UNIVERSITY EXAMINATIONS

UNIVERSITEITSEKSAMENS

UNISA university of south africa

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RTX203M

May/June 2010

TAXATION OF BUSINESS INCOME (INCOME TAX 203)

Duration 2 Hours 100 Marks

EXAMINERS
FIRST MR CD MAHLAULE MRS MSI WENTZEL
PROF LC POSTHUMUS
SECOND MRS KL DE HART

Use of a non-programmable pocket calculator is permissible

This paper consists of eight (8) pages plus annexures (pp i–vi).

IMPORTANT INSTRUCTIONS:

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

The answering of this paper
1 This paper consists of four (4) questions
2 All questions must be answered
3 Each question must be commenced on a new (separate) page
4 **All workings, where applicable, must be shown. Where an amount is subject to a limitation, clearly indicate the application of the limitation. Where any item is exempt from tax or not allowable as a deduction, this must be indicated. All amounts must be rounded to the nearest Rand.**
5 Please complete the cover page of the answer book in full
6 You are reminded that answers may **NOT** be written in pencil
7 Proposed timetable **(try as far as possible not to deviate from this timetable):**

Question	Topic	Marks	Minutes
1	Value-Added Tax (VAT)	20	24
2	Taxable income of a company	35	42
3	Capital Gains Tax (CGT)	20	24
4	Trusts	25	30
	TOTAL	**100**	**120**

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QUESTION 1 (20 marks, 24 minutes)

Sky Manufacturing CC manufactures plastic bags Their accountant (your cousin) requested you to assist him in submitting the VAT return to SARS The following information is supplied to you for the two month period ended on 31 March 2010

1 Sky Manufacturing CC is registered on the invoice basis for VAT purposes under Category A

2 All amounts include VAT at 14% where applicable

Income and expenses for two months ended 31 March 2010		
Income	**Notes**	**R**
Local sales		150 000
Export sales – by rail	1	200 000
Interest income		15 000
Indemnity award	2	10 500
Expenditure		
Purchases – raw material		88 000
Jewellery	3	25 000
Depreciation	4	50 000
Double cab bakkie	4	300 000
Salaries	5	200 000
Bad debts	6	13 500
Purchase of a second hand machine	7	40 000
Insurance premium		30 000

Notes:

1 Included in the export sales is an amount of R80 000 which is regarded as being indirect export in terms of the export incentive scheme

2 The indemnity award of R10 500 was received in respect of a microwave used in the canteen All the food and drinks in the canteen are provided to employees free of charge The microwave was stolen last month

3 As a token of appreciation the company purchased jewellery at a cost of R25 000 to give to the secretary for her excellent performance

QUESTION 1 (continued)

4. Depreciation is charged for the following assets owned by the company

   - A manufacturing machine was purchased two years ago for R250 000
   - A double cab bakkie was purchased on 1 February 2010 for R300 000 The financial manager has the sole use of the double cab and bears the full cost of maintaining the vehicle

5 Bad debts written off comprise of the following

   - R8 000 owing by the long time local customer (debtor) who became insolvent
   - R5 500 owing by an export sale debtor situated in Zimbabwe.

6 The company purchased a second hand machine for R80 000 from a non-vendor for use in the business The company paid half of the purchase price in the previous VAT period

7 The insurance premium of R30 000 was incurred for the following

• Manufacturing equipment and tools	R24 000
• Double cab bakkie for financial manager	R 6 000

REQUIRED:	MARKS
Calculate the VAT payable by/refundable to Sky Manufacturing CC for the two month period ended 31 March 2010. Round all amounts to the nearest Rand. Give reasons where the VAT amounts are nil.	20

QUESTION 2 (35 marks, 42 minutes)

Fafa (Pty) Ltd manufactures basket balls It is **not** a small business enterprise as defined in the Income Tax Act Fafa (Pty) Ltd is a registered VAT vendor

The following information is available to calculate the company's taxable income for the year of assessment ended 31 March 2010 All amounts **exclude VAT** unless otherwise stated

1 Taxable income amounts to R5 200 000, **before** taking the information below into account

2 Fafa (Pty) Ltd paid pension fund contributions of R70 000 during the year on behalf of an employee The employee's remuneration, as approved by the Commissioner, is R300 000

3 The company paid an annuity of R75 000 to the wife of an employee who died during the year

4 A restraint of trade compensation of R900 000 was paid to the financial manager who resigned during the year The restraint is effective for two years and the full amount was included in the financial manager's income on his 2010 income tax return

