Tutorial letter 201/1/2017

The Taxation of Business Activities

TAX3701

Semester 1

Department of Taxation

SUGGESTED SOLUTION

ASSIGNMENT 3

Bar code

Dear Student

This tutorial letter contains the questions and solution to assignment 3. Good luck with your preparation for the examination.

Kind regards

TAX3701 LECTURERS

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QUESTION 1 **(20 marks, 36 minutes)**

PART A **(16 marks, 29 minutes)**

Great North Construction (Pty) Ltd (Great North) is a construction company that operates in the Limpopo Province. Great North is a registered vendor for Value-Added Tax (VAT) purposes and imports specialised construction material from Australia on a regular basis. SARS has approved an apportionment ratio of 90% for input tax where input tax relates to both taxable and exempt supplies.

The accountant of Great North has compiled the following income and expenditure statement for the one-month tax period ending 30 September 2016. All amounts **exclude** VAT unless specifically stated otherwise:

Income	**Notes**	**R**
Construction contracts invoiced	1	7 850 130
Rent received from employees	2	550 870
Interest received on outstanding debtors accounts		25 715
Expenditure		
Construction material imported from Australia	3	?
Construction material purchased in South Africa		3 287 351
Insurance	4	16 175
Front-end loader purchased	5	350 350
Bank charges	6	9 872
Electricity	7	37 275

Notes:

1. A total value amounting to R7 850 130 was invoiced to clients during September 2016. Of this amount only R4 500 130 was received during September 2016. Also included in the total invoiced amount is a debtor who was issued with a tax credit note on 25 September 2016 for an amount of R12 750 (excluding VAT) for a discount on his tax invoice issued on 15 September 2016.

2. Great North erected a block of flats which it rents out to its employees on a monthly basis.

3. Construction material was imported from Australia during September 2016. The customs value of the construction material was R1 450 270 and the import surcharges were R40 290. All construction material (purchased either locally or internationally) is used solely for the making of taxable supplies.

4. Insurance paid comprised the following:

Block of flats	R 5 780
Office building and other business assets	R10 395

5. Great North purchased a second-hand front-end loader from a non-vendor on 15 August 2016 for a total amount of R520 000. An amount of R169 650 was paid on 29 August 2016 and the balance on 18 September 2016.

6. The bank charges only relate to the construction operations of Great North.

QUESTION 1 (continued)

7. The electricity paid was for both the block of flats and the office building and includes VAT.

REQUIRED:	MARKS
Calculate the VAT payable by/refundable to Great North Construction (Pty) Ltd that should be declared on the VAT201 return for the **one month** tax period ending on 30 September 2016. Should **no** VAT be applicable, please provide a **reason**.	**16**

PART B (4 marks, 7 minutes)

Great North Construction (Pty) Ltd wants to reward the financial director for his loyal service to the company. He will receive a company car as part of his remuneration package. The following information relates to the car that Great North Construction (Pty) Ltd intends to purchase:

	R
Total purchase price (including VAT and a maintenance plan) (sedan vehicle)	364 800
Monthly insurance (including VAT)	823
The vehicle will be used for both private and business purposes.	

REQUIRED:	MARKS
Calculate the VAT implications in the **first** month for Great North Construction (Pty) Ltd when the company car was purchased and provided as a fringe benefit to the financial director. Should **no** VAT be applicable, please provide a **reason**.	**4**

QUESTION 2 **(38 marks, 68 minutes)**

PART A **(18 marks, 32 minutes)**

Bling Bling CC is a distributor of high fashion baby clothes. The close corporation is **not a small business corporation** as defined in the Income Tax Act and its year of assessment ends on 28 February 2017. Bling Bling CC is **not a registered VAT vendor**.

You are provided with the following information.

1. Sales

Sales amounted to R950 000 for the year of assessment.

