REPUBLIC OF SOUTH AFRICA

SOUTH AFRICAN REVENUE SERVICE

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INCOME TAX : THE TREATMENT OF GAINS AND LOSSES ON FOREIGN EXCHANGE TRANSACTIONS IN TERMS OF SECTION 24I OF THE INCOME TAX ACT, 1962 (the Act)

ISSUED BY THE

COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE

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1. INTRODUCTION

The exchange rates between various currencies of the world have, for many years, increasingly been subject to substantial fluctuations. In addition thereto, the extent and complexity of international currency trading has also increased substantially. At present, currency markets are extremely sophisticated and are characterised by their technological advancement, their liquidity and the large variety of currency and currency instruments which are quoted and traded by way of an electronic medium. Most currency dealers manage their portfolios with the assistance of advanced computer systems which frequently revalue currency items at its latest market value during the course of a day.

The Act, unfortunately, did not keep pace with the reality of the modern currency trading. Consequently it did not reflect the economic reality of currency transactions and the accounting representation thereof. Section 24B of the Act taxed realised gains and losses in respect of currency obligations, irrespective of whether they were of a capital nature or not. All other gains and losses on transactions in foreign currency were, for tax purposes, dealt with in terms of the general provisions of the Act. In terms of the definition of *"gross income"* in section 1 of the Act, and the provisions of section 11(a), the taxation of gains or deductibility of losses depended *inter alia* on whether such gains or losses were realised or not and whether they were of a revenue or capital nature. In addition, the valuation of imported stock for purposes of section 22 of the Act also presented practical difficulties.

In order to address the shortcomings in the tax treatment of gains and losses on foreign exchange transactions, section 24I was introduced into the Act and certain other consequential amendments were made. Central to the amendments is the point of view that all gains and losses on foreign exchange transactions are on revenue account and that such gains and losses arise on a day-to-day basis, as the underlying exchange rates fluctuate.

The tax treatment of gains and losses on foreign exchange transactions will correspond to the accounting treatment thereof for the majority of transactions. Examples of situations where differences will arise are as follows:

(a) where a forward exchange contract entered into to serve as a hedge in respect of a transaction to be entered into, is rolled over;

(b) in respect of the treatment of a premium paid on the acquisition of a foreign currency option contract. An option premium is recognised for tax purposes when it is paid or received, which is not necessarily the case for accounting purposes;

(c) where a forward exchange contract is “closed out” by entering into an opposite forward exchange contract with the same maturity date and underlying foreign currency value;

(d) in respect of exchange gains or losses arising from transactions contemplated in section 24I(7); or

(e) in respect of unrealised exchange gains or losses arising from an unhedged exchange item of a capital nature, between connected persons.

2. BASIC OPERATION OF SECTION 24I

In terms of section 24I(2) a gain or loss on a foreign exchange transaction, which is defined as an *"exchange difference"* in section 24I(1), must be included in or deducted from the income of a taxpayer carrying on a trade within the Republic, if that exchange difference arose from a transaction entered into by that taxpayer in the course of that trade. An exchange difference is determined only in respect of an *"exchange item"* as defined in section 24I(1).

An exchange difference is determined in respect of each exchange item for the year of assessment in which such exchange item arose, as well as every subsequent year of assessment, until the year of assessment in which such exchange item is realised. In order to calculate an exchange difference for a specific year of assessment, a commencement and final date must be established in that year of assessment. The following combinations of commencement and final dates are possible -

(a) **transaction date** and **date of realisation**;

(b) **transaction date** and **date of translation** (last day of the year of assessment);

(c) **previous date of translation** (last day of the previous year of assessment) and **date of realisation**; and

(d) **previous date of translation** and **new date of translation**.

The exchange difference for a specific year of assessment is determined by multiplying the foreign currency amount of the exchange item by the difference between the prescribed *"ruling exchange rate"* on the commencement date in that year of assessment and the *"ruling exchange rate"* on the final date in that year of assessment. By so doing, the effect of the weakening or strengthening of the appropriate exchange rate over the period between the two dates, is converted into a gain or loss. This gain or loss is equal to the increase or decrease in the rand-value of the exchange item.

"Transaction date", *"realised"*, *"translated"*, *"ruling exchange rate"* and various other concepts are also defined in section 24I(1). The flow-chart in Annexure A illustrates how an exchange difference can be tested against the provisions of section 24I to determine the tax treatment thereof during a year of assessment.

3. SECTION 24I(2) - INCLUSION AND DEDUCTION OF EXCHANGE DIFFERENCES

In terms of section 24I(2) of the Act, which is hereafter partially quoted, certain basic requirements are prescribed before an exchange item may be taken into account for tax purposes.

"(2) In determining the taxable income of any person derived from carrying on any trade by him within the Republic ... there shall be included in or deducted from the income so derived, as the case may be, any transitional exchange difference ... and any exchange difference -

(a) arising from a transaction entered into by such person in the course of such trade; or

(b) arising from a loan or advance owing by such person or a debt incurred by such person, where such loan or advance has been utilized or such debt has been incurred in order to finance expenditure incurred by a connected person in relation to such person in the course of the carrying on of any trade within the Republic by such connected person."

The carrying on of any trade within the Republic

As the opening words of section 24I(2) are, in substance, based on the opening words of section 11*(a)*, the general meaning which has been attached to the words *"... the carrying on of any trade ... within the Republic..."* by the South African case law (read together with the definition of the term *"trade"* in section 1 of the Act), should be adhered to.

The test of whether a transaction is entered into in the course of any trade and whether such trade is carried on within the Republic, always depends on the actual circumstances of the specific case. A euro loan (exchange item) entered into by a taxpayer and utilised to finance a productive asset, such as manufacturing equipment would normally be considered to be incurred in the course of the taxpayer's trade. The loan may, however, be utilised to finance a private loan to a shareholder, which will not necessarily be considered to be incurred in the course of a trade. As the merits of each case should be considered individually, it is impossible to formulate specific guidelines in this regard.

It must be noted that source or deemed source of an exchange difference, premium or like consideration, or discount is irrelevant for purposes of the application of section 24I. The tax treatment of gains and losses on foreign exchange transactions in relation to section 9C and 9D of the Act will be dealt with in a separate practice note.

Exchange difference arising from a transaction

As the word *"transaction"* is not a defined term, the general meaning of the word, as used in the context of the relevant section, should be attached to it.

The entering into of a transaction may give rise to an exchange item. If an exchange difference arises from such an exchange item, then such exchange difference is considered to have arisen from such transaction. Therefore, the importation of stock on a dollar account may give rise to a debt. Any exchange difference flowing from that debt, will be considered to have arisen from that importation transaction.

Transfer of an exchange difference to a connected person

Section 24I(2)*(b)* of the Act also makes provision for the inclusion in, or deduction from the income of the taxpayer, of an exchange difference arising from a loan or advance owing by the taxpayer or a debt incurred by the taxpayer if -

(a) such loan or advance was utilised, or the debt was incurred to finance expenditure of a connected person in relation to the taxpayer; and

(b) such expenditure was incurred by such connected person in the course of the carrying on by such connected person, of any trade within the Republic.

Section 24I(2)*(b)* does not provide that such exchange difference may be included in or deducted from the income of the connected person. A taxpayer may, however, by way of a charge or credit in respect of the cost of the financing provided to the connected person, transfer exchange differences in respect of such exchange item to the connected person. Such a charge may be deducted by the connected person, for tax purposes, if it complies with the relevant section of the Act in terms of which it is claimed as a deduction. The charge will be taxable in the hands of the taxpayer.

4. DEFINITIONS: SECTION 24I(1)

All the terms which are necessary for the application of section 24I, are defined in section 24I(1). Five definitions may be considered as the key definitions, in that such definitions form the basis for the determination of an "*exchange difference*", as defined (see paragraph 2 above). The five key definitions are *"exchange item"*, *"transaction date"*, *"realised"*, *"translate"* and *"ruling exchange rate"*.

4.1 *"EXCHANGE ITEM"*

There are three basic categories of exchange items, namely -

(a) the foreign currency amount which is owing-
   (i) by a taxpayer in respect of a **loan**, **advance** or **debt** (a liability); or
   (ii) to a taxpayer in respect of a **loan**, **advance** or **debt** (including a unit of currency held by a taxpayer for its own benefit, or held by any other person on behalf of the taxpayer) (an asset);

(b) the foreign currency amount which is owing by or to a taxpayer in respect of a **forward exchange contract**; and

(c) the foreign currency amount which -
   (i) the holder of a **foreign currency option contract** is entitled, **but not obliged** to buy or sell in terms of that contract; or
   (ii) the writer of a **foreign currency option contract** is obliged to buy or sell in terms of that contract, should the holder of the contract exercise his option.

Cash balances in foreign currency

An exchange item contemplated in paragraph (b) of the definition of exchange item in section 24I(1) includes a unit of currency held by the taxpayer for its own benefit or held by any other person on behalf of the taxpayer. This paragraph, therefore, includes any cash balances which are held in foreign currency which are exchangeable for the currency of the Republic, for example, physical cash, bank balances, traveller's cheques and fixed deposits.

Consequently, an exchange difference in respect of a cash balance should be determined at every year-end (date of translation) on which it is still unrealised as well as on the date of realisation. For purposes of the determination of an exchange difference, the transaction date will be the date on which such cash balance is received by the taxpayer. The date of realisation will be the date on which such cash balance is utilised to acquire-

- an item which is not an exchange item (for example a dollar cash balance which is sold for rands); or
- another exchange item (for example a dollar cash balance which is sold for a German mark cash balance) or an asset or to settle a liability.

Where the cash balance is held at year end, the ordinary rules of translation will apply.

Forward exchange contracts and foreign currency option contracts

Forward exchange contracts and foreign currency option contracts are specifically excluded from the definition of *"trading stock"* in section 1 of the Act. The reason for this is that all foreign exchange gains and foreign exchange losses arising therefrom are taken into account for tax purposes by way of section 24I.

Loan

Stock or bonds, as capital market instruments, are interest-bearing arrangements and, therefore, have the characteristics of a loan which is repayable by the issuer thereof, on a future date. An investment in stock denominated in a foreign currency is, therefore, an exchange item in terms of paragraph (b) of the definition of “exchange item”. The same will apply to money market instruments.

Trading stock

Stock is generally costed at the spot rate, although the forward rate may be used if a related or matching forward exchange contract has been entered into to hedge the debt relating to the stock and the forward rate has been used to record the debt for accounting purposes, in accordance with generally accepted accounting practice.

If stock is costed at the spot rate, any exchange difference must be dealt with in terms of section 24I and is in terms of section 22(3)*(a)* specifically excluded from the cost of trading stock.

If stock is costed at the forward rate in terms of a forward exchange contract entered into to hedge the debt in respect of the purchase of the stock, any premium on the forward exchange contract is not an exchange difference. It will therefore not be dealt with in terms of section 24I, but will form part of the cost of the stock. In these circumstances the premium on the forward exchange contract loses its character.

The cost of trading stock is determined at the time of purchase. Subsequent exchange differences do not affect the original cost price.

See annexure C, examples 5.1, 5.2, 5.3 and 5.4.

Change of the type of currency unit in which a loan, advance or debt is reflected

When an existing loan, advance or debt, which is reflected in a specific currency, is exchanged and is thereafter reflected in another currency, it will, for purposes of the determination of the correct exchange difference (by using comparable exchange rates) be considered that such loan, advance or debt has been realised on the date of exchange and that a new exchange item came into existence on that date.

See annexure C, example 8.

Where the other currency in which the loan, advance or debt is reflected after such exchange, is the currency of the Republic, then such loan, advance or debt is considered to have been realised on the date of such exchange without a new loan, advance or debt coming into existence. An example of such an exchange will be where a loan due by a foreign subsidiary to the holding company in the Republic, which loan is payable in a foreign currency, is converted to a loan payable in rands.

4.2 ***"TRANSACTION DATE"* and *"REALISED"***

"Transaction date" defines the date on which the various exchange items arise. From that date, exchange differences are determined in respect of such exchange items.

The transaction date is, in relation to -

(a) **Loans** and **advances:** The day on which the taxpayer -
  (i) received the amount payable in respect of such loan or advance (a liability);
  (ii) paid the amount payable in respect of such loan or advance (an asset); or
  (iii) acquired the loan or advance in any other manner (an asset);

(b) **Debts:** The day on which -
  (i) the debt was actually incurred by the taxpayer (a liability);
  (ii) the amount payable in respect of the debt, accrued to the taxpayer (an asset); or
  (iii) the date on which the debt was acquired in any other manner (an asset);

(c) A **forward exchange contract:** The day on which that contract was entered into; and

(d) A **foreign currency option contract:** The day on which that contract was entered into or acquired.

In terms of the definition of *"realised",* the time of realisation of an exchange item is, in the case of -

(a) **Loans**, **advances** or **debts:** When and to the extent that payment is received or made, or when and to the extent to which the loan, advance or debt is settled or disposed of in any other manner.

(b) A **forward exchange contract:** When payment is received or made in respect of that contract.

(c) A **foreign currency option contract:** When payment is received or made in respect of the right having been exercised in terms of that contract, or when such contract expires without such right having been exercised, or when such contract is disposed of.

Spot rate transactions (normally transactions in respect of cash balances)

Transactions which are concluded at spot rate, for example, where dollars which are held in cash are sold for rands, generally allow two business days after the day of such transaction for the delivery of the cash.

In terms of the definitions "*transaction date*" and "*realised*", the transaction date and the date of realisation is, in the case of a loan or advance, generally the date on which payment is made or received. For a spot rate transaction, the transaction date (if currency has been purchased), or the date of realisation (if currency has been sold), would be the date on which the transaction was concluded, irrespective of when the cash would be exchanged during the following two business days.

4.3 ***"TRANSLATE"***

"Translate" defines the process whereby an exchange item is, at the end of the year of assessment, translated into the currency of the Republic. This is accomplished by multiplying the foreign currency amount of the exchange item by the ruling exchange rate.