5 Fafa (Pty) Ltd entered into a learnership agreement with an employee on 1 January 2010 This employee concluded a three year learnership agreement with a previous employer at the beginning of April 2007, but resigned from that employer on 31 December 2009 and continued with the original learnership agreement at Fafa (Pty) Ltd The employee successfully completed the learnership with Fafa (Pty) Ltd on 31 March 2010 The employee is not disabled

6 A trademark licence was renewed on 1 January 2010 for R5 000 A new trademark was also purchased on 1 February 2010 for R50 000

7 Trading stock, which was acquired in a previous year of assessment at a cost of R2 000, was removed during the year by the managing director for private use. The market value of the trading stock on the date it was removed was R3 000

Fafa (Pty) Ltd also donated trading stock during the year, which was acquired in the previous year of assessment at a cost of R7 000, to a local basketball club The donation does not qualify for the section 18A deduction The market value of the trading stock on the date it was donated was R10 000

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QUESTION 2 (continued)

8. The cost price of fixed assets that Fafa (Pty) Ltd used during the year consists of the following

	R
- Manufacturing machine Z purchased new on 1 May 2009 (cost price includes VAT)	513 000
- Truck purchased second hand on 1 December 2009	800 000
- Burglar alarm purchased on 1 March 2009	60 000
- Manufacturing building purchased on 1 January 2005	2 500 000
- New commercial building situated within an urban development zone brought into use on 1 August 2009 All the requirements for an urban development zone allowance have been met	1 500 000
- Manufacturing machine A purchased second hand on 1 April 2009 The machine was not bought from a connected person. This machine was sold on 31 January 2010 for R100 000 Fafa (Pty) Ltd selected the section 11(o) allowance..	200 000

Interpretation note 47 allows the following write-off periods for assets:

- Trucks	4 years
- Burglar alarm	6 years

9 On 1 May 2009, Fafa (Pty) Ltd sold a low-cost residential unit (just after it was erected at a cost of R300 000) to an employee for R300 000 on an interest free loan account from Fafa (Pty) Ltd The employee made no repayment in 2010

10. Fafa (Pty) Ltd decided to lease a commercial building to sell some of their own manufactured stock and concluded a lease agreement with Property (Pty) Ltd The lease period commenced on 1 August 2009 for a 10 year period, with an optional extension period of another 5 years In terms of this agreement Fafa (Pty) Ltd had to pay a lease premium of R90 000 on 1 August 2009 for the right of use of the property Fafa (Pty) Ltd also had to effect improvements on the premises to the value of R285 000 and pay a monthly rent amounting to R10 000 from 1 August 2009 The commercial building was brought into use by Fafa (Pty) Ltd on 1 August 2009

The building improvements commenced on 1 September 2009 and were completed and brought into use on 1 February 2010 The total cost of the improvements was R305 000

QUESTION 2 (continued)

11 Fafa (Pty) Ltd received a huge long-term order of basketballs from one client during September 2009 An instalment credit agreement was concluded which provides for the payment of a deposit of 25% and the balance (including the finance charges) over a period of 18 months This debtor's outstanding balance on 31 March 2010 was R150 000 (excluding finance charges) Fafa (Pty) Ltd's gross profit percentage is 50%

The debtor's allowance claimed during the previous year of assessment amounts to R100 000

12 The company incurred an assessed loss of R90 000 during the previous year of assessment.

REQUIRED:	MARKS
Calculate the normal income tax payable by Fafa (Pty) Ltd for the year of assessment ended 31 March 2010	35

QUESTION 3 (20 marks, 24 minutes)

Digital Systems (Pty) Ltd entered into the following transaction during the year ended 30 April 2010

A factory building in Durban was sold on 30 November 2009 for R3 750 000 The building was acquired on 1 December 2000 for R1 500 000 Additions to the building to the value of R275 500 were made during June 2006 Valuation costs of R10 500 were paid to a sworn appraiser who determined the market value of the building to be R2 025 000 as at 1 October 2001 The time apportionment base cost on 1 October 2001 is R2 613 000. The factory building qualified for a section 13 industrial building allowance of 5% per annum

REQUIRED:	MARKS
Calculate the taxable capital gain or loss for the year of assessment ended 30 April 2010	20

QUESTION 4 (25 marks, 30 minutes)

Mr Gary Teichman, a resident in South Africa since 1989, is 67 years old and married to Demi Teichman (age 59) They are married out of community of property and have just celebrated their 25th wedding anniversary

