UNIVERSITY EXAMINATIONS

UNIVERSITEITSEKSAMENS

UNISA university of south africa

TAX2601

May/June 2013

PRINCIPLES OF TAXATION

Duration 2 Hours 100 Marks

EXAMINERS
FIRST MS R MATENCHE PROF AP SWANEPOEL
MRS MSI WENTZEL
SECOND MRS KL DE HART

Use of a non-programmable pocket calculator is permissible

Closed book examination

This examination question paper remains the property of the University of South Africa and may not be removed from the examination venue

This paper consists of six (6) pages plus the annexures (pp i – iii).

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 five (5) questions
2 Answer all the questions
3 Start each question on a new (separate) page
4 **Show all workings, where applicable. 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	Gross income and general deduction	25	30
2	Provisional tax and tax administration	15	18
3	Taxable income of a small business corporation	25	30
4	Tax liability of a company	20	24
5	Capital gains tax	15	18
	TOTAL	**100**	**120**

QUESTION 1 (25 marks, 30 minutes)

QUESTION 1(a) (10 marks, 12 minutes)

Dinepe Fela (Pty) Ltd (Dinepe) is a South African company that sells contemporary art Dinepe's financial year ends on 31 March On 28 March 2013 they sold an artwork worth R10 000 to an advertising company The advertising company bought the artwork to hang in their reception area Instead of paying cash for the artwork, the advertising company offered Dinepe an advertising campaign also worth R10 000 On 30 March 2013, Dinepe accepted the advertising campaign instead of cash The campaign would consist of 10 monthly advertisements in a local newspaper, commencing during April 2013

REQUIRED:	MARKS
Discuss whether the receipt of the advertising campaign would constitute **gross income** of Dinepe Fela (Pty) Ltd as defined in the Income Tax Act 58 of 1962 for the year ending 31 March 2013	10

QUESTION 1(b) (15 marks, 18 minutes)

Dikoloto Fela (Pty) Ltd (Dikoloto) is a residential property developer with a March year-end Dikoloto's main business is selling residential property in the form of freestanding full-title homes, sectional title townhouses and full-title stands

On 13 October 2012, hurricane Sally struck one of the towns in which Dikoloto operates and destroyed four unsold townhouses with an original cost of R4 500 000 in total The insurance company paid Dikoloto R3 900 000 in respect of this loss

REQUIRED.	MARKS
Discuss whether the expenditure and/or losses above are deductible by Dikoloto Fela (Pty) Ltd in terms of the general deduction formula (s11(*a*) read with s23) for the year of assessment ending 31 March 2013 Where applicable, **briefly** make reference to the applicable case law	15

QUESTION 2 (15 marks, 18 minutes)

QUESTION 2(a) (10 marks, 12 minutes)

Sunshine (Pty) Ltd is **not** a small business corporation as defined Its year of assessment ends on 31 March each year Its records show the following

Tax year	Taxable income	Date of assessment
2011	R1 200 000	4 April 2012
2012	R1 354 980	15 September 2012
2013	R1 784 432	(estimated - not yet assessed)

REQUIRED:	MARKS
a) Calculate the first and second provisional tax payments for the 2013 year of assessment Clearly state on which date the payment must be made	9
b) For the **first** provisional tax payment for the 2013 year of assessment, what will the basic amount be if the 2012 assessment was issued on 15 June 2012?	1
Ignore the Tax Administration Act that came into effect on 1 October 2012	

QUESTION 2(b) (5 marks, 6 minutes)

Majuba (Pty) Ltd was issued its 2012 ITA34 tax assessment on 31 January 2013 The accountant of Majuba (Pty) Ltd has reviewed the issued assessment and disagrees with the disallowance of a capital allowance claimed of R15 500 The ITA34 reflects an amount of R6 875 due to SARS, payable on/before 31 March 2013 The accountant submitted an objection against the issued tax assessment on 4 February 2013 and SARS declined the objection on 15 March 2013

