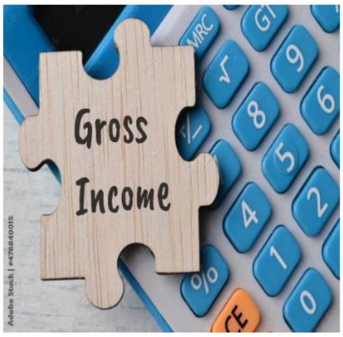


LEARNING UNIT 4:

DETERMINATION OF INCOME (GROSS INCOME LESS EXEMPT INCOME)

LEARNING OUTCOMES

After studying LU 4, you should be able to achieve the following outcomes:

- Illustrate the interpretation of tax legislation by calculating a taxpayer's 'income'.
- Demonstrate an in-depth knowledge of the gross income definition and the application thereof through case law principles by analysing a practical scenario to identify an amount as being gross income or capital in nature.
- Identify and explain whether an amount should specifically be included in 'gross income'.
- Evaluate whether a natural person meets the requirements of a resident for income tax purposes.
- Identify which amounts are exempt from normal tax and understand the impact thereof on income.

Apply your knowledge in practical case studies (to calculate and discuss) to improve your critical thinking.

STUDY PROGRAMME AND TIME FRAME

A total of 6 hours 25 minutes of your study time is allocated to LU 4.

Your time should be divided between two aspects:

- Obtaining the required knowledge
  This entails working through this learning unit **and** the textbooks (SAICA Student Handbook and SILKE), underlining, making summaries and familiarising yourself with the determination of income.
- Application of knowledge
  This entails the completion of the examples and activities included in this learning unit. After completion of your studies of LU's 4 to 6 you will have the opportunity to test your knowledge by completing some questions which will comprise of integrated activities covering the three LU's in Topic 2, but it will also incorporate some of the sections covered during your studies of Topic 1 last week. These integrated activities will be included at the end of LU 6.

The following time allocation is recommended:

Determination of income (gross income less exempt income)		**Minutes**
	Outcomes and assessment criteria	5
4.1	Background	5
4.2	Beancounter scenario	5
4.3	Content of learning unit 4	215
4.4	Important law amendments	10
4.5	Additional notes (including Activity 4.1 – 20 minutes)	45
4.6	Outcomes of the Beancounter scenario – Discussion Forum	15
4.7	Integrated activities 4.2 and 4.3	85
	Total	**385**

Note that there is a lot of work to master in the allocated time, however all the sections covered in this LU, except for section 7E (Timing of interest payable by SARS to a taxpayer – SILKE 3.4.8), have been covered in detail in your undergraduate studies. Since the calculation of income is one of the cornerstones of the tax framework (see below) used to calculate the taxation of a taxpayer, we allow some time in this LU to refresh your memory and work through some notes and examples to assist in honing your critical thinking and decision-making skills. If the time allowed is not enough, you will have to refresh your memory regarding sections you already covered in your prior studies **in your own time**.

4.1 BACKGROUND

The topics covered in learning unit 4 fit into the tax framework as follows:

TAX FRAMEWORK

GROSS INCOME (s 1)
LESS: Exempt income (ss 10 and 10A to 10C, 12T)
= INCOME
LESS: Deductions and allowances (ss 11 – 24P, excluding s 20 and s 18A)
LESS: Assessed loss brought forward (s 20)
ADD: Amounts to be included in taxable income including *TAXABLE CAPITAL GAINS*
LESS: Deductions in terms of s 11
LESS: Qualifying donations (s 18A)
= TAXABLE INCOME

Use taxable income to calculate NORMAL TAX PAYABLE.

Learning unit 4 deals with income as defined in section 1 of the Income Tax Act, meaning gross income (also special inclusions) less any applicable exemptions (exempt income). Based on your undergraduate studies, you should have a good knowledge of gross income and exempt income. In this learning unit we will concentrate on those areas that were not covered in your undergraduate studies and master the **more complex** sections covered by this unit. When you plan your study time, also bear in mind that most of these areas would have been covered in depth in your previous studies. While reviewing, concentrate on **recent amendments** to the Income Tax Act, as these tend to receive more attention in the SAICA examinations. Where the relevant section will be discussed in a later LU, we will indicate this, and we won't discuss the section in detail in this LU.

4.1.1. **UNGC Principle 10**

As you work through the tax legislation, you need to remember and apply ethical tax behaviour. In line with the UNGC principles (introduced in LU 2), compliance with the laws and regulations is the basis on which the taxation legislation is founded.

Thus, to not declare an amount as gross income if it falls within the definition, comes down to tax evasion, which in turn would fall within the ambit of corruption. UNGC principle 10 (businesses should work against corruption in all its forms, including extortion and bribery) encourages entities to find a balance between the social obligation to pay taxes and tax planning, to minimise the 'cost' of these taxes for an entity within the ambit of the law. This non-aggressive tax planning should always be done with integrity and whilst demonstrating ethical behaviour from both the planner and the taxpayer.

