

**Occupational Certificate
Tax Professional**
SAQA ID: 93624

**External Integrated Summative
Assessment (EISA)**

**November 2016
Paper 2: Corporate Taxation Question**

CASE STUDY

Instructions to Candidates

1. This external integrated summative assessment paper consists of a Part A and Part B.

Time: 8 hours

2. Enter your examination number on each document and save all documents with your examination number.
3. Your name must not appear anywhere in the answer books or saved documents.
4. Answer the questions using effective presentation skills and pay attention to the use of concise language, clarity of explanation and logical argument. Marks will be awarded for these aspects of your response.
5. It is your responsibility to ensure that all assessment stationary is handed in to the invigilator before leaving the examination room and saved documents are forwarded as per assessment requirements.
6. Total marks for Paper 2: 100
7. Pass mark: 50 % pass is required for each paper and competence should be demonstrated for all exit level outcomes.
8. Open book policy applies. All published bounded books are allowed.
9. Candidates have full access to the internet.
10. The assessment is only available in English and is typed.

CASE STUDY

Part A

You have just been promoted as a tax manager in the tax department of a medium sized audit firm, RTS Incorporated (“RTS”).

One of your clients, Hillary Millar, recently contacted you. Hillary is the financial manager of X-Diagnostic (Pty) Ltd (“X-Diagnostic”). She is very stressed as X-Diagnostic received a *Letter of Audit Findings* from the South African Revenue Services (SARS).

Hillary told you that SARS contacted her three months ago and informed her that they will be performing an audit of X-Diagnostic’s 2014 tax year. Two SARS officials spent a week during August 2016 at X-Diagnostic’s office. During this time, they went through Hillary’s 2014 financial year files. In October 2016, SARS e-mailed a letter with some further questions which Hillary replied to. Hillary indicated that the SARS officials asked some difficult questions that she struggled to answer. Hillary did not hear from the SARS officials again until she received the *Letter of Audit Findings* via e-mail today.

Hillary requested that you please assist X-Diagnostic with responding to the SARS *Letter of Audit Findings*.

Company background

X-Diagnostic is a South African tax resident company with a financial year ending on the last day of December. X-Diagnostic’s holding company, Diagnostic Group Plc, is incorporated in the United Kingdom.

X-Diagnostic is engaged in the importation, installation and commissioning of x-ray analytical equipment for industrial and scientific uses. X-Diagnostic mainly operates in South Africa.

SARS Letter of Audit Findings

X-Diagnostic received the following *Letter of Audit Findings* from SARS in respect of the 2014 tax year:

SARS

X-DIAGNOSTIC (PTY) LTD
PO BOX 5104
FERNDALE
2194

CORPORATE INCOME TAX

Audit Findings

Contact Details:

Auditor information
Name: Pieter Fourie
Telephone: (011) 862 2000
Fax: 0865442000
Email: audit@sars.gov.za

Details:

Tax Reference No: 6419/923/49/6
Tax Period: 2014
Case No: 39311076
Date: 18/11/2016

Dear Taxpayer

AUDIT FINDINGS

The South African Revenue Service (SARS) has completed the corporate income tax audit for the 2014 tax period. This letter informs you of the proposed adjustment(s) to your assessment based on the audit findings.

Summary of Findings			
Tax Period	Provisions of the Income Tax Act No.58 of 1962 (IT Act)	Brief description of proposed adjustment	Amount
2014	Sections 11(e), 11(a) and 22(1)(a) Interpretation Note 47 and Practice Note No.36 of the Income Tax Act read with section 102(1) of the Tax Administration Act.	Depreciation claimed on demonstration equipment in the 2014 tax year for which calculations, rulings, records and supporting invoices were requested in compliance with section 11(e) of the Income Tax Act read with Interpretation Note 47 and for which nothing was received, are to be disallowed.	R280 500
2014	Sections 11(a) and 23(o) of the Income Tax Act read with section 102(1) of the Tax Administration Act.	Penalties claimed as a deduction should be disallowed for Income Tax purposes.	R1 300
2014	Sections 11(a) and 23(g) of the Income Tax Act read with section 102(1) of the Tax Administration Act.	Rotating stock tube provision claimed in the 2014 tax year for which the sale of the tubes kept on behalf of the customer were not proven to have been included in income of the company in the 2014 and prior tax years.	R1 400 513
Total			R1 682 313

Explanation of proposed adjustment(s):

1. Depreciation claimed on demonstration equipment in the 2014 tax year for which calculations, rulings, records and supporting invoices were requested in compliance with section 11(e) of the Income Tax Act read with Interpretation Note 47 and for which nothing was received, are to be disallowed.

