OF PRESCRIBED BOOK THAT YOU MAY IGNORE

Section 2.9

CONTENTS OF LEARNING UNIT

2.1 BACKGROUND

No prescribed text

The framework on page 20 is the starting point on how to calculate an individual's taxable income and tax liability. The general framework for calculating taxable income and tax liability starts with "gross income". If an amount does not fall into gross income, it cannot be taxed (apart from taxable capital gains that are included directly in taxable income). As a result, it is crucial to know and understand the definition of "gross income", in order to determine whether an amount meets the requirements of that definition.

2.2 GROSS INCOME

Prescribed book sections: 2.1 – 2.2 and 5.2

Gross income, in relation to any year or period of assessment, means

> *in the case of a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident, during such year or period of assessment, excluding receipts or accruals of a capital nature.*

Since not all of these terms in the definition are defined in the Act, we will now examine each term to determine its meaning for taxation purposes.

There are two parts to the definition of gross income:

- The first deals with "residents".
- The second deals with "non-residents" (this is discussed in learning unit 8).

You need to determine whether an individual is a resident or not because

- residents are taxed on their worldwide income while
- non-residents are only taxed on income received from a South African source – see learning unit 8

Questions on gross income will usually be discussion-type questions. If necessary, you will have to discuss each component of the definition of gross income, in order to establish whether an amount constitutes gross income or not.

TIVITY

Visit the discussion forum on **gross income and special inclusions** and discuss any concepts that you do not understand or, if you do understand, then answer those students who have posted questions.

2.3 RESIDENT OF THE REPUBLIC

Prescribed book sections: 2.3 – 2.3.2

A natural person can be a resident by complying with either:

- the "ordinarily resident" test, or
- the "physical presence" test

It is not a requirement that both tests must be met.

The first step is to determine where a person is “ordinarily resident”. If the person is “ordinarily resident”, then the rules applying to physical presence are irrelevant. If a person is not “ordinarily resident”, they may still be a resident because they meet the requirements of the “physical presence” test.

"Ordinarily resident" is determined on the balance of probabilities, as different factors will result in different answers.

There are two important cases that dealt with “ordinarily resident”:

1. *Cohen v CIR* 13 SATC 362
2. *CIR v Kuttel* 54 SATC 298

These cases established the principle that a person is “ordinarily resident” in the place where they return to from their wanderings.

“Physical presence test": a natural person who is not “ordinarily resident” in the Republic may be “resident” if he is physically present in the Republic for certain periods.

Study the “physical presence” test or the “day test” rules. Note: you have to be able to apply the physical presence test in a practical situation under examination conditions.

Attempt examples 2.1 and 2.2 at this point, without referring to the solution. Now compare your attempt with the solution, as provided, and mark your own work – highlight the areas that you missed and revisit your work.

Note:

- ✓ Both residence tests must be applied before it can be decided that a person is **not** a resident of South Africa.
- ✓ Where a person is not ordinarily resident in South Africa then the physical presence test needs to be applied.
- ✓ **All** the requirements for the physical presence test must be met before a person qualifies as a resident.
- ✓ Being a South African “resident” does not necessarily mean that you are a South African passport holder.

2.4 TOTAL AMOUNT IN CASH OR OTHERWISE

Prescribed book section: 2.4

You must be able to determine an actual **amount** received or accrued before there can be any question of gross income. The tax is to be assessed on all receipts or accruals having a money value. If it is something that has no value in money or cannot be turned into money, it cannot fall into gross income.

Even the value of any property received must be included in gross income. This was established in the *Lategan v CIR* 2 SATC case where the court held that the term “amount” included not only money, but also the value of every form of property the taxpayer earned.

2.5 RECEIVED BY OR ACCRUED TO

Prescribed book section: 2.5

“Received” means that a taxpayer receives the amount for his or her own benefit and on his or her own behalf.

“Accrued” means that the taxpayer has become entitled to the amount.

An amount is included in gross income at either date of receipt or date of accrual, whichever event happened first. You cannot be taxed twice on an amount.

Accrual only takes place when a taxpayer becomes unconditionally entitled to an amount. This means that if I will only receive R10 000 if it rains on 4 April, then the amount will only accrue to me and be included in my gross income on 4 April **– and only if it rains**. If it does not rain, the amount will not be included in gross income.

Note:

- ✓ An amount is taxable at the earliest of receipt or accrual, and it is thus not required that the amount be received before it can be taxed.
- ✓ With cash sales, accrual and receipt coincide.
- ✓ With credit sales, accrual takes place before receipt.
- ✓ With advance payments, receipt takes place before accrual.

2.6 YEAR OR PERIOD OF ASSESSMENT

Prescribed book section: 2.6

An amount is only income and subject to taxation in a relevant year if it has been received by or has accrued to a taxpayer during that year of assessment. Each year of assessment stands on its own.

When rates of tax or special provisions change from one year to the next, it becomes important from the point of view of both the taxpayer and SARS to ensure that all amounts received or accrued during a particular year of assessment are included in the assessment for that year.

2.7 RECEIPTS OR ACCRUALS OF A CAPITAL NATURE

Prescribed book sections: 2.7 – 2.7.3

The definition of "gross income" **excludes** receipts and accruals of a capital nature.

This requirement for gross income is usually the most difficult to apply. The nature of transactions differs from person to person. Most transactions under dispute will end up with a court having to decide whether the amount is capital or not. The courts have laid down some factors that they use to assist them in deciding.

The nature of the receipt is determined by subjective considerations. In other words, the intention of the taxpayer is taken into account, but it must be supported by objective factors. The taxpayer cannot state a specific intention but then none of his actions support what he says.

Generally, the receipt or accrual will be income in nature if the asset was acquired with the purpose of selling it at a profit. However, if the asset itself was acquired and held, not for the purpose of resale at a profit but to produce income from that asset such as rent, interest or dividends, then the proceeds on the disposal of the asset will be capital in nature. For example, a house that was acquired to produce rental income, if sold, will produce a capital receipt. It is, however, possible that a taxpayer could have acquired an asset for investment (capital), but later changed his intention to embark on a scheme of profit making. In such a case, the receipt or accrual would be of an income nature.

Subjective factors:

- What is the intention of the taxpayer – this is a subjective matter and the courts have dealt with it as follows:
  - o What was the taxpayer's intention at the time he acquired the asset?
  - o What was the taxpayer's intention during the whole period over which he held the asset (there may have been a change of intention)?
  - o What was the taxpayer's intention at the time he disposed of the asset?
  - o Were there possible mixed intentions?

Objective factors:

As previously stated, the court will weigh up the taxpayer's evidence of his intention by having regard to certain objective factors. Some of the objective factors considered by the court are as follows:

- manner of acquisition
- manner of disposal
- period for which the asset was held
- continuity
- occupation of the taxpayer
- no change in ownership of the asset
- nature of the asset disposed of
- reason for the receipt
- legal nature of the transaction
- an operation of business in carrying out a scheme of profit making
- other factors

Case law – please understand the principles laid down in the case law pertaining to the objective factors and why the courts decided on the outcome. Application of the case law is imperative to a question in the examination paper.

If a receipt is of a capital nature it is not included in gross income **but** it **may** be subject to capital gains tax. Refer to learning unit 6, which covers capital gains tax.

This component of the definition of gross income is the most difficult to ascertain. In discussion-type questions the greatest emphasis will usually be placed on this component; you do need to know what principles to apply and their application to the cases in the question asked. References to the case law and the principles applied are recommended.

2.8 SPECIAL INCLUSIONS IN GROSS INCOME: INTRODUCTION

The general definition of "gross income" is contained in section 1 of the Income Tax Act. That definition is extended by the addition of paragraphs (*a*) to (*n*). These are the so-called "special inclusion" provisions. These provisions are also dealt with in this learning unit. They involve certain receipts and accruals that do not fall within the scope of the general definition of "gross income" (usually because they are capital in nature) but are nevertheless **specifically included**. In other words, even though these amounts may be capital in nature, they still **must be** included in gross income.

2.8.1 Annuities and Periodic payments: paragraph (*a*)

Prescribed book sections: 2.8 to 2.8.1 and 9.3 to 9.3.4

Pension income is received in regular, periodic payments. Periodic payments include monthly receipts from any type of pension, provident, preservation or retirement annuity fund. These payments are specially included in gross income in terms of paragraph (*a*) of the gross income definition.

Non-residents of South Africa will be taxed on pensions paid to them from South Africa, as well as certain pensions that are deemed to be from a South African source. In some cases, it might be necessary to apportion the pension between the periods for which the person was employed in South Africa and the period for which he or she was employed outside South Africa.

Any type of annuity is also specially included in terms of paragraph (*a*). It is important to be aware that annuity income does not only originate from retirement annuity funds. For example, annuity income can be received from insurance policies, from employers and from the purchaser of a business. Ensure you know and understand the three main characteristics of an annuity, as outlined in *ITC 761* 19 SATC 103.

Also be aware of the following principle: a receipt that is regarded as being capital in nature and not normally subject to taxation, such as an inheritance, will be specially included in gross income if it is payable in the form of an annuity. See *Kommissaris van Binnelandse Inkomste en 'n Ander v Hogan* 55 SATC 329.

A taxpayer can invest an amount with an insurance company and thereby purchase an annuity. The taxpayer will then receive monthly annuity payments from the insurance company. This type of annuity is called a "purchased annuity". The annuities received by the taxpayer are composed of two elements: a partial repayment of the original capital investment (which is non-taxable) and an investment return. The non-taxable portion is calculated in terms of a formula. That amount is then deducted from the total returns received during the year of assessment in order to determine the taxable portion of the purchased annuities.

2.8.2 Alimony, allowances or maintenance: paragraph (*b*)

Prescribed book section: 2.8.2

You need to know nothing more than that these receipts are specially included in gross income. (The exemptions that apply to them are covered in learning unit 4.)

2.8.3 Amounts received in respect of services rendered, employment or holding an office: paragraphs (*c*), (*cA*), (*cB*) (*d*), (*f*) & (*i*)

Prescribed book section: 2.8.3

These are important "catch-all" paragraphs, which ensure that any receipts relating to employment, holding of an office or for services rendered will be included in gross income – regardless of the fact that they may be capital in nature.

Be aware that there must be a **causal connection** between the amount received on the one hand, and the fact of employment, holding of an office or the services rendered, on the other. Consider the following situation: Jill pays R10 000 to John in respect of services that were actually rendered by Jack (John's father). The R10 000 must be specially included in Jack's (not John's) gross income. It was Jack's services that **caused** the payment therefore, it must be included in his gross income.

It is important to note, "services rendered" are not limited to employer/employee situations. See the case of the police reward payment in *C: SARS v Kotze* 64 SATC 447.

You should also realise that this is where fringe benefits are included in gross income, via paragraph (*i*). Lump sums from employers are included via paragraphs (*d*) and (*f*).

2.8.4 Retirement fund lump sum benefits or retirement fund lump sum withdrawal benefits: paragaphs (*e*) & (*eA*)

Prescribed book section: 2.8.4

These paragraphs are relatively straightforward; they simply ensure that the taxable portions of retirement fund lump sums are included in gross income.

Learning unit 7 deals with how the taxable portion of these lump sums is calculated and taxed.

2.8.5 "Know-how" payments: paragraph (*gA*)

Prescribed book section: 2.8.5

All you need to know about this paragraph is that payments received for selling scientific and technical knowledge, or for the rendering of services in connection with the application of that knowledge, are specially included in gross income.

2.8.6 Dividends: paragraph (*k*) and specific income

Prescribed book section: 2.8.6 and 5.1 – 5.2

The above specially include all dividends, interest and other income (both local and foreign) in a taxpayer's gross income. The exemptions that are applicable to dividends and interest are covered in learning unit 4.

2.8.7 Other amounts included in gross income: paragraphs (*g*), (*l*), (*m*), (m*A*) & (*n*)

Prescribed book section: 2.8.7

In this section, for the purposes of this module, the most important paragraph is paragraph (*n*). This paragraph states that any amount, which in terms of **any other** provisions of the Act, is required to be included in a taxpayer's income must be specifically included in gross income. This is another "catch-all" paragraph, which ensures that all taxable receipts or accruals (whether actual or deemed), do not slip through the gross income "net". The paragraph covers a wide range of receipts and accruals, including recoupments, income from an estate accruing to beneficiaries and gains from foreign exchange transactions.

One amount that is included in gross income via paragraph (*n*) is particularly relevant to this module. This is where a portion of income that is actually received or accrued by one spouse, is deemed to accrue to the other spouse. This occurs where taxpayers are married in community of property. For couples married in community of property, passive income and rental income are deemed to be received in an equal share by both spouses. Passive income includes dividend income and interest income. It is important to be aware that the interest **exemptions** (to be covered in learning unit 4) that are available to individuals are not halved. Each spouse is still entitled to his or her full exemption.

For examination purposes, note that for discussion-type questions you will have to

- discuss the theory relating to the question
- apply the main principles of any relevant case law to the given scenario

After a brief discussion and analysis of what you understood by the question (in reference to the case law applied), you will then draw a conclusion.

Do the self-assessment test on "Gross income" on myUnisa.

WRAP UP

- ✷ Both residence tests must be applied before it can be decided that a person is not a resident of South Africa.
- ✷ Where a person is not ordinarily resident in South Africa then the physical presence test needs to be applied.
- ✷ All the requirements of the gross income definition must be met. If one of the components is not met, the receipt or accrual will not be included in gross income (except if it is one of the special inclusions).
- ✷ Receipts and accruals that do not meet the general gross income definition may nevertheless be specially included in gross income.
- ✷ In order for an amount to constitute an annuity, it must have three main characteristics.
- ✷ Any amounts received in respect of employment, services rendered or holding an office are specially included in gross income.
- ✷ Amounts received "in respect of services rendered" are not limited to employer/employee situations.
- ✷ Fringe benefits are specially included in gross income via the provisions of paragraph (*i*).
- ✷ The taxable portions of retirement fund lump sum benefits or retirement fund lump sum withdrawal benefits are specially included in gross income via the provisions of paragraphs (*e*) and (*eA*).
- ✷ Amounts that are specially included in gross income may nevertheless be exempt from income tax.

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

ASSESSMENT CRITERIA

We could assess your work on this learning unit in assignments or in the exam by asking you to:

- ✷ re-write the components of gross income for a resident
- ✷ state the factors that can be used to determine whether an amount is of a capital nature or not
- ✷ re-write the main difference between the receipt and accrual requirements
- ✷ summarise and list the requirements (for both residence tests) that have to be met before a person is considered a resident of the Republic
- ✷ discuss whether a particular receipt or accrual should be specially included in gross income
- ✷ discuss whether a particular receipt or accrual constitutes an annuity or whether it is simply the re-payment of a capital debt
- ✷ list the various types of receipts and accruals that are specially included in gross income, despite their capital nature
- ✷ identify whether a particular amount has been received or accrued as a result of services rendered, employment or holding an office
- ✷ apply relevant case law in determining whether a particular receipt or accrual should be specially included in gross income
- ✷ determine the taxable portion of periodic payments

QUESTIONS | **Prescribed book section: 2.11**

With regard to **gross income and special inclusions, work through** exam preparation questions 2.1 to 2.4 in the prescribed book as well as questions 2.1 to 2.11 in part B of this tutorial letter.

The exam preparation questions are similar to the situations you will face in practice.

The questions in the exam will also be based on practical applications. The exam preparation questions will therefore help you prepare for the exam.

LITERATURE CONSULTED

Stiglingh, M, Koekemoer, AD, Van Zyl, L, Wilcocks, JS & De Swardt, RD. 2017. SILKE - South African Income Tax. Durban: LexisNexis.

Bruwer, L, Coetzee, K, De Hart, KL, Koekemoer, AD & Stedall, C. 2017. *A student's approach to income tax: Natural persons.* Durban: LexisNexis.

NOTES

LEARNING UNIT 3

INTRODUCTION
STUDY PROGRAMME
LEARNING OUTCOMES
PRESCRIBED STUDY MATERIAL FOR THIS STUDY UNIT
SECTIONS OF PRESCRIBED BOOK THAT YOU MAY IGNORE

CONTENTS OF LEARNING UNIT

WRAP UP
ASSESSMENT CRITERIA
LITERATURE CONSULTED

Learning unit
3
Fringe benefits and allowances

INCOME TAX FRAMEWORK

		R	
	Gross income	xxxxxxx	*(learning unit 2)*
	• **Special inclusions**	xxxxx	*(learning unit 2)*
	• **Fringe benefits**	xxxxx	***(learning unit 3)***
	• **Lump sums (lump sums are taxed separately)**	xxxxx	*(learning unit 7)*
less:	**Exempt income**	(xxxxx)	*(learning unit 4)*
gives:	**Income**	xxxxxx	*(learning unit 1)*
less:	**Allowable deductions**		
	- **General deductions**	(xxxx)	*(learning unit 5)*
	- **"Other" allowable expenses**	(xxxx)	*(learning unit 5)*
add:	**Taxable capital gain**	xxxx	*(learning unit 6)*
		xxxx	
less:	**Retirement fund contributions**	(xxxx)	*(learning unit 5)*
		xxxxx	
less:	**Donations**	(xxxx)	*(learning unit 5)*
gives:	**Taxable income**	xxxxx	*(learning unit 1)*
	Normal tax (per the tax tables)	xxxxx	*(learning unit 1)*
less:	**Rebates and credits**		
	- **Primary**	(xxxx)	*(learning unit 1)*
	- **Age $\geq$ 65**	(xxxx)	*(learning unit 1)*
	- **Age $\geq$ 75**	(xxxx)	*(learning unit 1)*
	- **Medical scheme fees tax credits (section 6A)**	(xxxx)	*(learning unit 1)*
	- **Additional qualifying medical expense tax credits (section 6B)**	(xxxx)	*(learning unit 1)*
	- **Foreign tax (section 6*quat*)**	(xxxx)	*(learning unit 1)*
gives:	**Net normal tax payable**	xxxxx	*(learning unit 1)*
less:	**Prepaid tax**		
	- **Employees' tax**	(xxx)	*(learning unit 9)*
	- **Provisional tax**	(xxx)	*(learning unit 9)*
gives:	**Tax liability**	xxxxx	*(learning unit 1)*

INTRODUCTION

A person working as an employee for an employer earns a salary. Employees may also receive certain benefits from their employers as part of their salary packages. These benefits are not received by the employee in the form of cash. For tax purposes, these benefits are called fringe benefits. These fringe benefits must be converted into a cash equivalent amount and the taxable benefit should be included in the employee's taxable income calculation. Allowances, however, are cash payments to an employee.

The amounts discussed in this learning unit refer only to benefits that are granted by an employer to an employee. (Therefore, there must be an employer-employee relationship in order for these rules to be applicable.)

STUDY PROGRAMME

Refer to the study plan contained in *Tutorial Letter 101*.

LEARNING OUTCOMES

After working through this learning unit, you should be able to:

- explain that fringe benefits form part of "gross income"
- identify fringe benefits in a case study type question and be able to value them and bring them in as "gross income" when calculating taxable income
- calculate the cash equivalent of the Seventh Schedule fringe benefits covered in this module, and point out in which circumstances they will have no value or be excluded or exempted
- calculate the amount to be included in income where a person receives a travel allowance for a full year of assessment or part of a year of assessment
- calculate the amount of the subsistence or public officer allowance to be included in income, based on actual expenses incurred or deemed expenses
- identify when uniforms, transfer costs and bursaries will be exempt from income tax

PRESCRIBED MATERIAL FOR THIS LEARNING UNIT

Chapter 6 in the prescribed book.

SECTIONS OF PRESCRIBED BOOK THAT YOU MAY IGNORE

The following sections in the prescribed book may be ignored:

- 6.5 Taxation of amounts derived from broad-based employee share plans
- 6.6 Taxation of directors and employees on vesting equity instruments
- 6.7.3 Qualifying equity shares in terms of broad-based employee share plans
- 6.7.4 Equity instruments in terms of section 8C
- 6.7.5 Equity instruments in terms of section 8C – "stop loss" provision
- 6.8 Administrative provisions

CONTENTS OF LEARNING UNIT

3.1 BACKGOUND

Prescribed book sections: 6.1 – 6.3

In order to understand the application of taxation it is important that you have a good foundation on how taxes are levied in South Africa.

Fringe benefits form part of gross income. They are employee benefits a taxpayer receives that are **not** in the form of cash. The Income Tax Act provides the rules in the Seventh Schedule to determine how a taxable benefit must be converted into a cash amount (cash equivalent) that should be included in "gross income". At this point, it is important to realise that where an employee makes use of any asset for business purposes, there are no tax consequences as far as SARS is concerned. It is only where private or domestic use of an asset is more than incidental that there will be tax consequences.

Several sections of the Act deal with the inclusion of fringe benefits in a person's taxable income. Let's start by discussing fringe benefits that are included in taxable income as a result of the definition of "gross income" in paragraph (*i*). Paragraph (*i*) refers to all fringe benefits listed in the Seventh Schedule. Remember that fringe benefits form part of a taxpayer's income because they are benefits given instead of cash remuneration.

When answering a longer, case study type question, it will be expected from you to be able to identify fringe benefits, calculate their value and include the correct amount in your calculation of taxable income. Do not study this learning unit independently – remember that you could come across fringe benefits in any question where there is an employer-employee relationship.

We will now investigate which fringe benefits are specifically listed in the Seventh Schedule and study the rules applicable for calculating the value of the fringe benefit to be included in the income of a taxpayer.

3.2 FRINGE BENEFITS IN TERMS OF THE SEVENTH SCHEDULE

Prescribed book section: 6.3.1

Paragraph (*i*) of the gross income definition applies only to those benefits that are actually listed in the Seventh Schedule. Therefore, if a person receives a benefit that is not listed here, one of the other rules provided for in the Act will have to be used to include the amount in gross income.

It is very important that you know which benefits are included in the Seventh Schedule. You also need to know the rules for calculating the cash equivalent of each fringe benefit. All the exemptions and exclusions are also very important because they indicate in which circumstances an amount will be excluded from taxable income.

Also, remember that where a relative of the employee receives a benefit, the employee will still be taxed on that benefit and where an associated institution (in relation to the employer) grants a benefit to an employee, it is still taxable in the hands of the employee.

You should look out for the following and ensure you know:

- ✓ who an employee is
- ✓ who an employer is
- ✓ what an associated institution is
- ✓ which benefits are excluded from taxable benefits
- ✓ the meaning of each term
- ✓ all the fringe benefits that are dealt with in the Seventh Schedule

Each of the taxable fringe benefits that are listed in the Seventh Schedule has a special rule for calculating the amount that must be ***included*** in "gross income".

Without referring to your prescribed book

- list all the taxable fringe benefits in the Seventh Schedule

We will now deal with each fringe benefit separately. After studying all the fringe benefits, it is advisable to make a summary for yourself. As an example, you could use the following format.

Fringe benefit: ***Acquisition of an asset***	**Calculation of cash equivalent**
• Asset acquired from employer for nothing or for less than market value	**Market value** at time acquired by employee Less: Amount paid by employee
• Movable asset purchased specifically for the employee	**Cost** to employer Less: Amount paid by employee
• Trading stock of employer	**Lesser of cost** to employer **or market value** Less: Amount paid by employee

Exclusions
• Asset given for bravery: **lesser of** **cost** to employer **or** **R5 000** exempt • Asset given for long service (15 years initial, 10 years subsequent) **lesser of** **cost** to employer **or** **R5 000** exempt • **Cash** given for bravery or long service **not** exempt

We summarised the first fringe benefit for you to give you an idea of what your summary could look like.
Once you have dealt with a fringe benefit, add it to your own summary. Ensure you covered all aspects of each fringe benefit in your summary.

3.2.1 Acquisition of an asset at less than the actual value

Prescribed book section: 6.3.2

Where an employee is provided with or buys an asset from his employer at less than what it is valued at, a benefit arises and the employee will be taxed on this benefit in terms of the Seventh Schedule. There are a number of circumstances that can result in a benefit arising, and you must know the specific rule in each case. For example, an employee could purchase trading stock from an employer, he might purchase an old, used asset from the employer, or the employer might purposefully purchase an asset to give or sell to the employee.

3.2.2 Right of use of an asset

Prescribed book section: 6.3.3

Right of use of an asset implies that the employee does not become the legal owner of the asset. However, the employee is allowed to make use of the asset - either for a temporary period or for the full useful life of the asset. Where the employee uses this asset for private or domestic purposes, a fringe benefit will arise.

You should have noted the following:

✓ There are different rules depending on whether the employer leases or owns the affected asset.
✓ There are different rules where the employee is granted temporary use of the affected asset and where the employee may use the affected asset for its entire useful life.

