Tax Professional

Final Integrated Summative Assessment

2014 Sample Paper

Paper 1: Solution

South African
Institute of
Tax Professionals

Part A

Dear Mr Puma

You have requested that I provide you with an indication of my views on the potential tax risks and costs, tax inefficiencies as well as any favourable tax aspects of the current structure of your estate

Please find below my views on the aspects of your current estate structure that you have requested assistance on:

General principles applicable

- Taxes on wealth are generally imposed when the wealth is realised or deemed to have been realised for purposes of a specific type of tax.
- If a taxpayer disposes of an asset held on capital account, this disposal is subject to capital gains tax. The capital gain or loss in respect of a disposal is determined as the difference between the proceeds and base cost.
- For estate planning purposes, it is important to realise that a person is deemed to have disposed of his or her assets at market value when he or she passes away.
- In addition to the capital gain or loss that will arise on the deemed disposal when a person passes away, the net value of the person's estate will be subject to estate duty at a rate of 20% to the extent that the value of the estate exceeds R3,5 million.
- In addition to the tax implications of the accumulated wealth, the income earned from the assets may be subject to tax.
- The potential tax risks and costs, inefficiencies and favourable aspects of your current estate structure are set out below.

Residence

- Should this property be disposed of (by way of sale or deemed disposal at the time of death), such a disposal will be subject to capital gains tax.
- As the property was acquired prior to 1 October 2001, the base cost of the property must be based on the valuation date value. As the estimated market value

(proceeds) exceed the costs incurred to acquire the property, the valuation date value can be based on the market value (if determined at 1 October 2001), the time apportioned base cost as determined in terms of paragraph 30 of the Eighth Schedule to the Income Tax Act or as 20% of the proceeds less any expenditure incurred after 1 October 2001 (refer paragraph 26 of the Eighth Schedule to the Income Tax Act). In practice, a taxpayer would use the higher of the alternatives available for which the information has been obtained.[1]

- The use of the valuation date value will result in the full increase in the value of the property from R600 000 at the time of acquisition not necessarily being subject to capital gains tax.
- As the property is used by Mr Puma as his primary residence, the property qualifies for the primary residence exclusion of R2 million of the capital gains on disposal in terms of paragraph 45 of the Eighth Schedule to the Income Tax Act. This exclusion is only available to natural persons and can therefore be utilised by Mr Puma because of the fact that the property is currently held in his own name.
- From the current market value of the property (R2 million) and the base cost (above) it appears as if there is room for the market value to increase without such increases being subject to capital gains tax.
- The residence would constitute property for purposes of the Estate Duty Act. As such, the property would be included in the net value of Mr Puma's estate that would be subject to estate duty to the extent that the value of the estate exceeds R3,5 million.
- From the perspective of estate duty it may be more efficient to hold the property in a trust where this estate duty charge would not arise. There may however be tax costs to transfer the property to such a trust. Once the property has been transferred to the trust, the increase in value would not be excluded from capital gains tax on the basis that the property is used by Mr Puma as a primary residence.

[1] Paragraph 29(4)*(a)* of the Eighth Schedule to the Income Tax Act requires that the market value of the property at 1 October 2001 had to be determined by 30 September 2004 in order to be used to determine the valuation date value.

Investment property in Wonderboom

- The rental income is currently taxed at a rate of 40% in the hands of Mr Puma, given that his salary income from Puma Engineering exceeds the top threshold of the tax rates applicable to natural persons.
- If the property were to be held by a company, the rental income will be taxed in the company at a rate of 28%. Any distribution of this rental income as a dividend is subject to a further 15% dividends tax on the amount distributed, which would result in an effective tax rate of 38, 8%. The timing of the 15% tax on the distribution can however be deferred until the time of distribution. This may mean that Mr. Puma (through the company) has more cash at his disposal to invest in other ventures through the company. This could be inefficiency in the current structure.
- Any capital gain or loss on the disposal of the property to realise the capital growth of approximately R800 000 will be subject to inclusion at a rate of 33, 3% into the taxable income of Mr Puma to be taxed at a rate of 40% (effective tax rate 13,33%). This rate is more favourable than the effective rate of 66,6% inclusion into taxable income to be taxed at a rate of 28% (effective tax rate 18,6%) in the hands of a company. The current structure is favourable from this perspective.
- The intention that Mr Puma has with the property will be important in this case. If it is to generate rental income, it may be more efficient to hold the property in a company. If however the purpose it to unlock capital appreciation at some stage, it may be more beneficial to hold the property in his own name in order to benefit from the lower effective capital gains tax rate.
- In instances (holding the property in his own name or in the name of a company owned by him), the property or shares will be property to be included in the net value of his estate and be subject to estate duty to the extent that the value of the estate exceeds R3,5 million.

