Strategic Professional – Options

Advanced Taxation – South Africa (ATX – ZAF)

Tuesday 8 December 2020

ATX ZAF ACCA EN

Time allowed: 3 hours 15 minutes

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – BOTH questions are compulsory and MUST be attempted

Tax rates and allowances are on pages 2–5

Do NOT open this question paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

Please note that you are not expected to make any reference to Covid 19 or the global economic crisis as a result of this pandemic in your exams. None of the temporary financial or legislative measures implemented as a result of Covid are examinable.

ATX – ZAF

Think Ahead ACCA

The Association of Chartered Certified Accountants

TAX RATES AND ALLOWANCES

The following tax rates and allowances are to be used in answering the questions.

Year ended 29 February 2020/31 March 2020

Rebates	
Primary rebate	R14,220
Secondary rebate (over 65)	R7,794
Tertiary rebate (over 75)	R2,601
Interest exemption	
Under 65	R23,800
Over 65	R34,500

Foreign dividend exemptions

Fully exempt where 10% or more of the equity shares and voting rights are held.
Fully exempt where received by a company from a foreign company resident in the same country as the recipient.
To the extent of any controlled foreign company inclusions (net of applicable foreign tax)
To the extent that the foreign dividend is from a company listed on the JSE

To the extent that the above do not apply:
For individuals 25/45ths of the dividend is exempt
For companies 8/28ths of the dividend is exempt

Medical aid contribution tax rebate rates	
Single member	R310
Member plus one dependant	R620
Each subsequent dependant	R209

Additional medical expenses tax rebate

Persons 65 or older or persons younger than 65 if that person, his or her spouse or his or her child is a person with a disability:

((Medical contributions – (medical aid contribution tax rebate x 3)) + other qualifying medical expenses) x 33·3%

Persons younger than 65:

((Medical contributions – (medical aid contribution tax rebate x 4)) + other qualifying medical expenses) as exceeds 7·5% of taxable income x 25%

Trusts (other than a special trust)	45%
Dividends tax	20%
Companies	
Normal tax rate	28%
Value added tax (VAT) (standard rate)	15%
Donations tax	20% (up to R30 million) 25% (from R30 million)
Estate duty	20% (up to R30 million) 25% (from R30 million)
Official rate of interest (assumed)	8%

Rates of normal tax payable by persons (other than companies)
for the year of assessment ended 29 February 2020

Where taxable income:	
does not exceed R195,850	18% of each R1 of the taxable income
exceeds R195,850 but does not exceed R305,850	R35,253 plus 26% of the amount over R195,850
exceeds R305,850 but does not exceed R423,300	R63,853 plus 31% of the amount over R305,850
exceeds R423,300 but does not exceed R555,600	R100,263 plus 36% of the amount over R423,300
exceeds R555,600 but does not exceed R708,310	R147,891 plus 39% of the amount over R555,600
exceeds R708,310 but does not exceed R1,500,000	R207,448 plus 41% of the amount over R708,310
Exceeds R1,500,000	R532,041 plus 45% of the amount over R1,500,000

Tax rates for small business corporations
for the year of assessment ended 31 March 2020

Where taxable income:	
does not exceed R79,000	Nil
exceeds R79,000 but does not exceed R365,000	7% of the amount over R79,000
exceeds R365,000 but does not exceed R550,000	R20,020 plus 21% of the amount over R365,000
exceeds R550,000	R58,870 plus 28% of the amount over R550,000

Turnover tax rates for micro businesses
for the year of assessment ended 29 February 2020

Where taxable turnover:	
does not exceed R335,000	Nil
exceeds R335,000 but does not exceed R500,000	1% of the amount over R335,000
exceeds R500,000 but does not exceed R750,000	R1,650 plus 2% of the amount over R500,000
exceeds R750,000 but does not exceed R1,000,000	R6,650 plus 3% of the amount over R750,000

Car allowance

Maximum vehicle cost for actual expenses	R595,000

Fringe benefit (company car)

Benefit percentage (where no maintenance plan exists)	3·5%
Benefit percentage (where a maintenance plan exists)	3·25%

General business reduction: Benefit value x business kms/total kms (as per logbook)
Private fuel reduction: Private fuel (R) x private kms/total kms (as per logbook)
Private maintenance reduction: Private maintenance (R) x private kms/total kms (as per logbook)

Subsistence allowances

Deemed expenditure for meals and incidental costs (per Government regulation) R435 per day (local travel)
Deemed expenditure for incidental costs only (per Government regulation) R134 per day (local travel)
Deemed expenditure for meals and incidental costs (foreign travel) – (per published tables) will be supplied in the question where relevant