3.2.3 Right of use of a motor vehicle

Prescribed book section: 6.3.4

The previous fringe benefit applied to the use of an asset but specifically excluded the use of motor vehicles. We will now study the specific rules for determining the taxable inclusion in respect of the use of an employer-owned motor vehicle. This benefit is often referred to as a "company car". Once again, you must bear in mind that the taxpayer is being taxed on the private use of the vehicle.

This fringe benefit is based on the assumption that the employee **only drives the vehicle for private purposes** during a year of assessment. Where an employee keeps a proper logbook and can prove the business kilometres travelled then, on assessment, the value placed on the private use may be reduced. The value will be reduced by the following ratio: business kilometres travelled divided by total kilometres travelled.

You should have noted the following:

✓ There are two rates at which the right of use of a company vehicle can be taxed:
- 3,5% **per month** of the “determined value” of the motor vehicle, or
- 3,25% **per month** of the “determined value” of the motor vehicle if it is subject to a maintenance plan (contractual obligation should terminate at the earlier of the end of a period of three years or the date on which 60 000 km have been travelled by the vehicle).

✓ Where two or more employer-owned vehicles are used at the same time and the Commissioner agrees that each vehicle is primarily used for business purposes:
- the value for private use of all the vehicles will be determined using the value of the vehicle having the **highest** “determined value”

✓ Determined value for a company car is the cash cost of the vehicle **including VAT** (but excluding finance charges and interest). Where applicable, the determined value may be reduced by 15% p.a.
✓ The value of the fringe benefit **cannot** be reduced for purposes of **calculating employees’ tax** (dealt with in learning unit 9). Where the employee pays for the full cost of the licence, insurance, maintenance or private fuel for that vehicle – this will be done on assessment (when the employee submits his own tax return), provided the employee has kept accurate records.
✓ The value of this fringe benefit **can** be reduced by any consideration paid by an employee for the use of the vehicle.
✓ A claim for the full fuel cost actually incurred by an employee for private purposes will be calculated **on assessment** by applying the prescribed rate per kilometre to the kilometres travelled for private purposes.
✓ No value is placed on the private use of a company owned vehicle if
- it is available and used by all employees (private use is incidental and the vehicle is not normally kept near the employee’s residence or used outside normal business hours – the vehicle is effectively a pool car), or
- the employee’s duties require regular use of the vehicle for the performance of duties outside normal hours of work and private use is infrequent or incidental to business use.

In the exam, the percentages above will be supplied to you as part of the schedules at the end of the exam paper. However, the exam duration is very short and it will be a beneficial use of your time if you do know the relevant percentages.

3.2.4 Meals, refreshments and meal and refreshment vouchers

Prescribed book section: 6.3.5

Take special note of the exclusions in this section. In many instances, these exclusions mean that a taxpayer will not be taxed on meals provided to him or her by an employer.

3.2.5 Accommodation

Prescribed book section: 6.3.6

This fringe benefit covers the situation where an employer supplies the employee, and sometimes his or her family, with residential accommodation. It covers accommodation owned by the employer as well as accommodation that is leased on behalf of the employee.

A fringe benefit will also arise if any holiday accommodation is provided by the employer, for the benefit of an employee.

You need **to learn the residential accommodation formula** as it will not be supplied in the schedules at the end of the exam paper.
Please take note of the exclusions for residential accommodation.

You should have noted the following:

- ✓ There are different rules for residential accommodation and for holiday accommodation.
- ✓ Where the employer owns the residential accommodation then the cash equivalent will be determined as per the formula.
- ✓ Where the employer does not own the residential accommodation, then the cash equivalent will be the lower of the formula or the rental paid by the employer.
- ✓ (A-B) x C/100 x D/12
  A in the formula is referred to as the remuneration proxy. You should be able to calculate this amount from given information.
  B = R75 750 in most circumstances
  C = 17, or
  C = 18 (**at least** four rooms, and furnishings **or** electricity supplied), or
  C = 19 (**at least** four rooms, and furnishings **and** electricity supplied)
  D = the number of months the accommodation is used
  Make sure you recognise under which circumstances you will have to use the various figures.
- ✓ The cash equivalent of holiday accommodation depends on whether the accommodation is owned or leased by the employer and will be reduced by the amount of any consideration given by an employee.

3.2.6 Free or cheap services

Prescribed book section: 6.3.7

This fringe benefit relates to services that was performed for the private or domestic benefit of an employee, but have been paid for by the employer.

Please take note of the exclusions.

Did you notice that if an employer provides a transport service for employees between their homes and workplace, there is no taxable benefit?

3.2.7 Low interest or interest-free loans

Prescribed book section: 6.3.8

Where an employer lends money to an employee, there could be a fringe benefit. This fringe benefit depends on whether interest has been charged at less than the official rate of interest (a rate of interest used by the Commissioner for the purpose of calculating a deemed fringe benefit on low or interest-free loans). The value of the fringe benefit is determined by multiplying the amount of the loan granted with the difference between the actual interest rate applicable to the loan and the official rate of interest.

The official rate of interest is announced by the Minister of Finance and does change from time to time. For the purpose of this benefit, the interest rate is set as follows:

- For loans in rand – 100 basis points above the Reserve Bank repurchase rate (repo rate)
- For loans in a foreign currency – 100 basis points above the SA repo rate for that foreign currency
- 100 basis points are equal to 1%
- Official interest rate = repo rate + 1%

We will provide the official/repo rate of interest in the exam, therefore you need not memorise this. If the repo rate changes, the official rate changes from the beginning of the next calendar month.

You should have noted the following:

✓ The cash equivalent is the difference between the official interest rate and the actual interest rate (if any) that is paid by an employee.
✓ The rate is for a full year; where the employee has a loan for less than 12 months then the cash equivalent is reduced pro rata.
✓ The deemed interest can be deducted as an interest expense in terms of section 11(*a*) provided it would have been incurred by the taxpayer in the production of income.
✓ Casual loans of less than R3 000 are excluded from this fringe benefit.
✓ Loans to further one's own studies are excluded from this fringe benefit.

Deemed loans:

Paragraph 10A of the Seventh Schedule deems a benefit granted by an employer under a housing scheme to constitute a loan where:

- any employee has been granted a right to occupy residential accommodation owned by his or her employer or any associated institution in relation to his or her employer
- the employee, his or her spouse or minor child is entitled or obliged, in terms of an agreement entered into with such employer or associated institution, to acquire such residential accommodation at a future date at a price stated in such agreement
- the employee is required to pay a rental, which is calculated wholly or partially on the price referred to in the agreement above, in respect of his or her occupation of such residential accommodation

You should have noted that the cash equivalent of this benefit will be calculated by multiplying the price according to the agreement with the official rate of interest and deducting from such calculated amount the rent actually paid by the employee.

Also note that there will be no taxable benefit if an employee will acquire the property at a future date for the price as per the agreement and the market value of the property exceeds the said agreement price.

3.2.8 Subsidy in respect of loans

Prescribed book section: 6.3.9

This fringe benefit refers to the situation where an employer assists an employee in repaying any interest or capital portion of any loan due by an employee to a third party, such as a financial institution.

You should have noted that:

- ✓ any amount paid on the employee's behalf by the employer is taxable in full in the employee's hands as he or she has received a benefit

3.2.9 Medical fund contributions paid on behalf of an employee and incurral of medical services costs

Prescribed book sections: 6.3.10 and 6.3.11

A fringe benefit arises in terms of medical aid fund contributions paid by an employer.

How do medical aid funds work?

When a person chooses to belong to a medical aid fund, the fund will inform that person of the contributions they require each month from them in order to be a member of a medical aid fund. These contributions are based on various criteria and take into consideration the age of the person, how many dependants they have and who will also be members of the fund.

Depending on the person's employment contract, these contributions might be paid by the person (employee) or they might be shared by the person (employee) and their employer. The employer might even take responsibility for the full contributions to be paid to the fund.

In terms of the Income Tax Act, the contributions paid by the employer will give rise to a taxable fringe benefit in the hands of the employee.

You should have noted the following:

- ✓ Where the employee or a dependant has a disability, as defined, then the employer must still calculate a fringe benefit.
- ✓ The contribution amount paid by an employer on behalf of an employee who is 65 years and older, and has **not** retired from the employer, is a taxable fringe benefit.
- ✓ If an employee has retired, and the employer continues to pay contributions on behalf of the retired employee, the fringe benefit will be non-taxable.

Incurral of medical services costs:

You should have noted that services rendered by the employer to employees in general at their place of work for the better performance of their duties, would not be regarded as a taxable benefit.

3.2.10 Benefits in terms of insurance policies

Prescribed book section: 6.3.12

You should have noted that the cash equivalent of any insurance policy premiums paid by an employer in terms of an insurance policy, directly or indirectly, for the benefit of an employee, his or her spouse, child, dependant or nominee would constitute a taxable benefit for the employee.

3.2.11 Retirement fund contributions paid on behalf of an employee

Prescribed book section: 6.3.13

In terms of the Income Tax Act, any retirement fund contributions paid by an employer will give rise to a taxable fringe benefit in the hands of the employee.

3.2.12 Payment of an employee's debt or the release of an employee from the obligation to pay a debt

Prescribed book section: 6.3.14

You should have noted that where an employer pays any amount on behalf of an employee to a third party, the amount so paid is taxable in the employee's hands.

You should have noted that subscriptions paid on behalf of an employee by an employer to a professional body (if the employee has to belong to that body in order to be employed), are not taxable.

3.3 ALLOWANCES AND ADVANCES

Prescribed book sections: 6.4, 6.4.1, 6.4.2, 6.4.3, 6.4.4 and 6.4.5

Sometimes an employee will receive allowances from his or her employer in order to assist him or her in paying certain expenses that the employer expects him or her to incur in order to perform a job.

These allowances may take the form of reimbursive allowances, where the employee will be refunded the amount that he or she spends, once he or she provides the employer with proof that the expenditure has actually been incurred for business purposes.

Other allowances are provided to employees to cover certain expenses, but the employee has to decide whether or not he or she will use the allowance for such purpose.

All allowances (except for travelling, subsistence and public office allowances) are included in full in an employee's taxable income. The exceptions to the rule, namely travel, subsistence and public office allowances, are discussed below.

Travelling allowance:

The full travel allowance received is **not** included in income. Only the part of the allowance that remains (if anything), once the cost of travelling for business purposes has been deducted, is included.

Travel allowance received
Less: cost of business travelling

⇩	⇩
Amount of the remaining allowance (Positive answer)	**Cost exceeds allowance** (Negative answer)
⇩	⇩
Include in taxable income	**No inclusion** (No deduction of cost that exceeds allowance)

What you are trying to achieve when dealing with a travel allowance is that, so long as the employee has used the travel allowance to pay for business travelling, there will not be a fringe benefit.

Where employees received an allowance of more than what they spent on business travelling, then the excess amount of the travel allowance will be taxed. However, how do we calculate the cost of business travelling?

In order to calculate the cost of business travelling, we need two variables:

1. Actual business kilometres travelled
2. Cost per kilometre travelled

How do we obtain this information?

Business kilometres travelled:

In order to ascertain the distance a person travelled for business purposes, we have to refer to

- a logbook

The logbook will give us the actual kilometres travelled during the year of assessment. A logbook is used every time the employee travels in his car to record how far he travelled and the purpose of the trip. Travelling can only be for private or business purposes. Therefore, if we supply you with the total kilometres travelled for the year of assessment and we give you the private kilometres travelled for same year of assessment, then the difference between the two values must be the business kilometres travelled.

Be aware that if an employee does not keep a logbook, he will not be entitled to claim any business travel expenditure. His entire travel allowance will therefore be fully taxable.

Cost per kilometre:

Now that we understand how to calculate the business kilometres, we need to calculate how much it costs a person to run his vehicle for the year of assessment. We can

- make use of the actual expenses, where the employee has kept proof, or
- we can make use of the tables that are provided in the Income Tax Act

Where an employee keeps proof of all his expenditure on travelling during the year of assessment, the total actual expenditure will be divided by the total kilometres travelled to give us a calculated cost per kilometre. Actual costs cannot be calculated where the employee only knows the cost price of the vehicle.

Where an employee does not keep proof of his actual expenditure on travelling, he can make use of the tables to calculate the total cost per kilometre (fixed plus variable).

You will be supplied with the "Employee-owned vehicles" table for the purpose of determining the portion of the travel allowance expended for business purposes. Remember that the determined value of the vehicle includes VAT, but excludes finance charges or interest payable. The table is contained in Appendix B of the prescribed textbook.

Subsistence allowance:

You should have noted the following:

- ✓ Only the portion of the allowance that is not spent for business purposes is included in taxable income.
- ✓ A taxpayer is allowed to either use the actual expenditure incurred or deemed figures, whichever yields the greater deduction.

Public officer allowance:

There are two important elements to this type of allowance. Firstly, you should know who qualifies as a holder of public office. Secondly, you need to know the five categories of deductible expenses.

Other allowances:

You should have noted that section 23(*m*) limits the deductions that can be allowed for salaried persons and therefore no deduction against these allowances is allowed in terms of section 23(*m*).

3.4 EXEMPTIONS

Prescribed book section: 6.7

Note only the following exemptions:

- special uniforms
- transfer costs
- scholarships and bursaries

Summarise all the taxable fringe benefits applicable to employees in the Republic.

Visit the discussion forum – **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.

Do the self-assessment test on fringe benefits on myUnisa.

3.5 QUESTIONS

Prescribed book section: 6.10

Work through exam preparation questions 6.1 to 6.4 as well as questions 3.1 to 3.6 in part B of this tutorial letter. In these questions, you will have an opportunity to test the knowledge you have gained relating to fringe benefits. The exam preparation questions are similar to the situations you will face in practice. The questions in the exam will also be based on practical applications; the exam preparation questions will therefore help you to prepare for the exam.

Remember that any person who receives a salary may also receive any of the above-mentioned fringe benefits or allowances. It is therefore important that you understand how these form part of a taxpayer's income, because in the exam fringe benefits can be integrated into any of the other topics that are examinable for individuals.

WRAP UP

In this learning unit, we studied amounts that employees can earn, over and above their cash salaries. These fringe benefits are subject to special rules for calculating the cash equivalent. Where the benefit is not listed in the Seventh Schedule, then other sections of the Act must be applied to determine whether the benefit should be included in taxable income or not. Where the Seventh Schedule does apply, any amount of consideration paid by the employee for the benefit may normally be used to reduce the cash equivalent before it is included in taxable income.

The requirements for a taxable fringe benefit:

- Employer-employee relationship must exist
- It is added to income before deductions

Now you have completed this learning unit, please revisit the learning objectives and ensure that you have attained all of them.

ASSESSMENT CRITERIA

We could assess your work on this learning unit in assignments or in the exam by asking you to:

- calculate the cash equivalent of a fringe benefit
- identify exceptions to the general valuation rule for a particular fringe benefit
- calculate reductions in the value of a fringe benefit
- identify benefits that are excluded as taxable fringe benefits
- calculate the taxable portion of fringe benefits and allowances

LITERATURE CONSULTED

Stiglingh, M, Koekemoer, AD, Van Zyl, L, Wilcocks, JS & De Swardt, RD. 2017. SILKE - South African Income Tax. Durban: LexisNexis

Bruwer, L, Coetzee, K, De Hart, KL, Koekemoer, AD & Stedall, C. 2017. *A student's approach to income tax: Natural persons.* Durban: LexisNexis.

NOTES

LEARNING UNIT 4

Learning unit

4

Exempt income

INTRODUCTION
STUDY PROGRAMME
LEARNING OUTCOMES
PRESCRIBED STUDY MATERIAL FOR THIS STUDY UNIT
SECTIONS OF PRESCRIBED BOOK THAT YOU MAY IGNORE

CONTENTS OF LEARNING UNIT

POINTS TO PONDER
WRAP UP
ASSESSMENT CRITERIA
LITERATURE CONSULTED

INCOME TAX FRAMEWORK

		R	
	Gross income	xxxxxxx	*(learning unit 2)*
	• **Special inclusions**	xxxxx	*(learning unit 2)*
	• **Fringe benefits**	xxxxx	*(learning unit 3)*
	• **Lump sums (lump sums are taxed separately)**	xxxxx	*(learning unit 7)*
less:	**Exempt income**	(xxxxx)	***(learning unit 4)***
gives:	**Income**	xxxxxx	*(learning unit 1)*
less:	**Allowable deductions**		
	- **General deductions**	(xxxx)	*(learning unit 5)*
	- **“Other” allowable expenses**	(xxxx)	*(learning unit 5)*
add:	**Taxable capital gain**	xxxx	*(learning unit 6)*
		xxxxx	
less:	**Retirement fund contributions**	(xxxx)	*(learning unit 5)*
		xxxxx	
less:	**Donations**	(xxxx)	*(learning unit 5)*
gives:	**Taxable income**	xxxxx	*(learning unit 1)*
	Normal tax (per the tax tables)	xxxxx	*(learning unit 1)*
less:	**Rebates and credits**		
	- **Primary**	(xxxx)	*(learning unit 1)*
	- **Age ≥ 65**	(xxxx)	*(learning unit 1)*
	- **Age ≥ 75**	(xxxx)	*(learning unit 1)*
	- **Medical scheme fees tax credits (section 6A)**	(xxxx)	*(learning unit 1)*
	- **Additional qualifying medical expense tax credits (section 6B)**	(xxxx)	*(learning unit 1)*
	- **Foreign tax (section 6*quat*)**	(xxxx)	*(learning unit 1)*
gives:	**Net normal tax payable**	xxxxx	*(learning unit 1)*
less:	**Prepaid tax**		
	- **Employees’ tax**	(xxx)	*(learning unit 9)*
	- **Provisional tax**	(xxx)	*(learning unit 9)*
gives:	**Tax liability**	xxxxx	*(learning unit 1)*

INTRODUCTION

If an amount has been included in a taxpayer's gross income, there are certain cases where the Act exempts the amount from income tax. Section 10 of the Act provides the list of exempt institutions and exempt income categories.

When calculating taxable income, make sure that you subtract "exempt income" from "gross income" to determine the "income". Allowable deductions are then subtracted from "income" to determine the "taxable income".

In this learning unit, amounts exempt from income tax will be studied.

STUDY PROGRAMME

Refer to the study plan contained in *Tutorial Letter 101*.

LEARNING OUTCOMES

After working through this learning unit, you should be able to:

- identify the types of income which are exempt (or partially exempt) from income tax
- recognise how the subtraction of exempt income fits into the overall income tax framework
- distinguish between an **exemption** and a **deduction**

*- An **exemption** relates to income.*
*- A **deduction** relates to an expense*

PRESCRIBED MATERIAL FOR THIS LEARNING UNIT

Chapter 3 in the prescribed book.

SECTIONS OF PRESCRIBED BOOK THAT YOU MAY IGNORE

You do not need to study the specific topics mentioned below. However, the other topics under these sections must be studied.

3.4.1 *'Payable to State President, Deputy State President or his widow or her widower'*
3.4.2 *'Beneficiary fund awards'*
3.4.3 *'Amounts received by the employer'*
3.4.4 *'Distribution from a portfolio of collective investment scheme'*
3.4.5 *'Government grants'*

CONTENTS OF LEARNING UNIT

4.1 INTRODUCTION

Prescribed book section: 3.1

In the previous learning units, we looked at amounts that are included in a taxpayer's "gross income". Even though an amount has been included in gross income, it may still be exempt (or partially exempt) from income tax. The exempt income is subtracted from gross income to arrive at "income" (refer to the income tax framework on page 46).

Exempt income arises because of two possible causes:

1. the tax status of the taxpayer, or
2. the nature of the income

4.2 EXEMPTIONS RESULTING FROM THE STATUS OF THE TAXPAYER

Prescribed book section: 3.2

Read section 3.2 on **exemptions resulting from the status of the taxpayer**.

All the income received by these institutions is exempt from tax.

We do not expect you to learn this list of exempt taxpayers. However, you will benefit from reading the list, as you will get an idea of what types of taxpayers are not subject to tax at all.

4.3 EXEMPTIONS APPLICABLE TO NON-RESIDENTS

Prescribed book section: 3.3

The following exemptions are available specifically for non-residents. You will learn about them in learning unit 8, when we deal with non-residents.

Study the following sections:

- *3.3.1 South African dividends* received by non-residents are subject to Dividend Tax and are therefore fully exempt from normal tax.
- *3.3.2 South African interest* received by non-residents is fully exempt where the non-resident has not been present in the Republic for more than 183 days during the year of assessment **or** where they do not carry on business in the Republic. This exemption does not apply to any annuity received by a non-resident. Do you remember what an annuity is? See learning unit 2.
- *3.3.3 Royalties* that are paid to non-residents, and that are subject to withholding tax, are fully exempt from normal tax. Covered in learning unit 8.
- *3.3.4 Foreign entertainers and sportspersons* are exempt from normal tax provided the amount that they receive in South Africa is subject to the foreign entertainers and sportspersons withholding tax. Covered in learning unit 8.
- *3.3.5 Employment of non-residents.* A number of conditions have to be met for this exemption to apply. Remember that one of these conditions is that the employer must be in the national or provincial sphere of government; therefore it will not apply to private employers.

4.4 EXEMPTIONS BASED ON THE NATURE OF INCOME

Prescribed book section: 3.4

Of importance in this section is that you understand how to identify exempt income. By this, we mean that if a certain type of income is listed in a question, you should be able to know straight away that it is exempt and to what extent it is exempt. To do this means that you will need to learn a list of exempt income.

TOTALLY EXEMPT INCOME:

Some exemptions mean that the income so received will not be taxed or will not be taxed, ***provided certain conditions are met***. The following types of income are all fully exempt from tax when received by a taxpayer, ***provided the appropriate conditions (where applicable) are met***.

Study the following sections:

- *3.4.1 War pensions and awards for diseases.* Fully exempt from tax: therefore, a taxpayer that receives this type of income will not pay tax on it.
- *3.4.1 Disability pensions and workmen's compensation.* Fully exempt from tax: therefore, a taxpayer that receives this type of income will not pay tax on it. Remember, where an employer pays compensation in respect of the death of an employee while they were working, this exemption is limited to R300 000.
- *3.4.1 Foreign pensions.* The foreign portion of a pension that relates to both South African employment and foreign employment will be exempt from tax. Make sure you know how to calculate the portion that is received from a South African source.
- *3.4.1 Non-deductible element of compulsory annuities*

- *3.4.2 Funeral benefits*.
- *3.4.2 Unemployment insurance fund benefits (UIF)*.
- *3.4.2 Insurance policies*

- *3.4.3 Employer-owned insurance policies.*
- *3.4.3 Pure risk policies.* The amount received by an employee is only exempt when the premiums paid by the employer are included as a fringe benefit in the taxable income of the employee.
- *3.4.3 Other policies.* Fully exempt where all premiums paid are included as fringe benefits in the taxable income of the person receiving the amount.
- *3.4.3 Compensation plans.* Fully exempt where all premiums paid have been included as fringe benefits in the taxable income of the person receiving the amount.
- *3.4.3 Uniforms and uniform allowances.* Take note of the conditions that need to apply before the value of a uniform or a uniform allowance is exempt from tax.
- *3.4.3 Relocation benefits.* Take note of what is exempt and the conditions that need to be met before an amount will be exempt from tax in respect of moving an employee. You need to be able to ascertain whether the conditions have been met when you are answering a practical question.
- *3.4.3 Employment outside the Republic.* Take note of the conditions that need to apply before an amount is exempt from tax, also note when the exemption will **not** be applicable.
- *3.4.3 Scholarships and bursaries*. Where a scholarship (or bursary) is awarded to a person to further their studies, it will be exempt from tax. Bursaries have, however, been abused and used to give employees tax-free money and the employees never complete their studies. Therefore, where the scholarship or bursary is *granted by an employer to an employee*, it will only be exempt if the employee agrees to repay the employer, should they not complete their studies.

- *3.4.4 Tax free savings accounts*. Natural persons can invest up to R33 000 per annum, with a lifetime limit of R500 000, in approved saving instruments such as unit trusts, fixed deposits or REITS (Real Estate Investment Trusts). All returns, including interest, dividends and capital gains on disposal of those investments, are tax-free. A penalty of 45% of the excess capital contribution is applicable where the annual or lifetime limits are exceeded.

- *3.4.4 Dividends (other than foreign and headquarter company dividends).* Most local dividends are fully exempt from normal tax, but they are subject to 20% dividend tax.
- *3.4.4 Foreign and headquarter company dividends.* You need to know that these foreign dividends are fully exempt from tax.

