

Part (a) Discuss the income tax implications for SA Solar in respect of the sale of trading stock to The Power Store for the 2018 year of assessment. Refer to case law principles.		Marks
1	Issue	
1.1	As SA solar sold trading stock on credit subject to a condition being met. In terms of the gross income definition in section 1 inclusion takes place at the earlier of receipt or accrual. The issue is thus when does the R160 000 (<i>R139 130 VAT excluding</i>) accrue to SA Solar?	1 1
2	Case law principles	
2.1	Accrued to means entitled to. An amount is included in gross income when a person is entitled to it and not only when the amount is received after the end of the year of assessment (<i>People's Stores</i>).	1
2.2	Accrued means unconditionally entitled to (<i>Mooi</i>).	1
2.3	The onus of proof is on the taxpayer in terms of <i>section 102 of the TAA</i>	1
3	Application to issue	
3.1	The sale agreement came into effect on 23 February 2018, (also the date of delivery of the trading stock) but subject to a condition as the finance application must be approved by Investor Bank, i.e. a third party.	1
3.2	The sale condition was only met on 1 March 2018 (2019 year of assessment) and this is the date on which SA Solar is unconditionally entitled to the R160 000 (<i>or R139 130 if accepted that VAT was included in the sales amount</i>).	1
4	Conclusion	
4.1	No accrual takes place in the 2018 year of assessment, as the amount accrues in 2019. Therefore there is no inclusion in gross income in 2018 i.r.o. the sale of trading stock to The Power Store	1
	Available	8
	Maximum	5
	Total for part (a)	5

Part (b) Discuss whether SA Solar would qualify as a small business corporation and calculate the taxable income of SA Solar for the 2018 year of assessment, on the assumption that it does qualify as a small business corporation.		Marks
	<ul style="list-style-type: none"> Start with taxable income of R1 222 759. Provide reasons where no tax implications arise. 	
1	All shareholders must be natural persons: Phumlani is the sole shareholder and is a natural person. The entity must be a CC or private company: Solar SA is a private company. The gross income of Solar SA is R18 760 000 for the year of assessment (less than R20 million).	1 1 1
2	The shareholders must not hold any shares or has any interest in the equity of any other company: Phumlani has no dividend or interest-bearing investments.	1
3	SA Solar does not derive more than 20% in investment income and personal services income, as its income is derived solely from manufacturing and SA Solar is not a personal services provider.	1 1
3.1	Conclusion: SA Solar will qualify as a 'small business corporation'.	1
	Amount	
	Calculations	CGT
		Income tax
4 Taxable income		1 222 759
4.1 Conditional sale		
Not accrued to in 2018 tax year, subject to a condition		0
		1

<i>Alt: Argued that amount accrued in a)</i>				160 000	1
4.2 Laminating machines					
Recoupment – Machine 1					
Selling price limited to original cost		499 999			1
Less: Tax value		0			
Cost	499 999				
Less: section 12E 100% allowance	(499 999)				1
Recoupment ito s 8(4)(e) (new machine not brought into use in 3 years –par 66)				499 999	1
<i>Alt: The full proceeds were used to fund the purchase the replacement machine and assume brought into use within 3 year, section 8(4)(e) will apply and recoupment is deferred.</i>				nil	1
Capital gain					
Proceeds		250 000			
Selling price	749 999				
Less: recoupment	(499 999)				1P
Less: Base cost					
Cost (par 20(3))	499 999				1P
Less: allowances	(499 999)	0			
Capital gain (new machine not brought into use in 3 years)			250 000		1
<i>Alt: The full proceeds were used to fund the purchase the replacement machine and assume brought into use within 3 year par 66 of the Eighth Schedule applies– the capital gain is deferred.</i>				nil	1
Allowance – Machine 2					
Less: section 12E 100% allowance				(499 999)	1
4.3 Aluminium cutting machine					
No allowance as not yet brought into use				nil	1
4.4 Second-hand automatic laminating machine					
Less: section 12E 100% allowance as s 12E available on second-hand machinery <i>If brought from non-vendor: R250 000 x 100/115 e R217 391</i>				(250 000)	1
<i>Alt: No allowance as not yet brought into use</i>				nil	1
4.5 Pre-payments					
Insurance premium					
Services rendered within six months of the end of the year of assessment, s 23H will not apply.				(79 512)	1
Machine maintenance					
Services not rendered within 6 months but within the R100 000 limit				(98 319)	1
4.6 Stock imported					
Trading stock					
No deduction, $\text{¥}100\,000 \times \text{R}2,50 = 250\,000$					1
no inclusion in closing stock (s 23F(1)), as stock has not arrived				nil	1
Import duties					
No section 11(a) deduction as cost not incurred in the 2018 year of assessment.				nil	1
Debt					

