# Tutorial letter 201/1/2018

## Taxation of Individuals

## TAX3702

## Semester 1

## Taxation Department

**Self-assessment assignment 3**

**Solution – assignment 3**

Bar code

Dear Student

Enclosed please find self-assessment assignment 3, as well as the solution to assignment 3/2018. Please work through the solution in conjunction with the assignment and your answers. This is a significant part of the learning process. It is important to understand why marks were allocated to specific parts of your solutions.

You should identify any problem areas early in the semester and make every effort to understand all aspects of the work that you have covered.

We hope that you have found the assignment and questions stimulating.

PLEASE NOTE: The schedules that are contained at the end of the assignment in this tutorial letter (assignment 3), are the schedules that will also be included in the exam paper that you will be writing during May 2018.

Kind regards

**<u>LECTURERS: TAX3702</u>**

| The lecturers who are available to assist you are: | |
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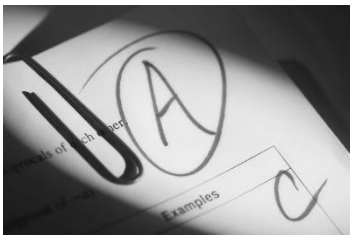
**ANNEXURE A: SELF-ASSESSMENT ASSIGNMENT 3/2018**
**ANNEXURE B: SOLUTION TO ASSIGNMENT 3/2018**

**ANNEXURE A**:

## SELF-ASSESSMENT ASSIGNMENT 3: FIRST SEMESTER




This is a self-assessment assignment.

These are the instructions that will also appear on your examination paper. Read them now and make sure that you understand what we require from you. We also suggest that you try to do this assignment like a proper examination, under examination conditions, to see how much you know and what you need to spend time on.

**This paper consists of seven (7) pages, plus schedules (pp i – viii)**

**IMPORTANT INSTRUCTIONS**

Assumptions:

1. **All amounts exclude VAT unless stated otherwise.**
2. **All persons mentioned are residents of the Republic unless stated otherwise.**

Regarding the answering of this paper:

1. This paper consists of five (5) 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 and a brief reason provided. 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 | Subject | Marks | Minutes |
|---|---|---|---|
| 1 | Net normal tax | 33 | 59 |
| 2 | Employees' tax | 20 | 36 |
| 3 | Capital gains tax | 20 | 36 |
| 4 | Estate duty and retirement benefits | 17 | 31 |
| 5 | General deduction formula | 10 | 18 |
| | **TOTAL** | **100** | **180** |

**QUESTION 1 (33 marks, 59 minutes)**

Kenneth (45 years old) is a qualified electrical engineer. On 1 March 2017, he started with a new employment position at a company located in Johannesburg. In the previous year of assessment (2017), he worked for a different employer in Cape Town. He is married out of community of property and has two children (both under 18 years of age). He supplied you with the following information relating to the 2018 year of assessment:

| | Notes | R |
|---|---|---|
| **Income/fringe benefits** | | |
| Salary | | 780 000 |
| Travel allowance | 1 | 100 000 |
| Residential accommodation | 2 | ? |
| Restraint of trade receipt | 3 | 900 000 |
| Foreign dividends (earned from a unit trust) | | 2 800 |
| Foreign interest (earned on a fixed deposit account) | | 680 |
| Taxable capital gain | 4 | 11 000 |
| **Expenses/contributions** | | |
| Medical expenses | 5 | 54 000 |
| Provident fund contributions | 6 | 52 000 |
| Retirement annuity fund contributions | 6 | 275 000 |

**Notes:**

1. Travel allowance

Kenneth received a travel allowance for the full year of assessment. His vehicle was purchased on 1 November 2015 from a VAT registered car dealer under a finance lease at a cost of R390 000 (**VAT exclusive**). His logbook indicated that he travelled 10 400 kilometres in total during the year of assessment (of which 2 300 kilometres were for private purposes).

Kenneth kept accurate records of all costs relating to his vehicle during the period in which he received the allowance. Total running costs amounted to R34 000. Finance charges for the full four-year term of the finance lease amounted to R96 800 (you can assume that interest is incurred evenly each year).

2. Residential accommodation

Kenneth had the free use of a four-roomed, furnished house from the date of his employment until 31 December 2017. His employer rented the house from an unconnected person for an amount of R9 500 per month. Kenneth had to pay electricity costs himself.

You may assume that Kenneth's remuneration amounted to R69 000 for the month of March 2017.

3. Restraint of trade receipt

An amount of R900 000 accrued to Kenneth during March 2017 from his previous employer. The amount accrued in terms of a restraint of trade agreement whereby Kenneth had agreed not to accept a new employment position within a 100 kilometre radius of his former employer's head office in Cape Town.

**QUESTION 1 (continued)**

4. Taxable capital gain

Kenneth disposed of some listed shares during the year of assessment. You may assume that the taxable capital gain on the disposal amounted to R11 000.

5. Medical expenses

Kenneth's medical expenses for the 2018 year of assessment comprise the following:

| | R |
|---|---|
| Total medical scheme contributions | 46 000 |
| Qualifying medical expenses not covered by the medical aid scheme | 8 000 |
| | 54 000 |

Kenneth's wife and two children are dependent members of his medical scheme. His one child has a disability as defined in terms of section 6B.

6. Provident fund and retirement annuity fund contributions

From 1 March 2017 until the end of the year of assessment, Kenneth's own total contributions to a provident fund amounted to R52 000. In addition to the latter, his employer also contributed a total amount of R38 000 to the provident fund on his behalf.

Kenneth also contributed an amount of R275 000 to a retirement annuity fund during the year of assessment.

You may assume that his remuneration for the 2018 year of assessment amounted to R965 000 (correctly calculated).

| **REQUIRED:** | **MARKS** |
|---|---|
| Calculate Kenneth's net normal tax for the 2018 year of assessment. | **33** |

**QUESTION 2** **(20 marks, 36 minutes)**

Azania (27 years old) is a vibrant, outgoing young lady. She has been employed as a journalist at #MyNews (Pty) Ltd since 1 September 2016.