4.4 ***"RULING EXCHANGE RATE"***

The definition of *"ruling exchange rate"* determines for every type of exchange item, for the purposes of the determination of an exchange difference, the exchange rates which are applicable on the relevant dates. A summary thereof appears in annexure B.

4.4.1 **GENERAL**

Format of use

The term *"ruling exchange rate"* is defined for purposes of the determination of exchange differences in respect of exchange items. In order to determine the correct exchange difference, the ruling exchange rate should be stated in the format of **quantity of rands for every foreign currency unit**. The rand/dollar exchange rate is, therefore, for purposes of this practice note stated as 6,1275 (R6,1275 ÷ $1) and not as 0,1632 ($0,1632 ÷ R1).

Decimal accuracy

In order to achieve a uniform minimum accuracy level, the ruling exchange rate must be expressed to at least the fourth decimal, for example R6,2461 ÷ $1.

Various types of ruling exchange rates

"Spot rate" is defined in section 24I(1) of the Act as the appropriate quoted exchange rate for the delivery of currency within a period of two business days. The word *"appropriate"* is used to provide for cases where more than one currency exists in a country, for example, financial rands or commercial rands (in South Africa until 13 March 1995). The rate applied on translation date must be the closing rate quoted by the authorised foreign currency dealer used by the taxpayer for the relevant day for a similar amount of foreign currency. The quoted selling rate must be applied in the case of an exchange item which is a liability and the quoted buying rate where the exchange item is an asset.

"Forward rate" is defined in section 24I(1) as the specified exchange rate at which currency will be exchanged at a future date, in terms of a forward exchange contract.

"Acquisition rate" and **"disposal rate"** are defined in section 24I(1) of the Act as the exchange rate in respect of an exchange item obtained by dividing the amount of the expenditure incurred for the acquisition, or the amount received or accrued in respect of the disposal of the exchange item, as the case may be, by the foreign currency amount in respect of the exchange item. See point 12 in this regard.

The **market-related forward rate available for the remaining period of a forward exchange contract** is the rate at which another forward exchange contract with similar terms (specifically in respect of the foreign currency amount and the maturity date) is offered by the authorised foreign exchange dealer used by the taxpayer on translation date. Because the term to maturity of such other forward exchange contract will be shorter, the premium or discount should generally be less than the premium or discount in respect of the forward exchange contract which is being translated.

The rate applicable to a foreign currency option contract at translation or realisation date is usually the rate obtained by dividing the market value of that option on that date by the foreign currency amount, as specified in that option.

Alternative rates

An "*alternative rate*" to be used instead of any other rate prescribed in the definition of "*ruling exchange rate*", may be used by a taxpayer in the calculation of an exchange difference, if:

(a) it is determined and applied in terms of generally accepted accounting practice;

(b) the taxpayer applies the rate for accounting purposes; and

(c) the basis on which such rate is determined is approved by the Commissioner.

In exercising his discretion the Commissioner shall take into account the particular circumstances of the case and also whether the specific rates prescribed in terms of the definition of "*ruling exchange rate*" are inappropriate and inapplicable.

4.4.2 LOAN, ADVANCE OR DEBT

The exchange rate which must be used as the ruling exchange rate on the transaction date and on the date of translation, is normally the spot rate on such date. Where, however, for accounting purposes and in accordance with generally accepted accounting practice the taxpayer used the forward rate in terms of a forward exchange contract, the tax treatment will follow such accounting treatment.

Therefore, if, for accounting purposes, the taxpayer used the **spot rate** on -

(a) the transaction date, for the initial recording of the transaction; **or**

(b) the date of translation (year end), to translate the loan, advance or debt,

such spot rate must, for tax purposes, also be used as the ruling exchange rate on that transaction date or that date of translation, as the case may be.

Alternatively, if -

(a) the loan, advance or debt is hedged by a related or matching forward exchange contract; **and**

(b) the taxpayer used, for accounting purposes, the **forward rate** in terms of such forward exchange contract -
   (i) to record the loan, advance or debt on the transaction date; or
   (ii) to translate the loan, advance or debt on the date of translation (year end),

then such forward rate must, for tax purposes, also be used as the ruling exchange rate on that transaction date or that date of translation, as the case may be.

The ruling exchange rate on the date of realisation is normally the spot rate on such date.

See annexure C, examples 1, 5 and 6.

When the loan, advance or debt is acquired on the transaction date or is disposed of on the date of realisation and the consideration paid or payable, or received or receivable, in terms of that acquisition or disposal, is calculated by using a rate other than the spot rate on that date, the ruling exchange rate, and not the spot rate on such dates is the "*acquisition rate*" or the "*disposal rate*". Should the transaction have taken place at the "*acquisition rate*", but the taxpayer used the forward rate to record the transaction on the transaction date, as set out above, then the ruling exchange rate for the taxpayer will also be the forward rate.

See annexure C, example 4.

Valuation of a transaction

Generally the cost price of a purchase transaction or the cost of an expense which is financed by a loan, advance or debt, or the selling price of a sale transaction or the value of services rendered, which gives rise to a loan, advance or debt, is determined by using the spot rate on the transaction date in respect of that loan, advance or debt for purposes of the Act. Alternatively the transaction is valued with reference to the forward rate in terms of a related or matching forward exchange contract which has been entered into to hedge the loan, advance or debt arising from the transaction.

The use of the forward rate as the ruling exchange rate on transaction date in terms of paragraph (a)(i) of the definition of "ruling exchange rate", has the effect that the premium or discount on the forward exchange contract is included in the cost price or selling price of the item which is bought or sold, or the cost of an expense, or the value of services rendered. Such cost price or selling price is, for purposes of the Act, considered to be the cash price of such a purchase or sale transaction.

See annexure C, example 5.

The cost price of a fixed asset on which a capital allowance may be claimed, may include a premium on a related or matching forward exchange contract, provided that the following criteria are met:

(a) the forward exchange contract is set to mature within 3 months from the acquisition of the asset;

(b) the forward exchange contract has been entered into prior to, at, or immediately after the transaction date, in order to hedge the loan, advance or debt in respect of the purchase transaction; and

(c) the forward rate in terms of the forward exchange contract was used to record the loan, advance or debt for accounting purposes in accordance with generally accepted accounting practice.

However, where the fixed asset and related liability were, for accounting purposes, recorded at the forward rate and the related or matching forward exchange contract which was used to hedge the transaction, matures more than 3 months after the date of acquisition of the asset, the premium or discount in respect of the forward exchange contract may not be spread over the term of the forward exchange contract and the cost price of the asset must be recorded at the spot rate for tax purposes. The deductibility of the premium on the forward exchange contract paid or payable or the taxability of the discount received or accrued is to be determined in terms of the provisions of sections 11*(a)* or 11*(bB)*, or the definition of “gross income” in section 1 of the Act, as the case may be.

Where such a related or matching forward exchange contract is realised on a date prior to the transaction date for the purchase of the fixed asset, any exchange difference realised must be treated as an exchange difference in terms of section 24I and may not be treated as part of the cost price of the fixed asset.

See annexure C, example 15.

Average spot rate

The ruling exchange rate on the transaction date with regard to exchange items which are loans, advances or debts, is generally the spot rate on that date. In order to simplify the recording of **large volumes** of transactions on different transaction dates, some undertakings use an average spot rate to record certain currency transactions for accounting purposes. Such an average spot rate may also, for tax purposes, be used on the **transaction date** as the ruling exchange rate in respect of exchange items which arose from transactions where trading stock was bought or sold, provided the same rate is used to record such transactions for accounting purposes. This average rate may, however, not be applied on translation or realisation of the relevant loan, advance or debt.

If historical spot rates are used to determine the average rates, such historical spot rates may not be more than two months old. If an average spot rate is based on spot rates which have been estimated for future periods, the period in respect of which an average spot rate has been estimated must agree with the period for which such average spot rate is to be applied for accounting purposes.

Taxpayers who apply an average spot rate to trading stock transactions must -

(a) notify the Commissioner of the basis used to calculate the average rate as well as any changes in the basis of calculating the average rate;

(b) also use such basis for accounting purposes in terms of generally accepted accounting practice; and

(c) apply such basis consistently from year to year.

See annexure C, example 9.

4.4.3 **FORWARD EXCHANGE CONTRACT**

The ruling exchange rate on the transaction date is normally the forward rate in terms of the forward exchange contract.

In paragraph (b)(ii) of the definition of ruling exchange rate, the rate which is to be used at the date of translation (year end) as the ruling exchange rate in respect of a forward exchange contract, is specified as either -

(a) the market-related forward rate which is available for the remaining period of that forward exchange contract; or

(b) in the case where the forward exchange contract is an affected contract, the forward rate in terms of such affected forward exchange contract.

When the taxpayer uses the forward rate in terms of the forward exchange contract as the ruling exchange rate for a related and matching loan, advance or debt, on the date of translation, the ruling exchange rate for that forward exchange contract on the date of translation is also that forward rate.

The ruling exchange rate on the date of realisation is normally the spot rate on that date.

Market-related forward rate available for the remaining period

The use of the market-related forward rate available for the remaining period of the forward exchange contract, has the effect that exchange differences in respect of that forward exchange contract are taken into account for tax purposes over the period of that forward exchange contract. The market-related rate available for the remaining period of the forward exchange contract should be determined by obtaining from the authorised foreign exchange dealer used by the taxpayer, the closing rate on translation date for such remaining period for a similar foreign currency amount.

As an alternative, a rate that is substantially the same as such a market-related forward rate may be determined by spreading the premium or discount in respect of that forward exchange contract, over the period of that contract. This is practically implemented by spreading the difference between the forward rate in terms of that contract and the spot rate on the transaction date of that contract, over the period of that contract and by, on each date of translation, adding the amount attributable to the unexpired portion of the period of that forward exchange contract, to the spot rate on that date of translation.

The spreading of the premium or discount may be effected by applying either a straight-line or a compounding basis. The compounding basis has the effect that the amount per compounding period increases towards the end of the contract. The rate determined by either determining a quoted rate from the authorised foreign exchange dealer used by the taxpayer or the calculated market related rate, should be applied consistently during the term of a forward exchange contract and also to all forward exchange contracts of the taxpayer.

See annexure C, examples 2, 6 and 17.

4.4.4 FOREIGN CURRENCY OPTION CONTRACT

A foreign currency option contract is an agreement in terms of which a person acquires or grants the right to buy from or sell to any other person, on or before a future date, a certain amount of a nominated foreign currency, at a specified exchange rate. The person who acquires the right to buy or sell, is not obliged to act in terms of the contract. Although performance in terms of a foreign currency option contract is conditional on the exercising of such right, that right has a market value which fluctuates as the quoted spot rate of that specified foreign currency changes.

As in the case of loans, advances, debts and forward exchange contracts, fluctuations in the rand value of foreign currency option contracts are taken into account as exchange differences for tax purposes. The rand value of a foreign currency option contract is determined by taking into account various variables. To determine the ruling exchange rate by reference to a single variable, for example the spot rate of the nominated foreign currency, will not result in the correct rand value. For this reason, the ruling exchange rate in respect of a foreign currency option contract must, in all cases, be calculated.

The ruling exchange rate on the transaction date is always **nil**. The reason for this is that the Act specifies that the ruling exchange rate for a "*foreign currency option contract*" on transaction date should be nil. The acquisition cost (premium) in respect of a "*foreign currency option contract*", is immediately deductible for tax purposes and on the other hand taxable if the taxpayer is the writer or seller of such option contract. The possibility that the market value of a "foreign currency option contract" on the date of acquisition may differ from the acquisition cost does not affect the tax treatment thereof.

The ruling exchange rate on the **date of translation** is the rate which is determined by dividing the *"market value"* of the foreign currency option contract on that date, by the foreign currency amount specified in that contract.

"Market value" in relation to a foreign currency option contract is defined in section 24I(1). Where a taxpayer consistently includes any change in the value of all his foreign currency option contracts in his accounting profit and the value is determined by applying a market-related valuation method (which apart from the intrinsic value of that option, also takes into account variables such as time), then the value so determined is the market value. In all other cases it is the *"intrinsic value"* of that foreign currency option contract.

"Intrinsic value" is defined in section 24I(1). It is the gain which the **holder** of a foreign currency option contract could realise by exercising that option contract at a given time, because the option strike rate at that time is more favourable than the spot rate. When the exercising of a foreign currency option contract will result in a loss for the holder of that contract, the intrinsic value is nil for both the holder and writer, because that option would not be exercised under such circumstances. This evaluation must be done on date of translation even where the holder of the foreign currency option contract does not have the right to exercise the option on that date, but only on maturity of the option.

The *"market value"* of a foreign currency option contract is, for the **writer** of such contract a negative value (a liability) of which the absolute value is equal to the market value of such contract for the holder thereof. This means that where the market value of a foreign currency option contract increases for the holder of such contract and an exchange gain consequently accrues to such person in respect thereof, the writer of such contract incurs an exchange loss of the same magnitude.

In terms of the definition of *"realised",* a foreign currency option contract may be realised in three ways, namely -

(a) by exercising the right in terms of that contract;

(b) by allowing such contract to expire without exercising the right in terms thereof; or

(c) by the disposal of that contract during the term thereof.

If a foreign currency option contract is realised by the exercising thereof, or by allowing the contract to expire without it being exercised, the ruling exchange rate is calculated by dividing the market value of that foreign currency option contract by the relevant foreign currency amount. The market value of a foreign currency option contract at the exercising thereof is equal to the intrinsic value at that time. The market value of a foreign currency option contract which has expired, is always nil.

It is important to note that the option holder's loss is limited to the premium paid or acquisition cost, but his profit potential is unlimited, while the writer's profit is limited to the premium received or consideration received on disposal, but his loss potential is unlimited.

See annexure C, example 3.

If a foreign currency option contract is realised by the disposal thereof, then the ruling exchange rate is calculated by dividing the amount received or accrued as a result of the disposal thereof, by the foreign currency amount.