2. Trading stock

Trading stock is valued as follows:

	Cost price	**Market value**
1 March 2016	**R**	**R**
Completed products	250 000	360 000
Raw materials	60 000	20 000
28 February 2017		
Completed products	175 000	285 000
Raw materials	35 000	72 000

3. Key man policy

Bling Bling CC took out a key man insurance policy on one of its key employees, Mrs. Hope Radebe, on 1 February 2014. The company pays R650 per month for the policy. All the policy requirements are met in order for Bling Bling CC to qualify for a deduction.

4. Learnership agreement

Mr. Sean Buys entered into a learnership agreement with ABC Ltd on 1 June 2015 for a 12 month period. At the end of October 2015, the employee left the employment of ABC Ltd and took up employment with Bling Bling CC, where he continued with the original learnership agreement. The employee has a disability as defined. The learnership agreement was successfully completed.

5. Debtor information

	Bad debts recovered R	List of doubtful debts at year- end R	Outstanding debtors at year-end (before bad debts were deducted) R	Bad debts written off R
2015	5 000	25 000	50 000	4 800
2016	-	31 000	42 000	12 000
2017	2 500	48 000	38 000	14 400

The Commissioner for SARS permits a doubtful debt allowance deduction.

QUESTION 2 (continued)

6. Monthly rental

Bling Bling CC paid its rental for the distribution premises on 1 February 2017. An amount of R120 000 was paid in respect of the period 1 February 2017 to 30 September 2017.

7. Other trading expenses and information

- Other deductible trading expenses amounted to R46 255.
- Bling Bling CC has an assessed tax loss of R121 751 and has paid an amount of R160 132 provisional tax for the 2017 year of assessment.

REQUIRED:	**MARKS**
Calculate the normal income tax liability of Bling Bling CC for the year of assessment ended on 28 February 2017. Provide a brief reason where an amount has a nil effect on taxable income or is not deductible.	**17**

PART B (15 marks, 29 minutes)

MotoCross (Pty) Ltd is a manufacturer of racing car parts. The company **is a small business corporation** as defined in the Income Tax Act and its financial year ends on 31 March 2017. MotoCross (Pty) Ltd **is a registered VAT vendor**. All amounts **exclude VAT**, unless specifically stated otherwise. The company always wants to pay the minimum tax possible, but still wants to adhere to South African tax legislation.

1. Manufacturing machine AA is used to manufacture the steering wheels for all racing cars. This machine was badly damaged due to a load shedding incident on 1 June 2016. The machine was repaired at a cost of R150 000.

Option one	**Option two**
The R150 000 is fully deductible from taxable income.	The R150 000 is not deductible from taxable income.

2. A new manufacturing machine BB was purchased for R542 000 on 1 September 2016 and brought into use on the same date.

Option one	**Option two**
A capital allowance of R216 800 can be deducted from taxable income.	A capital allowance of R542 000 can be deducted from taxable income.

3. A second-hand delivery truck was purchased at a cost of R625 000 on 1 October 2015. Binding General Ruling No. 7 makes provision for the following write-off period:

QUESTION 2 (continued)

Delivery trucks: 4 years

Option one	Option two
An allowance of R156 250 can be deducted from taxable income.	An allowance of R187 500 can be deducted from taxable income.

4. The company purchased a new office block from a competitor in the market at a cost of R1 200 000 on 31 July 2016. The office block was brought into use on 1 September 2016.

Option one	Option two
An allowance of R33 000 can be deducted from taxable income.	An allowance of R60 000 can be deducted from taxable income.

5. Building CC was acquired in an urban-development zone at a cost of R1 500 000. The building was brought into use on 1 September 2015.

Option one	Option two
An allowance of R300 000 can be deducted from taxable income.	An allowance of R120 000 can be deducted from taxable income.

REQUIRED:		MARKS
a)	You are provided with **two** options after each note. Choose the correct option and provide reasons for your choice.	**11**
b)	MotoCross (Pty) Ltd purchased a computer software program on 1 June 2015 for R40 000 and brought it into use on the same date. Binding General Ruling No. 7 makes provision for a write-off period of two years for computer software. Determine which capital allowance will be more beneficial for the company in the short term.	**4**

PART C (5 marks, 9 minutes)

ABC Ltd is a company that is listed on the Johannesburg Securities Exchange (JSE). The company declared a dividend on 5 July 2016. The last day to register for the dividend is 18 July 2016 and the date of payment is 31 July 2016.

