

**Part 2****Chapter 5**  
**Accounting for taxation**

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Question	Key issues
5.1	Understanding provisional payments
5.2	Ledger accounts and disclosure of taxation expense and current tax asset/ liability
5.3	Calculation of provisional payments
5.4	Journal entries, ledger accounts and disclosure
5.5	Current normal tax: basic calculations and disclosure
5.6	Calculation of normal tax: (taxable profit includes a capital gain); disclosure
5.7	Calculation of normal tax: (taxable profit includes a temporary and permanent differences); disclosure
5.8	VAT on companies
5.9	Disclosure of taxation on statement of comprehensive income, statement of financial positions and notes
5.10	Statement of comprehensive income, statement of changes in owners equity and notes to financial statements
5.11	Current normal tax: calculation and journals: involving accruals with opening & closing balances
5.12	Current normal tax: calculation and journals: involving accruals with opening & closing balances
5.13	Current normal tax calculations and journals

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**Question 5.1**

"The accountant says we underprovided for last year's tax, yet we showed a current tax asset in last year's statement of financial position. I can't understand what he's talking about!"

**Required:**

Explain how the above situation could have arisen and how the under provision should be accounted for.

**Question 5.2**

The following information relates to Misty Ridge Limited, which commenced business on 1 January 20X1. The financial year-end of the company is 31 December.

		C
<b>First year</b>		
30 June 20X1	Provisional payment	26 000
31 December 20X1	Provisional payment	28 000
31 December 20X1	Provided for taxation	56 000
16 April 20X2	Amount of assessed normal tax on taxable profit	56 000
16 May 20X2	Paid assessment	
<b>Second year</b>		
30 June 20X2	Provisional payment	29 000
31 December 20X2	Provisional payment	30 000
31 December 20X2	Provided for taxation	58 000
19 May 20X3	Amount of assessed normal tax on taxable profit	59 500
19 June 20X3	Paid assessment	
<b>Third year</b>		
30 June 20X3	Provisional payment	31 000
31 December 20X3	Provisional payment	31 500
31 December 20X3	Provided for taxation	65 000
18 April 20X4	Amount of assessed normal tax on taxable profit	64 800
18 May 20X4	Paid assessment	
<b>Fourth year</b>		
30 June 20X4	Provisional payment	33 000
31 December 20X4	Provisional payment	34 000
31 December 20X4	Provided for taxation	67 400

All companies are required to make the provisional payments of tax during its financial year – the first, half way through the financial year or earlier and the second on or before the last day of the year

**Required:**

- a) Prepare the current tax liability/ asset and taxation expense ledger accounts for the four years 20X1 to 20X4.
- b) Show the relevant disclosure in the annual financial statements of Misty Ridge Limited for the four years ended 31 December 20X1 to 20X4 in respect of the above transactions.

**Question 5.3****Part A**

The accountant of Koogi Ltd. made the following estimates of the taxable profit for the year ended 31 December 20X9:

- On 30/6/20X9: estimated taxable profit for the year of C40 000
- On 31/12/20X9: estimated taxable profit for the year of C50 000
- On 30/4/20Y0: (when preparing the financial statements for the year ended 31/12/X9) estimated taxable profit for the 20X9 year of C40 000

Tax on taxable profits is levied at 30%.

**Part B**

Assume the same information in part A above, with the exception that the estimated taxable profit on 31/12/20X9 for the purpose of calculating provisional tax amounted to C30 000.

**Part C**

Assume the same information in part A above, with the exception that the estimated taxable profit on 31/12/20X9 for the purpose of calculating provisional tax amounted to C15 000 and the amount of assessed normal tax on taxable profit was C10 000, (not C14 000 per 'e' and 'f' of the required).

Assumption: Assume two provisional tax payments are required to be made as per the tax laws during the year.

