Part (a) Discuss the income tax implications of the following legal costs: **(i) Whether the legal costs paid by Makiti to Le Roux Attorneys for the drafting of the restraint of trade agreement may be deducted by Makiti. Assume the current tax legislation applies for all relevant years of assessment.** **Assume the current tax legislation applies for all relevant years of assessment.**	**Marks**
Special deductions take precedence over the general deduction (section 11(a) in terms of s23B. The R13 000 incurred by Makiti to prepare the restraint of trade agreement (RoT), Makiti would **not be allowed** a **deduction under s11(c)** as the drafting of the RoT agreement is **not incurred** *'in respect of any claim, dispute or action at law'*.	1
Therefore, the **general deduction in terms of section 11(a)** of the Income Tax Act must be considered.	1
While the RoT expense was incurred for purposes of trade, **no close connection** / ***no necessary concomitant*** exists between the cost to draft a RoT agreement	1P
and Makiti's **income-earning business activities** to operate as an auditing and advisory company. *(PE Electric Tramway case)*	1P
Essentially the RoT agreement **will protect Makiti's income-earning structure** as it will ensure that the technical know-how and possibility of competition/competitors. *(New State Areas case).*	1P
Therefore, the R13 000 legal costs would also not qualify for a deduction under s11(a) because it was not incurred in the production of income and **is capital in nature.**	1P
Available	**6**
Maximum for part (a)(i)	**4**

Part (a) Discuss the income tax implications of the following legal costs: **(ii) Whether Makiti may deduct the legal costs relating to the sexual harassment labour court case; and** **Assume the current tax legislation applies for all relevant years of assessment.**	**Marks**
Legal fees paid by Makiti Makiti has paid/incurred R39 000 **in legal fees to defend against a claim of damages** the CCMA. This action falls under the provision of *s11(c).*	1
The legal expenses of R39 000 were actually incurred in respect of a claim that arose during an out of town audit **in the course of, or during the ordinary operations undertaken by Makiti** as an employer.	1
The R39 000 is **not of a capital nature** because it was incurred in relation to a claim more **closely related to Makiti's income-producing operations**, not its income-producing structure, due to the prevalence of labour-related issues in any work environment.	1P
In terms of proviso (ii) to section 11(c) the nature of the legal cost must be investigated. As an employer, Makiti has an obligation to ensure the **safety and well-being of its employees**, as well as to have a statutory obligation to maintain a discrimination-free workplace. The expenses are thus incurred for purposes of trade and in the production of income and **closely linked to the business operations**.	1P
In <u>conclusion,</u> the legal costs of R39 000 would be **deductible** under **s11(c)** as they were **incurred to defend a claim** in a court of law arising in the course of or by reason of the ordinary operations undertaken by Makiti in the carrying on of the audit and consulting trade.	1P

Damages and legal fees of Sarah The R800 000 for damages and R37 500 for Sarah's legal costs are both **expenses that resulted from the claim.**	1
Both expenses are part of the i**ncome-producing structure** and not capital in nature, thus may qualify for a deduction under s11(a)**.**	1P
The **resultant expenses** (damages and legal cost) would be deductible **under s11(a).**	1P
Available	**8**
Maximum for part (a)(ii)	**5**

Part (a) Discuss the income tax implications of the following legal costs: **(iii) Whether Sarah may deduct her legal costs relating to the sexual harassment case.** • **Assume the current tax legislation applies for all relevant years of assessment.**	**Marks**
Sarah is a **non-commission earning employee**, earning remuneration, therefore the deductibility of any expenses she incurs is subject to the **limitation in s23(m),**	1
Section 23(m) limits expenses to be deducted by employees except for certain specified deduction that includes the **deduction of legal expenses under s11(c).**	1
Sarah incurred the legal costs to **protect her** constitutional rights to human dignity and equality. Such rights are intrinsically attached to her ability to work productively, that is, her **income earning structure**, and therefore the legal costs to protect these rights would be **capital in nature**. – see proviso (i) to section 11(c).	1
As the compensation amount received by Sarah **would not constitute income** as required by proviso (iii) of s11(c),	1P
Sarah would **not qualify for the s11(c) deduction** in relation to the R37 500 legal costs – proviso (iii).	1P
in terms of **section 102** of the **Tax Administration Act** the **burden to proof** that an amount is **deductible** rests upon the **taxpayer.**	1
Available	**6**
Maximum for part (a)(iii)	**4**
Communication skills – logical argument	***1***
Total for part (a)	**14**