1.1. The facts (audit findings):

Trading stock is usually accounted for in terms of section 22(1)(a) of the Income Tax Act at the lower of cost or the market value at year end. The company claimed depreciation of R280 500 on the demonstration equipment in terms of section 11(e) of the Income Tax Act and the company was therefore requested, in a letter dated 15 October 2016, to furnish proof that the value of the stock has decreased by R280 500 during the 2014 tax year, if prior approval to use section 11(e) in depreciating the stock by SARS has not been granted prior to rendering the 2014 tax return for the company. In a reply, it became apparent that part of the stock with a cost of R540 000, on which depreciation of R180 000 was claimed in the 2014 tax year, was sold in the 2015 tax year for R800 000 to SteelCo. Limited, which is above the original cost of the demonstration stock.

Insufficient proof was furnished to support the write off used in providing a devaluation of the market value below the cost of the items purchased and no ruling was furnished which was obtained from SARS before the method was applied in depreciating these stock items which should be supported by sufficient statistical data supporting previous experience in selling these stock items used for demonstration purposes.

1.2. The law:

Section 11(a) of the Income Tax Act – General deductions allowed in determination of taxable income – For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of such person so derived -a) expenditure and losses actually incurred in the production of income, provided such expenditure and losses are not a capital nature;

Section 11(e) of the IT Act - General deductions allowed in determination of taxable income – For the purpose of determining the taxable income derived by any person from carrying on any trade, there shall be allowed as deductions from the income of

such person so derived -e) save as provided in paragraph 12(2) of the First Schedule, such sum as the Commissioner may think just and reasonable as representing the amount by which the value of machinery, plant, implements, utensils and articles (other than machinery, plant, implements, utensils and articles in respect of which a deduction may be granted under section 12B, 12C, 12DA, 12E or 37B) owned by the taxpayer or acquired by the taxpayer as purchaser in terms of an agreement contemplated in paragraph (a) of the definition of 'instalment credit agreement' in section 1 of the Value-Added Tax Act, 1991 (Act No.89 of 1991) and used by the taxpayer for the purpose of his or her trade has been diminished by reason of wear and tear or depreciation during the year of assessment;

Interpretation Note: No.47 – 2 November 2012 – “Income Tax: Deduction in respect of wear and tear or depreciation in terms of section 11(e) of the IT Act: Machinery, plant, implements, utensils and articles (including vehicles and equipment)

4.3.2 Method for determining the allowance

In determining the allowance, taxpayers may elect between –

- The diminishing-value method...
- The straight-line method (under this method the allowance is claimed in equal instalments over the expected useful life of the asset).

.... Taxpayers must ensure that they have necessary records supporting the write-off of all assets readily available, should these be requested by the Commissioner.

5. Record-keeping

Section 29(1) of the Tax Administration Act provides that a person must keep the records, books of accounts or documents that –

- Enable the person to observe the requirements of a tax Act;
- Are specifically required under a tax Act; and
- Enable SARS to be satisfied that the person has observed these requirements...

These records should be available for inspection purposes by a SARS official to verify compliance with the requirements as explained above, or for purposes of an inspection, audit or investigation...

Section 22(1) of the IT Act – Amounts to be taken into account in respect of values of trading stock – (1) The amount which shall, in the determination of the taxable income

derived by any person during any year of assessment from carrying on any trade (other than farming), be taken into account in respect of the value of any trading stock held and not disposed of by him at the end of such year of assessment, shall be

- (a) in the case of trading stock other than trading stock contemplated in paragraph (b), the cost price to such person of such trading stock, less such amount as the Commissioner may think just and reasonable as representing the amount by which the value of such trading stock, not being any financial instrument, has been diminished by reason of damage, deterioration, change of fashion, decrease in the market value or for any other reason satisfactory to the Commissioner; and
- (b) in the case of any trading stock which consists of any instrument, interest rate agreement or option contract...

