



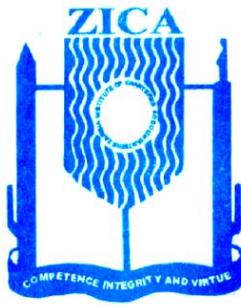
ZAMBIA INSTITUTE OF CHARTERED ACCOUNTANTS

LICENTIATE LEVEL
L 3: Advanced Taxation
June 2010
December 2010
June 2011

QUESTION PAPERS AND SUGGESTED SOLUTIONS

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ZAMBIA INSTITUTE OF CHARTERED ACCOUNTANTS
CHARTERED ACCOUNTANTS EXAMINATIONS

LICENTIATE LEVEL

L3: ADVANCED TAXATION

SERIES: JUNE 2010

TOTAL MARKS – 100

TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS TO CANDIDATES

1. You have ten (10) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question. You will be told when to start writing.
2. There are SEVEN questions in this paper. You are required to attempt any FIVE questions. ALL questions carry equal marks.
3. Enter your student number and your National Registration Card number on the front of the answer booklet. Your name must NOT appear anywhere on your answer booklet.
4. Do NOT write in pencil (except for graphs and diagrams).
5. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.
6. All workings must be done in the answer booklet.
7. Present legible and tidy work.
8. Graph paper (if required) is provided at the end of the answer booklet.
9. Present Value and Annuity Tables are attached at the end of the question paper.

Taxation Table for the charge year 2010/11

1. Income Tax

Personal Income Tax rates

	Chargeable Income (Kwacha)	Rate %
First	9,600,000	0
Next	6,420,000	25
Next	33,180,000	30
Excess over	49,200,000	35
Income from farming		15

2. Company Income Tax rates

	Rate %
On income from manufacturing and other	35
On income from non-traditional exports	15
On income from farming	15

3. Capital Allowances

(a) Implements, plant and machinery and commercial vehicles:

Wear and Tear Allowance: – Used normally	25%
-Used in manufacturing, tourism, farming, Leasing	50%

(b) Non-Commercial Vehicles

Wear and Tear Allowance	20%
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(c) Industrial Buildings:

Wear and Tear Allowance	5%
Initial Allowance	10%
Investment Allowance	10%

(d) Low Cost Housing: (Cost up to K20,000,000)

Wear and Tear Allowance	10%
Initial Allowance	10%

(e) Commercial Buildings

Wear and Tear Allowance	2%
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(f) Farming

Development Allowance	10%
Farm Works Allowance	100%
Farm Improvement Allowance	100%

4. Property Transfer Tax

Rate of Tax on Realised Value	3%
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5. Value Added Tax

Registration threshold	K200,000,000
Standard Value Added Tax Rate (on VAT exclusive turnover)	16%

6. Customs and Excise

Duty rates on:

- (i) Motor cars and Motor vehicles (including station wagons) principally designed for transport of less than ten persons, including the driver.

Customs duty	25%
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Excise duty:

Cylinder capacity of 1500cc and less	20%
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Cylinder capacity of more than 1500cc	30%
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- (ii) Pick up trucks/lorries with gross weight not exceeding 20 tones:

Customs duty	15%
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Excise duty	10%
-------------	-----

- (iii) Buses/coaches for transport of more than ten persons.

Customs duty	15%
--------------	-----

Excise duty:

Seating capacity of 16 persons and more	0%
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The minimum amount of customs duty on motor vehicles in categories from (i) up (iii) above is K2,000,000

Question 1

- (a) Your name is Bwalya Mutale and you are a reputable tax consultant in Kabwe. You have been approached by a Mr. John Zulu who recently won K35 million in a state lottery and wishes to go into business. John is not sure whether he should go into a business as:
- a sole trader
 - a partnership
 - a director of a private company by subscribing for some shares in a company

Required:

To give a reasoned account of the tax implications in setting a business as

1. A sole trader (3 marks)
 2. Partnership (3 marks)
 3. Purchase of shares in a private company and becoming a director. (3 marks)
- (b) Assuming that after your advice to John Zulu in (a) above, John opted to go into a business as a sole trader, introducing K10 million of his spoils as capital having donated the rest of his winnings to his family members. John's business started well and in no time he was earning super profits.

His uncle, a Mr. Amos Phiri, who was working as a political attaché in a diplomatic mission service, has just retired with some lucrative golden hand shake. And seeing that John is doing well in business has made a request to join him in partnership as from 1st April 2009. An alternative which John can consider is to employ his uncle in the capacity of Public Relations Manager. The arrangements under these possibilities would be as follows:

1. If the uncle is taken on as an employee, his monthly salary will be K12 000 000 and he will be required to contribute 5% of his salary to NAPSA. John Zulu is currently drawing a monthly salary of K10 million.
2. If the uncle is introduced to the business as a partner, it is agreed that he will introduce capital into the business of K10 million. And partnership salaries will be K10 million for John and K12 million for the uncle. Interest on capital of 1% is agreed upon. Profits and losses will be shared in the ratio of 2:1 respectively. NAPSA would not be payable under this arrangement.

Required:

1. Assuming that a final taxable profit K68 million was made in the year ended 31st March 2011, calculate the income tax that will be paid by John Zulu and Amos Phiri
2. If the uncle is admitted as a partner and (4.5 marks)
3. If the uncle is employed by his nephew John (4.5 marks)
4. Advise John Zulu as to which the above options is beneficial from a tax point view. (2 marks)

(Total: 20 marks)

Question 2

- (a) Property Transfer Tax legislation which is enshrined in Cap 340 of the Laws of Zambia stipulates that a tax is payable on the realisable value of qualifying property that is transferred between parties.

Required:

1. Outline categories of qualifying property (2 marks)
2. Explain what is meant by the immediate family and outline the tax implication on the transfer of property. (2 marks)

- (b) In cases where it is shares that are transferred or property that is transferred

Required

Explain how the realisable value on transfer of shares is determined. (1 mark)

- (c) In relation to trusts and estates, either the executor or the administrator is the tax paying agent of two persons namely the deceased person and the estate of the deceased person

Required:

Briefly explain the difference between the executor and an administrator as tax paying agents .

(½ mark)

Trusts can be those with an interest in possession or discretionary or accumulation and maintenance.

Required:

Distinguish between the remainder man and the life tenant. (½ marks)

- (d) Your late brother Jacob Choma was employed as an Accountant with Yesani Limited on 1 January 2006. Upon a successful completion of the professional examinations of the Zambia Institute of Chartered Accountants, on 5th February 2007 he was promoted to the position of Accountant. Unfortunately on 2nd December 2010 he died a tested person after a short illness. Prior to his death he received the following income:

- A monthly salary of K8 million from his employment with Yesani Limited
- Tax adjusted rental income of K4 400 000 (net)
- Bank deposit interest of K600 000 per month gross

The late Mwale left behind a bank deposit account of K60 million and a house valued at K650 million. The PAYE on his income was K26 450 000

Required:

Calculate the income tax payable by your late brother Mwale and the tax payable by the tax paying agent .

(14 marks)

(Total: 20 marks)

Question 3

PJ Ltd is planning to install a new machinery. The machine would cost K696 million vat inclusive.

A decision has now been made on the method of financing the project. Three methods of are being considered.

- The Company could purchase the machine for cash, using bank loan facilities on which the current rate of interest is 20%.
- The Company could lease the machine under an agreement of finance lease which would entail payment of K100million per year.
- The Company could purchase the machine under a hire purchase agreement. This would require an initial deposit of K400 million at the start of year and K300 million at the end of tax year 2010/11
- The last instalment compromise of K4 million.

Required:

- Advise PJ Limited of income tax and VAT implication of each of the above financial options. (7 marks)

The business can raise the finance through equity and debt financing.

- Explain the tax implication of the Debt financing in form of Debentures and equity finance through ordinary share capital. (4 marks)
- Advise on the tax incentives available for the following sectors.
 - Mining company holding a large scale license (5 marks)
 - Farming enterprise (4 marks)

(Total: 20 marks)

Question 4

On 1 May 2010 Chaaba House purchased a dilapidated freehold house for K254 million. Legal fees of K3.6 million were paid in respect of the purchase.

Chaaba then renovated the house at a cost of K101.2 million, with the renovation being completed on 10th August 2010. He immediately put the house up for sale, and it was sold on 31 August 2010 for K520 million. Legal fees of K5.2 million were paid in respect of the sale.

Chaaba financed the transaction by a bank loan of K300 million that was taken out on 1 May 2010 at an annual interest of 10%. The bank loan was repaid on 31 August 2010.

Chaaba had no other income or disposal profits for the tax year 2010/11 except as indicated above.

Chaaba has been advised that whether or not he is treated as carrying on a trade will be determined according to the six “badges of trade”

Required:

- (a) State and briefly explain the meaning of each of the six “badges of trade” Note: you are not expected to quote from decided cases. (12 marks)
- (b) Calculate Chaaba House’s income tax liability for the tax year 2010/11, if he is treated as carrying on a trade in respect of the disposal of freehold house. (8 marks)

(Total: 20 marks)

Question 5

Cheesu is a tailor who started working for Nex Designers Ltd on 6 April 2009. The following information is available in respect of the year ended 5 April 2011:

- (1) Cheesu is entitled to an average salary of K4 million, housing allowance of 30% of average salary and a transport allowance of K200,000 per month from Next Designers Ltd. He works a set number of hours each week and is paid an hourly rate for the work that he does. When Cheesu works more than the set number of hours he is paid overtime.
- (2) Cheesu is under an obligation to accept the work offered to him by Next Designers Ltd and the work is carried out under the control of the company’s production manager. He is obliged to do the work personally, and this is all performed at Next Designers Ltd’s premises.
- (3) All of the equipment that Cheesus uses is provided by Next Designers Ltd. Cheesus has several friends, who are tailors, and they are all treated as self employed, he therefore considers that he should be treated as self employed as well in relation to his work for Next Designers Ltd.