4.2 BEANCOUNTER SCENARIO

Before you start studying the detailed provisions of the Income Tax Act, read the following scenario relating to the Beancounter family or watch the video posted on myUnisa. The scenario requires you to read through the information provided. As you study the different income tax provisions, you should analyse areas of concern that should be brought to the attention of the Beancounter family and the impact thereof on their taxes due.

By now you know that Barry Beancounter (51 years old and married in community of property to Bizzie) is the managing director of Clothing Manufacturers (Pty) Ltd. Upon the death of his mother during this year, he inherited a share portfolio to the value of R1.8 million. His mother did not like Bizzie much and stipulated that the portfolio should be excluded from the joint estate. The portfolio consists of shares in blue chip

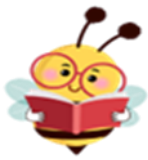
South African companies. Barry estimated that the dividends received on these shares will be 5% of the portfolio.

Barry wants to invest in foreign companies. He also plans to actively diversify the inherited portfolio. He feels that he should keep track of the movements in the portfolio daily on the internet and sell and acquire shares as he sees fit.

Barry would like to know if dividends are included in taxable income and if there will be any negative tax implications if he actively diversifies his portfolio in shares.

Discussion activity
Before attempting to help Barry with his queries, work through and master LU 4. Only then will you be ready to identify areas of concern and the impact thereof that should be brought to the attention of the Beancounter family and which you can share on the **Discussion Forum 4.2**. The outcomes (solution) for the Beancounter scenario will be made available during your study week for this learning unit.

4.3 CONTENT OF LEARNING UNIT 4



4.3.1 Study approach

We provide you with either a Table of Reference or a short summary. The Table of Reference contains the references to all the sections which must be studied in this learning unit together with a reference to the relevant paragraph in SILKE and a reference to additional notes provided (if any) in the learning unit, as well as an indication of whether a specific section is examinable or not and has been covered in your undergraduate studies (in this learning unit *all sections* (*except for section 7E*, see below) were covered in undergraduate studies and as such no distinction is necessary). The Table of Reference is presented in such a way that you can use it to guide you through the content of the learning unit. You should therefore work your way through the content by starting at the top of the table and working your way through to the end.

The short summary contains a reference to the relevant paragraph in SILKE and a reference to additional notes provided in this learning unit. You should use it to guide you through the content of learning unit 4 in this tutorial letter.

4.3.2 Short summary

General

- Whilst studying LU 1, you studied Chapter 2 of SILKE, if you find it necessary, you can, in your own time, revisit par 2.1 – 2.3 in SILKE for an overview of the taxes levied by the Income Tax Act and the administration thereof to enable you to understand the process of determining taxable income and normal tax liability.
- Read and understand the definitions of gross income, income, taxable income and person in section 1 of the Income Tax Act.
- Work through additional note 4.5.1.

Gross income

- Revise the definition of gross income in section 1 of the Income Tax Act and the principles in par 3.1 in SILKE. In this learning unit you may focus on part *(i)* of the definition of gross income, dealing with residents. Part *(ii)*, dealing with non-residents, will be discussed in detail in the following learning unit.
- Work through additional note 4.5.2.
- Refer to Chapter 2 of the **Case Law Guide** for relevant court cases to analyse and apply the applicable case law principles (*CIR v Kuttel*, *Cohen v CIR* and *CIR v Lever Brothers and Unilever Ltd*

will only be covered in LU 5). Where a court case is mentioned in SILKE, and that court case is also contained in the **Case Law Guide**, you should study that court case to apply it in a case study scenario – refer back to the video on case law in LU 1, Activity 1, to see how to study and apply case law if necessary).

- Although the gross income definition has been thoroughly covered during your undergraduate studies – take time to revisit this important concept by reviewing the remainder of chapter 3 in SILKE to improve your understanding of the 'gross income' definition. You can ignore SILKE par 3.2 as it will be covered in LU 5 and par 3.4.5 and 3.4.6 that cover topics not included in your syllabus. Pay special attention to SILKE par 3.4.8 that covers section 7E, which you have not covered in your prior studies.

Special inclusions to gross income

- Read and understand par (*a*) to (*n*) of the definition of gross income in section 1 of the Income Tax Act to evaluate why special inclusions are needed considering the basic principle of the gross income definition.
- Work through additional note 4.5.3.
- Revise your prior knowledge by reviewing chapter 4 (special inclusions in gross income) in SILKE, you can ignore par 4.20 that covers Short-term insurance policies (s 23L). Remember to highlight the principles understood in your Income Tax Act.

Ignore paragraphs of the gross income definition that do not form part of the *ITC 2025 Tax knowledge list*:

- par (*j*) dealing with capital expenditure for mines
- par (*l*) dealing with subsidies and grants on soil erosion works (par 4.15 in SILKE)
- par (*l*A) dealing with amounts received by or accrued to sporting bodies (par 4.16 in SILKE)
- par (*l*C) dealing with government grants (par 4.17 in SILKE)

Exemptions

- Read section 10 of the Income Tax Act **as indicated in the table below – take special note of the law amendments discussed under note 4.4**.
- Work through additional note 4.5.4.
- Revise your prior knowledge by reviewing chapter 5 in SILKE, as indicated in the table below.