Practice Note: No.36 of the IT Act – Income Tax: Valuation of Trading Stock – It is evident that a variety of questionable methods are used by taxpayers to write-off slow-moving and obsolete stock, without reference to its actual net realisable value. It has, therefore, become necessary to explain Inland Revenue's standpoint in this regard. Amounts written off, for instance on a fixed percentage basis, which cannot reasonably be justified will not be allowed to be deducted from the cost price of such stock held and not disposed of at the end of the year of assessment in terms of section 22(1) of the Income Tax Act (the Act). In Income Tax Case No. 1489 (53 SATC 99) it was held, *inter alia*: a) That if a method of reducing the cost of stock by a percentage is adopted, the percentage reduction should not only be supported by trading history and, where appropriate, post-balance sheet experience, but the Receiver of Revenue should be told how that percentage is arrived at. b) That the Commissioner for Inland Revenue has to exercise a discretion with regard to the amount by which the value of trading stock had been diminished and cannot exercise that discretion if he is not told on what basis the accounts submitted to him have been prepared; hence the Act, by implication, requires such disclosure. Taxpayers are, therefore, required to disclose the basis on which stock is valued, which disclosure must be made in the annual return of income. Where stock has not been valued at cost, but at a lower value, the taxpayer is also required to reveal this to the Receiver of Revenue, submit reasons therefore and indicate how the lower value was arrived at. If stock has been written off on a fixed, variable or any other basis, not representing the actual value by which it has been diminished, the write-off will not be accepted without reasonable justification for such basis. Where it is found that a taxpayer has undervalued his stock and has not revealed this fact to the Receiver of Revenue, such concealment will be

viewed in a serious light and the imposition of additional tax in terms of section 76 of the Act will be considered.

Section 102(1) of the Tax Administration Act No.28 of 2011 (TAA) – Burden of proof – A taxpayer bears the burden of proving (a) that an amount, transaction, event or item is exempt or otherwise not taxable; (b) that an amount or item is deductible or may be set-off; (c) the rate of tax applicable to a transaction, event, item or class of taxpayer; (d) that an amount qualifies as a reduction of tax payable; (e) that a valuation is correct; or (f) whether a ‘decision’ that is subject to objection and appeal under a tax Act, is incorrect. (2) The burden of proving whether an estimate under section 95 is reasonable or the facts on which SARS based the imposition of an understatement penalty under Chapter 16, is upon SARS.

1.3. Application of the law:

It is proposed that an additional assessment for R280 500 be raised in the 2014 tax year in terms of section 11(e), 11(a) and 22(1)(a) and Interpretation Note 47 and Practice Note No.36 of the IT Act read with section 102(1) of the TAA in order to disallow the depreciation claimed on Demo equipment for which no supporting records, calculations, rulings, invoices and other requested proof that the expense or loss was actually incurred in the 2014 were furnished.

2. Penalties claimed should be disallowed for Income Tax purposes

2.1. The facts (audit findings):

The company claimed penalties of R1 300 paid to the CIPC in terms of the Companies Act, 1973 (Act 71 of 2008).

2.2. The law:

Section 11(a) of the Income Tax Act – General deductions allowed in determination of taxable income – Refer to 1.2 above;

Section 23(o) of the Income Tax Act – Deductions not allowed in determination of taxable income – 1) No deductions shall in any case be made in respect of the following matters, namely (o) any expenditure incurred (i) ... or (ii) which constitutes

a fine charged or penalty imposed as a result of an unlawful activity carried out in the Republic or in any other country if that activity would be unlawful had it been carried out in the Republic.

Section 102(1) of the Tax Administration Act – Burden of proof – Refer to 1.2 above.

2.3. Application of the law:

It is proposed that an additional assessment for R1 300 be raised in the 2014 tax year in terms of section 11(a) and section 23(o) of the Income Tax Act read with section 102 of the Tax Administration Act in order to disallow the CIPC penalties.

3. Rotating stock tube provision claimed in the 2014 tax year for which the sale of the tubes kept on behalf of the customer were not proven to have been included in income of the company in the 2014 and prior tax years

3.1. The facts (audit findings):

The company received money from customers to purchase extra tubes for X-ray equipment. A rotating stock tube provision was raised by the company to purchase the tubes. The rotating stock tube provision amounted to R1 400 513 in the 2014 tax year. The company was requested to furnish proof that the sale of the tubes was included as part of sales in the 2014 tax year or in prior years but no reply was received.