REQUIRED:	**MARKS**
Discuss what procedures, if any, Majuba (Pty) Ltd can follow to rectify the incorrect 2012 tax assessment Ignore the Tax Administration Act that came into effect on 1 October 2012	**5**

QUESTION 3 (25 marks, 30 minutes)

Lazy Age CC is a small business corporation as defined and carries on business as a cosmetics product manufacturer The close corporation operates mainly in Johannesburg and sells most of its cosmetics products on credit to retailers in South Africa It has only one member, Jenny Levin

The following information is provided to you for the close corporation's year of assessment ended 28 February 2013

		R
1	Sales – cash	450 000
	Sales – credit	5 025 000
2	Purchases – cash and credit	3 587 150
3	Inventory at cost – 1 March 2012	290 000
4	Inventory at cost – 28 February 2013	330 000
5	Bad debts written off	119 000
6	Doubtful debts allowance, allowed by SARS for the 2012 year of assessment	12 500
7	List of doubtful debts at 28 February 2013	93 800
8	Personnel costs	
	- Salaries and wages (as approved by the Commissioner)	650 000
	- Contributions to pension fund on behalf of employees	125 850
9	On 30 April 2012, Lazy Age CC received a letter from Quick Attorneys regarding alleged facial damages caused by one of its night creams to the upper cheek of Amy Kumalo, a super model for Paris on the Vaal She is claiming R1 500 000 for a loss of income from Lazy Age CC The case went to court and the court ordered Lazy Age CC to pay Amy R1 000 000 for her loss of income on 31 March 2013	
10	Legal expenses incurred	
	- Legal cost relating to the Amy Kumalo case (refer note 9)	6 000
	- Legal cost paid on behalf of Jenny Levin	1 275
11	Advertising cost	
	- Cost of advertising a vacant post in the *Daily Informer*	3 750
	- Cost of erecting a billboard close to the local airport	25 850
12	Lazy Age CC owns the following capital assets - A new cosmetics manufacturing machine D was purchased on 31 January 2013 at a total cost of R300 000 and was brought into use on the same date - A second-hand delivery vehicle was purchased on 31 July 2011 at a total cost of R85 000 to deliver the cosmetics products of Lazy Age CC to its clients The delivery vehicle was only brought into use on 1 September 2011	

QUESTION 3 (continued)

		R
	- A manufacturing building was erected on 30 June 2009 and brought into use on 31 August 2009 at a total cost of R1 250 000 The building houses the whole cosmetics manufacturing process of Lazy Age CC	
13	Lazy Age CC sold technologically outdated manufacturing machinery Z for R20 000 It was originally bought second-hand on 30 April 2009 for R100 000 and brought into use on the same day	
14	The following costs were incurred relating to trademarks	
	- Renewal fee paid in 15 April 2012	8 500
	- New trademark purchased on 31 January 2013	55 000
15	Lazy Age CC entered into an agreement with Tommy Strong, the former chemical researcher, on 31 October 2012 (the date on which he resigned) and paid him an amount of R312 000 as a restraint of trade payment for a period of four years The R312 000 was paid on 15 November 2012 and the full amount was taxable in Tommy's hands for the 2013 year of assessment	
16	Lazy Age CC donated R15 000 on 15 December 2012 to "Ladies in Blue" a public benefit organisation uplifting women in the rural areas The necessary section 18A income tax certificate was received on 17 January 2013	

REQUIRED:	MARKS
Calculate the taxable income of Lazy Age CC for the year of assessment ended 28 February 2013 Ignore any capital gains tax implications	25

QUESTION 4 (20 marks, 24 minutes)

Notes CC carries on the business of manufacturing music instruments It is **not** regarded as a small business corporation as defined in the Income Tax Act

The taxable income of the close corporation for the year of assessment ending 31 March 2013, **before** taking into account the items mentioned below, amounted to R5 800 000

Additional information

Fixed assets obtained in prior years and still in use at 31 March 2013

1 Vehicles purchased new on 1 June 2007 for R120 000

2 Building CC in an urban development zone purchased new on 1 November 2011 for R1 200 000 All the requirements to claim an urban development zone building allowance were met

