Answers

Professional Level – Options Module, Paper P6 (ZAF)
Advanced Taxation (South Africa) **December 2011 Answers**

Note: The ACCA does not require candidates to quote section numbers or other statutory or case references as part of their answers. Where such references are shown below [in square brackets] they are given for information purposes only.

1 Poseidon Ltd

MEMORANDUM
TO: The Audit Team
FROM: Candidate
RE: Tax implications of transactions entered into by Poseidon Ltd
Date: 9 December 2011

This memorandum considers each transaction as a separate part.

(i) Fishing vessel acquired and subsequent change of use

(a) Acquisition and use until 31 October 2010.
The fishing vessel acquired represents a capital asset for income tax purposes. On acquisition, the full use of the vessel is anticipated to be for commercial taxable supplies. A full value added tax (VAT) input may therefore be claimed by the company (being R6,840,000 x 14/114 = R840,000). This reduces the 'cost' of the asset to R6,000,000 for income tax purposes. [Interpretation Note 47 provides that] The Commissioner permits fishing vessels to be written off over 12 years from the date of acquisition. The write-off is only permitted to the extent that the vessel is used for trade purposes. This means that for the period 1 April 2010 to 31 October 2010, the write-off would be as follows: R6,000,000/12 years x 7 months/12 months = R291,667 [in terms of s.11(e)].

(b) Change in use and use from 1 November 2010 to 31 March 2011
The change from full commercial use of the fishing vessel to partial use for taxable supplies results in a 'change of use' adjustment for VAT purposes. The change in use calculation is represented by the formula A x (B – C), where A (in this context) is represented by the lower of the acquisition consideration (R6,840,000) or market value on the date of the change in use (R6,150,000); B represents the current use percentage (100% as at 31 October 2010); and C represents the use percentage that has been deemed to take place over the year in the making of taxable supplies (calculated as 100% x 7/12 plus 50% x 5/12 = 79%). As the difference between B and C is greater than 10%, the change in use adjustment is effected:

14/114 x R6,150,000 x (100% – 79%) = R158,605.

This amount represents an output tax for VAT purposes.

The change in use also results in a change to the income tax write-off. The prior period (to 31 October 2010) is unchanged. However, a portion of the cost will now be disallowed (as it is for non-trade purposes). It is submitted that the VAT output adjustment (adding to the cost of the asset) may also be taken into account.

This results in a write-off for the period 1 November 2010 to 31 March 2011 of:

(R6,000,000 + R158,605)/12 years x 50% trade purpose x 5 months/12 months = R106,920.

(ii) Sale of going concern:

As the purchaser of the canteen business was not registered as a VAT vendor at the time of the sale, the sale of the going concern cannot be zero rated. VAT should have been levied at 14% on the sale price, i.e. R1,500,000 x 14% = R210,000. This incorrect treatment will result in VAT penalties for late payment of 10% and interest thereon until such time as the VAT liability is settled.

As the lease to the staff member of the floor space for the canteen is rental of commercial property, the lease (being an operating lease) should have VAT levied at 14%, being a taxable supply. The monthly payments should have VAT of R1,400 (R10,000 x 14%). This results in VAT of R14,000 having not been levied (R1,400 x 10 months). As Poseidon Ltd is a VAT vendor making a taxable supply of commercial property rental, the VAT must be levied, despite the recipient being a non-vendor. A 10% late payment penalty may be levied as well as interest on such late payment.

(iii) Acquisition of elevator (lift) for mixed use property

The building is used for 'mixed supplies' from a VAT perspective. The commercial property use is a 'taxable supply' and the residential use is an 'exempt supply'. The VAT input may only be claimed to the extent that the use is for the making of taxable supplies. In addition, the elevator was imported. Imports result in both an output VAT (on the import of the goods) and an input claim (for the intended use of the goods).

