

15. DEFERRED TAX: QUESTION BANK

QUESTION 1 (26 marks)

Mickey Limited is a manufacturing company. The following information is available for the year ended 31 December 2029:

Extracts from the trial balance

	RAND DEBIT	RAND CREDIT
Statement of comprehensive income		
Depreciation for accounting purposes on:		
Office buildings	11 000	
Factory buildings	25 000	
Machinery	31 250	
Credit losses	7 000	
Traffic fines (not tax deductible)	5 000	
Dividend income (not taxable)		30 000
Rent income		6 000
Statement of financial position		
Non-current assets		
Office buildings	89 000	
Factory buildings	100 000	
Machinery	48 750	
Current assets		
Electricity paid in advance (tax deductible in 2029)	8 000	
Current Liabilities		
Rental received in advance (taxable in 2029)		2 000

ADDITIONAL INFORMATION

- The accounting profit before tax for the year ended 31 December 2029 amounted to R186 000, after taking into account the above-mentioned items from the extract of the trial balance.
- The South African Revenue Service allows a building allowance of R37 500 on the factory buildings and wear and tear allowance of R50 000 on the machinery.

3. The South African Revenue Service does not allow any deduction in respect of the office buildings.
4. The tax base of the factory buildings on 31 December 2029 is R75 000 and the tax base of the machinery on 31 December 2029 is R11 250.
5. The credit loss is in respect of a trade debtor, and the South African Revenue Service is satisfied that the debt is not collectible (the debt is bad).
6. Assume that the residual value, useful life and depreciation method of all assets were reviewed at each financial year end and that there were no changes.
7. On 31 December 2028 the deferred tax account had a credit balance of R9 100.
8. The tax rate was 28% for the past two years. There are no other temporary or permanent differences other than those which are apparent from the information given.
9. Ignore dividends tax.
10. The company uses the comprehensive income statement approach to calculate deferred tax.

YOU ARE REQUIRED TO:

1. Calculate the current tax expense, as well as the deferred tax for the year ended 31 December 2029. (12 marks)
 2. Prepare the journal entries for the income tax expense and deferred tax calculated above. *Narrations are not required.* (6 marks)
 3. Show how income taxes will be disclosed in the statement of comprehensive income and notes thereto for the year ended 31 December 2029, in accordance with International Financial Reporting Standards. (8 marks)
- Comparative figures are not required.*

QUESTION 2 (41 marks)

The following information was extracted from the accounting records of ITALIA Limited for the year ended 28 February 2029.

1. The provisional tax payments for the year amounted to R580 000, consisting of a first payment of R280 000 and a second payment of R300 000.
2. The accountant calculated the taxable income for the year to be R1 860 000 while the statement of comprehensive income reflected a profit before tax of R2 340 500.

The following information was extracted from the accounting records for the financial year ended 28 February 2030:

1. On 5 June 2029 the company received its tax assessment for the company tax for the year ended 28 February 2029 which reflected a **balance due** of R11 550. The accountant agreed with the tax assessment and made the final payment on 12 July 2029 to settle the amount due for the tax year 28 February 2029.
2. On 31 August 2029 the accountant made the first provisional tax payment for the year ended 28 February 2030. The financial manager provided the accountant with the following budgeted figures for the year ended 28 February 2030:

Profit before taxation	R2 763 600
Taxable income	R1 984 200
3. During December 2029 the financial manager revised the budget for the year ended 28 February 2030 as a result of the profit variation reports generated from the accounting system. The revised budgeted profit before taxation was R2 357 800 and the revised budgeted taxable income was R1 726 700.
4. The draft statement of comprehensive income for the year ended 28 February 2030 reflected a profit before taxation of R2 875 200. The accountant highlighted the following items for the purposes of calculating taxable income. The amounts below are included in the R2 875 200 above.
 - Dividends received of R23 400 was exempt from tax (not part of taxable income).
 - Depreciation on machinery and equipment amounting to R308 900 is not allowed as a deduction in the calculation of taxable income. However, a wear and tear allowance in respect of machinery and equipment amounting to R378 600 is allowed as a tax deduction.
5. The corporate tax rate is 28%.
6. The company raised deferred tax on all temporary differences between the carrying amounts and tax bases, using the statement of comprehensive income method.

