

(a)	Discuss under what circumstances the interest paid to Star Bank on the loan would be deductible by Jodee for income tax purposes		
1	Section 15 (2) of the income tax act permits the deduction of — (a) expenditure and losses to the extent to which they are incurred for the purposes of trade or in the production of the income except — (i) to the extent to which they are expenditure or losses of a capital nature;	1	
2	The interest has to be an expenditure or loss. In this case Jodee had an unavoidable obligation.	1	
3	The interest should be incurred for the purposes of trade or in the production of income. Jodee obtained the loan to fund the business operations.	1	
4	The interest has to be of a revenue nature for it to be deductible.	1	
5	Case Law	1	
		Available	5
		Maximum	4
		Total for part (a)	4

(b)	Discuss – (i) what the income tax consequences would be for Jodee if it opts to convert the existing loan from CAF into 200 ordinary shares		
1	The loan repayment is of a capital nature hence not deductible.	1	
2	Case Law	1	
3	The issue of shares has no income tax implications because Jodee has not incurred anything. Furthermore, the transaction is of a capital nature.	1 1	
4	Case Law		
5	The value of the loan is ZWL 1 million where as the fair market value of the shares issued is ZWL800 000 (200 shares x 4000 per share). Accordingly the value of Jodee’s benefit received is ZWL 200 000.	1 1	
6	As the loan was taken out directly in connection with a capital asset the benefit received will be of a capital nature, hence not included in Jodee’s gross income.	1	
		Available	6
		Maximum	5
		Total for part (i)	5

(b)	Discuss – (ii) the appropriateness of the income tax treatment adopted by Jodee in respect of the industrial freezer and the modifications to the sewerage system		
	Industrial Freezer		
1	According S15(2)e (i) the lessee can claim a lease allowance on mandatory improvements	1	
2	The lessee can claim the allowance over the lesser of 10 years or life of lease	1	
3	Jodee is eligible to claim the lease allowance over 10 year on the \$1,000,000.	1	
4	Therefore, the treatment by Jodee is inappropriate of deducting a capital allowance.	1	
	Installation of Sewerage System		
5	According S15(2)e (i) the lessee can claim a lease allowance or capital allowance on voluntary improvements	1	
6	The lessee can claim the allowance over the lesser of 10 years or life of lease or can elect capital allowances	1	
7	Jodee is eligible to claim SIA of 25% on the \$200,000.	1	
8	Therefore, the treatment by Jodee is inappropriate of deducting a capital allowance in full as it needs to be spread.	1	
		Available	8
		Maximum	8
		Total for part (ii)	8

(b)	Discuss – (iii) the income tax consequences to the landlord in respect of the purchase and installation of the industrial freezer and the improvements to the drainage system by Jodee		
1	Section 8 (2) (e) of the Income Tax Act brings into gross income, in the hands of a Landlord, the value of leasehold improvements to the extent that they were agreed in the lease.	1	
2	The Landlord can elect to spread the amount of the gross income over the shorter of the lease term or 10 years.	1	
3	The mandatory improvements that Jodee carried out, hence will be taxable in the hands of the landlord.	1	
4	The voluntary improvements that Jodee carried out, which were not obligated in terms of the lease, would not be taxable in the hands of the Landlord.	1	
5	Accordingly the Landlord will be taxable on ZWL1 million but this will be spread over the shorter period of 10 years given the lease is for a 12 year period.	1	
		Available	5
		Maximum	5
		Total for part (b)(iii)	5
		Total for part (b)	18

Part (c) Critically discuss, supported by calculations, whether you agree with Anida's preference for importing the packaging equipment from the USA		Marks	
1	The financial manager's preference for importing the packaging equipment rather than purchasing it locally appears to be premised on whether it is subject to VAT (since both machines are identical) and the possible delay of claiming VAT on the purchase.	1	
1.1	However, imported goods are also subject to VAT in terms of 6(1)(b) of the VAT Act.	1	
1.2	The cost of purchasing the equipment locally would be ZWL1,3 million excluding VAT.	1	
1.3	Jodee would be entitled to claim the input tax of R1,3 million x 15% = R195 000 on acquisition provided that it obtains a valid tax invoice. S17(1)	1	
2	If the equipment is imported, the cost would be as follows:		
	Equipment \$70 000 x ZWL 17	ZWL 1 190 000	1
	Customs duty	ZWL 100 000	1
	VAT (R1 190 000) x 14.5%	ZWL 187 050	1
	Total	ZWL 1 477 050	
3	However, the VAT of ZWL 187 050 would also be deductible as input tax upon presentation of the relevant documentation.	1	
4	Therefore, the cost of the equipment is slightly cheaper (ZWL 1 290 000) when importing as opposed to purchasing locally.	1	
5	Importing the equipment will still result in the imposition of VAT, and thus the same potential delay exists.	1	
6	Another factor to consider when importing is potential fluctuations in the exchange rate (both favourable and unfavourable). The imported value is sensitive to the \$: ZWL exchange rate, and a hedging arrangement would add to the total cost incurred .	1 1	
7	Furthermore, importing could potentially take longer than expected / would take longer than receiving the equipment from a local supplier due to the distance travelled / supply chain disruptions caused by Covid-19 .	1	
8	Purchasing locally would be acting more socially responsibly by supporting the local economy	1	
9	Given the greater import of the import alternative, Jodee would likely need more financing for this alternative.	1	
10	Other factors, such as – <ul style="list-style-type: none"> • the ability to deal with maintenance, repairs and warranty claims; • possible assistance with installation of the equipment; • the risk that equipment may be stuck at the harbour / in customs for a long time; and • the reliability of the suppliers; would need to be considered to fully assess both options.	1 1 1 1	
		Available	19
		Maximum	13
		<i>Communication skills – logical argument</i>	1
		Total for part (c)	14