Details of her remuneration and expenses for the year ended 28 February 2018 are as follows:

- Azania does not receive a basic salary but is employed by #MyNews (Pty) Ltd strictly on a commission basis. Her commission varies, based on the number of articles she publishes per month. She received R385 000 in commission for the year of which R89 000 was earned in February 2018. #MyNews (Pty) Ltd calculates employees' tax based on the monthly commission earned.

- In respect of her own vehicle, purchased under a finance lease on 1 September 2016 at a cost of R220 400 (**VAT inclusive**), Azania receives a travel allowance of R2 500 per month from #MyNews (Pty) Ltd. Azania kept an accurate logbook which indicated that 24 600 kilometres were travelled for business purposes and 4 400 kilometres were travelled for private purposes during the year. Her employer was satisfied with her logbook in the previous year of assessment (2017) and will accept her logbook for the 2018 year of assessment. Unfortunately, she did not keep any records of the actual costs relating to the vehicle.

- Azania was part of the team covering a nation-wide student protest action during January and February 2018. She incurred business expenses amounting to R24 300 and R33 300 in January and February 2018 respectively. #MyNews (Pty) Ltd reimbursed her fully for these expenses incurred by her for each month.

- In February 2018, #MyNews (Pty) Ltd paid Azania a bonus of R30 000.

- In addition, Azania contributes R1 400 per month to #MyNews (Pty) Ltd's pension fund. #MyNews (Pty) Ltd also contributes R1 400 per month on Azania's behalf.

- Azania joined a medical scheme on 1 January 2018. She contributes R1 090 per month to the medical scheme. Azania has not informed her employer of this.

Azania saw an opportunity in the organic vegetable industry and in March 2017, she started to sell freshly grown vegetables to her colleagues.

Revenue relating to the sale of Azania's organic vegetables amounted to R15 000 for the year ending 28 February 2018. During the year, Azania incurred expenses directly related to the growing and selling of organic vegetables amounting to R6 200. You may assume the revenue and costs were received and incurred evenly throughout the period.

| **REQUIRED:** | **MARKS** |
|---|---|
| Calculate the employees' tax that #MyNews (Pty) Ltd should have withheld from Azania's remuneration for the month of February 2018. | **20** |

**QUESTION 3 (20 marks, 36 minutes)**

Jacob and Ruth, who are married in community of property, lived in their first house for six years. On 1 August 2009 the couple purchased the house for R500 000. They also paid R5 000 in attorney's fees and R25 000 transfer duty with the purchase.

Jacob and Ruth are IT specialists and work from home. For the time they lived in the house, they occupied 20% of the current house's area for office purposes.

While they were living in the current house, the following expenses were incurred:

- During September 2012 an outdoor entertainment area was built for R238 000.
- The kitchen was upgraded during April 2013. Larger kitchen cupboards were installed at a cost of R40 000. The stove and oven were upgraded with modern built-in appliances costing R17 000. A free standing combination refrigerator/freezer of R12 000 was also purchased.
- During September 2015, after Jacob and Ruth moved out, the entire house was repainted and repairs were done at a cost of R9 000.

During July 2015, Ruth gave birth to triplets and the couple decided to sell the current house and purchase a new, larger house to accommodate the larger family.

From 1 August 2015, the house, in which they previously lived, was put on the market as a private sale. While Jacob and Ruth tried to sell the house privately, advertising costs of R6 000 were incurred.

This house stood empty from August 2015 until August 2017. Various estate agents were then appointed to manage the sale. There was a dispute with the first estate agent, which cost Jacob and Ruth R4 000 in legal fees. On 1 August 2017 the second estate agent was able to secure a purchaser for the house at R1 700 000. Jacob and Ruth received a net amount of R1 615 000 after the estate agent's commission was deducted.

| **REQUIRED:** | **MARKS** |
|---|---|
| Calculate Jacob's taxable capital gain/(capital loss) for the 2018 year of assessment. | **20** |

**QUESTION 4 (17 marks, 31 minutes)**

Harry (59 years old) and Sally (57 years old) were married out of community of property. They were in a motorcar accident on their way back from holiday and both Harry and Sally passed away on 10 October 2017. They are survived by their son, Jack (31 years old).

The executor found the following in Harry and Sally's estates:

1. A pension fund lump sum of R2 500 000 was paid out to Harry's estate on date of his death. Harry previously received a lump sum from his employer amounting to R550 000 when he was retrenched in December 2013. A total of R3 000 of Harry's current pension fund contributions were not allowed as income tax deductions during the current year of assessment. His current pension fund contributions that were disallowed as deductions in previous years of assessment amounted to R82 000.

2. The proceeds on an insurance policy, that Jack had taken out on Harry's life to enable him to acquire Harry's interest in his business, should he die, amounted to R3 000 000. Harry did not pay any premiums on this policy.

3. Harry promised Jack that he would inherit his speedboat when Harry died one day. The speedboat has a market value of R345 000 on the date of death.

4. On 10 October 2017, Harry's home in Clearwater estate was valued at R5 515 000. The executor sold the house for R5 300 000.

5. On 1 September 2017, William, Harry's brother, donated his Land Cruiser valued at R1 000 000 to Harry. Harry paid the donations tax amounting to R200 000. The executor sold the Land Cruiser for R950 000.

6. Furniture and effects were valued at R890 000 on 10 October 2017.

7. Sally's net value of her estate only amounted to R500 000.

8. Administration and other costs in Harry's estate, including the Master's fee and executor's remuneration, amounted to R123 000 in total.

| **REQUIRED:** | **MARKS** |
|---|---|
| a) Calculate the estate duty payable by Harry's estate. | **12** |
| b) Calculate the tax payable on the pension fund lump sum received by Harry upon his death (deemed to be received by Harry immediately preceding his death). | **5** |

**QUESTION 5 (10 marks, 18 minutes)**

SubCo Ltd (SubCo) is a wholly owned subsidiary of HoldCo Ltd (HoldCo). SubCo is a wholesale distributor of canned foods.