YOU ARE REQUIRED TO:

1. Calculate the under/over provision for income tax for the year ended 28 February 2029. (3)
2. The Current Tax Payable: Income Tax (SARS) account for the year ended 28 February 2029, showing clearly the payment on 12 July 2029 and the under/over provision. Balance the account off after the above transactions have been entered. (4)
3. Calculate the tax and deferred tax amounts for year ended 28 February 2030. (6)
4. Calculate the first and second provisional tax payments for the 2030 financial year. (5)
5. Record all the journal entries, including cash transactions, in respect of tax and deferred tax for the 2029 and 2030 financial years. *Narrations are not required.* (15)
6. Disclose the above information in the statement of financial position for the year ended 28 February 2030 in accordance with International Financial Reporting Standards. *Comparative figures are not required.* (3)
7. Disclose the following notes for the year ended 28 February 2030:
Accounting Policy note for Deferred Tax
Income tax expense note, excluding the reconciliation

QUESTION 3 (33 marks)

Chemical Limited is a company that operates in the pharmaceutical industry. Due to technological changes in the manufacturing process and a small change in their product, the company decided to replace its existing plant, which is less than two years old, with a more modern plant.

Details regarding the old plant are as follows:

	R
Original cost	450 000
Accumulated depreciation to 31 December 2029	(67 500)
Carrying amount at 31 December 2029	<u>382 500</u>

ADDITIONAL INFORMATION:

1. Depreciation is written off on the old plant at 15% per annum on the straight-line method to nil residual values. The tax authorities grants a wear and tear allowance on the full cost of plant over five years, not apportioned from the date on which it was brought into use.
2. On 30 June 2030 the old plant was withdrawn from the process and was sold for R461 000, resulting in a taxable capital profit of R101 250. On 1 July 2030 a new plant with a cost price of R800 000 was brought into use in the production of its income.
The tax base of the new plant at 31 December 2030 amounted to R480 000.
3. The directors decided to depreciate the newly acquired plant over 4 years on the straight-line method.
4. The company had a profit before tax of R1 000 000 for the year ended 31 December 2310, before taking the above into account.
5. Dividend income of R30 000 (exempt from tax) and fines of R9 000 (not deductible for tax purposes) are included in the profit of R1 000 000.
6. An amount of R6 000 in respect of electricity for January 2030 was paid in December 2029 and an amount of R8 000 in respect of electricity for January 2031 was paid in December 2030. The South African Revenue Service allows the expenses prepaid as a deduction for tax purposes in the year in which they are paid.
7. The company sub-lets a portion of its premises and received rent income of R10 000 in 2030 that relates to rent only earned in 2031. The South African Revenue Service regards the rent received as taxable income in 2030.

8. The corporate tax rate is 28%.

YOU ARE REQUIRED TO:

- 1.1. Calculate the profit, exempt from tax, on the sale of the old plant.
(3 marks)
- 1.2. Calculate the carrying amount of the new plant at 31 December 2030.
(2 marks)
- 1.3. Calculate the current income tax and deferred tax for the year ended 31 December 2030, using the “income statement approach”. (15 marks)
- 1.4. Journalise the entries for current tax and deferred tax for the year ended 31 December 2030.
(4 marks)
- 1.5. Prepare the income tax expense note that will accompany the statement of comprehensive income for the year ended 31 December 2030, in accordance with International Financial Reporting standards.
(9 marks)

All amounts are regarded as material.

Comparative figures are not required.