Part (d) Discuss, with regard to the financing options available to Jodee for the packaging equipment –		Marks
<ul style="list-style-type: none"> • Anida’s negotiated proposal with CAF, supported by calculations where relevant; and • the factors that Jodee should take into account in deciding on the appropriate funding for the packaging equipment, considering alternatives with reference to the financing options identified in the two <i>MoneyGuru</i> article extracts. 		
Conversion of debt facility to equity		
1.	The possibilities of finance are limited due to	
	(i) the unlisted status of Jodee;	1
	(ii) the fact that it is a private company (limitations on approaching the public as well as maximum number of shareholders); and	1
	(iii) the fact that there is a covenant in place limiting the amount of debt finance.	1
2.	This option would hopefully (according to Anida) enable Jodee to stay within the covenant set by Star Bank.	1
3.	Current approximate debt to equity ratio:	
	Equity	13 550 000
	Debt (5 million + 1 million)	6 000 000
	Total	19 550 000
	Long-term debt : equity ratio	44.28%
		1C
4.	Approximate long-term debt to equity ratio after conversion and loan	
	Equity (13 550 000 + 800 000)	14 350 000
	Debt (6 million - 1 million + 1,3 million)	6 300 000
	Total	20 650 000
	Long-term debt : equity ratio	43.90%
	The covenant is therefore not breached	1C
5.	The cash flows might be erratic in the beginning and there might even be negative cash flows as a result of Covid-19. This causes uncertainty regarding the ability to meet the interest payments.	1
6.	Interest rates are currently low and it is expected that it would remain low for the foreseeable future. This makes debt financing attractive.	1
7.	In converting the current facility of ZWL 1 million to equity, Joe Dee gives up 20% of the shareholding in the company.	1
8.	The payment terms (timing of interest payments and capital repayments) of the new facility from CAF will have to be considered.	1
9.	The terms of the loan finance should match the term of the asset, if possible.	1
10.	Based on the above, the capital structure will remain highly levered, which could limit future financing.	1
11.	The negotiations with CAF are currently at ZWL 4 000 per share. The original shares to Joe were issued at ZWL 10 000 per share. Thus CAF will obtain a large equity stake for a minor investment.	1
12.	Joe will not lose control over his business with a 20% stake but he will not have control over parties to whom CAF may sell the shares to in future.	1
13.	A rough estimate of the current share value should be obtained by using an appropriate valuation methodology (e.g. valuation based on DCF or earnings multiple).	1
14.	Given the early development stage of Jodee and potentially low profitability, an alternative may be to value it on a revenue based multiple.	1

15.	The price per share negotiated with CAF should be compared to the value of the shares of Jodee, calculated using an appropriate valuation methodology.	1
16.	Given the impact of Covid-19 on the business' performance, incorporating this into any valuation will be difficult. Furthermore, the debt benefit of ZWL 200 000 should also be considered in terms of how to factor that into the valuation.	1 1
17.	Shares are being issued to CAF at ZWL 4 000 per share while they seem to be worth more, even at the lower 2020 earnings.	1
18.	Are there any other potential investors in Jodee?	1
Private equity/venture capital		
19.	The period of the financing matches the long-term nature of the investment in the new machine.	1
20.	Private equity investors will require a high return on their investment and will therefore not be willing to pay too much for the shares. This may require shares to be discounted.	1
21.	The question is therefore how many shares will have to be issued in order to obtain the required amount of financing.	1
22.	This could have an effect on the control of Joe Dee in Jodee, especially given the influence private equity investors prefer to have over investee companies.	1
23.	The possibility of further funding might be better if this route is chosen, given the access the investors may provide.	1
24.	The private equity investors might bring valuable expertise to the business and help professionalise it for a future exit.	1
25.	Jodee could tap into the private equity investor's business networks for growth opportunities.	1
Angel investors & Crowd funders		
27.	Angel investors can bring a great deal of expertise to the business, although Jodee would not benefit from a large team like a typical private equity/venture capital firm.	1
28.	Joe Dee will be giving up some control in his company but will probably find the angel investors more patient, and willing to wait for success/good results.	1
29.	Crowd-funding does not necessarily result in ownership and as such Jodee would need to consider what return/compensation the crowd-funders expect.	1
30.	In order to successfully raise crowd-funding, Jodee would need a strong digital / social media presence.	1
31.	Crowd-funders might prefer investing in technology investments rather than a packaging machine.	1
32.	One or a few Angel investors could cover the cost of investing to the packaging machine, whereas crowd-funding will require a large number of investors	1
33.	Crowd-funders and/or angel investors would expect a lower return on investment / be more patient in waiting for improved returns.	1
34.	Jodee could expose itself to reputation risk should its crowd-funding bid fail, given the crowd-funding is sourced in the public domain.	1
35.	Jodee would not benefit from a larger team-like approach as is typically the case with private equity / venture capital firm should one of these funding mechanisms be used and thus favour angel investing or crowd-funding	1
36.	Angel investors might contribute their expertise on an individual basis	1
Available		43

	Maximum	13
	<i>Communication skills – presentation</i>	<i>1</i>
	Total for part (d)	14