HoldCo granted SubCo a loan on which interest is payable by SubCo on a monthly basis. HoldCo also required SubCo to pay dividends bi-annually. SubCo is a profitable company and could pay the dividends from its own generated funds. However, the loan was required in order to purchase capital equipment to expand SubCo's business.

SubCo also paid an up-front amount, in respect of a lease agreement, which endured for 25 years. The purpose of the up-front payment was to secure premises that will be utilised by SubCo as storage space from which to distribute its merchandise. On top of the up-front payment, monthly rentals are payable as well.

| **REQUIRED:** | **MARKS** |
| --- | --- |
| a) Briefly discuss, by referring to relevant components of the general deduction formula, whether or not the interest payable on the loan will be deductible for income tax purposes. No reference to case law is required. Do not address section 24J as part of your answer. | **6** |
| b) Briefly discuss, by referring to the relevant components of the general deduction formula, whether or not the up-front payment in respect of the lease agreement will be deductible for income tax purposes. No reference to case law is required. | **4** |

# SCHEDULES

## A. 2018 – TAX TABLES

### (i) Persons (other than companies and trusts)

| Taxable income | Rates of tax |
|---|---|
| Where the taxable income does not exceed R189 880 | 18 % of each R1 of the taxable income; |
| exceeds R189 880 but does not exceed R296 540 .... | R34 178 plus 26% of the amount by which the taxable income exceeds R189 880; |
| exceeds R296 540 but does not exceed R410 460 .... | R61 910 plus 31% of the amount by which the taxable income exceeds R296 540; |
| exceeds R410 460 but does not exceed R555 600 .... | R97 225 plus 36% of the amount by which the taxable income exceeds R410 460; |
| exceeds R555 600 but does not exceed R708 310 .... | R149 475 plus 39% of the amount by which the taxable income exceeds R555 600; |
| exceeds R708 310 but does not exceed R1 500 000 . | R209 032 plus 41% of the amount by which the taxable income exceeds R708 310; |
| exceed R1 500 000 .................................................. | R533 625 plus 45% of the amount by which the taxable income exceeds R1 500 000. |

### (ii) Tax on retirement lump sum benefits (or death)

| Taxable income from benefit | Rate of Tax |
|---|---|
| R0 – R500 000.................................................. | 0 per cent of taxable income |
| Exceeding R500 000 but not exceeding R700 000 .......................................................... | R0 plus 18% of taxable income exceeding R500 000 |
| Exceeding R700 000 but not exceeding R1 050 000 ....................................................... | R36 000 plus 27% of taxable income exceeding R700 000 |
| Exceeding R1 050 000....................................... | R130 500 plus 36% of taxable income exceeding R1 050 000 |

### (iii) Tax on retirement lump sum withdrawal benefits (pre-retirement)

| Taxable income from benefit | Rate of Tax |
|---|---|
| R0 – R25 000....................................................... | 0 per cent of the taxable income |
| Exceeding R25 000 but not exceeding R660 000 ... | 18% of taxable income exceeding R25 000 |
| Exceeding R660 000 but not exceeding R990 000.. | R114 300 plus 27% of taxable income exceed-ing R660 000 |
| Exceeding R990 000............................................. | R203 400 plus 36% of taxable income exceed-ing R990 000 |

## B. FRINGE BENEFIT TABLES

### (i) Employee–owned vehicles (section 8(1))

**SCALE OF VALUES**

| Where the value of the vehicle | Fixed cost R | Fuel cost c | Maintenance cost c |
|---|---|---|---|
| does not exceed R85 000.......................................... | 28 492 | 91,2 | 32,9 |
| exceeds R 85 000 but does not exceed R170 000 ....... | 50 924 | 101,8 | 41,2 |
| exceeds R170 000 but does not exceed R255 000 ...... | 73 427 | 110,6 | 45,4 |
| exceeds R255 000 but does not exceed R340 000 ...... | 93 267 | 118,9 | 49,6 |
| exceeds R340 000 but does not exceed R425 000 ...... | 113 179 | 127,2 | 58,2 |
| exceeds R425 000 but does not exceed R510 000 ...... | 134 035 | 146,0 | 68,4 |
| exceeds R510 000 but does not exceed R595 000 ...... | 154 879 | 150,9 | 84,9 |
| exceeds R595 000 | 154 879 | 150,9 | 84,9 |

### (ii) Employer owned vehicles (Paragraph 7(4) of the Seventh Schedule)

**Scale of values**

Value of private use **per month**, vehicle not subject to maintenance plan = 3,5% x determined value

Value of private use **per month**, vehicle subject to maintenance plan = 3.25% x determined value

## C. REBATES

Persons under 65 .................................................................................................... R13 635

Persons 65 and under 75 (R13 635 + R7 479) ................................................................ R21 114

Persons 75 and over (R13 635 + R7 479 + R2 493) .......................................................... R23 607

## D. MEDICAL AID TAX CREDITS

Main member.................................................................................................... R303

Main member with one dependant (R303 + R303).................................................... R606

Main member with two dependants (R303 + R303 + R204)........................................ R810

Each additional dependant qualifies for a further rebate or credit of R204.

## E. FORMULAE

Section 10A (purchased annuity)

$$Y = A/B \times C$$

| | | |
|---|---|---|
| Y | = | the capital element to be calculated |
| A | = | the total cash price payable by the purchaser to the insurance company in terms of the annuity contract |
| B | = | the sum of all the expected returns over the term of the contract; and |
| C | = | the total receipts during the current year of assessment. |

Second Schedule

Formula C

$$A = \frac{B}{C} \times D$$

| | | |
|---|---|---|
| A | = | the portion subject to tax that must be calculated |
| B | = | the total completed years of service from 1 March 1998 |
| C | = | the total completed years of service that are recognised as pension funding |
| D | = | the lump sum that is payable. |

## F. 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.

(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.

