

Part (f) On the assumption that the company does convert an office building into residential accommodation units (see para. 6.2) –		Marks
	<ul style="list-style-type: none"> <li>• discuss the VAT consequences for Beeprop; and</li> <li>• suggest an alternative to any adverse VAT consequences.</li> </ul>	
1	The <b>letting of commercial buildings (offices)</b> constitutes <b>taxable supplies</b> made by an ‘enterprise’ in terms of s7(1). This meant that Beeprop (the vendor) was entitled to <b>claim 100% of the input tax</b> on the office building in terms of s17(1).	1 1
2	<b>Letting of a dwelling (residential accommodation)</b> under an agreement constitutes an <b>exempt supply</b> in terms of s12(c) of the VAT Act supplies and are <i>excluded from the definition of an ‘enterprise’</i> .	1
3	The VAT Act requires an <b>adjustment to output tax</b> in terms of <u>s18(1)</u> when <b>100% taxable</b> supplies change to <b>exempt</b> supplies. This s18(1) adjustment is calculated as: 15/115 <b>on the open market value</b> (s10(7)) of the building (office) at <b>the time of the conversion</b> ( <u>time of supply</u> ) in terms of s 9(6).	1 1 1
4	<b>No input tax</b> may be claimed on <b>any conversion cost</b> from office space into <u>residential</u> apartments as it is used in the making of exempt supplies, which by implication <b>increases the actual conversion cost</b> by the VAT fraction (15/115). As <b>no input tax is claimed</b> on the cost of the improvements, the cost subject to the <u>capital allowance</u> will <b>not be reduced by the VAT</b> in terms of s23C.	1 1 1B
5	Beeprop is currently a VAT vendor making <b>both taxable and exempt supplies</b> . Where goods and services are acquired in respect of both types of supplies, an <b>apportionment of input tax</b> is required. If office space is now converted into residential apartments, the <b>percentage of taxable supplies</b> in relation to total supplies will probably <b>decrease</b> and <b>less input tax</b> may be claimed in the future. If it <b>decreases by more than 10%</b> (only on capital goods >= R40 000), s18(2) <b>output tax adjustment</b> if the percentage may apply on year-end.	1 1 1
6	<b>Other suggestions</b> Clearly, Delien is correct to expect that the conversion of office buildings into residential apartments will have <b>negative VAT consequences, because output tax is payable immediately</b> . An <b>alternative to consider</b> is converting the office space into apartments providing <b>commercial accommodation</b> that is subject to VAT at the standard rate. An example of commercial accommodation would be where <b>furnished apartments are provided together with cleaning services</b> . It is, therefore, suggested that domestic goods and services are provided together with lodging to <b>continue making taxable supplies</b> with the building to avoid any negative VAT consequences.	1P 1P 1P
<b>Available</b>		<b>15</b>
<b>Maximum</b>		<b>12</b>
<i>Communication skills – logical argument</i>		<i>1</i>
<b>Total for part (f)</b>		<b>13</b>

Part (g) Calculate the effect of the conversion costs of the manufacturing building (see para. 6.2) on the taxable income of Beeprop for the 2021 year of assessment.			Marks
<ul style="list-style-type: none"> <li>• Consider all amounts.</li> <li>• Provide brief reasons to support your answers.</li> </ul>			
1. Air conditioning and heating system (s11(e) wear and tear deduction – R624 000/6 years x 2/12) or 61/365 days = (R17 381)		(17 333)	1R 1
2. Solar panels (s12B capital allowance less than 1 megawatt power) R1 750 000 x 100%)		(1 750 000)	1R 1
3. Water-saving system: Repairs (s11(d) repair to original value, part of the whole system)		(2 500 000)	1R 1
<b>Improvements:</b>			
4. Re-orientation of doors and windows (capital in nature as it improved the industrial capacity, or not a repair to original value i.t.o s11(d))	3 000 000	0	1R
5. Installation of energy-efficient lighting system (capital in nature it improved the industrial capacity, or not a repair to original value i.t.o s11(d))	450 000	0	1R
6. Installation of insulation material (capital in nature it improved the industrial capacity, or not a repair to original value i.t.o s11(d))	250 000	0	1R
<u>Total of improvements</u>	3 700 000		
S13(1) building allowance as improvements will be mainly used in a process of manufacture 5% of R3,7 million		(185 000)	1R 1P
Increase in base cost of R3,7 million (para. 20(1)(e) expenditure) has no effect on the current year's taxable income as it has not yet been disposed of <i>No mark awarded as it does not directly impact this year's taxable income calculation.</i>		0	
<b>Net effect of conversion cost on taxable income</b>		<b>(4 452 333)</b>	
<b>Available</b>			<b>11</b>
<b>Maximum</b>			<b>10</b>
<b>Total for part (g)</b>			<b>10</b>

