FEEDBACK TUTORIAL LETTER

2nd SEMESTER 2019

Test 1

Taxation 202
TAX621S
Question 1

Lucky B inherited money in 2011. He bought two residential duplex units, of R450 000 each, with his inheritance. He has since received rental income of R10 000 per month, which he has declared to SARS. He is emigrating to Australia and he decided to sell these units. The units were sold at R500 000 each to the tenants during the 2019 year of assessment.

REQUIRED:

Discuss, with reference to case law, whether the R1 000 000 that he received for the two duplexes should be included in gross income or not. Use the IACA approach to answer the question.

Solution Question 1 (15 possible, maximum 10 marks)

Provide the definition of gross income and briefly refer to the relevance of each of the requirements. (1)

Identify the crux of the matter (problem), namely capital vs revenue. (1)

In the Visser case (you must refer to the correct applicable case law) the "tree and the fruit" principle was introduced. The "fruit" is revenue in nature and the "tree" capital in nature. (1)

The duplexes are the "tree" and the rental income the "fruit". (1)

In the Stott case the test of intention was applied and the question to be asked is whether the taxpayer was busy with a scheme of profit-making or merely realising his capital asset to his best advantage. (1)

In the Natal Estates Ltd case it was asked whether the taxpayer had "crossed the Rubicon" and gone onto a scheme of profit-making (change of intention). (1)

The facts of each case must be considered and in any such inquiry important considerations will include (1)

The intention of the owner both when acquiring and selling the asset (1)

History of property transactions (1)

Continuity (1)

Method of finance (own funds or borrowed funds) (1)

The extent of marketing (1)

Owner's activities prior to selling the asset (1)

Reason for sale (1)

Utilisation of proceeds (1)
Mrs Aina, a SA resident, aged 50 years old, received the following amounts during the 2019 year of assessment.

- Interest from a local bank, R11 500
- Interest from a friend in UK, R5 000
- Dividends from a SA Company, R9 800
- Dividends from a 8% shareholding in a foreign company. R10 000 was paid into her bank account. This amount was subject to 10% withholding tax.
- Salary of R300 000

REQUIRED:
Calculate normal income tax liability for the 2019 year of assessment.

**Question 2 Solution (12 Marks)**

Mrs Aina - Tax calculation for the 2019 year of assessment

<table>
<thead>
<tr>
<th>Interest - local</th>
<th>11 500</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exemption</td>
<td>(11500)</td>
<td>0</td>
</tr>
<tr>
<td>Interest friend</td>
<td>5 000</td>
<td>1</td>
</tr>
<tr>
<td>Exemption</td>
<td>(5 000)</td>
<td>0</td>
</tr>
<tr>
<td>Dividends SA</td>
<td>9 800</td>
<td>1</td>
</tr>
<tr>
<td>Exemption</td>
<td>(9 800)</td>
<td>0</td>
</tr>
<tr>
<td>Dividends Foreign</td>
<td>11 111</td>
<td>10 000/90*100</td>
</tr>
<tr>
<td>Exemption</td>
<td>(7046)</td>
<td>4 065</td>
</tr>
<tr>
<td>Salary</td>
<td>300 000</td>
<td>1</td>
</tr>
<tr>
<td>Income/Taxable income</td>
<td>304 065</td>
<td></td>
</tr>
<tr>
<td>Tax per tables</td>
<td>63 388.64</td>
<td>304065 less 195 851 * 26% plus R35 253</td>
</tr>
<tr>
<td>Primary rebate</td>
<td>(14 067)</td>
<td>1</td>
</tr>
<tr>
<td>Tax liability</td>
<td>49 321.64</td>
<td>1/2 or 1</td>
</tr>
</tbody>
</table>
Question 3 (17 Marks)

Mr A, 55 years old, emigrated from the Republic five years ago and has since been ordinarily resident outside the Republic. He is also not a resident in terms of the physical presence test for South African income tax purposes for the 2019 year of assessment. He is therefore a non-resident. Ignore any double tax agreement (DTA).

