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UNIVERSITY OF JOHANNESBURG

South African Taxation 4

SUPPLEMENTARY ASSESSMENT OPPORTUNITY

November 2014

TIME: 150 Minutes

MARKS: 100

EXAMINER: Mr. L Maseko
Ms. P Sibiya

INTERNAL MODERATOR: Mrs. M Van Heerden

EXTERNAL MODERATOR: Mrs. A Chaffey

INSTRUCTIONS TO CANDIDATES

1. This paper consists of 9 pages
2. Answer all the questions.
3. Thirty minutes of reading time is given for the paper. The duration of the assessment is 2 hours 30 minutes.
4. During the 30 minutes reading time you may:
 - highlight the information presented in this document; and
 - make such annotations on this document as you consider appropriate; and
 - at the close of the 30 minute period you will be given the stationery packs.
5. You are reminded that answers may **NOT** be written in pencil. **No** tippex may be used.
6. 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.
7. Answer the questions by the use of:
 - effective structure and presentation;
 - clear explanations;
 - logical arguments; and
 - clear and concise language.
8. Show all calculations clearly
9. Any open spaces that are not crossed out will prohibit a student from applying for a remark.

QUESTION 1**25 MARKS**

Dr. Carlisle Cullen, a 57 year old South African resident founded the Cullen Family Trust in 2005 for the purpose of providing for the various members of his family situated around the world.

Upon creation of this trust Dr. Carlisle Cullen donated a 20% investment in Quileute PLC (a company listed on the London Stock Exchange) to the trust. On the same day he also donated a holiday home situated in Knysna to the trust. Dr. Carlisle Cullen donated an interest-bearing American investment (which he purchased in 2005 for R2 500 000) to the trust on 1 March 2013. The investment was valued at R2 500 000 on that date.

Dr. Carlisle Cullen is married to Esme Cullen, a 50 year old South African resident, out of community of property. Esme Cullen donated an 18m long speed boat to the trust, which is used in conjunction with the holiday home. Guests of the holiday home are granted full enjoyment of the boat free of charge during their stay at the guest house.

The beneficiaries of the trust are:

- Edward Cullen, their 17-year old son and Bella Cullen, Edward Cullen's 18-year-old wife. They are married in community of property.
- Renesmee Cullen, Edward and Bella Cullen's 2-month-old daughter.
- Jasper Whitlock, Dr. Carlisle and Esme Cullen's legally adopted son who is 16 years old.

The beneficiaries each have a vested right to 15% of the income and capital of the trust. The trust deed further stipulates that Edward Cullen, Bella Cullen and Renesmee Cullen are also to receive semi-annual annuity payments. The trustees have the discretion to make further distributions to any of the beneficiaries whenever they see fit.

The trust income for the 2014 year of assessment is as follows:

	Rental Income (holiday home)	Interest Income	Dividend Income	Total
Total trust income	R130 000	R227 500	R292 500	R650 000
Distributions to beneficiaries:				
Annuity: Edward 31 August 2013	(R7 800)	(R13 700)	(R17 500)	(R39 000)
Annuity: Bella 31 August 2013	(R7 800)	(R13 700)	(R17 500)	(R39 000)
Annuity: Renesmee 31 August 2013	(R7 800)	(R13 700)	(R17 500)	(R39 000)
Lump sum: Edward 31 August 2013	(R15 600)	(R27 400)	(R35 000)	(R78 000)

Lump sum: Jasper 31 August 2013	(R10 400)	(R18 200)	(R23 400)	(R52 000)
	R80 600	R140 800	R181 600	R403 000
Repairs to holiday home	(R9 200)			(R9 200)
Retained income at 31 December 2013	R71 400	R140 800	R181 600	R393 800

Distributions to beneficiaries:				
Annuity: Edward 28 February 2014	(R11 700)	(R20 475)	(R26 325)	(R58 500)
Annuity: Bella 28 February 2014	(R11 700)	(R20 475)	(R26 325)	(R58 500)
Annuity: Renesmee 28 February 2014	(R11 700)	(R20 475)	(R26 325)	(R58 500)
Lump sum: Jasper 28 February 2014	(R13 000)	(R22 750)	(R29 250)	(R65 000)
Retained income at 28 February 2014	R23 300	R56 625	R73 375	R153 300

Dr. Carlisle Cullen passed away on 31 December 2013 in a tragic New Years Eve accident. In addition to the abovementioned, the following information relates to the period 1 March 2013 to 28 February 2014:

Salary received (1 March 2013 – 31 December 2013)	R750 000
Funeral and deathbed expenses (after 31 December 2013)	R120 000

The following assets were in Dr. Carlisle Cullen's possession on the date of his death:

