Part (a) **Briefly discuss whether the agreement between IGS and LE Batteries contains a lease as defined in accordance with IFRS 16.**	**Marks**
A contract is, or contains, a lease if the (i) contract (iii) conveys the right to control the use of an (ii) identified asset for a (iv) period of time in exchange for consideration. (IFRS 16.9) In determining whether the agreement between IGS and LE Batteries contains a lease, the following will be considered:	1T
Does a contract exist?	
An agreement was entered into between IGS and LE Batteries which creates enforceable rights and obligations for the use of the industrial specialised machine in exchange for consideration, i.e., a contract exists between IGS and LE batteries.	1
Does the agreement explicitly or implicitly specify an identified asset?	
The agreement explicitly specifies an asset, the industrial specialised machine, OR the industrial specialised machine ('machine') is implicitly identified as IGS has no other available assets with which they can fulfil the obligations of the contract.	1
Per the agreement, IGS does not have a substantive right to substitute the machine during the ten-year period because:	1P
The machine was installed at LE Batteries' production plant, and uninstalling the machine and installing another would not be a simple process and IGS would not benefit economically from this because they would have to incur costs in doing so.	1
Furthermore, this is a specialised asset (industrial specialised machine) and IGS does not have an alternative asset that could be used as a substitute.	1
IGS can only substitute the components (not the machine as a whole) on the occurrence of a specified event, i.e., when the components become faulty or if they malfunction for whatever reason.	1
The agreement therefore contains an identified asset.	1P
Does the agreement convey the right to control the use of an identified asset to LE Batteries?	
The relevant decisions about how and for what purpose the machine is used are predetermined and specified in the agreement. LE Batteries will only be allowed to use the machine for its primary business activities to manufacture silicon cells.	1
LE Batteries has the right to operate the machine throughout the period of use without IGS or LE Batteries having the right to change the purpose for which the machine is used during the ten-year period.	1
LE Batteries has the right to obtain substantially all of the economic benefits from use of the identified asset because it has exclusive use of the asset throughout the period. LE Batteries will manufacture silicon cells which will be sold for cash.	1
Although LE Batteries is only allowed to use the machine for its primary business activities to manufacture silicon cells, this does not mean that LE Batteries does not have the right to control the machine as this is only a protective right OR the fact that only WeService can be used to service the	1

machine does not mean that LE Batteries does not have the right to control the machine as this is only a protective right.	
The agreement therefore does convey the right to control the use of the machine to LE Batteries.	1P
Does the agreement specify a period of time of use in exchange for consideration?	
The agreement gives LE Batteries the right to use the machine for a period of ten years.	1
Consideration is payable in the form of monthly payments of R140 000 payable in arrears to IGS.	1
Conclusion	
The agreement between IGS and LE Batteries contains a lease as defined in accordance with IFRS 16.	1P
Available	**16**
Maximum	**10**
Communication skills – clarity of expression	***1***
Total for part (a)	**11**

Part (b) Prepare the consolidation journal entry(entries) required to account for the intragroup lease transaction between IGS and LE Batteries in the consolidated financial statements of the IGS Group for FY2023. • Ignore all forms of taxation, including VAT. • Ignore any non-controlling interest(s). • Journal narrations are not required. • Assume that the agreement between IGS and LE Batteries contains a lease, and that it should be classified as a finance lease, as defined in accordance with IFRS 16, in the separate financial statements of IGS.			**Marks**
	Dr.	**Cr.**	
Alt 1: Machine (PPE) – Cost (SoFP) (Note 1)	R10 025 000		C1
Alt 2: *Machine (PPE) – Cost (SoFP)* *Retained earnings (SoFP) (Note 1)*	*R10 000 000* *R25 000*		C1
Accumulated depreciation – PPE machine (SoFP)		R1 670 833	C4
Gross investment in the lease (SoFP) (R140 000 x 96)		R13 440 000	1
Unearned finance income (SoFP) (25 – 120 Amrt Int)	R4 638 326		1P
Alt: *Net investment in the lease (SoFP)* (24 Amrt balance)		*R8 801 673*	*Alt 2P*
Finance income (p/l) (13 – 24 Amrt Int)	R1 040 382		1P
Lease liability (SoFP) (24 Amrt balance)	R8 801 673		1P
Finance cost (p/l) (13 – 24 Amrt Int)		R1 040 382	1P
Right-of-use asset (SoFP)		R10 025 000	C3
Accumulated depreciation – RoU asset (SoFP)	R2 005 000		C4
Alt: *Right-of-use asset (SoFP) (R10 025 000 – R2 005 000)*	*R8 020 000*		*Alt C3&C4*
Depreciation (p/l) R1 002 500 – R835 417)		R167 083	1P
Retained earnings (SoCE)		R167 083	1P
Elimination of intercompany lease transaction			
CALCULATIONS			
C1. Machine (PPE) – Cost			
Initial cost paid		R10 000 000	1
Legal fees paid (Note 1)		R25 000	1
		R10 025 000	

Note 1: *The cost of an item of property, plant and equipment comprises:…*
(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management (IAS 16.16(b).
Alt 1: IGS acquired the machine to lease to LE Batteries and the legal costs incurred are costs attributable to bringing the machine to the location and condition necessary for it to be capable of operating in the manner intended by management (i.e., to lease to LE Batteries).