- *3.4.5 Capital element of purchased annuity*
- *3.4.5 Gratuity received from public funds.*
- *3.4.5 Alimony received.* This relates to maintenance in terms of a divorce settlement that is received by a taxpayer. Where the divorce took place after 21 March 1962, any maintenance received is not taxable.

PARTIAL EXEMPTIONS:

The following exemptions are partial exemptions. Always remember that you can only exempt up to the amount that has actually been received by the taxpayer, meaning that the exemption cannot cause a net deduction!

Study the following sections:

- *3.4.3 Scholarships and bursaries (Employers to relatives of employees)*. Where the bursary is granted to a relative of an employee it will only be exempt up to R60 000 (higher education) or R20 000 (basic education) where the employee earns a maximum of R600 000 remuneration during that year of assessment. The bursary or scholarship will be fully taxable where the employee earns remuneration exceeding R600 000.

- *3.4.4 South African interest received by residents.* You have already been introduced to this exemption in learning unit 1. Remember that a person 65 years or older gets a greater “investment” exemption.
    - If a taxpayer is 65 years or older they have a maximum amount of R34 500 to use to exempt South African interest income. (South African dividends excluded.)
    - If a taxpayer is younger than 65 years then they have a maximum amount of R23 800 to use to exempt South African interest income. (South African dividends excluded.)

  All the monetary values will be given to you in the schedules to your exam paper (if you forget them).

- *3.4.4 Foreign dividends.* You need to learn that foreign dividends, which are not fully exempt, qualify for a partial exemption from tax, in the form of a ratio exemption. The ratio is 25/45. In other words, 55,6% (25/45 x 100%) of these foreign dividends are exempt in the hands of an individual.

All exempt amounts received by or accrued to a taxpayer must be declared by the taxpayer in the taxpayer’s annual income tax return (ITR12).

TIVITY

Do the self-assessment test on “Exempt income” on myUnisa.

ACTIVITY 4.1

Compile a summary of all the exemptions that relate to the type of income. Use the following format:

Type of income	Any conditions that must apply	Exempt amount
E.g. UIF	None	Fully exempt

Here you **do** need to study the list of types of income that will be exempt. You may be asked in a question to identify exempt income.

4.5 QUESTIONS

Prescribed book section: 3.6

At the end of every learning unit we refer you to practical questions (refer to part B). Remember the importance of attempting these questions on your own first, **without referring to the solutions**.

This will help you to ascertain whether you understand all the topics that were discussed.

Work through practical questions 3.1 to 3.4 in the textbook. By doing these questions, you once again learn how to apply the knowledge that you have just gained. The questions in the exam will also be based on application of this theory. These questions will therefore help you to prepare for the exam.

While answering the questions, you should have noted the following:

✓ In some cases, the full amount is exempt from income tax and in other situations; only a portion of the amount is exempt.

4.6 SOLUTION TO ACTIVITY

Activity 4.1: This feedback will be unique to you, based on the information provided in sections 3.3 and 3.4 of the prescribed book.

Visit the discussion forum – **learning unit 4** – and discuss any concepts that you don't understand **or,**
if you do understand, then answer those students who have posted questions.

POINTS TO PONDER

- Why are certain types of income exempt?
- Why is foreign interest not exempt?
- Would increasing the interest exemption or tax-free investment thresholds encourage saving?
- Why do certain bodies have tax exempt status?

WRAP UP

In this learning unit, you were introduced to exempt income. **This is income that has been *included* in gross income but is exempt from tax**. It is important to understand what is required in a question. If you are required to calculate **gross income**, remember that exempt income is always included in gross income. If you are required to calculate **income** or **taxable income***,* the exempt income amounts are excluded, but you still have to indicate in your answer that such amounts are exempt. Exempt income will usually be integrated into a question.

When doing tax planning, one should always bear in mind the exempt income, in order to take advantage of the greatest tax benefits allowed to a taxpayer.

In the next learning unit, we will discuss the requirements for general, prohibited, other and specific deductions for income tax purposes.

ASSESSMENT CRITERIA

We could assess your work on this learning unit in assignments or in the exam by asking you to:

- identify the types of income which are exempt (or partially exempt) from income tax
- apply the exemptions to gross income amounts, as part of an integrated question

LITERATURE CONSULTED

Stiglingh, M, Koekemoer, AD, Van Zyl, L, Wilcocks, JS & De Swardt, RD. 2017. SILKE: South African Income Tax. Durban: LexisNexis.

Bruwer, L, Coetzee, K, De Hart, KL, Koekemoer, AD & Stedall, C. 2017. *A student's approach to income tax: Natural persons.* Durban: LexisNexis.

LEARNING UNIT 5

Learning unit

5

Deductions: general, prohibited and specific

INTRODUCTION
STUDY PROGRAMME
LEARNING OUTCOMES
PRESCRIBED STUDY MATERIAL FOR THIS STUDY UNIT
SECTIONS OF PRESCRIBED BOOK THAT YOU MAY IGNORE

CONTENTS OF LEARNING UNIT

POINTS TO PONDER
WRAP UP
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INCOME TAX FRAMEWORK

		R	
	Gross income	xxxxxxx	*(learning unit 2)*
	• **Special inclusions**	xxxxx	*(learning unit 2)*
	• **Fringe benefits**	xxxxx	*(learning unit 3)*
	• **Lump sums (lump sums are taxed separately)**	xxxxx	*(learning unit 7)*
less:	**Exempt income**	(xxxxx)	*(learning unit 4)*
gives:	**Income**	xxxxxx	*(learning unit 1)*
	Allowable deductions		
less:	- **General deductions**	(xxxx)	***(learning unit 5)***
	- **"Other" allowable expenses**	(xxxx)	***(learning unit 5)***
add:	**Taxable capital gain**	xxxx	*(learning unit 6)*
		xxxx	
less:	**Retirement fund contributions**	(xxxx)	***(learning unit 5)***
		xxxxx	
less:	**Donations**	(xxxx)	***(learning unit 5)***
gives:	**Taxable income**	xxxxx	*(learning unit 1)*
	Normal tax (per the tax tables)	xxxxx	*(learning unit 1)*
less:	**Rebates and credits**		
	- **Primary**	(xxxx)	*(learning unit 1)*
	- **Age $\geq$ 65**	(xxxx)	*(learning unit 1)*
	- **Age $\geq$ 75**	(xxxx)	*(learning unit 1)*
	- **Medical scheme fees tax credits (section 6A)**	(xxxx)	*(learning unit 1)*
	- **Additional qualifying medical expense tax credits (section 6B)**	(xxxx)	*(learning unit 1)*
	- **Foreign tax (section 6*quat*)**	(xxxx)	*(learning unit 1)*
gives:	**Net normal tax payable**	xxxxx	*(learning unit 1)*
less:	**Prepaid tax**		
	- **Employees' tax**	(xxx)	*(learning unit 9)*
	- **Provisional tax**	(xxx)	*(learning unit 9)*
gives:	**Tax liability**	xxxxx	*(learning unit 1)*

INTRODUCTION

Allowable deductions are deducted from income in order to arrive at taxable income. The Act makes provision for both **general** and **specific** deductions. In this learning unit, we will deal with both types of deductions.

Section 11(*a*) of the Act makes provision for the deduction of expenses of a general nature. General expenses are essentially trade-related expenses, and they therefore apply to taxpayers who run their own business. Section 11(*a*) read with section 23 is referred to as **the general deduction formula**.

Private and domestic expenses are not deductible in terms of the general deduction formula; however, other provisions of the Act do make a limited number of specific deductions available to the salaried taxpayer. These sections will also be covered in this learning unit.

Always bear in mind that the general deductions must be deducted **before** the specific deductions.

STUDY PROGRAMME

Refer to the study plan contained in *Tutorial Letter 101*.

LEARNING OUTCOMES

After working through this learning unit, you should be able to:

- explain the difference between general and specific deductions
- identify and memorise the general deduction formula's list of positive and negative requirements that have to be complied with
- analyse each component of the general deduction formula and apply the formula in a practical case study
- identify the seven "other deductions" that a salaried person may deduct
- memorise the correct order of deductions
- show that you comprehend the concepts of remuneration and taxable income
- calculate the deduction limitations applicable to the various specific deductions available to an employed taxpayer

PRESCRIBED MATERIAL FOR THIS LEARNING UNIT

Chapters 4 and 5 in the prescribed book.

SECTIONS OF PRESCRIBED BOOK THAT YOU MAY IGNORE

The following sections in the prescribed book may be ignored:

- 5.4 Income of minors
- 5.6 Limiting losses when calculating taxable income

CONTENTS OF LEARNING UNIT

5.1 CARRYING ON A TRADE

Prescribed book sections: 4.1 – 4.2

Section 11 of the Act covers general trade-related expenses and some of the specific expenses. In order for any expenses to be deductible in terms of section 11, the taxpayer must be carrying on a “trade”. It is important to be aware that the definition of “trade” is very wide, extending beyond running a business to include activities such as carrying on a profession as well as being employed. It is also important to note that passive investment activities are not included in the definition of “trade”. This means that where expenses are incurred in earning investment income, they will not be deductible according to the general deduction formula. Passive investments generate returns such as interest, dividends and annuities.

Where the taxpayer carries on more than one trade, all income or losses for each trade are usually added together (aggregated) in order to calculate taxable income.

Familiarise yourself with the implications for the concept of “carrying on a trade” where there is no profit motive, as outlined in *Burgess v CIR* 55 SATC 185.

5.2 THE GENERAL DEDUCTION FORMULA

Prescribed book section: 4.3

There are two sides to the deduction of amounts for income tax purposes. On the one hand, there is a list of positive requirements (in s11(*a*)) that need to be met. On the other hand, there is a list of negative requirements (in s23) that result in an amount being prohibited as a deduction for tax purposes (we will get to the negative test later in the learning unit).

All the requirements of the general deduction formula need to be met before an amount may be deducted for income tax purposes.

You need to study the general deduction formula requirements, as you will often have to determine whether an amount can be deducted or not. As you gain more experience, there will be certain expenses that you immediately know are deductible; you will not need to apply the requirements of the general deduction formula every time you wish to deduct an amount. Alternatively, where you are confronted with an expense that you are unsure about, you will need to apply the components of the general deduction formula to ascertain whether it meets all the requirements and is consequently deductible, or not. It is important to realise that **every part** of the general deduction formula has to be complied with in order for an expense to be deductible.

Questions on the general deduction formula will usually be discussion-type questions.

Remember that the general deduction formula is more applicable to taxpayers who owns a business. Because of restrictions placed on salaried taxpayers in terms of section 23(*m*), persons who **only** earn remuneration in the form of salaries will **not**, for the most part, be able to deduct expenses in terms of the general deduction formula.

Each requirement for the general deduction formula (s11(*a*) read with s23) will now be looked at separately.

5.2.1 Expenditure and losses

Prescribed book section: 4.4

When working through the section, note that deductible expenditure is not restricted to expenditure in cash but includes the outlay of amounts in a form other than cash. Therefore, if a shopkeeper offers an asset – instead of cash – as payment for new stock, then the market value of the asset will be deductible. Where a taxpayer has acquired an asset through an inheritance or donation and then subsequently uses it to pay for something, then the market value of the asset will be allowed as a deduction.

5.2.2 Actually incurred

Prescribed book section: 4.5

A taxpayer may deduct expenses that have actually been paid as well as amounts that are being owed.

The liability for the expense must be **unconditional**, which means that it must not depend on some future event happening. Where an event must first take place, before an expense becomes payable, the expense will only be deductible for tax purposes in the year in which the event actually takes place. Assume, for example, that at the end of February (the end of the year of assessment), employer X has a contractual agreement to pay employee Y a bonus of R10 000 if, by the end of March, employee Y reaches a particular sales target. The liability of R10 000 is conditional at the end of February – because employer X cannot be certain that the employee will in fact reach the sales target by the due date in March. Therefore the expense of R10 000 will not have been **actually incurred** at the end of February.

A distinction must be made between expenditure that is **contingent** on an event (as above) and **estimated** expenditure. Where a taxpayer has a liability to pay an amount but cannot ascertain the amount on the last day of the year of assessment, he may deduct an estimated amount of expenditure. Note that where it ends up that the estimated amount is more than the actual amount, the excess will be included in the taxpayer's income. Where the estimated amount is less than the actual expenditure, the difference will not be deductible in any other year of assessment. It is possible to request SARS to reopen the applicable year of assessment and to adjust the expenditure to reflect the correct amount.

5.2.3 Year of assessment

Prescribed book section: 4.6

In general, only expenditure that is incurred during a particular year of assessment is deductible in that year of assessment. Expenditure incurred in one year of assessment is therefore not deductible in later (or prior) years of assessment. The accounting concept of matching does not apply to the deductibility of expenditure for tax purposes.

For individuals a year of assessment always runs from 1 March until 28/29 February. In this module, we are dealing with the **2018** year of assessment, which runs from 1 March 2017 to 28 February 2018.

5.2.4 In the production of income

Prescribed book section: 4.7

When attempting to deduct an expense, this requirement and the next one are usually the "troublesome" requirements to prove.

There are numerous court decisions that have hinged on the term "in the production of income". You do not need to be able to give accounts of specific court cases but you must understand the principles present in each case and be able to apply these principles to short case studies. The landmark case that dealt with this issue was *Port Elizabeth Electric Tramway Co Ltd v CIR* 8 SATC 13. The court held that, in order to be deductible, expenditure must be so closely connected to the cost of performing the income-earning operations of the business that it would be reasonable to regard it as part of the cost of performing the operation. See also *CSARS v BP South Africa (Pty) Ltd* 68 SATC 229.

Also familiarise yourself with the principles established in the following cases:

- *Joffe & Co (Pty) Ltd v CIR* 13 SATC 354 (deductibility of compensation payments)
- *Sub-Nigel Ltd v CIR* 15 SATC 381 (expenditure that produces income in a later year of assessment is deductible)
- *CIR v Drakensberg Garden Hotel (Pty) Ltd* 23 SATC 251 (interest paid on a loan to acquire shares can be deductible)
- *W F Johnstone & Co Ltd v CIR* 17 SATC 235 (expenditure paid in the current year in recognition of services rendered in prior years is not deductible)
- *CIR v Nemojim (Pty) Ltd* 45 SATC 241; *CSARS v Mobile Telephone Networks Holdings (Pty) Ltd* (966/12) [2014] ZASCA 4 (apportionment of expenditure incurred for different purposes)
- *Other court cases in the prescribed textbook*

Ensure that you know how specific expenses and losses are dealt with in terms of the general deduction formula, in particular fines, losses as a result of theft, social responsibility payments, recurring expenditure such as audit fees and *ex gratia* payments.

Ensure that you understand the “in production of income” requirement and remember that “income” is defined in the Act as “gross income” less “exempt income”. As a result, expenditure that produces exempt income (such as dividend income) will, by definition not be deductible.

5.2.5 Not of a capital nature

Prescribed book section: 4.8

Capital expenditure is not deductible in terms of the general deduction formula.

You must know how to apply the factors that the courts have laid down to assist in deciding whether an amount is of a capital or a revenue nature. Remember that the result of the factors will only give an indication of whether an amount is of a capital nature or not. Each case must be decided on the basis of its own unique circumstances. These factors involve the following questions:

- What is the true nature of the transaction?
- How closely connected is the expense to the income-earning operations (revenue) or income-earning structure (capital)?
- Does the expense create an asset or advantage with an enduring benefit?
- Does the expense relate to fixed or floating capital?
- Was the expenditure "once and for all"?
- What is the nature of the business being carried on?

If an expense is of a capital nature, it may not be deducted for income tax purposes in terms of section 11(*a*). However, you must keep in mind that the rest of section 11 up to section 19 **does** make provision for specific deductions. You should be familiar with some of these deductions when studying the business income taxation module (TAX3701). Later in this learning unit we will also refer to some of the "other specific deductions", applicable to individuals.

Remember that when you are arguing whether an expense is of a capital nature or not, your conclusion may not always be perfectly correct, but as long as your reasons are logically explained and supported in arriving at your conclusion, marks will be awarded.

Without referring to at your prescribed book, list the requirements of the general deduction formula.

5.2.6 Laid out or expended for the purposes of trade

Prescribed book section: 4.9

All the above requirements must be met for an amount to be deductible. Section 23 must then be consulted to see if any of the amounts are not allowed because they are listed as prohibited deductions in section 23.

"Trade" is a term that is defined in the Act and therefore only expenses that are for the purpose of trade will be considered for deduction. This means that where an expense is not for trade purposes, it cannot be deducted from income. Alternatively, where an amount is for both trade and other purposes, it will then be apportioned between trade and the other purpose. The trade portion of the expense may then be deducted for income tax purposes, as long as it complies with all the other requirements.

For example, Mr Abe attends a business conference in Cape Town for two days and stays on for the weekend (three additional days). The total cost of the trip amounts to R10 000. He may consider deducting R4 000 (R10 000/5 days x 2 days) for income tax purposes. Remember that all the other requirements must also be met before he may deduct this amount.

There are various appropriate bases for this splitting (apportionment) of the expense between trade purposes and other purposes.

5.2.7 Prohibited deductions

Prescribed book section: 4.10

Certain expenses will comply with all the requirements set out in section 11(*a*), but SARS is unwilling to allow them as deductions for tax purposes, because (as you will notice) in most of the cases listed in section 23 (the negative test), the expenses do not further the aims of income tax collection.

Make sure that you know which expenses are **not** deductible for income tax purposes, as listed in section 23.

Remember that these expenses will never be deductible, even if they do fulfil the requirements of the general deduction formula.

List (in summary) the expenses that are not deductible for income tax purposes according to section 23.

5.3 SPECIFIC TRANSACTIONS

Prescribed book section: 4.11

In terms of the definition provided in section 1 of the Income Tax Act, any employed taxpayer is “trading”. However, salaried taxpayers are, in terms of section 23(*m*), prevented from deducting any section 11 expenditure – except for certain specific expenses.

In the sections that follow, we will cover the limited number of section 11 expenses that a salaried taxpayer **may** deduct. We will also study the section 18A deduction (donations) that is not affected by the section 23(*m*) prohibition.

5.3.1 Other expenses

Prescribed book sections: 5.3.1 – 5.3.2

There are seven “other expenses” that a salaried person may deduct. The expenses may only be deducted if they relate to the employee’s employment. It is important to be aware that these “other expenses” are deducted **after** general expenses (discussed above), but **before** the other specific expenses discussed below.

Entertainment expenses are one of the “other expenses” that a salaried person may deduct. It is important to know the conditions under which they can be deducted. The entertainment expenses will only be deductible if the employee earns more than 50% of their remuneration in the form of commission and the expenditure complies with the requirements of section 11(*a*).

Remember that normal salary earners, who do not earn income **mainly** from **commission**, do not qualify for any deduction of entertainment expenditure, even if they receive an entertainment allowance.

5.3.2 Contributions to retirement funds

Prescribed book section: 5.3.3

Some employees contribute on a monthly basis to a pension fund, provident fund and/or a retirement annuity fund, so that on retirement they will be paid out retirement income/benefits. With effect from 1 March 2016, the contributions to pension funds, provident funds and/or retirement annuity funds are added together, and the **total contributions to all these funds** are taken into account for the section 11F (previously section 11(*k*)) deduction. These contributions are tax deductible, but subject to limitations imposed by the Act. This means that the deduction cannot exceed a certain amount. Also, be aware that you can never deduct more than what you actually contributed to the fund/s.

Where an employer contributes to a retirement fund on behalf of an employee, as part of the employee’s salary package, the portion contributed by the employer will be taxed as a fringe benefit in the employee’s hands (refer to learning unit 3). This fringe benefit is also deemed part of the employee’s contributions.

Remuneration – for purposes of questions dealing with the calculation of a person’s taxable income, the assumed remuneration amount will be provided in the question, you do not have to calculate it. Remuneration, for purposes of calculating this deduction, excludes lump sum and severance benefits received as a result of retirement, ill-health, death, withdrawal or retrenchment (dealt with in learning unit 7).

Taxable income – for purposes of calculating this deduction, excludes lump sum and severance benefits received as a result of retirement, ill-health, death, withdrawal or retrenchment. Taxable income will include any taxable capital gain. Retirement contributions are not deductible against a taxable capital gain.

Past period/reinstatement contributions occur where members of a pension, provident, and/or retirement annuity fund "buy back" extra retirement years in order to increase their retirement income/benefits. These contributions are taken into account for the section 11F deduction as well.

Retirement fund contributions that were not allowed as a deduction in the current year of assessment may be carried forward to subsequent years of assessment and taken into account there.

5.3.3 Donations to public benefit organisations

Prescribed book section: 5.3.4

Some donations are tax deductible, subject to certain requirements and a limitation. While studying this section, take note that not all donations to charities are deductible. Only donations to public benefit organisations (PBOs) that have the right to issue receipts in terms of section 18A, qualify for a deduction. The most common PBOs that have section 18A status include education institutions, conservation organisations and social welfare bodies. Churches and religious organisations are examples of PBOs that cannot issue section 18A receipts.

5.3.4 Calculation of taxable income (Order of deductions)

Prescribed book section: 5.3.5

Without referring to your prescribed book, write out the correct order of deductions for all the categories of expenses covered in this learning unit.

Visit the discussion forum – **learning unit 5** – and discuss any concepts that you do not understand or, if you do understand, then answer those students who have posted questions.

Do the self-assessment test on "**Deductions**" on myUnisa.

5.4 QUESTIONS

Prescribed book sections: 4.13 and 5.8

At the end of every learning unit we will refer you to practical questions (refer to part B). Remember the importance of attempting these questions on your own first, **without referring to the solutions**.

This will help you to ascertain whether you understand all the topics that were discussed.

Work through exam preparation questions 4.1 to 4.4 and 5.1 to 5.4, as well as questions 5.1 to 5.6 in part B of this study guide. By doing these questions, you will learn how to apply the knowledge you have just gained and they will help prepare you for the exam.

POINTS TO PONDER

- Would activities that produce only exempt income qualify as a trade?
- How does a "loss" differ from an "expense"?
- How does an “expense” differ from an “exemption”?
- Can the incurral of an expense have mixed motives: partly trade and partly private?
- Should Government increase the limits for pension, provident and retirement annuity fund contributions, in order to encourage saving?
- Should religious institutions qualify as public benefit organisations, and if they do, should they be involved in the upliftment of the community?

WRAP UP

- ✷ This learning unit introduced you to the general deduction formula, which contains the requirements that must be met before expenses of a general nature can be deducted for income tax purposes.
- ✷ All the requirements of the general deduction formula must be met before a general expense may be deducted.
- ✷ The Act also makes provision for the deduction of certain expenses (specific expenses) which would not necessarily be allowed in terms of the general deduction formula.
- ✷ All the specific expenses are subject to certain conditions or limitations, in order for them to be de-ductible.
- ✷ Expenses of a general nature are deducted before the specific deductions.
- ✷ Private or domestic expenses cannot be claimed – except the specific expenses discussed in this section.

Now that you have completed this learning unit, please revisit the learning outcomes and ensure that you have attained all of them.

ASSESSMENT CRITERIA

We could assess your work on this learning unit in assignments or in the exam by asking you to:

- ✷ discuss whether a particular expense is deductible in terms of the general deduction formula
- ✷ apply relevant case law in determining whether a particular expense is deductible in terms of the general deduction formula
- ✷ correctly apply the conditions and limitations relating to specific expenses, in a calculation-based question
- ✷ determine the deductibility of a variety of general and specific expenses and then to deduct them in the correct order

LITERATURE CONSULTED

Stiglingh, M, Koekemoer, AD, Van Zyl, L, Wilcocks, JS & De Swardt, RD. 2017. SILKE - South African Income Tax. Durban: LexisNexis

Bruwer, L, Coetzee, K, De Hart, KL, Koekemoer, AD & Stedall, C. 2017. *A student’s approach to income tax: Natural persons.* Durban: LexisNexis.