Mpumalanga Farm

- The forestry activities conducted by the Carrying on farming operations the local person may constitute pastoral, agricultural or other farming operations being carried on by Mr Puma. In the case of *ITC 1630* (or *ITC 166*) it was suggested that a person who lets a farm to another person in exchange for rental that consists of a percentage of the produce may be carrying on farming operations. This view was recently confirmed in the case of Kluh Investments (Pty) Ltd v C: SARS. It is submitted that the arrangement between Mr Puma and the local person may similarly result in Mr Puma carrying on farming operations as a result of his proceed sharing arrangement with the local person.
- As a person carrying on farming operations, any proceeds he receives for the forest/plantation on disposal would be included in his gross income in terms of paragraph 14(1) of the First Schedule to the Income Tax Act and be taxed at 40%.
- Any amounts received for the sale of the land would however still be subject to capital gains tax.
- The farm will be property to be included in the net value of his estate and be subject to estate duty to the extent that the value of the estate exceeds R3,5 million.

Shares in Puma Property

- A dividend is defined in section 1(1) of the Income Tax Act as "any amount transferred or applied by a company that is a resident for the benefit or on behalf of any person in respect of any share in that company".
- It was held in the case of C: SARS v Brummeria Renaissance (Pty) Ltd and Others that an amount includes anything that is of value and that has a monetary value, not necessarily only cash. The use or right of use of the boat would arguably have a money value.
- The risk therefore exists that the use or right of use of the boat by Mr Puma constitutes a dividend if he enjoys this benefit by reason of his shareholding in Puma Property.

- Similarly, the rental income that accrues to the company that is paid directly into the shareholder (Mr Puma) bank account may be viewed as a dividend.
- Such dividends paid to a natural person (Mr Puma) by a resident company would be subject to dividends tax
- As a dividend other than in cash, the dividends tax would be imposed on the company (Puma Property) at a rate of 15%.
- Both the shares (and therefore the value of the underlying property) and the loan to Puma Property will be property to be included in the net value of his estate and be subject to estate duty to the extent that the value of the estate exceeds R3,5 million.

Shares in Puma Engineering

- The salary and bonus paid to Mr Puma by Puma Engineering constitutes remuneration as defined in paragraph 1 of the Fourth Schedule. As such Puma Engineering is required to withhold employees' tax in respect of these payments.
- As a director of Puma Engineering (Pty) Ltd, a private company, Mr Puma falls within the scope of paragraph 11C of the Fourth Schedule to the Income Tax Act.
- In terms of that paragraph, Puma Engineering would be deemed to have paid remuneration based on his average remuneration per month for the previous year of assessment to him (paragraph 11C(1)) and would be required to pay employees' tax to SARS on this basis.
- An exception to this rule exists where the person derived more than 75% of the remuneration for the previous year of assessment from fixed monthly payments.
- Mr Puma would not qualify for this exclusion as his bonus constitutes more than 25% of his remuneration.
- The current structure of income from the shareholding/employment would therefore require Puma Engineering to pay PAYE over to SARS based on deemed remuneration. This could have a negative impact on Mr Puma's cash flow position if this amount is deducted from his remuneration every month.

- Both the shares (and therefore the value of the underlying property) and the loan to Puma Property will be property to be included in the net value of his estate and be subject to estate duty to the extent that the value of the estate exceeds R3,5 million.

Limpopo game farm

- The farm is owned by a trust, which is a separate person from Mr Puma. If Mr Puma were to pass away, the deemed disposal of the farm for capital gains tax purposes would arguably not occur. This structure is favourable.
- The farm is similarly not property as defined for estate duty purposes.
- Section 3(3)(d) of the Estate Duty Act however includes the following in a person's estate:

  > "property (being property not otherwise chargeable under this Act or the full value of which is not otherwise required to be taken into account in the determination of the dutiable amount of the estate) of which the deceased was immediately prior to his death competent to dispose for his own benefit or for the benefit of his estate."

