	Part (a) **Discuss the income tax consequences of the interest received and interest paid on both the ZAR20 million loans in Makhado's taxable income for the year of assessment ended 30 June 2017** **Refer to case law and applicable legislation where relevant**	**Marks**
1	Interest received/accrued from Shweshwe: Makhado, as a company, is a holder of an income instrument as envisaged in *s24J(1)* as the company is entitled to receive interest from Shweshwe in respect of this instrument (the loan is interest bearing).	1
2	In terms of *s24J(3),* interest deemed to accrue to Makhado, must be included in gross income. The amounts will accrue in the 2017 year of assessment on a day-to-day basis.	1 1
3	Amounts are based on the yield to maturity method – *s24J(5)* or interest is spread over the term of the investment/instrument (effective interest rate).	1
4	Conclusion: The interest is therefore included in the gross income (increase in taxable income), irrespective whether it is of a capital nature or not).	1
5	**Interest expenditure owed by Makhado:** In order to be able to deduct the interest expense, *s102 of the Tax Administration Act* requires that the onus of proof is on the taxpayer to prove that the amount is deductible. The discussion below details which points would need to be demonstrated.	1
6	*S24J(2)* is applicable to the interest expense as Makhado is the issuer of an instrument. An amount of interest is incurred in terms of an interest bearing arrangement or debt on the loan of ZAR20 million to the bank.	1 1
7	In terms of *s23B(3)*, no deduction may be allowed under s11(a) where a deduction or allowance may be granted under a specific provision. Therefore s11(a) must not be considered.	1
8	In order to be able to deduct the interest expense, Makhado must demonstrate that the interest was incurred – • while carrying on a trade • In the production of income..	
9	In terms of *s24J(2)* the amount should be calculated based on the effective interest rate. It is accepted that actual interest charged and the amount to be calculated would be the same.	1
10	*Burgess* states that trade should be given a wide interpretation, (also refer to *Practice note* 31). In support of the trade argument, Makhado can rely on the fact that the borrowing of money and re-lending it at a higher rate of interest is a venture, therefor the profitable activity constitutes the carrying on of a trade (*Scribante and MTN* case).	1 1
11	Makhado borrowed the loan of ZAR 20 million at 8% and lent it to Shweshwe at 10%, thereby making a profit, which constitutes a trade.	1P
13	According to the *PE Electric Tramway* the interest incurred should be closely connected to the production of income.	1
14	Conclusion:The interest incurred on the loan of ZAR20 million will be deductible i.t.o. *s24J(2*).	1P
	Available	**15**
	Maximum Total for part (a)	**11**

	Part (b) **Discuss, with supporting calculations, the VAT consequences for Kekana arising from the purchase of the new machinery**	**Marks**
1	In terms of s7(1)(b) of the VAT Act, tax is levied on the importation into South Africa of goods by any person, whether the person is a vendor or not. Therefore Kekana will be liable for VAT levied on the machinery imported from Saudi Arabia.	1
2	Per s13(2)(a) the tax is calculated on the customs duty value plus 10% of the customs duty value, as it is not a BLNS country. The import duties must be added to this as well. Customs duty value — 210 000 10% of R210 000 (import from non-BLNS country) — 21 000 Import duty — 19 000 Total — R250 000 Therefore VAT of ZAR250 000 x 14% = ZAR35 000 is paid	1 1 1 1
3	The time of the supply is when the machinery entered South Africa are released for home	

	consumption (*released by customs*) in terms of the Customs and Excise Act (s16(3)(a)(iii) of the VAT Act) (10 May 2017).	1
4	As this tax charge is paid to SARS during the clearance process, no entry is required on the VAT201 return for the chargeable VAT.	1B
5	Kekana is a registered vendor, therefore it will be able to claim an input tax on the importation of the machinery to the extent that the machinery is used to make taxable supplies.	1 1
6	Valid supporting documents must be provided to be able to claim the input tax in the two month VAT period of entry or declaration of home consumption.	1
	Available	**10**
	Maximum Total for part (b)	**8**