REQUIRED:		MARKS
a)	State on which date the dividends tax should be paid.	**1**
b)	State when the date of payment of the dividends tax would have been if the company had declared a dividend *in specie*. Provide a reason for your answer.	**2**
c)	ABC Ltd declared a total dividend of R125 000. Determine the dividends tax amount that must be withheld by ABC Ltd with regard to Mr Riaad Naidoo, a resident with a 25% interest in the company.	**2**

QUESTION 3 **(20 marks, 36 minutes)**

PART A **(12 marks, 22 minutes)**

Blue Ribbon (Pty) Ltd is a company that manufactures cell phones and has a February year-end. The business supplies you with the following information regarding a factory building, which was entirely used for manufacturing purposes:

Date	**Descriptions**	**Amount (R)**
1 May 2000	Purchased	3 200 000
1 February 2017	Sold to unconnected person	3 000 000

Other applicable Information	Valuation on 1 October 2001	1 700 000
	Time-apportionment base cost	638 842
	Cost of valuation (carried out on 1 July 2002)	10 000
	Capital allowances up until date of sale	?

REQUIRED:	**MARKS**
Calculate the taxable capital gain or capital loss for the 2017 year of assessment in respect of the sale of the factory building. You can assume that the factory building was not replaced with another factory building. Ignore Value-Added Tax (VAT).	**12**

PART B **(8 marks, 14 minutes)**

Bob Building CC manufactures office furniture. The close corporation is **not a small business corporation** as defined in the Income Tax Act and its financial year ends on 31 March 2017. Bob Building CC **is a registered VAT vendor**.

Bob Building CC purchased a second-hand manufacturing machine (JOB) that covers the furniture with a gloss finish. JOB was purchased on 1 May 2015 for R210 900 (including VAT) and was brought into use on the same date. On 1 February 2017, a competitor in the market offered Bob Building CC an amount of R350 000 (excluding VAT) for JOB, as there was a short-age in the market of these machines. Bob Building CC accepted the offer and JOB was sold for R350 000 (excluding VAT).

REQUIRED:	**MARKS**
Calculate the taxable income of Bob Building CC for the year of assessment ending on 31 March 2017. Start with the taxable income of **R865 223**.	**8**

QUESTION 4 (12 marks, 22 minutes)

Diamond Investments (Pty) Ltd (Diamond) is an investment company registered in South Africa and is also a registered VAT vendor. Diamond's year of assessment ends on 31 March 2017. Diamond regularly buys and sells listed shares, but also invests in commercial property primarily to generate rental income from such property. Diamond purchased a shopping mall in Cape Town for R385 million in July 2006.

A foreign investor from Qatar, approached a Cape Town based commercial property broker in October 2016 to make an offer of R750 million (excluding VAT) to Diamond to sell the shopping mall. Included in the offer price of R750 million is an amount of R15 million brokerage fees (excluding VAT). The board of Diamond signed the offer to purchase from the foreign investor on 2 January 2017 and the shopping mall was successfully transferred into the name of the foreign investor on 25 March 2017, on which date Diamond received a cash payment of R750 million from the foreign investor.

The shopping mall had a tax value of R173 250 000 on the date of sale.