**Required:**

For each of Part A, B and C above, calculate:

- a) The amount of the first provisional payment
- b) The amount of the second provisional payment
- c) The amount shown in the statement of comprehensive income as current tax for the year ended 31/12/20X9
- d) The balance on the current tax liability/ asset account shown in the statement of financial position as at 31/12/20X9 assuming a zero opening balance at the beginning of the year.
- e) Assuming that the amount of assessed normal tax on taxable profit was C14 000, calculate whether there is an under/over-provision of current tax in the following financial year, in respect of 20X9. If so calculate the amount.
- f) Assuming the same additional information given in (e) above (the amount of assessed normal tax on taxable profit was C14 000 for 20X9) determine whether a refund is due by the tax authorities or whether a payment with return is due to the tax authorities during the following financial year in respect of 20X9. Calculate the amount.

**Question 5.4**

Wak Limited is a company with a financial year ending on 28 February. The following information relates to the financial years 20X6, 20X7 and 20X8:

	20X8	20X7	20X6
	C	C	C
Profit before tax	16 700	15 200	12 000
Tax expense	5 845	5 320	4 200
Tax payments made during the year	5 950	5 000	4 000
The amount of assessed normal tax on taxable profit for:			
20X6 – Assessment received during 20X7 financial year			4 600
20X7 – Assessment received during 20X8 financial year		4 825	
20X8 – Assessment received during 20X9 financial year	6 000		

- Any amounts owing to or by the tax authorities (as a result of the tax authority's amount of assessed normal tax on taxable profit not equalling the accountants estimate) are settled in the year the assessment is received.
- There was no amount owing to the tax authority in respect of years prior to 20X6.
- There are no components of other comprehensive income.
- The tax on taxable profit remained 35% over the three years.

**Required:**

For each of the financial years in question, prepare journal entries to record the above transactions, enter the journal entries in the relevant ledger accounts, and show how the above information would be disclosed in the annual financial statements of Wak Limited.

**Question 5.5**

The following information has been provided in respect of Big Blue Ltd, a company that began operations in 20X2:

- The tax expense in the statement of comprehensive income for 20X3 is C83 650 (20X2: C87 000).
- The balance owing to the tax authority per the statement of financial position as at 31 December 20X2 was C5 000.
- The amount of assessed normal tax on taxable profit for 20X2 finalized during 20X3, stating that the tax for 20X2 (before taking into account any payments made during 20X2) was C85 900.
- The total payments made to the tax authority in respect of normal income tax during 20X3 is C80 000 (including the provisional payments for 20X3 and any payment with return/ refund in respect of 20X2).

- There was a capital profit of C13 000 (non-taxable), dividend income of C5 000 (non-taxable) and a fine of C500 (non-deductible for tax purposes) during 20X3.
- Profit before tax in 20X3 is C300 000 (20X2: C290 000).
- The rate of normal income tax is 30% on taxable profits. The tax rates have remained unchanged since 20X2.

**Required:**

Prepare, in accordance with the International Financial Reporting Standards and to the extent that information is available, the:

- a) Taxation expense note for the year ended 31 December 20X3
- b) Statement of financial position as at 31 December 20X3;

*Accounting policy notes are not required.*

*Comparative figures are required*

**Question 5.6**

The profit before tax of Zac Ltd for the year ended 31 December 20X2 of C500 000 includes the following items:

- Profit of C100 000 on sale of a building. The original cost was C300 000 and its carrying amount and tax base were both C280 000 on the date of the sale. Assume that the Sale Proceeds for tax purposes shall be taken up to the maximum of the cost of building.
- Dividend income of C10 000 is taxable at 10%.
- Donations of C50 000 (not deductible).
- Traffic fines of C30 000 (not deductible).

There are no components of other comprehensive income.

The applicable tax rate was 30% on taxable profits. Assume that no dividends were declared during the year and that there were no temporary differences during the year.

**Required:**

- a) Calculate the taxable profit and current tax.
- b) Show how this will be disclosed in the statement of comprehensive income and taxation note for the year ended 31 December 20X2 in accordance with International Financial Reporting Standards.