Required:

- (a) List and explain those factors that indicate that Cheesu should be treated as an employee in relation to his work for Next Designers Ltd rather than as self employed. You should confine your answer to the information given in the question. (6 marks)
- (b) Explain why it is important to distinguish between contracts of service and contracts for service. (8 marks)
- (c) Calculate Cheesu's income tax liability for the tax year 2010/11. (6 marks)

(Total: 20 marks)

Question 6

- (a) Zambia Revenue authority has in years made a list of effort at bringing the informal sector into the tax net in an effort to broadening the tax base and consequently reduce the tax burden on those who are in the formal sector. The results have not been very phenomenal, however, owing to the number of factors.

Explain the challenges and possible methods of taxing the informal sector. (12 marks)

- (b) Mr. Jack Loya and company is a law firm specialising in attorney services, liquidation and trusteeship bankruptcy. The senior partner Jack Loya was appointed as a liquidator for Defakiti limited which has gone under voluntary liquidation. The liquidator made the first declaration of a dividend of K500 million on 1st January 2011. The balance sheet of Defakiti Limited on that date appeared as follows:

Balance sheet as at 1st January 2011.

	K' million
Liabilities	
Paid up share capital	800
Share premium account	300
Reserves (note 1)	400
	1,500
Assets	
Immovable property at cost (note2)	600
Cash in hand	900
	<u>1,500</u>

Note:

1. This is made up of an appropriation account of which K60 million represents capital profits.
2. This consists of land and buildings not yet realized.

Required:

- (i) Compute the portion that will be regarded as a dividend for tax purposes. (3 marks)
- (ii) Calculate the withholding tax (W.H.T.) payable. (2 marks)
- (iii) Although the declaration was made on 1st January 2011, payment of the dividend was actually made on 16th February 2011. State the due date of payment of the withholding tax. You should give a reason(s) to support your choice of the due date. (3 marks)

(Total: 20 marks)

Question 7

Sampa has the past five years, run a business importing electrical goods from the far east which he then sells to wholesalers in Zambia.

During the year to 31st December 2010, Sampa was not satisfied with the tax liability calculated by the Zambia Revenue authority on some of his imports.

His profit and loss account for the year end 31st December 2010 is as follows:

	Note	K'000	K'000
Sales			650,000
Cost of goods sold			(345,000)
Gross profit			305,000
Rent received	1		<u>19,000</u>
			324,000
Wages and salaries		100,400	
Rent and rates	1	25,800	
Light and heat	1	10,500	
Depreciation of fixtures and fittings		3,00	
Insurance		7,100	
Travelling and entertain	2	21,500	
Impaired	3	13,500	
Depreciation of vehicles		15,000	
Motor car expenses	4	9,000	
Sundry expenses	5	1,500	
Legal and profession charges	6	9,500	
Interest on bank overdraft	1	3,000	
Van expenses		18,600	
Telephone		6,700	
Repairs and renewals	7	<u>7,000</u>	
		<u>(252,100)</u>	
		<u>71,900</u>	

Note: 1 Rent received

Rent received is in respect of a flat above Sampa's business premises that is rented out. Sampa estimates that a tenth of the rent and rates, and a seventh of the light and heat relate to the flat.

Note: 2 Travelling and entertaining expenses

	K'million
Sampa's business travelling expenses	10.35
Christmas presents for staff	0.50
Entertaining Zambian Suppliers	5.50
Entertaining Zambian customers	4.60
Gifts to customers' that carry the business name	
Boxes of chocolate costing K25,00 each	0.25
Calendars costing K20,000 each	0.30
	<u>21.50</u>

Note: 3 Impaired debts

Trading debts written off	7.50
Increase in allowance for debtors	3.50
Loan to employees written off	3.40
Trade debt recovered (written off last year)	<u>(0.90)</u>
	<u>13.50</u>

Note: 4 Motor car expenses

Sampa's motor car expenses	6.60
Salesman's motor car expenses	2.40
	9.00

Sampa's total mileage for the year was 12,000 miles. During the year he drove 2,000 miles on a touring holiday and estimates that the balance of his mileage is 20% private and 80% business.

Note: 5 Sundry expenses

Donation to a registered charity	0.06
Donation to local political party	0.20
Wedding gift to a member of staff	0.09
Sampa's squash club subscription	0.50
Advertising in trade press	0.65
	<u>1.50</u>

Sampa often uses his squash club as a place to take customers since several of them are keen squash players.

Note: 6 Legal and professional charges

	K'million
Cost of renewing a lease on business premises	0.50
Accountancy	6.05
Debt collection	0.65
Legal fees in connection with an action by an employee for Unfair dismissal	2.30
	9.50

Included in Sampa's accountancy fee is K1.9 million for taxation services. Of this K0.4 million is for the normal taxation work involved in submitting accounts to ZRA. The balance is in respect of calculating Sampa's tax liability following the disposal of some shares that he had owned.

Note: 7 Repairs and renewals

	K' million
Repairs to the office photocopiers	0.35
New printer for the office computer	1.30
Installation of the new central heating for the Decorating the office	4.40
	0.95
	7.00

Note: 8

During the year ended 31st December 2010 Sampa took various electrical goods out of the stock for his own and his family's use without paying for them. These goods cost K0.9 million and would have normally been sold at a mark up to 30%.

Note: 9

Sampa has a room in his private house that he uses as an office as he often works at home. The allowable amount for the use of office is K0.50 million and appears to be a fair estimate. Also, Sampa makes business calls from his private telephone and he estimates the business use as two fifths, the total of his private telephone bill for the year was K0.9 million.

Required:

- (a) Advice on the assessable income (before capital allowances) for the year ended 31st December 2010. (13 marks)
- (b) Advice Sampa on Appeals Procedure for the tax liability that he is not satisfied with. (7 marks)

(Total: 20 marks)

JUNE 2010
L3: ADVANCED TAXATION
SUGGESTED SOLUTIONS

Solution 1

(a) The following are the tax implications of setting the following forms of business:

Sole trader

- Assessed to income tax on the whole amount of tax adjusted profit whether any drawings are made or not (1 mark)
- Private use of assets results in restriction of capital allowances to the proportion of the private use and any expenses relating to such assets are not allowed for tax purposes. Only the proportion relating to business use is allowed. (1 mark)
- Drawings are charged to the personal account of the sole trader. (1 mark)

Partnerships

- Individual partners are assessed to income tax on the whole of the tax adjusted profit whether any drawings are made or not only appropriations (1 mark)
- Private use of assets results in restriction of capital allowances to the proportion of the private use and any expenses relating to such assets are not allowed for tax purposes. Only the proportion relating to business use is allowed (1 mark)
- Drawings are charged to partners (1 mark)

Directors

- Only assessed to income tax on any amounts that she or he receives from the company by way of emoluments (1 mark)
- Private use of assets does not result in restriction on capital allowances and related expenses by a director are allowed if full. (1 mark)
- Benefits which are not convertible to cash are charged to the company. These will include company housing and personal to holder cars (1 mark)

(b) Taxation of K68 million if Amos comes in as a Partner

Details	John	John Tax	Amos	Amos Tax	Total Family Situation
Partnership salaries	10,000,000		12,000,000		22,000,000
Interest on capital	100,000		100,000		200,000
Share of profits	30,533,333		15,266,667		45,800,000
Totals	40,633,333		27,366,667		68000000
Less Tax free amount	-9,600,000	-	-9,600,000	-	
7620000@25%	-6,420,000	1,605,000	-6,420,000	-1,605,000	-3,210,000
Amount @30%	-24,613,333	7,384,000	-11,346,667	3,404,000	-10,788,000
NET FAMILY INCOME	-		-		54,002,200

(4.5 marks)

Taxation of K68 million if Amos comes in as an employee

Details	John	John Tax	Amos	Amos Tax	Total family situation
Profits	68000000				68000000
Salary	-12000000		12000000		
NAPSA	-600000		-600000		-1200000
Net Income	55400000		11400000		
Tax free amount	-9,600,000	-	-9,600,000	-	
Taxable Amount			-1,800,000		
Amount taxed @25%	-6,420,000	1,605,000	-1,800,000	450,000	-2,055,000
Amount taxed @30%	-33,180,000	9,954,000	-		-9,954,000
Amount taxed @35%	-6,380,000	2,233,000	-		-2,233,000
BALANCE	-	13,792,000	-	450,000	52,558,000

(4.5 marks)

Conclusion

The family net income is more if Amos is brought in as a partner by K1 444 000. And as such John is advised to admit his uncle as a partner in the business. (2 marks)

(20 marks)

(a) Qualifying Property

1. This includes the following:

- Land in Zambia
- Improvements on land
- Shares issued by a company which is not listed in the Lusaka stock exchange (1 mark)

Realisable value

2. This is the price at which the property could be sold on the open market at the time of transfer (1 mark)

(b) Realisable values

- In a property transfer the realizable value is the higher of the contract price and the open market
- In a transfer of shares, the realizable value is the higher of the open market and the nominal value

(2 marks)

(c) Executor

- Is a person who is appointed in a will as the tax paying agent by the deceased

Administrators

- This is a person who is appointed to carry out the disposal of the property if there is no will (2 marks)

(d) Remainder man

- This is the person who receives trust property when the beneficiary dies

Life tenant

- This is the surviving spouse of the deceased Late Mwale / Tax Computation (2 marks)