Upon the advice of his financial advisor, Mr Gary Teichman created a trust in 1990 by donating his share portfolio to the trust At the time of the donation, the market value of the shares was R4 000 000 The sole purpose of the trust was for the benefit of the beneficiaries

The couple has two children, who are also the beneficiaries of the trust

Michael – 22 years old, unmarried and currently living in the USA (non-resident)
Jade – 16 years old, unmarried and currently living with her parents

The trust also used undistributed income of previous year's and invested R2 500 000 in Labsa participation bonds

The children's grandfather, Ben Teichman donated a block of flats to the trust

During the 2010 tax year the trust received the following income and made the following distributions

	Dividends	**Interest on bonds**	**Rental – Letting of flats**	**Total**
Donor	***Gary***	***Non-donation***	***Ben***	
	R	**R**	**R**	**R**
Net income	400 000	300 000	375 000	1 075 000
Less Expenses				
External trustee remuneration	(40 000)	(28 500)	(26 500)	(95 000)
Net income after trustee remuneration	360 000	271 500	348 500	980 000
Less: Distributions and vested rights	**(196 500)**	**(96 000)**	**(272 500)**	**(565 000)**
Annuity	*144 000*	*96 000*		*240 000*
• *Michael*	36 000	24 000		60 000
• *Jade*	36 000	24 000		60 000
• *Mrs Demi Teichman*	72 000	48 000		120 000
Distributions	52 500		272 500	330 000
• Michael	15 000		85 000	100 000
• Jade	12 500		67 500	80 000
• Mrs Demi Teichman	30 000		120 000	150 000
Undistributed income	**163 500**	**175 500**	**76 000**	**415 000**

Other information:

Upon the death of Mr Gary Teichman, the capital of the trust must be equally distributed to the children

QUESTION 4 (continued)

If none of the children survive Mr Gary Teichman, the capital of the trust will be donated to Unisa for the further education of students

Mr Gary Teichman's taxable income, excluding any trust income, is R50 000

Mrs Demi Teichman's taxable income from her drama society is R20 000

Michael received a profit share of R10 000 from a South African company

Jade received income of R15 000 from part-time modelling.

REQUIRED:	**MARKS**
Calculate the taxable income of each of the following taxpayers for the tax year ended 28 February 2010	
a. Michael	5
b. Jade	5
c Mrs Demi Teichman	7
d Mr Gary Teichman	8
	[25]

ANNEXURE A: EXTRACT FROM THE INCOME TAX ACT (ACT 58 OF 1962, AS AMENDED) – EIGHTH SCHEDULE

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

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

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

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

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

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

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

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

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

27. Valuation date value where proceeds do not exceed expenditure. - (1) Subject to subparagraph (2), where the proceeds from the disposal of a pre-valuation date asset do not exceed the expenditure allowable in terms of paragraph 20 incurred both before and after the valuation date in respect of that asset, the valuation date value of that asset must be determined in terms of this paragraph

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(2) This paragraph does not apply in respect of any asset contemplated in paragraph 28 or in respect of which paragraph 32 (3A) has been applied

(3) Where a person has determined the market value of an asset on the valuation date, as contemplated in paragraph 29, or the market value of an asset has been published in terms of that paragraph, and-

(a) the expenditure allowable in terms of paragraph 20 incurred before the valuation date in respect of that asset-

(i) is equal to or exceeds the proceeds from the disposal of that asset, and
(ii) exceeds the market value of that asset on valuation date,

is the valuation date value of that asset must the higher of-

(aa) that market value, or
(bb) those proceeds less the expenditure allowable in terms of paragraph 20 incurred on or after the valuation date in respect of that asset, or

(b) the provisions of item (a) do not apply, the valuation date value of that asset must be the lower of-

(i) that market value, or
(ii) the time-apportionment base cost of that asset as contemplated in paragraph 30

(4) Where the provisions of subparagraph (3) do not apply, the valuation date value of that asset is the time-apportionment base cost of that asset, as contemplated in paragraph 30

ANNEXURE B: ADDITIONAL INFORMATION

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

- 0% on taxable income not exceeding R54 200
- 10% on taxable income exceeding R54 200, but not exceeding R300 000
- R24 580 plus 28% on taxable income exceeding R300 000

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

This table represents all the monetary values prescribed in the Act and by the minister that are subject to change – this table gives the values that you will be working with when calculating taxable income or tax payable for the 2009 year of assessment You will be provided with this table in the examination

