Part A

**Group structure**

<table>
<thead>
<tr>
<th>Percentage</th>
<th>Entity</th>
</tr>
</thead>
<tbody>
<tr>
<td>100%</td>
<td>Ground Sample Ltd</td>
</tr>
<tr>
<td>11%</td>
<td>Driller Ltd</td>
</tr>
<tr>
<td>11%</td>
<td>Foreign Ground Ltd</td>
</tr>
</tbody>
</table>

**Second hand machine**

*Machine*
- s12C - used in process of manufacture
- s12C(2) - use lower of cost or market value
- s23C - reduce market value by input VAT to be taken

Input VAT (R5 700 000 x 14/114)

Cost price reduced by VAT input (5 700 000 – 700 000 = 5 000 000)

Therefore capital allowance (s12C @ 20%)

\[ (1 000 000) \]

**S24J loan**

Yield-to-maturity = 15.96% (given)

Interest incurred (s11(a) deduction) (5 700 000 x 15.96%) x 212/365

\[ (528 385) \]

**Patented process acquired**

*New patent*

This would be an imported service - No VAT leviable as used in enterprise. As it is not "goods", there is no deemed input credit

Deduction (3 420 000 x 5%)

\[ (171 000) \]

**Renewed patents**

Input VAT 14/114 x R570 000 - excluded

\[ 70 000 \]

s11(gB) - fully deductible

\[ (500 000) \]

**Trading stock**

Opening stock (s22)

\[ (7 500 000) \]

Closing stock (department practice)

Cost

\[ 9 000 000 \]

Write-down (9 000 000 x 6.3%)

\[ (567 000) \]

Items manufactured

\[ (15 000 000) \]

**Spare parts**

Opening stock (912 000 x 100/114)

\[ (800 000) \]

Parts acquired s11(d) - 2 280 000 x 100/114

\[ (2 000 000) \]

Spare parts on hand (spare parts are closing stock)

\[ 1 000 000 \]

**Transfer of machines to trading stock and vice versa**

*To fixed capital*

s22(8) recoupment:

\[ 3 300 000 \]

But proviso (a) to s22(8) deems the recoupment to be expenditure as the asset will still be used by the taxpayer in the carrying on of trade

s12C for item: R3 300 000 x 20%

\[ (660 000) \]

Asset has a base cost of R3 300 000 – no other CGT effect

Deduction for the manufacture of the item in terms of s11(a) accounted for in point 3

**Sales**

All included (22 800 000 x 100/114)

\[ 20 000 000 \]

**Contract work**

All included (R57 000 000 x 100/114)

\[ 50 000 000 \]
### Part 1 – Paper 1
#### Suggested solution – Question 3

**Bad and doubtful debts**

<table>
<thead>
<tr>
<th>Notes</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actual bad debts (s11(i))</td>
<td>6 500 000</td>
</tr>
<tr>
<td>Doubtful debts deduction</td>
<td>(1 875 000)</td>
</tr>
<tr>
<td>Doubtful debts add back</td>
<td>(2 000 000)</td>
</tr>
</tbody>
</table>

**Interest-bearing investments**

- No VAT implications

**Salaries and wages**

- No VAT implications

**Liquidation**

#### 11.6 Machine distributed as dividend in specie
- Market value (par. 75 - 8th schedule) assume excl VAT: 3 400 000
- Reduce by recoupment (par. 75 read with par. 35)
  
  \[(3 200 000 \times 20\% \times 3) - (1 920 000)\]  

  Proceeds: 1 480 000

- Expenditure (per par. 20): 3 200 000
- Less capital allowances (3 years): (1 920 000)
- Base cost: 1 280 000

#### Pre-valuation date asset; thus base cost at 01/10/2001 is highest of:
- MV on 01/10/2001: not known
- 20% of proceeds: R1 480 000 x 20% = R2 96 000
- Time apportioned base cost
- \[Y = B + \left(\frac{P-B}{T+N}\right)\times N\]
  
  \[= 1 280 000 + \left(\frac{1 480 000 - 1 280 000}{3}\right)\times 2\]

- Since no further expenditure, valuation date value is the base cost per TABC

#### Income tax payable (30% of R2 013 333)
- Against revenue reserve: (604 000)
- Against capital reserve: (50 000)

#### STC payable (1 546 000 x 12.5/112.5)
- 1 546 000
- 171 778

#### Dividend received by GSL
- 1 374 222 + 300 000 = 1 674 222

#### Lease rental paid by GSL
- 1 374 222 + 300 000 = 1 674 222
- (700 000)

#### Asset acquired s11(e)
- (220 000)
Part 1 – Paper 1
Suggested solution – Question 3

12 Controlled foreign entity
S9E applies to foreign dividend. Although controlled foreign entity, all
profits attributable to “business enterprise”, therefore net income will not be
apportioned to GSL
ADD: Proportionate share of profits before tax and withholding tax

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dividend (€5 000 000 x 11% x 17)</td>
<td>9 350 000</td>
</tr>
<tr>
<td>Company tax (€5 000 000 x 5/15 11% x 17)</td>
<td>3 116 667</td>
</tr>
</tbody>
</table>