**Question 5.7**

Wac Ltd has profit before tax of C250 000 for the year ended 31 December 20X1. When calculating this figure, the following information was correctly accounted for:

- Unearned sales income of C24 000 received in advance in respect of 20X2 (taxable in the current year).

- Interest income of C7 000 is receivable (taxable in the current year)
- Telephone payment of C5 000 is due for 20X1 but has not yet been paid (deductible for tax purposes in the current year)
- The rent for the first month in 20X2 of C10 000 has already been paid (deductible for tax purposes in the current year).
- Dividend income of C12 000 was earned during 20X1 taxable at 10%
- A donation of C8 000 was paid during 20X1 (not deductible for tax purposes)
- Depreciation of C40 000 was expensed during the year. The tax depreciation is of C25 000.

There are no components of other comprehensive income.

The applicable tax rate is 30% on taxable profits. There are no other permanent or temporary differences other than those apparent from the above information.

**Required:**

- a) Calculate the current tax and show the related journal entries.
- b) Show the disclosure of taxation in the statement of comprehensive income and taxation expense note for the year ended 31 December 20X1 in accordance with International Financial Reporting Standards.

*Ignore deferred taxation.*

**Question 5.8**

BG Ltd, registered as a vendor for VAT purposes, has the following transactions for the month of March 20X9:

- Bought inventories with a marked price of C200 000 from a non-VAT vendor.
- Bought inventories from a VAT vendor. The invoice totalled C33 000.
- Sold inventories to Mr. A (a non-VAT vendor) with an invoice value of C800 (includes VAT).
- Sold inventories to Mr. B (a VAT vendor) with an invoice value of C12 000 (includes VAT).
- Paid electricity and water: C420 (includes VAT).
- Paid telephone of C190 (includes VAT).
- Paid salaries of C20 000 in cash. Employees' tax owing to the tax authority as a result came to C8 000. VAT is not levied on salaries.

- Paid C11 000 employees' tax during the month and there was a balance owing at the beginning of the month of C6 000.
- The balance on the VAT account at the beginning of the month was C2 000 (debit).
- A VAT refund of C5 000 was received during the month of March 20X9.
- Dividend income of C12 000 was earned during the month. VAT is not levied on dividends.
- Dividends of C18 000 were declared during the month. VAT is not levied on dividends.

Rate of VAT is 14%.

There are no components of other comprehensive income.

**Required:**

- Journalise the above transactions.
- Show how the above would be disclosed in the financial statements of BG Ltd for the month of March 20X9.

**Question 5.9**

The following balances were extracted from the books of Peach Limited at 31 May 20X6:

	C	
Profit before tax	115 000	(Cr)
Dividends paid – 30 November 20X5	15 000	(Dr)
Provisional tax payments	43 000	(Dr)

**Additional information**

- Included in the profit before tax are dividends received of C8 000, other expenses of C40 000 and interest paid of C2 000.
- The company declared a final dividend of C10 000 on 31 May 20X6.
- Taxation for the year has not yet been calculated. Assume all revenue included in profit for the year to be taxable and all expenses to be deductible. The normal tax rate is 35% on taxable profits and the tax rate on dividend income is 10%.
- As the assessed amount of normal tax on taxable profit was received in May of the current year from the tax authority in respect of the 20X5 tax year which showed that there had been an under provision of C1 500 in that year.
- There are no components of other comprehensive income.

**Required:**

- Prepare the statement of comprehensive income of Peach Limited for the year ended 31 May 20X6 (starting with the gross profit).

- b) Prepare the statement of financial position of Peach Limited at 31 May 20X6.
- c) Prepare the taxation note for the financial statements of Peach Limited.