Description	Reference to Income Tax Act, 1962	Monetary amount

General savings thresholds

Broad-based employee share schemes: Employees can receive tax-exempt shares if the shares are part of a broad-based employee share plan Companies can also deduct shares issued under the plan		
Maximum exemption for shares received by employees	The definition of "qualifying share" in section 8B(3)	R9 000
Maximum deduction for shares issued by the employer	The proviso to section 11(*l*A)	R3 000
Exemption for interest and certain dividends:		
Exemption for domestic interest and otherwise taxable collective scheme dividends in respect of persons younger than 65 years	Section 10(1)(*i*)(*xv*)(*bb*)(B)	R21 000
Exemption for passive portfolio savings in respect of persons 65 years or older	Section 10(1)(*i*)(*xv*)(*bb*)(A)	R30 000
Maximum application of the above exemption for foreign interest and otherwise taxable dividends	Section 10(1)(*i*)(*xv*)(*aa*)	R3 500
Annual donations tax exemption:		
Exemption for donations made by entities	Section 56(2)(*a*) and the proviso thereto	R10 000
Exemption for donations made by individuals	Section 56(2)(*b*)	R100 000
Capital gains exclusions:		
Annual exclusion for individuals and special trusts	Paragraph 5(1) of Eighth schedule	R17 500
Exclusion for the disposal of a primary residence	Paragraph 45(1) of Eighth Schedule	R1,5 million
Maximum market value of all assets allowed within the small business definition on disposal when person over 55	Definition of "small business" in paragraph 57(1) of Eighth Schedule	R5 million
Exclusion amount on disposal of small business when person over 55	Paragraph 57(3) of Eighth schedule	R750 000
Exclusion on death	Paragraph 5(2) of Eighth schedule	R120 000

Retirement savings thresholds

Deductible retirement fund contributions: Pension fund and retirement annuity fund members may deduct their contributions subject to certain percentage or monetary ceilings		
Pension fund monetary ceiling for contributions	Proviso to section 11(*k*)(i)	R1 750

Description	Reference to Income Tax Act, 1962	Monetary amount
Pension fund monetary ceiling for arrear contributions	Paragraph (*aa*) of the proviso to section 11(*k*)(ii)	R1 800
Retirement annuity fund monetary ceiling for contributions (if also a member of a pension fund)	Section 11(*n*)(*aa*)(B)	R3 500
Retirement annuity fund ceiling for contributions (if not a member of a pension fund)	Section 11(*n*)(*aa*)(C)	R1 750
Retirement annuity fund ceiling for arrear contributions	Section 11(*n*)(*bb*)	R1 800
Permissible lump sum withdrawals upon retirement: Pension fund and retirement annuity fund members may withdraw lump sums upon retirement		
Pension fund monetary amount for permissible lump sum withdrawals	Paragraph(ii)(dd) of the proviso to paragraph (c) of the definition of "pension fund" in section 1	R50 000
Retirement annuity fund monetary amount for permissible lump sum withdrawals	Paragraph (*b*)(*ii*) of the proviso to the definition of "retirement annuity fund" in section 1	R50 000

Deductible business expenses for individuals

Car allowance: Individuals receive an annual vehicle allowance to defray business travel expenses, including deemed depreciation on the vehicle		
Ceiling on vehicle cost	Section 8(1)(*b*)(*iii*A)(*bb*)(A)	R400 000
Ceiling on debt relating to vehicle cost	Section 8(1)(*b*)(*iii*A)(*bb*)(B)	R400 000

Employment-related fringe benefits

Exempt scholarships and bursaries: Employers can provide exempt scholarships and bursaries to employees and their relatives, subject to annual monetary ceilings		
Annual ceiling for employees	Paragraph (*ii*)(aa) of the proviso to section 10(1)(*q*)	R100 000
Annual ceiling for employee relatives	Paragraph (*ii*)(*bb*) of the proviso to section 10(1)(*q*)	R10 000
Exempt termination benefits: Employees of age 55 or older receive exemption for payments related to employment termination subject to a monetary ceiling	Section 10(1)(*x*)	R30 000
Medical scheme contributions: Medical scheme contributions are tax deductible if the individual pays (and tax-free if the employer pays) subject to monthly ceilings		
Monthly ceilings for schemes with one beneficiary	Section 18(2)(c)(i)(aa) and paragraph 12A(1)(a) of the Seventh Schedule	R625
Monthly ceiling for schemes with two beneficiaries	Section 18(2)(c)(i)(bb) and paragraph 12A(1)(b) of the Seventh Schedule	R1 250
Additional monthly ceiling for each additional beneficiary	Section 18(2)(c)(i)(cc) and paragraph 12A(1)(c) of the Seventh Schedule	R380