Common capital allowances

New and unused manufacturing plant and equipment	40%/20%/20%/20%
Used or leased manufacturing plant and equipment	20% each year for five tax years
New or unused plant or machinery used for research and development (where it does not qualify for the research and development accelerated allowance)	50%/30%/20%
Small business corporation manufacturing plant and equipment	100%
Small business corporation (other assets) – unless wear and tear provides a greater deduction	50%/30%/20%

Wear and tear (based on Binding General Ruling 7) will be supplied in the question where relevant

Manufacturing building allowance (unless seller's rate supplied)	5%
New or unused commercial building (not a manufacturing building)	5%

– No deduction where another section of the Act applies to the building
– Where part of a building is acquired, 55% of the acquisition price is 'cost'
– Where an improvement to the building is acquired, 30% of the acquisition price of the improvement is 'cost'

Research and development (R&D) expenditure	150%

Costs related to immovable property, machinery, plant, implements, utensils or articles (excluding any prototype or pilot plant created solely for the purpose of the process of research and development) are not claimed as research and development expenditure. Financing, and administrative or compliance costs may not be claimed as research and development expenditure.

Capital gains tax

Annual exclusion (while alive)	R40,000
Annual exclusion (in year of death)	R300,000
Primary residence exclusion	R2,000,000
(where proceeds are R2 million or less, the full gain is excluded for the portion of the property used for domestic purposes as a primary residence)	
Inclusion rate (natural persons)	40%
Inclusion rate (non-natural persons)	80%

Time apportioned base cost formulae:

$$Y = B + [(P - B) \times N/(T + N)]$$

$$P = R \times B/(B + A)$$

Where deductible enhancement expenditure has been incurred after the valuation date, the time apportioned base cost formulae change to:

$$Y = B + [(P_1 - B_1) \times N/(T + N)]$$

$$P_1 = R_1 \times B_1/(A_1 + B_1)$$

Travel allowance table
for years of assessment commencing on or after 1 March 2019

Value of the vehicle (including value added tax (VAT) but excluding finance charges or interest)	Fixed cost	Fuel cost	Maintenance cost
R	R p.a.	c/km	c/km
0 – 85,000	28,352	95·7	34·4
85,001 – 170,000	50,631	106·8	43·1
170,001 – 255,000	72,983	116·0	47·5
255,001 – 340,000	92,683	124·8	51·9
340,001 – 425,000	112,443	133·5	60·9
425,001 – 510,000	133,147	153·2	71·6
510,001 – 595,000	153,850	158·4	88·9
Exceeds 595,000	153,850	158·4	88·9

Note: Where reimbursement is based on actual business kilometres travelled and no other compensation is paid to such employees and the kilometres travelled for business does not exceed 12,000, the prescribed rate is R3·61 per kilometre.

Transfer duty rates
for the year of assessment ended 29 February 2020

Where the acquisition price:

does not exceed R900,000	Nil
exceeds R900,000 but does not exceed R1,250,000	3% of the amount over R900,000
exceeds R1,250,000 but does not exceed R1,750,000	R10,500 plus 6% of the amount over R1,250,000
exceeds R1,750,000 but does not exceed R2,250,000	R40,500 plus 8% of the amount over R1,750,000
exceeds R2,250,000 but does not exceed R10,000,000	R80,500 plus 11% of the amount over R2,250,000
exceeds R10,000,000	R933,000 plus 13% of the amount over R10,000,000

Tax rates of normal tax retirement lump sum and severance benefits
in respect of the year of assessment ended 29 February 2020

Where taxable portion of lump sum:

does not exceed R500,000	Nil
exceeds R500,000 but does not exceed R700,000	18% of the amount over R500,000
exceeds R700,000 but does not exceed R1,050,000	R36,000 plus 27% of the amount over R700,000
exceeds R1,050,000	R130,500 plus 36% of the amount over R1,050,000

Tax rates of normal tax withdrawal lump sum benefits
in respect of the year of assessment ended 29 February 2020

Where taxable portion of lump sum:

does not exceed R25,000	Nil
exceeds R25,000 but does not exceed R660,000	18% of the amount over R25,000
exceeds R660,000 but does not exceed R990,000	R114,300 plus 27% of the amount over R660,000
exceeds R990,000	R203,400 plus 36% of the amount over R990,000

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Question 1 begins on page 7.