4.3.3 Table of Reference

Reference to the Income Tax Act (section)	Topic	Reference to SILKE (All covered in undergrad)	Examinable
10(1)(*a*), (*b*A) and (*b*B)	Government and municipalities	5.6.1 5.6.6	No
10(1)(*c*)	Foreign government officials and State president - Salaries and emoluments	5.6.2 5.6.4	No
10(1)(*c*A)	Specified research entities	5.11.2	No
10(1)(*c*E)	Political parties	5.7.4	No
10(1)(*c*G)	Ships and aircraft – foreign owners and charterers	5.8.6	No
10(1)(*c*N) & 30	Public benefit organisations	5.7.2	No
10(1)(*c*O) & 30A	Recreational clubs	5.7.3	No
10(1)(*c*P)	Company or trust contemplated in s 37A	5.9.2	No
10(1)(*c*Q) & 30C	Small business funding entity	5.8.2	No
10(1)(*d*) & 30B	Approved funds and associations	5.2.8	No

Reference to the Income Tax Act (section)	Topic	Reference to SILKE (All covered in undergrad)	Examinable
10(1)(*e*)	Bodies corporate, share block companies and other associations	5.7.1	No
10(1)(*g*), (*g*A) and (*g*B)	War pensions and award for diseases and injuries	5.11.4	Yes
10(1)(*g*C)	Foreign pensions	5.4.1	Yes
10(1)(*g*D)	Funeral benefit		Yes
10(1)(*g*E)	Minor beneficiary funds	5.11.5	No
10(1)(*g*G) and 10(1)(*g*H) 10(1)(*g*I) 10(1)(*g*J)	Proceeds from employer-owned policies Proceeds from insurance policies Disability policies Bargaining council policies	5.2.7 -	Yes No Yes No
10(1)(*h*) and 10(2)(*b*)	Interest – non-residents *Refer to LU 5*	5.2.2, 5.10.3	Yes
10(1)(*h*A)	Interest – holder of a debt instrument	5.11.3	No
10(1)(*i*)	Interest received	5.2.1	Yes
10(1)(*i*B)	Collective investment schemes	5.2.6	No
10(1)(*j*)	Foreign central banks	5.6.5	No
10(1)(*k*)(i) proviso (*aa* 10(2)(*b*)	Dividends	5.3	Yes
10(1)(*k*)(i) proviso (*dd*)- (*kk*)	Dividends	5.3.3	No
10(1)(*l*)	Payments to non-residents (royalties)	5.10.1	No
10(1)(*l*A)	Foreign entertainers and sportspersons	5.10.2	No
10(1)(*m*B)	Unemployment insurance benefits	5.4.2	Yes
10(1)(*n*A), (*n*B), (*n*D), (*o*)(ii)	Employment	5.4.3,5.4.4 5.4.7,5.4.9	Yes
(*n*C), (*n*E), 10(1)(o)(i), (o)(iA), (*o*)(ii) proviso(B) only	Employment	5.4.5,5.4.6 5.4.8, 5.4.9	No
10(1)(*p*)	Employment – non-residents	5.6.3	No
10(1)(*q*), 10(1)(*q*A)	Bursaries and scholarships	5.5.1	Yes
10(1)(*r*)	Gratuity received by person retiring from public service declared by Treasury as tax free	-	No
10(1)(*s*)	Employees' tax		Yes
10(1)(*u*)	Alimony and maintenance	5.11.1	Yes
10(1)(*y*)	Government grants or government scrapping payments	5.8.3	No
10(1)(*y*A)	Official development assistance agreement	6.5.13	No
10(1)(*z*J)	Micro businesses	5.8.1	No
10(1)(*z*K)	Small business funding entities	5.8.2	No
10(1)(*z*L)	Amounts received/accrued previously prohibited under section 23*(o)*(iii)	-	No
10(1)(*t*), (*z*E)	Specified institutions	5.6.6	No
10(2)	Exemptions in par (*h*) and (*k*) not applicable to an annuity	5.3	Yes
10(3)	Exclusions from the exemptions		Yes
10(5)	Disqualification from managing collective interests	5.7.1	No
10A	Purchased annuities	5.2.4	Yes

Reference to the Income Tax Act (section)	Topic	Reference to SILKE (All covered in undergrad)	Examinable
	(capital element will be given) Section 10A(3) – (11)		No
10B	Foreign dividends	5.3.8	Yes
10B(2)(*b*), (c), (6) & (6A)	Foreign dividends	5.3.8	No
10C	Exemption of non-deductible portion of qualifying annuities – *also refer to Topic 4*	5.2.5	Yes
12K	Certified emission reductions	5.9.1	No
12O	Film owners	5.8.4	No
12P	Government grants	4.17, 5.8.3	No
12Q	International shipping income	5.8.5	No
12T	Income from tax-free investments *(It will be stated whether the investment meets the requirements to be a "tax-free investment".)*	5.2.3	Yes
12T(8) & (9)	Income from tax-free investments	-	No

Interpretation Notes are not included in the SAICA Student Handbook, but to the extent that an Interpretation Note creates a practice generally prevailing (refer to section 5 of the Tax Administration Act), the relevant extract will be provided in the test or examination. Below is a list of Interpretation Notes that relates to sections covered in LU 4. You will find that some of these Interpretation Notes cover in addition sections that will be addressed in more detail in later LU's.