REQUIRED:	**MARKS**
Discuss, with reference to case law, whether or not the disposal of the shopping mall in Cape Town by Diamond Investments (Pty) Ltd will be included in its gross income for the year of assessment ended on 31 March 2017. Give consideration to the nature of the asset sold and the period for which it was held.	**12**

QUESTION 5 (10 marks, 18 minutes)

Bright Blue (Pty) Ltd (Bright Blue) is a marketing company and a registered VAT vendor. Bright Blue is **not** a **small business corporation** as defined in the Income Tax Act. Its year of assessment ends on 31 March 2017. The following information is available:

Year of assessment	Taxable income reflected on the ITA34 Income Tax Notice of Assessment	Date of ITA34 assessment
2014	R2 213 875	15 July 2014
2015	R2 458 326	30 November 2015
2016	R3 125 671	3 August 2016
2017	Note 1	Not yet assessed

Note 1

The accountant has estimated the taxable income for Bright Blue to be R3 325 870 for the 2017 year of assessment. Excluded from this estimated taxable income is a capital gain of R155 295 realised on the disposal of listed shares on 28 February 2017.

QUESTION 5 (continued)

REQUIRED:		MARKS
a)	Calculate the **first** provisional tax payment of Bright Blue (Pty) Ltd for the 2017 year of assessment and state the last date such payment must be made to SARS to avoid any penalties. Provide brief reasons for selecting or not selecting a particular basic amount.	**5**
b)	Calculate the **second** provisional tax payment of Bright Blue (Pty) Ltd for the 2017 year of assessment and state the last date such payment must be made to SARS to avoid any penalties.	**5**

SOLUTION: QUESTION 1

PART A (16 marks)

Description	**Calculation/Explanation**	**Calculation R**	**R**	**Marks**
Output tax				
Construction contracts	R7 850 130 x 14%		1 099 018	(1)
Rent received	Residential rent – exempt supply		-	(1)
Interest received	Financial service – exempt supply		-	(1)
Total output tax			**1 099 018**	
Input tax				
Construction material purchased in the RSA	(R3 287 351 x 14%)		(460 228)	(1)
Construction material imported	Customs duty value	1 450 270		
	10% of customs duty value (10% x R1 450 270)	145 027		(1)
	Import surcharge	40 290		(1)
		1 635 587		
	R1 635 587 x 14%		(228 982)	(1)
Insurance	Block of flats - residential accommodation – exempt		-	(1)
	Office Building and other business assets R10 395 x 14%		(1 455)	(1)
Front-end loader	R350 350 x 14/114 second-hand goods – to the extent that payment has been made		(43 025)	(2)
Bank charges	R9 872 x 14%		(1 382)	(1)
Electricity	Block of flats – exempt supply		-	(1)
	Office buildings – R37 275 x 90% x 14/114		(4 120)	(2)
Debtors credit note	R12 750 x 14%		(1 785)	(1)
Total input tax			**240 999**	
Vat payable	(R1 099 018 – R740 999)		**358 041**	(1)
			Total	**17**
			Max	**16**

PART B (4 marks)

Description	**Calculation/Explanation**	**R**	**Marks**
Output Tax			
Fringe benefit	R364 800 x 100/114 x 0,3% x 14/114 x 1	118	(2)
Input tax			
Purchase cost	Input tax denied – is a motor car as defined	-	(1)
Insurance	R823 x 14/114	101	(1)

SOLUTION: QUESTION 2 (38 marks, 68 minutes)

Calculation of the normal income tax liability of Bling Bling (CC) for the year of assessment ended 28 February 2017

PART A

	R	
Sales	950 000	
Trading Stock		
Opening stock (R250 000 + R20 000) (s 22(2))	(270 000)	(2)
Closing stock (R175 000 + R35 000) (s 22(1))	210 000	(2)
Keyman policy – s11(*w*) (R650 x 12)	(7 800)	(1)
Learnership agreement – (s12H)		
Entering allowance (R50 000 x 3/12)	(12 500)	(2)
Completion allowance	(50 000)	(1)
Debtors		
Bad debts recovered – s 8(4)(*a*)	2 500	(1)
Doubtful debts - 2016 – s11(*j*) (R31 000 x 25%)	7 750	(1)
Doubtful debts – 2017 – s11(*j*) (R48 000 x 25%)	(12 000)	(1)
Bad debts – s11(*i*)	(14 400)	(1)
Prepaid expenditure – s23H		
Current portion (R120 000/8 x 1)	(15 000)	(1)
Prepaid portion – (R105 000) not deductible, >6 months and > R100 000	Nil	(2)
Other trading expenses – s 11(*a*)	(46 255)	(1)
Sub-total	742 295	
Less: Assessed tax loss	(121 751)	(1)
Taxable income	620 544	
Tax liability - Normal tax @ 28% (R620 544 x 28%)	173 752	(1)
Less: Provisional tax paid for the 2017 year of assessment	(160 132)	(1)
Normal income tax liability for 2017	**13 620**	
Total marks		**19**
Max		**18**