Section A – BOTH questions are compulsory and MUST be attempted

1 You work for a firm of tax advisers. An extract from an email received from the chief executive officer (CEO) of Elegance Ltd, a prospective new client, is set out below:

Email extract from the CEO of Elegance Ltd – dated 8 December 2020

I am writing to you on behalf of the board of directors of Elegance Ltd for advice concerning South African tax.

Background

Elegance Ltd was incorporated, is tax resident, and operates in the country of Chocoland. The company manufactures and sells high-end chocolate. Due to a surge in demand in South Africa and considering the tariffs for the import of finished chocolate versus the tariffs applicable to the import of cocoa into South Africa, the board has decided to manufacture the chocolate in South Africa rather than exporting the finished product from Chocoland to South Africa. We anticipate that this will save costs in the long run.

We already understand that the South African Revenue Service (SARS) considers the making of chocolate as a process of manufacture. We note that South Africa does not have a tax treaty with Chocoland. Elegance Ltd has a year end of 31 March each year.

(a) Query 1: General tax overview

We have decided to set up a subsidiary incorporated in South Africa (SubCo) through which to run the South African operations. SubCo will employ a number of local South Africans as factory staff but staff seconded from Elegance Ltd in Chocoland will manage the operations and factory set-up. The seconded staff will be present on a rotational basis and never long enough to establish residence in South Africa. The remuneration paid to the seconded staff by Elegance Ltd is recovered from SubCo as a head office charge. The day-to-day management of SubCo will be undertaken by Elegance Ltd as the holding company, remotely from Chocoland.

The anticipated turnover of SubCo is R50,000,000 per annum in South Africa. There will be substantial initial capital costs (see Queries 2 and 3).

Explain which taxes SubCo will be subject to or administratively required to withhold in South Africa and any immediate matters to consider in respect of these taxes.

Note: Ignore withholding tax on royalties and dividend payments as detailed in Queries 4 and 5. (4 marks)

(b) Query 2: Factory acquisition

SubCo will acquire a factory for R25,000,000 to be used as the premises for the manufacture of chocolate. This factory is currently owned by Xytec Ltd, a South African company. SubCo has the option of either acquiring 100% of the shares in Xytec Ltd (the factory is its only asset) or to acquire the factory directly from Xytec Ltd. Xytec Ltd currently leases out the factory for commercial use.

Explain the immediate tax implications if SubCo acquires the factory (1) indirectly (by purchasing the shares of Xytec Ltd) and (2) directly from Xytec Ltd, clearly stating which option would be preferable. (4 marks)

(c) Query 3: Machinery and electrical generation equipment

SubCo will import all of its chocolate making machinery from Elegance Ltd in Chocoland. SubCo will acquire this machinery on an interest-free loan from Elegance Ltd. SubCo will also import the cocoa beans used in Elegance Ltd's secret blend formula from international suppliers (none of which are located in South Africa).

Some additional information you may need in respect of the import of machinery is as follows:

Anticipated purchase price in Chocoland currency (CCL): CCL 5,000,000
Anticipated exchange rate on date of purchase: CCL 1 = ZAR 16·0
Anticipated exchange rate on date of importation: CCL 1 = ZAR 16·5
Anticipated exchange rate at year end: CCL 1 = ZAR 16·6
Anticipated customs value on date of importation: ZAR 84,000,000
Customs duty applicable to this import: ZAR 4,000,000

Email extract from the CEO of Elegance Ltd – dated 8 December 2020 (continued)

The board of Elegance Ltd is very concerned by the continued disruption to the electrical supply in South Africa. We would therefore like to install renewable electrical generation equipment (sourced locally) at least sufficient to power our local factory and operation. We anticipate using a combination of wind and solar (photovoltaic) energy with battery storage.

(i) Explain the value added tax (VAT) implications for SubCo on the import of the machinery from Chocoland. (2 marks)

(ii) Explain the income tax deductions available to SubCo in respect of the imported machinery and the electrical generation equipment acquired. (5 marks)

(d) Query 4: Intellectual property and tax minimisation

SubCo will have to pay Elegance Ltd a royalty for the use of the secret blend formula (intellectual property) and the skills and training offered by the seconded staff to specially recruited local South African staff. Furthermore, a fee will be charged by Elegance Ltd for the management of SubCo.

We are concerned as to the income tax rate of 28% in South Africa as the Chocoland corporate tax rate is only 12%. We would like to maximise the amount of SubCo profit which is paid to Elegance Ltd in royalties to shift the profits to Chocoland.