**Question 5.10**

The financial director of Caribbean Limited is in the process of finalizing the financial statements for the year ended 28 February 20X7. The trial balance at that date is as follows:

**CARIBBEAN LIMITED****TRIAL BALANCE AT 28 FEBRUARY 20X7**

	Debit	Credit
Ordinary share capital		3 000 000
Share premium		1 500 000
Distributable reserves		1 424 200
Borrowings		2 000 000
Accounts payable		400 000
Accrued expenses		20 000
Property, plant and equipment	4 200 000	
Accounts receivable	1 100 000	
Accrued income	15 000	
Inventory	1 800 000	
Tax Refundable	200 000	
Cash at bank	2 059 200	
Revenue		12 000 000
Cost of sales	7 100 000	
Net operating expenses	3 480 000	
Interest on borrowings	240 000	
Share issue expenses	150 000	
	<u>20 344 200</u>	<u>20 344 200</u>

**The following information is relevant:**

- The authorized share capital comprises 10 000 000 ordinary shares of 0.50c each. During the year, 1 000 000 shares were issued at a price of C2.00. The issue of the shares has been correctly recorded in the accounting records. Share issue expenses of C150 000 were paid. The financial director wishes to account for these expenses with the minimum impact on distributable reserves.
- The borrowings relate to a loan taken out by Caribbean Limited on 1 July 20X4 for a three year period. The company does not have the right to defer settlement of the loan.
- The balance on the property, plant and equipment comprises land with a carrying amount of C3 150 000 and plant and equipment with a carrying amount of R1 050 000. Property is measured at revalued amount and plant and equipment is measured at cost.
- At year end, the directors engaged the services of an independent valuer who has valued the property at C3 950 000. There is no intention to sell the land. The managing director, who is not an accountant but has been perusing the IASB website, has queried whether the revaluation surplus should be recognized as income based on the following paragraph in IAS 1: "An entity shall recognize all items of income and expense in a period in profit or loss unless an IFRS requires or permits otherwise." (IAS 1, para 88).



- During the year, an item of plant and equipment was sold for C330 000. This item of plant had cost C300 000 and to date of sale accumulated depreciation and tax allowances amounted to C120 000. The sale of the plant has been correctly recorded in the accounting records and has been netted off against the operating expenses.
- The inventory has a net realizable value of C1 720 000 and the accounts receivable are expected to realize C980 000.
- Included in the operating expenses are depreciation of property, plant and equipment amounting to C210 000, salaries of C1 800 000, advertising of C35 000, repairs to equipment of C28 000 and auditors remuneration of C110 000.
- Dividends of five cents per share were declared on 25 March 20X7. The financial statements were authorized for issue on 30 March 20X7.
- The financial director wishes to present the statement of comprehensive income and the statement of financial position in accordance with the requirements of IAS I.

The current normal income tax rate is 29%.

**Required:**

- Prepare the statement of comprehensive income of Caribbean Limited for the year ended 28 February 20X7, in accordance with International Financial Reporting Standards
- Prepare the statement of changes in equity of Caribbean Limited for the year ended 28 February 20X7, in accordance with International Financial Reporting Standards
- Prepare the current liabilities section of the statement of financial position of Caribbean Limited at 28 February 20X7, in accordance with International Financial Reporting Standards
- Prepare the following notes to the financial statements in accordance with International Financial Reporting Standards
  - Statement of compliance and accounting policy for basis of preparation
  - Share capital, profit before tax, taxation expense and dividends

*Ignore deferred tax*

**Question 5.11**

Gripping Limited has provided you with the following extracts of its draft financials for the year ended 31 December 20X3:

	20X1 C	20X2 C	20X3 C
Profit before tax	300 000	400 000	450 000
Included in the profit before tax is:			
- donations to various charities	40 000	0	
- profit on sale of vehicle	50 000	0	
- depreciation on machine (purchased in yr 2) (Tax depreciation: 25 000 in year 2 and 25 000 in year 3)	0	15 000	15 000
- profit on sale of this machine (cost 70k, sales proceeds 80K)	0	0	40 000

Income received in advance (closing balance)	20 000	10 000	40 000
Expenses prepaid (closing balance)	30 000	40 000	20 000

The following tax related information has been provided to you:

	20X1 C	20X2 C	20X3 C
Capital gain on sale of vehicle/ machine	15 000	n/a	?
Provisional tax payments	60 000	70 000	100 000
Tax payment with return for previous year (assume payments made in full)	n/a	?	?
Tax for year 1 (per assessment received during year 2)		94 000	
Tax for year 2 (per assessment received during year 3)			114 500

- There were no other assets or liabilities other than those mentioned above.
- There were no other permanent or temporary differences other than those mentioned above.
- 20X1 is the first year of operations.