## G. INCOME TAX MONETARY THRESHOLDS SUBJECT TO PERIODIC LEGISLATIVE CHANGE:

| **Description** | **Reference to Income Tax Act, 1962** | **Monetary amount** |
|---|---|---|
| **Exemption for interest and certain dividends:** | | |
| In respect of persons 65 years or older, exemption for interest from a source within the Republic which are not otherwise exempt | Section 10(1)(*i*)(i) | R34 500 |
| In respect of persons younger than 65 years, exemption for interest from a source within the Republic which are not otherwise exempt | Section 10(1)(*i*)(ii) | R23 800 |
| **Annual donations tax exemption:** | | |
| 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 | R40 000 |
| Exclusion on death | Paragraph 5(2) of Eighth schedule | R300 000 |
| Exclusion for the disposal of a primary residence | Paragraph 45(1)(*a*) of Eighth Schedule | R2 million |
| Exclusion in respect of disposal of primary residence (based on amount of proceeds on disposal) | Paragraph 45(1)(*b*) of Eighth Schedule | R2 million |
| Maximum market value of all assets allowed within the small business definition on disposal when person 55 years or older | Definition of “small business” in paragraph 57(1) of Eighth Schedule | R10 million |
| Exclusion amount on disposal of small business when person 55 years or older | Paragraph 57(3) of Eighth schedule | R1 800 000 |
| **Retirement savings thresholds:** | | |
| **Deductible retirement fund contributions:** Members of retirement funds may deduct their contributions subject to certain percentage or monetary ceilings | | |
| Monetary ceiling for total contributions to retirement funds | Proviso to section 11(*k*)(i) | R350 000 |

| **Description** | **Reference to Income Tax Act, 1962** | **Monetary amount** |
|---|---|---|
| **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*)(*iii*A)(*bb*)(A) | R595 000 |
| Ceiling on debt relating to vehicle cost | Section 8(1)(*b*)(*iii*A)(*bb*)(B) | R595 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)(*q*) | R600 000 |
| Annual ceiling for employee relatives | Paragraph (*ii*)(*bb*) of the proviso to section 10(1)(*q*) | R60 000 & R20 000 |
| **Awards for bravery and long service:** | Paragraphs (a) and (b) of the further proviso to paragraph 5(2) of Seventh Schedule | R5 000 |
| **Employee accommodation:** | Paragraph 9(3)(a)(ii) of Seventh Schedule | R75 750 |
| **Exemption for *de minimus* employee loans:** | Paragraph 11(4)(a) of Seventh Schedule | R3 000 |
| **Administration** | | |
| **Exemptions from provisional tax:** | | |
| In the case of a natural person not carrying on a business | Paragraph 18(1)(c)(i) of Fourth Schedule | Taxable income below threshold |
| In the case of a natural person not carrying on a business | Paragraph 18(1)(c)(i) of Fourth Schedule | Taxable income from interest, foreign dividends and rental income does not exceed R30 000 |

## H. DECEASED ESTATES

### (i) RATE OF ESTATE DUTY

The rate of estate duty shall be 20 per cent of the dutiable amount of the estate.

Provided that where duty becomes payable upon the value of any movable or immovable property or on a value determined by reference to the value of any movable or immovable property, and duty has, upon the death of any person (hereinafter referred to as the first-dying person), who died within ten years prior to the death of the deceased, become payable upon the value of that movable or immovable property or upon a value determined by reference to the value of that movable or immovable property (or any movable or immovable property for which the Commissioner is satisfied that that movable or immovable property has been substituted), the duty attributable to the value of that movable or immovable property or, as the case may be, the value determined by reference to the value of that movable or immovable property, but not exceeding (in either case) an amount equal to the value on which duty has become payable on the death of the first-dying person, shall be reduced by a percentage according to the following scale:

| | |
|---|---|
| if the deceased dies within two years of the death of the first-dying person | 100 per cent |
| if the deceased dies more than two years but not more than four years after the death of the first-dying person ........ | 80 per cent |
| if the deceased dies more than four years but not more than six years after the death of the first-dying person ........ | 60 per cent |
| if the deceased dies more than six years but not more than eight years after the death of the first-dying person ........ | 40 per cent |
| if the deceased dies more than eight years but not more than ten years after the death of the first-dying person ........ | 20 per cent |

subject to a maximum reduction equal to so much of the duty previously payable upon the death of the first-dying person as is attributable to the value of that movable or immovable property or, as the case may be, to an amount equal to the value determined by reference to the value of that movable or immovable property, and as is proved to the satisfaction of the Commissioner to have been borne by the deceased.

**TABLE A**

(iv) THE EXPECTATION OF LIFE AND THE PRESENT VALUE OF R1 PER ANNUM FOR LIFE CAPITALISED AT 12 PER CENT OVER THE EXPECTATION OF LIFE OF MALES AND FE-MALES OF VARIOUS AGES