LEARNING UNIT 6

INTRODUCTION
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LEARNING OUTCOMES
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Learning unit

6

Capital gains tax (CGT) for individuals

INCOME TAX FRAMEWORK

		R	
	Gross income	xxxxxxx	*(learning unit 2)*
	• **Special inclusions**	xxxxx	*(learning unit 2)*
	• **Fringe benefits**	xxxxx	*(learning unit 3)*
	• **Lump sums (lump sums are taxed separately)**	xxxxx	*(learning unit 7)*
less:	**Exempt income**	(xxxxx)	*(learning unit 4)*
gives:	**Income**	xxxxxx	*(learning unit 1)*
less:	**Allowable deductions**		
	- **General deductions**	(xxxx)	*(learning unit 5)*
	- **“Other” allowable expenses**	(xxxx)	*(learning unit 5)*
add:	**Taxable capital gain**	xxxx	***(learning unit 6)***
		xxxx	
less:	**Retirement fund contributions**	(xxxx)	*(learning unit 5)*
		xxxxx	
less:	**Donations**	(xxxx)	*(learning unit 5)*
gives:	**Taxable income**	xxxxx	*(learning unit 1)*
	Normal tax (per the tax tables)	xxxxx	*(learning unit 1)*
less:	**Rebates and credits**		
	- **Primary**	(xxxx)	*(learning unit 1)*
	- **Age ≥ 65**	(xxxx)	*(learning unit 1)*
	- **Age ≥ 75**	(xxxx)	*(learning unit 1)*
	- **Medical scheme fees tax credits (section 6A)**	(xxxx)	*(learning unit 1)*
	- **Additional qualifying medical expense tax credits (section 6B)**	(xxxx)	*(learning unit 1)*
	- **Foreign tax (section 6*quat*)**	(xxxx)	*(learning unit 1)*
gives:	**Net normal tax payable**	xxxxx	*(learning unit 1)*
less:	**Prepaid tax**		
	- **Employees’ tax**	(xxx)	*(learning unit 9)*
	- **Provisional tax**	(xxx)	*(learning unit 9)*
gives:	**Tax liability**	xxxxx	*(learning unit 1)*

INTRODUCTION

On 1 October 2001, the government implemented capital gains tax (CGT). This means that if an asset is sold, such as a house, the transaction could be subject to capital gains tax. Prior to its implementation, the disposal of a capital asset was not taxed, as it did not meet the requirements of the gross income definition.

However, from 1 October 2001, a capital gain is taxed in terms of section 26A of the Income Tax Act, with the exception of certain exclusions and roll-overs. It is also possible that a capital loss can be incurred.

Capital gains tax is not a separate tax but rather a way of taxing capital gains when a person sells or disposes of an asset. The Income Tax Act contains rules in the Eighth Schedule, regarding how to calculate the gain and how to include it in the calculation of taxable income. The diagram on page 64 illustrates where in the income tax framework the taxable capital gains should be included.

Capital gains tax should not be studied in isolation. It forms an integral part of the calculation of taxable income.

Bear in mind that certain gains and losses are excluded or partly excluded from capital gains tax. In this learning unit, we will learn how to calculate capital gains tax payable by an individual.

STUDY PROGRAMME

Refer to the study plan contained in *Tutorial Letter 101.*

LEARNING OUTCOMES

After working through this learning unit, you should be able to:

- identify transactions to which capital gains tax is applicable and apply the framework to calculate the taxable capital gain or loss
- apply the principles to calculate **proceeds** for capital gains tax purposes
- apply the principles to calculate **base cost** for capital gains tax purposes
- apply the relevant exclusions, roll-overs and assessed capital loss in respect of capital gains tax
- apply the inclusion rate to calculate the taxable capital gain
- identify at what point of the taxable income calculation, capital gains are included

PRESCRIBED STUDY MATERIAL FOR THIS LEARNING UNIT

Chapter 13 in the prescribed book.

SECTIONS OF PRESCRIBED BOOK THAT YOU MAY IGNORE

Sections 13.6.1, 13.11, 13.12.4, 13.12.5.3 to 13.12.5.12, 13.14.1, 13.14.2, 13.14.4, 13.17 and 13.18

CONTENTS OF LEARNING UNIT

6.1 BACKGROUND

Prescribed book section: 13.1

When a person sells or disposes of a capital asset the profit will not be included in "gross income" because it is of a capital nature; however, the Income Tax Act has rules regarding how to calculate the profit and how to include it in the calculation of taxable income.

It is very important to realise that for every asset that is disposed of or sold during a year of assessment, the capital gain needs to be calculated separately. Once each gain or loss on each asset has been calculated, then these are added together (obviously the losses will reduce the total) and the aggregate gain is calculated. The overall structure of the capital gains tax calculation follows:

Calculating aggregate capital gain	
	R
Capital gain – asset 1	XXXX
Capital loss – asset 2	(XXXXX)
Capital gain – asset 3 (and so on)	XXXXX
	XXXXX
Less: Annual exclusion	(40 000)
Less: Assessed capital loss	(XXX)
Aggregate capital gain	XXXXX

In order to calculate the capital gain or loss for each asset, very specific rules need to be followed. You are supplied with the framework and as you study your way through this learning unit, we will refer you back to this framework so that you can add to the framework what you have learnt.

It is also important not to work on this learning unit completely in isolation: always remember that you are busy with the calculation of taxable income and that, once you have calculated the capital gain to be included, you include it in taxable income and continue with the calculation.

Below is the above-mentioned framework for calculating the capital gain on each individual asset:

Calculating capital gain on disposal of an asset	
	R
Proceeds	XXXXX
Less: base cost	(XXXX)
	XXXXX
Less: any specific exclusion/roll-over	(XXXX)
Capital gain for the asset	XXXXX

Let us study the rules that apply to each of these steps.

6.2 APPLICATION OF CAPITAL GAINS TAX

Prescribed book section: 13.2

In order to calculate the capital gain or loss on the disposal of an asset, a basic framework must be used. This framework is important because the remainder of the information in this learning unit is based thereon.

Referring to what you have just studied:

- If the result of step 7 in section 13.2 of the prescribed book **is** a net capital loss, the amount will be carried forward to the following year of assessment and will not be deducted from taxable income.
- If the taxpayer has a total capital loss for the year, the loss must be reduced by the R40 000 annual exclusion.

While studying the example you should note that the taxable capital gain is then added to the other taxable income to calculate the total taxable income for the year.

6.3 DETERMINE WHETHER A TRANSACTION IS SUBJECT TO CGT

Prescribed book section: 13.3

Certain basic requirements must be fulfilled before capital gains tax (CGT) can be calculated.

Determine whether the transaction is subject to capital gains tax.

6.4 CAPITAL GAIN OR LOSS ON DISPOSAL OF AN ASSET

Prescribed book section: 13.4

As stated in the introduction, the gain or loss on the sale of an asset must be calculated separately for **each asset**. Can you remember the framework we referred to? Can you write it down before you study the following section?

ACTIVITY 6.1

Draw up the framework that is used to determine the capital gain or loss on the disposal of an asset.

Now we are going to deal with each aspect of this framework and together we will learn how to apply the capital gains tax rules.

6.5 PROCEEDS ON DISPOSAL OF AN ASSET

Prescribed book section: 13.5

The basic rule is that the amount for which the asset is sold represents the proceeds. Be aware that where the taxpayer receives an amount net of transaction costs (such as commission), the proceeds is the gross selling price and not the net selling price. The transaction cost should be included in the base cost and not deducted from the gross proceeds. Bear in mind that where a portion of the amount received is subject to income tax, it will not be subject to capital gains tax as well.

For individuals the proceeds will be the selling price! It is only where the asset has had capital allowances written off against the cost that there might be a recoupment involved. You will deal with these types of assets when you study the business income module.

ACTIVITY 6.2

Draw up a list of amounts that can reduce proceeds.

- ____
- ____

6.6 BASE COST OF AN ASSET

Prescribed book section: 13.6

The base cost is the cost of the asset that must be deducted from the proceeds in order to calculate the gain or loss.

Because capital gains tax was implemented only from 1 October 2001, there are special rules for assets that were purchased before that date. In the Act, 1 October 2001 is referred to as “valuation date” – therefore wherever you see valuation date, realise they are referring to the value of the asset on 1 October 2001.

When calculating the base cost, the first question you should ask yourself is:

When was the asset purchased?

If the answer to your question is **before 1 October 2001**, then the base cost is equal to the valuation date value + any expenditure on/after 1 October 2001.

If the answer to your question is **on or after 1 October 2001**, then the base cost is the total of all qualifying expenditure on the asset. **Then paragraphs 26 and 27 of the Eighth Schedule do not apply, as discussed below.**

Expenditure refers only to capital expenditure on the asset and not revenue costs.

The base cost formula for assets acquired **before** 1 October 2001 is as follows:

	R
Valuation date value	**XXX**
Plus: allowable costs incurred on or after 1 October 2001	**XXX**
Base cost	**XXX**

The valuation date value is the value of the asset on 1 October 2001. This takes into account all the costs of the asset plus the increase in the value of the asset up to 30 September 2001. The valuation date value is “deemed” to be the cost price of the asset, as if you had acquired it on 1 October 2001.

The valuation date value is determined by paragraph 26 or paragraph 27 of the Eighth Schedule of the Act. Paragraph 26 is applicable when the adjusted proceeds are **more** than the adjusted cost of an asset (in other words a profit), and paragraph 27 is applicable when the adjusted proceeds are **less** than the adjusted cost of an asset (in other words a loss). These paragraphs contain provisions that serve as anti-avoidance measures, because a taxpayer can manipulate the market value of the asset to ensure that a capital loss is realised on the disposal of the asset.

An extract of paragraph 26 and paragraph 27 in the Eighth Schedule of the Income Tax Act will be provided to you in the exam, if necessary. You will be able to use it in the exam while answering a capital gains tax question. However, we strongly urge you to rather learn the rules of paragraph 26 and paragraph 27, in order to save time in the exam by not having to refer to the schedule provided.

Before you start with the valuation date value calculation, first divide all allowable costs between pre (before) 1/10/2001 and post (on/after) 1/10/2001.

The next step is to identify the following three values:

1. **Market value**. The market value will be provided to you in a question.

2. **20% rule**. You need to calculate this value as follows: 20% x (proceeds less allowable costs incurred on or after 1 October 2001).

3. **Time-apportionment base cost** (**TAB cost**). For the purposes of this module, we will not expect you to be able to calculate the time-apportionment base cost. The value will be supplied in a question and you just need to know where to use it.

Where the asset was purchased **before** 1 October 2001 and you have to calculate a valuation date value, did you make a note that the greatest of three options can be used (subject to paragraphs 26 or 27)?

We will determine how each of these is calculated.

The final step in determining the valuation date value is to apply the rules of paragraph 26 or paragraph 27 and select the valuation date value (to be used in the base cost calculation).

However, before you continue, have you made a note of which costs can be included in the base cost?

In an exam question, you will need to be able to distinguish between the costs that can be added to the base cost and those that cannot. Remember to indicate, with a nil and a brief reason, those that cannot be added. Marks will be allocated here, as you will indicate to us that you know which costs must be included or excluded.

Let us now deal with each of the components of valuation date value.

6.6.1 Market value of assets

Prescribed book section: 13.7

In order to make use of the market value of the asset, the owner had to have the asset valued by a valuator.

The general rule for determining the market value is that it should be calculated as the price that would have been agreed upon by a willing seller and a willing buyer on 1 October 2001.

Bear in mind that the market value will be supplied to you in the exam, should you need it.

6.6.2 Time-apportionment base cost (TAB)

Prescribed book section: 13.8

The time-apportionment base cost is another method for calculating the value of an asset that was purchased before 1 October 2001. This determines the value of the asset on 1 October 2001.

The time-apportionment method spreads the growth in the value of the asset over the period for which the person owned the asset. The time-apportionment base cost is the sum of the expenditure incurred before 1 October 2001, plus the growth (percentage of profit) of the asset before 1 October 2001.

In the exam, **you will be provided with the time-apportionment base cost** and you can always assume that it was calculated correctly. However, in practice, if you intend to become a chartered accountant or tax practitioner, you will need to know how to apply this formula.

6.6.3 20% Rule

Prescribed book section: 13.9

This is the third option that can be used to determine the value of an asset on 1 October 2001. This option will normally be used by taxpayers who cannot prove the cost of the asset.

The value of the option is calculated as 20% of the proceeds from the disposal of the asset after deducting the costs incurred on or after 1 October 2001. This will normally be used where no cost records are available.

6.6.4 Selecting the valuation date value of assets

Prescribed book section: 13.10

These rules provide for anti-avoidance measures.

Visit the myUnisa website and attempt the self-assessment questions on base cost for capital gains tax.

ACTIVITY 6.3: Valuation date value anti-avoidance rules

Sonnyboy Mhlanga provides you with the following information relating to assets that he sold during the current year of assessment.

Asset	Date purchased	Cost before 01/10/2001	Market value on 1 October 2001	Time-apportioned base cost	Selling price
A	1 August 2000	R80 000	R70 000	R95 000	R75 000
B	2 July 1980	R150 000	R230 000	R170 000	R60 000
C	3 December 1999	R100 000	R120 000	R115 000	R112 000

Calculate the capital gain or loss for each asset sold by Sonnyboy.

	R

6.7 EXCLUSION: PRIMARY RESIDENCE

Prescribed book section: 13.12.1

(Ignore transfer of a residence from a company or a trust.)

This is the most important provision for individuals because many people own a property in which they reside. If they sell this residence, the taxable capital gain can be reduced by applying this section.

If the property is owned by a combination of natural persons and persons other than natural persons, only the natural persons can claim their portion of the R2 million exclusion.

If the property is larger than two hectares, only the first two hectares qualify for the primary residence exclusion.

If a portion of the property is used for business purposes, that portion does not qualify for the primary residence exclusion.

If the proceeds are R2 million or less, then any capital gain or capital loss calculated on the disposal of the primary residence is disregarded (i.e. not taken into account). This exclusion is not applicable where the person did not reside in the house for the full period or where a portion of the residence was used for trade purposes.

A person is only allowed to have one primary residence at a time. The reason for the rules listed above is that there may be an overlap of two years, resulting in a person having two primary residences at the same time. He or she can therefore claim the full exclusion for both houses.

While studying the examples you should note the following:

- ✓ The maximum amount of the exclusion is R2 000 000, but if one of the exceptions exist, that portion does not qualify for the exclusion.
- ✓ If the running cost of the house is claimed as a business expense for income tax purposes, that portion of the gain on the disposal of the property does not qualify for the exclusion.

6.8 EXCLUSIONS: OTHER

Prescribed book sections:
13.12.2, 13.12.3, 13.12.5.1 – 13.12.5.2

Note that some exclusions only exclude losses, while others only exclude a portion or specific amount from the gain or loss.

A personal use asset is an asset that is used mainly for purposes other than conducting a trade.

The small business exclusion is limited to a maximum of R1 800 000 during a person's lifetime, but all the requirements must be met in order to claim the R1 800 000.

The exclusion for long-term insurance policies does not apply to the disposal of a long-term insurance policy abroad or the disposal of a second-hand long-term policy.

Please read through all the other exclusions.

ACTIVITY 6.4

List all the exclusions from capital gains tax that will have an effect on an individual.

6.9 LIMITATION OF LOSSES

Prescribed book section: 13.13

Remember that the capital losses in respect of certain assets must be disregarded in determining a person's aggregate capital gain or aggregate capital loss.

It is important to know the terms explained above, and to distinguish between them. You must use the correct term at the correct place in the capital gains tax framework when doing a capital gains tax calculation.

Visit the discussion forum in **learning unit 6** and discuss any concepts that you do not understand or, if you do understand, then answer those students who have posted questions.

6.10 ROLL-OVERS

Prescribed book sections: 13.14 and 13.14.3

The aim of these rules is to defer the payment of capital gains tax in certain situations, with the result that the original base cost of the asset is rolled over until the asset is disposed of. The requirements are important because they determine when the rules should be applied.

In certain cases, the roll-over relief makes provision for postponing the payment of capital gains tax, with the result that the initial base cost of the asset being disposed of is rolled over to the date when the asset is finally disposed of.

6.11 ASSESSED LOSSES AND INCLUSION RATE

Prescribed book sections: 13.15 – 13.16

Remember that the inclusion rate is not the tax rate, but it is used to determine the amount that is included in taxable income. You only need to know the rate for individuals.

6.12 MARRIED IN COMMUNITY OF PROPERTY

No prescribed text.

If an individual is married in community of property then all capital gains/losses are divided equally (i.e. 50/50 between the spouses), before the annual exclusion is applied. However, this does not apply to assets that are excluded from the joint estate. The annual exclusion of R40 000 is available to each spouse, which will reduce the respective portion of the total capital gain. The inclusion rate is then applied and the resulting amount is taken into account in the individual's taxable income.

Do the self-assessment test on **capital gains tax** on myUnisa.

6.13 QUESTIONS

Prescribed book section: 13.20

At the end of every learning unit we will refer you to practical questions (refer to part B). Remember the importance of attempting these questions on your own first, **without referring to the solutions**. This will help you to ascertain whether you understand all the topics that were discussed.

Work through practical questions 13.1 to 13.4 in the prescribed book, as well as questions 6.1 to 6.7 in part B of this study guide. In these questions, you can once again apply the knowledge that you have just gained. The questions in the exam will also be based on application of this theory. These questions will therefore help you to prepare for the exam.

6.14 SOLUTIONS TO ACTIVITIES

Activity 6.1: Refer to section 13.4 of the prescribed book.

Activity 6.2: Refer to section 13.5 of the prescribed book.

Activity 6.3:

Asset A	R
Proceeds	75 000
Less: Base cost	
Valuation date value (see calculation)	(75 000)
Expenditure on or after 1 October 2001	nil
Capital gain/loss	nil

Calculation: Valuation date value

As expenditure > proceeds and market value; paragraph 27(1)(*a*) applies, therefore the valuation date value is the greater of

- market value on 1 October 2001 = R70 000, or
- proceeds less expenditure on or after 1 October 2001 = R75 000 – Rnil = R75 000

The valuation date value is therefore R75 000.

Asset B	R
Proceeds	60 000
Less: Base cost	
Valuation date value (see calculation)	(170 000)
Expenditure on or after 1 October 2001	nil
Capital loss	(110 000)

Calculation: Valuation date value

As expenditure > proceeds but expenditure < market value, paragraph 27(1)(*b*) applies therefore valuation date value is the lower of

- the time-apportioned base cost = R170 000, or
- the market value on 1 October 2001 = R230 000

The valuation date value is therefore R170 000.

<u>Asset C</u>

	R
Proceeds	112 000
Less: Base cost	
Valuation date value (see calculation)	(112 000)
Expenditure on or after 1 October 2001	nil
Capital loss	nil

Calculation: Valuation date value

Expenditure < proceeds but market value > proceeds; paragraph 26(3) applies, therefore the valuation date value is proceeds less expenditure on or after 1 October 2001 = R112 000 – Rnil = R112 000.

The valuation date value is therefore R112 000.

Activity 6.4: Refer to section 13.12 of the prescribed book.

WRAP UP

Capital gains tax is the tax that is paid on the gains that are made when a person sells a capital asset. The gain is calculated as the proceeds less the base cost.

The first step is to calculate the proceeds. The formula to calculate this amount is always the same, whether the asset was purchased before or after 1 October 2001.

The second step is to calculate the base cost. The formula for this component depends on whether the asset was purchased before or on/after 1 October 2001. For assets purchased before 1 October 2001 start by dividing all the allowable costs into categories of “before 1 October 2001” and “on/after 1 October 2001”, and use this together with the other information provided in the question to determine the valuation date value and base cost.

If the proceeds are less than the base cost of the asset, certain limitation rules come into effect. Remember that if an asset was purchased on/after 1 October 2001, the base cost of the asset is the cost incurred in acquiring the asset, excluding any amounts of a revenue nature claimed for income tax purposes.

Do these calculations for every capital asset that has been sold during the year and then add them together to calculate the aggregate capital gain/loss. Follow the capital gains tax framework to calculate the taxable capital gain or capital loss.

Where there is an aggregate taxable capital gain at the end of the year, the amount is added to the other taxable income. Where there is an aggregate capital loss, the loss is carried over to the following year of assessment and is not offset against other income. The amount of the aggregate capital loss carried forward can be offset against taxable capital gains in the following years of assessment.

Now you have completed this learning unit, please revisit the learning outcomes and ensure that you have attained all of them.

ASSESSMENT CRITERIA

We could assess your work on this learning unit in assignments or in the exam by asking you to:

- determine whether capital gains tax is payable and provide reasons substantiating your decision
- calculate the adjusted proceeds of an asset
- calculate the base cost of an asset that was purchased on/after 1 October 2001
- calculate the base cost of an asset that was purchased before 1 October 2001
- calculate the capital gain or loss on one or more assets
- calculate the taxable capital gain for the year of assessment
- apply exclusions and/or roll-overs available to individuals
- apply the annual exclusion available to individuals
- apply any assessed capital loss from previous years
- apply the inclusion rate on the aggregate capital gain to be included in the taxable income
- state which assets or gains are not subject to capital gains tax

You will always be provided with the following information in a question for this module on capital gains tax:

- time apportionment base cost, if applicable
- market value, if applicable

POINTS TO PONDER

- Why don’t all countries have a capital gains tax?
- Who is most affected by capital gains tax?

LITERATURE CONSULTED

Stiglingh, M, Koekemoer, AD, Van Zyl, L, Wilcocks, JS & De Swardt, RD. 2017. SILKE - South African Income Tax. Durban: LexisNexis

Bruwer, L, Coetzee, K, De Hart, KL, Koekemoer, AD & Stedall, C. 2017. *A student’s approach to income tax: Natural persons.* Durban: LexisNexis.

NOTES

PART

B

QUESTIONS

PART B: QUESTIONS

1 INTRODUCTION TO TAXATION

2 GROSS INCOME (RESIDENTS) AND SPECIAL INCLUSIONS

3 FRINGE BENEFITS AND ALLOWANCES

4 EXEMPT INCOME – NO QUESTIONS (INTEGRATED INTO QUESTIONS IN OTHER SECTIONS)

5 DEDUCTIONS: GENERAL, PROHIBITED AND SPECIFIC

6 CAPITAL GAINS TAX

QUESTION 1.1 **(20 marks, 36 minutes)**

This is not a previous exam question but it will give you a chance to test whether you understand some of the concepts covered in learning unit 1.

a. Benny is 44 years old. His **normal tax** for the 2018 year of assessment, in respect of taxable income of R250 000, is:

(1) R26 202
(2) R28 695
(3) R36 174
(4) R49 809
(5) R45 000 (2)

b. Nolo is 66 years old. She incurred no medical expenditure during the year of assessment. Her **net normal tax** payable for the 2018 year of assessment, in respect of taxable income of R335 000, is:

(1) R103 850
(2) R50 226
(3) R52 719
(4) R73 833
(5) R60 198 (2)

c. Marie is 39 years old. She incurred no medical expenditure during the year of assessment. Her **net normal tax** payable for the 2018 year of assessment, in respect of taxable income of R877 000, is:

(1) R278 195
(2) R264 560
(3) R257 081
(4) R254 588
(5) R359 570 (2)

d. Mr and Mrs Bean are married in community of property. Mr Bean (75 years old), received a salary of R200 000 for the year of assessment ending 28 February 2018. He also received taxable interest of R71 400 on a fixed deposit held locally. (Individuals 65 years and older are entitled to a R34 500 local interest exemption, while individuals under 65 years are entitled to a R23 800 local interest exemption – see learning unit 4.)

Mrs Bean (64 years old) received rental income of R144 000 from renting out an apartment in Cape Town.

Mr Bean paid employees' tax of R60 000 and provisional tax of R10 000 during the year.

What is Mr Bean's **taxable income** for the 2018 year of assessment?

(1) R307 700
(2) R271 400
(3) R236 900
(4) R273 200
(5) R247 600 (2)

QUESTION 1.1 (continued)

e. Use the information in question d (above) and assume that Mr Bean's taxable income is R423 000. What is Mr Bean's **normal tax** for the 2018 year of assessment?

(1) R80 895
(2) R78 402
(3) R88 374
(4) R152 280
(5) R101 739 (2)

f. Using the information in question d (above), what is Mrs Bean's **taxable income** for the 2018 year of assessment?

(1) R144 000
(2) R72 000
(3) R273 200
(4) R155 900
(5) R83 900 (2)

g. Assume that Mrs Bean's taxable income is R158 500. What is Mrs Bean's **net normal tax payable** for the 2018 year of assessment?

(1) R28 530
(2) R7 416
(3) R14 895
(4) R4 923
(5) Rnil (2)

h. Using the information in question d (above), what is Mr Bean's **net tax liability**?
In order to answer this question you can assume that his normal tax for the 2018 year of assessment is R99 883.

(1) R29 883
(2) R16 276
(3) R6 276
(4) R66 276
(5) R76 276 (2)

i. Ronald passed away suddenly on 31 December 2017. He was 65 years old when he died. His taxable income for the 10 months that he was alive, for the year of assessment, amounted to R798 600. His **normal tax** for the 2018 year of assessment is:

(1) R228 350
(2) R222 444
(3) R246 051
(4) R224 937
(5) R232 416 (2)

QUESTION 1.1 **(continued)**

j. Using the information in question i (above), what is Ronald's **net normal tax payable**?
In order to answer this question you can assume that his normal tax for the 2018 year of assessment is R270 000.