	Note	Purchase Date	Purchase Price/ Valuation Date Value	Market Value on 31 December 2013	Selling price (provided by executor)
Mercedes S55 AMG	1	1 June 2012	See note 1	R415 000	N/A
Volvo S60	2	1 September 2012	R320 000	R150 000	N/A
House in Houghton	3	1 November 2005	R6 500 000	R12 250 000	N/A

Notes:

1. He leased the Mercedes S55 AMG in terms of a finance lease. The cash cost of the vehicle was R525 000 on 1 June 2013, the date on which the four year lease commenced. The monthly lease payments amounted to R13 672. The agreement stipulated that the legal title would pass to Dr. Carlisle Cullen at the end of the lease period.
2. He granted the usufruct of a silver Volvo S60 to his son, Edward Cullen. Dr. Carlisle Cullen stated in his will that the Volvo was to pass to Edward Cullen upon his death. The value of the usufruct, correctly calculated, was R65 200.

His primary residence was situated in Houghton. Dr. Carlisle Cullen lived in the house continuously since the date of purchase. He bequeathed it to Edward Cullen in his will.

Additional Information:

- Only make use of the abovementioned information in your calculation.
- You should **ignore Value-Added Taxation** in your answer.

YOU ARE REQUIRED TO:

Calculate all the taxes payable by Dr. Carlisle Cullen for the 2014 year of assessment and give reasons for inclusion or non-inclusion of relevant amounts. Deal with every amount and, where an amount has no tax effect, state the reason for this. (25)

QUESTION 2

65 MARKS

PART A

(37)

Mr. Herbert Butcher (hereafter 'Herbert'), aged 43, is a dental technician. On 1 March 2013 he retired from his previous employment at Pearly Whites Pty (Ltd). He received a bonus of R10 000 and a long service award to the value of R2 000. He had worked for Pearly Whites (Pty) Ltd (a VAT vendor) since 2001.

On 1 April 2013 he found new employment at Dentures Deluxe (Pty) Ltd (a VAT vendor), where he earned a salary of R28 000 per month. In December 2013 he also received a bonus of R7 000. He contributes 6% of his monthly salary to the company pension fund. In addition, he has contributed R6 000 per month to a retirement annuity fund (RAF) since he started his employment at Deluxe Dentures (Pty) Ltd.

Herbert also contributed R4 200 to Disillusion Health for the period 1 March 2013 to 30 June 2013. He was on the Coastal Crusher plan. This provided the absolute minimum of benefits for Herbert, his wife and their six children. Herbert had to pay doctors' bills amounting to R48 600 for his wife's breast cancer tablets. These bills were not recovered by the medical aid. By the end of June, Herbert was angry with the medical aid and decided to leave Disillusion Health.

From 1 July 2013, Herbert joined the Nitrous Oxide Medical Aid. He only paid for himself, his wife and the first child. The rest were 'free' (but still covered as dependents on the medical aid). His monthly payment from 1 July 2013 was R2 500 per month.

Herbert also received the following benefits (since 1 April 2013) from Dentures Deluxe (Pty) Ltd:

He received a car allowance of R7 000 per month for his Jeep Chokie (2009 model). He had paid R215 000 (excluding VAT) for the car on 1 April 2013. He had obtained vehicle finance at a fixed rate of 12% per annum. Herbert kept an accurate log book. He had travelled 43 000km for the year ended February 2014. Of the kilometres travelled, he had travelled 19 000km for private use. The balance was for business travel. Herbert's Jeep's engine had seized during the year, and although the vehicle was on a maintenance plan he had to pay in R16 000 for what the Jeep Company claimed was negligence on Herbert's part and therefore not covered by the plan. Herbert also paid R28 000 for petrol.

Herbert lived in a house provided by the company. It was a reasonably nice three bedroom house in Kenilworth and was fully furnished. It had no dining room, but a large kitchen and a separate lounge. Herbert was responsible for paying the utility bills (water and electricity). The company paid rent on the house of R7 500 per month and R2 000 per month for the furniture. The remuneration proxy is considered by the Commissioner to be R420 000. Herbert exerts no

ownership or control over the Dentures Deluxe (Pty) Ltd. The nature of the business does not require the company to provide employees with accommodation.

Herbert was also allowed to use the company boat on the Breede River. The boat was bought by the company on the 30 June 2012 for R760 000 (excl. VAT). Herbert used the boat for seven days over the September 2013 school holidays. He paid R300 for petrol per day and R100 per day to use the boat. The location of the boat is not considered a 'place of recreation' for employees, nor is the boat available to all employees.

After three weeks at Dentures Deluxe (Pty) Ltd, Herbert rescued the Managing Director from a vicious dog. The company decided to give Herbert a bravery award. The bravery award was a new set of dentures (false teeth) taken from trading stock. They had cost the company R5 400 (excl. VAT) and had a market value of R6 300 on the date they were given to Herbert.

