Tax Professional

Knowledge Competency Assessment

Sample Paper 2: Solution

South African
Institute of
Tax Professionals

Suggested Solution

Question	Topic	Marks
1	Various – Advisory	50
2	VAT, CGT and Capital Allowances	30
3	Normal Tax Calculation	40
4	Analysis of Financial Statements	40

Total marks: 160

The marks specified are an indication of the expected length and detail of your response.

Question 1 40 marks

Part A 30 marks

Query 1

- Before an amount can form part of the definition of gross income in s1 of the Income Tax Act, all of the requirements of that definition must be met. One of these requirements is that the amount must not be of a capital nature. (1½)
- As the originating cause of the payment is to compensate Miss Sibande for personal injury, it would be capital in nature. (1)
- Compensation for personal injury gives rise to a capital gains event. However, any capital gain or loss must be disregarded in terms of par 59 of the 8thSchedule. (1)
- If Miss Sibande receives the amount as a lump sum of R370 000, it will be capital in natureand it will have no tax effect. (1)
- If she receives a monthly payment it will be an annuity, which falls within the ambit of special inclusion in para (a) of the definition of gross income. Each payment will be included in her gross income as and when it accrues to her. (1)
- Such an amount will thus form part of gross income notwithstanding the underlying capital nature of the compensation for personal injury – KBI en 'n Ander v Hogan. (1)
- However, the gross income – compensation paid in terms of the Road Accident Fund, will be exempt in terms of s10(1)(gB)(iv). (1)

Layout and presentation (1)

Available 8½
Maximum 6

Query 2

Taxable income of Gloria Sibanda for the year of assessment ended 28 February 2014

	R	
Gross Salary from Envirocycle Ltd March 2013 – May 2013 3 months x R45 000 pm	135 000	(1)
Gross salary from Australian firm 9 months x R120 000 pm	1 080 000	(1)
Royalties received from South African company s9(2)(d)	700 000	(1)
Investment Income		
Local interest (R12 000 + R5 000 + R18 000)	35 000	(1½)
Foreign interest	4 650	(1)
Local dividends (R44 322 + R12 000)	56 322	(1)
Foreign dividends	5 770	(1)
Active portfolio shares sold (included in gross income, revenue in nature, speculative)	68 000	(1)
Sale of portfolio on 1 April 2013 (income in nature)	769 000	(1)
Gross Income	2 750 742	
Less: Exemptions		
Australian salary (s10(1)(o)(ii) exemption > than 183 days and continuous > 60 days outside SA	(1 080 000)	(1)
Local interest: section 10(1)(i) [she is younger than 65]	(23 800)	(1)
Local dividends: section 10(1)(k)(i)	(56 322)	(1)
Foreign dividends: section 10B(3) partial exemption: R5 770 x 25/30	(3 606)	(1)
Income	1 587 014	

Less: Deductions and Allowances		
No section 11(gC) allowance on development of patent as it excludes development of patent	-	(1)
Cost of registering the patent was incurred in 2013 year of assessment	-	(1)
Opening stock (active portfolio shares)[s22(2)]	(800 300)	(1)
Purchase of active portfolio shares (trading stock) [s 11(a)]	(40 000)	(1)
Taxable capital gains [s 26A] – refer to separate CGT calculation	-	
Taxable Income	**746 714**	

Capital gains tax calculation	R	R	
Patent and Blue-Chip portfolio – no deemed disposal as she remains ordinary resident in SA		-	(1)
Primary residence sold			
Proceeds [par 35]	2 200 000		(1)
Less: base cost [par 40(1A)(b)]	(2 300 000)		
Market value on the date inherited (post- valuation date asset) no par 20	2 300 000		(1)
Paint and leak in roof constitute repairs and not improvements, no par 20	-		(1)
Capital Loss	(100 000)		
Primary residence exclusion (R2 million limited to R100 000) [par 45(1)(a)]	100 000		(1)
Capital gain/(loss)	-		
Furniture – capital gain/loss disregarded: par 53 personal use assets	-	-	(1)
Sum of capital gains and losses		-	
Less: Annual exclusion		(30 000)	
Aggregate Capital Gain		-	
Less: Capital loss brought forward from the 2013 year of assessment		-	
Net Capital Gain		-	
Inclusion rate		x 33.3%	
Taxable Capital Gain		-	

