



UNIVERSITY
OF
JOHANNESBURG

DEPARTMENT OF ACCOUNTANCY

TAXATION 3A (BEL3A01)

FINAL ASSESSMENT OPPORTUNITY: 11 JUNE 2014

TIME: 2.5 hours

MARKS: 125

ASSESSOR: Mrs. S Mostert
Mr. R Wessels

INTERNAL MODERATOR: Mrs. A Chaffey

EXTERNAL MODERATOR: Ms S Scholtz (AdvTech)

INSTRUCTIONS TO CANDIDATES

1. This paper consists of six pages (three questions).
2. You are reminded that answers may **NOT** be written in pencil. **No** tippex may be used.
3. The marks shown against the requirement(s) for every question should be regarded as an indication of the expected length and depth of your answer.
4. Round all amounts to the nearest Rand
5. Show all calculations clearly.

Question	Marks	Time allocated (minutes)
1	60	72
2	10	12
3	55	66
Total	125	150

QUESTION 1

(60 MARKS)

Rackets Ltd is a South African resident company. They manufacture rackets for tennis and squash for sports enthusiasts.

They presented the following statement of comprehensive income before tax for the year of assessment ending 31 March 2014.

	Notes	R
Trading profit	1	15 000 000
Interest income	2	250 000
Dividends received	3	486 154
Less: Expenses		
Legal costs	4	(28 000)
Operating expenditure	5	(8 000 000)
Net profit before tax		7 708 154

They are not a small business corporation for the purpose of section 12E.

The following information relates to the year of assessment ending **31 March 2014**. *All amounts have been included in the net profit unless specifically stated otherwise.*

1. The following amounts have been included in income:
 - a. A refundable deposit received on 30 March 2014 from a client to the amount of R22 000 for the future delivery of rackets.
 - b. A provision for a pending law suit against an advertiser, Cabbage Promotions, who built an electronic billboard at the head office of Rackets Ltd to the amount of R120 000. The paint started to peel from the board after 2 weeks, and had to be taken down. The court date is set for 13 June 2014.
2. Rackets Ltd earned interest income to the amount of R250 000 on a fixed deposit with a local, South African bank, AB Bank.
3. Rackets Ltd received local dividends from JSE listed shares to the amount of R400 000 and foreign dividends of R86 154 (ignore the 10% rule).
4. Rackets Ltd incurred the following legal expenses during the year:
 - R10 000 in legal fees incurred by 31 March 2014 for the attorney employed in the law suit against the Cabbage Promotions mentioned in number 1 (b).
 - Legal cost incurred on bad debts (refer to number 5.1), to the amount of R18 000.
5. Included in **operating expenditure** is the following amounts relevant to the calculation of taxable income:

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5.1 Bad debts of R107 000 comprises of the following entries:

- *Transactions with employees:*
 - Loan to an employee R5 000.
 - Trading stock (rackets) sold to an employee R10 000.
- *Other Bad debts (not to employees)*
 - Trading stock (rackets) sold to a sports store R80 000.
 - Purchased debtor from a competitor R12 000.

5.2 Rackets Ltd increased the provision for unrecoverable debt in the statement of comprehensive income from R50 000 in 2013 to R63 000 in 2014 as part of operating expenditure.

SARS allows for a 25% allowance to be claimed on a list of debtors. The approved list for 2013 amounted to R60 000, and R72 000 for 2014.

5.3 The total approved remuneration for 2014 amounted to R3 500 000 (included in operating expenditure). (SARS allows 20% of approved remuneration to be deducted as employer contributions to funds). Rackets Ltd made contributions during 2014 as follows, included in operating expenditure:

Pensionfund contributions	500 000
Medical Aid contributions	250 000
	750 000

5.4 Rackets Ltd's fixed asset register reflected the following entries for the 2014 year of assessment as part of operating expenditure:

- Accounting depreciation (all assets) R344 000.

Sale of fixed assets

- Accounting profit on the sale of the Production Machine, the PP2 for R91 000. It was sold on 1 August 2013 for R100 000. The machine was purchased new and brought into use in a process of manufacture on 1 July 2011 for R560 000. There were no new machines purchased to replace this machine.

Other existing and new assets reflected in the register:

- Laptop (purchased and brought into used 30 June 2012 for R12 000)
- Desktop computer (purchased and brought into use 1 April 2013 for R 6 000)
- New Delivery vehicle B purchased 1 October 2013 and brought into use 1 November 2013 for R200 000.

Interpretation Note 47 allows for the following write-off periods:

- 4 years: delivery vehicles.
- 3 years: Computers and printers.

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5.5 Rental paid of R180 000 for the period 1 July 2013 until 31 March 2014 appear as an expense in its statement of comprehensive income. The rental payments are for a piece of land leased by Rackets Ltd for trade purposes.

- **The following are the terms of the lease agreement:**
 - Rackets Ltd had to pay a lease premium of R360 000 on the date that the lease commences.
 - The lease commenced on 1 July 2013 for 20 years.
 - In terms of the lease agreement Rackets Ltd have to construct a factory on the property to the value of R5 000 000.
 - The building was completed on 31 December 2013 and brought into use on 1 February 2014.
 - The value of the property amounts to R4 800 000 upon completion.
- **The following accounting entries were made as part of operating expenditure, over and above the rental payment of R180 000:**
 - Lease premiums write-off in full upon payment in the statement of comprehensive income.
 - R48 000 write-off of leasehold improvement.