| | Expectation of life | | Present value of R1 per annum for life | | |
|---|---|---|---|---|---|
| Age | Male | Female | Male | Female | Age |
| 0 | 64,75 | 72,36 | 8,237 91 | 8,331 05 | 0 |
| 1 | 65,37 | 72,74 | 8,328 28 | 8,331 14 | 1 |
| 2 | 64,50 | 71,87 | 8,327 76 | 8,330 91 | 2 |
| 3 | 63,57 | 70,93 | 8,327 14 | 8,330 64 | 3 |
| 4 | 62,63 | 69,98 | 8,326 44 | 8,330 33 | 4 |
| 5 | 61,69 | 69,02 | 8,325 67 | 8,329 99 | 5 |
| 6 | 60,74 | 68,06 | 8,324 80 | 8,329 61 | 6 |
| 7 | 59,78 | 67,09 | 8,323 81 | 8,329 81 | 7 |
| 8 | 58,81 | 66,11 | 8,322 71 | 8,328 69 | 8 |
| 9 | 57,83 | 65,14 | 8,321 46 | 8,328 15 | 9 |
| 10 | 56,85 | 64,15 | 8,320 07 | 8,327 53 | 10 |
| 11 | 55,86 | 63,16 | 8,318 49 | 8,326 84 | 11 |
| 12 | 54,87 | 62,18 | 8,316 73 | 8,326 08 | 12 |
| 13 | 53,90 | 61,19 | 8,314 80 | 8,325 22 | 13 |
| 14 | 52,93 | 60,21 | 8,312 65 | 8,324 27 | 14 |
| 15 | 51,98 | 59,23 | 8,310 29 | 8,323 20 | 15 |
| 16 | 51,04 | 58,26 | 8,307 70 | 8,322 03 | 16 |
| 17 | 50,12 | 57,29 | 8,304 89 | 8,320 71 | 17 |
| 18 | 49,21 | 56,33 | 8,301 80 | 8,319 26 | 18 |
| 19 | 48,31 | 55,37 | 8,298 41 | 8,317 64 | 19 |
| 20 | 47,42 | 54,41 | 8,294 71 | 8,315 84 | 20 |
| 21 | 46,53 | 53,45 | 8,290 61 | 8,313 83 | 21 |
| 22 | 45,65 | 52,50 | 8,286 13 | 8,311 61 | 22 |
| 23 | 44,77 | 51,54 | 8,281 17 | 8,309 12 | 23 |
| 24 | 43,88 | 50,58 | 8,275 64 | 8,306 33 | 24 |
| 25 | 43,00 | 49,63 | 8,269 59 | 8,303 26 | 25 |
| 26 | 42,10 | 48,67 | 8,262 74 | 8,299 81 | 26 |
| 27 | 41,20 | 47,71 | 8,255 16 | 8,295 95 | 27 |
| 28 | 40,30 | 46,76 | 8,246 77 | 8,291 71 | 28 |
| 29 | 39,39 | 45,81 | 8,237 37 | 8,286 97 | 29 |
| 30 | 38,48 | 44,86 | 8,226 94 | 8,281 70 | 30 |
| 31 | 37,57 | 43,91 | 8,215 38 | 8,275 83 | 31 |
| 32 | 36,66 | 42,96 | 8,202 57 | 8,269 30 | 32 |
| 33 | 35,75 | 42,02 | 8,188 36 | 8,262 10 | 33 |
| 34 | 34,84 | 41,07 | 8,172 62 | 8,254 00 | 34 |
| 35 | 33,94 | 40,13 | 8,155 36 | 8,245 09 | 35 |
| 36 | 33,05 | 39,19 | 8,136 47 | 8,235 17 | 36 |
| 37 | 32,16 | 38,26 | 8,115 58 | 8,224 26 | 37 |
| 38 | 31,28 | 37,32 | 8,092 74 | 8,211 99 | 38 |
| 39 | 30,41 | 36,40 | 8,067 81 | 8,198 66 | 39 |
| 40 | 29,54 | 35,48 | 8,040 30 | 8,183 86 | 40 |
| 41 | 28,69 | 34,57 | 8,010 67 | 8,167 62 | 41 |
| 42 | 27,85 | 33,67 | 7,978 44 | 8,149 83 | 42 |
| 43 | 27,02 | 32,77 | 7,943 44 | 8,130 12 | 43 |
| 44 | 26,20 | 31,89 | 7,905 47 | 8,108 81 | 44 |
| 45 | 25,38 | 31,01 | 7,863 80 | 8,085 27 | 45 |

**<u>TABLE A</u> (continued)**

| Age | Expectation of life | | Present value of R1 per annum for life | | Age |
|---|---|---|---|---|---|
| | Male | Female | Male | Female | |
| 46 | 24,58 | 30,14 | 7,819 24 | 8,059 56 | 46 |
| 47 | 23,79 | 29,27 | 7,771 09 | 8,031 19 | 47 |
| 48 | 23,00 | 28,41 | 7,718 43 | 8,000 26 | 48 |
| 49 | 22,23 | 27,55 | 7,662 36 | 7,966 17 | 49 |
| 50 | 21,47 | 26,71 | 7,602 01 | 7,929 50 | 50 |
| 51 | 20,72 | 25,88 | 7,537 13 | 7,889 67 | 51 |
| 52 | 19,98 | 25,06 | 7,467 48 | 7,846 46 | 52 |
| 53 | 19,26 | 24,25 | 7,393 87 | 7,799 65 | 53 |
| 54 | 18,56 | 23,44 | 7,316 31 | 7,748 34 | 54 |
| 55 | 17,86 | 22,65 | 7,232 34 | 7,693 55 | 55 |
| 56 | 17,18 | 21,86 | 7,144 14 | 7,633 63 | 56 |
| 57 | 16,52 | 21,08 | 7,051 78 | 7,568 96 | 57 |
| 58 | 15,86 | 20,31 | 6,952 25 | 7,499 27 | 58 |
| 59 | 15,23 | 19,54 | 6,850 04 | 7,423 21 | 59 |
| 60 | 14,61 | 18,78 | 6,742 06 | 7,341 35 | 60 |
| 61 | 14,01 | 18,04 | 6,630 10 | 7,254 57 | 61 |
| 62 | 13,42 | 17,30 | 6,512 32 | 7,160 20 | 62 |
| 63 | 12,86 | 16,58 | 6,393 01 | 7,060 46 | 63 |
| 64 | 12,31 | 15,88 | 6,268 22 | 6,955 37 | 64 |
| 65 | 11,77 | 15,18 | 6,137 89 | 6,841 61 | 65 |
| 66 | 11,26 | 14,51 | 6,007 26 | 6,723 93 | 66 |
| 67 | 10,76 | 13,85 | 5,871 65 | 6,598 93 | 67 |
| 68 | 10,28 | 13,20 | 5,734 03 | 6,466 35 | 68 |
| 69 | 9,81 | 12,57 | 5,591 82 | 6,328 18 | 69 |
| 70 | 9,37 | 11,96 | 5,451 65 | 6,184 66 | 70 |
| 71 | 8,94 | 11,37 | 5,307 75 | 6,036 07 | 71 |
| 72 | 8,54 | 10,80 | 6,167 44 | 5,882 78 | 72 |
| 73 | 8,15 | 10,24 | 5,024 37 | 5,722 22 | 73 |
| 74 | 7,77 | 9,70 | 4,878 76 | 5,557 43 | 74 |
| 75 | 7,41 | 9,18 | 4,734 90 | 5,388 93 | 75 |
| 76 | 7,07 | 8,68 | 4,593 54 | 5,217 27 | 76 |
| 77 | 6,73 | 8,21 | 4,446 63 | 5,046 79 | 77 |
| 78 | 6,41 | 7,75 | 4,303 09 | 4,870 92 | 78 |
| 79 | 6,10 | 7,31 | 4,158 98 | 4,693 89 | 79 |
| 80 | 5,82 | 6,89 | 4,024 40 | 4,516 47 | 80 |
| 81 | 5,55 | 6,50 | 3,890 51 | 4,343 99 | 81 |
| 82 | 5,31 | 6,13 | 3,768 02 | 4,173 15 | 82 |
| 83 | 5,09 | 5,78 | 3,652 76 | 4,004 82 | 83 |
| 84 | 4,89 | 5,45 | 3,545 46 | 3,839 88 | 84 |
| 85 | 4,72 | 5,14 | 3,452 32 | 3,679 21 | 85 |
| 86 | 4,57 | 4,85 | 3,368 64 | 3,523 71 | 86 |
| 87 | 4,45 | 4,58 | 3,300 66 | 3,374 26 | 87 |
| 88 | 4,36 | 4,33 | 3,249 07 | 3,231 75 | 88 |
| 89 | 4,32 | 4,11 | 3,225 97 | 3,102 96 | 89 |
| 90 | 4,30 | 3,92 | 3,214 38 | 2,989 12 | 90 |