- Section 3(5)(b)(i) determines that a person is competent to dispose of property if amongst other "he had such power as would have enabled him, if he were sui juris, to appropriate or dispose of such property as he saw fit whether exercisable by will, power of appointment or in any other manner".
- It is submitted that Mr Puma would be able to, as only trustee with discretionary powers, and beneficiary of the trust dispose of any trust property, including the farm, as he sees fit and distribute the income to himself without requiring the consent of another person.

Other aspects

- It appears as if no will exists for Mr Puma's estate. This poses a risk in respect of distribution of his wealth should he pass away. It is recommended that such a will be drafted with the assistance of a specialist in this field.
- It is a concern that Mr Puma is the sole trustee of the trust. The effect and acceptability of this occurrence in terms of the Trust Property Control Act must be considered. It is recommended that legal advice be obtained.
- Given the capital gains tax and estate duty that Mr Puma (his estate) will be liable to pay if he were to pass away, it appears as if his estate may not be sufficiently liquid to be able to pay these taxes without having to dispose of certain properties. It may be advisable for him to take out a policy to enable to the estate to cover these liabilities without having to dispose of the assets.

  Please note that the above views are based on the information you have provided to me and my interpretation of the relevant tax laws and authorities. If you have any questions or if there are any aspects you would like to discuss, you are welcome to contact me.

Yours faithfully,

Tax Student

Part B

18 August 2015

Dear Mr Puma

Opinion on the tax implications of a transfer of assets to the Lion family trust

Scope of the opinion and indemnification

- At your request this document sets out our views on the tax implications of the arrangement, transaction or other event described in part 3 of this document. If this understanding or background is incorrect, incomplete or changes, this may affect the views expressed in this document.

- This document is intended to constitute an opinion as contemplated in section 223(3)(b) of the Tax Administration Act (Act 28 of 2011) if:

  - it was obtained by you no later than the date when the relevant tax return(s) is due;

  - the facts and circumstances relating to the arrangement, transaction or other event set out in part 3 of this document have fully been disclosed to us (whether you are a direct party to the facts and circumstances or not) and are fully documented in part 3; and

  - you have followed the tax position(s) set out in this document, which we have indicated that we are of the view is more likely than not to be upheld if the matter were to proceed to court.

- We urge you to consider whether this is the case, should you intend to use this document for purposes of section 223(3)(b) of the Tax Administration Act.

- This document does not address any accounting, business or regulatory implications of the transaction.

- The views expressed in this note are based on our knowledge and interpretation of the relevant tax legislation, case law and practices as listed in part 5 and referred to in this document. These principles may change over time as a result of amendments, case law and other circumstances. Such changes may impact on the views expressed in this document. We do not undertake to inform you of the impact of any such changes on the views expressed in this document.

- The views expressed in this document are our views based on our interpretation of the relevant legislation and case law. These views are based on the information provided to us by you. The views of and interpretation of the relevant legislation and case law by other accountants, auditors or the tax authorities may differ from ours.

- Although our directors, employees and subcontractors perform their duties with the utmost diligence and with reasonable care, this document does not provide assurance that the views expressed herein will not be queried or disagreed with by any person, or that the views will be upheld by the tax authorities or a court of law in the event where action is taken in accordance with the views expressed in this opinion.

- The purpose of this document is therefore to provide you with views, arguments and insight into the issue at hand; you are encouraged to use this opinion as part of a process to formulate your own view on the issue(s) at hand.

- The liability of our firm, its shareholders, directors, employees and agents, in respect of any claims arising from this document is limited to twice the fees charged.

- This document is intended solely to provide an opinion for the benefit, information and use by Mr Puma and the Lion family trust. It should not be distributed to third parties without our prior written consent. We do not accept responsibility for a third party who relies on this opinion.

Our understanding of the facts

Our understanding of the facts, based on a schedule prepared by your accountant, is as follows:

(should ideally repeat information given)

Issues to be considered

At your request we have addressed the following questions in this opinion:

What are the tax implications of transferring the assets currently held in the name of Mr Puma to the Lion family trust (hereafter referred to as the Trust)? You have indicated that any proposed transaction to transfer the assets to the Trust should not have any immediate cash impact for the Trust as it does not have cash reserves at this point in time.