REQUIRED:

Consider the receipts below and discuss, with reasons, the amounts (if any) to be included in Mr A's taxable income in the Republic for the 2019 year of assessment. You should in addition state the source of the income.

Purchased annuity (5 Marks)

Before he emigrated, Mr A purchased a 10-year annuity from a South African insurance company. He paid R180 000 for it and has been receiving R2 500 per month as from 1 March 2015.

Solution (7 Possible, 5 Maximum)

<table>
<thead>
<tr>
<th>Non Resident</th>
<th>Taxed on SA income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Source</td>
<td>Where contract was signed</td>
</tr>
<tr>
<td>Annuity</td>
<td>SA Source</td>
</tr>
<tr>
<td>Income</td>
<td>2 500x 12</td>
</tr>
<tr>
<td>Exemption</td>
<td>( Y = A \times \frac{C}{B} )</td>
</tr>
<tr>
<td></td>
<td>( A = 180 \ 000 )</td>
</tr>
<tr>
<td></td>
<td>( B = (2500 \times 12 \text{ months}) \times 10 \text{ years} = 300 \ 000 )</td>
</tr>
<tr>
<td></td>
<td>( C = 2500 )</td>
</tr>
<tr>
<td></td>
<td>(18 000)</td>
</tr>
<tr>
<td>Taxable portion</td>
<td>12 000</td>
</tr>
</tbody>
</table>

Dividends (2 Marks)

Mr A received dividends to the amount of R5 000 in respect of shares which he still holds in South African listed companies, incorporated in terms of the South African Companies Act.

Solution (possible 3, maximum 2 marks)

<table>
<thead>
<tr>
<th>Non Resident</th>
<th>Taxed on SA income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Source</td>
<td>Where contract was signed</td>
</tr>
<tr>
<td>Interest</td>
<td>SA Source</td>
</tr>
<tr>
<td>Income</td>
<td>5 000</td>
</tr>
<tr>
<td>Exemption</td>
<td>(5 000)</td>
</tr>
<tr>
<td>Taxable portion</td>
<td>0</td>
</tr>
</tbody>
</table>
Research Income (2 Marks)

The South African government appointed Mr A in terms of a service contract to conduct research abroad. He received R15 000 as remuneration for his research.

Solution

*In terms of section 9(2)(h) any amount received in respect of services rendered on behalf of an employer which is a government entity (public sector)* (1)

*is from a source within the Republic. The R15 000 is therefore from a source within the Republic and will be included in Mr A’s gross income.* (1)

Services rendered (2 Marks)

During the 2019 year of assessment Mr A also entered into an agreement with a South African company in terms of which he does contract work for them in the Republic from time to time.

Solution (maximum 2 marks)

As there is no specific source rule in section 9 of the Act, case law applies. (1)

The work is physically done in the Republic, so the true source of the remuneration is where the services were rendered, i.e. the Republic. (1)

*It will therefore be included in his gross income and consequently in his income.* (1)

Rental income (2 Marks)

Mr A still owns a furnished flat in Hout Bay, which he lets to tenants. He receives R15 000 rental per month, R10 000 of which is for the flat and R5 000 for the furniture.

Solution (Maximum 2 marks)

As there is no specific source rule in section 9 of the Act, case law applies. (1)

The flat is located in the RSA, so the R10 000 rental income is from a source within the Republic and should be included in his gross income. (1)
Interest received (3 Marks)

During the 2019 year of assessment, Mr A made an ad hoc loan to one of his old friends. The credit was granted overseas and the friend (who is ordinarily resident in the Republic) utilised the funds in the RSA. Mr A received R30 000 interest in respect of the loan during the 2019 year of assessment.

Interest of R10 000 from a SA bank.