## TABLE B

PRESENT VALUE OF R1 PER ANNUM CAPITALISED AT 12 PER CENT OVER FIXED PERIODS

| Years | Amount | Years | Amount | Years | Amount | Years | Amount |
|---|---|---|---|---|---|---|---|
| | R | | R | | R | | R |
| 1 | 0,892 9 | 26 | 7,895 7 | 51 | 8,307 6 | 76 | 8,331 8 |
| 2 | 1,690 0 | 27 | 7,942 6 | 52 | 8,310 4 | 77 | 8,332 0 |
| 3 | 2,401 8 | 28 | 7,984 4 | 53 | 8,312 8 | 78 | 8,332 1 |
| 4 | 3,037 4 | 29 | 8,021 8 | 54 | 8,315 0 | 79 | 8,332 3 |
| 5 | 3,604 8 | 30 | 8,055 2 | 55 | 8,317 0 | 80 | 8,332 4 |
| 6 | 4,111 4 | 31 | 8,085 0 | 56 | 8,318 7 | 81 | 8,332 5 |
| 7 | 4,563 8 | 32 | 8,111 6 | 57 | 8,320 3 | 82 | 8,332 6 |
| 8 | 4,967 6 | 33 | 8,135 4 | 58 | 8,321 7 | 83 | 8,332 6 |
| 9 | 5,328 2 | 34 | 8,156 6 | 59 | 8,322 9 | 84 | 8,332 7 |
| 10 | 5,650 2 | 35 | 8,175 5 | 60 | 8,324 0 | 85 | 8,332 8 |
| 11 | 5,937 7 | 36 | 8,192 4 | 61 | 8,325 0 | 86 | 8,332 8 |
| 12 | 6,194 4 | 37 | 8,207 5 | 62 | 8,325 9 | 87 | 8,332 9 |
| 13 | 6,423 6 | 38 | 8,221 0 | 63 | 8,326 7 | 88 | 8,333 0 |
| 14 | 6,628 2 | 39 | 8,233 0 | 64 | 8,327 4 | 89 | 8,333 0 |
| 15 | 6,810 9 | 40 | 8,243 8 | 65 | 8,328 1 | 90 | 8,333 0 |
| 16 | 6,974 0 | 41 | 8,253 4 | 66 | 8,328 6 | 91 | 8,333 1 |
| 17 | 7,119 6 | 42 | 8,261 9 | 67 | 8,329 1 | 92 | 8,333 1 |
| 18 | 7,249 7 | 43 | 8,269 6 | 68 | 8,329 6 | 93 | 8,333 1 |
| 19 | 7,365 8 | 44 | 8,276 4 | 69 | 8,330 0 | 94 | 8,333 1 |
| 20 | 7,469 4 | 45 | 8,282 5 | 70 | 8,330 3 | 95 | 8,333 2 |
| 21 | 7,562 0 | 46 | 8,288 0 | 71 | 8,330 7 | 96 | 8,333 2 |
| 22 | 7,644 6 | 47 | 8,292 8 | 72 | 8,331 0 | 97 | 8,333 2 |
| 23 | 7,718 4 | 48 | 8,297 2 | 73 | 8,331 2 | 98 | 8,333 2 |
| 24 | 7,784 3 | 49 | 8,301 0 | 74 | 8,331 4 | 99 | 8,333 2 |
| 25 | 7,843 1 | 50 | 8,304 5 | 75 | 8,331 6 | 100 | 8,333 2 |