Part (h) Discuss the deductibility of the tenant installation allowance for Beeprop in terms of the general deduction formula.	Marks
Expenditure incurred in the carrying on of a trade may only be deductible if the requirements laid down in <b>s11(a) read together with s23(g)</b> are complied with.	1
In terms of s102 of the Tax Administration Act, the <b>burden of proof is on Beeprop</b> to prove that the amount is deductible.	1
It is submitted that Beeprop is carrying on a <b>trade</b> ('trade' has a very wide meaning in s1(1)) and the <b>letting of properties</b> is included in the 'trade' definition. Beeprop is wholly carrying on a trade and s23(g) does not need to be considered. ( <i>Burgess case</i> )	1
The primary concerns is whether the tenant installation allowance (expenditure) can qualify as a deduction in terms of the general deduction formula ' <b>not of a capital nature</b> '.	1
The <b>tenant installation</b> allowance therefore results in the <b>acquisition of an asset of a permanent nature</b> ( <u>an enduring benefit</u> as a lease of 5 years was signed), and therefore the expenditure is of a <u>capital nature</u> .	1
Improvements to a building does <b>add to the income-earning structure</b> ( <i>New State Areas</i> ). <b>OR</b> <i>Alternative: This does not provide an enduring benefit and is therefore <u>not capital</u> in nature. It may qualify as a deduction <b>income earning operations</b>, similar to advertising <b>expenditure incurred by a business already in existence</b> (<u>already earning income</u>).</i>	1
Beeprop made the payment so that they did not need to make the necessary improvements to the building. The payment is therefore <b>on behalf (proxy) for the improvements that Beeprop would normally have made as landlord</b> . <b>OR</b> <i>Alternative: Beeprop provides tenant installation allowance (expenditure) in order to <b>secure tenants (a continuous income stream)</b>. Based on the fact pattern, some candidates may view the incentive component as more important than the required improvements.</i>	1
Conclusion: Because the tenant installation allowance is considered to be of a capital nature it will <b>not be allowed as a deduction in terms of s11(a)</b> .	1P
<b>Available</b>	<b>8</b>
<b>Maximum</b>	<b>7</b>
<i>Communication skills – clarity of expression</i>	1
<b>Total for part (h)</b>	<b>8</b>