(1) R248 886
(2) R246 393
(3) R221 077
(4) R252 299
(5) R270 000 (2)

GROSS INCOME AND SPECIAL INCLUSIONS	2

QUESTION 2.1 **(8 marks, 14 minutes)**

You are the tax manager of a small auditing and accounting firm. One of the junior trainees has approached you to help him complete his assignment.

Gross income is defined in section 1 of the Income Tax Act as follows:

Gross income, in relation to any year or period of assessment means, in the case of any resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such resident, or in the case of any other person than a resident, the total amount, in cash or otherwise, received by or accrued to or in favour of such person from a source within the Republic, during such year or period of assessment, excluding receipts or accruals of a capital nature.

REQUIRED:

Read the scenario below. Discuss whether the income received would be included in Auntie O's gross income or not. **If not**, indicate which of the requirements of gross income is **not** met and give a short reason why the requirement is not met.

The format of your answer should be, e.g.:
5. Included – revenue nature – taxpayer is a property dealer

Auntie O, a South African rap artist, held a benefit concert in aid of a specific charity in South Africa.

1 R2 000 000 was collected from ticket sales. This R2 000 000 is legally payable to the charity.

2 A sponsor donated R1 000 000 directly to Auntie O to help her to cover expenses in respect of the concert.

3 Auntie O sold a recording studio of hers for R3 000 000, and donated the proceeds to the charity.

4 After the show, a producer signed a recording contract with her, entitling her to a gross amount of R10 000 000 over the term of the contract. She received R1 000 000 up front and will receive the balance of the money as CDs are sold. The first CDs were sold in the following year of assessment.

<u>QUESTION 2.2</u> (11 marks, 20 minutes)

Listed below are eleven receipts or accruals that South African taxpayers have either received or which have accrued to them in the circumstances as indicated.

1. as a legacy
2. as a lottery win
3. as a prize from an employer for making the most sales
4. as cash stolen by a thief
5. from regularly backing many “winners” at various KwaZulu-Natal racehorse meetings
6. from the sale of shares held as an investment
7. from the sale of shares held as trading stock for a year
8. as a restraint of trade payment after 23 February 2000
9. as a loss of profit insurance claim
10. as compensation received for damages as a result of a successful personal defamation action instituted against a former work colleague
11. from the Unemployment Insurance Fund while being out of work for three months

<u>REQUIRED</u>:

Establish whether each particular receipt or accrual will constitute gross income or not.

<u>QUESTION 2.3</u> (14 marks, 25 minutes)

Bobby Bright has never been ordinarily resident in the Republic. However, he has a number of relatives who are ordinarily resident. Bobby enjoys visiting these relatives in the Republic.

The following are five different scenarios of time Bobby spent in the Republic during the 2018 year of assessment and in the five previous years of assessment.

Scenario 1

Year	Present (*days*)
2018	61
2017	92
2016	121
2015	184
2014	32
2013	98

QUESTION 2.3 **(continued)**

Scenario 2

Year	Present (*days*)
2018	92
2017	92
2016	92
2015	92
2014	92
2013	92

Scenario 3

Year	Present (*days*)
2018	182
2017	183
2016	184
2015	183
2014	183
2013	183

Scenario 4

Year	Present (*days*)
2018	122
2017	61
2016	365
2015	152
2014	193
2013	202

Scenario 5

Year	Present (*days*)
2018	92
2017	335
2016	0
2015	245
2014	195
2013	184

REQUIRED:

Determine in each of the scenarios whether Bobby Bright is a resident of the Republic for the 2018 year of assessment in terms of the definition of a “resident” as set out in section 1 of the Income Tax Act.

<u>QUESTION 2.4</u> (8 marks, 14 minutes)

You are the tax official at a small accounting firm. You received the following queries from clients, and you must indicate whether they are correct or not.

<u>REQUIRED</u>:

Indicate whether the following statements from your clients are correct according to the gross income definition (s1 of the Income Tax Act).

If the statement is correct, indicate with a "true". If the statement is incorrect, indicate with a "false". No reasons are required for your answers.

1 A natural person is ordinarily resident where he or she normally resides, apart from temporary and occasional absences.

2 If a farmer exchanges produce he has grown on his farm for a plough at his local cooperative, the value of the plough will not be included in his gross income.

3 The onus of establishing an amount to be included in gross income lies with the taxpayer.

4 Amounts received from illegal business activities will be included in gross income.

5 The concept of "accrued to" means due and payable.

6 If a taxpayer keeps the money from deposits received outside of his control in a separate trust account, the deposits are not taxable.

7 Dividends will usually accrue on the date they are paid.

8 The source of income is the place where the capital is employed and not where the "brain" of the company is located.

<u>QUESTION 2.5</u> (20 marks, 36 minutes)

In the following six case studies, the inclusion of the amounts in "gross income" is in question.

(1) Bud Costello, who lives in Cape Town and works there as a teacher, inherited a house valued at R500 000 in Johannesburg from his grandfather, who had lived in the house at the time of his death. As Bud had no wish to live in Johannesburg, he immediately advertised the property in the *Star* newspaper in Johannesburg and it was sold within two weeks for R650 000. (4)

(2) Lou Abbott, an estate agent living and trading in Pretoria, inherited a block of flats in Pretoria on 3 March 2017, valued at R2 million, from an uncle who also lived in Pretoria. As Lou was planning to sell two other blocks of flats under sectional title, he immediately applied for sectional title rights on the inherited property as well and by 28 February 2018 had sold all the flats in this property for R3 million. (3)

(3) Dean Crosby, a civil engineer, carried on business as an equal partner in an estate agency in Durban until 1 March 2017, when he sold his share in the partnership for R300 000, R100 000 representing his share of the partnership trading debtors, R60 000 his share of the furniture and fittings of the business and R140 000 representing goodwill. The amount of R160 000 representing the payment for the debtors and fixed assets was paid out in cash. Dean agreed to accept an amount of R7 000 per annum for life as payment for the goodwill.

QUESTION 2.5 **(continued)**

On 1 April 2017, he accepted employment in a large civil engineering company in Johannesburg. On 1 May 2017, he purchased a plot of land in Bryanston on which he wished to erect a house for himself and his family. He was forced to acquire a far larger property than he required, as the seller was unwilling to dispose of only part of the property. Dean therefore immediately advertised and sold the excess portion of the property for R500 000 on 30 June 2017. (5)

(4) Marty Hope holds deposits amounting to R10 000 on flats in a block of flats in Bloemfontein which he erected during the previous year of assessment and which he has let during the current year of assessment. These deposits are refundable to tenants who vacate the premises, provided the premises are in the same condition as when they obtained the right to lease them and they have occupied the premises for at least a contractual period of lease of six months. He has banked the R10 000 in a separate bank account and will not use these funds, except for the repayment of deposits to qualifying tenants. (3)

(5) Bob Feldmann requires a deposit of 5% on orders placed by his customers for fresh eggs and farm chickens. Should the customer cancel the order, the customer forfeits the deposit. During February of the current year of assessment, he accepted deposits amounting to R5 000 for deliveries to be made in March of the following year of assessment. (2)

(6) Lenny Diver is a diving instructor in a local scuba-diving club. While diving, he discovered the undamaged wreck of a ship in fairly shallow water off the coast of East London. The ship sank two hundred years ago, carrying a cargo of china. He realised that this cargo of antique china would now be very valuable and proceeded to embark on a salvage operation, hiring a boat, equipment and assistants for this purpose. He received an advance payment of R1 million for the treasure from a museum in London, to which he granted the sole right to purchase the entire cargo. By the end of the year of assessment, he had salvaged china with a total market value of R1,3 million. (3)

REQUIRED:

For each of the above cases, determine (giving brief reasons for your answer) what amounts will be included in the “gross income” of the taxpayers in question for the 2018 year of assessment.

Ignore capital gains tax. Unless stated otherwise you can assume all taxpayers are residents of South Africa.

(**Source:** Cronjé, M, Mitchell, LD & Nieuwoudt, MJ. *Tax workbook*, Butterworths: LexisNexis)

QUESTION 2.6 **(14 marks, 25 minutes)**

Joyce (60 years old) was an employee at a South African landscaping company until her retirement during the 2018 year of assessment. The following are some of the amounts she received during the year of assessment:

(1) A once-off prize of R1 000, from her employer, for being voted the “Best employee of the year”.

(2) A once-off R20 000 prize from the local municipality. The municipality held a landscape design competition that was open to the general public. The winning submission would be used as a blueprint to redesign an important public space in the city centre. Joyce submitted the winning entry. (Joyce submitted in her private capacity and not as an employee of her company.)

(3) Maintenance payments amounting to R12 000, received from her former husband, in terms of a 2011 divorce order.

QUESTION 2.6 (continued)

(4) A cash inheritance of R30 000 from her late aunt.

(5) A lump sum, amounting to R300 000, from her pension fund. Following her retirement, Joyce also received pension income amounting to R80 000.

(6) On retirement, Joyce received a lump sum of R15 000, from her employer, in respect of a severance benefit.

(7) For a farewell gift, Joyce's colleagues held a collection among themselves. They presented Joyce with a R2 000 voucher to be spent at her favourite department store.

REQUIRED:

You are required to state which amounts will be included in Joyce's gross income for the current year of assessment. Provide brief reasons for your answers.

QUESTION 2.7 (7 marks, 13 minutes)

On 1 May 2017, Jacob withdrew R250 000 from his savings account in order to purchase an annuity. He was 60 years old. In terms of the purchase annuity contract, Jacob was to receive an annuity of R2 000 per month for life with effect from 1 June 2017.

REQUIRED:

Calculate the taxable portion of the total annuities that Jacob received during the 2018 year of assessment.

QUESTION 2.8 (7 marks, 13 minutes)

On 1 November 2017, Mary withdrew R400 000 from her savings account in order to purchase an annuity. She was 65 years old. In terms of the purchase annuity contract, Mary was to receive an annuity of R4 500 per month for ten years with effect from 1 December 2017.

REQUIRED:

Calculate the taxable portion of the total annuities that Mary received during the 2018 year of assessment.

QUESTION 2.9 (15 marks, 27 minutes)

Jack, a chemical engineer, was seriously injured in a motor vehicle accident during the 2018 year of assessment. As a result, he was not able to work again and he became entitled to receive compensation from the Motor Vehicle Assurance Fund for loss of future earnings.

Jack had the option of either receiving the compensation in a large, once-off payment or, alternatively, in the form of smaller monthly payments for the rest of his life. Jack elected to receive the compensation in monthly payments. He received the first monthly payment in January 2018.

REQUIRED:

Briefly discuss, with reasons, whether Jack's compensation will be included in his gross income or not.

<u>QUESTION 2.10</u> (20 marks, 36 minutes)

Fred Fortune is a retired doctor who, in March 2017, used his lifetime savings to purchase a rental property in Cape Town. This was the first rental property Fred had ever owned. The property was immediately let to tenants.

During August 2017, Fred received an unexpected phone call from the representative of a Middle Eastern company. The company wanted to purchase Fred's property and convert it into a small boutique hotel, in time for an international congress that was being held in Cape Town and for the upcoming holiday season. The company was prepared to offer Fred almost double what he had paid for the property.

After thinking about the offer overnight, Fred decided to accept it, as he felt the offer was too good to turn down. The sale of the property duly took place in August 2017.

<u>REQUIRED</u>:

Briefly discuss at least five relevant factors that the courts could apply in determining whether Fred Fortune's sale proceeds will, on a balance of probabilities, be included or excluded from his gross income based on its revenue or capital nature.

You may ignore the effect of capital gains tax.

<u>QUESTION 2.11</u> (8 marks, 14 minutes)

Dr Perry Williams, a 39-year-old South African man and married out of community of property, works at a government hospital and earns a salary.

Dr Williams also has an investment portfolio, which includes several blocks of flats that he owns. He has appointed an estate agency to manage all the administrative affairs relating to the flats.

For the 2018 year of assessment, the estate agency collected rental income on his behalf and deducted the estate agency's administrative fees.

During November 2017, Dr Williams bought a lottery ticket. In February 2018, he received a telephone call confirming he had won a cash prize.

Dr Williams also owned South African shares throughout the year of assessment. On 1 February 2018, dividends were declared on these shares. Entitlement to the dividends was obtained by all shareholders registered on 25 February 2018 and the dividends became payable on 15 March 2018.

<u>REQUIRED</u>:

Briefly discuss whether or not the above receipts or accruals should be included or excluded from Dr Perry Williams' gross income for the year of assessment ended 28 February 2018.

In your discussion of each receipt or accrual, refer only to the most relevant requirement(s) of the gross income definition.

FRINGE BENEFITS AND ALLOWANCES	3

QUESTION 3.1 (24 marks, 43 minutes)

Miss Trix Galore, 33 years old and unmarried, is employed as a project leader by Cancount Limited, a provider of telecommunication products and services.

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

1. She earned a basic salary of R132 000 for the year, as well as a pensionable 13th cheque equal to one month's salary.

2. Trix contributed R42 000 towards the company's pension fund in respect of current contributions. Her employer contributed R20 000 to the pension fund on her behalf. Trix's remuneration amounted to R220 323 for the 2018 year of assessment.

3. From 1 March 2017 to 31 July 2017 (153 days), Trix used her own vehicle for business purposes. She received a travelling allowance of R3 200 per month for this purpose. Her odometer reading on 1 March 2017 was 38 942 kilometres and on 31 July 2017 it was 53 177 kilometres. Trix kept an accurate logbook during the period she received the travel allowance. The logbook indicated that she travelled 8 402 kilometres for private purposes during the period. She owns a 2011 A3 Diau, which cost her R188 100 (including VAT).

4. Trix borrowed R60 000 from her employer on 1 December 2016 to finance a portion of the acquisition of her vehicle. The company charges her a fixed interest rate of 5% per annum. On 1 March 2017 the outstanding capital balance was R54 000. During the current year, she made capital repayments of R10 000 on 31 July 2017 and R14 000 on 28 February 2018.

5. From 1 August 2017, Trix's employer provided her with a company car and ceased paying her the monthly travelling allowance of R3 200. She was provided with a BMW 118, with a cost price of R130 000 (excluding VAT). Another employee previously used the BMW for one year. The BMW was not subject to a maintenance plan.

6. Trix was living in one of her employer's three-roomed houses up to 31 January 2018. The house is unfurnished and she had to pay for her own power consumption. Trix's remuneration proxy was R155 245 for the previous year.

7. Trix receives R500 per month to entertain clients. During the year, she spent R6 750 on entertaining clients.

8. Cancount Limited runs a cafeteria for their staff. On average Trix has a meal there twice a day, three days a week, 48 weeks a year. She saves approximately R10 per meal compared to what she would have paid had she eaten at a public restaurant.

REQUIRED:

Calculate Trix's taxable income for the year of assessment ended 28 February 2018.

Assume that the official rate of interest was 8% for the full period.

<u>QUESTION 3.2</u> (17 marks, 31 minutes)

Mr Koen is 40 years of age and married out of community of property. Financials Ltd employs him. Mr Koen had the following income and expenses for the year of assessment ended 28 February 2018:

From Financials Ltd:	R
Salary	250 000
Performance bonus	100 000
Entertainment allowance	2 000
Travel allowance (note 5)	94 425
Company car (note 1)	?
Other income:	
Workmen's compensation (note 2)	8 000
Dividends received – C Ltd (note 3)	130 000
Expenses:	
Entertainment	2 300
Donation to university (note 4)	5 000
Monthly instalment paid on car loan (note 5)	7 000

Notes:

1. **Company car.** Mr Koen has the free use of the company's Izuzu double-cab bakkie. The company purchased the bakkie at the beginning of the previous year of assessment for R250 000 (inclusive of VAT). Mr Koen had the use of the vehicle from 1 March 2017. In terms of the company rules, he must keep accurate records of all his travels. For the current year of assessment he travelled 6 900 kilometres for business purposes and 7 000 kilometres for private purposes. He did not pay any costs related to the use of the vehicle. The Izuzu is not subject to a maintenance plan.

2. **Workmen's compensation.** The amount was paid after Mr Koen was injured on the job. The claim complied with the requirements of the Act and he received the amount of R8 000.

3. **Dividends received – C Ltd.** Mr Koen owns 13% of the shares in C Ltd. The company is a South African company. The company had a taxable income of R2 000 000 and paid corporate tax of 28% on the income. The company declared a dividend of R1 000 000. The dividend tax on the dividend amounted to R150 000.

4. **Donation.** Mr Koen obtained the required receipt.

5. **Travel allowance.** Mr Koen bought a Woodeo 2.0 motor vehicle on 1 September 2016. The vehicle had a cost price of R126 000 (including VAT). On 1 March 2017 the odometer reading was 4 890 kilometres and 39 390 kilometres on 28 February 2018. Mr Koen's logbook indicated that his private travel amounted to 20 700 km. He kept no records of his vehicle's running costs.

<u>REQUIRED</u>:

Calculate Mr Koen's taxable income for the year of assessment ended 28 February 2018.

QUESTION 3.3 **(19 marks, 34 minutes)**

Jean Banister's employer (a company) has given him the choice to select, as from 1 March 2017, either the free use of a company car for private and business purposes or a travel allowance.

Jean would keep a detailed logbook, and he estimates that he will travel a total of 35 000 kilometres per annum, of which 15 000 kilometres would be for business purposes. This applies for the travel allowance and use of a company car.

Travel allowance:

Should he choose the travel allowance, he will receive an allowance of R6 500 a month. He will purchase a new car on 1 March 2017 for R180 000 (excluding VAT at 14%).

In order to assist him to purchase the car, the company will on 1 March 2017 grant him a loan of R100 000 at an interest rate of 1% per annum (assume an official interest rate of 8% per annum for the entire period). The capital will be repayable in eight six-monthly payments of R12 500 each. The first payment is due on 31 August 2017.

The expenses for the period to be incurred in running the car have been estimated as follows:

	R
Fuel (private use R6 000 included)	14 500
Maintenance	7 500
Licence	480
Insurance	4 600
	27 080

Use of a company car:

The car that he will use was purchased by the company on 1 January 2017 for R180 000 (excluding VAT at 14%); the car will be purchased specifically for him and no one else will have the use of the vehicle. The car was bought under a maintenance plan of five years or 100 000 km.

REQUIRED:

Calculate whether Jean Banister must choose the travel allowance or the use of the company car based on his estimated figures. Compare only the tax implications of the two possibilities in respect of the year of assessment ended 28 February 2018.

QUESTION 3.4 (15 marks, 27 minutes)

Gary Noomsa receives a travelling allowance from his employer. He would like to know if he would receive a refund from SARS as a result of his travelling expenses.

His details are as follows:

- Travelling allowance received R108 000
  He received the allowance from 1 June 2017 (R12 000 per month)

- Vehicle - Dada 2.0 exec
  - Cost R230 000
  - VAT R32 200
  - Deposit paid R20 000
  - Total finance charges of R146 832 over 4 years

- Logbook for period from 1 June 2017 – 28 February 2018
  - Total kilometres travelled amounted to 30 600 km
  - Total private kilometres travelled amounted to 11 200 km

- Expenses for period from 1 June 2017
  - Fuel R6 500
  - Maintenance (covered by a maintenance plan) R3 570
  - Tyres R1 755
  - Speeding fines (to get to work on time) R1 600

REQUIRED:

Advise Gary whether he will receive a refund when he is assessed by SARS solely because of the above information (ignore any other factors).

QUESTION 3.5 (14 marks, 25 minutes)

Penny Nkosi joined Reeva Cosmetics Ltd during 2000. On 1 August 2017, Penny was promoted to provincial manager. Her promotion allowed her to structure her remuneration package, which will come into effect on 1 September 2017. Penny, who had never owned a car, was completely overwhelmed by the idea of having her own car and opted for a travel allowance of R11 500 per month. On 31 August 2017, she bought a new Audi A2 with a cash value of R600 000 (including VAT of 14%). Finance charges amounted to R207 800 over 4 years.

Penny, a precise and organised person, kept an accurate record of all her private and business trips. She travelled 15 000 kilometres in total for the period 1 September 2017 to 28 February 2018, of which 8 800 kilometres was for business purposes. She also kept record of every cent that she spent on the car; these expenses, which are all deductible for income tax purposes (and excluding any finance charges), amounted to R35 780 for the period.

REQUIRED:

Calculate the amount to be included (if any) in Penny Nkosi's taxable income arising from the travel allowance received for the 2018 year of assessment.

QUESTION 3.6 **(24 marks, 43 minutes)**

David, a chemical engineer, accepted a new job with effect from 1 June 2017.

Before starting his new contract of employment, David had to choose between two possible remuneration packages. Details of each package are listed below:

(You may assume that David was not employed in the period prior to 1 June 2017 and that all fringe benefits would take effect from the date of his employment. You may also assume that all references to the market value of assets are at the date of employment.)

PACKAGE #1	**PACKAGE #2**
Basic salary: R40 000 per month	**Basic salary:** R40 000 per month
Housing/Accommodation: Employer-provided accommodation with the sole use of a four-bedroom house. The employer does not own the house but it pays a monthly rental of R6 000 for the right to house an employee in it. The house is furnished but David would have to pay for the premises' electricity costs.	**Housing/Accommodation:** A R500 000 loan from Finba Bank to be taken out by David to enable him to purchase his own house. David will be required to pay 5% per annum interest on the loan. The interest rate is low because David's employer would compensate the bank for loss of interest on the difference between 5% and the rate of 10,5% that it normally charges its clients. The official rate of interest is 8% per annum.
Cellphone: The right of use of a company-owned cellphone. The market value of the phone is R5 800 and original cost was R6 500. David would be required to use the phone mainly for business purposes but he would be entitled to occasionally use it for private purposes as well.	**Cellphone:** Receipt of a cell phone allowance of R450 per month, if David agrees to use his private cellphone for work-related purposes. The above amount would more than cover the monthly contract payment of R250 that David has to make for his private cellphone.
Computer: Receipt of a computer allowance of R600 per month should David agree to use his own home computer for work-related purposes. David accurately estimates that his computer-related expenses average out at R510 per month.	**Computer:** Sole right of private use of a company-owned computer over its full, four years of useful life. The cost to the employer of the computer is R11 800 and its market value is R12 000.

QUESTION 3.6 (continued)

PACKAGE #1	PACKAGE #2
Motor vehicle/travel: Receipt of a reimbursive travel allowance of R3.40 for every kilometre travelled for business purposes in David's own car. You may assume that David's travelling would amount to 600 km per month, of which 20% would be for private purposes.	**Motor vehicle/travel:** Right of use of a company-owned vehicle. The vehicle's cost was R300 000 (VAT exclusive) when it was purchased by the company on 1 May 2016. The vehicle is subject to a maintenance plan. You may assume that David's travelling would amount to 600 km per month, of which 20% would be for private purposes. David's only vehicle-related cost would be fuel. You may assume that his total fuel expenses would amount to R8 100 for the entire period.
Insurance premiums: Payment by the employer, on David's behalf, of R800 per month for insurance premiums. The premiums would indemnify David against any claims arising from any negligent act that he may commit while rendering services to his employer.	**Insurance premiums:** Receipt by David of an additional stipend of R800 per month from his employer. David would be allowed to contract directly with an indemnity insurance provider at a cheaper monthly rate. Assume that David could obtain indemnity insurance at a rate of R640 per month.

REQUIRED:	MARKS
a) Calculate David's taxable income for the 2018 year of assessment if he accepted remuneration **package #1**.	**11**
b) Calculate David's taxable income for the 2018 year of assessment if he accepted remuneration **package #2**.	**12**
c) Based on your above calculations, advise David which package would be the most tax efficient for him to accept.	**1**

DEDUCTIONS: GENERAL, PROHIBITED AND SPECIFIC	5

QUESTION 5.1 (7 marks, 13 minutes)

You are the tax manager of a small auditing and accounting firm. One of the junior trainees has approached you to help him complete his assignment.

The general deduction formula (s11(*a*) of the Income Tax Act) provides:

> *For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived … expenditure and losses actually incurred in the production of the income, provided such expenditure and losses are not of a capital nature.*

REQUIRED:

Discuss in the following scenario whether the deductions sought would be allowed for tax purposes in terms of the general deduction formula. ***If not***, indicate which of the **requirements of section 11(*a*)** are ***not*** met and give a short reason why the requirement is not met.

The format of your answer should be:
4 Not deductible – not in production of income – not closely related to performance of business activities.

Mrs Bend, an occupational therapist, started a practice from home during the current year of assessment.

1 Before she commenced trading, she had a section of her home converted into a reception/administration room, consulting/workshop area and a bathroom for patients and staff. General repair work relating to the practice, like painting, replacement of broken floor tiles and ceilings and replacement of the toilet, totalling a cost of R10 000, was included in the total construction cost of R70 000.