Available 22(½)
Format, layout & presentation 2
Maximum 24

Question 1

Part B 10 marks

- All the requirements of the so-called general deduction formula as found in s 11(a) (the positive requirements) must be met for the amounts to qualify for deduction: (1)
  - expenditure or loss (½)
  - actually incurred (½)
  - in the production of income (½)
  - excluding capital amounts (½)
- Section 23(g) (the negative requirements) must not be applicable. (1)
- Both the opening words of s11 and the provisions of s23(g) require that before an expense or loss may be tax deductible it is necessary that the taxpayer be carrying on a trade. (1)
- The word 'trade' is widely defined in s1 and specifically includes a 'venture'. Vuyo will thus be regarded as carrying on a trade – refer to *Burgess v CIR* in this regard for the fact that a trade will be widely interpreted. (2)
- On the strength of the decision in *Port Elizabeth Electric Tramway Co Ltd v CIR (or Joffe& Co (Pty) Ltd v CIR* – close link/relationship) it would seem that costs of this nature would be an inevitable concomitant of trade because in a free market place one has free access to intellectual property whether it is regulated or not and a person like Vuyo with no business trading or experience will be ignorant as to what he is allowed to do or not. (2)
- One needs to prove that the compensation was expended as part of the production of income and not of a capital nature before it could be allowed as a deduction in terms of s11(a) and then one need to look at whether the legal cost would be allowable in terms of s11(c). (1)

- Whether the compensation is capital or not would be determined by answering whether the cost was expended for purposes of either:
  - adding to the capital structure of the business (capital); or (½)
  - normal trading expenditure (revenue). (½)

  (New State Areas Ltd v CIR or Rand Mines (Mining & Services) Ltd v CIR or BPSA (Pty) Ltd v C:SARS) (either case) (1)
- Even though Vuyoa is not going to register any intellectual property on his venture the expenditure relates to Vuyo's ability to continue to use the structure and the name and as such would be capital and not allowed in terms of s 11(a). No special allowances are available in terms of s 11(gA) or s 11(gC). (1)
- The legal fees would thus also be regarded as capital because of the provisions of s11(c) proviso (ii). (1)
- The R65 000 would form part of the 'base cost' of the business in terms of para 20 of the Eighth Schedule. (1)

Available 15
Maximum 10

Question 2 30 marks

Joe Biggs, 45 years, resident of RSA

			R	R	
Income from farming			1 417 500		(1)
Less: amount deposited in Land Bank			400 000		(1)
				1 017 500	
Subsidy received				240 000	(1)
Sales of maize				630 000	(1)
Closing stock – livestock					
No.Std Value					
Bulls	4	50	200		(½)
Oxen	38	40	1 520		(½)
Cows	295	40	11 800		(½)
Tollies& heifers	10	20	200		(½)
Calves	120	5	600		(½)
			14 320	14 320	
Donation of cows 2 @ R10 000 (MV)				20 000	(1)
Natural increase – no adjustment				-	(½)
Rations – deductible, no adjustment required				-	(1)
Own Consumption: 1 @ R5 000 (cost)				5 000	(1)
Total farming income				1 926 820	