Interpretation Notes are available at: Interpretation Notes | South African Revenue Service (sars.gov.za)
Binding General Rulings (BGR) are available at: Binding General Rulings (BGRs) | South African Revenue Service (sars.gov.za)

Interpretation Notes
Interpretation Note: No. 11 (Issue 4). Date: 6 February 2017 - Trading stock: Assets not used as trading stock
Interpretation Note No. 16 (Issue 4). Date: 28 June 2021 - Exemption from income tax: Foreign employment income
Interpretation Note: No. 19 (Issue 5). Date: 18 November 2020 - Year of assessment of natural persons and trusts: Accounts accepted to a date other than the last day of February
Interpretation Note: No. 26. Date: 30 March 2004 - Taxation of CCMA and Labour Court awards to employees and former employees
Interpretation Note: No. 55 (Issue 2). Date: 30 March 2011 - Taxation of directors and employees on vesting of equity instruments
Interpretation Note: No. 58 (Issue 3). Date: 12 May 2022 - The *Brummeria* case and the right to use loan capital interest free
Interpretation Note: No. 64 (Issue 4). Date: 13 November 2018 - Income tax exemption: Bodies corporate, share block companies and associations of persons managing the collective interests common to all members
Interpretation Note: No. 66. Date: 1 March 2012 - Scholarships or bursaries
Interpretation Note: No. 76. Date: 26 February 2014 - Tax treatment of tips for recipients, employers and patrons
Interpretation Note: No. 104. Date: 4 October 2018 - Exemption – Foreign pension and transfers
Interpretation Note: No. 117. Date: 17 May 2021 - Taxation of the receipt of deposits

4.4 IMPORTANT LAW AMENDMENTS

The taxation laws are amended annually. These amendments are first published in the form of draft Bills and then as Bills. Only once the Bills have passed through Parliament and have then been assented to by the President are they published as Acts.

The publishing of the Bills coincides with the Medium-Term Budget Policy Statement (MTBPS) made by the Minister of Finance. The MTBPS was made on 1 November 2023 and the following Acts, relevant to your studies, were promulgated on 22 December 2023:

- Rates and Monetary Amounts and Amendment of Revenue Laws Act 19 of 2023
- Taxation Laws Amendment Act 17 of 2023
- Tax Administration Laws Amendment Act 18 of 2023

Use the following link to access the newly published Acts:
https://www.sars.gov.za/legal-counsel/primary-legislation/amendment-acts/

The important proposed amendments, which are applicable to this LU, are summarised below. In some instances, we repeat – for your ease of reference – amendments from previous years, which were enacted.

Law amendments enacted by the Taxation Laws Amendment Act 17 of 2023:	
Section 10(1)(*g*A)	**Exemption of disability pensions:** Disability pensions paid under section 2 of the *Social Assistance Act 13 of 2004* are exempt from normal tax – the amendment is a technical correction to correct an outdated reference to a previous version of the same Act, namely *Social Assistance Act 59 of 1992*.
Section 10B(3)*(b)*(ii)*(bb),* (4) and (4A)	**Exemption of foreign dividends and dividends paid or declared by headquarter companies** *Subsection (3)(b)(ii)(bb):* A foreign dividend may qualify for the ratio exemption which is calculated in terms of the formula A = B × C In this formula 'B' represents the ratio of 25/45 if the person receiving the dividend is a natural person, deceased or insolvent estate or a trust and *7/27* where the person receiving the dividend is a person other than a natural person, etc. thus also if it is a company. This amendment replaced the previous ratio of 8/28 with the ratio of 7/27 for 'B' in the formula and applies for years of assessment ending on or after 31 March 2023 due to the company tax rate that changed to 27% from this date. *Subsection (4) and (4A):* The application of section 10B(4) has been extended, effective from 1 January 2024 it also applies to the ratio exemption (s 10B(3)) and listed share exemption (s 10B(2)(*d*)). It previously only applied to the participation exemption (s 10B(2)(*a*)) and the country-to-country

Law amendments enacted by the Taxation Laws Amendment Act 17 of 2023:	

	exemption (s 10B(2)(*b*)). The listed exemptions will not be available if:
	• the amount of the foreign dividend arises from an amount paid, which is deductible from the income of the person paying it, but is not subject to normal tax in the hands of the person receiving it. The same applies if the amount of the dividend is determined directly or indirectly with reference to such amount paid. This exclusion from the listed exemptions will not apply if:
	  • the amount is paid as consideration for the purchase of trading stock by the person paying the amount or
	  • if it relates to foreign dividends declared from profits where less than 20% of the profits were generated from transactions with persons that deducted the amount of the foreign dividends from income (s 10B(4)(*a*) and (*b*)).
	The participation exemption (s 10B(2)(*a*)) and the country-to-country exemption (s 10B(2)(*b*)) will also not be available if a foreign collective investment scheme pays the amount of the dividend (new s 10B(4A)).

