Part (a) With reference to the transactions listed in note 3.3 and for FY2019 –calculate the current and deferred taxation implications for Sticky (company) **Alternative 1** **Assumption – starting point is profit before tax x 28%**				**Marks**
Description	**Calc.**	**PnL impact**	**Tax impact @28 %**	
	R	**R**	**R**	
Profit before taxation			xxx	
Total permanent / reconciling differences			(1 428)	
Roller machine				
Accounting profit on disposal of roller machine	(575 000)			
Taxable portion (40 000 + 342 400)	382 400			
Non-taxable accounting gain	**192 600**	**(192 600)**	**(53 928)**	1P
Office building				
Depreciation on office building		187 500	52 500	1P
(3 750 000 / 20) *(note 3)*				1
No s13quin allowance				1
Total temporary differences		**32 859 112**	**9 200 551**	1P+1P
Packaging machine				
Depreciation on packaging machine *(note1)*		9 112		1P
Initial cost	1 081 000			1
Transport costs	12 420			1
	1 093 420			
(1 093 420 / 10 x 1/12)	9 112			1P
Wear and tear – S12C *(note1)*		–		1
Roller machine				
Recoupment of allowances claimed (s8(4)(a))		40 000		1
Taxable capital gain on disposal of roller machine (428 000 x 80%)		342 400		1P
- Proceeds	535 000			
Amount received	575 000			1
Less: recoupment	(40 000)			1
- Base cost	(107 000)			
20% of proceeds (535 000 x 20%) *(note 2)*	107 000			1
Less: allowances previously deducted	Nil			1
- Capital gain (535 000 – 107 000)	428 000			1P
Taxable accounting profit on disposal of roller machine		(382 400)		1P
Expected credit losses				

Prior-year deduction on allowance on credit losses (8 200 000 x 25%) (s11(j))		2 050 000		1
Current year deduction on allowance on credit losses (12 500 000 x 40%) (s11(j))		(5 000 000)		1
Increase in current year allowance for credit losses (12 500 000 – 8 200 000)		4 300 000		1
Advance payment				
Accounting		–		1
Taxation (€2 000 000 x 15.75) *(Note 4)*		31 500 000		1+1P
Net Impact on taxable Income and current tax		**32 854 012**	**9 199 123**	1P+1P
Note 1: No s12C allowance since machine not yet brought into use (s12C(1)).				
Note 2: No indication of valuation performed on 1 October 2001 to determine market value. TAB is not used since taxpayer cannot discharge burden of proving original cost (section 102(1)(b) of the Tax Administration Act and par 26(2)).				
Note 3: Not new and unused, therefore no s13*quin* allowance.				
Note 4: Taxed at the earlier of receipt or accrual. Non-refundable, therefore Sticky received the amount on its own behalf and for its own benefit (Geldenhuys v CIR). Not a deposit kept in trust (Pyott Ltd v CIR). Since the advance payment is non-refundable, it is not a foreign currency debt and therefore not an exchange item as contemplated in section 24I(1). As such, no exchange difference is determined in accordance with section 24I(3). S25D(1) of the Income Tax requires a company to use 'spot rate' to convert the Euro amount to Rands.				
			Available	**27**
			Maximum	**26**
			Total for part (a)(i) Alternative 1 solution	**26**

Alternative 2 **Deferred tax adjustment (balance sheet method)**					**Marks**
FY2019	**CA**	**TB**	**TD**	**DT (A / (L))**	
	R	**R**	**R**	**R**	
Packaging machine Initial cost 1 081 000 (1) Transport cost 12 420 (1) Total cost <u>1 093 420</u> Depreciation: (1 093 420/10 x 1/12) 1P	1 084 308	1 093 420	9 112 (1P)	2 551	1+1+1P+1P
Office building (3 750 000 – (187 500 x10))	1 875 000	-	1 875 000	Exempt (IAS12.15b)	1P + 1
Allowance for credit losses (12 500 000 x 40%)	12 500 000	5 000 000	7 500 000	2 100 000	1
Non-refundable deposit	31 500 000	-	31 500 000	8 820 000	1P
Sale of roller machine Only current tax impact and no deferred tax impact – there is a permanent difference due to 20% of the gain not being taxed	-	-	-	-	1P 1P
Net adjustment to deferred tax balance for FY2019				10 922 551	
FY2018					
Allowance for credit losses (8 200 000 x 25%)	8 200 000	2 050 000	6 150 000	1 722 000	1
Deferred tax balance on above items in prior year				1 722 000	
Adjustment to be recognised at the end of FY2019 (10 922 551 – 1 722 000)				**9 200 551**	1P