	Part (c) Discuss, with supporting calculations, the income tax consequences for Kekana with respect to the new machinery as well as the solar-powered water pumps for the year of assessment ended 31 December 2017	**Marks**
1	**<u>New machinery</u>** The purchase of the machinery is capital in nature therefore Kekana will not be able to claim a s11(a) deduction for the purchase.	1
2	However, as the machinery is used in the process of manufacture, Kekana will be entitled to an *s12C* allowance when brought into use during the year of assessment (2017).	1 1
3	In terms of s12C(2) the allowance should be calculated on the lesser of the cost of the asset or a cash transaction concluded at arm's length, thus the actual cost of the machinery.	1
4	All costs must be VAT exclusive under *s23C* as Kekana will be entitled to claim the VAT incurred as input VAT.	1
5	The costs include any direct costs of acquisition of the machinery, including the direct costs of installation and the import duties. Therefore the actual cost of the machinery is the full price of USD15 000 including the cost of testing and installation of *USD1 000* and import duties of *R19 000* as theses cost are direct costs of acquisition and installation..	1 1
6	In terms of s25D the cost of the machine must be translated to the currency of the Republic by applying the spot rate on the date on which that amount was so received or accrued or expenditure or loss was so incurred. Thus the cost of the machine will be the spot rate on transaction date.	1
7	In terms of case law, the word 'incurred' means the amount 'paid' or 'the unconditional obligation' to pay. Kekana has incurred USD4 500 on 1 March 2017 (when the amount was paid) and USD10 500 on 1 May 2017 (when the unconditional obligation to pay arose).	1
8	The amounts must therefore be translated as follows: USD4 500 x 13,12 = R59 040 USD10 500 x 13,27 = R139 335	1 1
9	The cost of the assets is therefore Deposit: 59 040 Remaining price: 139 335 Import duties: 19 000 Total: R217 375 The additional costs relating to raw materials and labour (ZAR25 000) as well as the marketing division (ZAR30 000) are not included in the cost as they are not part of the acquisition cost of the asset, but can be claimed in terms of section 11(a) as a deduction.	1P 1 1 1
10	The s12C allowance is 40% of ZAR217 375 for the 2017 year of assessment, as the machinery is new and unused. Therefore, ZAR217 375 x 40% = R86 950 will be the allowance deducted for the 2017 year of assessment.	1
11	The transaction is not an affected transaction in terms of s24I(1) as the order for the machinery and delivery of the machinery takes place in the same year of assessment, namely the 2017 year of assessment	1

12	**<u>Solar-powered water pumps donated</u>** Cost incurred to manufacture the water pumps (trading stock) of ZAR5 000 will be deductible in terms of s 11(*a*) during the 2017 year of assessment	1
13	The trading stock is donated, therefore in the 2017 year of assessment a recoupment at the cost of ZAR5 000 (*alt R7500*) will be included in gross income – s22(8)(C).	1
14	Kekana will be able to claim a s18A deduction if a s18A receipt was obtained from the public benefit organisation. The value to be placed on the donation is equal to the amount recouped in terms of s 22(8)C), thus ZAR5 000, deduction is limited to 10% of taxable income before the donations deduction.	1 1P
15	CGT implications The donation of trading stock is a disposal of an asset for CGT purposes where the proceeds equal the base cost (*Proceeds R7 500 - R5 000 (Recoupment) – Base Cost R0 = R2 500)* In terms of par 62 of the Eighth Schedule, a person must disregard a capital gain or loss in respect of the donation to a PBO	1 1
16	Foreign exchange The exchange difference on the **<u>debt</u>** will be calculated between the spot rate at transaction date (1 May 2017), when the machinery is delivered and ownership takes place, thus *ZAR 13.27 x USD10 500* and the spot rate on realisation date (30 June 2017), when the debt was settled, *thus ZAR13.75 x USD10 500*.	1 1
17	Therefore, the exchange loss on the debt will be deductible from income in the 2017 year of assessment, amounting to (ZAR13,27- ZAR13,75) x USD10 500 = ZAR5 040.	1P
18	The exchange difference on the **<u>forward exchange contract</u>** will be calculated between – • the forward rate at transaction date (1 March 2017) when the forward exchange contract was placed (*ZAR13,43 x UDS10 500*); and • the spot rate on realisation date (30 June 2017) when the foreign exchange was purchased (*ZAR13,75 x USD10 500*).	1 1
19	Therefore, the exchange gain on the forward exchange contract will be included in income in the 2017 year of assessment, amounting to (ZAR13,43 – ZAR13,75) x USD 10 500 = ZAR3 360.	1P
20	The deposit of USD4 500 paid upfront does not constitute an exchange item in terms of section 24I. Therefore no exchange differences will be calculated on this amount.	
	Available	**29**
	Maximum Total for part (c)	**26**

