



SPECIAL EXAMINATION

**TXN203D
RTX203M**

January 2012

TAXATION OF BUSINESS INCOME (INCOME TAX 203)

Duration 2 Hours

100 Marks

EXAMINERS :
FIRST
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SECOND

 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 Principle mistakes will be marked negatively
- 8 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 | Trust | 25 | 30 |
| | TOTAL | 100 | 120 |

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QUESTION 1 (20 marks, 24 minutes)

Bry Manufacturing CC manufactures plastic pipes. Their accountant 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 December 2011.

- 1 Bry 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 December 2011 | | |
|--|--------------|----------|
| | Notes | R |
| Income | | |
| 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 an 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.

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QUESTION 1 (continued)

- 4 Depreciation is charged for the following assets owned by the company
- A manufacturing machine that was purchased two years ago for R250 000
 - A double cab bakkie was purchased on 1 November 2011 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 the following
- R8 000 owing by a long time local customer (debtor) who became insolvent
 - R5 500 owing by an export sale debtor situated in Botswana
- 6 The company purchased a second hand machine for R80 000 from a resident 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 in respect of 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 Bry Manufacturing CC for the two month period ended 31 December 2011 Round off all amounts to the nearest Rand Give reasons where the VAT amounts are nil | 20 |

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QUESTION 2 (35 marks, 42 minutes)

Bat (Pty) Ltd manufactures cricket bats. It is a small business corporation as defined in the Income Tax Act. Bat (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 2011. All amounts **exclude VAT** unless otherwise stated.

- 1 Taxable income amounts to R5 200 000, **before** taking the information below into account.
- 2 Bat (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. The amount was paid in terms of company policy.
- 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 2011 income tax return.
- 5 Bat (Pty) Ltd entered into a learnership agreement with an employee on 1 January 2011. This employee commenced a three year learnership agreement with a previous employer at the beginning of April 2008, but resigned from that employer on 31 December 2010 and continued with the original learnership agreement at Bat (Pty) Ltd. The employee successfully completed the learnership with Bat (Pty) Ltd on 31 March 2011. The employee is disabled.
- 6 A trademark licence was renewed on 1 January 2011 for R5 000. A new trademark was also purchased on 1 February 2011 for R50 000.
- 7 Trading stock, 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.

Bat (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 cricket 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 Bat (Pty) Ltd used during the year consists of the following
- | | R |
|---|-----------|
| - Manufacturing machine Z purchased new on 1 May 2010 (cost price includes VAT) | 513 000 |
| - Truck purchased second hand on 1 December 2010 | 800 000 |
| - Burglar alarm purchased on 1 March 2010 | 60 000 |
| - Manufacturing building purchased on 1 January 2006 | 2 500 000 |
| - New commercial building situated within an urban development zone brought into use on 1 August 2010 All the requirements for an urban development zone allowance has been met | 1 500 000 |
| - Manufacturing machine A purchased second hand on 1 April 2010 The machine was not purchased from a connected person This machine was sold on 31 January 2011 for R100 000 Bat (Pty) Ltd has selected a section 11(o) allowance | 200 000 |

Interpretation note 47 allows the following write-off periods for assets (where applicable)

- | | | |
|-----------------|---------|--|
| - Trucks | 4 years | |
| - Burglar alarm | 6 years | |
- 9 On 1 May 2010, Bat (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 Bat (Pty) Ltd The employee made no repayment in 2011
- 10 Bat (Pty) Ltd decided to lease a commercial building to sell some of their own manufactured stock and concluded a lease agreement with Prop (Pty) Ltd The lease period commenced on 1 August 2010 for a 10 year period, with an optional extension period of another 5 years In terms of this agreement Bat (Pty) Ltd had to pay a lease premium of R90 000 on 1 August 2010 for the right of use of the property Bat (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 2010 The commercial building was brought into use by Bat (Pty) Ltd on 1 August 2010

The building improvements commenced on 1 September 2010 and were completed and brought into use on 1 February 2011 The total cost of the improvements was R305 000

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QUESTION 2 (continued)

- 11 Bat (Pty) Ltd received a substantial long-term order of cricket bats from one client during September 2010. 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 2011 was R150 000 (excluding finance charges). Bat (Pty) Ltd's gross profit percentage is 50%.