Details	K000	K000
Salary		88 000
Rental income		5 176
Bank Deposit interest Final		
Assessable income		93 176
Less tax free amount	9,600	
Taxable income	83,576	
Tax Payable		
K6,420,000 @ 25%		
K33000000 @ 30%	1,605	
K43,916,000@ 35%	<u>15455</u>	
	27,014	
Less tax suffered at source - PAYE	-26 450	
- withholding tax on rent	-776	
Tax repayable	212	

(7 marks)

Income Tax on the Estate

Bank Deposit	60 000 000
House	<u>650 000 000</u>
Total Estate	<u>710 000 000</u>
Income tax at 35%	<u>248 500 000</u>

Total amount of income tax payable by the executors

• Mwale's income tax	(212,000)
• Income tax on the estate	<u>248 500 000</u>
	<u>248 288 000</u>

(7 marks)

(Total: 20 marks)

Solution 3

(a) Tax implication of various financing options:

- (i) If the machinery is acquired by use of the bank loan, the company will:
- claim capital allowance at 25% wear and tear on Cost. The capital allowances will be $K696m \times 25/29 \times 25\% = K150m$.
 - Loan interest of $(K696m \times 20\%) K139.2m$ will be deductible when arriving at the taxable business profit.
- (ii) — Lease rentals of K100m per year will be allowed when arriving at the taxable business profit.
- Input tax of $(K100m \times 4/20) K13.79m$.
- (iii) If the machinery is acquired under the Hire Purchase the tax implication will be as follows:
- Hire purchase interest of K4m will be allowed
 - Capital allowances of $(K696m \times 25/29 \times 25\%) K50m$
 - Input tax of $(K696 \times 4/29) K96m$
- (1 mark for each valid point up to the maximum of 7 marks)

(b) The tax implication of Debt finance will be:

- interest will be deductible on arriving at taxable business profit
- Issue of Cost of debentures are disallowed

The tax implication of equity finance through ordinary shares

- It should deduct withholding tax on dividends at rate of 15% final
- Issue Cost will be disallowed.

(1 mark for each valid point up to 4 marks)

(c) Tax concession for Mining Companies are:

- Dividends from Mining Income are not subjected to Withholding tax
- Indexation of loss brought forward
- Indexation of capita allowances
- Capital expenditure incurred on the Mining operations
- A reduction in the rate corporation tax from 35% to base rate of 30%. Although it is subject to the level of trading profit.

Tax concession for farming enterprises are:

- Farm work allowances of 100% on Cost
- Farm Improvement allowance of 100% on Cost

- Tax rate of 15% for the listed farming company. For listed is 13% or 8%
 - Accelerated wear and tear allowance at rate 50%
 - Implements used directly in farming
- (1 mark for each valid point up to maximum of 9 marks)

Solution 4

(a) 2 marks each for stating and explaining (maximum 12 marks)

- Subject matter of the transaction – Trading is indicated where the property (subject matter) does not yield an ongoing income or give personal enjoyment to its owner.
- Length of ownership – The sale of property within a short time of its acquisition is an indication of trading.
- Frequency of similar transaction - Trading is indicated by "repeated transactions in the same subject matter."
- Work done on the property -A trading motive is indicated where work is carried out to the property to make it more marketable, or where steps are taken to find purchasers
- Circumstances responsible for the realization - A forced sale to raise cash for an emergency is an indication that the transaction is not of a trading nature.
- Motive - If a transaction is undertaken with the motive of realizing a profit, this is a strong indication of trading.

(b) 1 mark each

Trading profit for Chaaba House

	K'000	K'000
Income		520,000
Cost of property	254,000	
Renovation costs	101,200	
Loan interest ($300,000 \times 6\% \times 4/12$)	6,000	
Legal fees ($3,600 + 5,200$)	<u>8,800</u>	
		<u>(370,000)</u>
Trading profit		<u>150,000</u>

Tax liability for Chaaba House for 2010/11:

	K'000
First ($9,600 \times 0\%$)	0
Second ($7,620 \times 25\%$)	1,605
Third ($33,180 \times 30\%$)	9,954
Fourth ($100,800 \times 35\%$)	<u>35,280</u>
Total liability	<u>46,839</u>

Solution 5

- (a) 1 mark each (maximum 6 marks)
- (i) Cheesu is under the control of slick-Productions Ltd.
 - (ii) Cheesu is not taking any financial risk.
 - (iii) Cheesu works a set number of hours, is paid by the hour and is paid for overtime.
 - (iv) Cheesu cannot profit from sound management.
 - (v) Cheesu is required to do the work personally.
 - (vi) There is an obligation to accept work that is offered.
 - (vii) Cheesu does not provide his own equipment.
- (b) Importance of distinction – 1.5 marks each (maximum 8 marks)
- (i) Employees receive statutory protection (e.g. unfair dismissal/redundancy)
 - (ii) There are implied terms in a contract of employment (e.g. duty of obedience)
 - (iii) An employer is vicariously liable for the acts of employees when they act in the course of the employer's business. The employer is not liable for the acts of independent contractors.
 - (iv) On the insolvency of the employer, an employee is a preferential creditor, whereas someone who is self-employed ranks as an unsecured creditor.
 - (v) Employees receive their pay net of income tax and NAPSA under the PAYE system. Independent contractors are taxed under the trading income provisions
 - (vi) Certain state benefits (e.g. statutory sick pay) are only available to employees.
- (c) Income tax liability for Cheesu (1 mark each)

	K'000	
Salary (K,000 × 12)	48,000	
Housing allowance (K8,000 × 30%)	14,400	
Transport allowance (K00 × 12)	2,400	
	64,800	
First (K,9,600,000 × 0%)		0
Next (K6,420,000 × 25%)		1,605
Next (K33,180,000 × 30%)		9,954
Balance (K15,600,000 × 35%)		5,460
Total Liability		17,319

Solution 6

(a) Challenges (1 mark for a good explanation)

- Lack of political will
- Insufficient administrative capacity
- Taxpayer apathy
- Comprehensive list of these potential tax payers not readily available
- Administrative cost of dealing with the sector if not properly planned can be extremely high
- Poor record keeping if any by the informal sector business
- Outright evasion of tax e.g. not issuing receipts to customers
- Low literacy levels which render voluntary compliance difficult
- Difficult to categorise them based on their income levels

Possible methods (1 mark each for a good explanation Max. 7 marks))

- Sub-contracting of the collect role
- Use of presumptive taxes
- Determination of presumptive taxation
- Base tax
- Tax payer education campaigns

(max 5 marks)

(Total: 12 marks)

(b) (i) Taxable dividend computation

$$= \frac{\text{Undistributed Revenue Profit liquidation Dividend}}{\text{Share Capital + Share Premium Account + total Undistributed}} \quad (1 \text{ mark})$$

$$= \frac{(K400m - K60) \times K600m}{K1,500m} \\ = K136m \quad (2 \text{ marks})$$

(ii) W.H.T.

$$K136m \times 155 = K20.4m \quad (2 \text{ marks})$$

(iii) In the case of a company which is being wound-up or liquidated, the dividend is deemed to be paid when it is actually received by the shareholder. (1 mark)

(iv) For a company which is a going concern the dividend is deemed to be paid on the day the resolution is made declaring the dividend. (1 mark)

(v) Therefore, the W.H.T of K20.4m should be paid by 14th March 2010 as the dividend was paid on 16th February 2011. (1 mark)

(Total: 8 marks)

Solution 7

(a) Adjusted Trading profit before capita allowances for Sampa

	K'000	K'000	
Profit per accounts		71,900	
Less: Rent received	19,000		½
Use of office	500		½
Private telephone (450 × 3/5)	540		1
		<u>(20,040)</u>	
		51,860	
Add: Rent and rate (25,800 × 1/10)	2,580		1
Light and heat (10,500 × 1/7)	1,500		1
Depreciation of fixtures and fittings	3,000		½
Entertaining suppliers	5,500		½
Entertaining customers	4,600		½
Employee loan written off	3,400		½
Depreciation of vehicles	15,000		½
Private motor expenses (3,300 × 4000/12000)	2,200		1
Political donation	200		½
Squash club subscription	500		1
Taxation services re shares' disposal	1,500		1
New printer	1,300		1
Central heating	4,400		1
Own consumption (900 × 130/100)	1,170		1
		<u>46,850</u>	
Adjusted trading profit before capital allowances)		<u>98,710</u>	

(b) Appeals procedure

1. An appeal must be made in writing and needs to provide the following Information: (1 mark)
 - (a) Details of the decision appealed against
 - (b) Date of the decision by the ZRA
 - (c) The office giving the decision
 - (d) The ground for the appeal
2. The appeal has to be filed with the Revenue Appeals Tribunal (RAT) who shall send copies of all such documents to the ZRA within 7 days of receipt of the appeal. (1 mark)
3. The ZRA is given 30 days from the receipt of the appeal to respond by filling a written statement of the case setting out the facts and reasons for the disputed decision. (1 mark)

4. Both parties have 30days to lodge a list of all documents the party proposes to produce at the hearing. (1 mark)
5. The registrar shall thereafter advise all parties to the appeal of the date of hearing. (1 mark)
6. Any party to an appeal may withdraw the appeal or decision appealed against at any time before or during the hearing in writing. However, the withdrawal of the matter shall not prevent a party from applying for costs. (1 mark)
7. It must be noted that the Registrar demands 6 copies of any documents filed with he RAT. (1 mark)



ZAMBIA INSTITUTE OF CHARTERED ACCOUNTANTS

CHARTERED ACCOUNTANTS EXAMINATIONS

LICENTIATE LEVEL

L3: ADVANCED TAXATION

SERIES: DECEMBER 2010

TOTAL MARKS – 100 TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS TO CANDIDATES

1. You have ten (10) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question. You will be told when to start writing.
2. There are SEVEN questions in this paper. You are required to attempt any FIVE questions. ALL questions carry equal marks.
3. Enter your student number and your National Registration Card number on the front of the answer booklet. Your name must NOT appear anywhere on your answer booklet.
4. Do NOT write in pencil (except for graphs and diagrams).
5. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.
6. All workings must be done in the answer booklet.
7. Present legible and tidy work.
8. Graph paper (if required) is provided at the end of the answer booklet.