4.4.5 AFFECTED CONTRACT

Where a taxpayer takes out cover by way of either a forward exchange contract or a foreign currency option contract to serve as a hedge for future loans, advances or debts in foreign currency the amounts of which (both capital and interest) can be determined with certainty, the forward exchange contract should be translated at the forward rate and the foreign currency option contract should be translated at the rate determined by dividing the consideration (e.g. premium or like consideration paid or received on acquisition of the foreign currency option contract by the foreign currency amount of that contract. This option is available only where the underlying exchange item has not yet arisen at year-end, but for which an agreement has already been entered into and -

(a) the loan, advance or debt will be utilised to acquire any asset or to finance any expense; or

(b) the loan, advance or debt will arise from the sale of any asset or the supply of any services,

in the ordinary course of the taxpayer’s trade.

The effect will be that no exchange differences will arise on the translation of a forward exchange contract or foreign currency option contract entered into to serve as a hedge in respect of such a loan, advance or debt until the underlying exchange item comes into existence.

See annexure C, example 16.

5. SECTION 24I(3) - TRANSITIONAL EXCHANGE DIFFERENCES

"Transitional exchange difference" is defined in section 24I(1). It is the accumulated unrealised foreign exchange gain or loss which, in respect of certain exchange items, existed on the date of commencement of section 24I. Every transitional exchange difference is included in income, or deducted therefrom, in terms of section 24I(2) if it complies with the basic requirements of that section. Such inclusion or deduction must be effected taking into account the phasing-in provisions, as incorporated in section 24I(3).

Section 24I of the Act came into effect from the beginning of the first year of assessment ending on or after 1 January 1994. Therefore, if the taxpayer's year of assessment ends on 28 February 1994, the date of commencement would be 1 March 1993.

Transitional exchange differences are determined in respect of all exchange items which existed on the last day of the year of assessment which ended prior to the commencement of section 24I, except for loans, advances or debts contemplated in paragraph (b) of the definition of *"exchange item"*, which are of a capital nature. The capital nature of these exchange items should be determined according to the ordinary rules relating to capital versus income.

An example of a loan in respect of which a transitional exchange difference need not be determined, is a long-term loan from a South African holding company (which loan is not floating or circulating capital in the hands of the lender) to its foreign subsidiary, where such loan forms part of the fixed investment in such subsidiary by such holding company.

In order to determine a transitional exchange difference, the provisions of section 24I are deemed to apply on the transaction date of the relevant exchange item and on the last day of the year of assessment (date of translation) which ends immediately prior to the commencement of section 24I. The transitional exchange difference is calculated by multiplying the difference between the ruling exchange rate on those two dates, by the foreign currency amount of the exchange item. The transitional exchange difference so determined must, however, be adjusted to ensure that all the exchange gains or losses which have already been taken into account previously to determine taxable income in terms of any other section of the Act, are not included in income or allowed as a deduction more than once.

Transitional exchange differences are phased-in in terms of section 24I(3), as follows -

(a) transitional exchange differences which are realised in the first year of assessment after the commencement of section 24I (that is the first year of assessment ending on or after 1 January 1994) are included in income or allowed as a deduction in such year of assessment; and

(b) in respect of those transitional exchange differences which are not realised in that first year -
    (i) 50 per cent is included in income or allowed as a deduction in that first year; and
    (ii) the balance of 50 per cent is included in income or allowed as a deduction in the succeeding year.

It must be noted that exchange differences are to be calculated and treated in terms of section 24I(2) in the case of all exchange items in existence after the date when a transitional exchange difference is determined in respect of such an exchange item.

See annexure C, example 14.

6. SECTION 24I(4) - PREMIUMS AND DISCOUNTS

Foreign currency option contracts

There is normally a premium or similar consideration payable when entering into a foreign currency option contract and consideration payable when an existing foreign currency option contract is acquired. The inclusion in, or deduction, of a premium or consideration which is paid or received, from the income of a taxpayer is governed by section 24I(4)*(a)*.

Such inclusion or deduction is conditional upon such foreign currency option contract being entered into or acquired by the taxpayer in the course of any trade carried on by him within the Republic. See paragraph 3 of this practice note for the discussion of the concept of *"... the carrying on of any trade within the Republic"*.

In terms of section 24I(4), any premium or similar consideration -

(a) received or paid in respect of the entering into of a foreign currency option contract by a person in the course of his trade, is included in the income of the writer of that contract and is deducted from the income of the holder of that contract, as the case may be (see example 3); and

(b) paid by a person in respect of the acquisition of an existing foreign currency option contract, is deducted from the income of the person who acquired that contract.

See also under paragraph 12 "Disposal or acquisition of a foreign currency option contract".

Forward exchange contract

On recording of a transaction for accounting purposes, there may be instances where a loan, advance or debt is recorded at the forward rate, in accordance with the alternative treatment, as described in paragraph 4.4.2, but the underlying asset, liability, item of income or expenditure is not recorded at the forward rate. In such situations the premium or discount not included in the amount of the underlying asset, liability, item of income or expenditure, must be spread on a day-to-day basis over the term of the forward exchange contract when calculating the taxpayer's taxable income.

See annexure C, example 5.4.

7. SECTION 24I(5) - PREMIUMS/DISCOUNTS ON FORWARD EXCHANGE CONTRACTS

Section 24I(1) defines a *"premium or discount on a forward exchange contract"* as follows -

> *"means the amount obtained by applying the* ***difference*** *between the* ***forward rate*** *in respect of a forward exchange contract and the* ***spot rate*** *on the date on which such forward exchange contract was entered into, to the foreign currency amount specified in such forward exchange contract;"*.

Section 24I(5) identifies various circumstances under which an exchange difference in respect of a loan, advance or debt, includes such a premium or discount on a forward exchange contract.

When this occurs, the premium or discount portion included in such exchange difference must, in the application of section 24I(2), be included in the income of the taxpayer or deducted therefrom, on a day-to-day basis over the period of the forward exchange contract. These circumstances occur when the ruling exchange rates in respect of such loan, advance or debt comprise one of the following combinations -

Combination	First ruling exchange rate	Second ruling Exchange rate
1.	Spot rate on the transaction date	Forward rate
2.	Spot rate on previous date of translation (end of preceding year of assessment)	Forward rate
3.	Forward rate which differs from the forward rate which is used as the second ruling exchange rate because the original forward exchange agreement has been replaced by another forward exchange contract	Forward rate
4.	An alternative rate prescribed by the Commissioner to any of the preceding 3 rates	An alternative rate prescribed by the Commissioner to a forward rate

See annexure C, example 12.

8. SECTION 24I(6) - DOUBLE DEDUCTION OR DOUBLE INCLUSION

Section 24I(6) prevents the double deduction or double taxation of any exchange difference, premium or discount in respect of a forward exchange contract, transitional exchange difference or a premium or other consideration in respect of, or in terms of a foreign currency option contract. This is accomplished in that that section provides that where such inclusion in, or deduction from income can also be dealt with under any other provision of the Act, then the inclusion or deduction must be made in terms of section 24I instead of in terms of such other provision of the Act.

9. SECTION 24I(7) - POSTPONEMENT OF EXCHANGE DIFFERENCES

The purpose of section 24I(7) is to postpone the inclusion in, or deduction from the taxpayer's income, of exchange differences in terms of section 24I(2) and premiums or other consideration in terms of section 24I(4), until the year of assessment in which the assets (as mentioned in the subsection) to which it relates, are brought into use for purposes of that person's trade.

This postponement applies to -

(a) any exchange difference arising in respect of a loan, advance or debt which is utilised by a taxpayer for purposes specified in section 24I(7)*(a)*(i) and (ii);

(b) any exchange difference in respect of a forward exchange contract or foreign currency option contract which is entered into by the taxpayer in (a) above to serve as a hedge for such existing or future loan, advance or debt mentioned in (a) above; and

(c) any premium or other consideration in respect of a foreign currency option contract which is entered into or acquired by the taxpayer in (a) above to serve as a hedge for such existing or future loan, advance or debt mentioned in (a) above.

Loan, advance or debt which is still to be obtained or incurred

Section 24I(7) of the Act provides *inter alia* for the postponement to a later year of assessment of ***either*** any exchange difference in respect of a forward exchange contract or a foreign currency option contract which is entered into ***or*** any premium or other consideration paid or payable in respect of a foreign currency option contract which is entered into or acquired to serve as a hedge in respect of a loan or advance obtained or to be obtained, or a debt incurred or to be incurred.

Sufficient proof that such forward exchange contract or foreign currency option contract was entered into as a hedge in respect of a loan, advance or debt which is still to be obtained or incurred, as the case may be, must be furnished before such postponement of exchange differences, or any premium, or other consideration will be allowed. Factors which will be taken into account in determining the intention of the taxpayer to hedge a transaction, include the amount of the relevant exchange items, transaction dates, realisation dates and contractual agreements.

If, in a subsequent year of assessment, it appears that such loan, advance or debt will no longer be acquired or entered into, or has not been utilised as required, then no further postponement shall take place and the exchange differences, premium or other consideration shall be taken into account in the determination of the taxable income in that year. The same principle will apply if the assets are not brought into use or the expenditure is not incurred, as the case may be.

See annexure C, examples 10 and 11.

Apportionment

The exchange difference, or premium, or other consideration, as contemplated in section 24I(7)*(b)* and *(c)* of the Act, is postponed in terms of that section only to the extent that the relevant forward exchange contract or foreign currency option contract serves as a hedge in respect of an existing or future loan, advance or debt which is obtained or incurred or will be obtained or incurred, for the purposes mentioned in paragraph (a) of section 24I(7).

It is possible that the foreign currency amount of a forward exchange contract or foreign currency option contract, may exceed the portion of the foreign currency amount of the loan, advance or debt which is or will be utilised for such purposes. It is also possible that a single forward exchange contract or foreign currency option contract may serve as hedge for more than one loan, advance or debt, of which some are not utilised for such purposes. An apportionment must be done in such cases in order that only the appropriate portion of the exchange difference, or premium, or other consideration is postponed.

See annexure C, examples 10 and 11.

Subject to sections 36 and 37E

Section 24I(7) of the Act postpones the inclusion in, or deduction of an exchange difference or premium or other consideration, from a taxpayer's income, until the year of assessment in which the qualifying assets are brought into use for purposes of the taxpayer's trade.

If any deduction in respect of the cost of a qualifying asset is to be allowed having regard to section 36 or 37E, then the inclusion or deduction of such exchange difference, premium or other consideration, shall be postponed only until the first year of assessment in which a deduction in respect of such qualifying asset is to be taken into account in the taxpayer's taxable income, taking into account the provisions of section 36 or 37E.

See annexure C, example 11.

10. SECTION 24I(7A) - SPREADING OF EXCHANGE DIFFERENCES

Companies often make loans or advances to, or receive loans or advances from, other companies in a group of companies, which loans or advances are of a capital nature. A relief measure is available to soften the impact of taxation in respect of unrealised gains or losses arising from loans or advances between companies which are connected persons.

To qualify, a loan or advance must be of a capital nature and should not be covered by a forward exchange contract. Unrealised gains and losses on loans or advances which arose from the commencement of section 24I (excluding unrealised losses attributable to loans and advances made before 1 January 1995 in respect of years of assessments ending before 1 January 1996) shall qualify for the spreading of the exchange differences.

The spreading is brought about by annually including in or deducting from a company's income, as the case may be, 10 percent only of the deferred amount of an exchange difference. The deferred amount consists of the sum of -

(a) unrealised exchange differences which arise during a current year of assessment in relation to a qualifying exchange item; and

(b) the unrealised exchange differences, which arose in previous years, in relation to such qualifying exchange item, reduced by such portions which have already been taken into account in income.

The spreading consequently takes place on the reducing balance basis.

The deferred amount of exchange differences, as at the end of the preceding year of assessment, which has not been taken into account for tax purposes, must be reduced by -

(a) an amount which bears to the deferred balance the same ratio as any reduction in the amount of the uncovered loan or advance expressed in the foreign currency from the end of the preceding year of assessment to the end of the current year of assessment bears to the amount of the uncovered loan or advance at the end of the preceding year of assessment; and

(b) 100 per cent if the loan or advance is -
   (i) no longer between companies which are connected persons;
   (ii) no longer of a capital nature; or
   (iii) not in existence.

Any reduction in the deferred balance must be included in or deducted from the taxpayer's income, as the case may be, during the relevant year of assessment.

Where a qualifying exchange item is converted into a qualifying exchange item expressed in another foreign currency, any exchange difference arising as a result of the conversion, shall be included in the deferred amount in relation to the old qualifying exchange item. After conversion, the old and the new qualifying exchange items are deemed to be one and the same exchange item. The amount of the exchange item at the end of the preceding year must be restated in the currency of the new exchange item by applying the -

(a) exchange rate at which the conversion took place;

(b) disposal rate of the old qualifying exchange item; or

(c) acquisition rate of the new qualifying exchange item.

See annexure C, example 13

11. SECTION 24I(8) - ANTI-AVOIDANCE RULES

Where -

(a) (i) any foreign exchange loss was incurred in respect of a transaction entered into by a person; or
   (ii) any premium or other consideration was paid in respect of or in terms of a foreign currency option contract entered into or acquired by a person; and

(b) such transaction was entered into or such foreign currency option contract was entered into or acquired, solely or mainly to enjoy a reduction in tax by way of a deduction from income,

such loss, or premium or other consideration shall not be allowed as a deduction from such person's income in terms of subsection (2) or (4) of section 24I.

The provisions of section 103(1) may, however, also be applied, in addition to the provisions of section 24I(8).

12. DISPOSALS AND ACQUISITIONS

Disposal or acquisition of a loan, advance or debt

Paragraphs (c) and (d) of the definition of *"transaction date"* in section 24I(1), determine the transaction date for the acquisition by a person of an existing loan, advance or debt which is an asset. Paragraph (a) of the definition of *"realised"* determines the date of realisation where a loan, advance or debt is disposed of. The terms *"acquisition rate"* and *"disposal rate"* are also defined in section 24I. The proviso to paragraph (a) of the definition of *"ruling exchange rate"* prescribes the circumstances whereunder the acquisition and disposal rates should be applied (see annexure C, example 4).