Section 12T(4)(*a*) and (7)(*a*)	**Income from tax-free investments:** If a taxpayer ceases to be a resident during a 12-month tax period (see LU 5), resulting in two years of assessment in the same 12-month tax period, one as a resident and the other as a non-resident, the annual investment contribution limit (currently R36 000) on the tax-free savings account under s 12T(4)(*a*) will be limited to R36 000 in a 12-month tax period, irrespective of the number of years of assessment (effective for years of assessment from 1 March 2024). If a person's contributions are more than the R36 000 annually or the total contributions exceeds the R500 000 limit, the person will be penalised by having 40% of the excess contribution being deemed to be normal tax payable. Note that all proceeds received from the tax-free investment will still be exempt, although the contributions are in excess of the limits. From 1 March 2024, the 40% penalty will be calculated on the excess of the R36 000 limit with reference to the *last* year of assessment if there is more than one year of assessment during the period of 12 months starting in March and ending at the end of February of the immediately following calendar year. This would be the case, for example, when a natural person emigrates and ceases to be a resident (s 12T(7)(*a*)).

Law amendments enacted by the Taxation Laws Amendment Act 20 of 2022:	
The amendment below is repeated from last year because of its importance or since the effective date of implementation falls within an individual's 2024 year of assessment.	
Section 10(1)(*i*)	**Interest received or accrued to a natural person:** A proviso has been added to section 10(1)(*i*) that provides that where any person's year of assessment is less than a period of 12 months (for example emigration), the amount that shall be exempt from normal tax under section 10(1)(*i*)(i) (i.e. R34 500) or (ii) (i.e. R23 800) shall be apportioned at the same ratio as the number of days in that year of assessment over 365/366 days. This new proviso applies with effect from 1 March 2023 and is also explained in par 5.2.1 in SILKE
Section 10B	**Exemption of foreign dividends and dividends paid or declared by headquarter companies** Section 10B(7)(*a*) was amended to allow for the exempt portion of foreign dividends referred to in s 10B(3)(*b*)(ii)(*a*) and (*c*) to be updated if the corporate tax rate is amended (in this case from 28% to 27%) The section 10B(3) exempt portion for foreign dividends thus changes to 7/27 (it was 8/28).

4.5 ADDITIONAL NOTES

4.5.1 Determination of taxable income and normal tax

Normal tax framework
The normal tax framework is derived from the definitions in the Income Tax Act of gross income, income and taxable income. When studying any unit dealing with income tax, you must always keep this framework in mind. Please note that the order of the calculation is important:

GROSS INCOME (defined in section 1)
  LESS: Exempt income (section 10, 10A to 10C and 12T)
= INCOME (defined in section 1)
  LESS: Deductions
  ADD: Amounts to be included in taxable income including **TAXABLE CAPITAL GAIN**
  LESS: Qualifying donations (section 18A)
= TAXABLE INCOME (defined in section 1)

TAXABLE INCOME is used to calculate **NORMAL TAX**

4.5.2 Gross income

Gross income is certainly the most important definition in the Income Tax Act and also one of the most comprehensive ones. You should therefore study it in detail, together with the case law (refer to the **Case Law Guide**, chapter 2) applicable to it.

The principles of gross income are applied widely in any question on income tax. The topic also lends itself to discussion-type questions and you should keep this in mind when preparing for tests and examinations.

Below follows an illustrative example of how to answer a discussion question on gross income, followed by a learning activity.

Illustrative example:
How to answer a discussion question on gross income

Lucky B inherited money in 2015. 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 immigrating to Australia and he decided to sell these units. The units were sold at R1 500 000 each to the tenants during the 2024 year of assessment.

REQUIRED:
Critically evaluate, with reference to case law, whether the R3 000 000 that he received for the two duplexes should be included in gross income or not.

Suggested approach to answering the question

Step 1: Provide the definition of gross income and briefly refer to the relevance of each of the requirements.

Step 2: Identify the *crux* of the matter (problem), namely capital vs revenue. This is essential in your discussion as this step tests your critical thinking skills. Are you thus able to evaluate the scenario, review the definition and provide feedback on the impact of the amount received on his gross income?

Step 3: The ***crux of the matter*** in this case is the "tree and the fruit" principle. We want you to be able to APPLY the scenario, using the correct principle of the applicable case law.

Step 4: Using the court case, you ought to know that the "fruit" of the asset is revenue in nature and the "tree" (asset itself) is capital in nature. Now we apply:
'The duplexes are the "tree" and the rental income the "fruit".'

Step 5: Using critical thinking, you need to dig deeper. The principle in the *Stott* case was to test the intention of the taxpayer when he/she sold the property. 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 when he sold the duplexes.
Using the principle in the *Natal Estates Ltd* case, you should ask yourself whether the taxpayer had "**crossed the Rubicon**" and gone onto a scheme of profit-making (change of intention).