Attempt any FIVE_(5) questions out of SEVEN (7)

Question 1

Northend Limited is an engineering company which has been trading since 2002. The shares are being held equally among three brothers Jamba, Nguvu and Ndumba who have no interest in any other companies. Accounts have always been prepared to 31st May. In order to raise funds for the company's expansion, they have considered the following options:

1. The first option would involve selling 100,000 shares to its existing employees under an employee share option scheme. The nominal value of shares is K1,000 each and will be sold to its employees at K1,200 each, K100 less than its current market value.
 2. The second alternative would involve listing on the Lusaka Stock Exchange (LUSE) and offering its shares to members of the public. It is anticipated that the share price will be more or less same and conditions will be as under the employee share option scheme in 1 above.
 3. Sale off 20,000 shares with a nominal value of K1,000 per share. The market value of the shares was K1,300 per share. The shares were held in an associated company, Eastend Limited with a 30% shareholding by Northend Limited. The shares were originally bought for K1,100 each.
 4. Sale off land at K180 million. The land was bought some years ago for K60 million. The sales value is the same as the market value.
 5. Sale off two (2) trucks for K60 million each. The trucks were bought two years ago and their income tax value was K50 million each. The financial written down value was the same as its income tax value at the start of the year.
- (a) Advise Northend Limited of the conditions which must be met if the share option scheme is to be approved by Zambia Revenue Authority (Z.R.A.) in note (1) above. (7 marks)
- (b) Explain the tax benefits of an approved share option scheme in Note (1) above accruing to Northend Limited and its employees. (4 marks)
- (c) Advise on the tax implications of offering the shares owned by Northend Limited to members of the public in Note (2) above. (3 marks)
- (d) Advise Northend Limited of the property transfer tax implications of the sale of assets in Notes (3), (4) and (5). (6 marks)

(Total: 20 marks)

Question 2

- (a) For the charge year ended 31st March 2011, L and M plc, a large scale mining company has the following results:

	Km
Turnover	650,000
Cost of sales	<u>300,000</u>
Gross profit	350,000
Less: other expenses	<u>110,000</u>
Net profit (pre-capital allowances)	<u>240,000</u>

Additional information:

- 1 Capital allowances on locally acquired fixed assets were calculated at K2,400 million. Office equipment bought abroad in 2009/10 was K8,000 million. The bank of Zambia mid rate on 31st March 2010 was K4,000 to one US dollar. The Bank of Zambia mid rate on 31st March 2011 was K5,000 to one US dollar.
- 2 The net profit shown in the profit and loss account is equivalent to the assessable income before capital allowances.
- 2 Provisional tax paid on a quarterly basis was K62,500 million.

Required:

- (i) Calculate the indexed capital allowance for the foreign acquired assets. (1 mark)
 - (ii) Calculate the final adjusted mining profit. (2marks)
 - (iii) Calculate the variable profit tax rate on the mining income. (3 marks)
 - (iv) Calculate the final income tax payable by the company for the tax year 2010/11. (1 mark)
- (b) L and M Plc, as large scale mining license holders received a lot of tax concessions which were not available to other business organisations.
- Explain why L and M Plc were given the tax incentives and explain four incentives available. (5 marks)
- (c) Tin Limited is a private Limited company established five years ago. It is involved in the manufacturing of tinned food stuffs for the Zambian local market. For the tax year 2010/11 it started exporting some of its products to neighbouring countries.

The summarised Profit and Loss account for the year to 31st March 2011 is as follows:

	K'000
Gross profit for the year	2,890,000
Exchange gains	<u>14,500</u>
	2,904,500
Less: expenses (all allowable)	<u>1,362,800</u>
Net profit	<u>1,541,700</u>

Note 1:

The company has opened a US dollar account with a local bank to use for export transactions. The exchange gain is unrealized.

Note 2:

30% of the gross profit for the year relates to export activities. However, due to the need for a permanent foothold on its exports, 40% of the expenses in the profit and loss account relate to export activities and 60% to the domestic market.

Required:

- (i) Calculate the following: adjusted taxable profit for the export and domestic markets separately; the tax liability in the export and the domestic market activities separately; and total tax payable. (5 marks)
- (ii) A new tax student has informed you that she cannot differentiate between tax liability and tax payable. Explain the differences between the two. (3 marks)

(Total: 20 marks)

Question 3

In January 2011, ABC Limited made a computer payroll package changeover. Due to the changeover, the General Manager has asked you to calculate his payroll figures again manually for January and February 2010 so as to compare with the computer generated figures.

The General Manager's cumulative figures as at 31st December 2010 are as follows:

	K'000
Cumulative salary	72,000
Cumulative PAYE	20,691
Cumulative pension	1,395

The General Manager's salary from April 2010 to January 2011 was K8 million per month. A salary increment of K2 million per month from February 2011 was effected.

Required:

- (a) Calculate the General Manager's PAYE and net pay for January and February 2011. (9 marks)
- (b) Explain the role played by taxation in the modern economy. Identify and briefly describe the main sources of public revenue. (6 marks)
- (c) Explain five (5) properties of a good tax system. (5 marks)

(Total: 20 marks)

Question 4

Having being declared redundant two friends Hamaja and Sianja set up their own business but are unsure of whether to run it as a partnership or as a private limited company. In both situations the profit before capital allowances and expenses relating to the two individuals is estimated at K480 million.

The expenses relating to the two individuals include the following:

1. The firm will pay for electricity and water estimated at K7 million each per annum.
2. Two cars (2,200cc) will be bought during the year for K30 million each. The cars will be bought by the firm and will have 40% private use.
3. Both individuals will be accommodated by the firm. Rentals payable by the firm relating to the accommodation is K2 million per month per individual.
4. The firm will deduct 5% of basic salary as pension and contribute 5% as employer's contribution if the two are employed.
5. Whether the business is run as a partnership or as a private limited company, both Hamaja and Sianja will participate in managing the business. The annual salary will be K120 million and K80 million respectively.

If the business is run as a partnership the balance of profits and losses will be shared equally and if the business is run as a private limited company, the balance of the profits will be paid out as dividends to Hamaja and Sianja in equal amounts. As a limited company, it will be called Siamanja limited.

Required:

- (a) Calculate the amounts of income tax payable by Hamanja and Sianja for the tax year 2010/11, assuming that the business is run as a partnership. (6 marks)
- (b) Assuming that the business is run as a private limited company, calculate:
 - (i) The amount of income tax payable by Hamanja and Sianja for the tax year 2010/11. (3 marks)
 - (ii) The amount of company income tax payable by Siamanja Limited together with the withholding tax for the tax year 2010/11. (7 marks)
- (c) Advise Hamanja and Sianja whether it is beneficial for the business to be run as a partnership or as a private limited company. (4 marks)

(Total: 20 marks)

Question 5

For the purpose of this question, you should assume that today's date is 30th November, 2010.

Mr Joseph Thole who worked for Chipata Mining Corporation died on 30 November 2010 after being trapped underground. His will leaves his assets split in the following percentages to the two daughters:

Miriam Thole	60%
Tihonenji Thole	40%

The assets comprised in Mr Thole's estate were as follows:

	K'000
Chipata Lodge	900
Sinda Lodge	200
Indo Zambia Bank account	100
Bank of Zambia bonds	450
Shares in Zambian Companies	1,000
Other quoted investment	225

Notes:

1. All the assets were valued at market value.
2. Interest and dividends were received by Mr Thole's executor.

Prior to his death, Mr Thole had the following income:

	K'000
Salary up to the time of death.	92,000
Housing allowance (per month)	1,200
School children allowance (per month)	300
Transport allowance (per month)	400
Rent received (net)	9,350
Royalties received (net)	18,700
Dividends received (net)	7,200
Interest received (net)	6,200

Before his death, he made the following payments:

	K'000
NAPSA	7,400
Life assurance	3,000
Profession subscription	2,000
PAYE	22,300

As the appointed executor in the will left behind by Mr. Thole, you are confused and not sure about the tax treatment of the Income accrued before and after the death of the testator. On 1st December 2010 you decide to engage a tax expert to advise you to deal with various tax issues.

Required:

Give an explanation of how Income accrued before and after the death of Mr Thole will be treated for Tax purposes. Your answer should include:

- (a) A computation of Income tax payable by Mr Thole for the tax year 2010/11. (7 marks)
- (b) Calculations of both the tax payable on the Estate left by Mr Thole and inheritance due to Mirriam and Tihonenji. (7 marks)
- (c) An explanation of the person who is responsible for payment of taxes in (1) and (2) above. (3 marks)
- (d) Advice on three types of trusts which could have been created by Mr Thole. (3 marks)

(Total: 20marks)

Question 6

For the purpose of this question, you should assume that today's date is 1st March 2010.

You are a tax consultant and your cousin has approached you to give him advice on two offers of employment which he received.

Alpha Limited offer

Basic salary per annum	K50 million
Housing allowance per annum	K18 million
Medical allowance per annum	K 6 million
Utility allowance per annum	K 4 million

A pension of 5% of the basic salary will be deducted by the employer. The employer will provide him with a personal to holder car.

Omega Limited offer

Basic salary per annum	K60 million
Car allowance per annum	K8.2 million
School children's allowance per child	K 1.5million

Your cousin has two school going children. A pension of 5% of the basic salary will be deducted by the employer.

