

	Part (e) Discuss, supported with calculations where necessary, the following with respect to the contract entered into with CLease: (i) The VAT implications for AHire as a result of the lease agreement for the July and August 2016 VAT periods. Provide reasons where no tax implications arise.	Marks
VAT: Acquisition of motor vehicles under lease agreement		
1	The motor vehicles that are leased by AHire represent corporeal movable goods falling within the scope of the definition of 'instalment credit agreement' (s1 def. 'instalment credit agreement').	1
2	The repayments consist of the stated sum of money of R410 145 payable in monthly instalments over a period in the future (par (b)(i) of 'instalment credit agreement' in s 1).	1
3	The one-year extension option needs to be taken into account. Thus, the full period during which the instalments will be paid in the future will be four years and not 3 years (par (b)(i) of 'instalment credit agreement' in s 1).	1
4	The sum of money R410 145 includes finance costs; OR The sum of R19 686 960 [R410 145 x 12 x 4] includes a finance cost component of R5 214 784 (par (b)(ii) of 'instalment credit agreement' in s 1).	1
5	The total amounts payable under the lease agreement of R19 686 960 [R410 145 x 12 x 4] exceed the cash value of R14 472 176 [R19 686 960 – R5 214 784] or [R12 694 892 x 1.14] (par (b)(iii) of 'instalment credit agreement').	1P
6	The lease term is greater than 12 months and CLease accepts the full risk of destruction / loss of the vehicles and assumes all obligations in respect of insurance, (par (b)(iv) and par (v)(bb) of 'instalment credit agreement').	1
7	While AHire is responsible for maintenance and repairs and is required to reimburse CLease for the insurance (par (v)(bb) of 'instalment credit agreement').	1
8	Conclusion: The agreement is a lease which meets the definition of an 'instalment credit agreement' par (b)(s1 def. 'instalment credit agreement').	1P
ALTERNATIVE 1: If concluded that it is an instalment credit agreement		
9	AHire is therefore entitled to claim the full input tax.	1
VAT: Motor car		
10	AHire will be entitled to an input tax deduction as the denied input in respect of motor cars does not apply in cases where it is acquired by the vendor exclusively for making taxable supplies under an instalment credit agreement (s17(2)(c)(i)).	1
11	The latter would only be allowed should AHire have a valid tax invoice (s20).	1
12	Per the Jazz Festival court case, the lease agreement can be used as a valid tax invoice.	1
VAT: Value of supply		
13	Capital repayment: The value of supply is deemed to be its cash value of R14 472 176 (inclusive of VAT) (s10(6)).	1
14	The input tax in this amounts to R1 777 285 which is calculated as follows: [R14 472 176 x 14/114] OR [R12 694 892 x 14%] (s17(1)).	1
15	No apportionment is required as the motor vehicles are used 100% for taxable supplies (s17(1)).	1
16	No input tax can however be claimed on the July 2016 and August 2016 lease payments of R820 290 [R410 145 x 2] as the input tax on the finance lease agreement has been claimed in full upfront (s9(3)(c)).	1
17	Interest: Interest paid is a financial service (s2(1)(f)).	1

18	As it is a financial service it holds no VAT implications as it is an exempt supply (s12(a)).	1
19	Time of supply: The time of supply is when the goods are delivered or any payment is received by CLease (whichever is the earlier) , thus 1 July 2016 (s9(2)(b)) and (s9(3)(c)).	1
20	AHire can therefore claim the full input tax in its VAT return for August 2016 (s9(2)(b)) and (s9(3)(c)).	1
21	AHire would be able to claim an input tax deduction on any repairs and maintenance incurred should they have a valid tax invoice (s20).	1
22	AHire would be able to claim an input tax deduction on the reimbursement of the insurance costs to CLease should they have a valid tax invoice (s20).	1