## ANNEXURE B: SOLUTIONS TO ASSIGNMENT 3

### SOLUTION: QUESTION 1 (33 marks)

Calculation of Kenneth's net normal tax for the 2018 year of assessment

| | | R | R | R | |
|---|---|---|---|---|---|
| Salary | | | | 780 000 | |
| Travel allowance | | | 100 000 | | |
| Business km travelled: 10 400km – 2 300km = 8 100km **(1)** | | | | | |
| Determined value: R390 000 x 1.14 = R444 600 | | | | | |
| Deemed cost: | | | | | |
| Fixed cost: | R134 035**(1)**/10 400km**(1)** x 365/365 days | 12.888 | | | |
| Fuel | | 1.460 | | | |
| Maintenance | | 0.684 | | | |
| | | 15.032 | | | |
| Actual cost: | | | | | |
| Wear-and-tear | R444 600/7 years**(1)** | 63 514 | | | |
| Finance charges | (R96 800/4 years) | 24 200 | | | **(1)** |
| Running costs | | 34 000 | | | |
| | | 121 714 | | | |
| Actual cost per km: R121 714/10 400km **(1)** = R11.703 | | | | | |
| Use deemed cost as it is higher, business travel expenditure: 8 100km x R15.032 **(1)** = R121 759 but limited to R100 000 | | | (100 000) | 0 | **(1)** |
| Residential accommodation (fringe benefit): | | | | | |
| Lower of: | | | | | |
| ((R69 000 x 12) **(1)** – R75 750 **(1)**) x 18% **(1)** x 10/12 **(1)** = | | 112 838 | | | |
| Or | | | | | |
| Rental paid (R9 500 pm x 10 months) | | 95 000 | **(1)** | | |
| Therefore | | | | 95 000 | **(1)** |
| Restraint of trade receipt | | | | 900 000 | **(1)** |
| Foreign dividends | | | 2 800 | | |
| Less: Ratio exemption (R2 800 x 25/45) | | | (1 556) | 1 244 | **(1)** |
| Foreign interest | | | | 680 | **(1)** |
| Provident fund fringe benefit | | | | 38 000 | **(1)** |
| | | | | 1 814 924 | |
| Taxable capital gain – listed shares | | | | 11 000 | **(1)** |
| | | | | 1 825 924 | |
| Less: Retirement fund contributions | | | | | |
| Provident fund contributions – employee | | | 52 000 | | |
| Provident fund contributions – employer | | | 38 000 | | |
| Retirement annuity fund contributions | | | 275 000 | | |
| | | | 365 000 **(1)** | | |

| **<u>SOLUTION: QUESTION 1</u> (continued)** | **R** | **R** | |
|---|---|---|---|
| Percentage limit: the greater of | | | |
| Taxable income: R1 825 924**(1)** x 27.5%**(1)** = R502 129 or | | | |
| Remuneration: R 965 000**(1)** x 27.5% = R265 375 | | | |
| | | | |
| Deduction limited to the lesser of: | | | |
| R350 000 **(1)** or R502 129 | | | |
| Therefore | | (350 000) | **(1)** |
| **Taxable income** | | **1 475 924** | |
| | | | |
| Normal tax *[R209 032 + (R1 475 924 – R708 310) x 41%]* | | 523 754 | **(1)** |
| <u>Less</u>: Primary rebate | | (13 635) | **(1)** |
| Medical scheme fees tax credit [(R303 + R303 + R204 + R204)**(1)** x 12 **(1)**] | | (12 168) | |
| Additional medical expenses tax credit | | | |
| Medical scheme fee contributions | 46 000 | | **(1)** |
| <u>Less</u>: 3 x medical scheme fees tax credit [R12 168 **(1)** x 3 **(1)**] | (36 504) | | |
| Excess contributions | 9 496 | | |
| <u>Add</u>: Qualifying expenses | 8 000 | | **(1)** |
| | 17 496 | | |
| Additional qualifying medical expense tax credit (33.3% **(1)** x R17 496) | | (5 826) | |
| **Net normal tax** | | **492 125** | |

**MAX 33**

**SOLUTION: QUESTION 2 (20 marks)**

**Calculation of employees' tax for the month of February 2018**

| | Monthly R | | Annual **(1)** R | |
|---|---|---|---|---|
| Commission | 89 000 | **(1)** | 1 068 000 | **(1)** |
| Travel allowance | | | | |
| (24 600km / 29 000km = 84.8% business use) **(1)** | | | | |
| (R2 500 x 20%) | 500 | **(1)** | 6 000 | **(1)** |
| Reimbursive business expenses – excluded | 0 | **(1)** | 0 | **(1)** |
| Taxable income from sale of vegetables – not remuneration | 0 | **(1)** | 0 | **(1)** |
| Pension fund contributions (fringe benefit) | 1 400 | **(1)** | 16 800 | **(1)** |
| **Remuneration** | **90 900** | | **1 090 800** | |
| Less: Current pension fund contributions: | | | | |
| Employee R1 400 **(1)** | | | | |
| Employer R1 400 **(1)** | | | | |
| R2 800 | | | | |
| Percentage limit: | | | | |
| Remuneration: 27,5%**(1)** x R90 900 = R24 998 or | | | | |
| Deduction limited to the lesser of: | | | | |
| R24 998 (percentage limit) or | | | | |
| R350 000/12 **(1)** = R29 167, therefore | (2 800) | **(1)** | (33 600) | **(1)** |
| **Balance of remuneration** | **88 100** | | **1 057 200** | |

| | | |
|---|---|---|
| Annual equivalent of remuneration (R88 100 x 12 months) **(1)** | 1 057 200 | |
| Normal tax [R209 032 + (R1 057 200 - R708 310) x 41%] | 352 077 | **(1)** |
| Less: Primary rebate | (13 635) | **(1)** |
| Less: Medical scheme fees tax credit – employer not advised | 0 | **(1)** |
| Employees' tax for the year | 338 442 | |
| Employees' tax per month (R338 442/12 months) **(1)** | 28 204 | |

**Annual amount**

| | | |
|---|---|---|
| Annual equivalent | 1 057 200 | |
| Bonus (s 7B – deemed to accrue once paid) | 30 000 | **(1)** |
| | 1 087 200 | |
| Normal tax [R209 032 + (R1 087 200 - R708 310) x 41%] | 364 377 | |
| Less: Primary rebate | (13 635) | |
| Less: Medical scheme fees tax credit | 0 | |
| Employees' tax for the year | 350 742 | **(1)** |
| Employees' tax on bonus (R350 742 - R338 442) **(1)** | 12 300 | |
| Employees' tax for February 2018 (R28 204 + R12 300) **(1)** | 40 504 | |