Disposal or acquisition of a forward exchange contract

Reserve Bank regulations currently require that a fixed and determined currency obligation must exist before a forward exchange contract may be entered into. The transfer of ownership of an existing forward exchange contract by way of negotiation, cession or in any other manner, is therefore an exception to the rule. Where, however, a disposal or acquisition of a forward exchange contract takes place at an exchange rate other than the spot rate or forward rate as prescribed in the Act, an alternative rate, which is used for accounting purposes in terms of generally accepted accounting practice, will be acceptable.

Disposal or acquisition of a foreign currency option contract

When a foreign currency option contract is originally entered into, there is generally a premium or like consideration payable by the person acquiring the option. A premium or like consideration paid, is, in terms of section 24I(4)*(a)*, included in the income of the person who wrote the option and is deducted from the income of the person who acquired the option.

There is a market for existing foreign currency option contracts. They can therefore be traded after being issued. The consideration paid in respect of the transfer of a foreign currency option contract is, in terms of section 24I(4)*(a)*(ii), deducted from the income of the person who acquired the option. Such consideration is, however, included in the income of the person who disposed of the option, not directly, but indirectly, by reason of the fact that such consideration is used to determine the ruling exchange rate in respect of that foreign currency option contract on the date of realisation. In this regard see paragraph (c)(iii) of the definition of *"ruling exchange rate"*.

13. THE TREATMENT OF BAD DEBTS

Bad debts: provision and write-off thereof

Bad debts in respect of exchange items must be determined after providing for adjustments as a result of fluctuations in the underlying exchange rates. This means that where an exchange item became bad or the recovery thereof became doubtful, the loss, bad debt or allowance in terms of sections 11*(a)*, 11*(i)* and 11*(j)*, in respect of such an exchange item, are based on an amount which takes into account all exchange differences which were, or will be, included in or deducted from the taxpayer's income in any previous year or in the current year of assessment. This is achieved by basing such loss, bad debt, or allowance on the amount which is obtained by multiplying the spot rate, in respect of such exchange item on the date of write-off, by the foreign currency amount (to the extent that it is irrecoverable) of such exchange item.

The total deduction which is determined in the above-mentioned manner for purposes of section 11*(j)*, is included, in terms of that section, in the income of the taxpayer during the succeeding year of assessment.

Exchange items, to the extent that the foreign currency amount thereof became irrecoverable and in respect of which a loss or a bad debt was allowed as a deduction from income in terms of sections 11*(a)* and 11*(i)* are, for practical purposes, considered to have been realised for purposes of section 24I. Thus, no further exchange differences are thereafter taken into account for tax purposes in respect of such exchange items, except in respect of that portion of the amount of the exchange item written-off, which is recouped or recovered at a later stage. In this regard see the paragraph dealing with the recoupment of bad debts written-off.

An exchange difference on debt written off, calculated from the translation or transaction date to the write off date will, therefore, be included in taxable income and the amount of the debt translated on write off date will be considered as a deduction in terms of sections 11*(a)* or 11*(i)*.

Exchange items in respect of which an allowance in terms of section 11*(j)* has been granted, remain exchange items until the date on which they are realised in a manner defined in section 24I(1) or until they become irrecoverable, with the result that exchange differences in respect of such exchange items should still be taken into account for tax purposes.

See annexure C, example 7.

Recoupment of bad debts written off

When a taxpayer recoups amounts in relation to an exchange item in respect of which a loss or a bad debt was claimed and deducted in terms of sections 11(*a*) or 11(*i*), the total amount recouped by him is included in his taxable income in the year of assessment in which such recoupment occurred. The recoupment can be broken down into two parts. The first portion is that portion of the amount which was written off in terms of section 11*(a)* or 11(*i*) and which is now recouped. Such portion is recouped in terms of section 8(4)*(a)*. The second portion of the "recoupment" is the exchange difference, in respect of that portion of the exchange item which was written off but which is now recouped, which should have been calculated had such portion not, for practical purposes, been considered realised for purposes of section 24I, as determined above. The reason for this is that the debt is an exchange item until the date when it is repaid; the write-off of a bad debt does not constitute repayment, settlement or disposal thereof.

See annexure C, example 7.

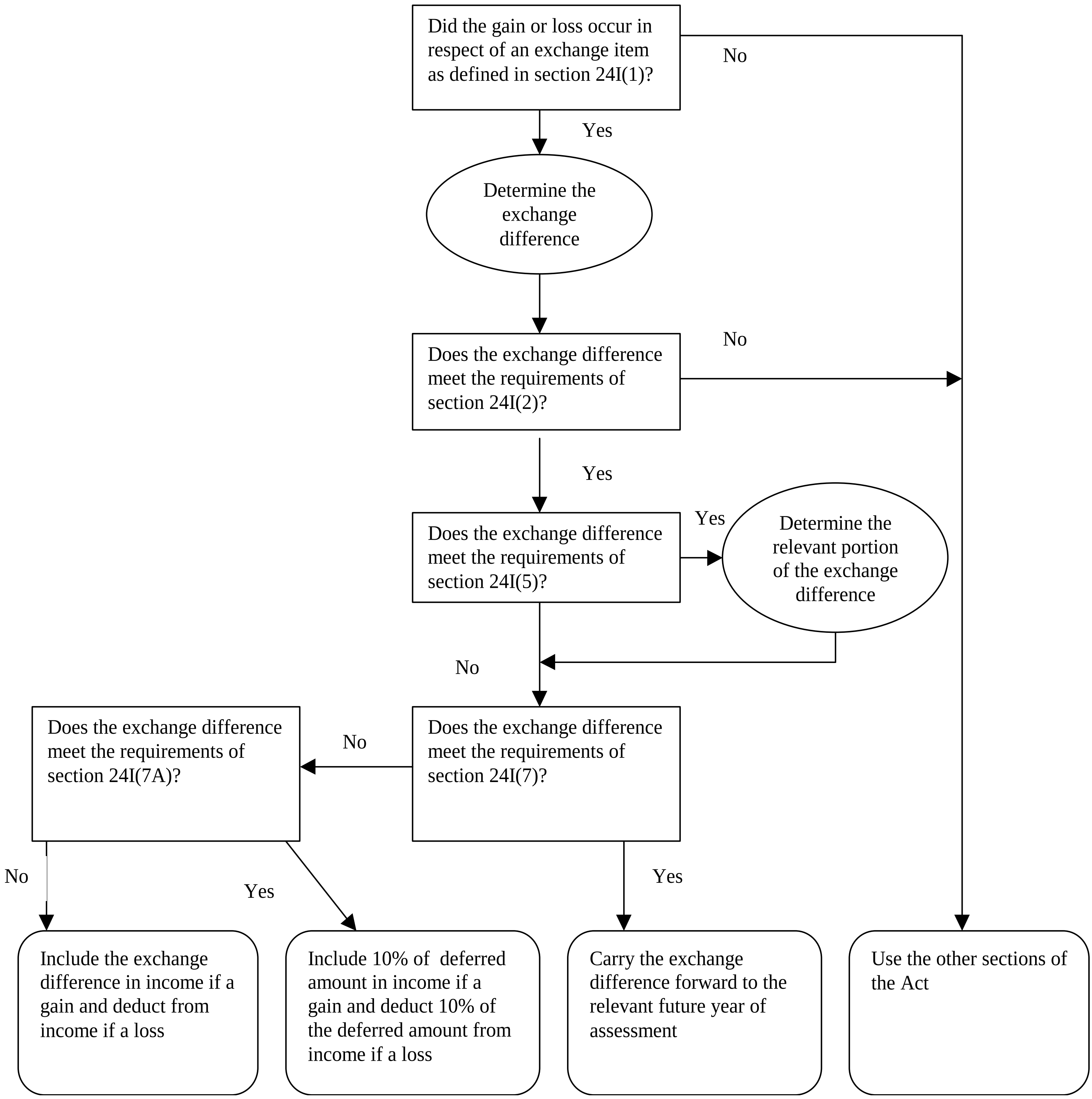
14. ASSESSED LOSS

Exchange differences which are taken into account in the determination of the taxpayer's taxable income in terms section 24I of the Act, may give rise to or increase an assessed loss.

15. OBJECTION AND APPEAL

Any decision of the Commissioner for the South African Revenue Service under section 24I is subject to objection and appeal in terms of section 3(4) of the Act.

DETERMINATION OF THE TAXATION OF GAINS AND LOSSES ON FOREIGN EXCHANGE TRANSACTIONS



ANNEXURE B

RULING EXCHANGE RATES

	EXCHANGE ITEMS		
	LOAN, ADVANCE OR DEBT (L, A or D)	**FORWARD EXCHANGE CONTRACT (FEC)**	**FOREIGN CURRENCY OPTION CONTRACT**
Transaction date	Spot rate on transaction date (or acquisition rate [1]) or If a related or matching FEC is entered into to hedge the L, A or D **and** the forward rate ito such FEC was used to record the L, A or D for accounting purposes, such forward rate	Forward rate in terms of the FEC	Nil rate
Date of translation	Spot rate on date of translation or If a related or matching FEC is entered into to cover the L, A or D **and** the forward rate ito such FEC was used to translate the L, A or D for accounting purposes, such forward rate.	Market related forward rate available for the remaining term of the FEC or If the forward rate in terms of the FEC has been used to translate a L, A or D, such forward rate or If a FEC qualifies as an affected contract, such forward rate	Rate is determined as follows: Market value ÷ foreign currency amount or In the case of an affected contract, consideration paid or received ÷ foreign currency amount
Date of realisation	Spot rate on date of realisation (or disposal rate [2])	Spot rate on date of realisation	Rate calculated as follows: (i) If option is exercised or has matured: Market value ÷ Foreign currency amount (ii) If option is disposed of: Receipt from disposal ÷ foreign currency amount

Notes:

1. If the loan, advance or debt is acquired and any consideration paid or payable in respect of the acquisition of such loan, advance or debt was determined by using a rate other that the spot rate on the transaction date, then such other rate (defined as the "*acquisition rate*" in section 24I(1)), must be used as the ruling exchange rate. (See example 4)

2. If the loan, advance or debt is disposed of and any consideration received or receivable in respect of the disposal of such loan, advance or debt was determined by using a rate other than the spot rate on the date of realisation, then such other rate(defined as "*disposal rate*" in section 24I(1)), must be used as the ruling exchange rate. (See example 4)

3. An alternative rate to any of the aforementioned rates may be prescribed by the Commissioner, if such alternative rate is used for accounting purposes in terms of generally accepted accounting practice and such aforementioned rates are inappropriate and inapplicable.

ANNEXURE C

EXAMPLES

EXAMPLE 1

NORMAL LOAN (DOLLAR OBLIGATION)

The taxpayer borrowed $100 000 on 31-01-1998.
The loan was repayable on 30-06-1998.
The tax year ends on 28 February.

MARKET RATES FOR PURPOSES OF THE EXAMPLE	
DATE	SPOT RATE R/$
31-01-1998	6,4200
28-02-1998	6,4500
30-06-1998	6,6000

YEAR END 28-02-1998

Ruling exchange rates:

Transaction date (31-01-1998)	6,4200
Date of translation (28-02-1998)	6,4500

Exchange difference:
[(6,4200 - 6,4500) x $100 000] R3 000 loss

YEAR END 28-02-1999

Ruling exchange rates:

Previous date of translation (28-02-1998)	6,4500
Date of realisation (30-06-1998)	6,6000

Exchange difference:
[(6,4500 - 6,6000) x $100 000] R15 000 loss

NET TAX RESULT R18 000 loss

(- R3 000 - R15 000)

RECONCILIATION

Rand equivalent on transaction date ($100 000 x 6,4200)	R642 000
Rand equivalent on date of realisation ($100 000 x 6,6000)	R660 000
Net loss	R 18 000

EXAMPLE 2

FORWARD EXCHANGE CONTRACT

The taxpayer entered into a forward exchange contract on 01-01-1998 in terms of which $150 000 would be purchased on 30-06-1998 at a forward rate of 6,5200. The dollars purchased on 30-06-1998 were immediately resold at the spot rate. The taxpayer's financial year ends on 28 February.

MARKET RATES FOR PURPOSES OF THE EXAMPLE			
DATE	SPOT RATE	FORWARD RATE	
	R/$	6 MONTHS	4 MONTHS
01-01-1998	6,4000	6,5200	
28-02-1998	6,4500		6,5400
30-06-1998	6,5800		

Two methods of treatment are possible, for tax purposes:

Method 1 - The market related forward rate available for the remaining period of the forward exchange contract is used as the ruling exchange rate on the date of translation.

Method 2 - The difference between the forward rate in terms of the forward exchange contract and the spot rate on the transaction date of such contract, is spread over the period of such contract. The portion of such difference which is attributable to the period of such forward exchange contract which has not expired on the date of translation, is added to the spot rate on such date of translation, in order to determine the ruling exchange rate.

YEAR END 28-02-1998

	Method 1	**Method 2**
Ruling exchange rates:		
Transaction date	6,5200	6,5200
Date of translation	6,5400	6,5300[1]
1. 6,4500 + [(6,5200 - 6,4000) x 4 ÷ 6]		
Exchange difference :		
[(6,5200 - 6,5400) x $150 000]	+R3 000	
[(6,5200 - 6,5300) x $150 000]		+R1 500

YEAR END 28-02-1999

	Method 1	**Method 2**
Ruling exchange rates : Previous date of translation Date of realisation	 6,5400 6,5800	 6,5300 6,5800
Exchange difference : [(6,5400 - 6,5800) x $150 000] [(6,5300 - 6,5800) x $150 000]	 +R6 000 	 +R7 500

NET TAX RESULT R9 000 gain

(+ R3 000 + R6 000) or (+ R1 500 + R7 500)

RECONCILIATION

Rands paid on date of realisation (6,5200 x $150 000)	R978 000
Rands received on date of realisation (6,5800 x $150 000)	R987 000
Net gain	R 9 000

EXAMPLE 3

FOREIGN CURRENCY OPTION CONTRACT

On 01-01-1998 the taxpayer concluded a foreign currency option contract in terms of which the right was obtained to purchase $80 000 on 30-06-1998 at a rate (the option strike rate) of 6,4000. The premium on the option contract amounted to R4 000. The taxpayer used a market related valuation method for accounting purposes, to value the option at year end. The option was exercised on 30-06-1998 and the dollars obtained were sold on the same day at the spot rate. The tax year ends on 28 February.