Less: Expenses

Opening stock – livestock					
No.Std Value					
Bulls	5	50	250		(½)
Oxen	30	40	1 200		(½)
Cows	350	40	14 000		(½)
Tollies& heifers	150	20	3 000		(½)
Calves	80	5	400		(½)
			18 850	(18 850)	
Fuel				(15 800)	(½)
Various farming expenditure (all deductible)				(586 000)	(½)
Repairs to fences				(2 000)	(½)
New tractor purchased – capital				-	(½)
New tractor: s 12B allowance: R155 000 x 50%				(77 500)	(1)
Prevention of soil erosion				(8 000)	(½)
Repairs to maize shed				(5 400)	(½)
Food for livestock				(45 900)	(½)
Wages				(31 900)	(½)
Cost of seed and fertilizer				(56 000)	(½)
Spare parts				(34 000)	(½)
Railage paid for maize				(1 200)	(½)
Hail and drought insurance premiums paid on the crops				(2 500)	(½)
Section 13*sex* capital allowance (10% of R135 000)				(13 500)	(1)
Add taxable capital gain – *refer separate CGT calculation* [s 26A]				-	
Profit before capital expenditure				1 028 270	

Less: Capital expenditure

Opening balance	(250 800)		(1)
Less: tractor sold – recoupment of allowances (originally cost R65 000, allowance granted R65 000)	65 000		(1)
	(185 800)		
Cost to build a new road - capital	(18 500)		(½)
New fences erected (R10 500 – R2 000 repairs)	(8 500)		(½)
New cattle shed – par 12(1)(f) of the first schedule	(80 000)		(1)
Cost of water pump	(45 000)		(½)
Fruit trees purchased	(1 900)		(½)
	(399 700)		
Allowed to be deducted	(339 700)	(399 700)	(½)
Carried forward	-		
Farming taxable income of the year		**688 570**	

Farming taxable income		688 570	
Plus: local dividends (s1, gross income, par (k))	15 000		
Less: exemption from normal tax unders10(1)(k)(i)	(15 000)	-	(1)
Taxable income before medical deduction		688 570	
Less: Medical and dental deductions (s 18)			(1)
Medical scheme contributions of R60 000 (R5 000 x 12)	60 000		
Less four times medical scheme fees tax credit: 4 x 12 x [484 + (164 x 4)]	(54 336)		(1)
	5 664		
Add medical expenses paid (R58 000 – R10 000)	48 000		(½)
	53 664		
Reduced by R51 643 (7.5% of R688 570)	(51 643)	(2 021)	(½)
Taxable Income		**686 549**	

Capital gains tax calculation

Tractor			
Proceeds (par 35)		5 000	
Sold for	70 000		
Less: gross income inclusion (recoupment)	(65 000)		
Less: Base cost		-	
Original cost	65 000		
Less: Capital allowances	(65 000)		
Capital gain		5 000	(1)
Add other capital gains and deduct other capital losses		-	
Sum of all capital gains and losses		5 000	
Less: Annual exclusion – R30 000 limited to capital gain		(5 000)	(1)
Aggregate/Net capital gain		-	
Inclusion rate		33.3%	(1)
Taxable capital gain		-	

Available 33
Maximum 30

Question 3 55 marks

Vinesh Pillay, 54 years old, divorced on 1 July 2013

	Lump Sum	R	
1.1 Salary (HurryCurry CC) (R35 000 pm x 3 months)		105 000	(½)
1.1 Fringe benefit: Medical expense (par 12A, 7th schedule) (R2 200 pm x 3 months)		6 600	(½)
1.1 Fringe benefit: RAF (par 2(h), 7th schedule) (R1 000 pm x 110/100 x 3 months)		3 300	(1)
2. Fringe benefit: Low interest rate loan on Honda (par 11, 7th schedule) (R538 080 x 90%) x (5% + 1% - 4%) x 3/12		2 421	(2)
2. Fringe benefit: Waiver of debt (par 2(h), 7th schedule) R538 080 – (R538 080 x 10%) payment on 01/03/2013 *Note: s19 is not applicable, see s19(8)(c)*		484 272	(1)
1.1 Accumulated leave payment from HurryCurry CC Not a severance benefit, because Vinesh's employer is a company (CC) and Vinesh holds more than 5% (namely 10%) of the CC's members interest		120 000	(1)
1.2 Salary (SamoosaKing Ltd) (R600 000/12 months x 9 months)		450 000	(½)
1.2 Employer's contributions to the pension fund No fringe benefit		-	(½)
1.2 Birthday bonus in December 2013		40 000	(½)