**<u>SOLUTION: QUESTION 3</u> (20 marks)**

| | R | R | |
|---|---|---|---|
| <u>Primary residence</u> | | | |
| Proceeds | 1 700 000 | | **(1)** |
| <u>Less</u>: Base cost | (920 000) | | |
| Cost | (500 000) | | **(1)** |
| Attorney's fees | (5 000) | | **(1)** |
| Transfer duty | (25 000) | | **(1)** |
| Outdoor entertainment area (improvement) | (238 000) | | **(1)** |
| Kitchen cupboards (improvement) | (40 000) | | **(1)** |
| Stove and oven (improvement) | (17 000) | | **(1)** |
| Combination refrigerator/freezer – not part of fixtures | - | | **(1)** |
| Repainting and repairs – not allowed - para 20(2)(*b*) | - | | **(1)** |
| Advertising costs | (6 000) | | **(1)** |
| Legal fees - dispute with estate agent | (4 000) | | **(1)** |
| Estate agent's commission (R1 700 000 - R1 615 000) | (85 000) | | **(1)** |
| Capital gain | 780 000 | | |
| Portion in respect of period not used as a primary residence (R780 000 x 20% **(1)** x 72mnths / 96mnths **(1)**) | (117 000) | 117 000 | **(1)** |
| | 663 000 | | |
| Primary residence exclusion (R2 000 000 **(1)** limited to R663 000) | (663 000) | 0 | **(1)** |
| Total capital gain | | 117 000 | |
| <u>Less</u>: Ruth's 50% **(1)** - married in community of property | | (58 500) | |
| | | 58 500 | |
| <u>Less</u>: Annual exclusion | | (40 000) | **(1)** |
| Net capital gain | | 18 500 | |
| Taxable capital gain (x 40%) **(1)** | | 7 400 | |

| **<u>Alternative primary residence exclusion calculation</u>** | **R** | **R** | **R** | |
|---|---|---|---|---|
| Capital gain | | 780 000 | | |
| (R780 000 x 80% **(1)** x 72mnths / 96mnths **(1)**) | 468 000 | | | |
| (R780 000 x 24mnths / 96mnths **(1)**) | 195 000 | | | |
| Capital gain in respect of period used as primary residence | 663 000 | (663 000) | | |
| Capital gain in respect of period not used as primary residence | | 117 000 | 117 000 | **(1)** |
| Capital gain in respect of period used as primary residence | | 663 000 | | |
| Primary residence exclusion: (R2 000 000 **(1)** limited to R663 000) | | (663 000) | 0 | |

**<u>SOLUTION: QUESTION 4</u> (17 Marks)**

a)

| | | R | R | |
|---|---|---|---|---|
| 1. | Lump sum – deemed to be received by Harry prior to death | | 0 | **(1)** |
| 2. | Current pension fund contributions disallowed | | 3 000 | **(1)** |
| 3. | Insurance policy – exempt as key man policy | | 0 | **(1)** |
| 4. | Donation to Jack – specifically with death in mind | | 345 000 | **(1)** |
| 5. | Home in Clearwater | | 5 300 000 | **(1)** |
| 6. | Proceeds on sale of Land Cruiser | 950 000 | | |
| | <u>Less</u>: Donations tax – not allowed **(1)** | (0) | 950 000 | **(1)** |
| 7. | Furniture and effects | | 890 000 | **(1)** |
| Gross value of estate | | | 7 488 000 | |
| <u>Less</u>: Administration and other costs | | | (123 000) | **(1)** |
| | | | 7 365 000 | |
| <u>Less</u>: Section 4A rebate (R3 500 000 **(1)** + R3 000 000 **(1)**) | | | (6 500 000) | |
| Taxable amount | | | 865 000 | |
| Estate duty at 20% | | | 173 000 | **(1)** |

**[12]**

b)

**<u>Calculation of tax payable on lump sum</u>**

| | R | R | |
|---|---|---|---|
| Pension fund lump sum: | 2 500 000 | | |
| Current pension fund contributions previously disallowed | (82 000) | | **(1)** |
| Taxable portion of pension fund lump sum | 2 418 000 | | |

Taxable amount = R2 968 000 [R2 418 000 + R550 000 **(1)**]

| | | |
|---|---|---|
| Tax = R130 500 + (R2 968 000 - R1 050 000) **(1)** x 36% = | 820 980 | |
| <u>Less</u>: Hypothetical tax on R550 000<br>(R550 000 - R500 000) **(1)** x 18% = | (9 000) | **(1)** |
| Tax on pension fund lump sum | 811 980 | |

**[5]**

**<u>SOLUTION: QUESTION 5</u> (10 marks)**

For an expense to be deductible, it needs to comply with all the requirements of **section 11(a)/the general deduction formula (1)**. These are:

- for purposes of trade, **(1)**
- expenditure and losses,
- actually incurred,
- during the year of assessment,
- in the production of income, **(1)**
- not of a capital nature. **(1)**

a) Interest on loan

The interest paid on the loan by SubCo is clearly an "expense", "actually incurred", "during the year of assessment". **(1)**

The interest on the loan was incurred to purchase capital equipment for the expansion of SubCo's business – it was laid out for purposes of trade. **(1)**

SubCo's business will expand, resulting in additional income – interest is incurred in the production of income. **(1)**

Although the interest is incurred to finance the purchase of capital equipment, it is not of a capital nature. **(1)** The purchase of equipment is of a capital nature.

The interest will therefore be deductible in terms of the general deduction formula. **(1)**

b) Up-front payment to secure lease

The up-front payment made by SubCo to secure the lease agreement is clearly an "expense", "actually incurred", "during the year of assessment" for trade purposes. **(1)**

The expense was also incurred "in the production of income", as SubCo has to have business premises (storage space) from where it can distribute its merchandise. **(1)**

However, as the lease agreement is for a 25-year period, it creates an enduring benefit **(1)** and is consequently capital in nature. **(1)**

The up-front payment expense does not comply with the final requirement of the general deduction formula ("not of a capital nature") and therefore will not be deductible for the purposes of determining SubCo's taxable income. **(1)**

**Max 10**

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