Executive summary of views

(to complete with main aspects of discussion)

Relevant authority

In arriving at our view, we have considered the following sources:

(student to list authority consulted here)

Discussion of our view

- Based on your requirement that the assets need to be transferred to the Trust without any immediate cash flow implications, the alternatives that would in my view be available to you are:
    - Option 1 Mr. Puma donates the assets to the Trust
    - Option 2 Mr. Puma sells the assets to the Trust and the sales price remains outstanding on loan account

  The tax implications of each of the options are set out below, with our recommendations following this.

- The following tax implication would arise in both cases and need to be taken into account in your decision:
    - It is firstly important to note that as Mr. Puma is a beneficiary of the trust, he will be considered a connected person in relation to the trust (refer para)

Capital Gains Tax

- The Eighth Schedule to the Income Tax Act imposes capital gains tax on the disposal of any asset.

- Paragraph 11(1) of the Eighth Schedule to the Income Tax Act includes both a sale as well as a donation of any asset as a disposal. Both of these forms of transfer will therefore have capital gains tax implications.

- If assets are disposed (sold on loan account) of to a connected person at any amount other than the arm's length price, the proceeds must be deemed to be the market value of the asset in terms of paragraph 38 of the Eighth Schedule to the Income Tax Act. This same paragraph also applies to donations and deems an asset that has been donated to have been disposed at market value. The proceeds on the disposal will therefore be similar under both alternatives.

- The capital gain arising on the transfer of your primary residence would qualify for the exclusion of R2 million in paragraph 45 of the Eighth Schedule to the Income Tax Act.

- In addition, the aggregate capital gains for the year in which the transfers take place will qualify for the annual exclusion available to natural persons of R30 000.

Transfer duty

- The acquisition of the immovable property by the trust will be subject to transfer duty to the extent that it is not subject to VAT (refer section 2(1) and section 9(15) of the Transfer Duty Act). Transfer duty is imposed at the sliding rates provided in section 2 of the Transfer Duty Act.

- In terms of section 3(1) of the Transfer Duty Act, the acquirer of the property is liable for transfer duty (i.e. the Trust). Given the fact that the Trust does not have any cash reserves, Mr. Puma may have to pay these taxes on behalf of the Trust for the amount to remain outstanding on loan account to the Trust.

- The assets subject to transfer duty will be:

  - House (para (a) of the definition of property in section 1 of the Transfer Duty Act);

  - Investment properties (para (a) of the definition of property in section 1 of the Transfer Duty Act);

  - The shares in Puma Property constitute shares in a residential property company as contemplated in paragraph (d) of the definition of property.

  - A residential property company is defined in section 1 of the Transfer Duty Act as: "any company, other than a REIT as defined in section 1 of the Income Tax Act, 1962 (Act No. 58 of 1962), that holds property that constitutes—

  - Residential property …

  and where the fair value of that property or contingent right comprises more than 50 per cent of the aggregate fair market value of all the assets, as defined in paragraph 1 of the Eighth Schedule to the Income Tax Act, 1962, (other than financial instruments as defined in section 1 of that Act or any coin made mainly from gold or platinum), held by that company on the date of acquisition of an interest in that company"

- Residential property is defined in section 1 of the Estate Duty Act as "any dwelling-house, holiday home, apartment or similar abode, improved or unimproved land zoned for residential use in the Republic (including any real right thereto)". It excludes "an apartment complex, hotel, guesthouse or similar structure consisting of five or more units held by a person which has been used for renting to five or more persons, who are not connected persons, as defined in the Income Tax Act, 1962 (Act No. 58 of 1962), in relation to that person" and "any "fixed property" of a "vendor" forming part of an "enterprise" all as defined in section 1 of the Value-Added Tax Act, 1991 (Act No. 89 of 1991)". The two properties rented out for residential purposes therefore constitutes residential property as the supply is an exempt supply for VAT purposes and Puma Properties only hold 2 such units.

- As R2 million of the R3 million of assets of Puma Property is attributable to residential property, these shares are residential property company shares.