Elegance Ltd usually receives royalties from other regions of 50% of EBITDA (EBITDA is approximately equal to 20% of gross sales). However, we would like to charge SubCo a royalty rate of 25% on gross sales in South Africa.

The management fee (or profit allocation) applicable to the services supplied to SubCo from Elegance Ltd will be set at 10% of gross sales. Globally, this fee is usually 10% of EBITDA.

We believe the increased fees and royalties are justified based on the increased business risk in setting up new operations in South Africa.

(i) Advise how the royalties for the use of the intellectual property and the training of employees and the management fee will be treated for both SubCo and Elegance Ltd (assuming we do not undertake the structuring as outlined in Query 5). (6 marks)

(ii) Explain the South African anti-avoidance provisions which may impact the royalties and management fees proposed by Elegance Ltd and calculate the potential impacts of these provisions. (6 marks)

(e) Query 5: Tax treaty issues

We are considering interposing a wholly owned intermediary company incorporated in the country of Havia between Elegance Ltd and SubCo. Havia levies no corporate tax or withholding taxes. Havia has an OECD-style tax treaty with South Africa except that the dividend article provides for a reduction in the dividend withholding tax rate to 1% for holdings of greater than 10% of the equity capital. It also provides that royalties may only be taxed in the resident State. However, the reduction to the dividends tax and the royalties being taxed in the resident State only apply if the recipient (i.e. the intermediary company in Havia) is the beneficial owner.

To this end, Elegance Ltd will transfer all its intellectual property to the Havian intermediary company (making Havia the resident State for the treaty as regards intellectual property) and will receive only dividends from the Havian company. Havia has a tax treaty with Chocoland which provides for a 0% withholding tax on dividends paid from Havia to Chocoland.

Assuming the Havia–South Africa treaty does apply, explain the impact this will have on any South African dividends tax which would otherwise apply in the absence of the treaty. Also comment on the beneficial owner issue in the treaty from a South African perspective. (4 marks)

Required:

Prepare a report for the directors of Elegance Ltd in which you respond to each of their queries (1) to (5), providing supporting calculations where necessary.

Notes:
1. The split of the mark allocation is shown against each of the queries above.
2. Where applicable, your answer should clearly set out any conditions which must be met for the tax implications you have identified to apply.

Professional marks will be awarded in Question 1 for the format and presentation of the report and for the effectiveness of communication. (4 marks)

(35 marks)

2 You should assume that today's date is 1 November 2020.

Mr Freiheit is 40 years old. He was born and grew up in South Africa. At the age of 22, he began to travel extensively, spending no longer than two months in any country. Since then, Mr Freiheit has only returned to South Africa twice per year and in each case for only two weeks (i.e. only four weeks each year).

Over this time, Mr Freiheit has built a substantial business. His company, MobiFree Ltd, was incorporated and is tax resident in Freezania (by virtue of incorporation). MobiFree Ltd develops and sells applications for mobile phones, most of which have proven extremely popular. Initially Mr Freiheit developed all the applications himself, but he now utilises freelance developers across the world, who he visits during his brief stays in each country. All payments to freelancers are made from Freezania and all income is paid into the company's bank account in Freezania.

Mr Freiheit owns no property anywhere in the world and stays in rented serviced apartments for the duration of his stays in each country. He is not considered to be tax resident in any of the countries in which his freelancers operate. He is also not considered resident in Freezania.

Mr Freiheit has, over time, introduced other shareholders to invest in MobiFree Ltd, none of which are resident in South Africa, nor participate in the management of the company. Mr Freiheit controls 51·5% of the equity share capital. He draws a salary of FRZ 700,000 (local Freezania currency) per year as the current managing director and receives dividends from the company.

MobiFree Ltd's annual net profit averages FRZ 20,000,000 per year (before corporate tax in Freezania) and the dividends paid to shareholders are 10% of the net profit. Dividends are paid on 30 December each year.

Mr Freiheit is tired of travelling so extensively and plans to settle in South Africa from 1 December 2020. He also would like to step back from the micromanagement of the business and instead provide occasional input as the chairman of the board for the company (a non-executive director position). A managing director based in Freezania will be appointed on 1 January 2021, to run the day-to-day operations. Mr Freiheit's salary would be converted to chairman and directors fees; the amount would remain the same and is at the open market rate. The dividend stream would remain the same for all shareholders. Board meetings will take place virtually, hosted from Freezania by the new managing director and the remaining directors (apart from Mr Freiheit) are resident outside South Africa.