3.2. The law:

Section 11(a) of the Income Tax Act – General deductions allowed in determination of taxable income – Refer to 1.2 above;

Section 23(g) of the Income Tax Act – Deductions not allowed in determination of taxable income – any moneys, claimed as a deduction from income derived from trade, to the extent to which such moneys were not laid out or expended for the purpose of trade;

Section 102(1) of the Tax Administration Act – Burden of proof – Refer to 1.2 above.

3.3. Application of the law:

It is proposed that an additional assessment for R1 400 513 be raised in the 2014 tax year in terms of section 11(a) and 23(g) of the IT Act read with section 102(1) of the TAA in order to disallow the rotating stock tube provision claimed in the 2014 tax year as no proof was furnished that the sale of the tubes was included in “income” of the company for the 2014 or prior tax years.

Understatement Penalty

In terms of section 222 of the Tax Administration Act, where an ‘understatement’ was made by a taxpayer, the taxpayer must pay, in addition to the tax payable for the relevant period, an understatement penalty.

Therefore, an understatement penalty of 50% may be levied, which is determined in accordance with the table as set out in section 223 of the Tax Administration Act, and is based on the fact that the taxpayer had no reasonable grounds for the ‘tax positions’ taken as explained above.

Finalisation of Audit

If you are not in agreement with any of the proposed adjustments, kindly respond in writing furnishing reasons and/or supply any relevant material within 21 business days from the date of this letter. Also provide reasons in writing as to why understatement penalty and interest shall not be imposed.

When submitting your relevant material, enclose this original letter as it contains a unique bar-coded reference which links it to your income tax account with SARS. A photocopy of this letter will not be accepted by SARS. You may make a copy of this letter for your records.

Note that SARS only accepts relevant material in A4 format and no other format will be accepted. Electronically stored data can be submitted by arrangement with the SARS official.

Relevant material can be submitted through the following channels:

- At your nearest SARS branch
- By post to the address above
- Electronically via eFiling (if you are registered as an eFiler)

Should you have any queries relating to the audit, please address them to the SARS official as per the contact details above.

Should you have any queries please call the SARS Contact Centre on 0800 00 SARS(7277). Remember to have your income tax number at hand when you call to enable us to assist you promptly.

Sincerely

ISSUED ON BEHALF OF THE COMMISSIONER FOR THE SOUTH AFRICAN REVENUE SERVICE

Information received from X-Diagnostic based on your enquiries

After you have read through the SARS letter of audit findings, you obtained the following information from Hillary:

Demonstration equipment -

- Demonstration equipment is classified in terms of IAS 2 as inventory in the annual financial statements of X-Diagnostic. Due to the high cost of manufacturing the X-ray analytical equipment, it has always been management's intention to sell the demonstration equipment in order to recover costs;
- X-Diagnostic writes off demonstration equipment over 3 years. This is in accordance with the group instruction that was received. Hillary provided you with the memo that was issued by Diagnostic Group Plc:

<p>MEMO</p> <p>FROM: DIAGNOSTIC GROUP PLC</p> <p>TO: X-DIAGNOTIC (PTY) LTD</p> <p>DATE: 16 JANUARY 2013</p> <p>RE: DEMONSTRATION STOCK</p>
<p>In terms of the group accounting policy, demonstration stock should be written off over a three-year period. This is based on historic data gathered by the group which indicated that:</p> <ul style="list-style-type: none">- Technology development and enhancements (especially on the computer software) results in the X-ray analytical equipment used as demonstration stock being out dated after 3 years;- Demonstration stock is frequently moved between customer sites for demonstration purposes and therefore deteriorates rapidly.