The output VAT arising from the imported goods is based on the actual acquisition cost plus the customs duty and 10% of the acquisition price, i.e. (R750,000 + R150,000 + 10% x R750,000) x 14% = R136,500.

The input that may be claimed for the intended use of the elevator is based on the same value as applies to the output VAT calculation. However, as this use is intended to be 'mixed', only the taxable supplies portion of 70% may be claimed. The input is determined as follows:

R975,000 x 14/114 x 70% = R83,816.

The building was acquired used and is not an industrial building but is used for commercial purposes. As the building was not acquired new or unused, no 5% deduction on the acquisition cost is permissible. However, the new elevator represents an improvement to the building. The elevator is not seen as an individual asset as it attaches and forms part of the building. As a result, a wear-and-tear allowance is not applied. However, as a new and unused improvement to a commercial building, the improvement qualifies for the commercial building allowance of 5% (not apportioned for the period of use within a year of assessment). The requirement is simply that the improvement must relate to a building used wholly or mainly for commercial purposes. As 70% of the building is used for commercial purposes, the requirement is met. The allowance to be claimed is therefore:

(R975,000 – R83,816) x 5% = R44,559.

(iv) Disposal of 'mixed use' building

The disposal of the building represents a taxable supply for VAT purposes. As a result, an output VAT must have been levied. As the tax invoice value is R14,000,000, this must be the consideration inclusive of VAT. The VAT levied on the sale would therefore have been R14,000,000 x 14/114 = R1,719,298. The output is only recognised, however, to the extent that payment is made (as the taxable supply is fixed property). This means that only half the output VAT is payable by 31 March 2011, with the remaining VAT falling to be recognised in April 2011.

As a result of the output VAT being levied in full (despite the mixed use for input purposes), an input adjustment must be determined. This is represented by the formula A x B x C, where A represents the tax fraction (14/114); B represents (in this context) the lower of the cost of R5,700,000 and the market value (R14,000,000); and C represents the exempt supply use percentage (30%). The input adjustment is therefore:

14/114 x R5,700,000 x 30% = R210,000

2 Capt Jones

XYZ Tax consultants
[Firm's address]

Capt Jones
[Client's address]

9 December 2011

Dear Capt Jones

Further to your request as regards the suggested estate plans, below please find an assessment of the tax implications of each plan.

(i) Donation of all assets to Nautica Jones

A donation of all your assets to your wife has the advantage of being exempt from donations tax, which would otherwise be a levy of 20% of the market value of the assets donated. The disposal of these assets would also not generate a capital gain or capital loss as the 'roll-over' provision applies, transferring your expenditure and 'use' of the assets to your wife.

Such a donation would certainly remove these assets from your estate for estate duty and immediate income tax purposes. In addition, any future income from such assets would accrue to your wife.

However, such a plan has its disadvantages. Firstly, no legal control remains over the assets you have generated and subsequently donated. Secondly, such a plan merely defers the liability to tax rather than minimising it as the wealth has transferred to your wife. Should she pre-decease you, the tax liability on death would remain, both in the form of capital gains tax at death and in terms of estate duty to be levied at 20%.

(ii) Donate a usufruct in all assets to Nautica with the bare dominium being left to the children (Matey and Calipso) on death

As detailed above, any donation to your wife is free of donations tax. The creation of the usufruct and bare dominium generates two new assets, one of which is donated to your wife. This new asset will qualify for the capital gains tax roll-over provision (as detailed above).

For estate duty purposes, only the bare dominium still held forms part of your estate. On your death, this would be aggregated with your other remaining property and, after deductions and an abatement of R3·5 million, the dutiable amount remaining would be subjected to estate duty. In addition, the bare dominium would be disposed of to your estate at market value at date of death. This may generate a capital gain or loss that would have to be aggregated with your other capital gains and capital losses in that year to determine a taxable capital gain to be subjected to normal tax. However, it should be noted that the value of the bare dominium is usually only a small portion of the total value of the property and is unlikely to yield a high capital gain or large capital loss.

