Part (a)	**Discuss, with reference to the principles of relevant case law and the *Income Tax Act,* 1962 (Act 58 of 1962), as amended, whether the payment of ZAR175 000 may be claimed as a deduction by Constak in the 2019 year of assessment.**	**Marks**
1	The deduction must be considered in terms of the_general deduction formula as set out in *section 11(a),* read together with *section 23(g)* of the Income Tax Act.	1
2.	In terms of *section 102* of the Tax Administration Act, the onus of proof is on Constak to prove that the amount is deductible. *No mark if reference to Income Tax Act.*	1
3.1	Did Constak pay the compensation as part of carrying on a trade? As 'trade' should be given a wide interpretation (*Burgess*), the retail sales of the Moroccan branch constitutes the carrying on of a trade and	1
3.2	included in Constak's gross income as Constak is a resident and is therefore taxed on world-wide_income, regardless of the source (Moroccan sales are not exempt in terms of section 10).	1
4	Section 11(a) does not permit the deduction of expenses of a capital nature. As the compensation does **not add to the income earning structure as it relates to staff costs** *(New State Areas*), the expenditure is **not capital in nature** *OR does* ***add to the income earning structure*** *(New State Areas)****as this might damage the reputation of Constak****, the expenditure is then* ***capital.***	1
5	The *crux* of the issue is whether the compensation expenditure incurred in the production of income.	1
5.1	The case of *Port Elizabeth Electric Tramway Co Ltd v CIR* established the principle that this requirement will be met if the action that gave rise to expenditure are closely connected to the trade.	1
5.2	The action that gave rise to the expenditure was the employment of Dipuo by Constak as a necessary element of the income producing operation.	1
5.3	In the case of *Joffe & Co (Pty) Ltd v CIR* it was held that negligence in construction was not a necessary (inevitable) concomitant of income-producing activities (trading operations).	1
5.4	The question is if it is_reasonable to expect that injuries and accidents may occur in the workplace in the course of retail of building products or is it negligence?	1
	ALTERNATIVE A – decision made by candidate	
5.5	There is nothing in the question to indicate that the accident was caused by gross negligence of Constak that is not a necessary or inevitable concomitant of trade, thus it is submitted that the Joffe principle does not apply as there is an inherent risk.	1
6	Conclusion: The amount is therefore deductible in the 2019 year of assessment (*take into account all arguments before the conclusion).*.	1
	ALTERNATIVE B – decision made by candidate	
5.5	The accident may have been caused by gross negligence such as insufficient safety measures by the driver or that Dipou did not observe protocol in entering the workspace and was herself negligent, thus it is submitted that the Joffe principle does apply.	1
6	Conclusion: The amount is therefore not deductible (*take into account all arguments before the conclusion).*	1
	Available	**12**
	Maximum	**10**
	Communication skills – logical argument	*1*

Note: This is the communication mark awarded for a conclusion that is consistent with the argument of the candidate, thus no mark for any contradiction in the argument/arguments.	
Total for part (a)	**11**

Part (b) **Calculate the normal tax payable by Constak for the 2019 year of assessment based on the information provided in the scenario. Start your calculation with the branch profits disclosed in the income statement.**					**Marks**
	Workings	**Non-SA**	**SA**	**Total**	
Moroccan branch: profit before taxation translated to rand using the **average exchange** rate for the 2019 year in terms of s 25D(2). Profit before taxation - SA branches.	MAD 2 180 000 1,3380	 2 916 840	 30 605 000	 33 521 840	 1
Add back: Provision for warranties (not expenditure actually incurred)			5 782 000	5 782 000	1
Less: Warranty costs actually incurred (refunds paid during the year)	*Or -R144 800* *Two marks*		-5 926 800	-5 926 800	1
Trading stock donated at market value (s 22(8)B)			475 000	475 000	1
Less: Assessed loss brought forward –s 20			–845 000	–845 000	1
Add back: donation per income statement **Taxable income before s18A deduction**		 2 916 840	100 000 30 190 200	100 000 33 107 040	1
S 18A: Deduction R33 107 040 x **10% (limited to donation calculated/R100 000)** • Donation to: Johannesburg Children's Home (PBO)	R3 310 704 –R100 000			–100 000	1P
• **Inventory** donated**: not to a PBO**	–			-	1
Taxable income				33 007 040	
SA normal tax at **28%** (no mark if only on SA taxable income)				9 241 971	1P

Less: <u>s 6quat rebate</u> for Moroccan taxes paid Moroccan taxable income Moroccan corporate tax Translated to rand at **average exchange rate** (s 6quat(4))	MAD <u>2 180 000</u> 545 000 1,3380 ***** 545 000 = R729 210				1
Taxable income before s 18A deduction **S18A allocated pro rata** to the SA and non-SA taxable income (proviso to s 6quat(1B))	1)R2916840/33107 040 x 100 000 2) R100 000 – R8 810	2 916 840 –8 810	30 190 200 –91 190	33 107 040	1P
Split of taxable income for calculation of s 6quat after s 18A Limitation on s6quat = 2 908 030/33 007 040 x 9 241 971 =		2 908 030 814 248	30 099 010	33 007 040	1P 1P
All foreign tax paid may be claimed **(limiting amount based on calculations and original foreign tax)** Normal tax payable for the year				-729 210 8 512 761	1P
				Available	**14**
				Maximum	**13**
Communications skill – presentation (Taxable Framework had to be used: correct position of s20; s 18A and/or s6quat or should start of profit before tax as provided in Required)					*1*
				Total for part (b)	**14**