ALTERNATIVE 2: If concluded that it is a normal rental agreement		
9	AHire is therefore entitled to claim the input tax on the lease payments.	1
10	AHire will be entitled to an input tax deduction as the denied input in respect of motor cars does not apply in cases where it is acquired by the vendor exclusively for making taxable supplies by way of a rental agreement at an economic rental consideration (s17(2)(c)(i)).	1
11	The latter would only be allowed should AHire have a valid tax invoice (s20).	1
12	Per the Jazz Festival court case , the rental agreement can be used as a valid tax invoice .	1
13	Repayment: The value of supply is deemed to be its amount of the money of R410 145 (inclusive of VAT) (s10(3)).	1
14	The input tax in this amounts to R50 369 per month which is calculated as follows: [R410 145 x 14/114] OR [R50 369 x 2 = R100 738 for 2 months] (s17(1)).	1
15	No apportionment is required as the motor vehicles are used 100% for taxable supplies (s17(1)).	1
16	Time of supply: The time of supply is when a payment becomes due or payment is received (whichever is the earlier) , thus 31 July 2016 and 31 August 2016 (s9(3)(a)).	1
17	AHire can therefore claim the full input tax on these two rental payments in its VAT return for August 2016 (s9(3)(a)).	1
18	AHire would be able to claim an input tax deduction on any repairs and maintenance incurred should they have a valid tax invoice (s20).	1
19	AHire would be able to claim an input tax deduction on the reimbursement of the insurance costs to CLease should they have a valid tax invoice (s20).	1
	Available – Alt 1	22
	Available – Alt 2	19
	Maximum	14
	Total for part (e)(i)	14

	<p>Part (e) Discuss, supported with calculations where necessary, the following with respect to the contract entered into with CLease: (ii) The income tax implications for AHire arising for the 2017 year of assessment.</p> <p>Provide reasons where no tax implications arise.</p>	Marks
INCOME TAX: Acquisition of motor vehicles under lease agreement.		
ALTERNATIVE 1: If concluded that it is an instalment credit agreement		
1	The lease payments made by AHire is incurred in the production of income, and is therefore deductible (s11(a)).	1
2	Interest incurred by AHire is not claimed under section 24J, as section 24J is not applicable to leases (s11(a), s24J def. of 'instrument').	1
3	As AHire does not own the cars (legal title), it is not entitled to any capital allowances/wear-and-tear (s11(e)).	1
4	The deduction of lease repayments of R4 921 740 must exclude from each rental payment an amount which bears to the input tax the same ratio as such rental payment bears to the sum of all rental payments (s23C(1)) which are calculated as follows:	1
4.1	$[R1\ 777\ 285 \times R410\ 145 / R19\ 686\ 960]$ or $[R1\ 777\ 285 / 48] = R37\ 027$ OR $[R1\ 777\ 285 / 4] = R444\ 321$	1P
4.2	$[R4\ 921\ 740 - (R37\ 027 \times 12)] = R4\ 477\ 416$ OR $[R4\ 921\ 740 - R444\ 321] = R4\ 477\ 419$ <i>*Note: Difference due to rounding</i>	1P
5	Any repairs and maintenance costs incurred by AHire during the year of assessment would be deductible in terms of s11(d) .	1
6	The reimbursement of the insurance costs to CLease by AHire during the year of assessment would be deductible in terms of s11(a) as it is incurred in the production of income.	1
ALTERNATIVE 2: If concluded that it is a normal rental agreement		
1	The lease payments made by AHire is incurred in the production of income, and is therefore deductible (s11(a)).	1
2	As AHire does not own the cars (legal title), it is not entitled to any capital allowances/wear-and-tear (s11(e)).	1
3	The deduction of lease repayments of R4 921 740 must exclude VAT as the input tax per rental payment is allowed (s23C(1)) which are calculated as follows:	1