Being the bare dominium holder allows you to retain control over your asset, however, you sacrifice the use of the asset (and future income thereon) to your wife.

The future implication for your wife, being the usufructuary, is that the value of the usufruct will be included in her estate on death, but a matching deduction is permitted in terms of the estate duty act.

Your children would inherit the bare dominium, with an initial base cost set at the market value of the bare dominium as at your death. However, on your wife's death, the usufruct restores all rights to the property with no increase in the base cost. Should your children dispose of the asset after both your and your wife's deaths, they may face a large capital gains tax liability.

(iii) Formation of a trust with donation or sale of assets to the trust

A trust is a traditional estate-planning vehicle. On formation, control of the assets is lost to some extent, in that the Trustees control the assets on behalf, and for the benefit, of the beneficiaries (which you stipulate would be your wife and two children). You should therefore ensure that you do not have a majority or casting vote, should you be a trustee, as failure to do so would result in the property being deemed yours for estate duty purposes.

Disposal to the trust, whether by donation or sale, will generate a capital gains tax disposal event. Capital gains would have to be determined using the market value of the property disposed of as the proceeds figure. This generates an immediate cash flow issue. In addition, disposal by means of donation will generate a 20% levy (donations tax) on the assets transferred to the trust. While relief, to a limited extent, then applies to the capital gains tax calculation (being that a portion of the donations tax paid is added to base cost), the relief is not as great as the cash outlay.

The trust should be discretionary both as regards income and capital. This prevents unnecessary growth in the hands of the beneficiaries, rather trapping such growth in the trust.

Any sale to the trust is likely to be on loan account (as the newly formed trust would have no capital with which to buy the assets). Should you charge market related interest on the loan account, you would be taxed (for income tax purposes) on such interest earned. Furthermore, difficulties may arise should the trust have insufficient income to fund the interest expense. The alternative is to exclude the mention of interest in the loan agreement. The interest forgone does, however, result in the income earned by the trust by virtue of purchase on such loan account being deemed to be yours for income tax purposes. Any income distributed by the trustees to your minor child, Calipso, will be deemed to be yours. However, any income distributed to your wife or your major son will not be so deemed. Income undistributed by the trust in the year in which it is earned will also be deemed to yours for income tax purposes.

In terms of case law, relief does exist in that the amounts deemed to be yours (either retained in the trust or vested in your daughter) must be capped at the interest that could have been charged on the loan account at market related lending rates. Note further that this limit may be reduced should the trust repay some of the loan balance. This relief does not apply where the assets have been donated.

On your death, the balance of the loan account falls into your estate for estate duty purposes. There will be no capital gains tax effect as the proceeds (market value of the loan account on death) will match the base cost. For donations, no value remains to be included in your estate (provided no control over the trust is possible).

In my opinion, option (iii) forms the basis for the most viable estate plan for the following key reasons:

– The disposal to a trust by donation would reduce your estate and by sale on interest free loan account would 'freeze' your estate;
– Growth in any of the Trust assets can (by retention in the Trust) be excluded from any of your dependants' estates (minimising their subsequent estate duty);
– Trustees have a fiduciary duty to act in the interests of the beneficiaries ensuring, to some extent, the longevity of the assets in favour of your dependents.

Should you have any further queries, or would like any further advice, please do not hesitate to contact me.

Yours faithfully

Candidate

3 Exchange Data Ltd

(a) Issue 1:

The general deduction formula [s.11(a)] provides: 'For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived – (a) expenditure and losses actually incurred in the production of income, provided such expenditure and losses are not of a capital nature.'

From the agreement, it is apparent that expenditure has been incurred (namely the R35 million). That the expenditure comprises shares issued and a loan account does not detract from the expenditure having been incurred, the shares and loan account merely being the means to settle such expenditure.