**Required:**

Provide all journal entries relating to the current normal for each of the years ended 31 December 20X1, 20X2 and 20X3. Ignore deferred tax.

**Question 5.12**

Alaska Limited *correctly* calculated profit before tax of C885 000 *after* taking into account the following:

- Depreciation on office equipment of C110 000 in 20X8. The local tax authority allowed the deduction of C80 000 capital allowances on this equipment in 20X8.
- Rental income received in advance (taxable when received):
  - 31 December 20X7: C6 500
  - 31 December 20X8: C7 500
- Insurance expense prepaid:
  - 31 December 20X7: C3 000
  - 31 December 20X8: C6 000
- A provision for leave pay of C50 000 was raised on 31 December 20X8. The tax authority only allows this to be deducted when paid.
- A profit was made on sale of machinery of C150 000. The machine was acquired on 1 January 20X6 at a cost of C600 000 and sold on 31 December 20X8. Depreciation is calculated at 25% p.a. straight line to a nil residual value. Capital allowances of 20% p.a. straight line are granted.
- A VAT penalty of C6 000 was paid for late payment of VAT.

- Total tax depreciation for the year of assessment is C170 000.
- The 20X5 tax assessment arrived in June 20X6 and reflected current normal tax of C234 000.
- The first provisional tax payment was made on 31 December 20X5 on an estimated taxable income of C600 000.
- The second provisional tax payment was made on 30 June 20X6 on an estimated taxable income of C405 000.
- The C11 350 owing at the beginning of the year was paid on 1 September 20X5.
- The corporate normal tax rate is 30%.
- There are no other permanent or temporary differences other than those evident from the information above.

**Required:**

- a) Calculate the current normal tax for the year ended 30 June 20X6.
- c) Prepare all the journals relating to current tax for the year ended 30 June 20X6.

- A non-deductible traffic fine of C1 000.
- Dividends received of C60 000.
- The tax assessment for 20X7 arrived in 20X8 and indicated taxable profits of C700 000. Current normal tax of C230 000 was recorded in 20X7.
- The corporate normal tax rate is 30% for both 20X7 and 20X8.
- Dividends are exempt from tax.
- The balance owing to the tax authorities at 31 December 20X7 was C8 000.
- Payments of C200 000 have been made to the tax authorities during 20X8.

**Required:**

- Calculate the current normal tax for the year ended 31 December 20X8.
- Prepare the journal entries relating to current tax, the accruals and the provision.

**Question 5.13**

DCI Limited has correctly calculated profit before tax of C535 000. An extract from the statement of comprehensive income for the year ended 30 June 20X6 is as follows:

	20X6
	C
Donation (non-deductible: for tax purpose)	30 000
Donation (deductible: for tax purpose)	50 000
Depreciation on plant and machinery	190 000
Profit on sale of plant	30 000
Impairment of machinery	20 000
Profit on sale of machine	?

An extract from the statement of financial position for the year ended 30 June 20X6 is as follows:

	20X6	20X5
	C	C
Accrued expenses	4 000	11 000
Expense prepaid	17 000	18 000
Income received in advance	5 500	8 900
Current tax payable	?	11 350

- The profit on sale relates to plant that was sold for C230 000 and had originally cost of C800 000. Total capital allowances claimed to date on the plant are C400 000 (up to and including the 20X6 financial period).
- An item of machinery (not the item impaired above) was sold during the year. The depreciation on this machine is included in the C190 000 depreciation mentioned above. Accounting profit realised was C120 000. Its cost was C100 000, carrying amount of C80 000 and a tax base of C90 000 on the date of sale.