PART B

a)

1 Option one, this constitutes a repair and a repair is fully deductible from taxable income. [s 11(*d*)] (2)

2 Option two, this is a manufacturing asset and the company is a small business corporation and therefore Machine BB qualifies for 100% deduction in the first year. [s 12E] (1) (1)

3 Option two, the company is a small business corporation and therefore 30% of the cost of the delivery truck can be deducted in the second year. [s 12E] (2) (1)

4 Option two, the company is entitled to an allowance of 5% per year on the cost of any new commercial building. [s 13 *quin*] (2)

5 Option two, an allowance of 8% per year is allowed for 10 years after the building was first brought into use. (2)

Marks 11

SOLUTION: QUESTION 2 (continued)

b)

Section 12 E

1 June 2015 – 31 March 2016: R40 000 x 50% = R20 000
1 April 2016 – 31 March 2017 = R40 000 x 30% = R12 000 (1)
1 April 2017 – 31 March 2018 = R40 000 x 20% = R8 000

Wear-and-tear allowance – s11(*e*)

1 June 2015 – 31 March 2016: R40 000/2 x 10/12 = R16 666
1 April 2016 – 31 March 2017 = R40 000/2 = R20 000 (1)
1 April 2017 – 31 May 2017 = R40 000/2 x 2/12 = R3 333

The wear-and-tear allowance will be more beneficial to MotoCross (Pty) Ltd as the software will be written off at the end of May 2017, where as if the small business corporation allowance was used, the software will only be written off on 31 March 2018. The software will be written off sooner. (1) (1)

	Marks	**4**
	Total Marks	**16**

PART C

		R	
a)	When the dividend is paid, 31 July 2016		(1)
b)	The earlier of when it became due and payable or when it was paid, 18 July 2016		(2)
c)	R125 000 x 25% x 15%	4 688	(2)
		Marks	**5**
		Total	**38**

QUESTION 3 (20 marks, 36 minutes)

PART A (12 marks, 22 minutes)

	R	R	
Tax value			
Cost		3 200 000	
Less: Capital allowances claimed (R3 200 000 x 5% x 17)		(2 720 000)	(1)
Tax value		480 000	
Recoupment			
Selling price		3 000 000	(1)
Less: Tax value		(480 000)	(1)
Recoupment		2 520 000	
Adjusted proceeds			
Proceeds		3 000 000	
Less: Recoupment		(2 520 000)	(1)
Adjusted proceeds		480 000	

Calculate valuation date value (VDV)
Total expenditure = R480 000 + R10 000 = R490 000 (2)
Adjusted proceeds = R480 000
As the adjusted proceeds are less than the total expenditure, par 27 applies. (1)

Market value was determined and

Costs before 1 October 2001 ≥ proceeds (R480 000 = R480 000) (1)
Costs before 1 October 2001 < market value (R480 000 < R1 700 000) (1)

VDV is lower of (1)
Market value: R1 700 000 (1)
TAB cost: R638 842 (1)
Thus, TAB cost is the lowest and therefore the VDV.

