

IGNORE VALUE-ADDED TAX**1 Background**

The Bala Family Trust ('the Trust') is a resident of South Africa for normal tax purposes and was created by Elvis Bala five years ago. The Trust holds all the issued ordinary equity shares and voting rights in Fruities (Pty) Ltd ('Fruities'). Fruities is a company that was incorporated in South Africa. It is effectively managed in South Africa and has a 31 December financial year end. Fruities is the Bala family's business and is situated in Kimberley. The company specialises in the retail and distribution of dried fruit and nut products across South Africa. Fruities was incorporated on 1 February 2012 when Elvis subscribed for all the authorised and issued ordinary equity shares of the company. On 1 March 2017, Elvis donated his entire interest in Fruities to the Trust.

All trust income and trust asset distributions are subject to the discretion of the appointed trustees of the Trust, namely Elvis and his attorney. Elvis is also a director and the chief executive officer (CEO) of Fruities. The trust beneficiaries have no vested right in any capital assets held by the Trust.

Since the Trust was founded, it has had the following beneficiaries:

- Candice Bala, married out of community of property to Elvis;
- Vincent Bala, who is 30 years old and the biological son of Elvis and Candice. He is employed on a full-time basis as a general operational manager at Fruities. He is unmarried and has no dependants;
- Hope Bala, who is 25 years old, and was legally adopted by Elvis and Candice when she was still a baby. Hope emigrated from South Africa to Namibia in 2020 after she tracked down her birth mother. She has lived with her birth mother in Windhoek, Namibia, ever since. She has formally notified SARS of her change in residency; and
- Joy Bala, who is 16 years old and a full-time school learner. Joy is the biological daughter of Elvis and Candice.

Gift Mpopo is the biological son of Joy and the grandchild of Elvis and Candice. Gift was born on 28 December 2020 and was added as a beneficiary of the Trust on that date.

2 The Trust

2.1 The Trust held the following assets and earned the following amounts during its financial year ended 28 February 2022:

2.1.1 The full 100% of the authorised and issued ordinary equity shares in Fruities (see also section 1 above). On 23 December 2021, Fruities declared a distribution to its ordinary equity shareholders, paid in cash on 31 December 2021. The directors of Fruities issued a written notice to the trustees of the Trust, which indicated that ZAR200 000 of the total distribution of ZAR300 000 represented the first-ever return of contributed tax capital made by Fruities.

2.1.2 An office building situated in the central business district (CBD) of Kimberley, which was constructed by the Sol Plaatje Municipality during 2008, and used by the Municipality up to the date of its disposal to Vincent. Vincent acquired the office building from the Municipality at a bargain price of ZAR3,8 million (ZAR200 000 below its market value)

on 1 January 2010. He donated it to the Trust on the same date. The Trust has let the building as a commercial office space to various independent tenants since its acquisition from Vincent. The Trust earned total market-related annual rental income of ZAR960 000 during its 2022 financial year.

2.1.3 All of the shares in Prop (Pty) Ltd ('Prop'). The trustees nominated Vincent to be the sole director of Prop to comply with the requirements of the Companies Act. However, any decisions made by Vincent are discussed and agreed to with the other trustee first. Prop is a resident company, the sole asset of which is an unfurnished house situated in Kimberley. The house consists of an open-plan kitchen and living room area, three bedrooms, two bathrooms, a study, and a single garage. Vincent was granted the right of use of this property on 1 February 2021. Vincent pays for all costs related to this property.

2.1.4 A loan of ZAR600 000 to Vincent (see note 3.4).

2.2 The trustees of the Trust exercised their discretion in making the following distributions during its 2022 financial year (none of which represented annuity distributions):

2.2.1 ZAR50 000 of the gross dividend received on the Fruities shares (see note 2.1.1 above) was distributed in equal parts to each of the Trust beneficiaries on 28 February 2022.

2.2.2 A cash distribution of ZAR80 000 to Hope on 1 May 2021 from rental income earned by the Trust on the office building situated in the Kimberley CBD (see note 2.1.2).

3 Vincent Bala

3.1 Vincent is the beneficiary of a life insurance policy taken out at a local insurance company on the life of his father, Elvis. Vincent pays the full monthly premium on this policy.

3.2 Vincent's life is insured by his sister, Hope, who took out a life insurance policy from an insurance company in Namibia. Hope is responsible for the full monthly premiums payable on this policy.

3.3 In February 2021, Vincent decided to reduce his investment risk. After careful consideration of a variety of investments, he decided to make the following long-term investments on 1 March 2021:

3.3.1 An investment in DiT Plc ('DiT'), a computer manufacturing and retail company listed on the London Stock Exchange. DiT is incorporated in and effectively managed from the United Kingdom. Vincent acquired the interest at a cost of ZAR60 000 (correctly converted to ZAR for income tax purposes). This investment yielded the following returns on investment during Vincent's 2022 year of assessment:

- ZAR6 300 was deposited into Vincent's personal South African bank account on 30 June 2021. This cash dividend was subject to a foreign withholding tax of 10%, which was paid to His Majesty's Revenue and Customs; and

- A tablet worth ZAR20 000 (correctly converted to ZAR for income tax purposes) was delivered by courier to Vincent's residence in Kimberley (see note 2.1.3) on 18 December 2021. This was because DiT declared that each holder of shares in the company was eligible to receive one of the latest range of tablets manufactured by DiT.

