ACQUISITION FROM THE NON-VENDOR

The building is acquired from a non-vendor. Therefore, **no VAT will be payable** on the acquisition of the building. However, **transfer duty** will be payable.

But, the building that is acquired from a non-vendor constitutes **second-hand goods** as it has been previously owned and used as defined in the Value-Added Tax Act.

Consequently, **a notional/deemed input tax deduction** may be claimed.

The notional input tax deduction will be based on the:

- Application of the tax fraction of **14/114**
- To the **lower** of
- The **consideration paid** for the property of **R2,5 million** or
- The **open market** value of the property.

Therefore, **14/114 x R2,5 million**, being **R307 018**.

However, the notional input tax deduction is **limited to the transfer duty** paid of **R2,5 million x 8%**, being **R200 000**.

In addition, as the building is going to be used to make **exempt supplies** to the extent of 60%, the input tax deduction is **limited** to 40% of the transfer duty paid.

Therefore, a notional input tax deduction of **R80 000** (40% of R200 000) is available.

The notional input tax deduction will be **claimable** in the VAT period **when the transfer duty is paid**.

The asset must be acquired from a Republic **resident** and a copy of a **letterhead** or **ID** document retained in order to claimed the notional input tax credits (any **requirement**).

ACQUISITION FROM THE VENDOR

As the second building is to be acquired from a vendor and **VAT is payable** on the transaction, no transfer duty is payable and **input tax credits may be claimed**.

If the requirements of section 11(1)(e) of the VAT Act are complied with the sale will be **zero-rated as it constitutes the sale of a going concern**.

For the sale of a going concern to be zero rated, section 11(1)(e) requires the following to be met:

- The supply must be **to a registered vendor** (by implication by a registered vendor)
- The enterprise or part of it must be **capable of separate operation**
- The supplier and recipient must agree in **writing** that the enterprise will be **disposed of as a going concern**
- The supplier and recipient must agree in **writing** that the enterprise is an **income-earning activity on the date of the transaction**
- The parties must agree in **writing** that the consideration agreed upon for the supply is inclusive of tax at the rate of **zero percent**.
- The **assets which are necessary** for carrying on such enterprise are disposed of by the supplier to the recipient

Thus if it is a zero rated sale, VAT is payable at 0% and **no input tax deduction** is available to Advance Ltd.

As the building is currently being used less than 95% to make taxable supplies, a **section 18A adjustment to output tax** would normally apply.

However, as Advance Ltd is going to use the building exclusively to make taxable supplies **no adjustment** is required, as it is clearly stated in the question that Advance Ltd will **convert** the residential letting activities into **commercial letting activities immediately upon acquisition**.

If the acquisition is not structured as a going concern sale, VAT is payable on the acquisition of the building and Advance Ltd will be able to **claim input tax credits** on the acquisition of the building in total as the company will be **converting** and using the entire building for commercial letting purposes **immediately upon acquisition**.

Therefore, **R2,85 million x 14/114**, being **R350 000** may be claimed as input tax credits.
Suggested solution

Paper 2 Question 1

<table>
<thead>
<tr>
<th>Question 1</th>
<th>Marks</th>
<th>Marker</th>
</tr>
</thead>
<tbody>
<tr>
<td>as in accordance with section 16(3) input tax is only claimable to the extent to which the consideration has been paid.</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Input tax credits may be claimed when the vendor is in possession of a valid VAT invoice.</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>Total possible marks</td>
<td>22</td>
<td></td>
</tr>
<tr>
<td>Maximum</td>
<td>12</td>
<td></td>
</tr>
</tbody>
</table>

**Query 2**

**VALUE-ADDED TAX IMPLICATIONS**

The indemnity payment was received from the insurer under a contract of insurance.

Therefore, a deemed supply arises in terms of section 8(8) and output tax must be accounted for in the period when the payment is received.

As the vehicle is not a motor car as defined, the entire indemnity payment will constitute a deemed supply.

The output tax that Maluti (Pty) Ltd must account for is **R14 000**, being 14/114 x R114 000.

The payment to compensate the client is not an amount paid to indemnify another person in terms of a contract of insurance and therefore does not meet the criteria for an input tax deduction in respect of the tax fraction of the payment (see section 16(3)(c)).

**INCOME TAX IMPLICATIONS**

The proceeds from the insurance company (net of VAT) in respect of the delivery vehicle is of a capital nature.

However, the proceeds (net of VAT) must be compared to the tax value of the delivery vehicle to see if there is a recoupment or whether a loss on disposal can be claimed in terms of section 11(o). As the proceeds (net of VAT) are R60 000 and the tax value is R61 000 a loss of R1 000 is available in terms of section 11(o).

The loss of R1 000 is deductible on election by Maluti (Pty) Ltd.

The theft of the vehicle is also a disposal as defined in the Eighth Schedule and capital gains tax consequences will arise that are set out below.

Proceeds on the disposal will be calculated as follows:

\[
\text{Selling price/proceeds - output VAT - recoupments} = \text{R60 000}
\]

Base cost will be calculated as follows:

\[
\begin{align*}
\text{Acquisition price - input tax credits claimed - allowances} & = \text{R61 000 - R1 000 (if section 11(o) was claimed on election)} \\
& = \text{R60 000}
\end{align*}
\]

Or R61 000 if the taxpayer did not elect to claim the section 11(o) allowance. (1)

Therefore, no CGT gain or loss arises.

Therefore, a capital loss of R1 000 arises that will be aggregated with other gains and losses.