The issue that requires an answer is whether or not such expenditure for licences over five years represents expenditure of a capital nature (and is therefore not deductible). Such answer lies in the interpretation of the agreement and establishing the exact meaning of what the licence fees 'acquired'.

It is accepted, by virtue of case law, that capital may be distinguished into fixed or floating capital, the former indicating capital nature as contemplated in the Income Tax Act ('the Act') and the latter being accepted as of a revenue nature (for example, trading stock). That the data service charges of the multiple service providers were previously permitted as a deduction serve as evidence that the data sold is the stock-in-trade.

The nature of the business that Exchange Data Ltd conducts is essentially the sale of a data service 'live-streaming data'. This 'data feed' is essentially the trading stock (or floating capital) of the company.

While it is apparent that the data is trading stock, the licences to supply such data and to read and transmit such data are not necessarily the same. Without the licences, however, the data cannot be read and no trading stock can exist. It is therefore submitted that the payment for the licence was a payment for the right to operate the system. In addition, that the contract was to last for five years does not of itself indicate that an enduring benefit was created by virtue of such agreement. The import and context of the expenditure has to be analysed. The long-term arrangement was not unlike the data the respondent had purchased previously from different sources. The enduring benefit test for capital nature on its own is unhelpful.

The *expenditure* for the data feed was more closely related to the income-producing activities of on-selling data than to the acquisition of infrastructure. The day-to-day activities of the software is such that the expenditure is more closely linked to producing revenue.

It is finally submitted that the true legal nature of the transactions show that the expenditure is for the acquisition of data being the 'trading stock' and the money outlaid for the acquisition of the integrated system was its floating capital used wholly for the purposes of trade. The expenditure is not an enduring asset, nor a 'once and for all' payment. (Payment five years in advance does not change its character as an annual fee.) A valid commercial reason was given for fixing the price upfront over a five-year period, namely, the volatility of rand currency. The expenditure did not alter the nature of the business; it made the trading stock more attractive.

Therefore the expenditure should be deducted in terms of the general deduction formula. It should be noted, however, that as the benefit of the R35 million extends beyond six months after the year end and exceeds R80,000, the deduction, must [in terms of s.23H] be spread over the period of the agreement, allocating the appropriate proportion (based on time) to each year of assessment.

Tutorial note: *This question is based on the facts and decision in* Commissioner for the South African Revenue Service *v* I-Net Bridge (Pty) Ltd *(2010).*

(b) Issue 2:

It is clear from the scenario supplied, that the critical issue is whether or not the proceeds from the disposal of land will be of a capital or a revenue nature.

The purpose for which the land was acquired is that of a capital nature, being the warehousing of Exchange Data Ltd's servers used in the conduct of its business. Such intention is only deemed to have changed should some intervening factor or the surrounding circumstances indicate such change [*John Bell and Co (Pty) Ltd* v *Secretary for Inland Revenue*]. It is further noted that a taxpayer may realise an asset to best advantage and that the realisation at a profit does not of itself indicate a change of intention [*Commissioner of Taxes* v *Booysens Estates Ltd* and *Commissioner for Inland Revenue* v *Stott*].

(i) It is therefore submitted that a simple sale by Exchange Data Ltd to the local municipality would remain of a capital nature. The proceeds would therefore not be gross income, but rather would fall to be taxed as capital gains or losses.

(ii) The formation of a realisation company does not of itself ensure that the profits are of a capital nature. Independent enquiry must take place to establish whether or not the intention of such realisation company is one of capital.

The realisation company, while formed with the purpose of realising the capital asset to best advantage, in total appears to be performing the actions of a property dealer, in that the company will sub-divide, provide services and market the disposal of the erven. In addition, it cannot be said that the realisation company acquired the land with a capital intention, as the intention of the holding company (Exchange Data Ltd) on its disposal to the realisation company cannot be imputed onto the realisation company as its acquisition intention.

It is therefore submitted that the additional actions performed by the realisation company and its initial purpose of acquisition would appear to be that of trading in land. As such, the proceeds in this instance would be treated as gross income.