Alternative 2 (cont.) **Current tax adjustment** **Assumption: Starting point is not profit before tax x 28% - the starting point is zero – candidates may calculate the current tax impact for the 5 transactions in isolation and not referenced to profit before tax x 28%**			**Marks**
	Calc	**R**	
Packaging machine No s12C allowance since machine not yet brought into use (s12C(1)).		-	1
Roller machine Recoupment of allowances claimed (s8(4)(a))		40 000	1
Taxable capital gain on disposal of roller machine (428 000 x 80%)		342 400	1P
Proceeds	535 000		
Amount received	575 000		1
Less: recoupment	(40 000)		1
Base cost	107 000		
20% of proceeds (535 000 x 20%) (Note 1)	107 000		1
Less: allowances previously deducted	(Nil)		1
Capital gain (535 000 – 107 000)	428 000		1P
Office building Not new and unused, therefore no s13*quin* allowance.		-	1
Expected credit losses Prior-year deduction on allowance on credit losses (8 200 000 x 25%) (s11(j))		2 050 000	1
Current year deduction on allowance on credit losses (12 500 000 x 40%) (s11(j))		(5 000 000)	1
Advance payment Advance payment (€2 000 000 x 15.75) *(Note 2)*		31 500 000	1+1P
Taxable income impact		**28 932 400**	1P
Current tax impact (28 932 400 x 28%)		**8 101 072**	1P
Note 1: No indication of valuation performed on 1 October 2001 to determine market value. TAB is not used since the taxpayer cannot discharge the burden of proving the original cost (s102(1)(b) of the Tax Administration Act and par. 26(2)).			
Note 2: Taxed at the earlier of receipt or accrual. Non-refundable, therefore Sticky received the amount on its own behalf and for its own benefit (Geldenhuys v CIR). Not a deposit kept in trust (Pyott Ltd v CIR). Since the advance payment is non-refundable, it is not a foreign currency debt and therefore not an exchange item as contemplated in s24I(1). As such, no exchange difference is determined in accordance with s24I(3). S25D(1) of the Income Tax requires a company to use 'spot rate' to convert the Euro amount to Rands.			
Available			**27**
Maximum			**26**
Total for part (a)(i) Alternative 2 solution			**26**

Part (a) **With reference to the transactions listed in note 3.3 and for FY2019 –** **(ii) prepare the correcting journal entries in the accounts of Sticky (company).**			**Marks**
	Dr	**Cr**	
	R	**R**	
Income tax expense (P/L)	9 199 123/ 8 101 072		Alt 1 or 2
Accounts payable: SARS (SFP)		9 199 123/ 8 101 072	1P
Correcting of current tax during FY2019			
Deferred tax (SFP)	9 200 551		Alt 1 or 2
Income tax expense (P/L)/ Deferred tax (P/L)		9 200 551	1P
Correcting of deferred tax during FY2019			
		Available	**2**
		Maximum	**2**
		Total for part (a)(ii)	**2**
		Total for part (a)	**28**

Part (b) **Prepare the consolidated tax rate reconciliation to be disclosed in the consolidated financial statements of the Sticky group for FY2019 as prescribed by IAS12.81(i).** **Comparative figures are not required.**			**Marks**
Notes to the consolidated financial statements for the year ended 31 December 2019			
	2019		
	R	**R**	
13. Income tax expense			
Income tax rate reconciliation			
Accounting profit (120 500 000 x 28%)		33 740 000	1
Non-taxable portion of fair value adjustments on investment property (2 700 000 x 20% x 28%)		(151 200)	1
Non-taxable dividends received from equity investment (360 000 x 28%) *(note 1)*		(100 800)	1
Non-deductible restraint of trade payment (500 000 x 28%) *(note 2)*		140 000	1
Non-taxable portion of capital gain on sale of roller machine ((575 000 – (428 000 x 80%) – 40 000) (a)(i) x 28%)		(53 928)	1P
Depreciation on office building (187 500 (a)(i) x 28%)		52 500	1P
Reversal of prior year unrecognised deferred tax asset (30 500 000 / 80% x 20%)		(7 625 000)	1
Bargain purchase gain (no tax effect 312 000 (C1) x 28%)		(87 360)	1P
Tax on profit share of Klebrig (associate) (1 198 800 x 28%) / (1 192 920 x 28%) (C1)		(335 664) / (334 018)	1P