The employer will provide him with free residential accommodation. The house is owned by the employer.

The employer will pay for his medical expenses which he estimates will be K4.6 million for the year. The employer will pay for his electricity and water bills which he estimates will be about K6.8 million.

Alpha Limited's offer is a five year contract and the gratuity payable is 25% of the total basic salary earned during the period of contract. The salary will be the same for the next five years.

Omega Limited's offer is on a permanent and pensionable term. For employees who work between five to ten years, the accrued service bonus will be K62.5 million with a 10% increment on the bonus each year after year five. Your cousin does not wish to work for more than five years and therefore will certainly stop work after five years.

Required:

- Calculate the taxable income for 2010/11 for each offer of employment on normal PAYE. (5 marks)
- Calculate the tax payable on cessation of employment (terminal benefits). (5 marks)
- Advise your cousin which offer of employment should be accepted and explain any other consideration. (4 marks)
- State the due date when the employer must submit the annual return, CF/P18 relating to the tax year 2010/11 and the return details. (2 marks)
- Explain the basis of assessment of pay as you earn (PAYE), whether it is on a receipt basis or accruals basis. (4 marks)

(Total: 20 marks)

Question 7

- (a) Mr. and Mrs. Wajimona got married in 1980 and were born in Zambia. The first born child was born in Zambia. The trio left Zambia in 1984 for employment in Utopia, a country in Western Europe. The couple had two children who were born in Utopia.

During the period of absence from Zambia, Mr. Wajimona bought a house in Utopia and also invested some of his earnings in shares in Utopian companies.

They returned to Zambia in February 2010 and the following information relates to the period after their return:

1. Mr. Wajimona took up employment with a Zambian company from which his salary was K120 million. He was also entitled to a general purpose allowance of K2 million per month.
2. Mr. Wajimona was receiving dividends of K18 million per annum from his investments in Utopia. The amount is net of Utopian withholding tax at the rate of 10% of gross amount.
3. Mr. Wajimona received bank interest from Utopia banks of K12 million during the tax year 2010/11. This amount is net of Utopian withholding tax of 25% of the gross amount.
4. The second born child is married in Utopia and has acquired Utopian citizenship and does not intend to return to Zambia permanently. The other child however, came back to Zambia with the parents and is employed by a Zambian company.
5. Mr. Wajimona intends to sell his house in Utopia for K900 million. The sales proceeds are however, only 60% of his planned intention to set up a heavily capitalized company in Zambia, in the immediate future..

Required:

- (i) Advise Mr. Wajimona as to his domicile status as well as the domicile status of each of the members of his family. (5 marks)
 - (ii) Calculate the income tax payable by Mr. Wajimona for the tax year 2010/11. You should assume that credit against Zambian Income Tax is available in respect of the attributable Utopian Income Tax. (10 marks)
- (b) Concerning note (5) above, Mr. Wajimona has two options as follows:
- (i) If he cannot raise the other funds to form a limited company, the sale proceeds of the house in Utopia will be used to buy shares on the Lusaka Stock Exchange (LUSE) listed Zambian Company and will dispose of the shares when the price rises by 50%. From the proceeds of the sale of shares he will buy real estate which will be let out on a commercial basis.
 - (ii) Funds will be available to raise the other 40% after the sale of the Utopia house by raising a bank loan for the balance of the 40% of the funds.

Required:

Advise Mr. Wajimona of the taxation implications of his planned transactions given in note (b) (i) and (ii) above. You should ignore VAT and assume the tax rates for the tax year 2010/11 will apply in the future.

(5 marks)

(Total: 20 marks)

END OF PAPER

**DECEMBER 2010
ADVANCED TAXATION
SUGGESTED SOLUTIONS**

Solution 1

(a) Share option schemes

A share option scheme is a scheme under which the employer grants options to employees to buy shares in that employer company at a price determined now in the future.

The price agreed now at which the shares would be bought in the future is known as the exercise price or striking price. (1 marks)

On the expiry date of the option, an employee may exercise the option. This means the employee would buy the shares at that agreed share price. The employee may also not exercise the option at all. This means the option would lapse.

Employees exercise the options when the market price per share at the expiry date is more than the exercise price, thereby making a gain. If the actual market price per share is less than the exercise price, employees would not exercise the options. (1 mark)

In order for a share option scheme to be approved, the following are the requirements to be met:

- (i) The scheme must be established in Zambia and the employer carries on business wholly or partly in Zambia.
- (ii) The scheme should provide for the participation of all eligible employees (including directors).
- (iii) An employee participating in the scheme should not acquire more than twenty percent of the shares to be issued under the scheme.
- (iv) Only ordinary shares of the company may participate in the scheme.
- (v) The scheme entitles an employee to acquire a set number of shares at a fixed price.
- (vi) The employees must be citizens or permanent residents of Zambia regardless of where they perform their duties.

(1 mark for each valid point, up to a maximum of 5 marks)

(b) The benefits of operating an approved share option scheme for the employer are as follows:

- (i) Costs incurred by the employer to set up and administer the scheme will be allowed as a deduction in computing the company's profits for tax purposes. (1 mark)
- (ii) The income of an approved share option scheme will be exempt from tax. (1 mark)
- (iii) The employer will be exempt from paying Property Transfer tax on shares transferred under the terms of an approved share option scheme. (1 mark)

The employees' benefit is that the benefit which arises to him or her on allotment or acquisition of shares under an approved share option scheme is exempt from tax.

(1 mark)

- (c) Where shares are sold through the Lusaka Stock Exchange (LUSE), there is no Property Transfer Tax. (1 mark)

In the year in which the shares are quoted on the LUSE, a 2% discount is given from the normal company Income tax rate. A further 5% discount is given when more than one third ($\frac{1}{3}$) of the shares are taken up by indigenous Zambians. (2 marks)

- (d) Eastend Limited Shareholding.

The realised value of the shares is the higher of the nominal value of the shares and their open market value. (1 mark)

The nominal value of the shares was:

$$20,000 \text{ shares} \times \text{K}1,000 = \text{K}20 \text{ million}$$

The market value of the shares was;

$$20,000 \times \text{K}1,300 = \text{K}26 \text{ million}$$

The original cost is irrelevant

Therefore the PTT payable is

$$\text{K}26\text{m} \times 3\% = \text{K}780,000 \quad (1 \text{ mark})$$

Since Eastend is an associated company and not a subsidiary, no concession for PTT will be available i.e. not exempt for PTT. (1 mark)

- (e) Sale of land

The sales value is the same as the market value – K180m. The original cost, K60m is irrelevant for the PTT purposes. The realized value of land disposed of is the open market value as determined by the Commissioner General. Therefore the PTT payable is $\text{K}180 \text{ m} \times 3\% = \text{K}5,400,000$. (2 marks)

- (f) For PTT purposes, plant and Machinery do not constitute property. Therefore any disposal of plant and machinery is not subject to PTT. (1 mark)

Solution 2

(a) (i) Capital allowances computation:

		Km	Marks
2009/10			
Office equipment – cost	8,000		
Wear & tear @ 25%	(2,000)		
I.T.V. c/f	6,000		1

2009/10

Indexed capital allowance

$$K2,000 \text{ million} \times \left(1 + \frac{K5,000 - K4,000}{K4,000} \right)$$

= K2,500 million

(ii)	Adjusted profit (pre CA)	Km	Km	
	Less: Capital allowances		240,000	1
	- On local assets	2,400		½
	- On foreign acquired asset	<u>2,500</u>		½
		<u>4,900</u>		
	Adjusted profit		<u>235,100</u>	

(iii) Variable Profit tax rate:

$$Y = 30\% + [(a - (ab/c))]$$

Where:

$$a = 15\%$$

$$b = 8\%$$

$$c = \frac{\text{Assessable income}}{\text{Turnover}} = \frac{235,100}{650,000} \times 10 = 36\% \quad (1)$$

$$Y = 30\% + \left(15\% - \frac{15\% \times 8\%}{36\%} \right)$$

$$= 30\% + (15\% - 3\%)$$

$$= \underline{42\%} \quad (2)$$

(iv) Company Income Tax payable:

	Km	
42% × K235,100 million	= 98,742	(½)
Less: provisional tax paid	(62,500)	(½)
	36,242	

(v) The following tax incentives are given to large scale mining licence holders:

- (a) The company Income tax rate was reduced from 35% to a base rate of 30%. However, due to the variable profit tax rate which may apply, the company income tax rate can be more than 30% up to a maximum of 45%.
- (b) No withholding tax applies on dividends paid by large scale mining licence holders.
- (c) Mining losses can be carried forward to be off set in the next ten (10) years, instead of five (5) years for other business.
- (d) Indexation of capital allowances is allowed in order to maintain real tax values of capital allowances on imported equipment.
- (e) Indexation of mining losses brought forward is also allowed to maintain real tax values of losses.
- (f) Expenditure on community services e.g. schools, hospitals and amateur sporting activities are allowable deductions in arriving at the taxable mining profit.
- (g) Expenditure on road and rail infrastructure are allowable if constructed on a mine site or transportation of mining produce if constructed outside the mine site. However, road or rail infrastructure is not allowed within the mine township.