Part (b) **Calculate the employees' tax that Makiti should have withheld from the severance package paid to Sarah in March 2023.** • **Provide a brief reason for your treatment of each item.** • **Where applicable, assume the current tax legislation and tax rates apply for all relevant years of assessment.**		**Marks**
	R	
Salary – specifically included in her **gross income** in terms of para. *(c)* (*or d)*of the definition, and in the definition of '**remuneration' i**n para. 1 of the Fourth Schedule, in March 2023	100 000	1
Entertainment allowance – included in taxable income as an **allowance** under *section 8(1)* and in the definition of **'remuneration'** in para. 1 of the Fourth Schedule in March 2023	5 000	1
Leave pay is an amount paid in terms of her contract of employment, which is therefore included in her **gross income** under para. (*c), (d) or (f)* of the definition in s1, and in the definition of '*remuneration' in para. 1* of the Fourth Schedule.	23 000	1
The **leave pay is 'variable remuneration'** as defined in *s7B read with par 2(1B) of the Fourth Schedule*, deemed to *accrue when it is paid*		1
RoT payment – included in **gross income** under *para. (cB)*	700 000	1
The employees' tax for March 2023 is determined as follows:		
Salary	100 000	
Entertainment allowance	5 000	
Total remuneration, **excluding annual payment**	105 000	1P
Plus: Annual payment (leave pay + RoT)	723 000	1P
Total remuneration including annual payment	828 000	
Annual equivalent (AE) of total remuneration excluding annual payment = R105 000 **x 12**	1 260 000	1P
Normal tax liability on AE of total remuneration excluding annual payment: 2023 tables		
Schedule tax payable on R1 260 000		
– On R817 600	239 452	
– On R442 400 (R1 260 000 – 817 600) at 41%	181 384	
Normal tax payable (s5)	420 836	1P
Less: Primary rebate (s6): under 65	(16 425)	1
Normal tax liability on AE of total remuneration **excluding** annual payment	404 411	
PAYE for 1 month on remuneration excluding annual payment = R404 411 **x 1/12**	33 701	1P
PAYE on annual payment (AE including the annual payment):		
Schedule tax payable on R1 983 000 (R1 260 000 + R723 000)		1
- On R1 731 600 = R614 192	614 192	
- On R251 400 (R1 983 000 - R1 731 600) x 45% = R113 130	113 130	
Normal tax payable (s5)	727 322	1P
Less: Primary rebate (s6): under 65	(16 425)	0.5
Normal tax liability on AE of total remuneration **including** annual payment	710 897	
PAYE withheld in March 2023 (R710 897 – R404 411 + R33 701))	340 187	0.5P
	Available	**14**
	Maximum	**13**

Communication skills – presentation	*1*
Total for part (b)	**14**

	Part (c) **Discuss, with supporting calculations, the employees' tax that Makiti should have withheld from the CCMA arbitration award paid to Sarah in February 2024** • **Where applicable, assume the current tax legislation and tax rates apply for all relevant years of assessment.**		**Marks**
1.	Employees' tax on CCMA arbitration award: back pay	1 155 000	
2.	The back pay is included in Sarah's **gross income** in terms of para. (c) of the definition in s1 as it is **compensation for remuneration lost** (*WJ Fourie Beleggings v C:SARS*)		1
3.	It is **not a payment for termination or variation of employment** and therefore does not come into para. (d) of the definition of gross income in s 1, and neither a severance benefit as defined.		1
4.	The date on which Sarah becomes **unconditionally entitled** to the amount is the date of the award: 8 February 2024. The payment is due and payable on 29 February 2024.		1
5.	The back pay therefore accrues to Sarah on 8 February 2024 and will be **taxed in the 2024 tax year** under the normal accrual rule.		1
6.	The back pay is taxed according **to the normal tax tables** and not the severance benefit table.		1
7.	As the back pay is **'remuneration'** as defined in para. 1 of the Fourth Schedule, **the employer is obliged to withhold** the correct amount of employees' tax from the award		1
8.	**The employees' tax payable on the back pay for February 2024 would be determined as follows:**		
9.	Total remuneration year to date (March remuneration including leave pay – as determined above)	828 000	0.5C/F
10.	February remuneration: annual payment (back pay)	1 155 000	0.5
11.	Total remuneration including annual payment	1 983 000	
12.	Schedule tax payable on R1 983 000		
13.	– On R1 731 600	614 192	
14.	– On R251 500 (R1 983 000 – 1 731 600) at 45%	113 130	
15.	Normal tax payable (s5)	727 322	1P
16.	Less: Primary rebate (s6): under 65	(16 425)	1
17.	Normal tax liability on R1 983 000	710 897	
18.	Less: PAYE withheld in March 2023	(340 187)	1C/F
19.	PAYE to be withheld from the back pay in February 2024	370 710	
		Available	**10**
		Maximum	**10**
		Total for part (c)	**10**