1.2 Fringe benefit: medical expense (par 12B, 7th schedule). Vinesh's physiotherapy: Consultation: R800 x 60% = R 480 Prescriptive medicine: R2 000 x 80% = R1 600		2 080	(1)
2. Restraint of trade payment on the curry meat recipe (s1, gross income, par (cA))		50 000	(1)
5. Lump sum withdrawal benefit: R990 000			(½)
Less: par 6 deductions: s11(n) deductions not yet allowed (par 6(1)(b)(i)) (R28 131)			(1)
RAF to PF does not qualify for (par 6(1)(a)(ii)(ee)) -			(½)
Net amount (s1, gross income, par(e)) taxed separately	961 869		
2. Fringe benefit: Right of use of vehicle (R171 000x 0.85x 3.5% pmx 9 months		45 785	(2)
3. Royalties received on copyright Does not have to share with spouse (s7(2C)(c)(ii))		120 000	(1)
3. Excessive salary paid to Rachel (s7(2)) Purpose was to avoid tax: (R15 000 – R5 000) x 4		40 000	(1)
4.1 Maintenance payment (s7(11)) I.t.o maintenance order paid from "minimum individual reserve"		20 000	(1)

5. Withdrawal from PF for benefit of Shanaazito divorce order. Deemed to be lump sum withdrawal benefit in Shanaaz's hands. No effect on Vinesh *Dividend in specie received (s1, gross income, par(k)): Asset (residence) for share (member's interest) (s24BA), only a deemed dividend in specie for dividend tax purposes (s64E(4)(a))*	-	-	(1)
8. Interest earned on fixed deposits (R20 000 + R30 000)/2 (married in community of property)		25 000	(1)
Gross income	**961 869**	**1 514 459**	
Less: Exemptions			
8. Only local interest qualifies for the exemption [s 10(1)(k)(i)]		(10 000)	(1)
Income	**961 869**	**1 504 459**	
Less: Deductions & allowances			
3. Cookbook trade: salary to Shanaaz for marketing services (s11(a)) (R15 000 x R4 000) + (R5 000 x 8 months)		(100 000)	(1)
7. Restraint of trade payment partially repaid (s11(nB)) R50 000 x 80% = R40 000		(40 000)	(1)
	961 869	**1 364 459**	
1.2 Pension Fund contributions No s11(k) deduction, because all contributions were paid by the employer, and not the employee		-	(1)

5. RAF contributions (s22(n))

Deductions not allowed up until 29/02/2012: R150 000 (½)

2013: R1 000 x 12 monthsR12 000 (½)

(s11(n) may not create or increase a loss position)

2014: R1 100 pm x 3 month R3 300 (½)

Total contributions: R165 300

Deductions is <u>the greater of</u>:

15% x (R1 364 459 – R450 000)= R137 169;or (1½)

R3 500 – Rnul = R3 500; or (½)

R1 750 **(137 169)** (½)

The difference of R28 131 (R165 300 – R137 169), is set off against the lump sum withdrawal benefit (refer above).

Taxable capital gains (s26A) 6 660

Refer separate CGT calculation

Plus: Other inclusions in taxable income

2. Travel allowance (CurryHurry CC) (s8)

Allowance received (R4.00 x 6 900 km)= R27 600 (½)

Option 1: Fixed tariff per km = R3.24 p/km (given)

Total km for business = 6 900 and is ≤ 8 000km Remunerated based on actual distance travelled for business.