Exchange difference: gain (section 24l)	¥100 000 x (R2,50 - R2,28)		22 000	1 1
4.7 Marketing and entertainment				
<u>Family holiday trip,</u> not in the production of income for purposes of trade (s 11(a) read with s 23(g))			nil	1
<i>Alt: Seen as a fringe benefit ito 7th Schedule or R248 663 x 105/100 = R261 096</i>			(248 663)	1P
<u>Bribe - deduction prohibited (s 23(o))</u> as an activity defined in Chapter 2 of the <i>Prevention and Combating of Corrupt Activities Act</i>			nil	1
4.8 Bonuses and commissions				
Assume: Paid March 2017 and March 2018 respectively: Accrual for 2017: actual payment deducted under section 7B Accrual for 2018: deductible in 2019 as employer is deemed to incur the expenditure on the date on which the amount is paid to the employees			(155 915) nil	1 1
<i>Alt: Assume: Paid March 2018, deductible in 2019 (not deductible in 2018) because the employer is deemed to incur the expenditure on the date on which the amount is paid to the employees (s 7B) i.e. 2019.</i>			nil	1 1
Aggregate capital gain		250 000		
x inclusion rate <i>No mark if candidate applied annual exclusion</i>		x 80%	200 000	1
<i>Alt: The full proceeds were used to fund the purchase the replacement machine and assume brought into use within 3 year par 66 of the Eighth Schedule applies– the capital gain is deferred.</i>			0	1
Taxable income before donation			861 013	
4.9 Donation				
Limited to 10% of taxable income (s 18A)		R861 013 x 10% =	(86 101)	1P
Note: The balance of R163 899 is carried forward to the next year of assessment (2019) since any amount disallowed in terms of s 18A can be forwarded (proviso to s 18A(1)(B))				
<i>Alt; If candidate argued that there is no valid receipt for s18A donation.</i>				1
Taxable income			774 912	
			Available	30
			Maximum	30
			<i>Communication skills – presentation; clarity of expression</i>	2
			Total for part (b)	32

Part (c) Discuss the ethical concerns you may have regarding the conduct of Phumlani, his tax practitioner and SA Solar. Include any actions that SARS may take against these parties.		Marks
1	The ethical concerns regarding the conduct of Phumlani, his tax practitioner and SA Solar	
1.1	In a broad sense, ethical behaviour entails what is good/beneficial to the majority of parties involved and not only considering yourself.	1
1.2	Bribery and the claim of private expenses is unethical behaviour of SA Solar (and directly Phumlani as he is the only shareholder of this company).	1
1.3	This could negatively impact on the reputation of all of the parties involved (loss of jobs etc) and is in contravention of good corporate citizenship.	1
1.4	The parties should have been aware that it is contravention of tax legislation to claim the deduction. <i>Due diligence</i> was not applied	1
2	Ethical concerns: SA Solar and Phumlani (as sole shareholder):	
2.1	As the company claimed expenses (private expenses and a bribe), the result will be that that its will be beneficial for SA Solar (indirectly to Phumlani as sole shareholder) as it claims more tax deduction,	1
2.2	But detrimental to SARS will receive less revenue/taxes	1
3	Ethical concerns: Tax practitioner:	
3.1	The tax practitioner can lose his accreditation as a member of the Law Society and as a tax practitioner	1
4	The actions that SARS may take against SA Solar/Phumlani	
4.1	SARS will disallow the deductions that SA Solar wrongfully claimed (private expenses and bribes) and issue an <i>additional assessment</i> .	1
4.2	As SA Solar's intention was to evade tax, the behaviour is intentional tax evasion (onus on SARS to prove this behaviour).	1
4.3	SARS may impose an understatement penalty (and interest) on income tax on SA Solar / Phumlani for the addition tax deductions claimed	1
4.4	It is likely that Phumlani's employees certificate did not reflect the fringe benefit from the overseas trip (if received as an employee) that was paid by the company and an underpayment of PAYE, took place	1
4.5	SARS may impose penalties and interest for the understatement or non-declaration of remuneration for provisional tax (PAYE) purposes.	1
4.6	If Phumlani received the overseas trip in his capacity as shareholder, it would be a dividend <i>in specie</i> and SA Solar under paid the dividends tax	1
5	The actions SARS may take against the tax practitioner:	
5.1	A senior SARS official may lodge a complaint (s 241 of the Tax Administration Act).with the Law Society of South Africa, because	1
5.2	the tax practitioner assisted the taxpayer to evade tax /due diligence was not applied.	1
	Available	16
	Maximum	9
	<i>Communication skills – appropriate style</i>	1
	Total for part (c)	10