Alt 2: The legal costs incurred are costs incurred to draw up the lease agreements and are not costs attributable to bringing the machine to the location and condition necessary for it to be capable of operating in the manner intended by management.

C2. Finance lease		
Rate implicit in the lease:		
N (10 x 12) =	120	1
PMT =	R140 000	1
PV = (R10 000 000 + R12 500 (R25 000 x 50%)) =	(R10 012 500)	1+1
Comp i =	**0,95%**	

C3. Right-of-use asset and lease liability				
Initial cost of right-of-use asset				
Amount recognised for lease liability		**C2**	R10 012 500	1P
Legal fees (R25 000 x 50%)			R12 500	1P
			R10 025 000	
C4. Adjustment to depreciation and accumulated depreciation	**Depreciation**		**Accumulated depreciation**	
RoU asset: (R10 025 000 **(C3**) / 10)	R1 002 500	x 2	R2 005 000	1P+1P
PPE (group) (R10 025 000 (**C1**) / 12)	(R835 417)	x 2	(R1 670 833)	1P+1P
	R167 083		**R334 167**	
			Available	**19**
			Maximum	**18**
			Communication skills – presentation (for logical pro forma entry(ies))	*1*
			Total for part (b)	**19**

Part (c)	**Discuss, supported with calculations, the normal tax consequences for IGS of the letting of the industrial specialised machine to LE Batteries for the year of assessment ended 31 December 2023.** • **Do not discuss the related legal fees.**	**Marks**
1. Normal tax consequences		
1.1.	IGS will include the lease payments excluding VAT in its gross income. (Gross income definition in section 1 of the Income Tax Act).	1
1.2.	The lease payments are included into gross income excluding VAT, as the VAT is collected on behalf of SARS and not for the taxpayer's own benefit.	1
1.3.	Total output tax levied upfront: R1 304 348 (R10 million x 15/115).	1
1.4.	The VAT on current year lease payments is R1 304 348 x R1 680 000/ R16 800 000 (12/120) = R130 435.	1
1.5.	Current year lease payments to be included in gross income excluding VAT: (R140 000 x 12) R1 680 000 - R130 435 = R1 549 565.	2
1.6.	IGS will not include section 24J interest income in its gross income as lease agreements are excluded from the definition of an instrument.	1
1.7.	In terms of section 23C of the Income Tax Act, IGS may claim a capital allowance on the cost price excluding VAT R10 000 000 x 100/115 x 100% = R8 695 652.	2
1.8.	IGS is a small business corporation therefore in terms of section 12E(1A) IGS can elect the most beneficial capital allowance. IGS can elect either s12E(1A) or s11(e). IGS leases the industrial specialised machine to LE Batteries and therefore is not used by IGS directly in its process of manufacture. Therefore the 100% allowance cannot be claimed.	1
1.9.	As this is the second year in which allowances can be claimed as 30% of the cost will be claimed as a capital allowance R2 608 696 (R8 695 652 x 30%).	1
1.9.	Section 11(e) allowance: R869 565 (R8 695 652 / **10 years).**	1
1.10.	The **most beneficial allowance is the section 12E(1A) allowance as R2 608 696 is greater than R869 565** and will be elected by IGS in line with its goal of electing an option available to minimise its normal tax liability or defer its normal tax liability.	1P
Notes: *Section 23A (not examinable) will not apply as the taxpayer claimed a deduction in terms of section 12E(1A).* *Section 12C(1)(b) does not apply as LE Batteries did not use the industrial specialised machine in its trade for the first time.* *Section 23G does not apply as this is not a sale and leaseback.*		
	Available	**13**
	Maximum	**11**
	Communication skills – layout and structure	***1***
	Total for part (c)	**12**

Part (d) Calculate, supported with brief reasons, the impact of part 3 of the scenario (the solar systems service technicians) on the taxable income of IGS for the year of assessment ended 31 December 2023.			**Marks**
	Workings (ZAR)	Taxable income (ZAR)	
12H(2)(b)/Learnership allowance in respect of the employee without a disability.	40 000 x 3/12	(10 000)	1 (reason) 1 (amount)
12H(2)(b) read with section 12H(5)/ Learnership allowance in respect of the employee with a disability.	60 000 x 3/12	(15 000)	1 (reason) 1 (amount)
Section 11(a) deduction for salary expense.	95 000 x 2	(190 000)	1 (reason) 1 (amount)
Section 11(a) deduction for contract for monthly training and industry update sessions as the amounts are incurred in the production of income.			1
Section 11(a) read with section 23H The training service will be performed during 1 October 2023 and 30 September 2024, and this is more than six months after the end of IGS's 2023 year of assessment (i.e. 9 months), therefore the amount will be limited by section 23H (para. (aa) of proviso to section 23H).			1
As no other amounts were paid for in advance, it is evident that the total prepaid expenditure of R262 500 (R350 000 x 9/12) which may have been limited by section 23H exceeds R100 000, therefore the amount will be limited by s23H (para. (bb) of proviso to section 23H).			1
	350 000 x 3/12	(87 500)	1
		Available	**10**
		Maximum	**8**
		Total for part (d)	**8**
		TOTAL FOR PAPER 4 QUESTION 2	**50**