Apart from dividend withholding tax and employees tax levied on his salary in Freezania (see additional information below), no other tax has been paid on Mr Freiheit's earnings.

Mr Freiheit would like to sell 10,000 shares in MobiFree Ltd to fund the purchase of a house and furnishings in South Africa. The sale will reduce his holding to 51%. He will either sell the shares on 30 November (before he moves to South Africa) or on 30 December 2020 (after he has moved). The expected market values of 10,000 MobiFree Ltd shares at these dates are as follows:

Date	**Market value of 10,000 MobiFree Ltd shares**
	FRZ
30 November 2020	5,000,000
30 December 2020	5,300,000

Additional information about tax in Freezania

– Corporate tax in Freezania is levied at 10%.
– Employees tax is levied at 7·5%.
– There is a dividend withholding tax in Freezania of 5% applied to all dividends declared.
– There is no capital gains tax in Freezania and the transfer of shares carries no tax implications.
– Freezania has no double tax treaties with any countries.

Required:

(a) Discuss whether or not Mr Freiheit is likely to have been considered resident in South Africa at any point since he left at the age of 22 and whether or not he is likely to be considered resident if he moves back to South Africa as proposed. (5 marks)

(b) Assuming Mr Freiheit will only become South African resident from 1 December 2020, explain the South African tax consequences if he sells 10,000 shares in MobiFree Ltd on 30 December 2020. Compare this position to the tax implications if he sells the shares on 30 November 2020.

Exchange rates:
30 November 2020: FRZ 1 = ZAR 11·0
30 December 2020: FRZ 1 = ZAR 12·0
Average exchange rate for the 2021 year of assessment: FRZ 1 = ZAR 11·7 (4 marks)

(c) Assuming Mr Freiheit becomes resident in South Africa on 1 December 2020:

(i) Explain whether or not Mr Freiheit's presence in South Africa creates any residence issues for MobiFree Ltd before the new managing director is appointed. (3 marks)

(ii) Assuming MobiFree Ltd is not resident in South Africa, explain why it will be a controlled foreign company (CFC), stating the implications of this status, and discuss whether or not the foreign tax rate threshold or foreign business establishment exemptions are likely to apply. Advise specifically whether the applicability of these exemptions will change after the appointment of the new managing director. (5 marks)

(iii) Explain, with supporting calculations, the South African tax implications for Mr Freiheit of MobiFree Ltd's CFC status, assuming none of the CFC exemptions apply.

Note: You should use the company's net profit converted at the average exchange rate of FRZ 1 = ZAR 11·7 in your calculations. (3 marks)

(iv) Advise whether any of the South African tax implications in your answer to (iii) can be mitigated by deferring the date Mr Freiheit becomes South African resident to later in the 2021 tax year of assessment and whether other requirements should be met before becoming a resident. (2 marks)

(v) Advise Mr Freiheit of the value added tax (VAT) implications of his directors fees when he becomes chairman of the board. (3 marks)

(25 marks)

Section B – BOTH questions are compulsory and MUST be attempted

3 Dr Jalka (45 years old) is a registered podiatrist operating from Johannesburg in South Africa. He is a resident of South Africa. Dr Jalka is employed by an academic hospital to teach on podiatry courses and also runs an independent private practice. His main earnings come from his private practice.

Dr Jalka conducts his business as a sole trader and is registered for value added tax (VAT). His turnover for the year from his private practice amounts to R8,500,000. There are significant deductible costs (excluding capital allowances). He has a number of large machines which are used in the practice, which generate capital allowances and have a low value on resale.

An extract from the email Dr Jalka has sent you is set out below:

Extract from email from Dr Jalka

> I am writing to you with respect to my podiatry practice and my personal tax position.
>
> Loss of income
> I am very concerned about the risk of loss of income from my practice. The practice relies on patients coming in for assessment and fitment of orthotics (customised foot and ankle devices). All the services are rendered by me in my personal capacity.
>
> My financial adviser suggested I get a loss of income insurance policy to provide cover for up to 12 months of income should I become injured or ill and am unable to work. This insurance is expensive so I am thinking of saving the same amount in a collective investment scheme (CIS) to draw on when the need arises instead.
>
> Retirement and emigration
> Although I am 25 years from retirement, I have been contributing R350,000 per year to a retirement annuity fund. I currently have R5,000,000 in the retirement annuity fund. I have also been contributing the maximum amount to a tax-free savings investment and I own a share portfolio.
>
> I am not sure that I will retire in South Africa and I am concerned about the volatility of the Rand relative to other world currencies. My underlying investments have limited global asset exposure and I would like to increase my investment offshore.
>
> The country I am looking to move to has no tax treaty with South Africa (I don't know what that means, but an accountant friend said I should tell you).