- The following assets would arguably not be subject to transfer duty (the assumptions must however be confirmed):

  - The forest in Mpumalanga, as farming operations are carried on and 20% of the proceeds are between R500 000 and R800 000, this joint venture or enterprise should be registered for VAT (based on the compulsory registration threshold of R1 million). As output tax must be charged, no transfer duty will be payable.

  - The Limpopo farm is already in the name of the Trust and will not be acquired by it.

  - In the case of the sale on loan account, the transfer duty will be imposed on the consideration agreed (i.e. sales price) (section 5(1) (a) of the Transfer Duty Act).

  - In the case of the donation where no consideration is payable, the transfer duty will be imposed on the declared value (section 5(1) (b) of the Estate Duty Act).

- In both instances, section 5(6) of the Transfer Duty Act allows the following:

  "If the Commissioner is of opinion that the consideration payable or the declared value is less than the fair value of the property in question he may determine the fair value of that property, and thereupon the duty payable in respect of the acquisition of that property shall be calculated in accordance with the fair value as so determined or the consideration payable or the declared value, whichever is the greatest"

  In both instances, the transfer duty may therefore be imposed on the fair value of the property. It would therefore be prudent to determine the transfer duty implications of the transactions based on such fair value.

- Option 1 Donation of the assets to the Trust

  - The capital gains tax and transfer duties referred to above will arise. As section 8(4)(k) only deems an amount equal to market value to be received where a person donates an asset to a connected person for purposes of section 8(4)(a), no such deemed disposal will arise when no allowances have been deducted in respect of the forest. As no amount is received or accrues to Mr. Puma on donation of the forest, the deemed proceeds will only be the amount in terms of paragraph 38 of the Eighth Schedule.

  - In addition to the above capital gains taxes, transfer duties and VAT on the sale of the forest, the donation of the assets will attract donations tax. In terms of section 54 of the Income Tax Act, donations tax is imposed on the donation of any property by a resident.

  - This donations tax will be imposed at a rate of 20%. Mr. Puma, as a natural person, will however qualify for the annual exemption of R100 000 from donations tax (section 56(2) (b) of the Income Tax Act).

  - A portion of such donations tax can be deducted from the base cost of the assets sold under paragraph 20(1) (c) (vii) read with paragraph 22 of the Eighth Schedule to the Act.

  - The assets donated to the trust will be excluded from Mr. Puma's estate for estate duty purposes. Please note that concerns in this regard exist under section 3(3)(d) of the Estate Duty Act, as expressed in earlier communication, due to the fact that Mr. Puma is the only trustee of the trust. These concerns can however be addressed relatively easily by the appointment of further trustees.

- Option 2 Sale of the assets to the Trust on loan account

  - The capital gains tax and transfer duties referred to above will arise, with the exception of the amount referred to in the next point.

  - If the forest is sold by Mr. Puma to the trust, the provisions of paragraph 14(1) of the First Schedule would deem R4 million of the proceeds (amount received for the plantation) to be included in Mr. Puma's gross income, as a person who carried on a pastoral, farming or other agricultural activity. Such amount would not be subject to capital gains tax.

  - As the assets will be sold for consideration (even though not yet received in cash) under this alternative, this will not constitute a donation and not be subject to donations tax. If no right to receive interest is created, no such right can be waived. An interest-free loan where the right to interest has never been established would therefore not result in donations tax being payable as no property is donated.

  - Note that it was held in the case of CIR v Berold that the interest-free nature of a loan may constitute another disposition for purposes of section 7. Amounts that accrue to the trust (under section 7(5)) or other beneficiaries as a result of this other disposition (interest-free nature of the loan) may be deemed to have accrued to Mr. Puma as the donor of this benefit.

  - As the distributions are all at the discretion of the trustee (Mr. Puma), the distributions of amounts retained in the trust are inherently subject to a condition which may result in section 7(5) being applicable.

  - The sole trustee status of Mr. Puma also implies that he has the power to confer a right to income on certain beneficiaries. This may result in section 7(6) being applicable.

- Even though the assets will no longer be included in Mr. Puma's estate (if the concerns referred to in 6.3.4. are addressed), the loan to the Trust will constitute property to be included in the estate. The value of such a loan will be subject to estate duty.