**Solution (3 maximum)**

*In terms of section 9(2)(b) interest is received from a source within the Republic if the debtor is a resident OR if the funds are utilised in the Republic.*

(1)

*Therefore, the interest is received from a source within the Republic and needs to be included in Mr A’s gross income.*

(1)

*The interest income of R30 000 will be exempted in full in terms of section 10(1)(h) so that no amount will be included in income as defined.*

(1)

Pension received (2 Marks)

When Mr A was 50 years old, he retired from the services of his South African employer where he had been working for many years. He emigrated immediately afterwards. He has been receiving a monthly pension of R18 000 from this previous employer from 1 March 2018.

**Solution (2 Maximum)**

*In terms of section 9(2)(i), a pension is from a source within the Republic if the services were rendered in the Republic.*

(1)

*This being the case, Mr A will have to include the pension received in his gross income.*

(1)

*R216 000 will therefore be included in his gross income.*

(1)
Question 4

Amy is 40 years old and works in Saudi Arabia as a contractor. She commenced as a contractor in Saudi Arabia in 2016 with an initial contract for a two-year period renewable every two years. She has renewed and extended her contract for the period 2018-2019. Housing is provided by the employer. Every time she extends her contract, she has to obtain a work permit through the Department of Foreign Affairs in the Republic.

She is single and does not own any fixed property. She visits her parents, who live in South Africa, twice a year during April and December for a total period of three weeks at each visit. Amy travels on her South African passport. She does not possess any other passport. Her monthly income is $2 800 (R28 000 per month). She is a member of a South African medical aid fund and pays a monthly contribution of R750 to the fund. The tax rate applicable to individuals in Saudi Arabia is 0%.

Assume that there is no DTA between the two governments in place.

Amy is uncertain about whether she will still be regarded as ordinarily resident in the Republic.

REQUIRED:

(a) Discuss (with reference to case law) whether Amy will be regarded as ordinarily resident in the Republic in terms of the definition of resident in the Act. (You do not have to discuss the physical presence test.) (4 Marks)

(b) Advise Amy on her South African normal tax position for the 2019 year of assessment. (Assume that she will be regarded as a resident and that there are no DTAs.) (6 Marks)
Solution (4 maximum)

Amy is a resident because she is ordinarily resident in the Republic. "Ordinarily resident" is not defined but the courts consider various factors in deciding whether a taxpayer is ordinarily resident in the Republic or not. (1)

In Cohen v CIR the principle was laid down that a person may be resident in more than one country at a time but the person can only be ordinarily resident in one country. Ordinary residence is the residence in the country to which a person would naturally and as a matter of course return from their wanderings. Their principle residence would be their real home. Physical absence during the whole year of assessment is not decisive in the question of ordinary residence. (1)

CIR v Kuttel held that a person is ordinarily resident where they have their usual or principal residence, that is, what may be described as their real home. (1)

The following circumstances indicate that Amy is ordinarily resident in the Republic: (1 mark each, 2 marks maximum)

She does not own property in either of the countries.

It appears that her family resides in the Republic.

She travels on a South African passport and does not possess any other passport.

Her medical aid fund is in the Republic. She returns to her parents in South Africa during her vacations. If her contract expires, she will have to return to the Republic.

The circumstances indicate that she regards her real home as the Republic and, therefore, she is ordinarily resident in the Republic.

Maximum 6 Marks

(b) Amy is a South African resident and, in terms of the gross income definition (1)

she has to include her worldwide income of R336 000 (R28 000 x 12) in gross income. (1)

Section 10(1)(o)(ii) exempts remuneration derived by a person in respect of services rendered outside the Republic if the person concerned was outside the Republic for more than 183 complete days in aggregate during any 12-month period commencing or ending during any year of assessment; and (1)

for a continuous period of absence exceeding 60 full days during the relevant period of 12 months; and (1)

the services were rendered during that period for or on behalf of an employer, who can be situated in or outside South Africa. (1)

The R336 000 will be exempt (1)

END OF TEST