Thus, look and apply the following to the **facts** in the scenario provided and analyse each case to consider the following:

- What was the intention of the owner when acquiring and selling the asset?
- The taxpayer's history of property transactions;
    - Is the taxpayer continuously busy with property transactions?
- How did the taxpayer finance the initial purchase of the property? (own funds or borrowed funds)
- Did the taxpayer use extensive marketing?
- What is the owner's own activities prior to selling the asset?
- What was the taxpayer's reason for sale?
- How were the proceeds utilised?

Step 6 Application:

- Lucky B bought the duplexes with the intention of keeping them as an investment to rent them out.
- The holding period of 9 years and the fact that he bought them with surplus funds are objective evidence of his intention to keep it as an investment.
- He did not cross the 'Rubicon' and go onto a scheme of profit-making.
- He sold these assets because he is immigrating, thus it is a realistic business decision as he will not be able to look after his property in South Africa.
- He did not follow an extensive marketing strategy. He sold it to the current tenants.
- He only wanted to realise his capital assets to his best advantage.

Step 7 Conclusion:
Always conclude your argument and do NOT contradict yourself. You will lose valuable marks. In this argument you ought to conclude that the R3 million received is of a capital nature and not part of the taxpayer's gross income.

Take note of the REQUIRED part of the question. The question required only of you to critically evaluate the gross income implications. If the question required a discussion of all **income tax implications**, you would have discussed the capital gains tax (CGT) implications (learning unit 6) as well. If the question required a discussion of all tax implications, you would have discussed the CGT and VAT implications of the transaction as well. Note the number of marks. For 20 marks it is an in-depth discussion of case law and you need to evaluate in full all relevant aspects of the scenario.

Activity 4.1 - Case law (7 marks/20 minutes)

You have now studied the gross income definition relevant to residents and should be able to answer the following learning activity relating to the applicable case law principle(s).

Share your solution on the myUnisa **Discussion Forum 4.1**, then refer to the solution that will be made available on the Friday of your study week.

Make the effort to read through previous case studies on gross income in your under-graduate studies.

The South African taxpayer, a small business jewellery retailer, issues gift cards to customers. The revenue received from the issuing of gift cards in the taxpayer's 2024 year of assessment amounted to R150 000. No redeemed or expired gift cards are included in the R150 000. The revenue received from the gift cards are held in a separate business bank account.

Reflect on whether the income of R150 000 received from the issue of the gift cards is taxable and if so, when will the taxpayer be taxed on it?

Support your answer with reasons. (7 marks)

4.5.3 Special inclusions in gross income

Paragraphs (*a*) to (*n*) of the definition of gross income include certain amounts in a taxpayer's gross income **even though they may be of a capital nature**. These receipts and accruals are referred to as **the special inclusions** to expand the gross income definitions. Although you should review all the special inclusions, some of them will be revisited and covered in more detail in other learning units.

4.5.4 Exempt income

Note on examination technique

When answering a question in a test or examination, always indicate an amount which is gross income in terms of the definition, as such. If a full or partial exemption is then applicable to that amount of gross income, indicate the exemption separately. For example:

	R
Dividend received (gross income) (section 1)	50 000
Less: Exempt income (section 10(1)(*k*)(i))	(50 000)

If you only indicate the dividend as not taxable or Rnil, you will not receive all the marks allocated. The reason is that your answer should reflect the legislation:
Income = Gross income (definition in section 1) less exemptions available.

Remember – Section 10(1)(*i*)

Section 10(1)(*i*) applies to both resident and non-resident natural persons. It applies to a taxpayer who is a natural person who receives interest from a South African source. Note that from years of assessment starting 1 March 2023, this exemption is apportioned in the year you emigrate.

4.6 SOLUTION OF THE BEANCOUNTER SCENARIO

Read the Beancounter scenario again, and/or watch the video, and make a rough summary of what your solution would be now that you have studied gross income and exemptions. You should be able to answer Barry Beancounter's query on his share portfolio. Share your solution on the myUnisa **Discussion Forum 4.2,** then refer to the solution that will be made available on the Unisa online platform on the Friday of your study week. You need to review the solution to improve your own understanding of the tax principles involved.

The more you actively participate the more your critical skills will develop to ultimately attain your CA(SA)!

4.7 SUMMARY OF LEARNING UNIT 4

This learning unit introduced you to the general framework that you should always use when either discussing or calculating the 'income' of a taxpayer, using the Income Tax Act. You need to update yourself with the newest relevant law amendments. The framework in note 4.5.1 was provided to assist you in analysing a given scenario. Note that you must always use the correct terminology in taxation. If a question requires you to address the 'income' of a taxpayer, ensure that you address both gross income and exemptions.

You need to have a good understanding of case law so that you can use the principles thereof to answer discussion type questions. Consider every scenario to critically analyse all aspects of the gross income definition. It is important that you identify the crux of the question in this part and to then centre your answer around that essential part (crux), using relevant case law principles (no case law dumping!). Ensure that you have worked through (flagged and highlighted) the sections referred to in learning unit 4 (refer to note 4.3) in your Income Tax Act as well as in SILKE. In the next learning unit, we will analyse the meaning of a 'resident' and that of a 'non-resident', as well as the impact of a double tax agreement on the taxable income of a resident.