Part (d) Calculate the taxable income of Phumlani for the 2018 year of assessment. Provide reasons where no tax implications arise in respect of a specific item.					Marks
ALTERNATIVE A	Amount			Income tax	
	Calculations		CGT		
GROSS INCOME					
<i>Income deemed to accrue only to Phumlani, s 7(2A)(a)(i)</i>					
Salary, gross income	150 000 x 12			1 800 000	1
Fringe benefit: medical aid par. 2(l) and 12A	1 500 x 12			18 000	1
Fringe benefit: provident fund (par. 2(l) and 12D)	1 800 000 x 10%			180 000	1P
'Fringe benefit' - holiday trip to Dubai (par. 10, 7th Schedule) or <i>Alt. Dividend in specie</i>				248 663 nil	1
Total remuneration				2 246 663	
<i>Alt. total remuneration</i>				1 998 000	
Deemed dividend on loan:					
Dividend in specie in terms of s 64E(4), for which the company is liable for dividends tax. It is thus not included in the gross income of Phumlani.					
				Nil	1
Interest income deemed to accrue to both spouses equally, s 7(2A)(b)					
Interest received	30 000 x 50%			15 000	1
Annual exemption of interest (s 10(1)(i) - R23 800, limited to				(15 000)	1P
Income				2 246 663	
Alt. Income				1 998 000	
Net capital gain			100 000		
Taxable capital gain included at 40%				40 000	1
Taxable income after capital gain				2 286 663	
Alt. Taxable income after capital gain				2 038 000	
Less: deductions					
S 11F: Actual contributions: Employee contribution	1 800 000 x 7,5%	135 000			1P
Employer contribution	1 800 000 x 10%	180 000			1P
		315 000			
Deduction limited to lesser of three:					
• R350 000; or	350 000; or				1
• 27,5% of the higher of remuneration (2 246 663) or taxable income after capital gain (R2 286 663); or	27,5% x 2 286 663 = 628 832; or				1P
• Taxable income before s11F and inclusion of taxable capital gain	2 246 663				1P

**QUESTION 1 PART I
PAPER 1**

**ITC JUNE 2019
SUGGESTED SOLUTION**

Therefore R350 000 is the lesser but limited to actual contributions				(315 000)	1P
Taxable income before rental income				1 971 663	
<i>Alt. Taxable income before rental income</i>				<i>1 723 000</i>	
Residential letting					
Deemed to accrue in equal shares, section 7(2A)(b)	19 888 x 50%				1
Loss from residential letting, section 20A	9 944				
Taxable income is equal to or exceeds the amount at which the maximum marginal rate applies, which is R1 500 001, and					1P
Residential letting is a suspect trade (to only a relative)					1
Ringfence loss for current year (s 20A(2)(b)), can only be set off in future against this trade				nil	1
Taxable income				1 971 663	
				Available	19
				Total for part (d)	18
				Total for part I	65