QUESTION 4 (25 MARKS)

The following post-adjustments trial balance of Orange Ltd, for the year ended 31 March 20X2, is available:

	Dr	Cr
	R	R
Gross profit		541 500
Dividend income		6 000
Administrative cost	47 000	
Depreciation: vehicle	26 000	
Depreciation: plant	45 000	
Penalty paid	8 000	
Rent income (R4 500 per month)		54 000
Ordinary share capital		10 000
Retained earnings		5 000
Deferred tax (1 April 20X1)		16 500
Vehicle: Cost (acquired on 1 April 20X0)	260 000	
Vehicle: Accumulated depreciation		52 000
Plant: Cost (acquired on 1 July 20X9)	300 000	
Plant: Accumulated depreciation		120 000
Rent received in advance (for April 20x2)		4 500
Financial asset: Shares in ZZ Ltd	120 000	
Bank	3 500	
	<u>809 500</u>	<u>809 500</u>

Other information:

The following information must be considered for income tax purposes:

1. Wear and tear is allowed, on the straight-line method, as follows:
Plant: 20% p.a.
Vehicle: 15% p.a.
2. The administrative costs are all tax-deductible.
3. Rent is taxed in the year of receipt.
On 1 April 20X1, rent received in advance had a balance of R3 000.
4. The applicable tax rate is 30%.

REQUIRED:

- 1.1 Calculate normal current tax and the movement on the deferred tax account, using the “income statement approach”, starting with the calculation of profit before tax. (14)
- 1.2 Prepare the Income Tax expense note that will accompany the statement of comprehensive income for the year ended 31 March 20X2, including the tax rate reconciliation. (9)
- 1.3 Show the journal to record deferred tax for the year ended 31 March 20X2. (2)

All amounts are regarded as material.

Comparative figures are not required.

DEFERRED TAX QUESTION BANK SOLUTIONS

QUESTION 1

CURRENT TAX EXPENSE			Tax at 28%	
Accounting profit – given	186,000			
Permanent differences				
Tax effects of expenses – not deductible:				
Depreciation – Office buildings	11,000	√		
Traffic fines	5,000	√		
Tax effect of income – not taxable				
Dividend income	<u>(30,000)</u>	√		
	172,000		48,160	√
Temporary differences	(37,250)		(10,430)	√
Depreciation for accounting purposes:				
Factory buildings	25,000	√		
Machinery	31,250	√		
Building allowances (factory building)	(37,500)	√		
Wear and tear – machinery	(50,000)	√		
Electricity paid in advance	(8,000)	√		
Rent received in advance	2,000	√		
	<u>134,750</u>		37,730	√

JOURNAL ENTRIES

Dr Income Tax expense	√	37,730	√P
Cr Current Tax Payable: Income Tax	√		37,730
(Provision for normal tax for the year 2029.)			

Dr Income Tax expense	√	10,430	√P
Cr Deferred Tax	√		10,430
(Deferred tax on temporary differences for the year 2029.)			

MICKEY LIMITED

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2029.

Profit before tax	186,000
Income tax expense	<u>48,160</u> √P
Profit for the period	<u><u>137,840</u></u>

MICKEY LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2029.

INCOME TAX EXPENSE

Normal taxation	
Current tax for the current year	37,730 √
Deferred tax for the current year	<u>10,430</u> √
Total income tax expense as per SOCI	<u><u>48,160</u></u>

Rate reconciliation:

Applicable tax rate	<u>28%</u>		
<i>Tax effects of:</i>			
Profit before tax (186 000 x 28%)	52,080	√	
Depreciation: office building (R11 000 x 28%)	3,080	√	
Traffic fines (R5 000 x 28%)	1,400	√	
Dividend income (R30 000 x 28%)	<u>(8,400)</u>	√	
	<u>48,160</u>		
Effective tax rate (48 160 / 186 000)	25.89%	√P	(26)

QUESTION 2

FINANCIAL YEAR END 2029

1. Calculation of under provision:

Provisional tax paid	580,000	
Balance still outstanding	<u>11,550</u>	√
Assessment	591,550	
Provision for income tax (1 860 000 x 28%)	<u>520,800</u>	√
Under provision	<u><u>70,750</u></u>	√

CURRENT TAX PAYABLE: INCOME TAX					
2.					
Bank	580,000	√	Income Tax expense	520,800	√
	<u> </u>		Balance carried down	<u>59,200</u>	
	<u><u>580,000</u></u>			<u><u>580,000</u></u>	
Balance brought down	59,200		Income Tax expense (underprov)	70,750	√P
Bank	<u>11,550</u>	√		<u> </u>	
	<u><u>70,750</u></u>			<u><u>70,750</u></u>	