MARKET RATES FOR PURPOSES OF THE EXAMPLE	
DATE	SPOT RATE R/$
01-01-1998	6,4000
28-02-1998	6,4500
30-06-1998	6,6000

YEAR END 28-02-1998

Ruling exchange rates:

Transaction date (01-01-1998)	0,0000
Date of translation (28-02-1998)	0,0650
(See calculation 1)	

Exchange difference:	
[(0,0000 - 0,0650) x $80 000]	R5 200 gain

Note:

The premium of R4 000 is deductible from income, in this year of assessment, in terms of section 24I(4)(a).

YEAR END 28-02-1999

Ruling exchange rates:

Previous date of translation (28-02-1998)	0,0650
Date of realisation (30-06-1998)	0,2000
(See calculation 2)	

Exchange difference:	R10 800 gain
[(0,0650 - 0,2000) x $80 000]	

NET TAX RESULT	R16 000 gain

(+ R5 200 + R10 800)

RECONCILIATION

Rands paid on date of realisation ($80 000 x 6,4000)	R512 000
Rands received on date of realisation ($80 000 x 6,6000)	R528 000
Net gain	R 16 000

Calculations:

(1)	*Intrinsic value [(6,4500 - 6,4000) x $80 000]*	*4 000*
	Time value (Estimated)	*1 200*
	Market value of option contract	*R5 200*
	Ruling exchange rate (R5 200 ÷ $80 000)	*0,0650*

(2)	*Intrinsic value [(6,6000 - 6,4000) x $80 000]*	*16 000*
	Time value	*0*
	Market value of option contract	*R16 000*
	Ruling exchange rate (R16 000 ÷ $80 000)	*0,2000*

Note:

The tax result for the writer of a foreign currency option contract is always exactly the opposite of the result for the holder of such contract. In this example the tax result for the writer of the foreign currency option contract will therefore be -

YEAR END 28-02-1998

Exchange difference	*R5 200 loss*
Premium received	*R4 000 gain*

YEAR END 28-02-1999

Exchange difference	*R10 800 loss*

EXAMPLE 4

ACQUISITION AND DISPOSAL OF A DEBT (DOLLAR ASSET)

On 31-01-1998 a bank purchased a debt of $26 000 from a business for R165 000. The bank sold the same debt to another bank on 30-04-1998 for R174 000. The tax year ends on 28 February.

MARKET RATES FOR PURPOSES OF THE EXAMPLE	
DATE	SPOT RATE R/$
31-01-1998	6,4200
28-02-1998	6,4500
30-04-1998	6,5300

YEAR END 28-02-1998

Ruling exchange rates:

Transaction date (31-01-1998) *(See calculation 1)*	6,3462
Date of translation	6,4500

Exchange difference: [(6,3462 - 6,4500) x $26 000] — R2 700 gain

YEAR END 28-02-1999

Ruling exchange rates:

Previous date of translation (28-02-1998)	6,4500
Date of realisation	6,6923
(See calculation 2)	

Exchange difference: R6 300 gain
[(6,4500 - 6,6923) x $26 000]

NET TAX RESULT R9 000 gain

(+ R2 700 + R6 300)

RECONCILIATION

Rands paid on transaction date	R165 000
Rands received on realisation	R174 000
Net gain	R 9 000

Calculations *:*

(1)	*Costs incurred to acquire debt*	*R165 000*
	Foreign currency amount of debt	*$26 000*
	Acquisition rate (R165 000 ÷ $26 000)	*6,3462*
(2)	*Amount received on disposal of debt*	*R174 000*
	Foreign currency amount of debt	*$26 000*
	Disposal rate (R174 000 ÷ $26 000)	*6,6923*

EXAMPLE 5

DEBT (DOLLAR OBLIGATION) HEDGED BY A FORWARD EXCHANGE CONTRACT

The taxpayer imported stock to the value of $100 000. He took delivery of the stock on 01-12-1997. On this date he became liable for the purchase price. The debt was payable on 31-05-1998. The taxpayer entered into a forward exchange contract on 01-12-1997. In terms of this contract he would purchase $100 000 on 31-05-1998 at a forward rate of 6,4900. The taxpayer's financial year ends on 28 February.

MARKET RATES FOR PURPOSES OF THE EXAMPLE			
DATE	SPOT RATE R/$	FORWARD RATE	
		6 MONTHS	3 MONTHS
01-12-1997	6,3700	6,4900	
28-02-1998	6,4500		6,5100
31-05-1998	6,5600		

5.1 The transaction was recorded on the transaction date at the spot rate, for accounting purposes. At the end of the financial year (date of translation) the debt was translated at the spot rate, for accounting purposes.

<u>Accounting recording of the transaction</u>

Dr Purchases (Stock)	*R637 000*	
Cr Creditor		*R637 000*
($100 000 x 6,3700)		

YEAR END 28-02-1998

Debt

Ruling exchange rates:

Transaction date (01-12-1997)	6,3700
Date of translation (28-02-1998)	6,4500

Exchange difference: R8 000 loss
[(6,3700 - 6,4500) x $100 000]

Forward exchange contract

Ruling exchange rates:

Transaction date (01-12-1997)	6,4900
Date of translation (28-02-1998)	6,5100

Exchange difference: R2 000 gain
[(6,4900 - 6,5100) x $100 000]

YEAR END 28-02-1999

Debt

Ruling exchange rates:

Date of previous translation (28-02-98)	6,4500
Date of realisation (31-05-1998)	6,5600

Exchange difference: R11 000 loss

[(6,4500 - 6,5600) x $100 000]

Forward exchange contract

Ruling exchange rates:

Date of previous translation (28-02-98)	6,5100
Date of realisation (31-05-1998)	6,5600

Exchange difference: R5 000 gain

[(6,5100 - 6,5600) x $100 000]

NET TAX RESULT

(- R8 000 + R2 000 - R11 000 + R5 000) R12 000 loss

RECONCILIATION

Cost price of stock on transaction date ($100 000 x 6,3700)	R637 000
Rands paid to purchase $100 000 on 31-05-1998 ($100 000 x 6,4900)	R649 000
Net loss	R 12 000

5.2 The transaction was recorded on the transaction date at the forward rate, for accounting purposes. At the end of the financial year (date of translation) the debt was translated at the forward rate, for accounting purposes.

<u>Accounting recording of the transaction</u>

Dr Purchases (Stock)	*R649 000*	
Cr Creditor		*R649 000*
($100 000 x 6,4900)		

The forward exchange contract was not recorded separately.
The premium on the forward exchange contract is included in the cost price of the stock which is taken into account as a deduction for tax purposes in terms of sections 11(a) and 22.

YEAR END 28-02-1998

Debt

Ruling exchange rates:

Transaction date (01-12-1997)	6,4900
Date of translation (28-02-1998)	6,4900

Exchange difference: R nil
[(6,4900 - 6,4900) x $100 000]

Forward exchange contract

Ruling exchange rates:

Transaction date (01-12-1997)	6,4900
Date of translation (28-02-1998)	6,4900

Exchange difference: R nil
[(6,4900 - 6,4900) x $100 000]

YEAR END 28-02-1999

Debt

Ruling exchange rates:

Date of previous translation (28-02-98)	6,4900
Date of realisation (31-05-1998)	6,5600

Exchange difference: R7 000 loss
[(6,4900 - 6,5600) x $100 000]

Forward exchange contract

Ruling exchange rates:

Date of previous translation (28-02-98)	6,4900
Date of realisation (31-05-1998)	6,5600

Exchange difference: [(6,4900 - 6,5600) x $100 000]	R7 000 gain

NET TAX RESULT	R nil

(R0 + R0 - R7 000 + R7 000)

RECONCILIATION

Cost price of stock on transaction date ($100 000 x 6,4900)	R649 000
Rands paid to purchase $100 000 on 31-05-1998 ($100 000 x 6,4900)	R649 000
Net loss	R nil

Note:

The premium on the forward exchange contract is included in the cost price of the stock. The premium is therefore indirectly allowed as a deduction for income tax purposes in terms of section 11(a).

5.3 The transaction was recorded on the transaction date at the spot rate, for accounting purposes. At the end of the financial year (date of translation) the debt was translated at the forward rate, for accounting purposes.

Accounting recording of the transaction

Dr Purchases (Stock)	R637 000	
Cr Creditor		R637 000
($100 000 x 6,3700)		
Dr Premium on forward exchange contract	R 12 000	
Cr Creditor		R 12 000
[$100 000 x (6,4900 - 6,3700)]		

The forward exchange contract was not accounted for separately.

YEAR END 28-02-1998

Debt

Ruling exchange rates:

Transaction date (01-12-1997)	6,3700
Date of translation (28-02-1998)	6,4900

Exchange difference: R12 000 loss
[(6,3700 - 6,4900) x $100 000]

Note:

This exchange difference (loss) of R12 000 complies with the provisions of section 24I(5) and the premium portion thereof (in this case the full exchange difference) must be spread on a day-to-day basis over the period of the forward exchange contract.

Portion of the exchange difference allocated to the 1998 year of assessment R6 000 loss
(R12 000 x 3 ÷ 6)

Forward exchange contract

Ruling exchange rates:

Transaction date (01-12-1997)	6,4900
Date of translation	6,4900

Exchange difference: R nil
[(6,4900 - 6,4900) x $100 000]

YEAR END 28-02-1999

Debt

Portion of the premium portion of the exchange difference on 28-02-1998 allocated to the 1999 year of assessment R6 000 loss
(R12 000 x 3 ÷ 6)

Debt

Ruling exchange rates:

Date of previous translation (28-02-98)	6,4900
Date of realisation (31-05-1998)	6,5600

Exchange difference: R7 000 loss
[(6,4900 - 6,5600) x $100 000]

Forward exchange contract

Ruling exchange rates:

Date of previous translation (28-02-98)	6,4900
Date of realisation (31-05-1998)	6,5600

Exchange difference: R7 000 gain
[(6,4900 - 6,5600) x $100 000]

NET TAX RESULT R12 000 loss

(- R6 000 + R0 - R6 000 - R7 000 + R7 000)

RECONCILIATION

Cost price of stock on transaction date ($100 000 x 6,3700)	R637 000
Rands paid to purchase $100 000 on 31-05-1998 ($100 000 x 6,4900)	R649 000
Net loss	R 12 000

5.4 The debt was recorded on the transaction date at the forward rate, for accounting purposes. The stock was recorded at spot rate.

Accounting recording of the transaction

Dr Purchases (Stock)	R637 000	
Dr Premium on forward exchange contract	R 12 000	
Cr Creditor		R649 000

Although the creditor was recorded at the forward rate, the cost price of the stock purchased was fixed at the spot rate. The forward exchange contract was not recorded separately.

YEAR END 28-02-1998

Debt

Ruling exchange rates:

Transaction date (01-12-1997)	6,4900
Date of translation (28-02-1998)	6,4900

Exchange difference: R nil
[(6,4900 - 6,4900) x $100 000]

Premium:
[(6,4900 - 6,3700) x $100 000] R12 000

Note:

The premium of R12 000 complies with the provisions of section 24I(4)(b) and must be spread on a day-to-day basis over the period of the forward exchange contract.

Portion of the exchange difference allocated to the 1998 year of assessment R6 000 loss
(R12 000 x 3 ÷ 6)

Forward exchange contract

Ruling exchange rates:

Transaction date (01-12-1997)	6,4900
Date of translation (28-02-1998)	6,4900

Exchange difference: R nil
[(6,4900 - 6,4900) x $100 000]

YEAR END 28-02-1999

Debt

Portion of the premium portion of the exchange difference on 28-02-1998 allocated to the 1999 year of assessment R6 000 loss
(R12 000 x 3 ÷ 6)

Debt

Ruling exchange rates:

Date of previous translation (28-02-98)	6,4900
Date of realisation (31-05-1998)	6,5600

Exchange difference: [(6,4900 - 6,5600) x $100 000]	R7 000 loss

Forward exchange contract

Ruling exchange rates:

Date of previous translation (28-02-98)	6,4900
Date of realisation (31-05-1998)	6,5600

Exchange difference: [(6,4900 - 6,5600) x $100 000]	R7 000 gain

NET TAX RESULT	R12 000 loss

(+R0 - R6 000 - R6 000 - R7 000 + R7 000)

RECONCILIATION

Cost price of stock on transaction date ($100 000 x 6,3700)	R637 000
Rands paid to purchase $100 000 on 31-05-1998 ($100 000 x 6,4900)	R649 000
Net loss	R 12 000

EXAMPLE 6

DEBT (RECEIVABLE IN DOLLARS) HEDGED BY A FORWARD EXCHANGE CONTRACT FOR A PORTION OF THE PERIOD

On 1 December 1997 a South African company in the packaging industry concluded a contract with a business in America. In terms of the contract the company sold a used packaging machine for $300 000. Ownership was transferred on 10 January 1998 (date of accrual), on shipping of the machine. Settlement took place four months later on 10 May 1998. The company entered into a forward exchange contract on 1 February 1998 in terms of which $300 000 would be sold three months later on 1 May 1998 at a forward rate of 6,4900. The company's financial year ends on 28 February. The forward rate was used at year end to translate the debt for accounting purposes.

MARKET RATES FOR PURPOSES OF THE EXAMPLE			
DATE	SPOT RATE	FORWARD RATE	
	R/$	3 MONTHS	2 MONTHS
10-01-1998	6,4100		
01-02-1998	6,4300	6,4900	
28-02-1998	6,4500		6,5000
01-05-1998	6,5300		
10-05-1998	6,5400		

YEAR END 28-02-1998

Debt

Ruling exchange rates:

Transaction date (10-01-1998) 6,4100
Date of translation (28-02-1998) 6,4900

Exchange difference: R24 000 gain
[(6,4100 - 6,4900) x $300 000]

Note:

This exchange difference (gain) complies with the provisions of section 24I(5) and the premium on the forward exchange contract must be spread over the period of the forward exchange contract on a day-to-day basis.