4	$[R410\ 145 \times 14/114] = R50\ 369$ per month OR $[R410\ 145 \times 14/114 \times 12]$ or = R604 428 per year of assessment	1P
5	$[R4\ 921\ 740 - (R50\ 369 \times 12)] = R4\ 317\ 312$ OR $[R410\ 145 \times 100/114 \times 12] = R4\ 317\ 316$ <i>*Note: Difference due to rounding</i>	1P
6	Any repairs and maintenance costs incurred by AHire during the year of assessment would be deductible in terms of s11(d) .	1
7	The reimbursement of the insurance costs to CLease by AHire during the year of assessment would be deductible in terms of s11(a) as it is incurred in the production of income.	1
	Available – Alt 1	8
	Available – Alt 2	7
	Maximum	6
	Total for part (e)(ii)	6
	<i>Communication skills – presentation and layout</i>	1
	Total for part (e)	21

<p>Part (f) Discuss the accounting treatment of the contract with CLease in the statement of financial position of AHire for the reporting period ended 30 June 2017 in terms of International Financial Reporting Standards.</p> <p>Limit your discussion to –</p> <p>(i) IFRS 16 Leases (assume that AHire has early adopted IFRS16)</p> <ul style="list-style-type: none"> • Include all relevant calculations. • Round all amounts to the nearest rand. • Assume all amounts are material. • Ignore current tax. • Ignore comparative amounts, presentation and disclosure in your discussion. 		Marks
IFRS 16 Leases considerations		
Whether the contract contains a lease		
1	At inception of the contract, AHire shall assess whether the contract with CLease is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration.	1
2	Identified asset The contract between CLease and AHire contains an identified asset because the assets in the contract are typically identified by being explicitly specified in the contract as CLease will provide a fleet of 100 vehicles to AHire which are explicitly identified by their respective registration numbers ; and	1
3	AHire has the right to use the identified asset (vehicles) because CLease has no substantive substitution rights to substitute the vehicles for alternative assets as CLease can only substitute any vehicles in the fleet at the request of A-Hire .	1
4	Right to control AHire has the right to control an identified asset because AHire, the customer, has the right to direct how, and for what purpose , the vehicles are used throughout the period , as AHire can use the vehicles at their own discretion (specifically noted in the contract); and	1
5	AHire will receive substantially all of the economic benefits from the use of the vehicles during the lease period as AHire will use or rent out the vehicles for its own account .	1
6	Conclusion: As AHire has the right to control an identified asset for a specified period, the contract constitutes a lease in terms of IFRS 16 Leases.	1P
Classification and initial recognition of the lease contract		
7	Initially, at the commencement date, AHire shall recognise a right-of-use asset and a lease liability, except to the extent that AHire elected not to, if the lease constitutes either: <ul style="list-style-type: none"> • A short-term leases (i.e. less than 12 months); or • A lease for which the underlying asset is of low value. 	1

8	Short-term lease AHire cannot elect to recognise the lease as a short-term lease because the lease term in the contract is four years as it includes the non-cancellable period of three years as well as the option to extend the lease as AHire is reasonably certain that the option will be exercised .	1
9	The latter lease term therefore exceeds 12 months which is more than what is allowed to account for the lease as a short-term lease.	1