- The write down of demonstration equipment was correctly disclosed under the gross profit/loss section of the Income Statement on the 2014 ITR14 tax return;
- In the Detail Income Statement provided to SARS to support the 2014 income tax return, a breakdown of cost of sales was performed which included an adjustment for "Depreciation on Demo equipment" amounting to R280 500. It appears that the description of the adjustment caused confusion;

- Due to the fact that clients have different, specific requirements for the X-ray analytical equipment and due to the fact that this type of equipment is large in size, X-Diagnostic does not keep stock on hand of these specialised equipment. The inventory on the Statement of Financial Position relates to spare parts;
- The specialised X-ray analytical equipment consists of hardware (including computer hardware such as PC and printer components) and computer software components.
- Hillary explained that the sale of the demonstration equipment to SteelCo. Limited was a rare event. Generally, the X-ray analytical equipment is ordered specifically for a client based on the client's unique requirements. The specific X-ray analytical equipment ordered by the client is imported from the United Kingdom. It can take between 6 to 12 months to deliver the specialised X-ray analytical equipment to the client. New demonstration equipment was acquired by X-Diagnostic in 2014 and the equipment was demonstrated to SteelCo. Limited in the beginning of 2015. The demonstration equipment met the specifications of SteelCo. Limited and to ensure immediate delivery, SteelCo. Limited bought the demonstration equipment from X-Diagnostic. The sale to SteelCo. Limited was treated as a normal sale of trading stock for accounting purposes.

Penalties claimed as a tax deduction

- X-Diagnostic was required to pay a penalty of R1 300 to the Companies and Intellectual Property Commissioner (CIPC) in terms of section 216 of the Companies Act, 2008 for the late submission of the company's annual return.

Rotating stock tube provision

- Hillary explained that the rotating stock tube scheme is an agreement where the customer purchases a replacement tube from X-Diagnostic when the customer acquires the X-ray analytical equipment. However, the replacement

tube is only delivered to the client when required. It can sometimes take 3 to 4 years before the client requests a replacement tube;

- Although the company has several customers, X-Diagnostic only keeps one replacement tube in stock as these tubes have a limited lifespan and can break easily.
- When a customer requires a replacement tube, X-Diagnostic releases the tube that the company has from stock and orders a new tube from the United Kingdom;
- When a customer purchases X-ray analytical equipment, it is not always possible to split the sales price between the equipment and the replacement tube. The accounting entries are as follow:

Dr Bank

Cr Sales (for full invoice value including replacement tube)

Sale of X-ray analytical equipment and replacement tube

Dr Cost of sales

Cr X-ray analytical equipment stock

Cr Rotating stock tube provision (at cost value)

Recording of X-ray equipment sale and providing for future tube expense

CASE STUDY

Part B

Due to the SARS audit and other group reporting requirements, Hillary has not yet finalised X-Diagnostic's 2015 income tax return. Hillary has prepared the income tax calculation and supporting schedules on the same basis as in prior years. However, after the SARS audit, Hillary has lost confidence in her abilities and would appreciate if you could assist in reviewing the 2015 income tax return calculation of X-Diagnostic before she submits it for review and approval by the Public Officer.

You agreed with Hillary that you will perform a high-level review of X-Diagnostic's 2015 tax return calculation and the information provided. You also agreed to issue a memo to X-Diagnostic that will set out any potential tax issues or opportunities identified during your high-level review, with recommendations. You will also indicate if additional information is required.

Information provided relating to the 2015 income tax calculation

Hillary provided you with the following extract from the annual financial statements of X-Diagnostic for the 2015 financial year:

X-Diagnostic (Pty) Ltd

Annual Financial Statements for the year ending 31 December 2015

Statement of financial position

	Note	2015 R	2014 R
Assets			
Non-current assets			
Plant and equipment	1	381 350	489 449
Goodwill		22 944 599	22 944 599
Deferred tax asset	2	2 775 408	2 467 969
		<u>26 101 357</u>	<u>25 902 017</u>
Current assets			
Inventory		12 970 495	10 426 581
Loans to group companies		304 351	-
Trade and other receivables	3	17 454 056	4 560 636
Cash and cash equivalents		15 683 299	14 769 630
		<u>46 412 201</u>	<u>29 756 847</u>
Total Assets		<u>72 513 558</u>	<u>55 658 864</u>
Equity and liabilities			
Equity			
Share capital		400	400
Retained earnings		43 190 081	36 961 940
		<u>43 190 481</u>	<u>36 962 340</u>
Liabilities			
Current liabilities			
Loans from group companies		5 118 924	4 558 653
Current tax payable		1 587 340	2 222 811
Trade and other payables	4	17 440 235	5 075 199
Deferred income		1 391 740	2 354 224
Provisions	5	3 784 838	4 485 637
		<u>29 323 077</u>	<u>18 696 524</u>
Total equity and liabilities		<u>72 513 558</u>	<u>55 658 864</u>