(1½ marks for each point – maximum 6 marks)

(b) (i)

	Export K'000	Domestic K'000	Total K'000	Marks
Gross profit	867,000	2,023,000	2,890,000	½
Exchange gain	<u>14,500</u>	-	<u>14,500</u>	1
	881,500	2,023,000	2,904,500	
Less: Expenses	<u>545,120</u>	<u>817,680</u>	<u>(1,362,800)</u>	½
Net profit	<u>336,380</u>	<u>1,205,320</u>	<u>1,541,700</u>	½

Tax liability

Exports:

K321,880,000 × 15%	=	K48,282,000	½
Domestic			
K1,205,320,000 × 35%	=	K421,862,000	½
Total tax liability	=	K470,144,000	

- (ii) Tax liability is the gross tax payable to Zambia Revenue Authority (ZRA). The tax can be paid at source or be paid directly by the tax payer. (1 ½ mark)

Where the tax suffered at source (tax credit) is deducted from the tax liability, including the provisional tax, it is called tax payable. (1 ½ mark)

Solution 3

(a) January 2011

	K'000
Cumulative salary (K72m + K8.0m)	80,000
Less: Cumulative Pension (K155,000 × 10)	<u>(1,550)</u>
Cumulative Taxable Income	<u>78,450</u>

(1 mark)

Tax payable (PAYE)

	K'000	
1 st K8,000,000 @ 0%	0	
Next K5,350,000 @ 25%	1,337.5	
Next K27,650,000 @ 30%	8,295	
Balance K37,450,000 @ 35%	<u>13,107.5</u>	
Cumulative PAYE	22,740	(1 mark)
Less: Cumulative PAYE (1 April to 31 December 2010)	<u>(20,691)</u>	(1 mark)
PAYE for January 2011	<u>8,049</u>	(1 mark)

	K'000	
Basic pay	8,000	
Less: PAYE	(2,299)	
Pension	(400)	
Net pay January 2010	<u>5,551</u>	(1 mark)

February 2010

	K'000	
Cumulative salary K80m + K10m)	90,000	
Less; Cumulative Pension (Ks155,000 x 11)	<u>(1,705)</u>	
Cumulative Taxable Income	<u>88,295</u>	(1 mark)

	K'000	
Tax payable (PAYE)		
1 st K8,88,000 @ 0%	–	
Next K5,885,000 @ 25%	1,471.5	
Next K30,415,000 @ 30%	9,124.5	
Balance K43,195,000 @ 35%	15,118.25	
Cumulative PAYE	25,714	(1 mark)
Cumulative PAYE (1 April to 31 Jan 2010)	22,740	(½ mark)
PAYE (February 2011)	2,974	(1 mark)
	K'000	
Basic pay	10,000	
Less: PAYE	(2,974)	
Pension	(500)	
Net pay (February 2010)	<u>6,526</u>	(1 mark)

(b) Taxation is the process through which the central government raises its revenue to enable it to meet public expenditure. The functions of taxes are as follows:

- (i) The main function of taxation is to raise revenue for the central government. This is the revenue that the central government uses to provide public goods for the benefit of all persons in the nation.
- (ii) Influencing economic activity in the country.

The government uses taxes to influence the level of economic activity in the country. This is done through giving tax incentives to individuals and institution that engage in activities that contribute towards economic growth. Examples are the capital allowances given on implements, plant and machinery and on buildings. All these assets are used in the conduct of business activity that leads to economic growth. Savings are encouraged through exempting a large amount of interest earned by individuals from withholding tax.

- (iii) Re-distributing incomes and wealth

Some individuals generate more income than others. Those who generate more income get rich, while those who generate less income remain poor. If this trend continues, the rich would keep on getting richer while the poor would get poorer and poorer. The government uses progressive tax systems to redistribute income and wealth. This prevents the poor getting poorer and the rich from getting richer at the expense of the poor.

(iv) Maintaining the well being of the environment

In some countries, heavy taxes are imposed on income and gains arising from activities which are not friendly to the environment. Activities such as those contributing to global warming are discouraged using taxes levied on the income or on the acquisition of assets used to the conduct of those activities.

Apart from taxation as the main source of public revenue, other sources are as follows:

(i) Privatization of state owned enterprises

This is the process of transferring state owned enterprises to the private sector. Huge amounts of revenue can be raised when there are state owned enterprises to sell. Once all the state owned enterprises are sold, it would mean there would be no source of revenue for the government.

Privatization cannot therefore be relied upon as the sole source of revenue for the government.

(ii) Borrowing from the International Financial Institutions

The government can borrow from the International Monetary Fund (IMF) and the world Bank (IBRD) to finance certain projects only. Amounts borrowed from these two institutions will normally have conditions attached to them and in addition, the amounts have to be serviced normally at high interest rates. The government may not have funds to repay these amounts borrowed when they fall due.

As such, it is not possible to rely only on borrowing from the international financial institutions for the purpose of meeting all the recurring public expenditure.

(iii) Through issuing government securities/Domestic borrowing

Instead of borrowing from the international financial institutions, the government can be able to borrow locally through the issue of government bonds and treasury bills.

This method is costly. It leads to high interest rates and normally also causes inflation. Government can use this as a means to raise short term finance for a specific purpose.

(iv) Donor funding

Various donor agencies have been set up that provide funding to poor countries. However, these donors provide funds for clearly defined projects and cannot provide the funds for the government to meet all the recurring public expenditure. In addition, donors can only be able to provide funds if the funds are available with them. No matter how much they can be pleaded with so that they provide some funding, they cannot take any action unless they have the funds for that purpose.

All these methods may not be as successful as raising revenue through taxes because the costs which would be incurred to raise the revenue would be too high. If revenue is raised through taxes, the costs incurred are relatively manageable.

(1 mark for each valid point to a maximum of 6 marks in total)

(c) Properties of good taxation

To foster:

- (i) Economic efficiency
- (ii) Administrative simplicity
- (iii) Flexibility to changes in economic conditions
- (iv) Transparency i.e. ease of ascertaining tax burdens
- (v) Fairness on individuals and organizations i.e. equity principle.

(1 mark per point up to maximum of 5 marks)

Solution 4

(a) As Partnership

	K'000	K'000	K'000	Marks
Net profit			480,000	½
Less:				
Capital allowances (K30m × 2 × 205 × 60%)			<u>(7,200)</u>	1
Adjusted taxable profit			472,800	
	Total K'000	Hamanja K'000	Sianja K'000	
Salary	200,000	120,000	80,000	1
Balance 1:1	<u>272,800</u>	<u>136,400</u>	<u>136,400</u>	1
Taxable income	<u>472,800</u>	<u>256,400</u>	<u>216,400</u>	
Tax payable				
1 st K9.6m @ 0%		0	0	½
Next K6.420m @ 25%		1,605	1,605	½
Next K33.18m @ 30%		9,954	9,954	½
Balance K207.2m/K167.2m @ 35%		<u>72,520</u>	<u>58,520</u>	½
		84,079	70,079	½

(b) If the business is run as a private company.

(i) Personal income tax computation for Hamanja and Sianja for the tax year 2009/10

	Hamanja K'000	Sianja K'000	
Emoluments	120,000	80,000	½
Income Tax			
1 st K9.6m @ 0%	—	—	
Next K6.420m @ 25%	1,605	1,605	½
Next K33.18m @ 30%	9,964	9,954	½
Balance K70.8m/K30.8m @ 35%	<u>24,780</u>	<u>10,780</u>	½
Income tax payable	<u>36,339</u>	<u>22,339</u>	½

(ii) Company Income Tax computation for the tax year 2010/11

	K'000	K'000	
Profit		480,000	½
Less: Salary - Hamanja	120,000		½
Salary- Sianja	-80,000	-	½
– Capital allowances (K30 × 2 × 20%)	12,000		½
– electricity (K7m × 2)	14,000		½
– Employer Pension Contribution			
5% x K120m	<u>6,000</u>		½
5% x K80m	<u>4,000</u>		½
– Rental payable K2m × 12 × 2	<u>48,000</u>		
		<u>284,000</u>	
Taxable profit		<u>196,000</u>	½
Company Income Tax 35% × K196,000,000	<u>68,600,000</u>		1
Balance of profit is:	K'000		marks
Taxable Profit	196,000		
Less: company Income Tax	<u>(68,600)</u>		
	<u>127,400</u>		1

The whole of the distributable profit will be paid to Hamanja and Sianja in equal amounts. Withholding tax = 15% x K110,600,000 = K16,590,000.

(iii) The amount of net income based on each of the two modes of running the business are as follows:

(a) If the business is run as a partnership, the tax payable to ZRA would be:

	K'000	
Income tax – Hamanja	84,079	½
– Sianja	70,079	½

(b) If the business is run as a private company the amount of taxes payable to ZRA would be:

	K'000	
Income tax on salary – Hamanja	36,339	½
Income tax on salary - Sianja	22,339	½
Company income tax	68,690	½
Withholding tax	<u>16,590</u>	½
	<u>143,868</u>	

As a partnership, the tax payable is more as compared to when the business run as a private limited company. Therefore, the partnership mode is not beneficial than the private limited company in the above circumstances.(½ mark)

Total: 4 marks

Solution 5

The income accrued by the person before death is taxed normally using the tax bands. The Income will be taxable as if the person is still living as follows:

(i) Mr Joseph Thole Income tax payable CY 2010/11

	K'000	K'000	
Earned Income			
Salary		92,000	½
Housing allowance (1200 × 8)		96,000	½
School children allowance (300 × 8)		24,000	½
Transport allowance (400 × 8)		3,200	½
		<u>107,200</u>	
Investment Income			
Rent received $K9.35 \times \frac{100}{85}$		11,600	½
Royalties received $18,700 \times \frac{100}{85}$		<u>22,000</u>	½
Total Income		140,200	
Less allowable deductions			
NAPSA (Restricted)	1,860		
Profession subscription	<u>2,000</u>		
		<u>(3,876)</u>	½
Assessable Income		136,324	
Less tax free income		<u>(9,600)</u>	½
Chargeable Income		126,724	½
Income tax			
Next 7,620 × 25%	1,605		½
Next 33,180 × 30%	9,954		½
Balance 78,724 × 35%	<u>27,553.4</u>		½
Income tax liability	39,112.4		
	<u>(22,300)</u>		½
Less PAYE			
Withholding tax on			
Rent 11,000 × 15%	(1,650)		½
Royalties 22,000 × 15%	(33,00)		½
Final Income tax payable	<u>11,862.4</u>		

- (ii) The Income accrued after the death of Mr Thole will be treated as deceased Estate. For the purpose of tax, the deceased Estate will be treated as a corporate person and it will be taxed at 35%. (1 mark)

Income tax payable on the estate

	K'm	marks
Chipata lodge	900	½
Sinda lodge	200	½
Indo Zambia Bank Account	100	½
Bank of Zambia Bonds	450	½
Shares in Zambian companies	1,000	½
Other quoted investments	<u>225</u>	½
Gross estate	<u>2,875</u>	½
Tax @ 35%	<u>1,006.25</u>	½
Inheritance due	K'm	
Gross estate	2,875	½
Less tax paid	<u>(1,006.25)</u>	½
Inheritance due	<u>1,868.75</u>	½

The inheritance due will be shared between the two daughters as follows:

Miriam Thole $60\% \times K1,868.75 \text{ m} = K1,121.25 \text{ m}$. ½

Tihonenji Thole $40\% \times K1,868.75 \text{ m} = K747.50 \text{ m}$.