10	Low-value asset AHire cannot elect to recognise the lease as a lease for which the underlying asset is of low value because the individual value for each vehicle is R126 949 (excl. VAT) which exceeds AHire's policy threshold of R25 000 for determining low-value assets.	1
11	Therefore, AHire is required to account for this lease agreement by recognising a right-of-use asset and corresponding lease liability on 1 July 2016 when delivery of the vehicles to AHire took place (i.e. the commencement date) .	1
Initial measurement		
12	Lease liability At the commencement date, AHire shall measure the lease liability initially at R15 720 988 [$n = 48$; $i = 11,5/12$; $pmnt = R410\ 145$] which is the present value of the lease payments that are not paid at that date.	1P
13	To arrive at this amount, the lease payments will be discounted at the interest rate implicit in the lease , if that rate can be readily determined . The lease term is 4 years (as discussed above), whereas the useful life of the motor vehicles are estimated to be 5 years. There is also an option to purchase the motor vehicles at the end of the contract term . This indicates that, at the end of the lease term (4 years), the motor vehicles will still have value for CLease (i.e. unguaranteed residual value).	1
14	As the unguaranteed residual value is not available to AHire, AHire cannot calculate the interest rate implicit in the lease which would require AHire to use its incremental borrowing rate of interest of 11,5% to discount the lease payments.	1
15	The lease payments not paid at commencement date, as mentioned above, will consist of only the annual fixed payment of R410 145 .	1
16	Right-of-use asset The right-of-use asset will be measured at cost, which comprises the amount of the initial measurement of the lease liability of R15 720 988 excluding any input VAT.	1C
17	The agreement is an instalment credit agreement as defined in the VAT Act and AHire will be allowed to recover the input VAT with reference to the day 1 cash cost of the vehicle fleet.	1P
18	The right-of-use asset will therefore be measured initially at R13 943 703 [$R15\ 720\ 988 - R1\ 777\ 285$].	1P
Subsequent measurement		
19	Lease liability AHire will measure the lease liability subsequently by increasing the carrying amount to reflect the finance cost of R1 638 431 [Amrt 1-12 Int] on the lease liability.	1P

20	Furthermore, the lease liability carrying amount will also be reduced by the lease payments made of R4 921 740 OR The carrying amount of the lease liability at 30 June 2017 would amount to R12 437 680 [Amrt 12 Bal OR R15 720 988 – R4 921 740 + R1 638 431].	1P
21	Right-of-use asset Subsequently A-Hire will measure the right-of-use asset on the cost model and as ownership is not acquired at the end of the contract period, and the cost of the asset does not reflect that AHire will exercise the purchase option, the right-of-use asset will be depreciated over the shorter of the lease term (four years) or the useful life (five years) which is four years subsequent to initial recognition.	1
22	Depreciation of R3 485 926 [R13 943 703/4] would therefore have been recognised for the year ended 30 June 2017 OR The carrying amount of the right-of-use asset at 30 June 2017 would therefore amount to R10 457 777 [R13 943 703 x 3 / 4 years].	1P
	Available	22
	Maximum	16
	Total for part (f)(i)	16

Part (f)	<p>Discuss the accounting treatment of the contract with CLease in the statement of financial position of AHire for the reporting period ended 30 June 2017 in terms of International Financial Reporting Standards.</p>	Marks
	<p>Limit your discussion to –</p> <p>(ii) IAS 12 Income Taxes.</p> <ul style="list-style-type: none"> • Include all relevant calculations. • Round all amounts to the nearest rand. • Assume all amounts are material. • Ignore current tax. • Ignore comparative figures, presentation and disclosure in your discussion. 	