Deduction = 6 900 km x R3.24 p/km (1)

= R22 256

Option 2: Actual cost per km (1½)

The cost inclusive of VAT is limited to: (½)

R480 000 (½)

W&T: Maximum R480 000/7yr x 3/12= R17 143

Interest: Max R480 000 x 4% x3/12 = R4 800

Actual fuel cost = R8 600 (1)

Actual maintenance cost = R1 443

R31 986 (1½)(½)

Total cost ÷ Total km = R31 986 ÷ 9 600 km (½)

= R3.33 p/km

Option 3: Deemed cost per km

Fixed cost per km (R118 078/9 600 x 92/365) (1)

= R3.100

Fuel cost per km = R1.477

Maintenance cost per km =R0.705

Total cost per km = R5.282

Deduction = 6900 km x R5.28 p/km

= R36 432 (most beneficial is option 3)

Sub-total	**961 869**	**1 233 950**

6. Less: Medical expenditure (s18)

Medical fund contributions (employer + employee) (2)

((R1 400 + R800) x 4) + (R1 400 x 8) =20 000

Plus: Vinesh's physiotherapy (see s18(5)(b)): (½)

Consultation: taxed as par 12B fringe benefit = R480 (½)

Prescribed Meds: Taxed as par 12B fringe benefit = R1 600

R 22 080 (2)

Less: 4 x (R484 x 4) + (242 x 8)

(R15 484)

= R 6 592

Plus: qualifying medical expenditure (½)

Vitamins – not prescribed medicine

Shanaaz'scronic medicine (R700 x 4 x 50%) (1)

R1 400 (½)

Vinesh's pain killers: (R2 000 x 20%) R 400

R8 392

Less: 7.5% x R1 233 950(R92 546) (1)

Rnil

Taxable Income	961 869	1 233 950

Tax on lump sums

5. Transfer from RAF to PF

Withdrawal benefit:

(((R961 869 + R80 000) – R900 000) x 36%) + R184 950	236 023	(1½)
Less: Hypothetical tax		(1)
(R80 000 – R22 500) x 18%	(10 350)	
Tax on withdrawal benefit	**225 673**	

Tax on normal income and non-severance benefits		
((R1 233 950 – R638 600) x 40%) + R185 205	423 345	(1)
Less: primary rebate	(12 080)	(½)
	411 265	
Plus: Tax on lump sum withdrawal benefit	225 673	
Less: s6A rebate for medical scheme fee contributions ((R484 x 4) + (R242 x 8))	(3 872)	(1)
Total normal income tax liability	**633 066**	

Capital gains tax calculation (Eight Schedule)

Disposal over primary residence (post-valuation date asset):		
Both Vinesh and Shanaaz are connected persons i.r.t the CC, because they are both members of the CC. (s1, connected persons, par(d)(vi)(aa)).		
Proceeds (market value)(par 38)	3 000 000	(½)
Less: Base cost		
Cost	(900 000)	(½)
Capital gain	2 100 000	
Married in community of property	X50%	(½)
Vinesh's capital gain	1 050 000	
Less: Primary residence exclusion par 45(2) (R2 million/2)	(1000 000)	(½)
Sum of capital gains	50 000	
Less: Annual exclusion	30 000	(½)
Aggregate capital gain	20 000	
Capital loss carried forward from 2013	-	
Net capital gain	20 000	
Inclusion rate	33.3%	(½)
Taxable capital gain	**6 660**	

Available (53½)
Format: correct order of deductions (1)
Presentation: lump sum included and excluded – taxed separately (1)
Maximum 55

Question 4 — 35 marks

Part A — 5 marks

- Section 104 of the Tax Administration Act provides that a taxpayer who is aggrieved by an assessment may object to the assessment. (1)
- He may object to the assessment within 30 days after one of the following two dates: (1)
  - The date of the assessment; or (1)
  - If the taxpayer requested reasons for the assessment, the date of the reasons or notice that adequate reasons have already been provided. (1)
- The taxpayer's objection must comply with the following requirements:
  - It must lodged on the following prescribed forms:
    1. NOO – for personal income tax (administrative penalties and assessed tax), PAYE (penaltiesonly) and corporate income taxpayers (assessed tax); and (1)
    2. ADR1 – for trusts, STC, VAT, PAYE assessments. (1)