3. Income Tax expense calculation – 2030

Profit before tax		2,875,200		
Permanent difference:	Dividends received	<u>(23,400)</u>		√
		2,851,800	798,504	√
Temporary differences:		-	-	
		(69,700)	(19,516)	√
Depreciation		308,900		√
Wear & tear		(378,600)		√
Taxable profit		<u>2,782,100</u>	778,988	√P

4. First provisional tax payment calculation

Taxable profit		<u>1,984,200</u>		
Income Tax expense estimate (1,948,200 x 28%)		<u>555,576</u>		√
First payment (R555 576 / 2)		<u>R 277,788</u>		√

Second provisional tax payment calculation 2030

Taxable profit		1,726,700		
Income Tax expense estimate (R1,726,700 x 28%)		483,476		√
Less: First provisional payment		<u>277,788</u>		√P
Second provisional payment		<u>205,688</u>		√

5. JOURNALS – 2029

Dr	Income Tax exp	√	70,750		√
Cr	Current Tax Payable: Income Tax (Under provision for 2029 financial year)	√		70,750	
Dr	Current Tax Payable: Income Tax	√	11,550		√
Cr	Bank (Final payment for the 2029 financial year)			11,550	
Dr	Current Tax Payable: Income Tax	√	277,788		√
Cr	Bank (First provisional tax payment for 2030 financial year)			277,788	
Dr	Current Tax Payable: Income Tax	√	205,688		√
Cr	Bank (Second provisional tax payment for 2030 financial year)			205,688	
Dr	Income Tax exp	√	778,988		√
Cr	Current Tax Payable: Income Tax (Provision for 2030 income tax expense)	√		778,988	
Dr	Income Tax exp	√	19,516		√
Cr	Deferred Tax (Provision for 2030 deferred tax)	√		19,516	

6. ITALIA LIMITED
STATEMENT OF FINANCIAL POSITION AT 28 FEBRUARY 2030

Non-current liability

Deferred tax	19,516	√P
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Current Liability

Current tax payable: income tax (778 988 - 277 788 √ - 205 688 √)	295,512	
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7. ITALIA LIMITED
NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED
28 FEBRUARY 2030

Accounting policy: Deferred tax

Deferred tax is provided on the comprehensive basis, using the statement of comprehensive income (“income statement”) method √

Income tax expense

R

Current Tax	849,738	
Current tax for the current year	778,988	√
Under-provision of current tax in a prior year	70,750	√P
Deferred Tax	19,516	√P
Total Income Tax expense as per SOCI	869,254	

Deferred tax asset/liability

R

Deferred tax was caused by temporary differences relating to:

Machinery and equipment	19,516	√P
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QUESTION 3 (33 MARKS)

WORKINGS: OLD PLANT:

	Carrying	
	Amount	
	Rand	
Balance at 1 January 2030 (given)	382 500	
Depreciation up to 30 June 2030	<u>(33 750)</u>	√
Carrying amount – 30 June 2010	348 750	
Selling price	<u>461 000</u>	
Profit on sale	<u>112 250</u>	√
Taxable profit	<u>101 250</u>	
Capital profit	<u>11 000</u>	√

(3 marks)

NEW PLANT

	Carrying	
	Amount	
	Rand	
Cost 1 July 2030	800 000	
Depreciation up to 31 December 2030	<u>(100 000)</u>	√
Carrying amount at 31 December 2030	<u>700 000</u>	√

(2 marks)

Calculation of current and deferred tax

	Rand		Tax	
Accounting profit (before new items below)	1 000 000			
Depreciation – old plant	(33 750)	√		
Depreciation – new plant	(100 000)	√		
Profit on disposal of old plant	<u>112 250</u>	√		
Profit before tax (after items above)	978 500			
Permanent differences:				
Capital profit – old plant	(11 000)	√P		
Dividend income	(30 000)	√		
Fines	<u>9 000</u>	√		
Taxable accounting profit	946 500		265 020	√
Temporary differences:	(268 250)		(75 110)	√
Depreciation (33 750 + 100 000)	133 750	√P		
Wear & tear – old plant	(90 000)	√		
Wear & tear – new plant	(320 000)	√		
Add: Expenses pre-paid (electricity): open bal	6 000	√		
Less: Expenses pre-paid (electricity): clos bal	(8 000)	√		
Add: Income received in advance: clos bal	<u>10 000</u>	√		
Taxable income	<u>678 250</u>		189 910	√P