2 During the year, she accidentally cut a patient's arm with her scissors while removing a cast. Because of this, the patient incurred medical costs of R2 500. She agreed to pay all the patient's medical expenses.

3 During the year a patient that owed Mrs Bend R1 000 died. Mrs Bend will never receive the amount owed to her.

QUESTION 5.2 (16 marks, 29 minutes)

1. Johannes, a maker of garden pots, incurred a cost of R15 000 when moving machinery and plant from his old premises to his new premises.

2. Molato owns a property that he rented to tenants. He incurred a cost of R12 000 because he used the services of a letting agent who collected rentals on his behalf.

3. Lesley was a builder who, while constructing a house, had to pay damages and medical expenses to a pedestrian who was struck by a brick that fell from the building site.

QUESTION 5.2 **(continued)**

4. Pamela paid R16 000 for a motorcycle that she awarded to her employee as a prize for reaching a sales target.

5. Mr Old is a retired taxpayer whose only receipts and accruals are pension and interest. In his income tax return, he has claimed accounting fees for the preparation of his financial records.

6. Jeffrey inadvertently forgot to deduct allowable expenses in the 2017 year of assessment and therefore decided to claim them in the current (2018) year of assessment.

7. Ms Hungria claimed the cost of meals and argued that if she did not eat she would not be able to work and therefore produce income.

8. Andisha incurred expenses amounting to R3 800 in the 2018 year of assessment in respect of income, which will only be produced in the 2019 year of assessment.

REQUIRED:

In each of the above circumstances state, whether the expenses incurred may be deducted in terms of section 11(*a*), read with section 23 of the Act, or not. Give reasons for your answers.

QUESTION 5.3 **(13 marks, 23 minutes)**

Indicate whether the following statements from your clients are correct according to the general deduction formula – section 11(*a*) of the Income Tax Act read with section 23.

If the statement is correct, indicate with a "**true**". If the statement is incorrect, indicate with a "**false**". No reasons are required for your answers.

1 A taxpayer may only claim expenses for one trade during the year of assessment.

2 A deduction can be claimed for the taxpayer's own labour where the asset was created by him, as his labour increases the value of the asset.

3 If a taxpayer disputes a claim against him and at the end of the year of assessment, the dispute is undetermined, he cannot claim the disputed amount as a deduction for income tax purposes as the liability has not actually been incurred.

4 The concept of "matching" often requires expenditure to be carried forward to a subsequent year or back to an earlier year, for the purposes of calculating taxable income.

5 In order to claim an expense, the particular item of expenditure must produce some income in the year of assessment.

6 Expenditure is of capital nature if it is incurred in addition to the cost incurred to produce that income.

7 Expenditure is normally of a capital nature if the expenditure is a cost that is going to be spent once and for all, while expenditure of a revenue nature is often a cost that is going to be incurred every year.

8 There is no halfway house between expenditure of a capital nature and expenditure of a revenue nature.

QUESTION 5.3 (continued)

9 No loss or expense can be deducted if it is recoverable under any contract of insurance, guarantee, security or indemnity.

10 Interest which might have been made on any capital employed in trade (that is notional interest) can be deducted for income tax purposes.

11 Gifts are expenses incurred in the production of income and can generally be deducted as expenses for tax purposes.

12 Fines for the contravention of regulations, the late submission of tax returns or traffic offences are normally allowed as a deduction.

13 Assets such as mines, quarries and forests are exhausted in the course of their use. Nevertheless, expenditure incurred in the acquisition of these assets is of a capital nature.

QUESTION 5.4 (14 marks, 25 minutes)

Kate Singh is employed by Spicy Sauces CC. She is married, has one child and is 33 years of age.

You are her tax advisor and she supplies you with the following annual information in order to complete her tax affairs for the year of assessment ended 28 February 2018:

Income	R
Salary (including 13th cheque)	208 375
Deductions	
Premiums paid in terms of an insurance contract to cover loss of income (pay-out will not constitute income as defined)	12 000
Medical aid contributions paid by Kate (note)	35 440
Qualifying medical expenses not covered by the medical aid fund	3 500
Contributions to provident fund	10 800
Donations to public benefit organisations (the necessary receipts were obtained)	7 500

Note:

Kate's husband and child are registered as dependants on her medical aid. None of them has a disability, as defined.

REQUIRED:

Calculate Kate's net normal tax for the year of assessment ended 28 February 2018.

QUESTION 5.5 **(24 marks, 43 minutes)**

Sarah Baatman (45 years old and unmarried) is employed by a private museum, where she is the curator. She has worked for the museum for the past five years. Her income and expenses for the 2018 year of assessment are as follows:

Income:	R
Salary	153 500
Dividends:	
South African companies	2 800
Foreign dividends	544

Sarah holds less than 10% of the shares of company A. The dividend she received was after withholding tax of 10%. The gross dividend before corporate tax (30%) was R864. No special exemptions apply to the above foreign dividends.

Interest received:	
South African savings account (not from a tax free investment)	23 400
Foreign bank account	5 290
Bonus received in December 2017	13 000

Expenses:

Medical expenses	
Medical aid fund contributions (the museum did not contribute)	13 044
Amounts not covered by the medical aid fund	800
Amounts paid by Sarah and refunded to her by the medical aid fund	400
Amounts paid by the medical aid fund directly to medical practitioners	4 500
Current pension fund contributions	11 400
Sarah's employer paid R5 700 additional pension fund contributions. During the 2017 year of assessment R300 of her current pension fund contributions were disallowed as they exceeded the stipulated limitation.	
Past period pension fund contributions	1 000
During the past 5 years, a total of R200 was not allowed to be deducted for income tax purposes in respect of past period contributions.	
Donations:	
Archaeological society of South Africa – registered as a public benefit organisation in terms of the Ninth Schedule.	7 500
Local Boy Scout Troop – Scouts are entitled to register as a public benefit organisation in terms of the Income Tax Act but have not yet registered.	1 500

Where applicable an official receipt was received by Sarah.

REQUIRED:

Calculate Sarah's net normal tax for the year of assessment ended 28 February 2018.

QUESTION 5.6 (50 marks, 90 minutes)

Louis le Blanc (48 years old) is married in community of property to Maria. They have one son, Albert (16 years old).

Louis started working on 1 March 2017 as a project manager for Future Projects (Pty) Ltd, which is situated in Gauteng. He relocated from the Eastern Cape where he worked previously.

Details of Louis' income and expenses for the year of assessment ended 28 February 2018 are as follows:

Income and benefits	Notes	R
Salary		481 750
Repayment of bursary	1	15 000
Rental income	2	?
South African interest (not from a tax free investment)		50 000
Foreign interest		1 600
Foreign dividends		4 725
Expenses		
Sundry expenses	3	?
Total medical expenses paid by Louis	4	51 985
Current contributions to retirement annuity fund		54 000

Notes:

1. Repayment of bursary

Future Projects (Pty) Ltd repaid the balance of a bursary Louis received from his previous employer. Louis was supposed to work for his previous employer for another year in terms of the bursary conditions. As a condition of the repayment, Louis has to work for Future Projects (Pty) Ltd for at least one year.

2. Rental income

Louis purchased a house with a garden flat on the same property and moved into the house on 1 June 2017. The garden flat was let from 1 July 2017, after it had been renovated.

The following amounts were received:	R
Rental income received R3 500 per month, the rent for February 2018 was unpaid at 28 February 2018	24 500

3. Sundry expenses

Sundry expenses are made up of the following:	
Legal expenses	12 000
Purchase of laptop	13 500

During the year of assessment, Louis was involved in a legal dispute with his previous employer regarding outstanding salary payments that are owed to him. He incurred legal costs on consultations with lawyers regarding this matter.

In terms of his contract of employment, Louis has to use his own laptop computer for work purposes. On 1 July 2017, Louis purchased a laptop computer at a cost of R13 500.

QUESTION 5.6 **(continued)**

4. Medical expenses

Louis is a member of a registered medical aid scheme. His wife, son and 86-year-old mother are dependants. None of them has a disability as defined.

The following is a summary of Louis' medical expenses for the year of assessment:

	R
• Medical aid scheme contributions paid by Louis for the year of assessment	12 000
• Qualifying medical expenses not reimbursed by medical aid	8 000
• Prescriptions for medicine purchased at pharmacies, not submitted to the medical aid	4 985
• Medicine purchased at pharmacies without prescriptions	3 000
• Fees paid to a registered nurse to take care of Louis' mother	24 000
	51 985

In addition to the above payments, Future Projects (Pty) Ltd contributed R3 600 per month to the medical aid scheme on Louis' behalf for the full year of assessment.

5. Additional information

A write-off period of three years, for laptop computers, is considered acceptable by SARS.

REQUIRED:	**MARKS**
(a) Calculate Louis' **net normal tax** for the year of assessment ended 28 February 2018.	**28**
(b) Assume that Louis' taxable income is R540 000.	
(i) Calculate Louis' **medical scheme fees tax credit and additional qualifying medical expense tax credit** on the additional assumption that his son has a disability as defined.	**11**
(ii) Calculate Louis' **medical scheme fees tax credit and additional qualifying medical expense tax credit** on the additional assumption that he is 65 years old (not 48 years old).	**11**

CAPITAL GAINS TAX	6

QUESTION 6.1 **(20 marks, 36 minutes)**

You are the accountant at a holiday letting business. Your clients requested help with the capital gains tax implications on the following assets for the year of assessment ending 28 February 2018.

Client A:

Ms A purchased a holiday house in Durban 30 years ago. On 1 September 1999, she purchased an eight-metre boat. She uses the boat on weekends when she goes sailing and when her children visit her, they use the boat for fishing.

On 15 January 2018 she sold the boat for R600 000. The base cost of the boat was R450 000.

Ms A wants to know what the capital gain or loss on the disposal of the boat will be. (2)

Client B:

After Mr B retired in 1997, he purchased a house in Margate on 1 October 1997. He paid R300 000 for the house and he made improvements costing R100 000 to the house in 1998. He has been living in the house since 1997.

The market value of the property on 1 October 2001 was R780 000. Every year since 1997, Mr B has rented the house to students between 15 November and 15 January. During this period, he stays with a friend in Ramsgate. He receives rental income of R20 000 per annum and his municipal costs amount to R800 per month. On 1 February 2018, Mr B sold the house for R2 000 000 to an overseas investor. Mr B wants to know what the capital gain or loss on the disposal of the asset will be.
(10)

Client C:

Ten years ago, after Mr C retired, he purchased a house in Port Shepstone. On 1 September 2005, he decided to start his own sea tour business and purchased a nine-metre boat. He uses the boat to take holidaymakers out on sea tours.

On 15 January 2018, he sold the boat for R600 000. The base cost of the boat was R650 000. Mr C wants to know what the capital gain or loss implications of the transaction will be. (2)

Client D:

Mr D owns “Sea View Fast-foods”, a fish and chips shop at Ramsgate beach. He wants to retire from the business and sell the shop to a local businessman. He heard that if one sells one’s small business, one does not have to pay capital gains tax on a portion of the capital gain.

Mr D wants to know when a person will qualify for the exclusion and how much the exclusion is. (6)

REQUIRED:

Calculate the capital gain or loss on the sale of the asset for each of the above-mentioned clients or advise the client where applicable, with reasons.

QUESTION 6.2 **(12 marks, 22 minutes)**

Henk Roets, 55 years old, has been living in Pretoria for the past 25 years. Due to some health problems, he decided to go on early retirement and bought a townhouse in Stellenbosch. As he was moving from a big house to a townhouse, Henk needed to sell most of his assets before moving.

The following information relates to the assets sold during the 2018 year of assessment:

- Henk purchased his house in Pretoria on 1 October 1984 for R325 000. He and his wife have been living in it since they purchased it. In 1996 their third child was born and they built an additional bedroom, study and family room, which cost them R220 000.

  The house was not valued at 1 October 2001. It was sold for R1 600 000 on 30 September 2017. Assume the time-apportionment base cost is correctly calculated at R1 360 227.

- He received R75 000 on the disposal of a motor car inherited from his father on 1 April 2017. As his own motor vehicle was only a year old at the time, he disposed of the inherited motor car. The market value of the vehicle was R65 000 on the day he inherited it. He sold it for R75 000 and it had not cost him anything.

- During September 2004 Henk purchased a flat for R160 000 near the university that he held as a rent-producing asset. He sold this flat for R315 000. The selling price included agent's commission of R15 750. The sale was completed on 15 November 2017. His taxable income from the letting of the flat amounted to R18 000 for the current year of assessment.

- On 15 January 2018, he took his wife to Monte Casino to celebrate her birthday. As they were having a good time, they tried their luck on the roulette tables. He won R5 350 for the night.

- A gain of R10 000 on an antique dining room set. Henk collects antiques; he is not a dealer. He disposed of this dining room set as he purchased another set.

- A loss of R2 250 on the disposal of listed shares that he held as a long-term investment.

Henk Roets has an assessed capital loss of R5 000 in respect of the 2017 year of assessment.

REQUIRED:

Calculate Henk Roets' taxable capital gain or loss for the 2018 year of assessment.
You can assume that all gains/losses are correctly calculated for CGT purposes.

QUESTION 6.3 **(30 marks, 54 minutes)**

Joe Masinga is 31 years old and unmarried. He lived in Sabie (Mpumulanga province) until 30 May 2017. He has a BCompt degree. Joe decided to move to Pretoria, where he commenced a contract for articles in accounting and continued his part-time studies through Unisa.

Joe sold his home in Sabie on 1 April 2017 for R480 000. On 15 January 2000, he purchased the property for R160 000 and it was valued at R180 000 on 1 October 2001. He used 20% of the floor space of his house as an office where he had to work in the evenings and for which he had claimed certain tax deductions. During December 2006, Joe built a swimming pool and lapa as he thought that this would increase his chances of selling the property. The swimming pool and lapa cost him R25 000. Assume that Joe had correctly calculated the time-apportionment base cost of his home to be R230 631.

QUESTION 6.3 (continued)

The following are his income and expenses in respect of the year of assessment ended 28 February 2018:

	R
Sabie Trading Supplies (total for 3 months):	
Salary – Joe was the accountant for this shop	60 000
Medical fund contributions paid (note 1)	1 080
Pension fund contributions paid (note 2)	2 000
Touch and Anders Accountants (total for 9 months):	
Salary	56 600
Provident fund contributions paid (note 2)	11 520
Entertainment allowance	1 600
Joe is expected to entertain clients and has vouchers to prove that he spent R1 000 during the current year.	
Medical fund contributions paid (note 1)	1 840
Medical expenses not covered by either of the funds	2 900

In order to pay for his moving costs, Joe sold some shares that he had. He made a capital profit (correctly calculated by the broker) of R5 000. Joe is not considered to be a share dealer for income tax purposes.

Notes:

1. Neither employer contributed on his behalf to the medical aid fund. Joe does not have a disability as defined.
2. You may assume that Joe's total gross remuneration (for both Sabie Trading Supplies and Touch and Anders Accountants) amounted to R118 200 for the current year of assessment.

REQUIRED:

Calculate Joe's net normal tax for the year of assessment ended 28 February 2018.

QUESTION 6.4 (27 marks, 49 minutes)

Anthony Opkins is employed by a private company Vidbest (Pty) Ltd. He is 67 years old and has been working on contract for them since his retirement four years ago. Anthony is married out of community of property to Jezebel and they have five adult children. The following information encompasses all the income and expenditure for Anthony for the 2018 year of assessment:

	R
Income from employment:	
Salary	160 000
Other income:	
Sale of caravan (see other information)	
Investment income received	
Interest income from South African fixed deposit (not tax free)	35 625
Foreign dividends	1 481

QUESTION 6.4 **(continued)**

Expenses:

	R
Donations	
To public benefit organisation – section 18A receipt was received	6 000
His spouse – for her birthday..	10 000
A family friend – Anthony gave a spare car that he had to a friend when their uninsured car was stolen. The car had cost Anthony R80 000 (two years ago) and had a market value on the date of the donation of R66 000.	
Medical aid fund contributions – His employer contributed R600 per month in respect of Anthony and his wife. Anthony contributed R700 per month.	
Qualifying medical expenses not covered by the medical fund..	13 000
Anthony and his wife are the only members of the medical aid fund and neither have a disability as defined.	

Other information:

Caravan

When Anthony purchased the caravan on 1 August 2015, he approached his employer to help him finance the caravan. Vidbest is not a moneylender but did loan Anthony R60 000 at an interest rate of 3%. During the past three years, the caravan has been stored at Garmate Caravan resort and rented out to the general public. During the current year of assessment, Anthony received R33 000 in rental income.

During the current period storage amounted to R2 000 and advertising amounted to R3 000 in respect of advertising the caravan as available for holidays, and R1 500 in respect of advertising that the caravan was for sale. On 30 October 2017, Anthony sold the caravan to Joshua Tree for R107 500 and settled the loan with his employer (paid the full amount back). The market value of the caravan on that date amounted to R73 000.

REQUIRED:

Calculate Anthony's net normal tax for the year of assessment ended 28 February 2018.

You can assume that the official interest rate was 8% for the full period.

QUESTION 6.5 **(16 marks, 29 minutes)**

Jacques Botha is in the process of emigrating to England, after living in South Africa for 57 years. He is selling all his assets in South Africa. He would like to know how capital gains tax will affect his pocket.

He provides the following information regarding the selling of his assets:

1. Primary residence

Jacques Botha lived in the house for 20 years. The house cost him R300 000. He made improvements prior to 1 October 2001 of R200 000. He replaced the carport's roof during July 2008 at a cost of R10 000. The market value of the house at 1 October 2001 was R1 800 000. He sold the house for R2 800 000 in December 2017. Assume the time-apportionment base cost at 1 October 2001 was R1 942 000.

QUESTION 6.5 **(continued)**

2. Holiday flat

Jacques Botha owned a holiday flat on the north coast of KwaZulu-Natal. He acquired it in March 2004 for R500 000. He spent R50 000 during April 2004 to improve and make the flat more comfortable. He sold the holiday flat in November 2017 for R1 000 000.

3. Business

Jacques Botha owned a dry cleaning business, which he operated for the past seven years. The assets in the business were valued at R6 000 000. He sold the dry cleaning business for a capital gain of R2 400 000.

4. Other assets

Plants that Jacques Botha cultivated as a hobby were sold for R50 000 in January 2018. It cost him R25 000 to cultivate the plants during 2017.

REQUIRED:

Calculate the tax liability in respect of Jacques Botha's capital gains tax transactions above, assuming that he will pay 45% tax on it, if applicable, for the year of assessment ending 28 February 2018. Give reasons if items are not subject to capital gains tax.

QUESTION 6.6 **(17 marks, 31 minutes)**

Sherry Jones (59 years old), a qualified chartered accountant, decided to emigrate to the United Kingdom. The move occurred at the end of the 2018 year of assessment after she disposed of most of her assets.

Details of the disposals are as follows:

- Sherry has been the sole proprietor of a private consulting business for the past seven years. She managed to sell the business during the year of assessment for R3 400 000. Sherry correctly determined that the cost of acquiring and creating the business amounted to R600 000.

- Sherry made a capital gain of R30 000 on the sale of a painting. The painting had decorated Sherry's living room.

- Sherry lived in her house in Waterkloof (Pretoria) for 21 years. She purchased the house initially for R700 000. Additional legal fees and transfer duty amounted to R50 000 at the time of purchase. She made improvements prior to 1 October 2001 of R200 000. On 1 October 2001 the market value of the house was R1 200 000 and the time-apportionment base cost was R1 142 000. She installed a sprinkler system during October 2011 at a cost of R10 000. She sold the house in February 2018. She received the net amount of R2 200 000 after the deduction of agent's commission of R180 000. Sherry always used 5% of her house for business purposes.

REQUIRED:

Calculate Sherry's taxable capital gain or capital loss for the year ended 28 February 2018. Sherry has an assessed capital loss of R55 000 brought forward from the previous year of assessment.

<u>QUESTION 6.7</u> (17 marks, 31 minutes)

Jerry Naidoo, a shop owner, is 62 years old and married to Vanessa in community of property. Jerry owns a building in Gauteng. The building has three stories (floors). The ground floor is used to run his shop and the first and second floors are used as the family's primary residence. The shop comprises 30% of the building's floor space.

Jerry purchased the building in March 1993 and paid R850 000 for it. The ground floor area of the building had already been used as a shop when he purchased it.

Jerry improved the shop during 2006. The shop improvements were completed on 3 October 2006 at a cost of R400 000.

During 2006, Jerry had the residential area improved at a cost of R300 000. This entailed the installation of jacuzzis and built-in cupboards in every bedroom. He also purchased new loose-standing kitchen equipment at a cost of R80 000.

On 15 November 2017, a fire originated in the shop and destroyed the entire building.

The building was underinsured. As a result, the insurer paid out only R1 500 000 for the building.

Jerry's outstanding home loan owing to the bank was R50 000 at the date of the insurance payment.

Additional information relating to 1 October 2001:

	Entire building R
Time-apportionment base cost	781 557
Market value	1 800 000

REQUIRED:	MARKS
Calculate Jerry's taxable capital gain/(loss) for the year of assessment ended on 28 February 2018. **Note** Provide reasons for choosing the valuation date value.	**17**

PART C: SUGGESTED SOLUTIONS

PART

C

SUGGESTED SOLUTIONS

1 INTRODUCTION TO TAXATION

2 GROSS INCOME (RESIDENTS) AND SPECIAL INCLUSIONS

3 FRINGE BENEFITS AND ALLOWANCES

4 EXEMPT INCOME – NO QUESTIONS (INTEGRATED INTO QUESTIONS IN OTHER SECTIONS)

5 DEDUCTIONS: GENERAL, PROHIBITED AND SPECIFIC

6 CAPITAL GAINS TAX

INTRODUCTION TO TAXATION	1

SOLUTION 1.1 **(20 marks, 36 minutes)**

a **4** [(R250 000 – R189 880) x 26%] + R34 178 = R49 809

b **3** [(R335 000 – R296 540) x 31%] + R61 910 = R73 833 (normal tax)
R73 833 – R21 114 = R52 719 (net normal tax)

c **2** [(R877 000 – R708 310) x 41%] + R209 032 = R278 195 (normal tax)
R278 195 – R13 635 = R264 560 (net normal tax)

d **4** [R200 000 + (R71 400/2 – R34 500) + R144 000/2] = R273 200

e **5** [(R423 000 – R410 460) x 36%] + R97 225 = R101 739

f **5** (R71 400/2 – R23 800) + R144 000/2 = R83 900

g **3** (R158 500 x 18%) = R28 530 (normal tax)
R28 530 – R13 635 = R14 895 (net normal tax)

h **3** R99 883 – R23 607 – R60 000 – R10 000 = R6 276

i **3** [(R798 600 – R708 310) x 41%] + R209 032 = R246 051

j **4** R270 000 – (R21 114 x 306/365) = R252 299

GROSS INCOME AND SPECIAL INCLUSIONS	2

SOLUTION 2.1 **(8 marks, 14 minutes)**

1 Ticket sales R2 000 000 – not included
Requirement not met – not received by or accrued to or in favour of Auntie O
Reason – for the benefit of charity (2)

2 Donation from sponsor R1 000 000
– will form part of gross income (1)

3 Proceeds of R3 000 000 on the sale of recording studio – not included
Requirement not met – of a capital nature
Reason – not part of her trade, capital asset (2)

4 R1 000 000 will form part of gross income (1)

R9 000 000 balance of recording contract – not included
Requirement not met – not received or accrued during year of assessment
Reason – received/accrued in following years (2)

SOLUTION 2.2 **(11 marks, 20 minutes)**

Gross income

3, 4, 5, 7, 8, 9, 11

Not gross income

1, 2, 6, 10

SOLUTION 2.3 **(14 marks, 25 minutes)**

Scenario 1

Because Bobby was not physically present in the Republic for more than 91 days in the current (2018) and the 2014 year of assessment, he is not a resident of the Republic. (2)

Scenario 2

Bobby is physically present in the Republic for more than 91 days in the current (2018) year of assessment. He was physically present in the Republic for more than 91 days in the 2017, 2016, 2015, 2014 and 2013 years of assessment. However, in total in the previous five years of assessment he was not physically present in the Republic for more than 915 days (he was physically present in the Republic for a total of 460 days during these five years of assessment). Therefore, Bobby is not a resident of the Republic in respect of the 2018 year of assessment. (4)

Scenario 3

Bobby is physically present in the Republic for more than 91 days in the current (2018) year of assessment. He was physically present in the Republic for more than 91 days in the 2017, 2016, 2015, 2014 and 2013 years of assessment. In total in the previous five years of assessment, he was physically present in the Republic for more than 915 days (he was physically present in the Republic for a total of 916 days during these five years of assessment). Therefore, Bobby is a resident of the Republic in respect of the 2018 year of assessment. (4)

Scenario 4

Because Bobby was not physically present in the Republic for more than 91 days in the 2017 year of assessment, he is not a resident of the Republic. (2)

Scenario 5

Because Bobby was not physically present in the Republic for more than 91 days in the 2016 year of assessment, he is not a resident of the Republic. (2)

SOLUTION 2.4 **(8 marks, 14 minutes)**

1 True – a person is ordinarily resident in the country to which he would naturally and as a matter of course return from his wanderings and would, in contrast to other countries, call home (*Cohen v CIR*).