	Part (d) Calculate the capital gain or loss (if any), as defined in the Eighth Schedule, for Kekana from the sale of the building for the year of assessment ended 31 December 2017		**Marks**
		R	
1	Proceeds	**10 000 000**	1
2	Base cost		
3	S42 acquisition value (R30 million – 5% x *7 years)	19 500 000	2
4	Less capital allowances claimed by Kekana (*1 year)	**(1 500 000)**	1
5	*Alt:* split of 6 years and two years (R21m - R3m)*	R18 000 000	
6	Capital loss	R8 000 000	1P
	Available		**5**
	Maximum Total for part (d)		**5**

	Part (e) Discuss, with supporting calculations, the income tax consequences for Jali in respect of the sale of the shares in Kekana for the year of assessment ended 31 December 2017	Marks
1	Per the application of s42(2)(a)(ii), Jali is deemed to have acquired the shares on 1 January 2010 for investment purposes.	1
2	The intent of the transaction is capital, therefore the amount will not be included in gross income.	1
3	The base cost of the shares in Jali's hands is the total of the base cost of the office building and the trading stock. The value is therefore R19,5 million *(or R21 million*)+ R2 million = R21,5 million (*or R23 million*).	 1 1P
4	The proceeds will be R12 million, resulting in a capital loss (R9.5 million).	1P
	Available	**5**
	Maximum Total for part (e)	**5**

	Part (f) Discuss the income tax consequences of the foreign exchange differences that arise on the re-measurement of the loan provided to Kekana by Kermit for the year of assessment ended 31 December 2017	Marks
1	*S24I(10A)(a)* states if at the end of the year of assessment - the person who incurred the debt Kekana incurred the debt and the debt is within scope of s 24I/exchange item;	 1
2	- and the other party to the contractual provisions of that exchange item • form part of the same group of companies, OR Jali holds 100% of the equity shares in Kermit and 77% (100% – 23%) of the equity shares in Kekana, which is at least 70% of the equity shares in each company. Therefore Kermit and Kekana form part of the same group of companies	 1P 1 1P
3	ALT: Or • are connected persons to each other; and Jali holds 100% of the equity shares in Kermit and 77% (100% – 23%) of the equity shares in Kekana, which is more than 50% of the equity shares or voting rights. Therefore Kermit and Kekana are connected persons	 1P 1 1P
4	No forward exchange contract nor foreign currency option contract has been entered into by Kekana to serve as a hedge in respect of the loan from Kermit	1
5	The debt/loan is not a current liability for Kekana as the debt is only payable in the 2022 financial year and will only be a current liability in the 2021 financial year (repayable within 12 months after year end) AND	1
6	is not directly or indirectly funded by any debt owed to any person who ▫ is not part of the same group of companies Kermit funds the debt and is part of the same group of companies AND a connected person	 1P
8	Therefore, any exchange difference resulting from the loan to Kekana from Kermit will be deferred to subsequent year of assessment.	1P
9	The exchange loss is deferred until the 2021 year of assessment when the debt becomes a current liability.	
	Available	**8**
	Maximum Total for part (f)	**5**
	Communication skills – logical argument; clarity of expression *Skills are applicable to required sections (a) to (f)*	4