Available 6
Max 5

Part B

Part a: Taxable gain/assessed loss for 2014 year of assessment

	R	R	
Donation of SA property is a disposal (par 11):			
Proceeds: MV on date of donation		5 450 000	(1)
Base cost: MV on 01/10/2001	3 200 000		(1)
Donations tax: 1 070 000			
CG/MV of asset x DT (par 22 of the 8th schedule) (R5 450 000 – R3 200 000/5 450 000 x R10 070 000)	(441 743)		
Total base cost (R3 200 000 + R441 743)		(3 641 743)	(1)
Capital gain		1 808 257	
Disposal deemed to be disposal at MV on the date of death in terms of par 40			
Property in France: Proceeds		6 500 000	(1)
Base Cost		(4 000 000)	(1)
Capital Gain		2 500 000	
No CGT on cash: Not an asset (excluded, Def par1)		-	(1)
Sum of capital gains and losses		4 308 257	
Less: Annual exclusion during year of death (Note: not R30 000, but increased to R300 000)		(300 000)	(1)
Aggregate capital gain		4 008 257	
Less: Assessed capital loss brought forward from 2013		-	
Net capital gain		4 008 257	
Multiply with: CGT inclusion rate		33.3%	
Taxable capital gain		1 334 750	

Available 8
Max 8

Part b: Estate Duty

Property: France (lose mark if SA property included)		6 000 000	(1)
Remaining cash		2 000 000	(1)
Gross value of the estate		8 000 000	
No info available on the deductions			
Less: Abatement			
Own:	R3 500 000		(½)
Jade's (pre-deceased spouse dies after 1 January 2001); or	R3 000 000	(6 500 000)	(½)
(3.5 million x 2) – 500 000 = R6 500 000			
Dutiable amount		1 500 000	
Estate duty rate		X 20%	(1)
Estate duty liability		**300 000**	

Available 4
Max 4

Part c: SA taxes

Donations tax		
Market value of property on date of donation	5 450 000	(1)
Less: Donations tax basic exemption (s 56(2)(b))	(100 000)	(1)
	5,350,000	
Donations tax rate	X 20%	(1)
	1 070 000	
Transfer duty		
Market value of property on date of donation	5 450 000	(1)
Tax per transfer duty payable	353 000	(1)

Available 4
Max 4

Part (d): Taxable Income

	Ben	Tom	Trust	
Rentals from SA property				
January rentals	5 250	-	21 000	(1½)
Income vesting in the beneficiaries is taxed in their hands under 25B(1); income that has not vested is taxed in the trust. Although Ben is a minor and the rental results from a donation, s7(3) does not apply as the donor was his grandfather. Ben is taxed on the rentals.		Rental of R8 250 are taxed in Bill's hands (s7(8))		(1) (1)
As a non-resident, Tom is taxed on SA-source income. The rental from SA property is from a SA source.				(1)
February rentals	5 700	9 500	22 800	(1½)
Reasons: as above (Ben is no longer a minor).*From 1 Feb 2014 no s7 provision will apply as donor is dead.*				
Rentals from French property (Jan & Feb 2014)	12 300	-	49 200	(1½)
Ben is taxed on income from non-SA source under the dross income definition (R6 000 + R6 300)				(1)
As a non-resident, Tom is taxed only on SA-source income, which excludes the rental from foreign property				(1)

The trust is a resident and therefore non-SA rental income that has not vested in the beneficiaries must be taxed in the trust (R24 000 + R25 200)				(1)
Taxable Income	23 250	9 500	93 000	
Tax rate (per tables for Individuals)	18%	18%	40%	(2½)

Available 13
Max 13