Recommendations

- It is important to realize that both alternatives available to you would result in tax outflows in the form of capital gains tax and transfer duties. The benefit of incurring these tax cash flows at this stage, is that any further growth in the assets and wealth takes place in the trust where is excluded from Mr. Puma's estate for purposes of estate duty and capital gains tax should he pass away.

- The main difference between the alternatives that are available to you in my view are:

  - The donation option would result in immediate tax consequences in the form of the donations tax. The fact that the donations tax can be added to the base cost could reduce the capital gains tax. The effect of this would however effectively only be 13,33% (effective CGT rate for Mr. Puma) multiplied by a portion of the donations tax (at 20%). The benefit of this alternative is that no part of the wealth remains in his estate.

  - The sale on loan account option does not result in the same immediate cash flows as the donation. The loan amount (current value of the assets) however remains included in his estate and will be subject to estate duty at a rate of 20% to the extent that is exceeds R3,5 million (current exclusion). The benefit of this structure is therefore that future growth is excluded from the estate.

  - The additional tax payable on the proceeds of the sale of the forest (i.e. R4 million x (40% - 13,33%)) will still be less than the estimated donations tax (20% applied to R9,8 million).

- Based on the cash flow position of the trust and Mr. Puma, who has limited liquid investments available to pay the taxes referred to in 7.1., it is my recommendation that the sale of the assets on loan account alternative is preferable. The main reasons for this recommendation is that:

- The donation option would result in a 20% tax immediate, while the loan option would result in a 20% tax in future on the capped loan amount which will exclude future growth on the assets. The present value such a tax in likely to be less than the amount of the 20% donations tax.

- In addition, the exclusion at the time of donation is only R100 000 while it amounts to R3,5 million at the time of death.

- A negative consequence of this recommendation would be that the full primary residence exclusion available to Mr. Puma will not be utilized. The option can be adjusted for this to only sell the primary residence to the trust once the capital gain realized is R2 million. This may require the recommendation to be implemented in phases.

Concluding thoughts

If you have any questions on the views expressed or would like to discuss the implications of the assumptions that we have made in our views you are welcome to contact us to do so.

Thank you for engaging us to conduct this work.

Yours faithfully,

Tax Student

(Tax Practitioner Number: PR-123456789)

Part C

Proposed content of the presentation

Slide 1	Compare commercial terms of the two options – including Mongolian withholding tax of 20%
Slide 2	Provide overview of the relevant tax principles • Foreign sourced income included in a resident's gross income • Rebate for foreign taxes paid by taxpayer
Slide 3	Requirements for section 10(1) (o) (ii) to apply and impact on 'remuneration' for Puma Engineering purposes
Slides 4 and 5	Detail calculations of cash inflow to Mr Puma after tax
Slide 6	Recommendation on preferred alternative

Proposed document that contains the detailed workings and considerations

- You have requested my advice on the most tax efficient manner to structure a project to be undertaken by yourself, Mr Puma, in Mongolia.
- Based on the extracts from the draft agreement provided to me, the options available to you are in brief:
  - You contract with the government of Mongolia to conduct the work in your own name;
  - Puma Engineering contracts with the government of Mongolia to conduct the work. Puma Engineering makes you available, as employee of Puma Engineering, to perform the work and pays an additional amount of remuneration to you for the fact that this work is done on behalf of the company.
- The relevant principles are:
  - Any resident of South Africa for tax purposes is taxed on its worldwide income (based on the definition of gross income).

- Countries generally impose tax on foreigners (non-residents) on income earned from a source in that country. A method often used to collect such taxes is to impose a withholding tax. This appears to be the case with the 20% withholding tax on the service fee.
- The same income may therefore be subject to tax in South Africa and Mongolia.
- No double taxation agreement exists between South Africa and Mongolia to eliminate such a double tax issue.
- The double tax effect can however be reduced in two ways:
  - The first is that a rebate in terms of section 6quat of the Income Tax Act for the foreign tax is available to South African residents for foreign sourced income. As the work will be performed in Mongolia, it will be considered to be foreign sourced income. The effect of this rebate is that the South African tax on the income will be reduced by the foreign tax on the same profits/income. This can be illustrated as follows: (the amount of 180 million tugrugs convert to approximately R1 100 000, this will be used for illustrative purposes in this document)[2]

Income	R1 100 000
Expenses (if any)	R 100 000
Profit and taxable income	R1 000 000
Tax @ 28% in SA	R 280 000
Mongolian tax = R220 000 (R1m x 20%)	
Rebate based on R220 000, limited to R280 000	(R 220 000)
Total tax in SA	R 60 000
Total tax liability in SA and Mongolia (R60k + R220k)	R 280 000

[2] In reality, this amount would have to be translated to Rand at the spot rate for the period. This may be an average rate in the case of continuous service. Please refer to section 25D of the Income Tax Act.