- (iii) The Income accrued before death is taxed as normal Income. The payment of the tax due is undertaken by the executor of deceased. (1½ mark)
- (iv) The Income accrued after death is taxed as deceased Estate. The payment of tax is undertaken by the executor. The distribution of net estate is only done after payment of expenses and tax. (1½ marks)
- (b) A trust is a legal relationship that facilitates the transfer of property and/or the income from that property to another party or parties. The trust deed is a legal document which spells out how the property and/or income in trust is to be distributed. Mr Thole could have created three types of trusts as follows:
- (i) An interest in possession trust (vested interest trust) which must have one or more beneficiaries (life tenant(s)) who have an absolute right to the income of the trust. However, the right to capital need not necessarily be held by the same beneficiaries or in the same proportion and can be deferred to a future date or event e.g. attaining a specific age marriage or even death of the life tenant. The first born preferably can retain control of capital assets comprising the inheritance in the hand of the trustees. (1 mark)

- (ii) A discretionary trust (contingent interest) is where a beneficiary only has a hope rather than a right of receiving some benefit, which is usually at the complete discretion of the trustees. A contingent interest is one that waits or depends on the happening of an event. Therefore, the second born can have a contingent interest without having no present beneficial entitlement to income from the settled property. (1 mark)
- (iii) An accumulation and maintenance trust is a special form of discretionary trust which can be used for children/grandchildren. One or more of the beneficiaries must become absolutely entitled to the trust assets (or at least the income from them) not later than the age of 25. Prior to this point, the trust assets (and the income generated) can be used to maintain the child beneficiaries. (1 mark)

Total: 20 marks)

Solution 6

(a) Taxable Income:

	K'000	marks
Alpha Limited offer		
Basic salary	50,000	½
Housing allowance	18,000	½
Medical allowance	6,000	½
Utility allowance	4,000	½
	78,000	
Less: Pension	(1,860)	½
Taxable amount	76,140	
Omega Limited Offer		
Basic pay	60,000	½
Car allowance	8,200	½
School children allowance	3,000	½
Benefit in kind – electricity & water	6,800	½
	78,000	
Less: Pension	(1,860)	½
Taxable Income	76,140	

(Total: 5 marks)

(b) Terminal dues:

	K'000	marks
Gratuity from Alpha Limited		
Total earned – K50m × 5 years = K250m		½
Qualifying gratuity		
25% × 250m = K62.5m		1
Tax on qualifying gratuity	K'000	
1 st K9.6m @ 0%	–	
Balance K52.9m @ 25%	<u>13,225</u>	1
	<u>13,225</u>	
Accrued service bonus		
From Omega limited	K62.5m	
Tax on accrued service bonus	K'000	
1 st K25m @ 0%	–	1
Balance K37.5m @ 10%	<u>3,750</u>	1
	<u>3,750</u>	½

- (c) The taxable income for each offer of employment is the same and therefore the tax payable will be the same on the normal PAYE system. (1 mark)

However, on the tax payable on cessation of employment, the following should be noted:

– The gross payment on cessation of employment will be the same at K62.5m as gratuity for alpha Limited offer and K62.5m as accrued service bonus for Omega limited offer. (1 mark)

– The tax on the gratuity is higher than on the accrued service bonus by (K13.225 million – K3.75 million = K9.475 million. Therefore, the offer from Omega Limited is more beneficial than alpha Limited offer. (1 mark)

– However, the conclusion above will only hold if the tax system on the terminal dues will not change or will only change slightly to make the tax on gratuity beneficial. (1 mark)

- (d) Employers have an obligation to make an annual return on form CF/P18 no later than 1 June following the end of the charge year. Therefore, for the tax year 2010/11, this must be submitted on 31st May 2011. The return details include the total emoluments and tax deducted for each employee. (2 marks)

- (e) The basis of assessment for PAYE is on a receipt basis. However, due to timing differences between the receipt of the emoluments and entitlements, emoluments are deemed to be received on the earlier of: (1 mark)

– The time when entitlement to the pay arises and (½ mark)

– The time when payment is actually made (½ mark)

Directors are able to manipulate the timing of their emoluments and therefore the basis of assessment is the earliest of:

The two rules stated above

End of the company's accounting period.

When the amount payable is credited in the company's accounting records. (2 marks)

(Total: 20 marks)

Solution 7

- (i) Domicile refers to an individual's permanent home. There are two kinds of domicile:
- Domicile of origin which is acquired at birth. It is also dependent on the domicile of the parent.
 - Domicile of choice which is acquired by renouncing their domicile of origin and choosing another country as their new domicile. It involves severing ties with the domicile of origin and having an intention to set up a permanent residence in another country. However, long residence in another country does not necessarily mean acquiring a new domicile of choice. Mr. and Mrs. Wajimona and their first son are domicile in Zambia by birth. (2 marks)
 - The other child born in Utopia initially had a domicile of origin as Zambia. Since the second born does not intend to come back to Zambia permanently, and has the intention to sever the ties with the domicile of origin and therefore has acquired a domicile of choice.(2 marks)
- (ii) Mr Wajimona

Personal Income Tax computation for the tax year 2010/11.

	K'000	K'000	Marks
Basic Salary		120,000	½
General Purpose allowance (K2m × 12)		24,000	½
Utopia dividend (K18m × $\left(\frac{100}{90}\right)$)		20,000	1
Utopia bank interest (K12m × $\left(\frac{100}{75}\right)$)		<u>16,000</u>	1
		<u>180,000</u>	
Tax computation			
1 st K9,600,000 × 0%		0	½
Next K6,420,000 × 25%		1,605,000	½
Next K33,180,000 × 30%		9,954,000	½
Balance K130,800,000 × 35%		<u>45,780,000</u>	½
		57,339,000	
Less double taxation relief			
– Utopia dividend (W1)		(2,000,000)	1
– Utopia interest (W2)		<u>(4,000,000)</u>	1
Income tax payable		<u>51,339,000</u>	1

Workings for double taxation relief:

1. Utopia dividend:

Double taxation is the lower of;

$$\text{Foreign tax paid} = 10\% \times \text{K}20\text{m} = \text{K}2\text{m}$$

$$\text{Zambian tax} = \frac{\text{K}20\text{m}}{\text{K}180\text{m}} \times \text{K}57.339\text{m} = \text{K}6.371 \text{ million}$$

So, double taxation relief is the lower amount of K2 million

1 mark

2. Utopia interest:

Double taxation relief is the lower of:

$$\text{Foreign tax paid} = 25\% \times \text{K}16\text{m} = \text{K}4\text{m}$$

$$\text{Zambian tax} = \frac{\text{K}16\text{m}}{\text{K}180\text{m}} \times \text{K}57.339\text{m} = 5.0968 \text{ million}$$

So, double taxation relief is the lower amount of K4 million.

1 mark

- (iii) (a) On disposal of the Utopian house Mr. Wajimona will pay property transfer at the rate of 3% of the realized value. This will amount to $3\% \times \text{K}900\text{m} = \text{K}27\text{m}$. This is ignoring any double taxation relief that he could be entitled to claim. The balance of the proceeds will be $(\text{K}900\text{m} - \text{K}27\text{m}) = 873 \text{ million}$. (1 mark)

The net proceeds of K873m will be used to acquire shares in LUSE listed companies. The shares will be disposed of once their value rises to $1.5 \times \text{K}873\text{m} = \text{K}1,309.5 \text{ million}$. No property tax will apply on disposal of the LUSE shares as they are exempt from PTT. (1 mark)

The properties which will be acquired using the proceeds will be available for commercial letting. The amount of the rent received from lettings less any allowable expenses that would be incurred will be chargeable income for Mr. Wajimona. However, the rent received will be net of 15% withholding tax. (1 mark)

- (b) The net sales proceeds from the sale of the Utopia house will be K873 million. The total amount requirement to set up the heavily capitalized company will be:

$$\frac{100}{60} \times \text{K}873\text{m} = \text{K}582\text{m} \text{ will be raised as a bank loan. (1 mark)}$$

Interest on bank loan will be payable and the interest is an allowable deduction when arriving at the adjusted taxable profit. (1 mark)

(Total: 20 marks)

END



ZAMBIA INSTITUTE OF CHARTERED ACCOUNTANTS

CHARTERED ACCOUNTANTS EXAMINATIONS

LICENTIATE LEVEL

L3: ADVANCED TAXATION

SERIES: JUNE 2011

TOTAL MARKS – 100 TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS TO CANDIDATES

1. You have ten (10) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question. You will be told when to start writing.
2. There are SEVEN questions in this paper. You are required to attempt any FIVE questions. ALL questions carry equal marks.
3. Enter your student number and your National Registration Card number on the front of the answer booklet. Your name must NOT appear anywhere on your answer booklet.
4. Do NOT write in pencil (except for graphs and diagrams).
5. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.
6. All workings must be done in the answer booklet.
7. Present legible and tidy work.
8. Graph paper (if required) is provided at the end of the answer booklet.