The debtor's allowance claimed during the previous year of assessment amounted 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 Bat (Pty) Ltd for the year of assessment ended 31 March 2011. Clearly show if amounts are deducted from, or added to taxable income. | 35 |

QUESTION 3 (20 marks, 24 minutes)

Paint (Pty) Ltd sold one of its factory buildings on 31 January 2011 for R4 000 000. The company's accountant asks you to calculate the taxable capital gain or loss in respect of this asset and provides you with the following information regarding this transaction:

| | |
|-----------------------------------|-----------------|
| Acquisition date | 1 December 2000 |
| Purchase price | R1 500 000 |
| Market value as at 1 October 2001 | R2 025 000 |
| Time apportionment base cost | R2 613 000 |

Additions to the building of R275 500 were made during June 2007. 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 2011. | 20 |

QUESTION 4 (25 marks, 30 minutes)

Dr Henry Wills, a resident in South Africa, is 69 years old and married to Cindy Wills (age 60). They are married out of community of property.

Dr Henry Wills created a trust in 2002 by donating his investment portfolio consisting of shares in listed companies, which earn dividends, and a fixed deposit, which earns interest income, to the trust.

The sole purpose of the trust was for the benefit of the beneficiaries, being himself, his wife and two children, John and Elise. John is 25 years old, unmarried and currently living in the USA (non-resident) and Elise is 15 years old, unmarried and currently living with her parents.

Dr Henry Wills' father, Sen Wills, donated an office block to the trust.

During the 2011 tax year the trust received the following income and made the following distributions:

| | Dividends | Interest on fixed deposit | Rental – letting of offices | Total |
|-----------------------------|-----------------|---------------------------------|-----------------------------------|------------------|
| | R | R | R | R |
| Net income | 360 000 | 271 500 | 348 500 | 980 000 |
| Less: Distributions | | | | |
| Distributions | <i>(57 500)</i> | | <i>(152 500)</i> | <i>(210 000)</i> |
| • John Wills | 15 000 | | 85 000 | 100 000 |
| • Elise Wills | 12 500 | | 67 500 | 80 000 |
| • Mrs Cindy Wills | 30 000 | | | 30 000 |
| Annuity | <i>(83 000)</i> | <i>(55 000)</i> | | <i>(138 000)</i> |
| • John Wills | 36 000 | 24 000 | | 60 000 |
| • Elise Wills | 36 000 | 24 000 | | 60 000 |
| • Mrs Cindy Wills | 11 000 | 7 000 | | 18 000 |
| Undistributed income | 219 500 | 216 500 | 196 000 | 632 000 |

Other information:

Dr Henry Wills' taxable income, excluding any trust income, is R50 000.

John Wills received rental income of R120 000 from a property in South Africa that he purchased three years ago.

Elise Wills received income of R20 000 from performing in a television advertisement.

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QUESTION 4 (continued)

| REQUIRED: | MARKS |
|---|-------------------------------|
| Calculate the taxable income of each of the following taxpayers for the tax year ended 28 February 2011 a John Wills b Elise Wills c Mrs Cindy Wills d Dr Henry Wills | 5 5 6 9 <u>25</u> |

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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 R57 000
- 10% on taxable income exceeding R57 000, but not exceeding R300 000
- R24 300 plus 28% on taxable income exceeding R300 000

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 2011 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) | R50 000 |
| Maximum deduction for shares issued by the employer | The proviso to section 11(A) | R9 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) | R22 300 |
| Exemption for passive portfolio savings in respect of persons 65 years or older | Section 10(1)(i)(xv)(bb)(A) | R32 000 |
| Maximum application of the above exemption for foreign interest and otherwise taxable dividends | Section 10(1)(i)(xv)(aa) | R3 700 |
| 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)(l) | R1 750 |

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| 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)(iiiA)(bb)(A) | R400 000 |
| Ceiling on debt relating to vehicle cost | Section 8(1)(b)(iiiA)(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)(g) | R100 000 |
| Annual ceiling for employee relatives | Paragraph (ii)(bb) of the proviso to section 10(1)(g) | R10 000 |
| Exempt termination benefits: | | |
| Employees of age 55 or older receive exemption for payments related to employment termination subject to a monetary ceiling | | |
| 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 | R670 |
| Monthly ceiling for schemes with two beneficiaries | Section 18(2)(c)(i)(bb) and paragraph 12A(1)(b) of the Seventh Schedule | R1 340 |
| Additional monthly ceiling for each additional beneficiary | Section 18(2)(c)(i)(cc) and paragraph 12A(1)(c) of the Seventh Schedule | R410 |

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| 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 | R57 000 |
| 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 <i>de minimus</i> 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 |

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| 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 |

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