**Taxable income**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax payable (@30%)</td>
<td>12 076 834</td>
</tr>
<tr>
<td>Foreign taxes paid (in rand) (from point 12)</td>
<td>3 116 667</td>
</tr>
<tr>
<td>Withholding tax (€500 000 x 11% x 17)</td>
<td>935 000</td>
</tr>
<tr>
<td>Tax in South Africa (R12 466 667 x 30%)</td>
<td>3 740 000</td>
</tr>
</tbody>
</table>

Max s 6quat limited to foreign taxes paid

Max s 6quat rebate: lesser of R4 051 667 or [(R12m ~ R12,5m) x 30% = R3 740 000*]

Income tax liability

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>s6quat limited to foreign taxes paid</td>
<td>3 740 000</td>
</tr>
<tr>
<td>(3 740 000)</td>
<td></td>
</tr>
<tr>
<td>Income tax liability</td>
<td>8 336 834</td>
</tr>
</tbody>
</table>

Part B
VAT Consequences

- The compensation payment will only be subject to VAT if it can be said to be for the supply of goods or services (s 7).
- Supply is very widely defined and in addition to certain specific inclusions, refers to “all… forms of supply, whether voluntary, compulsory or by operation of law” (s 1).
- “Services means anything done or to be done, including the surrender of any right” (s 1).
- The supply, if there is one, will therefore come from Ground Sample Ltd and not from Beart Ltd, so it is not relevant that Beart Ltd is based in the United Kingdom and therefore not a VAT vendor.
- It is arguable as to whether one can say that a “surrender of a right” takes place in these circumstances, in that Ground Sample Ltd is suing Beart Ltd for compensation for loss of the agency, but it could be said that the surrender of the right takes place once Ground Sample Ltd accepts the compensation payment in lieu of its rights to, for example, enforce the agency agreement.

CGT Consequences

- A capital gain or loss will arise only on the "disposal" of any "asset".
- Disposal (very widely defined and includes "any event which...results in the extinction of an asset").
- Asset (defined to include "property of whatever nature...whether corporeal or incorporeal....and any right or interest of whatever nature to or in such property").
- Thus the capital gain will be included in taxable income: Proceeds less base cost.
- Proceeds = R5,7m (no VAT applicable as discussed above).
- Base cost: It is a pre-valuation date asset, therefore there are three options (take highest) to calculate base cost at 01/10/2001, namely
  - MV
  - Proceeds x 20%
  - TABC

<table>
<thead>
<tr>
<th>Assets of Driller Ltd</th>
<th>Fixed asset</th>
<th>Accounting tax</th>
<th>Deferred tax</th>
</tr>
</thead>
<tbody>
<tr>
<td>1/6/2000</td>
<td>Original cost</td>
<td>3 200</td>
<td>3 200</td>
</tr>
<tr>
<td>28/2/2001</td>
<td>Depreciation /Wear &amp; tear</td>
<td>(360)</td>
<td>(640)</td>
</tr>
<tr>
<td></td>
<td>Balance</td>
<td>2 840</td>
<td>2 560</td>
</tr>
<tr>
<td>28/2/2002</td>
<td>Depreciation /Wear &amp; tear</td>
<td>(480)</td>
<td>(640)</td>
</tr>
<tr>
<td></td>
<td>Balance</td>
<td>2 360</td>
<td>1 920</td>
</tr>
<tr>
<td>30/6/2002</td>
<td>Depreciation /Wear &amp; tear</td>
<td>(240)</td>
<td>(640)</td>
</tr>
<tr>
<td></td>
<td>Balance</td>
<td>2 120</td>
<td>1 280</td>
</tr>
</tbody>
</table>
Notes

1 In terms of par. 75 of the Eighth Schedule, distributions of asset as dividends in specie are treated as having been disposed of for proceeds equal to market value.

2 In terms of par. 35, proceeds are reduced by amounts included in gross income previously. Since the market value has been deemed to be the proceeds, the market value is reduced by the recoupment (s8(4)(k)). The market value is greater than the original cost and so the recoupment is limited to the original capital allowances received (including the allowance for the current year).

3 The time apportionment formula symbol (B) requires the expenditure to have first been determined in terms of the provisions of par. 20. This means that the expenditure incurred on the asset before and after valuation date must be reduced by the capital allowances in terms of par. 20 before being applied to the time apportionment formula. Same holds true for the proceeds.

4

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Original capital</td>
<td>R1 million / 5 = 200 000</td>
</tr>
<tr>
<td>Therefore capitalised amount</td>
<td>800 000</td>
</tr>
<tr>
<td>Share premium</td>
<td>80 000</td>
</tr>
<tr>
<td>Capital profits</td>
<td>240 000</td>
</tr>
<tr>
<td>Revenue profits</td>
<td>480 000</td>
</tr>
</tbody>
</table>

Since share premium remains in capital, the adjustment is R720 000 (R240 000 + R480 000).

5 The repayment of share premium after the capitalisation of reserves would (in terms of the first proviso of the definition of "dividend") be considered a dividend from revenue profits. The capitalised revenue profits are therefore reduced.

6 Proceeds on the disposal of the shares must represent the asset received at market value and the balance of the cash in the case of a liquidation.

7 The capital distribution from the dividend in specie is not used to reduce the base cost of the shares since this distribution is for the disposal of the shares.

8 Section 12C is not applicable since the asset acquired was previously brought into use by GSL, as lessee. The costs to move the asset are capitalised and wear and tear applied to the total balance.