	Part (d) **Discuss whether Lionel has any professional obligations relating to the information that he discovered with regard to the employees' tax situation.**	**Marks**
1.	**Code of Professional Conduct (CPC)**	
2.	From the perspective of a **CA(SA) also being the chairperson of the board and a director at the company**, Lionel is a **senior professional accountant in business** (para. 120.10 A2, read with CoPC 260.11) and is required to comply with SAICA's CoPC (**Part 1 & 2**).	1
3.	Lionel must **identify** the threat to the fundamental principles present: Lionel will have a **self-interest threat** (being a director of the company) and an **intimidation threat** to (CoPC260.2) – o **professional behaviour** <u>because</u> of the **failure of the employer to withhold PAYE is non-compliance with the Income Tax Act**, para. 2 (breach of the CoPC) and non-compliance will discredit the profession; and o **integrity** because he now must **act and respond appropriately and honestly from here** on, based on the discovery of the non-compliance. *Note to markers: the ½ marks for threats and/or fundamental principles will only be awarded where the threats and/or the fundamental principles are applied.*	0.5 0.5 0.5 1 0.5 1
4.	Lionel must **evaluate** the impact of the threat. The failure to withhold PAYE presents a contravention of the Income Tax Act which is non-compliance with the relevant laws and is, therefore significant as: • This will also result in an **undisclosed liability** for the PAYE owing to SARS and **additional liabilities in the form of penalties and interest** which could be a **significant amount** (CoPC 260.5); and • Possible **criminal prosecution** if the matter is not properly resolved with SARS.	1 1
5.	Therefore, it is concluded that the **threat is not at an acceptable level**.	1
6.	**Overall responsibility in complying with the CoPC** In all his actions Lionel is required to **exercise professional judgement and care in determining his actions** and reactions and rather **refer important decisions to the board of directors to address personal bias**.	1
7.	**NOCLAR**	
8.	Lionel must address the threat by taking appropriate action in terms of CoPC 260. **Obtaining an understanding** (CoPC 260.12) Lionel must obtain an **understanding of the matter**, as it relates to the **circumstances** that led to the employees' tax not being withheld. If the Lionel is not up to date to the newest **tax legislation** and the **course of action** that must be followed, Lionel must consider if he needs external advice on the tax legislation and the **impact** thereof in order to respond appropriately.	1
9.	**Addressing the NOCLAR** (CoPC 260) CoPC 260.14: Lionel should then bring the non-compliance to the **attention** of the **board** (as he is a senior professional accountant and director) **and** to the **person responsible for PAYE compliance**.	1
10.	CoPC 260.14.16: Lionel should **assess** the **appropriateness** of the **response** to the NOCLAR.	1
11.	CoPC 260.17: Lionel should determine whether **further action** is needed such as **reporting** the Issue to the **Commissioner of Revenue** or **SAICA**.	1
12.	CoPC 260.18 A2: Lionel could consider **informing the auditor** or resigning from the employing organisation, or as this would most probably also constitute a **reportable irregularity**, Lionel needs to ensure that Makiti will **discuss this with**	1

	its external auditor and submit proof that it is not ongoing and ensure that it is **reported to the shareholders in the annual financial statements**.	
13.	CoPC 260.19: Lionel might also **seek advice** on the matter. As this is an auditing and consulting firm, Lionel could discuss the matter with the **tax experts** employed by the firm or obtain **legal advice** from a tax expert.	1
14.	**Determining whether further action is needed** (CoPC 260.16) **and further disclosures** • Lionel should obtain **proof** that the matter has been **corrected** and the necessary **PAYE** have been recovered and **paid over to SARS** and the necessary **documentation completed and the penalties and interest paid over to SARS**. • In completion of the updated documentation and **correcting the mistake** on the EMP201, Lionel needs to ensure that the company would have **communicated the mistake to SARS**.	1 1
15.	**Documentation** (CoPC 260.23) Lionel should **document** the **substance** of the issue, the **details** of any **discussions**, the **decisions** made and the **rationale** for those decisions.	1
16.	**Director's responsibilities**	
17.	As chairperson and a member of the board (director), Lionel has a fiduciary duty to **act in the best interest of the company** in terms of s76 of the Companies Act.	1
18.	This matter indicates a **significant control weakness** whereby the employee' tax of an abnormal payment to an employee was not reviewed by someone with the necessary expertise. **Preventative controls** to ensure this matter does not occur again should be **implemented**.	1
19.	As Makiti is an auditing and advisory company, it might result in major reputational damage should this matter become known to the public. The chairperson should, therefore, **launch an investigation** to determine **similar situations** where laws and regulations were not complied with.	1
20.	**Further action with regard to the CFO** It appears that someone who is employed at the company (and who is a CA(SA)) does not have the necessary professional competence and due care for the position and title he holds**. Lionel should recommend through HR policies and performance evaluations that the CFO obtain the necessary training to complete his work**.	1
	Available	**22**
	Maximum	**11**
	Communication skills – appropriate style	***1***
	Total for part (d)	**12**
	TOTAL FOR QUESTION 2	**50**