4.8 INTEGRATED ACTIVITIES 4.2 AND 4.3

Below are two activities for you to complete. Use these activities to assess your own knowledge, competencies and take responsibility for your own learning experience. The activities will assist you to identify shortcomings in your knowledge relating to LU 4 and will also serve as a measure of your understanding.

The time provided for each activity (question) is calculated as 6 minutes of reading time for each activity, 1.5 minutes for every mark and then 6 minutes per page of the solution for you to review your answer against the solution provided.

ACTIVITY 4.2: Gross income (23 marks / 55 minutes)

You have been approached by Mrs Good (a widow) for tax advice regarding the sale of a block of flats that she owns. In 2002 Mrs Good inherited a large sum of money from her late father. She used the money to purchase a block of flats in Durban.

The flats were acquired in the 2003 year of assessment at a cost of R1.5 million. Mrs Good has derived rental income from the flats for the past 21 years.

Mrs Good has now decided to sell the block of flats because she is getting old and is in poor health. She has consulted a prominent estate agent who has advised her that she could sell the property in one of two ways. She could sell the entire block as one property in its present condition. Alternatively, she could divide the block into sectional title units and sell the flats individually. The estate agent estimates that the selling price of the block as a single property will be R10 million. He has told her that if she spends R1 million on upgrading the building and opening a sectional title register she can expect to sell the flats for R15 million.

Mrs Good is a South African resident and is not a VAT vendor.

YOU ARE REQUIRED TO:

Advise Mrs Good on the income tax consequences of the sale of the property either as a single property or as sectional title units. Refer to case law principles where appropriate. No calculations are required.

ACTIVITY 4.2 - SUGGESTED SOLUTION

Mrs Good

The sale of the flats will give rise to proceeds of either R10m or R15m depending on the choice that Mrs Good makes.

The income tax consequences will depend on whether the nature of the proceeds are gross income (revenue in nature) or a capital amount. (1)

If the proceeds are gross income the full amount will be subject to income tax. An adjustment has to be made as a capital asset has become trading stock. A capital gain will be calculated on the market value less base cost at the time of change of intention and 40% of this capital gain will be taxed. The market value will be included in opening stock for deduction against the revenue proceeds. (1)

If the proceeds are not gross income the amount will be subject to capital gains tax, in which case only 40% of the capital gain will be taxed. (1)

It is therefore important to determine whether the proceeds are included in gross income.

Gross income is a defined term. In terms of the definition all the following criteria must be fulfilled:

i. There must be an amount. In Mrs Good's case there is clearly an amount i.e. either R10m or R15m.
ii. The amount must be in cash or otherwise. Mrs Good will presumably be paid in cash.
iii. The amount will only be included in Mrs Good's gross income when it is received by her or accrued to her.
iv. The amount must not be of a capital nature. (1)

Clearly requirements (i) to (iii) will be met, and the only issue is the question of the capital or revenue nature of the proceeds (the *crux* of the matter). (1)

Capital receipts are the consequence of the disposal of a capital asset which was acquired as an investment. Revenue receipts are the consequences of a scheme of profit making. (1)

Whether Mrs Good holds the flats as a capital or revenue asset will depend on the purpose for which she holds the asset. (1)

The courts (*Stott*) have held that it is necessary to establish the intention of the taxpayer at the time of acquisition. If intention at the time of acquisition is capital and there is no subsequent change of intention, the proceeds are capital (*Stott*). (1)

Mrs Good's intention at the time of acquiring the flats is established by asking her what her intention was (SARS will ask her and) her answer to the question is her *ipse dixit* (i.e. 'what she says'). (1)

The courts have held that the taxpayer's *ipse dixit* must not be taken lightly, and must be supported by the circumstances. The veracity of the taxpayer's *ipse dixit* will be tested by taking into account the surrounding facts. (1)

ACTIVITY 4.2 - SUGGESTED SOLUTION (continued)

The factors that will be taken into account are:

- Length of time that the asset was held. In Mrs Good's case the flats were owned for more than 20 years which supports a capital intention.
- Frequency of property dealings. Assuming this is only property sale that Mrs Good has made the inference is one of capital.
- The flow of income. Mrs Good has received rental income for 21 years.
- The reason for the sale. Mrs Good is her poor health and age. (2)

All indications are that Mrs Good's original intention was one of a capital nature and in the absence of a change in intention the proceeds will be of a capital nature. (1)

The courts (*Stott*) have held that every person is entitled to realise their capital asset to the best advantage. Furthermore, it has been held that the mere decision to sell does not in itself intimate a change of intention (*John Bell*). (1)

A change of intention occurs when the taxpayer does something more than merely realise an asset to best advantage. The taxpayer's actions must metamorphose the asset and turn it into trading stock (*John Bell*). The taxpayer must cross the *Rubicon* and go over to a business of property dealing (*Natal Estates*). (1) (1)

If the property is sold as a single unit there is clearly no evidence of a change of intention. (1)