Tutorial note: *This question is loosely based on the facts and decision in* CSARS *v* Founders Hill (509/10) *[2011] ZASCA 66*.

4 Lease Co Ltd

(a) Instalment sale arrangement

Value added tax (VAT)
The instalment sale arrangement is an instalment credit agreement for VAT purposes. The implication is that the VAT is payable at the start of the instalment sale. The amount to be paid is R280,000 (R2,280,000 x 14/114).

Income tax
The instalment sale agreement results in the accrual of the proceeds for sale of the machine on entering into the agreement (i.e. gross income). The value to be recognised immediately is the cash value (excluding VAT), being R2,000,000 (R2,280,000 – R280,000 VAT).

The finance charges are recognised on a yield to maturity basis (see table below). The interest is based on the initial amount of R1,980,000 (being the initial debt of R2,280,000 less the initial deposit of R300,000).

Month	Initial Amount/Adjusted Initial Amount	Interest	Payment
February	R1,980,000	x 1% = R19,800	(R44,044)
March	R1,955,756	x 1% = R19,558	(R44,044)

A deduction for the cost of the asset acquired (net of input VAT), being R1,700,000 (R1,938,000 x 100/114), is claimed as the machine represents trading stock.

As the instalment sale agreement results in immediate recognition of the sale proceeds whereas the actual cash flows in terms of the agreement are very different, relief is granted in terms of the debtors allowance. The allowance provides that the gross profit element of the debtors balance at the end of the year of assessment is recognised as a deduction and reversed at the start of the next year of assessment. This would be calculated (as at 31 March 2011) to be:

– Gross Profit percentage of 15% (being the difference between the Sales price excluding VAT of R2 million (see above) and the cost price of the asset of R1,700,000 (see above) divided by the sales price excluding VAT), i.e. R300,000/R2,000,000 = 15% multiplied by the adjusted initial amount (as this represents the remaining capital balance (excluding remaining finance charges)), i.e.:

  15% x R1,931,270 (R1,955,756 + R19,558 – R44,044) = R289,691 (rounded up to the nearest Rand).

The allowance therefore allows for the mismatch in timing between cash flows and accruals. The allowance is reversed in the next year and recalculated at the 31 March 2012 year end.

(b) Finance lease arrangement

Value added tax (VAT)
The finance lease represents an instalment credit agreement for VAT purposes. As such, the VAT output payable in terms of the lease (namely R280,000) would have been paid at the start of the lease. There are no further VAT consequences when the lessee acquired the machine at the end of the lease.

Income tax
As the VAT implications are recognised at the start of the lease, the subsequent lease receipts are recognised in full in gross income. For this lease the 2011 year of assessment inclusion in gross income amounts to R68,000 x 7 months = R476,000.

During the lease, the lessor is entitled to claim a capital allowance dependent on the use by the lessee. The ‘cost’ for the purposes of claiming the allowance is based on the cash cost (excluding input VAT as required by the Income Tax Act) and reduced by the agreed residual value in terms of the lease [refer to Interpretation Note 47]. Furthermore, as the market value was equal to the cash cost (including VAT), the market value effects are equivalent to such cash cost and do not generate a lower value to consider for such allowance purposes.

The above would have resulted in a capital allowance claim in the 2011 year of assessment of 20% x R1,700,000 (R1,938,000 less R238,000 (input VAT)) = R340,000.

The sale of the leased asset to the lessee at the end of the lease will result in a recoupment of the allowances claimed during the lease, where the sales price is greater than the tax value or where the tax value is greater than the sales proceeds. Alternatively, should the tax value be greater than the proceeds, at the election of the company, a loss allowance may be claimed for the difference between such tax value and the proceeds paid. In this case, the following is true:

– The allowances claimed over the three years would be 20% x 3 years x R1,700,000 = R1,020,000
– The tax value at the termination of the lease was R680,000 (R1,700,000 – R1,020,000)
– The proceeds received amounted to R800,000
  [**Tutorial note:** *As there are no further VAT consequences – see above – no VAT is removed from the proceeds figure*]
– A recoupment of R120,000 (R800,000 less R680,000) arises.