2 False – an amount is not only money, but also the value of every form of property earned (*Lategan v CIR*).

<u>SOLUTION 2.4</u> (continued)

3 False – the onus of establishing an amount lies with the Commissioner (*CIR v Butcher Bros (Pty) Ltd*).

4 True – receipts from an illegal business will be included in gross income (*CIR v Delgoa Bay Cigarette Company*).

5 False – it means become entitled to (*CIR v People's Stores (Walvis Bay) (Pty) Ltd*).

6 True – *Pyott Ltd v CIR.*

7 False – an amount is included in gross income at the earliest date of receipt or accrual.

8 True – *Rhodesia Metals Ltd Liquidator v COT.*

<u>SOLUTION 2.5</u> (20 marks, 36 minutes)

(1) The definition of "gross income" in section 1 of the Act excludes receipts or accruals of a capital nature. There is no definition in the Act of what constitutes a receipt or accrual of a capital nature, so it has been left to the courts to establish a number of factors that can assist in determining the capital or revenue nature of the amount in question. One of the most important factors established by the courts is that of the taxpayer's intention. As Bud inherited the property, he would not at the time have had an intention to enter into "an operation of business in carrying out a scheme for profit-making" (*California Copper Syndicate Ltd v IR*, 1904, 41 Sc Lr 691, VI SC 894). He sold the property after a very short holding period, but his reason for selling was not the intention to speculate but to dispose of a property he did not want. Although he advertised the property in the local newspaper, he did not enter into an extensive advertising campaign to sell it. On the facts given, it would appear that the proceeds of the sale of the property would be of a capital nature and not be included in Bud's gross income. (4)

(2) Lou also inherited property but in his case, there are several factors that differ from that in (1) above, which would make it difficult for Lou to prove that the proceeds on the sale of the inherited property are of a capital nature. He carries on the trade of an estate agent, with a specialised knowledge of the trade. He applied for sectional title rights on the property and sold the flats at a large profit within a very short time. The mere fact that a property is subdivided would not necessarily indicate a speculative intention, but in Lou's case, he regularly enters into similar transactions. (The burden of proof rests with Lou.) Therefore, Lou must include the amount received for the inherited property as well as the other two blocks of flats in his gross income. (3)

(3) The amount of R100 000 received in cash for the sale of Dean's share of the partnership's debtors is an amount of a capital nature as the transactions giving rise to the amounts owing by the debtors were included in his income in the years of assessment in which the debts arose.

The amount of R60 000 received in cash for the sale of his share of the partnership's furniture and fittings would also be a receipt of a capital nature as furniture and fittings form part of the fixed capital structure of the business. However, he may have to include in his gross income an amount recouped on the "sale" of these assets in terms of section 8(4), where the "selling price" exceeded the tax value of his share of the assets.

Under normal circumstances, the sale of the goodwill of a business would also be of a capital nature as goodwill also forms part of the fixed capital structure. Where the purchase consideration is payable in the form of an annuity, the annuity is specifically included in gross income in terms of paragraph (*a*) of the definition, irrespective of the capital or revenue nature of the original transaction.

SOLUTION 2.5 (continued)

However, if the annual payment is nothing more than an instalment due in respect of a transaction of a capital nature, it cannot be regarded as an annuity. One must examine the particular circumstances applying in each instance in order to ascertain the nature of the annual payments. If the annual payments represent the liquidation by instalments of a definite ascertainable price payable for the sale of capital assets, they are not annuities and fall outside the scope of paragraph (*a*). This is not the case and therefore it is recognised as an annuity and included in gross income.

Dean's intention when he purchased the property was not to enter into a profit-making scheme. He was forced by circumstances to purchase property in excess of his needs. The sale of this excess portion would give rise to a receipt of a capital nature (see *CIR v Paul*, 1956 (3) SA 335 (A) (21 SATC 1) and *Stott v CIR*, 1928 AD 252 (3 SATC 253)), in spite of the fact that it was sold almost immediately. (5)

(4) The deposits received by Marty are amounts of a non-capital nature actually received. The issue to be determined is whether these benefits were received by him on his own behalf or for his own benefit (*Geldenhuys v SIR*, 1947 (3) SA 252 (C) (14 SATC 491)). His right to the deposits is only conditional and he has placed the deposits in a separate (trust) bank account. The amounts received in respect of deposits will therefore not be included in Marty's gross income. (3)

(5) The deposits received by Bob, unlike those received by Marty (see above), represent amounts received that are not subject to a condition, as his customers forfeit the deposits should they cancel their orders. The amount of R5 000 has therefore been "received" by Bob in terms of the definition of "gross income" and will be included in his gross income. (2)

(6) Lenny has entered into an "operation of business in carrying out a scheme for profit-making" (*California Copper Syndicate Ltd v IR*). His realisation of the value of the cargo, the extent of the operations he has entered into, including the hiring of a boat, equipment and staff and negotiating a contract with the museum, all support a business-like *modus operandi*, in spite of the fact that this is an isolated transaction (see *Stephan v CIR*, 1919 WLD (32 SATC 54)).

The advance payment received for the crockery is a non-capital amount actually received and would be included in Lenny's gross income. As he had granted the museum the sole right to purchase the entire cargo, it would appear that the full amount of R1,3 million has accrued to him as he is entitled to it (*People's Stores (Walvis Bay) Ltd v CIR*, 1990 (2) SA 353 A (52 SATC 9)). (3)

SOLUTION 2.6 (14 marks, 25 minutes)

(1) The once-off prize of R1 000 is in respect of Joyce's employment and in respect of services that she rendered to her employer. The prize is therefore a special inclusion in Joyce's gross income in terms of paragraph (*c*) of the gross income definition.

(2) The once-off prize of R20 000 is in respect of services that Joyce rendered to the municipality. The municipality needed a design and Joyce rendered the appropriate service. The fact that Joyce is not an employee of the municipality is irrelevant. The prize is therefore a special inclusion in Joyce's gross income in terms of paragraph (*c*) of the gross income definition.

(3) Maintenance payments of R12 000 are special inclusions in Joyce's gross income in terms of paragraph (*b*) of the gross income definition.

(4) Inheritances are not specially included in gross income. The cash, from Joyce's aunt, is a fortuitous capital receipt. As a result, the inheritance will be excluded from gross income because of its capital nature.

<u>SOLUTION 2.6</u> (continued)

(5) The retirement fund lump sum is a special inclusion in Joyce's gross income in terms of paragraph (*e*) of the gross income definition. Her pension income (which is annuity income) is also a special inclusion in gross income in terms of paragraph (*a*) of the definition.

(6) The lump sum of R15 000, from Joyce's employer, is in respect of the termination of her employment and is therefore a special inclusion in Joyce's gross income in terms of paragraph (*d*) of the gross income definition.

(7) The voucher, from Joyce's colleagues, is not in respect of services rendered and it is not in respect of employment. The gift is capital in nature and is therefore excluded from gross income.

<u>SOLUTION 2.7</u> (7 marks, 13 minutes)

	R	
The portion of the purchased annuity to be included in gross income is determined as follows:		
Purchased annuity received (R2 000 x 9 months)	18 000	**(1)**
Y = A/B x C = R250 000/(R2 000 x 12 months x 14,61 years) x R18 000 = R250 000 **(1)**/ R350 640**(2)** x R18 000 **(1)** Capital element of the purchased annuity	(12 834)	**(1)**
Portion of the purchased annuity included in gross income	5 166	**(1)**

<u>SOLUTION 2.8</u> (7 marks, 13 minutes)

	R	
The portion of the purchased annuity to be included in gross income is determined as follows:		
Purchased annuity received (R4 500 x 3 months)	13 500	**(1)**
Y = A/B x C = R400 000/(R4 500 x 12 months x 10 years) x R13 500 = R400 000 **(1)**/R540 000**(2)** x R13 500 **(1)** Capital element of the purchased annuity	(10 000)	**(1)**
Portion of purchased annuity included in gross income	3 500	**(1)**

<u>SOLUTION 2.9</u> (15 marks, 27 minutes)

For a receipt to be included in gross income, it must comply with all the requirements of the general definition of "gross income". That is:

- the total amount, in cash or otherwise
- received by or accrued to
- during the year of assessment
- not of a capital nature **(2)**

Alternatively, the receipt may be included in gross income via one of the special inclusions **(1)** as set out in paragraphs (*a*) to (*n*) of the gross income definition.

SOLUTION 2.9 **(continued)**

Jack clearly "*received" "amounts" "during the year of assessment*" **(1)**. The inclusion or exclusion of the compensation payments in Jack's gross income therefore hinges on the capital or revenue nature **(1)** of the receipts. Alternatively, it could hinge on whether the receipts are one of the special inclusions **(1)** as set out in paragraphs (*a*) to (*n*) of the gross income definition.

Jack has been compensated for the loss of his future earning capacity, which is effectively the loss of a capital asset **(1)**. However, he did elect to receive the compensation in the form of monthly amounts. If the amounts are annuities **(1)** they will be regarded as revenue in nature **(1)** and their originating cause is irrelevant **(1)**. Therefore, the starting point for establishing whether Jack's receipts will be included in his gross income is to determine whether the receipts would be regarded as annuities. **(1)**

Case law [*ITC 761*] **(1)** has identified the following characteristics of an annuity:

1. It provides for a *fixed, annual* payment even if it is divided into *instalments* **(1)**
2. It is *repetitive*, that is payable from *year to year* for a certain period **(1)**
3. It is *chargeable against some person* **(1)**

The compensation is periodical and the taxpayer has the right to receive more than one such payment **(1)**. The monthly payments can therefore be regarded as annuities. **(1)**

Accepting payment in the form of annuities means the capital status of an amount is lost **(1)**. See *KBI en 'n Ander v Hogan* **(1)**.

The annuities will therefore be specially included in Jack's gross income in terms of para (*a*) of the gross income definition. **(1)**

If he had elected to receive the compensation as a once-off payment, the receipt would have retained its capital status and would have been tax-free. **(1)**

Max: 15

SOLUTION 2.10 **(20 marks, 36 minutes)**

Any of the following factors could be applied to determine whether Fred Fortune's sale proceeds will, on a balance of probabilities, be included or excluded from his gross income.

Subjective factors:

- His intention at the time of acquisition: **(1)**
  - The property was originally purchased as a capital asset, which would generate investment returns, in the form of rental income, over a long-term period. **(1)**
  - On the basis of the information provided there is no evidence that Fred had a speculative intention when he acquired the property. **(1)**

- Change of intention: **(1)**
  - Fred had no intention of selling the property prior to receiving the unexpected phone call offer. **(1)**
  - He did not embark on a profit-making scheme in order to sell the property. **(1)**
  - Furthermore, a taxpayer who simply sells a capital asset for the best possible price has not necessarily changed his intention and embarked on a profit-making scheme. **(1)** See *CIR v Stott.* **(1)**
  - Fred did not appear to change his original intention during the short period that he held the asset. **(1)**

SOLUTION 2.10 (continued)

Objective factors:

- The occupation of the taxpayer: **(1)**
  - Fred is a retired engineer, and does not appear to be a property speculator. **(1)**

- The period for which the asset is held: **(1)**
  - The property was held for a relatively short period, **(1)** which could indicate that it was purchased for speculative purposes. **(1)**

- The manner of acquisition: **(1)**
  - Fred used his own funds to buy the property **(1)** which would tend to indicate that the property was purchased as a capital investment. **(1)**

- The manner of disposal: **(1)**
  - The offer to purchase by the Middle Eastern company was fortuitous **(1)**, and that would tend to indicate that the property was disposed of as a capital investment. **(1)**

- Continuity of transactions: **(1)**
  - Fred has not repeatedly bought and sold properties **(1)** and that would tend to indicate that the transaction was a disposal of a capital investment. **(1)**

It would appear that based on the above factors, Fred's sale proceeds would, on a balance of probabilities, be excluded from his gross income based on its capital nature. **(1)**

Max: 20 marks

SOLUTION 2.11 (8 marks, 14 minutes)

For an amount to be included in gross income, it must comply with all the requirements of the general definition of "gross income". That is:

- *the total amount, in cash or otherwise*
- *received by or accrued to*
- *during the year of assessment*
- *not of a capital nature* **(2)**

Alternatively, the receipt may be included in gross income via one of the special inclusions **(1)** as set out in paragraphs (*a*) to (*n*) of the gross income definition.

Perry's salary is included in gross income **(1)** as paragraph (*c)* of the definition of gross income specifically includes amounts in respect of services rendered and employment **(1)**.

In terms of the definition of gross income, the words *'in favour of'* mean that income received by another person on behalf of the taxpayer will be included in the taxpayer's gross income, therefore the rental income is included as it was received "*in favour of*" Perry. **(1)** The rental income has to be included at the gross amount so the administrative fees must be added back to get the gross rental amount **(1)**.

The lottery winnings are a once-off, fortuitous receipt and are therefore capital in nature **(1)** and are not included in gross income **(1)**.

The dividend declared accrued to Perry at year-end **(1)** as he was a registered shareholder on 25 February 2018, therefore the dividend is included in gross income in the 2018 year of assessment **(1)**.

Max: 8

FRINGE BENEFITS AND ALLOWANCES	3

SOLUTION 3.1 **(24 marks, 43 minutes)**

Calculation of the taxable income of Trix Galore for the 2018 year of assessment:

		R	R	
Salary and 13th cheque (R132 00/12 months x 13 months)			143 000	**(1)**
Pension fund fringe benefit – employer contributions			20 000	**(1)**
Travelling allowance (R3 200 x 5 months)		16 000		**(1)**
Less: Cost per km x business km				
Business km				
Total km: 53 177 - 38 942 km =	= 14 235 km			**(1)**
Less: Private km	= (8 402 km)			**(1)**
Business km travelled	= 5 833 km			
Cost per km				
Per tables				
Determined value - R188 100 (including VAT)				
Fixed cost (R73 427 / 14 235 km*[1]) x 153/365	R2,162			**(3)**
Fuel	R1,106*[2]			
Maintenance	R0,454			
Total cost per km	R3,722			
Business expenses (5 833 km x R3.722)		(21 710)	Nil	**(1)**
Low interest loan				
[R54 000 x (8% - 5%) x 5/12 months]			675	**(1)**
[(R54 000 - R10 000 repaid) x (8% - 5%) x 7/12 months]			770	**(1)**
Use of company car				
(R130 000 x 1.14 x 85%*[3] x 3,5% x 7 months)			30 863	**(4)**
Housing				
(A - B) x C/100 x D/12				
(R155 245 – R75 750) x 17/100 x 11/12 months			12 388	**(2)**
Entertainment allowance (R500 x 12)			6 000	**(1)**
Entertainment expenses – prohibited **(1)**, s23(*m*)			-	
Meals at cafeteria – no value **(1)**, para 8(3)(*a*)			-	
			213 696	
Less: Pension fund contributions				
Pension contributions – Employee		42 000		
Pension contributions – Employer		20 000		
		62 000		**(1)**
Percentage limit: higher of				
Taxable income: R213 696 **(1)** **x** 27.5% = R58 766 or,				
Remuneration: R220 323 **(1)** **x** 27.5% = R60 589				
Deduction limited to the lesser of: R60 589 (percentage limit) or R350 000				
Therefore			(60 589)	**(1)**
Taxable income			153 107	

SOLUTION 3.1 **(continued)**

Notes from the examiner:

**1 Remember to use the total kilometres that were driven, not business kilometres.*

**2 Because the fixed cost gives an answer in rand and the fuel and maintenance costs on the table are given in cents, you need either to convert the fixed cost amount to cents or convert the fuel and maintenance costs to rand. I find it much easier to convert the fuel and maintenance costs from the table into rand. The choice however is yours. Remember also that rounding off at different points in the calculation could give slightly different answers – again this does not matter when we mark your work as we are looking at the correct application of principles.*

**3 The Act provides that where someone else had the use of the vehicle before the current user, then the determined value for purposes of calculating the fringe benefit can be reduced by 15% for each completed period of 12 months using the reducing balance method. If the cost of the vehicle represents 100% and it is reduced by 15% then the balance remaining = 85%. It is therefore a short cut (and completely acceptable mathematically) to multiply the cost by 85% for each completed period of 12 months – you will arrive directly at the determined value that you need for your calculation.*

SOLUTION 3.2 **(17 marks, 31 minutes)**

Calculation of Mr Koen's taxable income for the current year of assessment:

			R	R	
Salary				250 000	
Bonus				100 000	**(1)**
Entertainment allowance				2 000	**(1)**
Travelling allowance			94 425		
Less: Allowable travel costs					
Kilometres travelled	28/2/2018	39 390 km			
	1/3/2017	(4 890 km)			
Total for the year		34 500 km			**(1)**
Total for the year		34 500 km			
Less: Private km		(20 700 km)			
Business km		13 800 km			**(1)**
Cost per km (per tables)					
Determined value of vehicle		R126 000			
Fixed cost (R50 924/34 500 km)		R1,476			**(1)**
Fuel		R1,018			
Maintenance		R0,412			
Total cost per km		R2,906			
Business cost (13 800 km x R2.906 per km)			(40 103)	54 322	**(1)**
Company car R250 000 x 85% x 3.5% x 12			89 250		**(4)**
Less: Business travel *1 [(6 900km/(7 000km + 6 900km)] x R89 250			(44 304)	44 946	**(1)**

SOLUTION 3.2 (continued)

	R	R	
Workmen's compensation	8 000		
Less: Exempt income - workmen's compensation	(8 000)	-	**(1)**
Dividend - C	130 000		
Less: Exempt income	(130 000)	-	**(1)**
Less: Entertainment expenses -		451 268	
prohibited **(1)** s23(*m*), taxpayer only received remuneration		-	
Instalment on car – prohibited **(1)** s23 private expense		-	
		451 268	
Less: Donations, R5 000			
Limited to 10% x R451 268 = R45 127		(5 000)	**(2)**
Taxable income		446 268	

Note from the examiner:

**1 As records of kilometres travelled are kept, the value can be reduced.*

SOLUTION 3.3 (19 marks, 34 minutes)

Calculation whether Jean must choose the travel allowance or the use of the company car

Travelling allowance:	R	R	
Allowance (R6 500 x 12 months)		78 000	**(1)**
Less: Business travelling expenses			
Business km = 15 000 km (given)			
Cost per km:			
Actual expenses:			
Wear and tear (R205 200 / 7 years)	29 314		**(2)**
Interest on loan (deemed and paid):			
(R100 000 x 8% x 6/12)	4 000		**(1)**
(R87 500 x 8% x 6/12)	3 500		**(1)**
Given expenses (per question)	27 080		**(1)**
	63 894		
Cost per km: R63 894 / 35 000 km = R1.826 per km			**(1)**

or

Deemed expenses:

Determined value of car R180 000 + 14% = R205 200 (VAT included)		**(1)**
Fixed cost (R73 427 / 35 000 km)	R2,098	**(1)**
Fuel	R1,106	
Maintenance	R0,454	
Deemed cost per km	R3,658	

Therefore, to use the expenses as per tables would give the biggest benefit. **(1)**

Cost of business km: 15 000 km x R3.658		(54 870)	**(1)**
Interest on loan fringe benefit:			
(R100 000 x (8% - 1%) x 6/12)	3 500		**(1)**
(R87 500 x (8% - 1%) x 6/12)	3 063	6 563	**(1)**
Inclusion in taxable income		29 693	

SOLUTION 3.3 **(continued)**

Company car:	R	R	
Cash equivalent (R180 000 x 1,14 x 3,25% x 12)	80 028		**(4)**
Less: Business travel (15 000km/35 000km x R80 028)	(34 298)		**(1)**
Inclusion in taxable income		45 730	

Therefore, the most beneficial for tax purposes would be the travelling allowance because it would increase his taxable income by the least amount. **(1)**

SOLUTION 3.4 **(15 marks, 27 minutes)**

1. Subject to monthly employees' tax R108 000 x 80% (refer to learning unit 9) R86 400 **(1)**
   Therefore the expenses need to exceed R21 600 (R108 000 x 20% = R21 600) in order for there to be a refund.

2. Annual return

		R	
Travel allowance		108 000	
Business km:			
Actual business km: 30 600 km – 11 200 km = 19 400 km			**(1)**
Cost per km:			
Using tables: Determined value R230 000 + R32 200 = R262 200			**(1)**
Fixed costs R93 267/30 600 km x 273/365	R2,280		**(2)**
Fuel	R1,189		
Maintenance	R0,496		
Total cost per km	R3,965		
Using actual figures:			
Wear and tear (R262 200/7) x 273/365	28 016		**(3)**
Finance charges (R146 832/4 x 273/365)	27 456		**(2)**
Fuel	6 500		**(1)**
Maintenance – not his expense **(1)**	-		
Tyres	1 755		**(1)**
Fines – prohibited **(1)** s23	-		
	63 272		**(1)**
Therefore cost per km R63 272/30 600 km = R2.083			
Therefore use tables as it is greater			
Business expense: 19 400 km x R3.965		(76 921)	

He should receive a refund, as his expenses exceeded 20% of the allowance. (**1 bonus mark**)

SOLUTION 3.5 **(14 marks, 25 minutes)**

		R	
Travel allowance (R11 500 x 6)		69 000	**(1)**
Cost per km:			
Calculated per tables: determined value – R600 000			
Fixed R154 879/15 000 km x 181/365	R5,120		**(3)**
Fuel	R1,509		
Maintenance	R0,849		
Deemed cost per km	R7,478		
Actual expenses:	R		
Given	35 780		**(1)**
Wear and tear R600 000 ltd to R595 000/7 x 181/365	42 151		**(3)**
Finance charges R595 000/R600 000 x (R207 800/4 x 181/365)	25 547		**(3)**
Total cost	103 478		
Actual cost per km R103 478/15 000 km = R6.899			**(1)**
Therefore use deemed			**(1)**
Business km:			
Actual business km: 8 800 km			
Therefore 8 800 km x R7.478		(65 806)	**(1)**
Included in taxable income		3 194	

SOLUTION 3.6 **(24 marks, 43 minutes)**

a) Package #1: Calculation of taxable income

	R	
Basic salary (R40 000 x 9 months)	360 000	**(1)**
Residential accommodation fringe benefit: lesser of • (A - B) x C/100 x D/12 ((R40 000 x 12mths) + (R600 x 12) **(1)** – R75 750**(1)**) x 18**(1)**/100 x 9/12**(1)** = R55 546 or, • Rental paid = R6 000 x 9 mths= R54 000 **(1)**		
Therefore use	54 000	**(1)**
Use of cellphone: excluded **(1)** used mainly for business, para 6(4)(*a*)	-	
Computer allowance: fully taxable*1 (R600 x 9 months)	5 400	**(1)**
Reimbursive travel allowance (non-taxable)	-	**(1)**
Indemnity insurance: excluded **(1)** paid by employer, para 13(2)(*bA*)	-	
Taxable income	419 400	

SOLUTION 3.6 **(continued)**

b) Package #2: Calculation of taxable income	R	R	
Basic salary (R40 000 x 9 months)		360 000	
Subsidy in respect of housing loan*2: R500 000 x (10,5% - 5%) **(1)** x 9/12 **(1)** =		20 625	
Cellphone allowance: fully taxable*1 (R450 x 9 months)		4 050	**(1)**
Use of computer: sole use over useful life (cost to employer)		11 800	**(1)**
Use of company car			
R300 000 x 1.14 **(1)** x 85% **(1)** x 3,25% **(1)** x 9 months **(1)**	85 030		
Less: Business travel [(5 400km – 1 080km)/5 400km x R85 030]	(68 024)		**(1)**
Less: Fuel (1 080 km **(1)** x R1.189*3 **(1)**)	(1 284)	15 722	
Indemnity insurance: additional stipend fully taxable (R800 x 9 months)		7 200	**(1)**
Taxable income		419 397	

c) David should choose package #2 (1)

Notes:

*1 *Business expenses may only be deducted from two allowances: a travel allowance and a subsistence allowance. A computer allowance and cellphone allowance are therefore fully taxable.*

*2 *A "subsidy in respect of a loan" differs from a "low interest loan". With a "subsidy in respect of a loan" the employer pays, on behalf of an employee, a portion of the capital or interest payments on a loan that has been granted to the employee by an independent financial institution. With a "low interest loan", the employer provides the loan directly to the employee at an interest rate below the official rate. Refer to your prescribed book for more details regarding their tax treatment.*

*3 *As the determined value is reduced (R300 000 x 1.14 x 85%), the value in the deemed expenditure table must correlate to it, for purposes of determining the fuel cost.*

DEDUCTIONS: GENERAL, PROHIBITED AND SPECIFIC	5

SOLUTION 5.1 **(7 marks, 13 minutes)**

1 Construction costs of R60 000 – not deductible
Requirement not met – capital nature
Reason – establishing an enduring benefit **(2)**

General repairs R10 000 – not deductible
Requirement not met – not in production of income
– capital nature
Reason – not practising yet or
– part of establishing an enduring benefit **(2)**

2 Payment of medical account R2 500 – deductible **(1)**

3 Patient's account not recoverable R1 000 – not deductible
Requirement not met – not in production of income
Reason – income was already earned **(2)**
The amount will not be deductible in terms of s 11(*a*), but will be deductible in terms of s 11(*i*) (bad debts).