Premium portion:

= [(6,4300 – 6,4900) x $300 000]
= R18 000

Portion of the exchange difference which is not a premium R6 000 gain
(R24 000 – R18 000) or ((6,4300 – 6,4100) x $300 000)

Portion of the premium allocated to the 1998 year of assessment (R18 000 ÷ 3)	R6 000 gain

Forward exchange contract

Ruling exchange rates:

Transaction date (01-02-1998)	6,4900
Date of translation (28-02-1998)	6,4900

Exchange difference: [(6,4900 - 6,4900) x $300 000]	R nil

YEAR END 28-02-1999

Debt

Portion of the premium of the exchange difference on 28-02-1998 allocated to the 1999 year of assessment (R18 000 ÷ 3 x 2)	R12 000 gain

Debt

Ruling exchange rates:

Date of previous translation (28-02-1998)	6,4900
Date of realisation (10-05-1998)	6,5400

Exchange difference: [(6,4900 - 6,5400) x $300 000]	R15 000 gain

Forward exchange contract

Ruling exchange rates:

Date of previous translation (28-02-1998)	6,4900
Date of realisation (01-05-1998)	6,5300

Exchange difference: [(6,4900 - 6,5300) x $300 000]	R12 000 loss

NET TAX RESULT	R27 000 gain

(+ R6 000 + R6 000 + R0 + R12 000 + R15 000 – R12 000)

RECONCILIATION

Selling price of machine on transaction date ($300 000 x 6,4100)	(R1 923 000)
Rands paid on 01-05-1998 to purchase dollars for delivery in terms of the forward exchange contract ($300 000 x 6,5300)	(R1 959 000)
Rands received on 01-05-1998 on the delivery of dollars in terms of the forward exchange contract ($300 000 x 6,4900)	R1 947 000
Rands received on 10-05-1998 on the sale of dollars received from the American business ($300 000 x 6,5400)	R1 962 000
Net gain	R 27 000

EXAMPLE 7

DEBT (RECEIVABLE IN DOLLARS) WHICH HAS BECOME IRRECOVERABLE, WAS WRITTEN OFF AND THEN PARTIALLY RECOVERED

On 1 November 1997 a South African company which manufactures vehicles delivered a consignment of 5 vehicles to a customer in Botswana. The selling price was $90 000 which was payable within 30 days. The customer was liquidated and on 28 February 1998 (end of the financial year) the company wrote off the full selling price. The company, however, received a payment of 50 cents in the dollar from the liquidator of the customer on 10 May 1998.

MARKET RATES FOR PURPOSES OF THE EXAMPLE	
DATE	SPOT RATE R/$
01-11-1997	6,3300
28-02-1998	6,4500
10-05-1998	6,5400

YEAR END 28-02-1998

Debt

Ruling exchange rates:

Transaction date (01-11-1997)	6,3300
Date of translation (28-02-1998)	6,4500

Exchange difference: [(6,3300 - 6,4500) x $90 000]	R10 800 gain

Bad debts

The debt would originally have been recorded at R569 700 calculated at the spot rate ($90 000 x 6,3300). The amount which could be written off on 28-02-1998 as irrecoverable in terms of section 11(i), is determined by translating the debt at the spot rate on the date of write-off (28-02-1998).

Bad debts on 28-02-1998	R580 500 loss
($90 000 x 6,4500) or (R569 700 + R10 800)	

Note:

As the debt is written-off as irrecoverable it is for practical purposes considered to have been realised and no further exchange differences will thereafter be taken into account for tax purposes, except in respect of that portion of the amount of the exchange item written-off which is recouped or recovered at a later stage.

YEAR END 28-02-1999

Bad debts recovered

Portion of the debt recovered	R294 300 recoupment
[($90 000 x 0.5) x 6,5400]	

The recoupment can be divided into two portions -

(1) Section 8(4)(a) recoupment *R290 250*

(R580 500 x 0.5)

(2) Exchange difference not calculated *R 4 050*

Ruling exchange rates:

Date written off	*6,4500*
Date recovered	*6,5400*

Exchange difference:

[(6,4500 - 6,5400) x ($90 000 x 0.5)]

R294 300

NET TAX RESULT R275 400 loss

(+ R10 800 - R580 500 + R294 300)

RECONCILIATION

Selling price of stock on transaction date ($90 000 x 6,3300)	(R569 700)
Rands received on 10-05-1998 on the sale of dollars received from the liquidator [($90 000 x 0.5) x 6,5400]	R294 300
Net loss	R275 400

EXAMPLE 8

CHANGE IN THE TYPE OF CURRENCY UNIT

On 1 November 1997 a taxpayer borrowed DM500 000 97 from a bank in Germany. The loan was repayable on 31 October 1998. On 1 May 1998 the taxpayer entered into an agreement with the bank that the loan was no longer repayable in German mark, but in US dollars, translated at the DM/$ spot rate on that date, namely DM1,6883/$1. The taxpayer's financial year ends on 28 February.

MARKET RATES FOR PURPOSES OF THE EXAMPLE		
DATE	SPOT RATE R/DM	SPOT RATE R/$
01-11-1997	3,5400	
28-02-1998	3,6300	
01-05-1998	3,6900	6,2298
31-10-1998		6,4850

YEAR END 28-02-1998

Loan (payable in German mark)

Ruling exchange rates:

Transaction date (01-11-1997)	3,5400
Date of translation (28-02-1998)	3,6300

Exchange difference:

[(3,5400 - 3,6300) x DM500 000] R45 000 loss

YEAR END 28-02-1999

Loan (payable in German mark)

Ruling exchange rates:

Previous date of translation (28-02-1998)	3,6300
Date of realisation (01-05-1998)	3,6900

(When the type of currency in which an exchange item is reflected, is changed, then it is considered to be a realisation of that exchange item and the creation of a new exchange item)

Exchange difference: [(3,6300 - 3,6900) x DM500 000]	R30 000 loss

Loan (payable in dollars)

Ruling exchange rates:

Transaction date (01-05-1998)	6,2298
Date of realisation (31-10-1998)	6,4850

(The new exchange item arises automatically on the realisation of the old exchange item)

Exchange difference: [(6,2298 - 6,4850) x (DM 500 000 ÷ 1,6883)]	R75 571 loss

NET TAX RESULT	R150 571 loss

(-R45 000 - R30 000 - R75 571)

RECONCILIATION

Rand equivalent on transaction date (DM 500 000 x 3,5400)	R 1 770 000
Rands paid on date of realisation [(DM 500 000 ÷ 1,6883) x 6,4850] = [$296 156 x 6,4850]	R1 920 571
Net loss	R 150 571

EXAMPLE 9

USE OF AVERAGE SPOT RATES TO RECORD DEBTS FOR ACCOUNTING PURPOSES

On 15 May 1998 a company which exports fruit delivered a consignment of fruit free-on-board to the Durban harbour. The selling price was $15 000 which was payable within 30 days. The company's financial year ends on 31 May. Immediately prior to the commencement of each month the company estimates an average exchange rate at which all export transactions are recorded on the transaction date. During April 1998 an average rand/dollar exchange rate of 6,2400 was estimated for the month of May 1998.

MARKET RATES FOR PURPOSES OF THE EXAMPLE	
DATE	SPOT RATE R/$
15-05-1998	6,4300
31-05-1998	6,4500
15-06-1998	6,4800

YEAR END 31-05-1998

	Normal method	**Average method**
Ruling exchange rates :		
Transaction date	6,4300	6,2400
Date of translation	6,4500	6,4500
Exchange difference :		
[(6,4300 - 6,4500) x $15 000]	+R 300	
[(6,2400 - 6,4500) x $15 000]		+R3 150
Tax result:		
Sales	R96 450	R93 600
Exchange difference	R 300	R 3 150
	R96 750	R96 750

YEAR END 31-05-1999

	Normal method	Average method
Ruling exchange rates:		
Date of previous translation	6,4500	6,4500
Date of realisation	6,4800	6,4800
Exchange difference:		
[(6,4500 - 6,4800) x $15 000]	+R 450	
[(6,4500 - 6,4800) x $15 000]		+R 450
Tax result:		
Exchange difference	R 450	R 450
	R 450	R 450

Note :

It is obvious from this example that the use of an average spot rate makes no difference in the net tax result, on condition that the transactions are in respect of the purchase and sale of trading stock.

EXAMPLE 10

POSTPONEMENT OF EXCHANGE DIFFERENCES IN TERMS OF SECTION 24I(7), IN THE CASE OF A MANUFACTURER

The borrower is a South African company which manufactures crockery and pottery sets. On 31 May 1998 the company made a drawdown on a foreign loan facility arranged with a bank in Frankfurt, Germany to finance a kiln and as well as special clay used as raw material in the manufacturing process. On that date the supplier of the kiln was paid DM 375 000 and the supplier of the clay was paid DM 125 000. The loan bore interest at 8% and was repayable on 30 November 1998. The kiln was commissioned on 1 September 1998. The company's financial year ends on 31 August.

MARKET RATES FOR PURPOSES OF THE EXAMPLE	
DATE	SPOT RATE R/DM
31-05-1998	3,7000
31-08-1998	3,6800
30-11-1998	3,7500

YEAR END 31-08-1998

Loan (DM500 000)

Ruling exchange rates:

Transaction date (31-05-1998)	3,7000
Date of translation (31-08-1998)	3,6800

Exchange difference: R10 000 gain
[(3,7000 - 3,6800) x DM500 000]

Interest incurred on the loan at the end of the year (DM10 000)

Ruling exchange rates:

Transaction date (31-08-1998)	3,6800
Date of translation (31-08-1998)	3,6800

Exchange difference: R nil
[(3,6800 - 3,6800) x DM10 000]

Note:

As the kiln had not been brought into use at the end of the year of assessment, all exchange differences shall be postponed and be taken into account in the year the kiln is brought into use for the purposes of the taxpayer's trade.

Portion of exchange difference carried forward to the 1999 year of assessment: R7 500 gain
(R10 000 x DM375 000 ÷ DM500 000)

Note:

As DM125 000 of the loan of DM500 000 was not utilised for the acquisition of the kiln, which qualifies in terms of section 24I(7)(a)(i), that portion of the exchange difference may not be postponed.

Portion of exchange difference included in income in the 1998 year of assessment R2 500 gain
(R10 000 - R7 500)

YEAR END 31-08-1999

Loan (DM510 000)

Ruling exchange rates:

Date of previous translation (31-08-1998)	3,6800
Date of realisation (30-11-1998)	3,7500

Exchange difference: R35 700 loss
[(3,6800 - 3,7500) x DM510 000]

Portion of exchange difference which is carried over from the 1998 year of assessment:	R7 500 gain

Note:

The kiln was brought into use during the year, for purposes of trade. No further postponement takes place.

Interest incurred on the loan during the year (DM10 000)

Ruling exchange rates:

Transaction date (30-11-1998)	3,7500
Date of realisation (30-11-1998)	3,7500

Exchange difference: [(3,7500 - 3,7500) x DM10 000]	R nil
NET TAX RESULT	R25 700 loss

(+ R2 500 - R35 700 + R7 500)

RECONCILIATION

Rand equivalent of loan on transaction date (DM500 000 x 3,7000)	R1 850 000
Interest incurred (DM10 000 x 3,6800) + (DM10 000 x 3,7500)	R74 300
Rands used to repay the loan of DM520 000 on 30-11-1998 (DM520 000 x 3,7500)	(R1 950 000)
Net loss	R 25 700

EXAMPLE 11

POSTPONEMENT OF EXCHANGE DIFFERENCES IN TERMS OF SECTION 24I(7), IN THE CASE OF A MINING COMPANY

On 1 October 1997 a company conducting mining activities signed a contract for the purchase of a new mineral processing plant to the value of $4 000 000. The plant qualifies as capital expenditure in terms of section 36 of the Act.

The expected completion date of the plant was 1 February 1998. The contract value was reduced by 2% for every extra full month the contractor took to complete the contract, after the expected completion date. The debt became due on completion of the contract and had to be settled immediately.

On 1 October 1997 the company entered into a forward exchange contract in order to hedge the current Rand-cost of the plant against future exchange rate movements, namely:

Value	Period	Maturity date
$4 000 000	4 months	1 February 1998

The contractor completed the contract only on 10 March 1998. Consequently the contract value was reduced by $80 000 ($4 000 000 x 2%). For purposes of the example the expenditure is considered to have been incurred on the date the contract was completed, i.e. 10 March 1994.

The company's financial year ends on 28 February. It had a loss of R600 000 (100% in respect of mining) in its 1998 year of assessment and an income of R1 000 000 (100% in respect of mining) in the 1999 year of assessment, before the aforementioned transactions were taken into account.

The plant was brought into use on 10 March 1998.

MARKET RATES FOR PURPOSES OF THE EXAMPLE		
DATE	SPOT RATE R/$	FORWARD RATE (contract period)
01-10-1997	5,3000	5,3600 (4 months)
01-02-1998	5,4000	
28-02-1998	5,4500	
01-03-1998	5,4600	

YEAR END 28-02-1998

Debt ($4 000 000)

As the contract had not been completed, it is considered, for purposes of the example, that the debt had not been incurred and therefore no exchange difference is to be calculated. Because the contractor completed the contract only on 10 March 1998 the contract value was reduced by $80 000 ($4 000 000 x 2%).

Forward exchange contract

Ruling exchange rates:

Transaction date (01-10-1997)	5,3600
Date of realisation (01-02-1998)	5,4000

Exchange difference:	R160 000 gain
[(5,3600 - 5,4000) x $4 000 000]	

Note:

Section 24I(7) provides inter alia that, to the extent that a forward exchange contract was entered into to serve as a hedge for a debt to be incurred for the utilisation thereof to acquire, for example plant and machinery, the exchange difference arising from the forward exchange contract is to be carried forward until the plant and machinery has been brought into use for purposes of the taxpayer's trade.