<p>ALTERNATIVE 1: SoFP approach <i>Note: The use of the SoFP approach is the preferred method for calculating deferred tax in terms of IAS 12 Income Taxes. It is therefore recommended that candidates follows this approach in future.</i></p>		
1	<p>At the reporting date (30 June 2017), deferred tax assets and liabilities are recognised for differences between the accounting and tax treatments of assets and liabilities except for those temporary differences that are exempt in terms of IAS 12.</p>	1
2	<p>Lease liability The tax base in respect of the lease liability will be the carrying amount less any amounts that will be deductible for tax purposes. The lease instalments of R410 145 excluding VAT will be deductible for tax purposes.</p>	1
3	<p>The VAT portion of the lease payment will not be deductible in respect of that liability as the input VAT relating to this lease agreement amounting to R1 777 285 was claimed upfront from the SARS, as this agreement complies with the definition of an instalment credit agreement in the VAT Act.</p>	1P
4	<p>The VAT amount that is not deductible is calculated based on the instalments still payable in the future amounting to R14 765 220 [R410 145 x 3 x 12] expressed as a fraction of the total instalments payable during the lease term amounting to R19 686 960 [R410 145 x 4 x 12] multiplied with the total input tax in respect of the lease amounting to R1 777 285 i.e. R1 332 964 [R14 765 220/ R19 686 960 x R1 777 285] OR [R1 777 285 x $\frac{3}{4}$].</p>	1P
5	<p>The tax base will therefore amount to R1 332 964 [R12 437 680 – (R12 437 680 – R1 332 964)].</p>	1P
6	<p>Right-of-use asset The tax base of an asset is the amount that will be deductible for tax purposes against any taxable economic benefits that will flow to an entity when it recovers the carrying amount of the asset. As current tax is based on the legal form of the transaction and legal title is vested in CLease (lessor), the SARS will give AHire the lease instalments as a deduction, and AHire will therefore receive no wear-and-tear allowances from the SARS which results in a tax base of R0.</p>	1
7	<p>Temporary difference The latter would result in a total deductible temporary difference (asset) amounting to R646 939 [(12 437 680 – 1 332 964) – (10 457 777 – 0)].</p>	1P
8	<p>Tax rate As the carrying amounts of the lease liability and the right-of-use asset will be recovered through use, the tax on the temporary difference should be provided for at 28%.</p>	1

9	Recognition The latter deferred tax of R181 143 [R646 939 x 28%] should be recognised on 30 June 2017.	1P
10	The latter recognition is however limited to the extent the deferred tax asset is recoverable in future based on the probability of future taxable profits and/or taxable temporary differences at 30 June 2017 against which to offset.	1
	Available	10
	Maximum	4
ALTERNATIVE 2: SoCI approach		
1	At the reporting date (30 June 2017), deferred tax assets and liabilities are recognised for differences between the accounting and tax treatments of assets and liabilities except for those temporary differences that are exempt in terms of IAS 12.	1
2	Temporary difference The current tax is based on the legal form of the transaction and the legal title is vested in CLease (lessor) , and not on the fact that a right-of-use asset or lease liability was recognised.	1
3	The SARS will give AHire the lease instalments of R4 921 740 (excluding VAT) [R410 145 x 12] as a deduction which will need to be deducted.	1
4	However, the VAT portion of the lease payment will not be deductible for current tax purposes, as the input tax relating to this lease agreement amounting to R1 777 285 was claimed upfront from the SARS , as this agreement complies with the definition of an instalment credit agreement in the VAT Act.	1P
5	The lease instalments deduction must exclude an amount which relates to the input VAT in the same ratio as the lease instalments paid , over the sum of all lease instalments (s23C) which will amount to R444 321 [R4 921 740 / R19 686 960 x R1 777 285 OR R1 777 285 / 4] which will need to be added back.	1P
6	The resulting finance cost recognised on the lease liability of R1 638 431 (Amrt 1-12 Int) will not be allowed as a deduction and would need to be added back.	1P
7	The resulting depreciation recognised on the right-of-use asset of R3 485 926 [R13 943 703/4] will not be allowed as a deduction and would need to be added back.	1P
8	The latter would result in a total deductible temporary difference (asset) amounting to R646 939 [-R4 921 740 + R444 321 + R1 638 431 + R3 485 926].	1P
9	Tax rate As the lease instalments of R4 921 740 (excluding VAT) will be allowed as a deduction for current tax purposes , the current tax rate of 28% will apply.	1
10	The latter deferred tax of R181 143 [R646 939 x 28%] should be recognised on 30 June 2017.	1P
11	The latter recognition is however limited to the extent the deferred tax asset is recoverable in future based on the probability of future taxable profits and/or taxable temporary differences at 30 June 2017 against which to offset	1
	Available – Alt 1	10
	Available – Alt 2	11
	Maximum	4
	Total for part (f)(ii)	4
	<i>Communication skills – logical argument</i>	1
	Total for part (f)	21