The market value of Vincent's interest in the equity shares of DiT amounted to ZAR78 000 on 28 February 2022.

3.3.2 The acquisition of crypto assets at an arm's length cost of ZAR40 000. The market value of these crypto assets amounted to ZAR35 000 on 28 February 2022.

3.3.3 USD31 250 invested in a five-year fixed deposit account held at a US Bank (a tax resident in America). This account is subject to interest accruing in USD at an annual interest rate of 1,8%, which is equivalent to the yield to maturity. At the end of the five years the original capital invested, together with all the accrued interest, will be paid to Vincent in USD.

3.4 To facilitate the financing of his new investments, Vincent considered two possible options:

Option 1: A discretionary distribution of income of ZAR600 000 to be made to him by the Trust.

Option 2: A ZAR600 000 loan granted to him by the Trust at a market-related annual interest rate of 10%. The loan is repayable on demand and the interest is payable annually.

Vincent elected option two.

4 Notice of additional assessment (ITA34) for income tax issued to Vincent

Vincent submitted and filed his income tax return (ITR12) in respect of his 2021 year of assessment. After an audit process, SARS issued an additional assessment to him on 18 August 2022 (see next page).



INCOME TAX **ITA34**

Notice of assessment

**MR VINCENT BALA
PRIVATE BAG X1022
KIMBERLEY
8301**

Contact Centre

Enquiries should be addressed to SARS:

KIMBERLEY
Tel: 0860 12 12 13
Website: www.sars.gov.za

Details

Tax reference number: **9876543210**
Date of assessment: **16/08/2022**
Year of assessment: **2021**
Type of assessment: **Additional assessment**

Additional assessment summary information

INCOME TAX	R
Non-declaration of occupation of residential accommodation benefit provided by employer (Prop (Pty) Ltd) in terms of paragraph 9 of the Seventh Schedule to the Income Tax Act: $(R1\ 600\ 000 - R83\ 100) \times (17/100) \times (1/12)$	21 489.42
Tax thereon	9 670.24
Understatement penalty (reasonable care not taken in completing the return – standard case)	2 417.56
Net amount payable by you to SARS under this additional assessment	12 087.80

ISSUED ON BEHALF OF THE COMMISSIONER OF THE SOUTH AFRICAN REVENUE SERVICE

5 Additional information

- The total market values of the shares issued by Fruities were as follows:

Date	Market value of 100% of ordinary equity shares
1 March 2017	ZAR1 million
28 February 2022	ZAR15 million

- The prevailing foreign exchange rates were as follows:

Date	Spot rate
1 March 2021	USD1 : ZAR16,000
28 February 2022	USD1 : ZAR15,200

- The average exchange rate for the period 1 March 2021 to 28 February 2022 was USD1 : ZAR15,050.
- All natural persons mentioned in this scenario are residents for South African income tax purposes, unless stated otherwise.
- All taxpayers will plan their affairs to pay the minimum tax possible.

INITIAL TEST OF COMPETENCE, JUNE 2023

PROFESSIONAL PAPER 4

**This paper consists of two questions.
Answer each question in a separate answer book.**

QUESTION 1 – REQUIRED		Marks	
		Sub-total	Total
(a)	Calculate the taxable income of the Trust, and that of each of its individual beneficiaries, for the 2022 year of assessment, based on the information in section 2.	17	
	<ul style="list-style-type: none"> • Indicate each item not included in or removed from the Trust’s taxable income calculation. • Provide a brief reason for the accrual or attribution of any amounts, where applicable. <p><i>Communication skills – layout and structure</i></p>	1	18
(b)	Calculate the effect of note 3.3 on Vincent’s taxable income for his 2022 year of assessment.	6	
	<ul style="list-style-type: none"> • Show all nil effect items, supported with a reason. • Ignore the effect of any double tax agreements. 		6
(c)	Indicate which option outlined in note 3.4 is the most tax beneficial for Vincent.	7	
	<ul style="list-style-type: none"> • Support your answer with an explanation of the different tax implications for Vincent of the two options. • Do not provide calculations. <p><i>Communication skills – logical argument</i></p>	1	8
(d)	Assume for this part only that Vincent died on 28 February 2022.		
	Explain the following tax consequences for Vincent, supported by calculations where relevant, that would have been triggered by his death:	8	
	(i) Income tax consequences in his last income tax calculation; and (ii) Estate duty consequences for his deceased estate.	4	
	<i>Communication skills – clarity of expression</i>	1	13
(e)	Discuss whether you agree or disagree with the additional assessment SARS issued to Vincent for his 2021 year of assessment.	5	
	<ul style="list-style-type: none"> • Ignore the penalty imposed by SARS. • Do not criticise the calculation. 		5
Total for question 1			50