Required:

(a) Explain the tax implications of a loss of income insurance cover and a collective investment scheme.
(2 marks)

(b) (i) Explain the advantages of saving for retirement through a retirement annuity fund. (4 marks)

(ii) Explain the South African tax implications if Dr Jalka uses his share portfolio and tax-free investment to increase his exposure to foreign assets. You should include the implications of making changes to those investments and the implications on death, assuming Dr Jalka is still resident in South Africa.
(5 marks)

(iii) Assuming Dr Jalka leaves South Africa before retirement age, explain, with supporting calculations, the normal tax implications if he withdraws the retirement annuities before emigration; or if he leaves the retirement annuities in place and allows them to mature after emigration. Also explain the impact of Dr Jalka's emigration on his share portfolio for both normal tax and estate duty purposes. (6 marks)

(iv) Explain the tax implications if Dr Jalka were to sell his practice as a whole and whether or not it would be beneficial for him to sell the practice before or after he emigrates.

Note: If Dr Jalka were to sell his practice after emigration, he would employ another podiatrist to carry out the services previously carried out by him. (3 marks)

(20 marks)

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Question 4 begins on page 14.

4 (a) Space4U Ltd

Space4U Ltd is an unlisted company which owns three commercial properties in South Africa and rents them out. Space4U Ltd is resident in South Africa and a registered value added tax (VAT) vendor.

Proposed sale of property assets to Equitas Commercial Property Fund

Space4U Ltd is currently considering signing a written agreement to transfer all of its assets to Equitas Commercial Property Fund, a real estate investment trust (REIT) listed on the South African stock exchange. Under the terms of the agreement, which is expected to be signed on 31 December 2020, all of Space4U Ltd's property assets are to be sold to Equitas Commercial Property Fund. Equitas Commercial Property Fund is also resident in South Africa and a registered VAT vendor. After settling any remaining liabilities and providing for liquidation costs, a final dividend will be declared to Space4U Ltd's shareholders and the company will be voluntarily liquidated.

Of the three South African properties to be transferred to Equitas Commercial Property Fund, one is leased to a manufacturing tenant and the other two had been acquired with tenants in situ, one of which is used by the tenant as administrative offices and the other is used by a different tenant as a distribution centre.

Required:

Explain the tax implications for Space4U Ltd arising from the transfer of Space4U Ltd's property assets to Equitas Commercial Property Fund. (10 marks)

(b) Global Manufacturing Ltd (GML)

GML operates various manufacturing sites across Africa. GML has a December year end.

On 1 December 2020 it sold a machine in its offshore branch in the country of Shemland and would like to use the proceeds to fund a new machine for use in its South African operations. Shemland does not have a treaty with South Africa and levies no tax on capital gains.

The machine was originally sourced from the United States at a cost of USD 100,000 on 1 October 2018. The machine had been used in Shemland in a manufacturing process. Shemland does not provide for capital allowances due to its low corporate tax rate.

The South African capital allowances are those applicable to a new machine purchased for use in a process of manufacture.

The machine was sold in Shemland to another manufacturer for SHM 75,000 (Shemland local currency). The buyer agreed to pay in two instalments, being 50% on the date of purchase (1 December 2020) and 50% two months later (1 February 2021). GML will remit the money to South Africa as it becomes available, but has earmarked it to purchase the new machine costing R2,500,000. GML will buy the new machine on 30 December 2020, obtaining a short-term loan from the bank to the extent it does not yet have the proceeds from the sale of the machine in Shemland, and will repay the loan on receipt of all proceeds.

All amounts stated are exclusive of value added tax (VAT) where applicable.

Exchange rates are as follows:

1 October 2018: USD 1 = ZAR 15·0
2018 year of assessment: USD 1 = ZAR 15·5
1 December 2020: SHM 1 = ZAR 20·2
2020 year of assessment: SHM 1 = ZAR 21·0
31 December 2020: SHM 1 = ZAR 20·8
1 February 2021: SHM 1 = ZAR 20·5

Required:

Explain, with supporting calculations, the income tax implications for Global Manufacturing Ltd (GML) of the disposal of the machine.

Note: Your answer must specifically address whether GML may make use of the roll over for capital gains tax purposes, electing the most advantageous rate to achieve the best outcome for the year of assessment ending 31 December 2020. (10 marks)

(20 marks)

End of Question Paper