Base cost		
Valuation date value	638 842	
Plus: Costs incurred after 1 October 2001	10 000	(1)
Base cost	648 842	
Capital loss		
Adjusted proceeds	480 000	
Less: Base cost	(648 842)	
Capital loss	(168 842)	(1)
Total Marks		**14**
Max		**12**

SOLUTION: QUESTION 3 (continued)

PART B (8 marks, 14 minutes)

	R	R	
Net profit before tax		865 223	
Recoupment JOB			
Cost: (R210 900 x 100/114)	185 000		(1)
Less: Capital allowances 2016: (R185 000 x 20%)	(37 000)		(1)
2017: (R185 000 x 20%)	(37 000)	(37 000)	(1)
Tax value	111 000		
Proceeds	350 000		
Recoupment (R350 000 – R111 000)	239 000		
Limited to previous allowances	74 000	74 000	(2)
Alternative:			
Proceeds (limited to cost)	185 000		
Recoupment R185 000 – R111 000)	74 000	74 000	
Taxable income before capital gain		902 223	
Taxable capital gain:			
Proceeds	350 000		
Less: Recoupment (calculated above)	(74 000)		
Adjusted proceeds	276 000		(1)
Less: Base cost	(111 000)		(1)
Original cost	185 000		
Less: Allowances	(74 000)		
Capital gain	165 000		
Taxable capital gain @ the inclusion rate of 80%		132 000	(1)
Taxable income		**1 034 223**	

Marks	**8**
Total	**20**

<u>SOLUTION: QUESTION 4</u> (12 marks, 22 minutes)

2 marks for definition

In the case of a resident, the total amount in cash or otherwise	The total amount of R750 Million was received in **cash**. **(1)**
Received by or accrued to such a resident	The amount was **paid** on 26 March 2017 to Diamond Investments (Pty) Ltd and thus received. **(1)**
During the year of assessment	The amount received falls within the **2017 year of assessment**. **(1)**
Not of a capital nature	A relevant court case would be **CIR v Visser. (1)** In this case, capital is compared to a tree and revenue to the fruit of the tree. **(1)** **<u>Shopping Mall</u>:** <u>Subjective factors</u>: It was the intention of the taxpayer to invest in commercial property primarily to generate rental income from such property. **(1)** <u>Objective factors</u>: <u>Nature of the asset</u>: The shopping mall was used to generate rental income for the taxpayer. **(1)** If the Visser case is applied, the fruit are the rental received **(1)** and the capital would be the shopping mall. **(1)** The mall is the income producing asset. **(1)** <u>Period for which the asset was held</u>: The shopping mall was purchased in July 2006 and sold on 26 March 2017. **(1)** Thus, held for a long period – not a speculative sale. **(1)** The selling of the shopping mall will therefore constitute capital to the extent that it does not represent a recoupment for income tax purposes. **(1)**
Conclusion	The sale of the shopping mall will not be included **(1)** in the gross income of Diamond Investments (Pty) Ltd for the 2017 year of assessment as it is capital in nature.

Total 16
Max 12

SOLUTION: QUESTION 5 (10 marks, 18 minutes)

		R	
a.	1st provisional tax payment (payable on 30 September 2016)		(1)
	Basic amount – 2016 assessment	3 125 671	(1)
	(2016 assessment is more than 14 days old and the end of the last year of assessment is not more than 18 months before the payment is due) and therefore no 8% adjustment is required.		(2)
	Tax on R3 125 671 =		
	R3 125 671 x 28%	875 188	(1)
	x 50% for the first payment	**437 594**	(1)
b.	2nd provisional tax payment (payable on 31 March 2017)		(1)
	Estimated taxable income for 2017	3 325 870	(1)
	Add: Taxable capital gain (R155 295 x 80%)	124 236	(1)
	Calculated estimated taxable income for 2017	3 450 106	
	Tax on R3 450 106 =		
	R3 450 106 x 28%	966 030	(1)
	Less: First provisional tax payment	(437 594)	(1)
	Amount payable to SARS	**528 436**	

Alternative > R1 million taxable income		
80% x R3 450 106	2 760 085	
Tax on R2 760 085 x 28%	772 824	
Less: First provisional tax payment	(437 594)	
Amount payable to SARS	335 230	
	TOTAL	**11**
	Max	**10**