If the sectional title method is used there could be evidence of a change of intention. The R1 million expenditure clearly complicates the situation. (1)

In *Stott's* case it was held that a person, in realising an asset to best advantage, is entitled to accommodate the asset to the exigencies of the market in which it is being sold. By selling as sectional title units Mrs Good is merely disposing of her capital asset in the most appropriate way. Sectional title is the commercially sound method of sale. (1)

If the expenditure is merely to accommodate the sectional title sale it should create no problem. (1)

If however the R1 million is spent to change the character of the property in order to make a bigger profit Mrs Good could be seen to have had a change of intention. (1)
The burden of proof is in the hands of the taxpayer (Mrs Good) in terms of section 102 of the Tax Administration Act (TAA). (1)

On balance, the evidence suggests that Mrs Good acquired the property with a capital intention and has not subsequently changed her intention. The amount received on sale should therefore be excluded from 'gross income', and she should recognise a capital gain. (1)

Total 23

ACTIVITY 4.3: Exempt income (11 marks / 30 minutes)

The following three case studies relate to exempt income:

1. Mr D is employed as a pilot by South African Airways. During his 2024 year of assessment, he was paid R65 000 per month. He was physically outside South Africa for a total of 190 days during this period. At no stage was he outside South Africa for a continuous period of more than 60 days.

2. Mr N, a SA resident, is employed as a mineworker, while his wife Mrs N, to whom he is married out of community of property, works as a marketer for the same mine. During his 2024 year of assessment his employer gave him a miner's uniform with a market value of R400. From 1 March 2023 they also gave his wife a clothing allowance of R500 per month.

3. Mr and Mrs Fred Couple, married out of community of property and both South African residents, are both employed by the same company. During April 2023 they were both advised that they would be transferred from the Johannesburg branch of the company to the Cape Town Branch. Mr Couple was transferred on 1 August 2023. He commenced work and moved into the Cape Town Holiday Inn from that date. The company paid the cost of his flight, R2 200 and also the costs of his accommodation at the hotel, for which the hotel charges him R6 000 per month. Mrs Couple flew down to join him in the hotel and at work on 15 January 2024, and on this date, Mr Fred then moved out from his single room to a suite that would accommodate the two of them. The company paid for the cost of her flight, R1 800 and the costs of both Mr and Mrs Couple's accommodation in the hotel, for which the hotel charges R12 000 per month. The company also paid all costs relating to the transportation of the household effects to Cape Town, which cost R41 500 and the estate agent's commission on the sale of their Johannesburg house, which amounted to R75 000. Mr and Mrs Couple purchased a house on 20 January 2024 and moved into it on 15 February 2024.

YOU ARE REQUIRED TO:

Discuss which amounts will constitute income for the taxpayers named in the above cases, in respect of their 2024 years of assessment. Provide short reasons and /or reference to applicable legislation for each case.

ACTIVITY 4.3 - SUGGESTED SOLUTION

(1) As a South African resident, the amount of R780 000 (R65 000 x12) received forms part (2)
of Mr. D's gross income. Section 10(1)(*o*)(ii) allows an exemption if the employee is outside the Republic for more than 183 full days in any period of 12 months, which must include a continuous period of 60 full days. Mr D meets the requirement of more than 183 days and the amount is less than R1.25 million but not the requirement of a continuous period of 60 full days in the 2024 year of assessment therefore his salary is not exempt.

(2) The cash equivalent of the uniform and the clothing allowance given to Mr N and Mrs N (3)
will be included in their gross income in terms of par (*c*) of the definition of gross income as these amounts were received in respect of services rendered. Section 10(1)(*n*A) would exempt the value of the uniform received in the case of Mr N, but the exemption would not apply in the case of Mrs N since her clothing is not a uniform (i.e. not separately distinguishable from everyday wear).

ACTIVITY 4.3 - SUGGESTED SOLUTION (continued)

(3) As the company paid for the relocation costs of Mr. and Mrs. Couple, the benefit of the relocation costs will be included in their gross income in terms of par (*c*) of the definition of 'gross income' as these were paid as a result of services rendered. The exemption in section 10(1)(*n*B) would apply to the costs of the flight, transporting their household and personal goods, costs of the sale of the previous residence and of hiring hotel accommodation (this latter exemption for a maximum period ending 183 days after the date from which the transfer takes effect). Although Fred's period of 183 days ends on 31 January 2024 (which is 183 days after 1 August 2023), Mrs Couple's accommodation exemption (from 15 January) would cover him since the exemption is for the employee and members of her household. During this period Mrs Couple is exempt on her portion of the costs as this is within 183 days of her appointment. All costs would be exempt. The income thus has a nil effect. (6)

Total 11

4.9 LIST OF REFERENCES OF LEARNING UNIT 4

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- SARS. 2024. Interpretation notes, Available at: https://www.sars.gov.za/legal-counsel/legal-advisory/interpretation-notes/
- South Africa. 2023. *Taxation Laws Amendment Act (Act No. 20 of 2022)*. Cape Town: Government Printer
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END OF LEARNING UNIT 4

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