<b>Part (i) Calculate the effect of the lease agreement between Beeprop and Callme on the taxable income of the lessor (Beeprop) and the lessee (Callme) in respect of the 2021 year of assessment (see para. 6.3).</b>		<b>Marks</b>
<ul style="list-style-type: none"> <li>• Provide brief reasons for your answer.</li> <li>• Consider all nil effects.</li> </ul>		
<b>LESSOR BEEPROP</b>		
<b>Gross income (s1) - rental payments</b> R200 000 x 11 months	<b>2 200 000</b>	<b>1</b>
<i>Section 23C requires the input tax allowed to be claimed to be removed from the cost before the capital allowance</i>	<b>0</b>	<b>1</b>
<b>Tenant installation allowance</b>	<b>Alternative</b>	
<b>S11(a):</b> No deduction as <b>capital in nature</b> <b>or</b> <i>Alternative: s11(a) deduction as Beeprop did incur the expenditure R3 450 000 x 100/115</i>	<b>(3 000 000)</b>	<b>0</b>  <b>1R</b>
<b>S13quin</b> improvement cost incurred by the taxpayer – 5% X R3 450 000 x 100/115 (s 23C) <b>or</b> <i>Alternative: must argue consistently that there is a <u>s11(a) deduction</u> as it's an incentive allowance thus <u>not capital allowance</u> as Beeprop then award the 1marks - refer to candidates reasoning part (h)</i>	<b>0</b>  <b>(150 000)</b>	<b>1</b>
<b>Obligatory improvements</b>		
<b>No gross income</b> para (h) inclusion of leasehold improvements <b>are incurred by the lessor.</b> <b>or</b> <i>Alternative: Para (h) Gross Income inclusion of Leasehold improvements effected in terms of lease agreement R4 600 x 100/115 or R3 450 000 x 100/115</i>	<b>4 000 000</b> <b>3 000 000</b>	<b>0</b>  <b>1</b>
<b>LESSEE CALLME</b>		
<b>Tenant installation allowance</b>	<b>Alternative</b>	
<b>Gross income</b> Receipt of tenant installation allowance ( <b>Capital in nature</b> as it relates to compensation for the leasehold improvements made by Callme) <b>or</b> <i>Alternative: receipt of tenant installation allowance is <b>revenue in nature</b></i>	<b>3 000 000</b>	<b>0</b>  <b>1</b>
<b>Obligatory improvements</b>		
Improvements to property: No deduction in terms of s 11(a) as <b>capital in nature OR s 11(g)</b> as the tenant did <b>not incur the cost</b> of these improvements (paid by the landlord). <b>or</b> <i>Alternative: If a candidate argues that the R4 600 000 or R3 450 000 x 100/115 should be included in income, then an allowance in terms of <b>s11(g)</b> should be allowed</i>	<b>0</b>  <b>0</b>	<b>0</b>  <b>1</b>

Claim over lease period that relates to current year: <b>No further claims</b> can be made <b>on the excess</b> related to capital expenditure for which no allowance can be claimed (s 13(1) not applicable as the building is not used for manufacturing)		0	1
<b>Alternative:</b> Consistent with above R3 000 000 or R4000 000 / (60 months – 4 months) x 7 months =	(500 000) (375 000)		
<b>S 11A - rental payments: Before trading</b> R200 000 x 4 months (Feb – May)		(800 000)	1
<b>S 11(a) - rental payments: Since trading</b> R200 000 x 7 months (June – Dec)		(1 400 000)	1
		<b>Available</b>	<b>10</b>
		<b>Maximum</b>	<b>10</b>
		<b>Total for part (i)</b>	<b>10</b>

Part (j) Discuss the VAT consequences of the leasehold improvements for Callme (see para. 6.3).	Marks
<b>Output tax</b>	
Callme (lessee) is a registered vendor. By effecting leasehold improvements Callme is making a <b>supply of leasehold improvements for Beeprop</b> (the landlord) in terms of s7(1)(a).	1
The tenant installation allowance can be linked to the leasehold improvements and will be the consideration paid for the leasehold improvements. It will trigger output tax of <b>R3 450 000 x 15/115 = R450 000</b> .	1
The fact that Callme ended up spending <b>more than was agreed</b> upon it does <b>not</b> give rise to a <b>separate supply</b> in terms of s8(29) read with s10(29) as there was no consideration.	1
<b>Time of supply</b> is the earlier of payment or invoice date of the tenant installation allowance, i.e. the <b>date of the lease agreement (1 February 2021) is the invoice date</b> and the <b>date the tenant installation allowance is paid (10 February 2021)</b> is the date of payment. This means that the time of supply is <b>1 February 2021 (earliest)</b> .	1 1
<b>Input tax</b>	
Callme will pay VAT on the expenses incurred in making the supply and <b>input tax</b> of <b>R4 600 000 x 15/115 = R600 000</b> may be <b>claimed</b> , because Callme makes only taxable supplies (given). The input tax is not denied in terms of s17(2) (assumed) and a tax invoice is received (given).	1
<b>Time of supply</b> is the earlier of payment or invoice date ( <b>both dates are given as 1 June 2021</b> ).	1
<b>Available</b>	7
<b>Maximum</b>	6
	<b>Total for part (j)</b>
	<b>6</b>
	<b>TOTAL FOR PART II</b>
	<b>47</b>