JOURNAL ENTRIES

Dr	Income Tax expense	✓	265 020		
Cr	Deferred tax	✓		75 110	✓
Cr	Current tax payable: Income Tax	✓		189 910	
	OR				
Dr	Income Tax expense	✓	189 910		
Cr	Current tax payable: Income Tax	✓		189 910	
Dr	Income Tax expense		75 110		
Cr	Deferred tax	✓		75 110	✓

(4 marks)

CHEMICAL LIMITED

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2030.

1. Income Tax expense

Normal tax:		
Current tax for the current year	189 910	✓
Deferred tax	75 110	✓
Total tax expense as per SOCI	265 020	

Rate reconciliation:

Applicable tax rate	28%	✓
<i>Tax effects of:</i>		
Profit before tax (978 500 x 28%)	273 980	✓P
Exempt Capital profit (11 000 x 28%)	(3 080)	✓
Exempt Dividend income (30 000 x 28%)	(8 400)	✓
Non-deductible Fines (9 000 x 28%)	2 520	✓
Total tax expense as per SOCI	265 020	
Effective tax rate (265 020/978 500) ✓P	27,08%	✓

(9 marks)

QUESTION 4 (25 MARKS)

1.1 Calculation of normal current tax and the deferred tax

	Profit	Tax at 30%
Gross profit	541 500 ✓ ^{1/2}	
Dividend income	6 000 ✓ ^{1/2}	
Administration cost	(47 000) ✓ ^{1/2}	
Depreciation – vehicles	(26 000) ✓ ^{1/2}	
Depreciation – plant	(45 000) ✓ ^{1/2}	
Penalties	(8 000) ✓ ^{1/2}	
Rent income	54 000 ✓ ^{1/2}	
Profit before tax (Accounting profit)	475 500 ✓ ^{1/2}	
Adjustment for permanent differences:	2 000	
Dividend income	(6 000) ✓	
Penalties	8 000 ✓	
Accounting profits that are taxable (Acc profit 477 500 X 30% = 143 250)	477 500	143 250 TE
Adjustment for movements in temporary differences:	(26 500)	(7 950) DT ✓
Add: Depreciation – vehicles	26 000 ✓	
Add: Depreciation – plant	45 000 ✓	
Less: Wear & Tear allowance – vehicles	(39 000) ✓	
Less: Wear & Tear/Capital allowances – plant	(60 000) ✓	
Add: Income received in advance – Closing	4 500 ✓	
Less: Income received in advance – Opening	(3 000) ✓	
Taxable Income (Taxable profit: 451 000 x 30% = 135 300)	451 000	Normal Current tax 135 300 ✓

(14)

1.2 Note for Income Tax Expense and Tax Rate Reconciliation for 20X2:

INCOME TAX EXPENSE	20X2
• Current Tax	135 300
- Current tax for the current year	135 300✓P
• Deferred Tax	7 950✓P
Total tax expense per the statement of comprehensive income	143 250
<i>RATE RECONCILIATION:</i>	RAND
Applicable tax rate	30%✓
<i>Tax effects of:</i>	
Profit before tax (475 500 x 30%)	142 650✓
Exempt dividend income (6 000 X 30 %)	(1 800)✓
Add: Non-deductible Penalties (8 000X 30%)	2 400✓
Total tax expense per the statement of comprehensive income	143 250✓
Effective tax rate $\frac{143\,250}{475\,500} \times 100 = 30,126\%$	30,13%✓
The effective tax rate is higher than the applicable tax rate due mainly to: Non-deductible penalties. ✓ Bonus mark	

(9)

1.3 JOURNAL TO RECORD DEFERRED TAX

Journal – March 20X2			Debit	Credit
20X2				
Mar	31	Income Tax expense ½	7 950	
		Deferred tax ½		7 950✓

(2)