5.6 The following advance payments were made in the 2013 and 2014 year of assessment:

- **Advance payments relating to the 2014 year of assessment.**
 - Over and above the rental payments made for its 2014 financial year of R180 000 (refer to note 5.4), Rackets Ltd paid rentals 'in advance', on 31 March 2014, the rental for the months of April, May and June 2014 of R60 000 (in total).
- **Advance payments relating to the 2013 year of assessment.**
 - This was the only payment in advance made during the 2013 year of assessment. Rackets Ltd paid its annual security fee on 1 March 2012 (for the period 1 March 2013 until 28 February 2014). The payment was for R60 000.

5.7 A restraint of trade payment of R700 000 is reflected as part of operating expenses in its statement of comprehensive income. The full R700 000 was paid to a sales agent who resigned. She left the employment of Rackets Ltd on 31 August 2013. The restraint of trade agreement is effective for 4.5 years, commencing on 1 June 2013.

6. Rackets Ltd has an assessed loss of R200 000 carried forward from 2013.

7. **The following accounting entry were NOT made by Rackets Ltd:**

- Rackets Ltd made a donation to the Nelson Mandela Children's Fund, an approved benefit organisation, to the amount of R250 000. A section 18A certificate was received.

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8. They have a R10 000 capital loss carried forward for the purpose of capital gains tax from the 2012 year of assessment, not utilised in the 2013 year of assessment.
9. No other capital disposals were incurred, other than the transactions mentioned during the 2014 year of assessment.
10. Rackets Ltd paid a dividend to their shareholders to the amount of R1 000 000 on 1 March 2014.
 - The shareholders comprise the following:
 - JJ Marketing CC: 20% (resident)
 - ACE Manufacturers (Pty) Ltd: 40% (resident)
 - Helping Hand Trust: 5% (A local public benefit organisation(PBO))
 - Mr. J Mandosa: 35% (resident)

YOU ARE REQUIRED TO:	MARKS
<p>A. Calculate the taxable income of Rackets Ltd for its 2014 year of assessment in terms of the Income Tax Act (commence your calculation with net profit before tax, as per the statement of comprehensive income).</p> <p>a. If an amount is not reflected in the income tax calculation, <u>provide a reason for your answer.</u></p> <p>b. Ignore VAT for the purposes of this question.</p>	(55)
<p>B. Calculate the amount of dividends tax that must be withheld by Rackets Ltd for the dividend declaration made on 1 March 2014. Also provide the amount of net dividends that will be paid to all the shareholders.</p>	(5)

QUESTION 2

(10 MARKS)

Happy Baker CC is a resident South African store owned by the Goldman family. Their trading stock comprises of various types of local and imported products for baking novelty cakes. Net profit for the financial year ending 31 March 2014 **before taking any of the following amounts into account was R2 000 000.**

1. Stock purchased during the 2014 financial year amounted to:
 - Local purchases R80 000; and
 - \$12 000, stock imported from the United States (Spot rate on date of purchase, R10.80/\$).
2. Closing stock in storage on 31 March 2014: R70 000
 - Transport cost of R2 000 was incurred and was not included as part of trading stock.
3. Closing stock in storage on 31 March 2013:
 - Purchase price paid by Happy Baker: R22 000
 - Damaged stock, included in the R22 000 closing stock, re-valued to R2 500 with reasons submitted and accepted by the Commissioner (initial cost price R2 800)

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4. Stock in transit not sold, and not included in closing stock on 31 March 2014: R1 000.
5. Stock used by the Goldman family to bake a cakes for a number of family members during the year: Cost price R5 000 (market value R6 200).
6. Baking products taken from trading stock to bake samples to be displayed in the store: Cost price R2 000 (market value R2 200).
7. Trading stock donated to a registered PBO, the necessary section 18A certificate obtained: Cost price and s22(2) opening stock value was R700 (market value R900).

YOU ARE REQUIRED TO:	MARKS
Calculate the taxable income according to the Income Tax Act for the 2014 year of assessment ending 31 March 2014 for Happy Baker CC. Ignore VAT for purposes of this question.	(10)

QUESTION 3

(55 MARKS)

Trono (Pty) Ltd (Trono) is a South African resident manufacturing company. Trono has a March year end and is a registered VAT vendor. Trono has a policy to defer tax wherever possible and have made all the necessary elections. Trono have the following unresolved transactions:

Trono sold a building on 31 December 2013. The building was used to house their manufacturing activities. Trono started construction of the building on 20 June 1999 and brought the building into use on 1 June 2000. The construction cost amounted to R2 850 000. The building was sold for R4 560 000 and Trono incurred selling expenses of R228 000.

Trono sold a machine on 30 September 2013. The machine was used for purposes of a trade. The machine was acquired on 1 October 2007 for R1 140 000. Trono sold the machine for R 1 482 000 and incurred selling expenses of R 114 000.

The proceeds from the sale were used to buy two new replacement machines:

- Machine H purchased and brought into use on 1 February 2014 for R1 710 000. The machine is used for the purposes of a trade. The commissioner agreed to an eight year write off period for all machines used for purposes of a trade.
- Machine T purchased and brought into use on 13 November 2013. The machine cost R2 565 000. The machine is used in a process of manufacture.

YOU ARE REQUIRED TO:	MARKS
Calculate the income tax effect that the abovementioned would have on Trono's taxable income for the 2014 year of assessment. ALL AMOUNTS INCLUDE VAT, UNLESS STATED OTHERWISE.	(55)