The disposal of the asset at the end of the lease will have capital gains tax consequences. Proceeds will be the residual value in terms of the lease (sales price) and not market value (refer Interpretation Note 47 and that the parties are unconnected). Proceeds will be reduced by any recoupment (see above). The base cost will be the acquisition cost (net of VAT) less the allowances to date and the loss allowance (if any – see above). This may be shown as follows:

Amount received	R800,000	
Less recoupment	R120,000	
Proceeds		R680,000
Less base cost:		
Acquisition cost	R1,700,000	
Less allowances on use	R1,020,000	(R680,000)
Capital gain/Capital Loss		0

The capital gain or capital loss resulting will be aggregated with the other capital gains and capital losses to determine whether the company has a net capital gain (of which 50% would be included in taxable income as a taxable capital gain).

[**Tutorial Note:** *The SARS practice is excluded from the question as it produces anomalous results for capital gains tax. This issue is under discussion with SARS.*]

5 Employee share schemes

(a) Current and future implications for the employees

On becoming beneficiaries of the Trust, the employees receive vested capital rights and limited vested income rights to shares in a Trust that carry restrictions. As these contractual rights have value in relation to shares in ABC Ltd and such rights are generated only by virtue of employment with ABC Ltd, such rights are classified as 'restricted equity instruments' for the purposes of employment scheme gains and losses [s.8C].

On receipt of the underlying right to the shares, which the employees each receive for their own benefit, gross income arises [paragraph (c) of gross income]. However, the full amount of gross income will be exempt [s.10(1)(nD)] on the effective date as the amount is governed by the section of the act [s.8C] 'Taxation of directors and employees on vesting of equity instruments'. Until vesting takes place in terms of the above mentioned section, no disposal for capital gains tax can take place from the employees perspective.

It is apparent from the structure that the vested rights in the Trust pertain to the capital of the shares and to only a set percentage of the income (the dividends). As a result, beneficiaries are only entitled to such set percentage of dividends accruing to the Trust (irrespective of whether the Trust distributes such dividend income). Such dividend income retains its nature in terms of the conduit pipe principle. The result is that the dividends vesting from the Trust remain dividends and the local dividend exemption will apply in full to such dividends. Thus, such dividends have no ultimate tax consequence.

The rights to the shares in the Trust remain 'restricted equity instruments' until the earlier of the termination of the vested right (for example, the employee leaves ABC Ltd before the expiry of the ten year period or shorter period where declared by the ABC Ltd directors) or conversion into company shares (by way of distribution of shares from the Trust).

As the Trust right (a restricted equity instrument) is converted to shares carrying a restriction, the shares themselves remain restricted equity instruments at the final date of the Trust. The terms of the scheme dictate that only seven days after distribution are all restrictions lifted and the employee may then dispose of the shares.

Seven days after the distribution is received, the restricted equity instruments (the shares) vest. On that date, the employees concerned each include any gain or deduct any loss arising from such vesting. The gain or loss will be determined with reference to the market value of the shares now held. Such gain or loss will be included in the respective employees taxable income calculation. In addition, such gain or loss is included in remuneration for employees tax purposes.

The market value of the shares (as applied to determine the gain or loss above) then becomes the base cost of the shares for capital gains tax purposes (where such share is subsequently held with a capital intent). Any further gain or loss on ultimate disposal of the shares will be determined in terms the capital gains tax schedule [the Eighth Schedule].

Any repurchase by the company of shares held by the Trust on the final date results in a loss in the Trust (being the difference between the amount received by the Trust less consideration paid by the Trust on the acquisition of the shares). Such loss must be included in the taxable income of the qualifying employees [in terms of s.8C].