Fixed assets obtained during the year

3 Two small item assets with a collective cost of R4 500 were purchased on 30 November 2012 These items qualify for the section 11(*e*) wear and tear allowance

4 Manufacturing machine MM was purchased second-hand on 1 June 2012 for R300 000 and brought into use on the same date

5 A new manufacturing machine LL was purchased on 1 February 2013 for R450 000 and brought into use on 1 March 2013

QUESTION 4 (continued)

6 Manufacturing building AA was sold on 1 January 2012 for R5 000 000 and Notes CC had a recoupment of R800 000 It purchased a new manufacturing building ZZ for R9 000 000 on 1 April 2012 and brought it into use on the same date The cost was made up as follows

Land	R1 000 000
Building	R9 000 000
Total	R10 000 000

Repair and extension to assets

7 Manufacturing building ZZ's roof was badly damaged during a storm and needed to be replaced on 1 April 2012 at a cost of R220 000 Notes CC decided to extend the roof to allow for an under-cover parking area for its employees The cost of this extension amounted to R300 000

Fixed assets sold during the year

8 On 31 March 2013 furniture, costing R30 000 and originally purchased on 1 October 2011, was sold for R10 000 The furniture was sold to a pawnshop because it was damaged and was no longer useable No transactions regarding this asset have been included in the taxable income calculation of R5 800 000 above

9 On 30 November 2012 manufacturing machine PP costing R290 000 was sold for R310 000 This machine was purchased new on 30 June 2006 No transactions regarding this asset have been included in the taxable income calculation of R5 800 000 above

Other information

10 Binding general ruling No 7 makes provision for the following write-off periods
- Vehicles – 5 years
- Undercover parking (carports) – 5 years
- Furniture – 6 years

REQUIRED·	**MARKS**
Calculate the income tax liability of Notes CC for the year of assessment ending 31 March 2013 **Note: The close corporation has elected to claim the section 11(o) allowance of the Income Tax Act, and to make use of the building recoupment set-off, where applicable. Ignore any capital gains tax implications.**	20

QUESTION 5 (15 marks, 18 minutes)

Frozen Lemons CC has a 31 March year-end The business supplies you with the following information regarding a manufacturing building

Date	Descriptions	Amount
		R
1 July 2000	Purchased	80 000
1 April 2012	Sold – to an unconnected person, at market value	890 000

Other applicable information	Valuation on 1 October 2001	88 000
	Time-apportioned base cost	90 000
	Cost of valuation (carried out on 1 July 2002)	4 500
	Capital allowances at date of sale	48 000
	Assessed capital loss brought forward from 2012	30 000

REQUIRED·	MARKS
Calculate the taxable capital gain for the 2013 year of assessment in respect of the sale of the manufacturing building	15

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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

ANNEXURE B: ADDITIONAL INFORMATION

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

- 0% on taxable income not exceeding R63 556
- 7% on taxable income exceeding R63 556, but not exceeding R350 000
- R20 051 plus 28% on taxable income exceeding R350 000

[TURN OVER]

The income tax rates applicable to micro businesses:
1 April 2012 – 31 March 2013

Turnover R	Rates of tax
0 – 150 000	Nil
150 001 – 300 000	1% of the amount over R150 000
301 000 – 500 000	R1 500 + 2% of the amount over R300 000
500 001 – 750 000	R5 500 + 4% of the amount over R500 000
750 001 – 1 000 000	R15 500 + 6% of the amount over R750 000

ANNEXURE C. INCOME TAX MONETARY THRESHOLDS SUBJECT TO PERIODIC LEGISLATIVE CHANGE (extract)

Description	Reference to Income Tax Act, 1962	Monetary amount
Employer deductions for employee housing. Expenses incurred for providing employee housing are 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

Description	Reference to Income Tax Act, 1962	Monetary amount
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
Prepaid expenses: Limit of prepaid expenses that will not be deferred until delivery of goods, services or benefits	Paragraph (bb) of the proviso to section 23H(1)	R100 000

Description	Reference to Income Tax Act, 1962	Monetary amount
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

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