Furthermore, section 24I(7) contains a proviso which makes that section subject to the provisions of section 36 of the Act. However, as no capital expenditure has been incurred during the current year of assessment in terms of section 15 read with section 36, that proviso is not yet operative and the carry-forward of the exchange difference remained valid.

Portion of exchange difference carried forward to the 1999 year of assessment:	R156 800 gain
(R160 000 x $3 920 000 ÷ $4 000 000)	

Note:

An amount of $80 000 of the total value of the forward exchange contract of $4 000 000 was not related or did not match the debt of $3 920 000 which was incurred in the following tax year.

Portion of exchange difference included in income in the current year of assessment	R3 200 gain
(R160 000 - R156 800)	

Tax calculation on 28-02-1998

Loss before these transactions	(R600 000)
Exchange difference:	
Forward exchange contract	R3 200
(R160 000 gain, less R156 800 carried forward to 1999)	
Loss from mining	(R596 800)
Section 36 deduction	R nil
(No capital expenditure was incurred. Therefore no expenditure qualifies for a deduction in terms of section 15 read with section 36)	
Assessed loss	(R596 800)

YEAR END 28-02-1999

Debt ($4 000 000 - 2%)

Ruling exchange rates:

Transaction date (10-03-1998)	5,4600
Date of realisation (10-03-1998)	5,4600

Exchange difference: [(5,4600 - 5,4600) x $3 920 000]	R nil

Forward exchange contract

Portion of exchange difference which is carried over from the 1998 year of assessment:	R156 800 gain

Note:

The mineral processing plant had still not been taken into use for purposes of trade, but, because the acquisition cost of the plant was incurred as capital expenditure in this year the proviso in section 24I(7) becomes operative and the exchange difference is not postponed further.

Tax calculation on 28-02-1999

Income before these transactions		R1 000 000
Exchange differences:		
Debt		R nil
Forward exchange contract (carried forward from 1998)		R156 800
Assessed loss brought forward from previous year (The exchange differences relating to the forward exchange contract are deemed to be closely related to the mining activities and the income from mining is therefore adjusted to determine the section 36 deduction)		(R596 800)
Income from mining		R560 000
Section 36 deduction		(R560 000)
Acquisition cost of plant ($3 920 000 x 5,4600)	R21 403 200	
Less: Utilised this year	(R560 000)	
Carried forward to 2000 (The acquisition cost of the plant was incurred in this year and qualifies for a deduction in terms of section 15 read with section 36 but only to the extent that there is taxable income from mining from that specific mine)	R20 843 200	
Taxable income		R nil

COST OF MINERAL PLANT

($3 920 000 x 5,4600)	R21 403 200

NET TAX RESULT (Exchange differences)

(R3 200 + R156 800)	R160 000 gain

RECONCILIATION

Cost of mineral plant (See calculation above)	R21 403 200
Rands paid to purchase $4 000 000 on 01-02-1998 ($4 000 000 x 5,3600)	(R21 440 000)
Rands received on the sale of $4 000 000 on 01-02-1998 ($4 000 000 x 5,4000)	R21 600 000
Rands paid to purchase $3 920 000 on 10-03-1998 ($3 920 000 x 5,4600)	(R21 403 200)
Net gain	R 160 000

EXAMPLE 12

IDENTIFICATION OF THE PREMIUM OR DISCOUNT PORTION OF AN EXCHANGE ITEM IN TERMS OF SECTION 24I(5)

The taxpayer imported stock to the value of $100 000. He took delivery of the stock on 01-01-1998, on which date he became liable for the purchase price. The debt was payable on 30-04-1998. The taxpayer took out a forward exchange contract on 28-02-1998. In terms of this contract he would purchase $100 000 on 30-04-1998 at a forward rate of 5,4900. The taxpayer's financial year ends on 28 February.

MARKET RATES FOR PURPOSES OF THE EXAMPLE	
DATE	SPOT RATE R/$
01-01-1998	5,4000
28-02-1998	5,4500
30-04-1998	5,5300

YEAR END 28-02-1998

Debt

Ruling exchange rates:

Transaction date (01-01-1998)	5,4000
Date of translation (28-02-1998)	5,4900

Exchange difference: R9 000 loss
[(5,4000 - 5,4900) x $100 000]

Note:

This exchange difference is determined by using the spot rate as the ruling exchange rate on the transaction date and the forward rate as the ruling exchange rate on the date of translation. This exchange difference therefore complies with one of the four possible circumstances, as envisaged in section 24I(5) and the premium portion of that exchange difference must be spread, on a day-to-day basis, over the period of the forward exchange contract.

Premium portion:

= *[(Spot rate on the date when the forward exchange contract is entered into) - (Forward rate)] x Foreign currency amount*
= *[5,4500 - 5,4900] x $100 000*
= *R4 000*

Portion of the premium deductible on 28-02-1998 R nil
[R4 000 x (nil months ÷ 4 months)]

Portion of the exchange difference which is not the premium portion R5 000 loss
(R9 000 - R4 000)

Note:

The portion of the exchange difference which is not a premium represents the exchange gain or exchange loss which arose during the period for which the loan, advance or debt was not hedged by the forward exchange contract. In this case the period from 01-01-1998 (5,4000) to 28-02-1998 (5,4500) with a consequential loss of R5 000 [(5,4000 - 5,4500) x $100 000].

Forward exchange contract

Ruling exchange rates:

Transaction date (28-02-1998)	5,4900
Date of translation (28-02-1998)	5,4900

Exchange difference: R nil
[(5,4900 - 5,4900) x $100 000]

YEAR END 28-02-1999

Debt

Portion of the premium portion of the exchange difference on 28-02-1998 allocated to the 1999 year of assessment (R4 000 x 4 ÷ 4)		R4 000 loss

Debt

Ruling exchange rates:

Date of previous translation (28-02-1998)	5,4900	
Date of realisation (30-04-1998)	5,5300	
Exchange difference: [(5,4900 - 5,5300) x $100 000]		R4 000 loss

Forward exchange contract

Ruling exchange rates:

Date of previous translation (28-02-1998)	5,4900	
Date of realisation (30-04-1998)	5,5300	
Exchange difference: [(5,4900 - 5,5300) x $100 000]		R4 000 gain

NET TAX RESULT R9 000 loss

(- R5 000 - R4 000 - R4 000 + R4 000]

RECONCILIATION

Cost price of stock on transaction date ($100 000 x 5,4000)	R540 000
Rands paid to purchase $100 000 on 30-04-1998 ($100 000 x 5,4900)	R549 000
Net loss	R 9 000

EXAMPLE 13

DEFERRAL OF EXCHANGE DIFFERENCES IN RESPECT OF A QUALIFYING LOAN OR ADVANCE

A South African company borrowed $200 000 interest free from it's foreign holding company on 1 April 1995 to expand it's trading activities in the Republic. On 30 June 1996 the loan was converted to a loan denominated in pound sterling. The conversion took place at an exchange rate of $1,5000/£1. On 9 November 1997 the company repaid £100 000 of the loan. The company's financial year ends on 31 December.

SPOT RATES FOR PURPOSES OF THE EXAMPLE		
DATE	R/$	R/£
01-04-1995	3,5500	
31-12-1995	3,6000	5,5800
30-06-1996	3,7500	5,6200
31-12-1996	3,7800	5,6600
9-11-1997		5,7200
31-12-1997		5,7800

YEAR END 31-12-1995

Loan ($200 000)

Ruling exchange rates:

Transaction date (01-04-1995)	3,5500
Date of translation (31-12-1995)	3,6000

Exchange difference:
[(3,5500 - 3,6000) x $200 000] R10 000 loss

Note:

The loan complies with all the requirements for a qualifying exchange item. Therefore any exchange difference arising from such loan is spread in terms of section 24I(7A)(a)

Portion of exchange difference deductible from income in the 1995 year of assessment R1 000 loss
[R10 000 x 10%]

Exchange difference to be deducted in following years R9 000 loss
[R10 000 - R1 000]

YEAR END 31-12-1996

Three alternatives are available for dealing with the conversion of the dollar loan to a loan in pound sterling, depending on the rates applied. The different alternatives do, however, have the same result.

<u>ALTERNATIVE 1</u>

Loan ($200 000)

Ruling exchange rates:

Date of previous translation (31-12-1995)	3,6000
Date of deemed realisation (30-06-1996)	3,7500

Exchange difference:

[(3,6000 - 3,7500) x $200 000]	R30 000 loss

Loan (£133 333)

Ruling exchange rates:

Transaction date (30-06-1996)	5,6200
Date of translation (31-12-1996)	5,6600

Exchange difference:

[(5,6200 - 5,6600) x $133 333]	R5 333 loss

GAIN ON CONVERSION

Rand equivalent of $200 000 on date of conversion [$200 000 x 3,7500]	R750 000
Rand equivalent of £133 333 on date of conversion [£133 333 x 5,6200]	R749 333
	R 667

Portion of exchange difference deductible from income in the 1996 year of assessment [(- R9 000 - R30 000 - R5 333 + R667) x 10%]	R4 367 loss
Deferred amount of exchange differences to be deducted in following years [R43 666 - R4 367]	R39 299 loss

ALTERNATIVE 2

Loan ($200 000)

Ruling exchange rates:

Date of previous translation (31-12-1995)	3,6000
Date of deemed realisation (30-06-1996)	3,7467
(See calculation 1)	

Exchange difference:	
[(3,6000 - 3,7467) x $200 000]	R29 333 loss

Loan (£133 333)

Ruling exchange rates:

Transaction date (30-06-1996)	5,6200
Date of translation (31-12-1996)	5,6600

Exchange difference:	
[(5,6200 - 5,6600) x $133 333]	R5 333 loss
Portion of exchange difference deductible from income	
in the 1996 year of assessment	R4 367 loss
[(- R9 000 - R29 333 - R5 333) x 10%]	
Deferred amount of exchange difference to be	
deducted in following years	R39 299 loss
[R43 666 - R4 367]	

ALTERNATIVE 3

Loan ($200 000)

Ruling exchange rates:

Date of previous translation (31-12-1995)	3,6000
Date of deemed realisation (30-06-1996)	3,7500

Exchange difference:	R30 000 loss
[(3,6000 - 3,7500) x $200 000]	

Loan (£133 333)

Ruling exchange rates:

Transaction date (30-06-1996) *(See calculation 2)*	5,6250
Date of translation (31-12-1996)	5,6600

Exchange difference:
[(5,6250 - 5,6600) x $133 333] R4 666 loss

Portion of exchange difference deductible from income in the 1996 year of assessment R4 367 loss
[(- R9 000 - R30 000 - R4 666) x 10%]

Deferred amount of exchange differences to be deducted in following years R39 299 loss
[R43 666 - R4 367]

Calculations *:*

(1)	*Amount received on disposal of dollar loan*	*R749 333*
	Foreign currency amount of loan	*$200 000*
	Disposal rate (R749 333 ÷ $200 000)	*3,7467*
(2)	*Costs incurred to acquire pound sterling loan*	*R750 000*
	Foreign currency amount of loan	*£133 333*
	Acquisition rate (R750 000 ÷ £133 333)	*5,6250*

COMPARISON OF GAIN AND LOSSES FOR THE YEAR IN RESPECT OF THE ALTERNATIVE TREATMENT OF THE CONVERSION			
ITEM	ALTERNATIVE 1	ALTERNATIVE 2	ALTERNATIVE 3
Realised dollar loan	(30 000)	(29 333)	(30 000)
Profit on conversion	667	-	-
Translation of £ - loan	(5 333)	(5 333)	(4 666)
Total	(34 666)	(34 666)	(34 666)

YEAR END 31-12-1997

Loan (£100 000)

Ruling exchange rates:

Date of previous translation (31-12-1996)	5,6600
Date of realisation (9-11-1997)	5,7200

Exchange difference: R6 000 loss
[(5,6600 - 5,7200) x $100 000]

Note:

As the portion of the loan which is repaid is not a qualifying exchange item, the provisions of section 24I(7A) do not apply and the full exchange difference calculated must be brought into account as taxable income

Unclaimed exchange differences brought forward from previous year R39 299 loss

Reduction in terms of s 24I(7A)*(d)*(i) deductible in current year R29 474 loss
[(100 000 ÷ 133 333) x 39 299]

Loan (£33 333)

Ruling exchange rates:

Date of previous translation (31-12-1996)	5,6600
Date of translation (31-12-1997)	5,7800

Exchange difference: R4 000 loss
[(5,6600 - 5,7800) x $33 333]

Portion of exchange difference deductible from income in the 1997 year of assessment R1 383 loss
[((-R39 299 + R29 474) - R4 000) x 10%]

Deferred amount of exchange difference to be deducted in following years R12 442 loss
[R13 825 - R1 383]

NET TAX RESULT R42 224 loss

(- R1 000 - R4 367 - R6 000 - R29 474 - R1 383)

RECONCILIATION

Rands received on transaction date ($200 000 x 3,5500)	R710 000
Rands used to repay £100 000 (£100 000 x 5,7200)	(R572 000)
Balance of deferred exchange differences on 31-12-1997	R12 442
Rand equivalent of loan on 31-12-1997 (£33 333 x 5,7800)	(R192 666)
Net loss	R 42 224

EXAMPLE 14

TRANSITIONAL EXCHANGE DIFFERENCE

On 1 September 1991 the taxpayer imported bicycles to the value of $900 000. The debt was payable in three equal instalments of $300 000 each, payable on the first day of September in 1992, 1993 and 1994. The taxpayer's financial year ends on 28 February. The cost of the stock was determined on 28 February 1992 by using the spot rate on that date, in accordance with the principles laid down in the case of Caltex Oil (SA) Ltd v CIR 1975 (1) SA 665 AD (37 SATC 1). Realised exchange differences were taken into account on 28 February 1993 for tax purposes. The taxpayer claimed an amount of R60 000 as an exchange loss in terms of section 24B on payment of the first instalment of $300 000. All the stock was sold by 28 February 1993.