Total income tax expense		**25 578 548 / 25 580 194**	
Calculation 1: Profit share in Klebrig (associate)			
Initial cost of investment		1 500 000	1
Gain from a bargain purchase (1 500 000 – 1 812 000)		312 000	1P
Consideration transferred	1 500 000		
Less share in net assets on acquisition date	(1 812 000)		
Net assets (€750 000 – €350 000 = 400 000 x 15.10)	6 040 000		1 + 1
Share in net assets (6 040 000 x 30%)	1 812 000		1P
Foreign currency translation reserve movement (given)		307 200	1
Intercompany dividend (€180 000 x 15.50 x 30%)		(837 000)	½ +½
Elimination of intercompany profit (350 000/125 x 25 x 30%) / (x 72%)		(21 000) / (15 120)	½ + ½
Closing balance (given)		**(2 460 000)**	1
Profit share after tax in Klebrig (associate)		(1 198 800)/ (1 192 920)	
Note 1: Exempt in terms of s10(1)(k).			
Note 2: Non-deductible in terms of s11(cA) read in conjunction with s1 gross income definition par(cB) as paid to a natural person that is not an employee.			
		Available	**18**
		Maximum	**17**
		Communication skills – presentation	*1*
		Total for part (b)	**18**

Part (c)	**Discuss the ethical issues that Rebecca is facing with regard to the tax savings ideas in item 3.4 from the perspective of the SAICA Code of Professional Conduct**	**Marks**
1	The junior financial manager (Rebecca Maseko) is a CA(SA) in business and should adhere to Part 1 and 2 **of the SAICA Code of Professional Conduct (COPC).**	1
2	If Rebecca were to change the invoice to reflect consulting services in order to claim the deduction from SARS, would create the following threats to **integrity** and **professional behaviour**:	½ + ½
	Self-interest threat	½
	- By aiming for Sticky to pay less tax, Rebecca would be **not be acting straightforward and honest**.	1
	- By evading tax for Sticky, Rebecca would **not be complying** with **relevant laws and regulations** and thereby knowingly discredit the profession.	1
	Intimidation threat	½
	- The financial director has indicated to Rebecca that this would reflect favourably on her performance evaluations and can be assumed, that it would **reflect negatively on her performance evaluation** if she does not change the nature of the expense.	1
	- There is **pressure** on Rebecca **to report misleading financial results** (changing nature of expense) to meet lender expectations/targets.	1

	These threats could be considered **not at an acceptable level** due to the fact that tax evasion, non-compliance to laws and regulations are fraudulent in nature, hence criminal offence. Therefore, threats **cannot be reduced/actioned**, other than not changing the nature of the expense.	1 1
3	In terms of section 260 of the SAICA CPC**, Rebecca has an obligation to respond to non-compliance with laws and regulations** (NOCLAR) given that the Financial Director mentioned that the practice of changing the nature of expenses has taken place in the past.	1
4	Depending on whether or not Rebecca is considered the **senior** professional accountant at Sticky, will define if she follows the obligations stipulated in 260.11 or 260.24. *(Rebecca can be considered the senior professional accountant, due to lack of information of whether Mr Rex is CA(SA))*	1
5	Rebecca should alert those charged with governance of the Sticky Group (Board of Directors)/Senior Professional Accountant, to enable them to rectify, remediate or mitigate the consequences of the non-compliance.	1
6	With regard to the tax haven, Rebecca would need to understand the impact and to what extent the tax haven would amount to **tax avoidance versus tax evasion**. Tax avoidance, while legitimate, can be seen as aggressive when it involves using financial instruments and arrangements (such as a tax haven) not intended as, or anticipated by, governments as a vehicle for gaining a tax advantage. However, **tax evasion would be against the Code**.	1 1
	Available	**14**
	Maximum	**8**
	Communication skills – logical argument	*1*
	Total for part (c)	**9**
TOTAL FOR THE QUESTION		**55**