X-Diagnostic (Pty) Ltd

Annual Financial Statements for the year ending 31 December 2015

Statement of Comprehensive Income

	Note	R
Revenue		40 613 747
Cost of sales		<u>-25 961 667</u>
Gross profit		14 652 080
Other income		801 420
Interest received on positive bank balances	588 496	
Unrealised exchange gains - related parties	212 924	
		<u>15 453 500</u>
Expenditure		8 012 433
Advertising, promotions and marketing	291 011	
Bank charges	80 944	
Consultation Fees – auditors’ remuneration	177 150	
Depreciation	1 151 626	
Discount Allowed	178 697	
Debt collections costs	190 163	
Electricity	38 067	
Entertainment	56 605	
Foreign exchange difference - realised	1 224 234	
Insurances	151 565	
Legal fees	25 130	
Premises - Contractual amounts	325 550	
Motor vehicle expenses	275 326	
ITC Infrastructure	264 685	
Postage and Courier Costs	45 921	
Repairs and maintenance	44 049	
Salaries and wages	3 228 330	
Small assets	143 615	
Stationery	65 371	
Telephone expenses	184 375	
Training	106 317	
Travel - local	190 140	
Travel - overseas	573 562	
		<u>7 441 067</u>
Net profit / (loss)		7 441 067

X-Diagnostic (Pty) Ltd

Annual Financial Statements for the year ending 31 December 2015

Notes

1. Plant and equipment

	2015			2014		
	Cost	Accumulated depreciation	Carrying value	Cost	Accumulated depreciation	Carrying value
	R	R	R	R	R	R
Plant and equipment	1 178 040	(796 690)	381 350	1 512 098	(1 022 649)	489 449

Reconciliation of plant and equipment – 2015

	Opening balance	Additions	Depreciation	Total
Plant and equipment	489 449	43 527	(151 626)	381 350

The useful lives of items of plant and equipment have been assessed as follows:

Item	Average useful life
Furniture and fittings	5 years
Office equipment	5 years
IT equipment	3 years

	2015	2014
	R	R

2. Deferred tax asset

Provisions	1 022 327	1 483 236
Prepayments	(31 988)	(17 566)
Income received in advance	1 785 069	1 002 299
	<u>2 775 408</u>	<u>2 467 969</u>

3. Trade and other receivables

Trade receivables	16 728 729	4 511 622
VAT receivable	301 287	49 014
Other receivables	424 040	-
	<u>17 454 056</u>	<u>4 560 636</u>

As at 31 December 2015, all trade and other receivables 3 months and older of R451 691 (2014: R628 190) were impaired and provided for.

	2015 R	2014 R
4. Trade and other payables		
Trade payables	16 615 372	5 075 199
Foreign exchange contracts	<u>824 863</u>	<u>-</u>
	<u><u>17 440 235</u></u>	<u><u>5 075 199</u></u>

Trade and other payables include debtors with credit balances totaling R12 507 300 (2014: R6 594 874).

5. Provisions

2015	Opening balance R	Utilised during the year R	Closing balance R
Warranties	1 080 395	(505 276)	575 119
Other provisions	<u>3 405 242</u>	<u>(195 523)</u>	<u>3 209 719</u>
	<u><u>4 485 637</u></u>	<u><u>(700 799)</u></u>	<u><u>3 784 838</u></u>

Hillary provided you with the following tax calculation and supporting schedules in respect of the 2015 income tax return:

X-Diagnostic (Pty) Ltd

Income tax reference number:6419/923/49/6

Year of assessment ended 31 December 2015

Tax computation

	Schedule Ref.	R	R
Net profit per financial statements			7 441 067
Add:			21 127 483
Depreciation		151 626	
Repairs and maintenance		-	
Recoupment on Sale of Asset		-	
Income in advance - Prepayments received		15 938 115	
Unrealised foreign exchange difference -related parties	P/Y	11 570	
Doubtful debts allowance - 2014	P/Y	137 761	
Section 24C allowance - 2014	P/Y	4 825 679	
Prepayment – 2014	P/Y	62 732	
Deduct:			(20 029 489)
Profit on Sale of Asset		-	
Unrealised foreign exchange difference - related parties		(212 924)	
Wear and tear on fixed assets	1	(400 221)	
Decrease in provisions	2	(691 080)	
Prepayment - 2015		(114 242)	
Doubtful debts allowance - 2015		(99 055)	
Section 24C allowance – 2015 (40% gross profit %)		(9 562 869)	
Income in advance - Prepayments received - 2014	P/Y	(8 949 098)	
Taxable income/(loss) [including capital gains]			8 539 061
Tax @ 28% of	=		2 390 937

P/Y – Agreed to prior year tax return

Schedule 1 Wear and tear

Description	Cost			W&T			Tax value
	Balance at	Additions	Balance at	Balance at	W & T this year	Balance at	
	2015-01-01		2015-12-31	2015-01-01		2015-12-31	
Computer equipment	639 949	29 018	668 967	553 616	(222 989)	330 627	338 340
Office equipment	68 801	14 509	83 310	68 801	(16 662)	52 139	31 171
Furniture and fittings	147 712	-	147 712	116 878	(29 542)	87 336	60 376
Other equipment	655 138	-	655 138	336 285	(131 028)	205 257	449 881
Asset Specific Tools	500	-	500	-	-	-	500
	1 512 100	43 527	1 555 627	1 075 580	(440 221)	675 359	880 268

Schedule 2 Provisions

Description	Prior year balance	Current year balance	Movement
Bad debt provision	628 190	451 691	(176 499)
Bonus provision	660 000	550 000	(110 000)
Leave pay provision	204 751	234 001	29 250
Warranty provision	1 080 395	575 119	(505 276)
Stock write off provision	2 540 491	2 425 718	(114 773)
Sundry accruals	110 981	120 700	9 719
	5 224 808	4 357 229	(867 579)

Doubtful debt allowance

	2015 R	2014 R
Bad debt provision	451 691	628 190
Excluding VAT	396 220	551 044
Doubtful debt allowance at 25%	99 055	137 761

QUESTION

REQUIRED:	MARKS										
<p>Part A</p> <p>1. Draft a letter to SARS in response to the Letter of Audit Findings that SARS issued to X-Diagnostic (Pty) Ltd.</p> <p>Communication skills – presentation and layout</p>	<p>35</p> <p>5</p>										
<p>Part B</p> <p>1. Prepare a tax reasonability test based on the information provided by comparing your tax calculation with the tax calculation performed by the financial manager.</p> <p>Support each of the items in your comparison with a <i>brief</i> comment. Your brief comment should indicate:</p> <ul style="list-style-type: none"> • How your adjustment is determined; and/or • Whether any additional information is required to determine a possible tax adjustment. <p>Your tax reasonability test should have the following layout:</p> <table border="1" data-bbox="229 1438 1195 1621"> <thead> <tr> <th data-bbox="229 1438 419 1621">Tax Adjustment Description</th> <th data-bbox="419 1438 647 1621">Your Tax Calculation</th> <th data-bbox="647 1438 837 1621">Client's Tax Calculation</th> <th data-bbox="837 1438 1024 1621">Difference</th> <th data-bbox="1024 1438 1195 1621">Comment</th> </tr> </thead> <tbody> <tr> <td> </td> <td> </td> <td> </td> <td> </td> <td> </td> </tr> </tbody> </table> <p>2. Based on your tax review performed (including your tax reasonability test), prepare a memorandum to the financial manager that briefly sets out in table format:</p> <p>a. Tax Issues Identified (you should include tax risks identified or potential tax risks identified); and</p>	Tax Adjustment Description	Your Tax Calculation	Client's Tax Calculation	Difference	Comment						<p>30</p> <p>25</p>
Tax Adjustment Description	Your Tax Calculation	Client's Tax Calculation	Difference	Comment							

<p>b. Recommendations (this will include recommendations to address the tax risk identified, or recommendations of procedures to follow to identify and address potential tax risks, or potential tax opportunities);</p> <p>Communication skills – presentation and layout</p>	<p>5</p>
<p>Total marks for the paper</p>	<p>100</p>