SOLUTION 5.2 **(16 marks, 29 minutes)**

1. Not deductible
Capital expense as it has an enduring benefit.

2. Deductible
The expense forms part of a lessor's normal trade expenses, therefore an expense incurred in the production of income.

3. Not deductible
This is not a recurring expense of a building contractor and not part of the normal operations, therefore it does not qualify as an expense incurred in the production of income.

4. Deductible
This form of incentive is an expense producing income for Pamela, albeit by means of an article instead of cash (salary).

5. Not deductible
Interest and pension are not included in the definition of trade and therefore the expenditure does not fulfil the trading requirement.

6. Not deductible
The expense must be deducted "during the year of assessment" in which it was incurred according to the general deduction formula.

7. Not deductible
This kind of expense does not meet all the requirements of the general deduction formula and is specifically prohibited in the provisions of **section 23(*a*)** and **23(*b*)**.

8. Deductible
An expense is **deductible in the year in which it has been incurred**, irrespective of the year in which the income has been produced.

<u>SOLUTION 5.3</u> (13 marks, 23 minutes)

1 False – the income and losses for each trade must be aggregated (unless the trade is a "suspect trade"; then it is "ring fenced").

2 False – no deduction may be claimed in respect of a taxpayer's own labour.

3 True – *CIR v Golden Dumps (Pty) Ltd.*

4 False – the accounting principle of matching does not apply for the purposes of calculating taxable income.

5 False – *Port Elizabeth Electric Tramway Co Ltd v CIR*; *Sub-Nigel Ltd v CIR.*

6 False – not of a capital nature if, for example, repairs are done to machinery.

7 True – once-off costs normally indicate expenditure of a capital nature, but it might not always be the case.

8 False – in *Tuck v CIR* the court sanctioned the apportionment of income between a capital and non-capital element.

9 True – section 23(*c*).

10 False – section 23(*h*).

11 False – gratuitous payments are not made in the production of income but rather as an appropriation of income that has already been earned.

12 False – unlawful activities, not a cost of performing a business operation – section 23(*o*).

13 True – Establishing of an income-producing asset - *CIR v George Forest Timber Co Ltd.*

(1 mark each)

<u>SOLUTION 5.4</u> (14 marks, 25 minutes)

	R	R	
Annual salary		208 375	
Less: Premiums – not deductible		(-)	**(1)**
		208 375	
Less: Provident fund contributions – R10 800			
Percentage limit: higher of: Remuneration: (27.5% x R208 375 = R57 303) **(1)**, or Taxable income: (27.5% x R208 375 = R57 303) **(1)**			
Deduction limited to lesser of: R350 000, or R57 303 (percentage limit), Thus actual		(10 800)	**(1)**
		197 575	
Less: Donation (R197 575 x 10%) = R19 758, allow actual donation		(7 500)	**(1)**
Taxable income		190 075	

SOLUTION 5.4 (continued)

	R	R	
Normal tax [R34 178 + (R190 075 – R189 880) x 26%]		34 229	**(1)**
Less: Rebate		(13 635)	**(1)**
Less: Medical scheme fees tax credit [(R303 x 2) + R204] x 12		(9 720)	**(1)**
Less: Additional qualifying medical expense tax credit			
Medical aid contributions	35 440		**(1)**
Less: 4 x R9 720 [(R303 + R303 + R204) x 12] **(2)**	(38 880)		
	-		
Add: Qualifying amounts not covered by fund	3 500		**(1)**
	3 500		
As exceeds: 7,5% x R190 075	(14 256)		**(2)**
	nil		
As the answer is not positive, no additional qualifying medical expense tax credit is available.			
Net normal tax		10 874	

SOLUTION 5.5 (24 marks, 43 minutes)

	R	R	
Salary		153 500	
Bonus		13 000	**(1)**
Employer pension fund contributions		5 700	**(1)**
Dividends – South African	2 800		
Dividends – South African – exempt	(2 800)	nil	**(1)**
Foreign gross dividends – company A	864		
Foreign dividend exemption – company A (R864 x 25/45)	(480)	384	**(1)**
Foreign interest		5 290	**(1)**
South African interest	23 400		
Less: Interest exemption (R23 800 limited to actual interest received)	(23 400)	nil	**(1)**
		177 874	
Less: Pension fund contributions (R5 700 + R11 400 + R300 + R1 000 + R200 = R18 600)			**(1)**
Percentage limit: higher of			
Remuneration: [27.5% x (R153 500 + R13 000 + R5 700) = R47 355], or			**(1)**
Taxable income: [27.5% x R177 874 = R48 915]			**(1)**
Deduction limited to the lesser of: R350 000, or R48 915 (percentage limit) therefore allow actual		(18 600)	**(1)**
		159 274	
Less: Donation			
Archaeological society of South Africa	7 500		**(1)**
Boy Scouts (not registered PBO)	nil		**(1)**
	7 500		
Limited to 10% x R159 274 = R15 927		(7 500)	**(1)**
TAXABLE INCOME		151 774	
Normal tax (R151 774 x 18%)		27 319	**(1)**
Less: Rebate		(13 635)	**(1)**

SOLUTION 5.5 (continued)

	R	R	
Less: Medical scheme fees tax credit (R303 x 12)		(3 636)	**(1)**
Less: Additional qualifying medical expense tax credit			
Medical aid contributions	13 044		**(1)**
Less: 4 x R3 636 [R303 x 12] **(2)**	(14 544)		
Excess contributions	-		
Add: Amounts not covered by fund	800		**(1)**
Amounts refunded to Sarah (non-qualifying expenditure)	nil		**(1)**
Amounts paid by the fund (non-qualifying expenditure)	nil		**(1)**
	800		
As exceeds: 7,5% x R151 774	(11 383)		**(2)**
	nil		
As the answer is not positive, no additional qualifying medical expense tax credit is available.			
Net normal tax		10 048	

SOLUTION 5.6 (50 marks, 90 minutes)

(a) Calculation of Louis' net normal tax for the year of assessment ended 28 February 2018

	R		R	
Salary			481 750	
Repayment of bursary – no value **(1)** (par 13 (3))			nil	
Rental income: Married in community R28 000/2			14 000	**(2)**
Foreign dividend (R4 725/2)	2 363			**(1)**
Less: Exemption (R2 363 x 25/45)	(1 313)	**(1)**	1 050	
Foreign interest (R1 600/2)			800	**(1)**
Local interest (R50 000/2)	25 000			
Less: Exemption	(23 800)	**(1)**	1 200	
Medical fringe benefit (R3 600 x 12)			43 200	**(1)**
			542 000	
Legal costs s 23(*m*)			(12 000)	**(1)**
Wear and tear s 23(*m*) R13 500/3 x 8/12			(3 000)	**(2)**
			527 000	

Less: Retirement annuity fund contributions: R54 000

Percentage limit: higher of
Remuneration: [27.5% x (R481 750 + R43 200) = R144 361]**(1), or**
Taxable income: (27.5% x R527 000 = R144 925) **(1)**

Deduction limited to the lesser of: R350 000, **or** R144 925 (percentage limit)

Thus allow actual	(54 000)	**(1)**
TAXABLE INCOME	473 000	

SOLUTION 5.6 (continued)

	R		R	
Normal tax per tables [R97 225 + (36% x (R473 000 – R410 460))]			119 739	**(1)**
Less: Rebate			(13 635)	**(1)**
Less: Medical scheme fees tax credit [((R303 x 2) + (R204 x 2)) x 12 months]			(12 168)	**(1)**
Less: Additional qualifying medical expense tax credit				
Medical aid contributions				
Louis' contribution	12 000	**(1)**		
Fringe benefit (above)	43 200	**(1)**		
	55 200			
Less: 4 x R12 168 [((R303 x 2) + (R204 x 2)) x 12 months] **(2)**	(48 672)			
Excess contributions	6 528	**(1)**		
Qualifying medical expenses				
Medical expenses not reimbursed	8 000	**(1)**		
Prescriptions not submitted	4 985	**(1)**		
Non-prescription medicine: non-qualifying expense	-	**(1)**		
Registered nurse	24 000	**(1)**		
	43 513			
As exceeds: 7,5% x R473 000 **(1)**	(35 475)			
	8 038			
Additional qualifying medical expense tax credit (25% x R8 038)			(2 010)	**(1)**
Net normal tax			91 926	

(b) Medical scheme fees tax credit and additional qualifying medical expense tax credit (family member with a disability)

	R		R	
Medical scheme fees tax credit [((R303 x 2) + (R204 x 2)) x 12 months]			12 168	**(1)**
Additional qualifying medical expense tax credit				
Medical aid contributions				
Louis' contribution	12 000	**(1)**		
Fringe benefit (above)	43 200	**(1)**		
	55 200			
Less: 3 x R12 168 [((R303 x 2) + (R204 x 2)) x 12 months] **(2)**	(36 504)			
Excess contributions	18 696	**(1)**		
Qualifying medical expenses				
Qualifying medical expenses not paid	8 000	**(1)**		
Prescriptions not submitted	4 985	**(1)**		
Non-prescription medicine	-	**(1)**		
Registered nurse	24 000	**(1)**		
	55 681			
Additional qualifying medical expense tax credit (33.3% x R55 681)			18 542	**(1)**

SOLUTION 5.6 **(continued)**

(c) Medical scheme fees tax credit and additional qualifying medical expense tax credit (taxpayer ≥ 65 years old)

	R		R	
Medical scheme fees tax credit [((R303 x 2) + (R204 x 2)) x 12 months]			12 168	**(1)**
Additional qualifying medical expense tax credit				
Medical aid contributions				
Louis' contribution	12 000	**(1)**		
Fringe benefit (above)	43 200	**(1)**		
	55 200			
Less: 3 x R12 168 [((R303 x 2) + (R204 x 2)) x 12 months] **(2)**	(36 504)			
Excess contributions	18 696	**(1)**		
Qualifying medical expenses				
Qualifying medical expenses not paid	8 000	**(1)**		
Prescriptions not submitted	4 985	**(1)**		
Non-prescription medicine	-	**(1)**		
Registered nurse	24 000	**(1)**		
	55 681			
Additional qualifying medical expense tax credit (33.3% x R55 681)			18 542	**(1)**

CAPITAL GAINS TAX	6

SOLUTION 6.1 **(20 marks, 36 minutes)**

Client A

A boat shorter than 10 metres is a personal use asset and any gain or loss on the disposal of the asset is ignored. **(2)**

Client B

	R	
Proceeds	2 000 000	**(1)**
Less: Base cost (note 1)	(780 000)	**(1)**
Gain (note 3)	1 220 000	
Less: Primary residence exclusion (note 2)	(1 016 626)	
Capital gain	203 374	

Notes:

1. **Base cost**:
   Greatest of:
   1) Market value: R780 000 **(1)**
   2) 20% rule: R2 000 000 x 20% = R400 000 **(1)**
   3) TAB (Time apportionment base cost)*:
      B = R400 000 (R300 000 + R100 000) **(½)**
      P = R2 000 000 **(½)**
      N = 4 **(½)**
      T = 17 **(½)**
      Y = B + [(P – B) x (N/(T + N))]
      = R400 000 + [(R2 000 000 – R400 000) x (4/(17 + 4))]
      = R400 000 + (R1 600 000 x 4/21)
      = R400 000 + R304 762
      = R704 762

   * *In the exam the TAB value will be given. This question merely provides an example of how the TAB is calculated.*

   The base cost therefore equals R780 000. **(1)**

2. **Primary residence exclusion**

   As Mr B does not live in the house for the whole year but rents it out for trade purposes for two months of the year, the full gain on the sale of the asset does not qualify for the primary residence exclusion.

   Portion of the gain does not qualify for the exemption:

Trade use (2 months/12 months)	16,67%	**(1)**
Gain	R1 220 000	
Non-qualifying amount (R1 220 000 x 16,67%)	R203 374	**(1)**
Amount of the exclusion (R1 220 000 – R203 374)	R1 016 626	**(1)**

3. Even though the proceeds are R2 million, none of the gain is disregarded as a portion of the primary residence was used for trade purposes.

SOLUTION 6.1 **(continued)**

Client C

Normally a boat shorter than 10 metres is a personal use asset and any gain or loss is ignored. However, if the asset is used for business purposes, the gain or loss will be included in the taxpayer's aggregate capital gains or loss.

	R	
Proceeds	600 000	**(1)**
Less: Base cost	(650 000)	**(1)**
Capital loss	(50 000)	

Client D

To qualify for the R1 800 000 exclusion, the following requirements must be met: **(1)**

- The **market value** of all the assets must be below **R10 million**. **(2)**
- The owner must be a natural person. **(1)**
- The person should have owned the interest for a continuous period of at least five years prior to disposal. **(1)**
- The person was substantially involved in the business. **(1)**
- The person has reached the age of 55 years. **(1)**
- The person sells because of ill health, other infirmity, superannuation or death. **(1)**
- All the gains must be realised within 24 months of disposal. **(1)**

Max 6

SOLUTION 6.2 **(12 marks, 22 minutes)**

	R	R	
House in Pretoria			
The house is a primary residence and the proceeds are less than R2 million; therefore the gain is disregarded. **(1)**		0	
Gain motor vehicle (personal use asset) **(1)**		0	
Flat near university			
Proceeds	315 000		**(1)**
Less: Base cost (R160 000 **(1)** + R15 750 **(1)**)	(175 750)		
Taxable gain		139 250	
Gain on antique dining room set (personal use – no gain) **(1)**		0	
Loss on shares		(2 250)	**(1)**
Winnings at casino (excluded) **(1)**		0	
		137 000	**(1)**
Less: Annual exclusion		(40 000)	**(1)**
		97 000	
Assessed capital loss		(5 000)	**(1)**
		92 000	
Taxable capital gain included at 40% **(1)**		36 800	

SOLUTION 6.3 **(30 marks, 54 minutes)**

The calculation of Joe's net normal tax for the current year of assessment:

	R	R	
Salary – Sabie Trading Supplies		60 000	
Salary – Touch and Anders Accountants		56 600	
Entertainment allowance		1 600	**(1)**
		118 200	
Entertainment expenses (not deductible because Joe does not earn mainly commission income) **(1)**		-	
Add: Taxable capital gain			
Capital gain – house (note 1.)	44 874		**(1)**
Capital gain – shares	5 000		**(1)**
	49 874		
Less: Annual exclusion	(40 000)		**(1)**
	9 874		
Multiply: Inclusion rate	x 40%	3 950	**(1)**
		122 150	
Less: Pension and provident fund contributions			
Pension fund contributions	2 000		**(1)**
Provident fund contributions	11 520		**(1)**
	13 520		
Percentage limit: higher of Taxable income: [27.5% x R122 150 **(1)** = R33 591], or Remuneration: [27.5% x R118 200 **(1)** = R32 505]			
Deduction limited to the lesser of: R33 591 (percentage limit) or R350 000 Therefore contributions deductible in full		(13 520)	**(1)**
TAXABLE INCOME		108 630	
Normal tax per tables (18% x R108 630)		19 553	**(1)**
Less: Rebate		(13 635)	**(1)**
Less: Medical scheme fees tax credit [R303 x 12 months]		(3 636)	**(1)**
Additional qualifying medical expense tax credit:			
Medical aid contributions (R1 080 + R1 840)	2 920		**(2)**
Less: 4 x medical scheme fees tax credit (R303 x12 x 4)	(14 544)		**(2)**
Excess contributions	-		
Qualifying expenses	2 900		**(1)**
As exceeds: 7,5% x R108 630 **(1)**	(8 147)	-	**(1)**
Net normal tax		2 282	

SOLUTION 6.3 (continued)

Note:

1. **Capital gain on disposal of house:**

	R	
Proceeds	480 000	**(1)**
Less: Base cost	(255 631)	
Valuation date valuation (note 2)	230 631	
Expenditure incurred after 1 October 2001	25 000	**(1)**
Gain	224 369	
Less: Primary residence exclusion (note 3)	(179 495)	**(1)**
Capital gain	44 874	

Even though the proceeds are less than R2 million, a portion of the primary residence was used for trade and therefore this exclusion does not apply.

2. **Valuation date value:**

	R	
Greatest of:		
• (Proceeds - expenditure after 1/10/01) x 20% = (R480 000 - R25 000) x 20%	91 000	**(2)**
• Market value	180 000	**(1)**
• Time-apportionment base cost – given	230 631	**(1)**

The valuation date value is therefore R230 631 **(1)**

3. **Primary residence exclusion:**

Gain on disposal of asset	224 369	
x 20% (does not qualify as primary residence)	(44 874)	**(1)**
Gain qualifying for primary residence exclusion limited to R2 000 000	179 495	

SOLUTION 6.4 **(27 marks, 49 minutes)**

Calculation of Anthony's net normal tax for the 2018 year of assessment:

	R	R	
Salary		160 000	**(1)**
Foreign dividends	1 481		
Less: exemption (R1 481 x 25/45)	(823)	658	**(1)**
SA fixed deposit interest (R35 625 – R34 500)		1 125	**(1)**
Rental income	33 000		
Less: Allowable expenses			
Interest on loan (R60 000 x 8% x 8/12) (note)	(3 200)		**(1)**
Storage fees	(2 000)		**(1)**
Advertising for rental	(3 000)	24 800	**(1)**
Low interest loan (R60 000 x (8% - 3%) **(1)** x 8/12 **(1)**)		2 000	
Medical benefit (R600 x 12)		7 200	**(1)**
		195 783	
Sale of caravan			
Proceeds (no adjustment)	107 500		**(1)**
Less: Base cost	(61 500)		
Cost	(60 000)		**(1)**
Advertising for sale	(1 500)		**(1)**
Gain	46 000		
Annual exclusion	(40 000)		**(1)**
Aggregate capital gain	6 000		
x 40% **(1)**		2 400	
		198 183	
Less: Donations			
PBO	6 000		**(1)**
Wife (not deductible)	0		**(1)**
Car – subject to donations tax (not deductible)	0		**(1)**
	6 000		
Limited to 10% x R198 183 = R19 818; therefore allow in full		(6 000)	**(1)**
TAXABLE INCOME		192 183	

Normal tax per tables (R34 178 + (26% x (R192 183 – R189 880))		34 777	**(1)**
Less: Rebate		(21 114)	**(1)**
Medical scheme fees tax credit [R303 x 2 x 12 months]		(7 272)	**(1)**
Additional qualifying medical expense tax credit:			
Medical aid contributions:			
Anthony (R700 x 12)	8 400		**(1)**
Employer (R600 x 12)	7 200		**(1)**
Less: 3 x medical scheme fees tax credit [(R303 x 2 x 12) x 3]	(21 816)		**(2)**
Excess contributions	-		
Add: Qualifying expenses	13 000		**(1)**
	13 000		
Additional qualifying medical expense tax credit (33.3% x R13 000)		(4 329)	**(1)**
Net normal tax		2 062	

Note: *The Act allows interest at the full official rate to be deducted in terms of s11(a). That is why we have used 8%.*

<u>SOLUTION 6.5</u> (16 marks, 29 minutes)

Primary residence	R	R	
Proceeds		2 800 000	**(1)**
Expenditure < proceeds > market value			
The valuation date value is the greatest of the following:			
• TAB	1 942 000		**(1)**
• Market value	1 800 000		**(1)**
• 20% x (proceeds less expenditure on/after 1/10/2001) (R2 800 000 x 20%)	560 000		**(1)**
The valuation date value is therefore R1 942 000			
Base cost		(1 942 000)	**(1)**
Gain		858 000	
Less: Primary residence exclusion, R2 000 000 limited to		(858 000)	**(1)**
Capital gain		0	
Holiday flat			
Proceeds		1 000 000	**(1)**
Less: Base cost			
Cost	500 000		**(1)**
Improvements	50 000		**(1)**
Base cost	550 000	(550 000)	
Capital gain		450 000	
Business			
Gain		2 400 000	**(1)**
Less: Exemption i.r.o. small business		(1 800 000)	**(1)**
Capital gain		600 000	
Other assets			
Plants (personal use)		0	**(1)**
Capital gain		0	
Total capital gain (R0 + R450 000 + R600 000 + R0)		1 050 000	**(1)**
Less: Annual exclusion		(40 000)	**(1)**
		1 010 000	
Inclusion rate		40%	**(1)**
Taxable capital gain (R1 010 000 x 40%)		404 000	
Taxation at 45% **(1)**		181 800	

SOLUTION 6.6 **(17 marks, 31 minutes)**

Calculation of Sherry's taxable capital gain/(loss) for the year of assessment ended 28 February 2018

	R	R	
Sale of business			
Proceeds	3 400 000		
Less: Base cost	(600 000)		**(1)**
Gross capital gain	2 800 000		
Less: Exemption i.r.o. small business	(1 800 000)		**(1)**
Capital gain		1 000 000	
Other assets:			
Gain on paintings (personal use – no gain)		0	**(1)**
Residential property			
Proceeds exceed expenditure, market value less than proceeds; use higher of			
TAB = R1 142 000, **or**			
Market value = R1 200 000, **or**			
20% rule = (R2 380 000 - R180 000 **(1)** - R10 000 **(1)**) x 20% = R438 000			
Thus use market value of R1 200 000			
Proceeds (R2 200 000 + R180 000 **(1)**)	2 380 000		
Less: Base cost	(1 390 000)		
Market value	(1 200 000)		**(1)**
Commission	(180 000)		**(1)**
Sprinkler system	(10 000)		**(1)**
Capital gain	990 000		
Business use (R990 000 x 5% **(1)** = R49 500)	(49 500)	49 500	**(1)**
Gain limited to primary residence exclusion	940 500		**(1)**
(R2 million limited to R940 500)	(940 500)		
Capital gain	0	0	**(1)**
Total capital gain (R1 000 000 + R49 500)		1 049 500	**(1)**
Less: Annual exclusion		(40 000)	**(1)**
Capital gain		1 009 500	
Less: Assessed capital loss		(55 000)	**(1)**
		954 500	
Inclusion rate - (R954 500 x 40**% (1)**)		381 800	

<u>SOLUTION 6.7</u> (17 marks, 31 minutes)

Par 27 applies, as proceeds do not exceed expenditure,
R1 500 000 < (R850 000 + R400 000 + R300 000). **(1)**
The market value was determined **(1)**, expenditure before valuation date is not equal to or does not exceed proceeds and market value **(1)**
The valuation date value is the lower of: **(1)**

TAB: R781 557 **(1)**, or

Market value (MV): R1 800 000 **(1)**

Must use TAB as it is the lowest.

	R	R	
<u>Building</u>			
Proceeds	1 500 000		
Less: Base cost	(1 481 557)		
Valuation date value	(781 557)		**(1)**
Improvement of shop	(400 000)		**(1)**
Improvement of residential area	(300 000)		**(1)**
Kitchen equipment – not part of building structure, not a cost of improvement **(1)** para 20(2)	-		
Outstanding home loan – not allowed – not a cost of improvement **(1)** para 20(2)	-		
Capital gain	18 443		
Portion in respect of shop not used as primary residence (R18 443 x 30% **(1)**)	(5 533)	5 533	**(1)**
	12 910		
Primary residence exclusion (R2 000 000 limited to R12 910) **(1)**	(12 910)	0	**(1)**
Capital gain		5 533	
Married in community of property – 50% **(1)** to spouse		(2 767)	
		2 766	
Less: Annual exclusion R40 000 limited to		(2 766)	**(1)**
Taxable capital gain		-	

Notes

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