For those employees forfeiting their vested rights, by virtue of leaving the employer before the final date, no vesting has occurred in terms of the employment scheme section. Furthermore, as the instrument has not vested for the purposes of that section, there is deemed to be no disposal for capital gains tax purposes.

(b) The Trust and Hold Co Ltd

As the trust has only vested capital beneficiaries, there are no capital gains tax implications for the Trust as all vesting has taken place.

The income retained in the Trust (being the portion of dividend income not distributed), will be included in the Trust's gross income. However, the local dividend exemption will exempt the entire amount. The dividends do not provide any tax consequences.

On reaching the final date, the shares are distributed to the vested capital beneficiaries (being the employees) with the forfeited shares being distributed to the residual beneficiary. In addition, the retained dividend income will be distributed to Hold Co Ltd.

Hold Co Ltd only has tax consequences on the final date. On such date, the shares forfeited by employees will vest in Hold Co as Hold Co is the residual beneficiary. Any capital gain realised by the Trust will be distributed to Hold Co to be aggregated with Hold Co's other capital gains and capital losses. Any capital loss realised by the Trust will be retained by the Trust and 'lost' on termination. In addition, the retained dividend income (to the extent it represents dividends earned in prior years of assessment) will be a single cash capital sum received with no capital gains tax consequences (being currency). Any dividend income earned by the Trust during the year of assessment into which the final date falls will be distributed to Hold Co. Such amount retains its nature as dividend income and the local dividend exemption will serve to exempt the full amount.

Tutorial note: *This scheme is adapted from Binding Class Ruling 001.*

Professional Level – Options Module, Paper P6 (ZAF)
Advanced Taxation (South Africa) **December 2011 Marking Scheme**

		Marks
1	Various Transactions – Poseidon Ltd	
(i)	**Acquisition of fishing vessel and change in use**	
	Acquisition results in capital asset providing taxable supplies	1
	Full input claim and calculation of input claim	1
	Write-off for income tax to the extent of trade and calculation	2
	Change of use adjustment for VAT identified and formula supplied	1
	Contextualisation of formula to facts (including calculation)	2
	Change of use conclusion as output VAT	1
	Change in write-off for income tax as non-trade use identified	1
	Addition of VAT output to 'cost'	1
	Determination of remaining period allowance	1
(ii)	**Going concern sale of canteen**	
	Going concern sale may not be zero rated	1
	VAT that should have been levied and consequence	1
	Lease of space should have been VAT-able	1
	Calculation of VAT that should have been levied	1
(iii)	**Acquisition of elevator for mixed use**	
	Mixed use and identification of components	1
	Import and identification of both input and output effects	1
	Calculation of VAT output	2
	Calculation of VAT input	2
	Use of new building and identification as a commercial building	1
	No allowance for building and reason	1
	No wear & tear for elevator and reason	1
	Commercial building allowance applicable to elevator as improvement	1
	Commercial building allowance restriction and application to facts	1
	Calculation of the allowance applicable to the elevator	1
(iv)	**Disposal of 'mixed use' building**	
	Output VAT on taxable supply of building	1
	Calculation of VAT and limit to extent paid	1
	Input adjustment and formula	1
	Calculation of input VAT adjustment	2
		32
	Presentation and effectiveness of communication	3
	Total	**35**