Description	Reference to Income Tax Act, 1962	Monetary amount
Awards for bravery and long service: The deemed values of bravery and long service awards are reduced by the monetary amount indicated	Paragraphs (a) and (b) of the further proviso to paragraph 5(2) of Seventh Schedule	R5 000
Employee accommodation: Employee accommodation is taxed by means of a formula if the employer owns the accommodation, but no tax is payable if the employee earns less than the amount indicated	Paragraph 9(3)(a)(ii) of Seventh Schedule	R54 200
Exemption for expatriate employees: The value of accommodation provided to expatriate employees is taxable to the extent that it exceeds the amount indicated	Paragraph 9(7B)(ii) of Seventh Schedule	R25 000
Exemption for *de minimus* employee loans: Employee loans below the amount indicated are not deemed to have any value as a fringe benefit	Paragraph 11(4)(a) of Seventh Schedule	R3 000
Employer deductions for employee housing: Expenses incurred for providing employee housing is limited to the ceiling indicated (per dwelling)	Paragraph (ii) of the proviso to section 11(t)	R15 000
Additional employer deductions for learnerships: Employers receive additional deductions for learnerships depending on the circumstances		
Monetary ceiling of additional deduction for the employer when entering into a learnership agreement with an existing employee	Section 12H(1)	R30 000
Monetary ceiling of additional deduction for the employer when entering into a learnership agreement with a new employee	Section 12H(2) and (3)	R30 000
Monetary ceiling of additional deduction for the employer in the case of completing a learnership agreement (all employees)	Section 12H(4)	+R20 000

Depreciation

Small-scale intellectual property: Intellectual property with a cost below the amount indicated is immediately deductible	Paragraph (aa) of the proviso to section 11(gC)	R5 000
Urban development zone: Developers undertaking projects in excess of the amount indicated must provide special notice to the Commissioner	Section 13quat (10A)	R5 million

Miscellaneous

Public benefit organizations: PBO trading income is exempt up to the greater of 5% of total receipts and accruals or the amount indicated	Section 10(1)(cN)(ii)(dd)(ii)	R100 000
Donations to trans-frontier parks are deductible if the donation equals or exceeds the amount indicated	Section 18A(1C)(a)(ii)	R1 million
PBO's providing housing are exempt if beneficiaries are households with a monthly income of the stated amount or less	Paragraph 3(a) of Part I of Ninth Schedule and paragraph 5(a) of Part II of Ninth Schedule	R7 500

Description	Reference to Income Tax Act, 1962	Monetary amount
Recreational clubs: Club trading income is exempt up to the greater of 5% of total receipts and accruals or the amount stated	Section 10(1)(cO)(iv)(bb)	R50 000
Farmer deductions for employee housing: Ceiling for expenses incurred by farmers to provide employee housing (per employee)	Paragraph 12(5) of First Schedule	R15 000
Prepaid expenses: Limit of prepaid expenses that will not be deferred until deliver of goods, services or benefits	Paragraph (bb) of the proviso to section 23H(1)	R80 000
Small business corporations: Corporations qualify for tax incentives if gross income does not exceed the amount referred to	Section 12E(4)(a)(i)	R14 million
Housing associations: Housing associations investment income is exempt up to the amount indicated	Section 10(1)(e)	R50 000

Administration

Investment income exempt from provisional tax: If a natural person solely generates income from interest, dividends and real estate rentals, the income amount indicated is exempt from provisional tax		
In the case of natural persons below age 65	Paragraph 18(1)(c)(ii) of Fourth Schedule	R20 000
In the case of natural persons over age 65	Paragraph 18(1)(d)(i) of Fourth Schedule	R80 000
S.I.T.E threshold: Tax on employment income is subject to the SITE system up to the amount indicated	Items (a) and (b) of paragraph 11B(2) and items (a), (b)(ii) and (b)(iii) of paragraph 11B(3) of Fourth Schedule	R60 000
Automatic appeal to the High Court: The full bench of the High Court has automatic jurisdiction to appeals if the disputed amount exceeds the amount indicated	Section 83(4B)(a)	R50 million