Part (c)	**Explain, with supporting calculations, the donations tax implications arising from the loan for Sogren, Forev and/or Sandile Assume that the official rate of interest for the period is 7,75% per annum**	**Marks**
1	**<u>Loan amount provided to Sogren</u>** Sogren is the recipient of the loan and has no donation tax implication.	1
2	There are no donations tax implications on advancing the loan itself for Forev as Sogren has an immediate obligation for repayment, (thus not gratuitous).	1
	<u>Interest free element loan provided</u> *<u>Scope: Section 7C</u>*	
3	Sandile is a connected person to Forev as he owns all the shares in Forev and the loan would be made at his instance thus the condition of *s7C(1)(b*) is met.	1
4	Forev advances the loan to Sogren, which is held indirectly by the XoliXaba Trust (70% interest, which is more than the 20% subminimum required by *s7C(1)(i*i)	1
5	Sandile (the individual behind the loan) is a connected person in relation to the XoliXaba Trust as he is a beneficiary of the Trust (s1 definition).	1
	<u>Application of section 7C</u>	

6	The requirements for s7C to apply have been met and Sandile will be deemed to have made a donation to the Trust through the use of a company (Forev).	1
7	Forev will have no donations tax consequences as s7C deems the donation to have been made by Sandile (interest free loan).	1
8	The amount of the donation is equal to the interest benefit on the loan: R2m x 7,75% = R155 000.	1
9	Sandile can deduct the R100 000 donations tax annual exemption (assuming Sandile has not already used this): R155 000 – 100 000 = R55 000 *(no mark if exemption is applied after calculating 20% and/or is the company is seen to be making the donation or if a R10 000 casual gift exemption was applied for companies)*	1
10	The donations tax will be 20% on the amount of the deemed donation: R55 000 x 20% = R11 000	1
11	The deemed donation is deemed to be made on the last day of the year of assessment of the Trust, which will be the last day of February 2019.	1
12	Sandile is liable for the donations tax and he must pay this to SARS by the end of the month following the month in which the donation is deemed to have been made. Thus, the donations tax must be paid to SARS by 31 March 2019.	1
13	The deemed donation will arise in the year that the loan remains unpaid. Thus, if a two-year loan is advanced on 1 March 2018, there will be a deemed donation on 28 February 2019 and again on 29 February 2020 if it remains unpaid.	1P
	Available	**13**
	Maximum	**10**
	Total for part (c)	**10**

Part (d)	**Explain, with supporting calculations, with regard to the letting of the flats – (i) all the VAT implications for Sogren**	**Marks**
1	**<u>Construction of flats</u>**: Sogren would have claimed input tax in terms of *s16(3)* on the costs of construction of the flats,	1
1.1	to the extent of making 100% taxable supplies. *No mark if s 16(3)(h) was applied*)	1
2	**<u>Change in use:</u>** When the ten flats are subsequently applied by the vendor as an exempt supply, a change of use adjustment arises in terms of *s18(1). No mark if section 18B has been applied*	1
3	The flats are deemed to have been supplied by Sogren by way of a taxable supply in the course of their enterprise, therefore output tax is charged.	1
4	Time of supply (s9(6)): when the change in use occurs, which will be when the lease agreement commences, that is, 1 March 2019 (included in the *end of April VAT* return). *No mark if section 18B has been applied*	1
5	Consideration for the supply (s10(7)): open market value of R10 million of the flats at the time of the supply.	1
6	Thus, in the March/April 2019 tax period, Sogren must raise output tax calculated by applying the tax fraction to the open market value of the flats: R10 million x 15/115 = R1 304 348 *(No mark if the three-year deferral provision is applied as it is no longer relevant from 1 Jan 2018 –section 18B)*	1

7	The renting out of the flats is the supply of a residential accommodation (*dwelling*) in terms of an agreement for the letting and hiring thereof, which is an exempt supply in terms of *s12(c)* of the VAT Act	1
8.	and Sogren may **not levy output tax** on the rental income received of R10 000 per month**.** (Conclusion on discussion of rent**)**	1P
9	**Insurance premiums**: Thus, Sogren may not claim any input tax credits on insurance premiums incurred in respect of the residential letting (an exempt supply).	1P
	Available	10
	Maximum	**8**
	Total for part (d)(i)	**8**

Part (d)	**Explain, with supporting calculations, with regard to the letting of the flats – (ii) in which year(s) of assessment the insurance payment made on 1 August 2019 may be claimed as a deduction by Sogren for normal tax purposes.**	**Marks**
1	The deduction may be claimed if it meets the requirements of the general deduction formula in terms of *s11(a) and s23g* of the Income Tax Act (*or Trade of letting flats)*	1
2	The insurance premiums is a pre-paid/advance payment incurred on 1 August 2019 relates to benefits enjoyed after year end, thus s 23H applies.	1
3	As the prepaid expense cover 7 months after the end of the year of assessment (more than 6 months), or	1
4	The advance payment exceed R100 000 (R1 650 x10 x 7 = R115 500), thus	1
5	the deduction for the 2019 year of assessment would be limited in terms of s23H to R198 000 x 5/12 = R82 500	1P
6	The remaining amount (balance) of R115 500 may only be deducted in the 2020 year of assessment (conclusion that must be in line with the calculation). Note: *3. to 6 is the application of the section, thus calculations need to be correct*.	1
	Available	**6**
	Maximum	**4**
	Total for part (d)(ii)	**4**
	Total for part (d)	**12**
TOTAL FOR THE QUESTION		**47**