			Marks
2	(i)	Donation exempt from donations tax (spousal donation)	1
		No capital gains tax (roll-over)	1
		Loss of control	½
		and transfer of estate duty and capital gains to wife	1
	(ii)	Creation of usufruct and bare dominium – identification of the assets created and of asset donated to wife	2
		Estate duty – bare dominium part of his estate	1
		Capital gains tax impact of disposal of assets by Capt Jones	1
		Retention of control	½
		Future implication for wife	½
		Future implication for children and capital gains problem	1
	(iii)	Control lost to trustees	1
		Deemed estate duty on assets if control retained	1
		Capital gains tax and donations tax cash flow effects	2
		Trust should be discretionary with reason	1
		Sale on loan account and market related interest charge	1
		Interest foregone results in trust income attributed to Capt Jones	1
		Income of minor children attributed to Capt Jones	½
		Deemed income limitation and potential reduction	2
		Capital gains tax implications on death for loan account	1
		No capital gains on death for donation and no relief for deemed income	1
		Recommendation with reason	2
			23
	Presentation and effectiveness of communication		2
		Total	**25**
3	(a)	Basic rule for deductibility of expenses from trading income	1
		Noting that shares and loan stock are merely the form of the consideration and do not affect deductibility	1
		Capital nature issue and meaning of acquisition	1
		Data receipt and use of data as trading stock or capital items	1
		Licences used to operate and obtain data	1
		Five-year period not indicative of enduring benefit	1
		Type of arrangement not unlike previous arrangements (permissible)	1
		Expenditure linked to producing revenue	1
		Acquisition of system represents floating capital and not enduring	1
		Payment in advance does not taint the nature of the expenditure	1
		Expenditure therefore deductible	1
		Deferred deduction applies	1
		Application of deferred deduction principle	1
			13
	(b)	Capital versus revenue issue identified	½
		Initial purpose and such purpose being of a capital nature	1
		No change of intention on disposal by Exchange Data Ltd	½
		Conclusion on disposal directly by Exchange Data Ltd and capital gains result	1
		Intention of realisation company to be separated from holding company	1
		Actions indicate property dealing (link to facts)	1
		Acquisition intention of realisation company to trade in land	1
		Conclusion that realisation company proceeds on disposal would be gross income	1
			7
		Total	**20**

			Marks
4	**(a)**	Stating that the instalment sale is an instalment credit agreement and calculating the VAT output	1
		Stating and calculating that proceeds (excluding VAT and finance charges) recognised as gross income	1
		Stating that finance charges recognised on a yield to maturity basis and determining the initial amount	1
		Calculating the interest and adjusted initial amounts	2
		Stating and calculating that there will be a deduction of the machine acquired as trading stock	1
		Stating that the debtors allowance will apply	½
		Explaining the application of and calculating the debtors allowance	1½
			8
	(b)	Stating that the finance lease is an instalment credit agreement and stating that the VAT output is determined at the start of the lease and that there are no further VAT consequences	1
		Stating that the lease payments are gross income and calculating the inclusion	1
		Stating that the lessor is entitled to claim a capital allowance	1
		Showing how the cost for the purposes of the allowance would be determined and determining the allowance	2
		Discussing the possible recoupment or loss allowance and the derivation thereof	2½
		Stating that the disposal will have capital gains tax consequences	1½
		Showing how the proceeds and base cost would be determined	2
		Stating that the resultant capital gain or capital loss would be aggregated with other capital gains and capital losses	1
			12
		Total	**20**

5	**(a)**	Vested capital beneficiaries	1
		Such right generates a restricted equity instrument	1
		Gross income on receipt of vested right and exemption	1
		Limited right to income	1
		Vesting of dividends and local dividend exemption	1
		Rights in trust remain restricted until either of two events	2
		Right converted to share remains restricted until seven days after distribution	1
		Vesting date and gain or loss determination	1
		Gain or loss included in remuneration for employees tax	1
		Market value of share becomes base cost	1
		Repurchase by company (for less than market value) triggers vesting [for s.8C] and results in a loss for the qualifying employees	1
		Forfeiture of vested rights: no gain and no capital gains disposal	2
			14
	(b)	No capital gains tax implications and why	1
		Dividend income accruing to the Trust and exemption	1
		Distribution on final date carries no consequences for the Trust	1
		Shares forfeited by employees vest in Hold Co Ltd	1
		Retained dividend income received as a capital sum	1
		Current dividend income retains its nature and is exempt	1
			6
		Total	**20**