(In the above-mentioned court case, the court held that, where a debt in respect of imported stock was still outstanding at the end of the year of assessment in which such debt was incurred, the cost of such imported stock must be determined by using the ruling spot rate at the end of such year of assessment)

MARKET RATES FOR PURPOSES OF THE EXAMPLE		Outstanding debt
DATE	SPOT RATE R/$	
01-09-1991	2,5000	$900 000
28-02-1992	2,6500	$900 000
01-09-1992	2,8500	$600 000
28-02-1993	3,0500	$600 000
01-09-1993	3,2500	$300 000
28-02-1994	3,4500	$300 000
01-09-1994	3,6400	$ nil

The taxpayer's first financial year end after 1 January 1994 was 28 February 1994. The date of commencement of section 24I for the taxpayer was therefore 1 March 1993. The transitional exchange difference must be determined in respect of the debt which was still unrealised on 28 February 1993. On 28 February 1993 $600 000 of the debt was still unrealised ($900 000 less the first payment of $300 000 on 1 September 1992).

Transitional exchange difference

Ruling exchange rates:

Transaction date (01-09-1991)	2,5000
Day prior to date of commencement (28-02-1993)	3,0500

Transitional exchange difference: [(2,5000 - 3,0500) × $600 000]	R330 000 loss

Note:

A portion of this transitional exchange difference has already been taken into account for tax purposes in that the cost of stock was determined on 28 February 1992 at the spot rate on such date.

Portion of the transitional exchange difference already taken into account for tax purposes:

Value of debt on transaction date ($900 000 × 2,5000)	R2 250 000
Cost of stock ($900 000 × 2,6500)	R2 385 000
Increased deduction	R 135 000

Adjusted transitional exchange difference [R330 000 - (R135 000 × $600 000 ÷ $900 000)]	R240 000

The transitional exchange difference is taken into account for tax purposes, in terms of the phasing in provisions of section 24I(3):

	Year of assessment	
	28-02-1994	28-02-1995
Portion of the transitional exchange difference realised in the first year of assessment after the date of commencement is taken into account in that year of assessment (R240 000 × $300 000 ÷ $600 000)	R120 000	
Portion of transitional exchange difference unrealised at the end of the first year of assessment after the date of commencement: (a) 50% of that portion is taken into account in the first year of assessment after the date of commencement [50% × (R240 000 × $300 000 ÷ $600 000)] (b) 50% of that portion is taken into account in the succeeding year of assessment	R60 000	R60 000

Note:

Any exchange difference in respect of that portion of the debt which was still outstanding at the beginning of the first year of assessment ending on or after 1 January 1994 (the commencement date of section 24I), arising after such date, must be brought into account in terms of that section as a normal exchange difference.

YEAR END 28-02-1993

Debt - paid

Claim in terms of section 24B — R60 000 loss
((2,8500 - 2,6500) x $300 000)

Cost of stock — R135 000 loss

See calculation above

YEAR END 28-02-1994

Debt - paid

Ruling exchange rates:

Date of first translation (28-02-1993)	3,0500
Date of realisation (01-09-1993)	3,2500

Exchange difference: — R60 000 loss
[(3,0500 - 3,2500) x $300 000]

Debt - outstanding

Ruling exchange rates:

Date of first translation (28-02-1993)	3,0500
Date of translation (28-02-1994)	3,4500

Exchange difference: R120 000 loss
[(3,0500 - 3,4500) x $300 000]

Transitional exchange difference R60 000 loss

See calculation in table above

YEAR END 28-02-1995

Debt - paid

Ruling exchange rates:

Date of previous translation (28-02-1994)	3,4500
Date of realisation (01-09-1994)	3,6400

Exchange difference: R57 000 loss
[(3,4500 - 3,6400) x $300 000]

Transitional exchange difference R60 000 loss

See calculation in table above

NET TAX RESULT R672 000 loss

(- R60 000 - R135 000 - R60 000 - R120 000 - R60 000
- R57 000 - R60 000)

RECONCILIATION

Cost price of stock on transaction date ($900 000 x 2,5000)	R2 250 000
Rands used to pay for $300 000 on 01-09-1992 ($300 000 x 2,8500)	(R855 000)
Rands used to pay for $300 000 on 01-09-1993 ($300 000 x 3,2500)	(R975 000)
Rands used to pay for $300 000 on 01-09-1994 ($300 000 x 3,6400)	(R1 092 000)
Net loss	R672 000

EXAMPLE 15

ROLL-OVER OF A FORWARD EXCHANGE CONTRACT

On 1 May 1996 a company which specialises in the transport of liquid chemicals ordered a special delivery vehicle from the United States of America. The vehicle was to be delivered and brought into use in May 1998. The purchase price of the vehicle was fixed at $200 000. An amount of $100 000 was payable on 1 May 1996 and $100 000 on 30 April 1998. The company entered into a forward exchange contract on 1 May 1996. In terms of this contract $100 000 would be purchased on 30 April 1997, at a forward rate of 4,6000. On 30 April 1997 the forward exchange contract was realised and a new forward exchange contract was entered into. In terms of the latter contract $100 000 would be purchased on 30 April 1998 at a forward rate of 5,9200. (In other words the first forward exchange contract was rolled over). The company's financial year ends on 30 April.

MARKET RATES FOR PURPOSES OF THE EXAMPLE		
DATE	SPOT RATE R/$	FORWARD RATE
01-05-1996	4,3500	4,6000 (12 months)
30-04-1997	5,6600	5,9200 (12 months)
30-04-1998	6,8700	

YEAR END 30-04-1997

Debt

Ruling exchange rates:

Transaction date (1-05-1996)	4,3500
Date of translation (30-04-1997)	5,6600

Exchange difference postponed in terms of section 24I(7)*(a)* to 1999 year of assessment [(4,3500 - 5,6600) x $100 000]	R131 000 loss

Forward exchange contract # 1

Ruling exchange rates:

Transaction date (1-05-1996)	4,6000
Date of realisation (30-04-1997)	5,6600

Exchange difference postponed in terms of section 24I(7)*(b)* to 1999 year of assessment — R106 000 gain
[(4,6000 - 5,6600) x $100 000]

Forward exchange contract # 2

Ruling exchange rates:

Transaction date (30-04-1997)	5,9200
Date of translation (30-04-1997)(market-related rate)	5,9200

Exchange difference: — R nil
[(5,9200 - 5,9200) x $100 000]

Note:

The provisions of section 24I(7) are applicable and the loss of R131 000 and the gain of R106 000 should, in terms of section 24I, be brought into account I as exchange differences in the year of assessment the vehicle is ***brought into use****.*

YEAR END 30-04-1998

Debt

Ruling exchange rates:

Date of previous translation (30-04-1997)	5,6600
Date of realisation (30-04-1998)	6,8700

Exchange difference postponed in terms of section 24I(7)*(a)* to the 1999 year of assessment: — R121 000 loss
[(5,6600 - 6,8700) × $100 000]

Forward exchange contract # 2

Ruling exchange rates:

Date of previous translation (30-04-1997)	5,9200
Date of realisation (30-04-1998)	6,8700

Exchange difference postponed in terms of section 24I(7)*(b)* to the 1999 year of assessment: — R95 000 gain
[(5,9200 - 6,8700) × $100 000]

YEAR END 30-04-1999

Exchange difference carried forward from the 1997 and 1998 years of assessment (- R131 000 + R106 000 - R121 000 + R95 000)	R51 000 loss

NET TAX RESULT R51 000 loss

RECONCILIATION

Cost price of a vehicle on 1 May 1996 ($200 000 x 4,3500)	R870 000
Rands used for first $100 000 payment ($100 000 x 4,3500)	(R435 000)
Rands received on realisation of first forward exchange contract	R106 000
Rands used for second $100 000 payment ($100 000 x 5,9200)	(R592 000)
Net loss	R51 000

EXAMPLE 16

AFFECTED CONTRACT IN RESPECT OF INTEREST

On 1 July 1997 a company which manufactures prescription medicines purchased equipment to be used in its production process. The purchase price of the equipment was fixed at $300 000. An amount of $200 000 was payable on 1 July 1997 and $100 000 on 31 December 1997. Interest of 12% per annum was charged on the instalment of $100 000 from 1 July 1997 and was payable on 31 December 1997. The company entered into a forward exchange contract on 1 July 1997. In terms of the contract the company would purchase $106 000 on 31 December 1997, at a forward rate of 4,7000. The company's financial year ends on 31 August. The company recorded the transaction at forward rates.

MARKET RATES FOR PURPOSES OF THE EXAMPLE	
DATE	SPOT RATE R/$
01-07-1997	4,6500
31-08-1997	4,6800
31-12-1997	4,7500

YEAR END 31-08-1997

Debt (paid)

Ruling exchange rates:

Transaction date (01-07-1997)	4,6500
Date of realisation (01-07-1997)	4,6500

Exchange difference: R nil
[(4,6500 - 4,6500) x $200 000]

Debt (outstanding capital)

Ruling exchange rates:

Transaction date (01-07-1997)	4,7000
Date of translation (31-08-1997)	4,7000

Exchange difference: R nil
[(4,7000 - 4,7000) x $100 000]

Debt (interest incurred until 31-8-1997)

Ruling exchange rates:

Transaction date (31-08-1997)	4,7000
Date of translation (31-08-1997)	4,7000

Exchange difference: R nil
[(4,7000 - 4,7000) × ($100 000 × 12% × 2 ÷ 12 months)]

Note:

Although interest accrues from 1-07-1997, the transaction date is assumed to be 31-08-1997.

Forward exchange contract

Ruling exchange rates:

Transaction date (1-07-1997)	4,7000
Date of translation (31-08-1997)	4,7000

Exchange difference: R nil
[(4,7000 - 4,7000) x $106 000]

Note:

As the forward rate of the forward exchange contract was used to record the debt and interest incurred and the forward exchange contract qualifies as an affected contract in respect of the interest not yet incurred at the end of the year of assessment, the forward rate in terms of the forward exchange contract may be used as the ruling exchange rate on translation of the forward exchange contract, in terms of paragraph (b)(ii) of the definition of "ruling exchange rate".

YEAR END 31-08-1998

Debt (balance outstanding as at 31-08-1997, paid on 31-12-1997)

Ruling exchange rates:

Date of previous translation (31-08-1997)	4,7000	
Date of realisation (31-12-1997)	4,7500	
Exchange difference: [(4,7000 - 4,7500) x ($100 000 + $2 000 interest incurred)]		R5 100 loss

Debt (interest accrued from 31-08-1997, paid on 31-12-1997)

Ruling exchange rates:

Transaction date (31-12-1997)	4,7000	
Date of realisation (31-12-1997)	4,7500	
Exchange difference: [(4,7000 - 4,7500) x $4 000]		R200 loss

Note:

Although interest accrues from 1-09-1997, the transaction date is assumed to be 31-12-1997.

Forward exchange contract

Ruling exchange rates:

Date of previous translation (31-08-1997)	4,7000	
Date of realisation (31-12-1997)	4,7500	
Exchange difference: [(4,7000 - 4,7500) x $106 000]		R5 300 gain

NET TAX RESULT — R nil

(+ R0 + R0 + R0 + R0 - R5 100 - R200 + R5 300)

Note:
The effect of the application of the forward rate to translate the affected forward exchange contract is that the net exchange difference on the transaction is nil.

EXAMPLE 17

ILLUSTRATION OF HOW, FOR TAX PURPOSES, A GAIN MADE BETWEEN A FORWARD EXCHANGE CONTRACT AND AN UNDERLYING POSITION ($50 000) IS TAKEN INTO ACCOUNT EVENLY OVER THE PERIOD OF THE FORWARD EXCHANGE CONTRACT, BY USING THE MARKET RELATED FORWARD RATE

A bank concluded a forward exchange contract on 1 March 1995 with a client. In terms of the contract the bank will sell $50 000 on 28 February 1999, at a forward rate of 4,6500. On 1 March 1995 the bank also purchased $50 000 at the spot rate on that date, which amount of dollars would be delivered to the client on 28 February 1999. The bank's financial year ends at the end of February.

MARKET RATES FOR PURPOSES OF THE EXAMPLE			
DATE	SPOT RATE R/$	CALCULATED MARKET RELATED FORWARD RATE (remaining period)	DETERMINATION OF FORWARD RATE
01-03-1995	3,0500	4,6500 (4 years)	[3,0500 + (4,6500 -3,0500) x 4 ÷ 4]
29-02-1996	3,7500	4,9500 (3 years)	[3,7500 + (4,6500 -3,0500) x 3 ÷ 4]
28-02-1997	4,7600	5,5600 (2 years)	[4,7600 + (4,6500 -3,0500) x 2 ÷ 4]
29-02-1998	5,1500	5,5500 (1 years)	[5,1500 + (4,6500 -3,0500) x 1 ÷ 4]
28-02-1999	6,5000	6,5000 (0 years)	[6,5000 + (4,6500 -3,0500) x 0 ÷ 4]

Note:

The market related forward rates for the remaining periods of the forward exchange contract are determined on each date of translation by dividing the premium in respect of that forward exchange contract, over the period thereof, on a straight line basis (see method 2 in example 2).

YEAR END	EXCHANGE DIFFERENCES		
	CASH BALANCE ($50 000)	FORWARD EXCHANGE CONTRACT	NET
29-02-1996	[1]+R35 000	[2]-R15 000	+R20 000
28-02-1997	+R50 500	-R30 500	+R20 000
29-02-1998	+R19 500	+R500	+R20 000
28-02-1999	+R67 500	-R47 500	+R20 000
TOTAL	+R172 500	-R92 500	+R80 000

Note:

The net exchange difference represents the gain made, which is evenly spread over the period of the forward exchange contract.

Calculations:

1. [(3,0500 - 3,7500) x $50 000]
2. [(4,6500 - 4,9500) x $50 000]

RECONCILIATION

Rands paid by the bank on transaction date to purchase dollars ($50 000 x 3,0500)	R152 500
Rands received from the client on the maturity date of the forward exchange contract ($50 000 x 4,6500)	R232 500
Net gain	R 80 000