- The second method of elimination of this double tax effect is that income earned by an employee in respect of services performed outside South Africa in terms of section 10(1)(o)(ii) of the Income Tax Act. This exemption in the hands of the employee is available only when the persons is outside of the country for more than 183 days in a 12 months period which includes 60 continuous days and the services are rendered during this period.

- Based on the terms of the contract, this appears to be a contract for independent service to be rendered. This view is based on the fact that the counterparty (either Mr Puma or Puma Engineering) will only be paid if the output is delivered. This differs from an employment type of agreement where a person is remunerated for his time rather than outputs. You can refer to Interpretation Note 17 for a detailed discussion in this regard.

- Detailed analysis of the arrangement if Mr. Puma contracts with the Mongolian government in his own name:
  - The income of R1 100 000 will be included in his South African taxable income.
  - It appears as if there will not be any deductible expenses. Further information about costs relating to the project would have to be provided to us to consider if there are such costs.
  - As Mr. Puma contracts as an independent contractor rather than an employee, he is not entitled to the exemption in section 10(1) (o) (ii).

- The only measure to relief the double taxation on his income is the rebate in terms of section 6quat. The effect of this, assuming no deductible expenditure, will be:

Income	R1 100 000
Profit and taxable income	R1 100 000
Tax @ 28% in SA	R 308 000
Mongolian tax = R220 000 (R1m x 20%)	
Rebate based on R220 000, limited to R308 000 (R220 000)	
Total tax in SA	R 88 000
Total tax liability in SA and Mongolia (R88k + R220k)	R 308 000

- This arrangement should have no tax implications for Puma Engineering.

- Detailed analysis of the arrangement if Puma Engineering contracts with the Mongolian government and employs Mr. Puma to provide services:
  - The income of R1 100 000 will be included in Puma Engineering's taxable income South African taxable income.
  - Puma Engineering will however pay remuneration to Mr. Puma that will be deductible under section 11(a) (similar to other salary costs).
  - This will leave Puma Engineering with no taxable income in South Africa from the transaction. Puma Engineering may however be affected as:
    - If the amounts constitute income for Mr Puma and remuneration, Puma Engineering would be required to withhold employees' tax from such remuneration at Mr Puma's tax rate of 40%. (See discussion below).
    - Puma Engineering would be liable for the withholding tax of R220 000 in Mongolia. It would therefore only be able to pay an amount of R880 000 (R1 100 000 – R220 000) to Mr Puma as remuneration. The South African tax on the taxable income of R1 100 000 minus R880 000 (salary) would be less than R220 000 (Mongolian tax) and be reduced to nil by the rebate.

    - As Mr Puma provides the services in Mongolia as an employee of Puma Engineering he qualifies for the exemption in section 10(1)(o)(ii) if he spends more than 183 days outside SA (he spends more than this period from October to April) and a period of 60 consecutive days (he will only return to SA over Christmas and therefore meets this requirement). The remuneration earned for services in Mongolia will therefore not be taxed in South Africa. As the withholding tax was not paid by Mr Puma, he does not qualify for any rebate (similarly, he has no foreign sourced income due to the exemption).
    - A risk may however exist that Mongolia could tax Mr Puma on the remuneration earned from a source in that country. This matter should be considered further with the assistance of the tax authority and/or a tax advisor in Mongolia.
    - The total tax liability is therefore equal to the withholding tax in Mongolia (R220 000)
- In my view, the preferred option is for Puma Engineering to contract with the Mongolian government and employ Mr Puma in exchange for remuneration to perform the service as the total tax effect is lower than when Mr Puma contracts directly (R220 000 for this option compared to R308 000 for the direct contracting option).