Herbert owned a property in Betty's Bay. He had initially taken out a bond on the property of R1 000 000 at the prime interest rate. The company had an arrangement with the bank and amended the terms on 1 April such that Herbert would only have to pay prime less 5% and the company would pay 5% interest to the bank. No portion of the outstanding capital has ever been repaid.

Prime rate was:

- 9% from 1 March 2013 to 31 August 2013.
- 6% from 1 September 2013 to end of February 2014.

The official rate of interest was 7% for the entire year.

YOU ARE REQUIRED TO:

Calculate Herbert Butcher's normal tax liability for the year ended 28 February 2014.

PART B

(20)

Sally Herb is a resident of the Republic. She is a sole trader, trading as 'The Jasmine Tree' an interior-decorating shop and coffee bar. She operates this business from a renovated Victorian house in Hillcrest, KwaZulu-Natal. Customers are invited to browse around the shop, choose their purchases and then enjoy a cup of tea or coffee accompanied by a light meal in the coffee bar.

Sally Herb is a registered VAT vendor. After a recent discussion with a customer (who claimed to be up-to-date with tax issues), she has queried the normal tax, including capital gains tax and the value-added-tax (VAT) implications of the following 4 transactions:

- Each Thursday morning is ‘housewives morning’ at ‘Jasmine Tree’. Sally Herb supplies free of charge a cup of tea and a scone to her lady customers. She does this to encourage the ladies in the Hillcrest area and elsewhere to visit her shop and purchase decorating items. She has determined that a cup of tea costs ‘The Jasmine Tree’ R1,71 (R1,50 plus VAT of R0,21) while the cost of a scone is R3,42 (R3 plus VAT of R0,42). A cup of tea is priced at R5,99 (R5,25 plus VAT of R0,74) and a scone at R8,55 (R7,50 plus VAT of R1,05) on the coffee-bar menu.
- At the request of the local junior school in Hillcrest (Sally Herb was a former pupil of it) she donated two needlepoint cushions from ‘The Jasmine Tree’ to the junior school. The school provided Sally Herb with section 18A certificate for this donation. A needlepoint cushion normally sell in the shop for R513 (R450 plus VAT of R63) representing a 150% mark-up on its cost.
- Sally Herb recently attended the wedding of a friend. As a wedding gift for this friend, she took a porcelain ginger jar (a decorative jar) from ‘The Jasmine Tree’. This ginger jar was for sale at R684 (R600 plus VAT of R84), representing a 150% mark-up on its cost.
- Because of the nature of her trading, Sally Herb does a physical stock take every three months. At her most recent stock take, she established that four silver picture frames were missing from ‘The Jasmine Tree’ (due to theft). A silver picture frame sells for R136,80 (R120 plus VAT of R16,80), representing a 100% mark-up on its cost.

YOU ARE REQUIRED TO:

Discuss the normal tax (including capital gains tax) and VAT implications that arise as a result of the 4 transactions as detailed above.

PART C

(8)

Armstrong (Pty) Ltd (a resident company) had equity share capital of R1 million (represented by 1 000 000 shares) and share premium of R500 000 at 31 December 2010. On 28 February 2014, the company issued 10 000 shares for a total value of R500 000.

The company has a year end of 31 March. There is only one class of share in this company.

YOU ARE REQUIRED TO:

1. Discuss based on the above information, the definition of contributed tax capital and state what would constitute the contributed tax capital of the company for the year ended 31 March 2014. Support your answer with a detailed discussion. **(4)**

2. Two months after the share issue above, the directors declared a distribution of R2 million to the shareholders, providing that the amount of R250 000 within the distribution is a return of contributed tax capital. Identify the dividend. Support your answer with a detailed discussion of what constitutes a dividend after 1 April 2012 in terms of case laws and the Income Tax Act. **(4)**

Source: Questions on SA Tax 2014 & Graded Questions 2014

QUESTION 3

10 MARKS

Betty advised Zama to purchase shares in a new company that will list on the venture capital market. Betty knows Zama respects her opinion and is an opportunist at heart. Betty knows the managing director of the new company very well and after many discussions, both she and Zama are very interested in this opportunity. They are sure that they will be able to make good money by subscribing to the shares and then selling the shares a number of months after listing.

Zama has decided to follow Betty's advice and subscribed to the equity shares in the new listed company.

A number of months after the listing, the share price fell below the opening subscription price of the shares and Zama sold his shares at a loss.

YOU ARE REQUIRED TO:

Advise Zama on what the tax implications will be if he sells his shares at a loss, after 1 year of ownership. Where applicable, substantiate your answer with the relevant case law and reference to legislation. **(10)**