The proceeds from the insurance company (net of VAT) in respect of the client's stock/products is a receipt of a revenue nature and falls into gross income.

The payment by the company to compensate the client is a deductible expense, being expenditure incurred in the production of income not of a capital nature (section 11(a)).

Alternative for the preceding two marks:

The receipt relates to a loss or expense that would otherwise have been allowable, but is recoverable under a contract of insurance. Therefore, there is no receipt and no deduction allowed in terms of the provisions of section 23(c). (Alt: 2)
In considering whether the insurance receipt is capital or revenue in nature, any of the following court cases could have been discussed for a bonus mark:

- Burmah Steamship Co Ltd v IRC
- CIR v Witwatersrand Association for Racing Clubs
- Joffe & Co (Pty) Ltd v CIR

Total possible marks 14
Maximum 10

<table>
<thead>
<tr>
<th>Query 3</th>
<th>Marks</th>
<th>Marker</th>
</tr>
</thead>
</table>

On the **acquisition** of the vehicle, **input tax credits** would have been **denied** as the vehicle is a motor car as defined.

**Free use of the motor car**

The **free use** of the luxury **motor car** given to the managing director is a **Seventh Schedule taxable fringe benefit**. The company is required to pay a **‘deemed’ output tax** over for the fringe benefit to the managing director.

As the motor car was acquired two years before the use thereof was given to the managing director, the output VAT **per month/12** is calculated as follows:

<table>
<thead>
<tr>
<th>Description</th>
<th>Calculation</th>
<th>VAT Rate</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Acquisition price less VAT, R450 000 x 100/114</td>
<td>394 737</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Less 15% depreciation on reducing balance for each full year of use by the company prior to giving the use to the MD (2 years)</td>
<td>394 737 x 0.15</td>
<td>59 211</td>
<td>R33 526</td>
</tr>
<tr>
<td>for period 1/2/2005 to 31/1/2006</td>
<td>394 737</td>
<td></td>
<td>R59 211</td>
</tr>
<tr>
<td>Less 15% depreciation on reducing balance for the period 1/2/2006 to 31/1/2007</td>
<td>394 737</td>
<td>50 329</td>
<td>R28 519</td>
</tr>
<tr>
<td>x 0,3% as it is a motor car as defined and input tax credits denied</td>
<td>394 737 x 0.3%</td>
<td></td>
<td>R118 421</td>
</tr>
<tr>
<td>x 14/114</td>
<td></td>
<td></td>
<td>R105,07</td>
</tr>
</tbody>
</table>

The further indirect receipt of the **running costs** by the managing director does **not** constitute a further fringe benefit that has **output VAT consequences**.

**Rich Ltd** will be able to **claim input tax credits** on the **repair, maintenance and other running expenses** for which it is in possession of valid VAT invoices.

**Petrol** costs borne by Rich Ltd will not lead to the claiming of input tax credits as petrol is **zero rated**.

**Subsistence allowance**

The company paid its salesman a R196 a day ‘no-questions-asked’ subsistence allowance in terms of section 8(1)(c) of the Income Tax Act. Since the **subsistence allowance is / not a Seventh Schedule taxable benefit** in terms of the Income Tax Act, **no deemed supply**, in terms of section 18(3), arises for VAT purposes.

In addition no input tax credit is available to the company on the payment of the subsistence allowance to its salesman as the salesman is not making a taxable supply to it as the provision of services by an employee to an employer is **excluded from the definition of an enterprise** and consequently the salesman cannot register as a VAT vendor for that purpose.

**Alternative**: The subsistence allowance merely constitutes the **supply of ‘money’**.

**Business trip expenses**

The **airfare expense** is a business expense to the company and it is not a fringe benefit to its salesman. Since the airfare expense is **not a Seventh Schedule taxable benefit** in terms of the Income Tax Act, **no deemed supply**, in terms of section 18(3), arises for VAT purposes.

The accommodation expense paid by the company is **a Seventh Schedule taxable benefit** in terms of the Income Tax Act being residential accommodation provided in terms of paragraph 2(d) of the Seventh Schedule.

The fringe benefit is, however, given a ‘nil’ value being accommodation **away from an employee’s usual place of residence** provided by his employer while he is absent from his
usual place of residence for the purposes of performing the duties of his employment. Therefore the **deemed supply** in terms of section 18(3) will be ‘nil’ (14/114 x nil).

The **meal expenses** paid by the company are a **Seventh Schedule taxable benefit** in terms of the Income Tax Act as provided for in paragraph 2(c) of the Seventh Schedule.

The fringe benefit is, however, given a ‘nil’ value as it is supplied to the **recipient during extended working hours** whilst away on a business trip. Therefore, the **deemed supply** will be ‘nil’ (14/114 x nil).

**INPUT TAX**

The company may **claim** back the **input tax credits on the airfare** as it was incurred in the course or furtherance of the enterprise.

**Hotel accommodation and meal costs** borne by the company constitutes **entertainment** as defined and **input tax credits are generally denied** upon the acquisition of entertainment.

However, as the salesman is **away from his usual place of residence and his usual working place for at least one night**, input tax credits will be claimable.

The input tax credits may be claimed on the valid business expenses when the vendor is in possession of a **valid VAT invoice**.

<table>
<thead>
<tr>
<th>Marks allocated</th>
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<tbody>
<tr>
<td><strong>Question section</strong></td>
</tr>
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<td>Query 1</td>
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<tr>
<td>Query 2</td>
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<td>Query 3</td>
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<td>Presentation, language &amp; layout</td>
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<td><strong>TOTAL</strong></td>
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