Attempt any **five** questions out of **seven**.

Question 1

You should assume that today's date is 1 February 2010

- (a) Lwangen Technology Limited (LTL) is a company that is involved in the development of computer software. The company makes up its accounts to 31 March each year and is a private company. LTL is considering engaging Grace, an Information and Communication Technology expert, either on an employed or self-employed basis to undertake work of a one-off nature for a specific development project for one of their clients.

The engagement which will begin on 1 April 2010 will run for one year.

If Grace is employed, the following will apply:

- (1) She will drive her own car and charge LTL K4,000 per kilometre for travelling to LTL and their client. The total mileage expected is as follows:
Travelling to LTL client's premises: 3,300 kilometres
Travelling to LTL's premises: 1,200 kilometres
- (2) Her salary will be K15,000,000 per month.
- (3) In addition LTL will pay Grace K2,000,000 per month for the additional costs incurred in working from home.
- (4) LTL will purchase computers and peripheral equipment costing K15,000,000 in total required for Grace's exclusive use on the project.

If Grace is self-employed

- (1) She will charge a fixed all-inclusive price to LTL of K17,500,000 per month for the services performed.
- (2) She will again use her own motor car for travelling. Grace's car will have a value of K30,000,000 on 1 April 2010. Grace's total mileage in the year to 31 March 2011 is expected to be 18,000 kilometres, including 1,200 kilometers on travelling to the premises of LTL and 3,300 kilometres on travelling to the premises of clients of LTL. Total motor car expenses over the year are expected to be K9,800,000.
- (3) Grace will purchase the required computer equipment costing K15,000,000 herself and it will be used 100% for the assignment.
- (4) Other allowable business expenses of K7,500,000 are anticipated.
- (5) Providing the project is completed within one year Grace can organise her work schedule as she pleases and, if she wishes, use her own staff to perform the work.

Grace has no other income or outgoings.

Required:

(i) Advise Grace and Lwangen Technology Limited of the taxation implications of engaging Grace on either an employed or self-employed basis. Your advice should include calculations of appropriate amounts that may be taxable/tax allowable.

(10 marks)

(ii) Calculate from Lwangen Technology Limited's perspective whether it is more beneficial for Grace to be treated as self-employed.

(5 marks)

(b) Lwangen Technology Limited has heard that whilst there may be savings and administrative convenience in engaging Grace on a self-employed basis this may be imprudent without first obtaining the Commissioner General's approval.

They have also heard that if Grace were to trade through a limited company rather than on a self-employed basis any potential problems from their perspective may be avoided.

Required:

Discuss, in the context of Grace's engagement, the factors that will be considered in determining whether she will be regarded by the Commissioner General as employed or self-employed by Lwangen Technology Limited;

(5 marks)

(Total: 20 marks)

Question 2

- (a) Describe the circumstances under which a mining company carrying on mining operations in Zambia would be said to be thinly capitalized and explain the taxation implications if a mining company is said to be thinly capitalized. (3 marks)
- (b) The following summarized Income Statement (profit and loss account) has been obtained from the annual report of Musweu Mining Corporation, a company that engages in the mining and sales of copper in Zambia, for the year ended 31 March 2011:

	K' million
Sales Revenue	234,900
Cost of Sales	<u>(90,500)</u>
Gross Profit	144,400
Operating expenses	<u>(34,450)</u>
Profit before interest and taxation	109,950
Net interest paid	<u>(11,950)</u>
Profit before taxation	98,000
Company income tax	<u>(40,180)</u>
Profit for the financial year	<u>57,820</u>

The following additional information is available:

- (1) For the year ended 31 March 2010, the company incurred a mining tax adjusted loss of \$1,200,000 from sales of copper only.
- (2) Included in the cost of sales is capital expenditure which accounts for 30% of the total cost of sales. Of this amount, 10% does not qualify for any tax relief. The remainder is eligible for tax relief as mining capital expenditure.
- (3) Included in the operating expenses are non-tax allowable revenue expenses that account for 20% of the total operating expenses. The remainder is revenue expenditure and therefore tax allowable.
- (4) Mineral Royalty has already been properly accounted for in respect of the year ended 31 March 2011.
- (5) The company income tax shown in the income statement above represents the provisional company income tax paid by the company in respect of the tax year 2010/11.
- (6) The company has a Debt : Equity ratio of 5 : 1.

- (7) The following Zambian Kwacha per US Dollar (ZMK/\$) exchange rates have been provided by the Bank of Zambia and approved by the Commissioner General:

Date	Exchange Rate (ZMK/\$)
31 March 2010	4,650
31 March 2011	4,700

Mining losses may be indexed using the formula:

$$\frac{1 + (R2 - R1)}{R1}$$

Required:

Calculate the company income tax payable on the mining profits for the tax year 2010/11. (9 marks)

- (c) The following information relates to MMC Mining corporation, a Zambian mining company that prepares its accounts to 31 March annually:

Year ended 31 March	2008 K' million	2009 K' million	2010 K' million	2011 K' million
Sales Revenue	456,900	567,840	657,460	678,434
Mining profit/(loss)	(123,890)	23,780	89,340	110,245

The amounts of mining profits and losses are the tax adjusted profits and losses.

The (ZMK/\$) exchange rates published by the bank of Zambia are as follows:

Date	Exchange Rate (ZMK/\$)
31 March 2008	4,120
31 March 2009	4,340
31 March 2010	4,680
31 March 2011	4,450

Required:

- (i) Calculate the taxable mining profits and the amounts of company income tax payable for all the tax years in the question. You should assume that the tax rates for the tax year 2010/11 apply for all the tax years and use the indexation formula in part (b) above where applicable. (4 marks)
- (ii) Discuss whether the current tax regime for mining companies results in Zambia obtaining the maximum tax revenue from the mining sector. (4 marks)

(Total: 20 marks)

Question 3

- (a) Explain the possible causes of, and the differences between tax avoidance and tax evasion and discuss the practical consequences of practicing each of them. (7 marks)
- (b) For the purpose of this part of the question, you should assume that today's date is 1 April 2010.

Lubasi had been employed as a driver for LSK company for the last ten years. The company has always owned buses which transport employees from appropriate places within the residential areas to the premises of LSK company.

From 1 April 2010, the company changed its policy concerning transportation of employees. All the drivers, including Lubasi, were therefore retrenched on 1 April 2010. The new policy includes the following:

- (1) The company would hire buses to provide transport for employees for six working days per week.
- (2) For each bus hired, the company would pay an amount of K12,500,000 per month.
- (3) Providers of the hired buses would be responsible for all repairs and maintenance of the buses and also provide their own drivers.
- (4) All retrenched drivers were free to provide transport services to LSK company using their own buses.
- (5) Buses available for hire should have a seating capacity of at least 30 passengers.
- (6) The hired buses should be tested for road worthiness by the LSK company's appointed engineers.

Using his terminal benefits and money from his relatives, Lubasi will buy three second hand 30 seater Fuso buses at a cost of K95,000,000 each. Each of the three buses will be available for hire by LSK company effective from 1 July 2010 on a long term basis. LSK company has arranged to hire two of the buses under the terms listed above, commencing on 1 July 2010. Lubasi will use the third bus to transport passengers on inter town routes with effect from 1 August 2010, earning K500,000 per day for six working days per week.

Lubasi will employ three drivers whom he will be paying salaries of K2,000,000 per month each. The bus running expenses, including the cost of fuel will average K2,500,000 per bus, per month. Each Driver will contribute 5% of the salary to the National Pension Scheme Authority (NAPSA). In addition, Lubasi will also contribute 5% of each driver's salary to NAPSA as employer's contribution.

In order to enhance his net income, Lubasi will take employment as a driver with a mining company where he will be earning K3,000,000 per month as his gross salary. He will be contributing 5% of the salary to NAPSA. The commencement date of this employment will be 1 October 2010.

The following additional information is also available:

- (1) All salaries will be payable in arrears on the last working day of each month.
- (2) Hire fees for all buses will be payable monthly in arrears on the last working day of each month.
- (3) Each month is assumed to be made up of twenty four (24) working days.

Required:

Advise Lubasi of the Taxation implications of his proposed business and employment activities for the tax year 2010/11. Your advice should be supported by appropriate calculations, which should include a calculation of his net income after all the payments mentioned above. (13 marks)

(Total: 20 marks)

Question 4

The following information has been provided from the files of clients of your firm in respect of the tax year 2010/11:

(a) Mailess

Today's date is 1 March 2010. Mailess intends to commence in business on 1 April 2010 trading as Mailess and Co. She expects her turnover to be in the range of K150,000,000 per annum, with revenue expenditure of approximately K65,000,000 per annum. All of the supplies that Mailess will make are exempt supplies for Value Added Tax purposes. She will purchase equipment at a cost of K24,000,000 on 1 April 2010 for exclusive use in her business. This equipment will be replaced in three years' time.

Required:

Explain, using appropriate calculations, the taxation implications of Mailess' activities for the tax year 2010/11. (4 marks)

(b) Tandiwe

Tandiwe has been employed on a pensionable basis as a personal secretary to the Chief Executive Officer of a large Lusaka Stock Exchange listed company earning an annual salary of K30,000,000. She has been paying NAPSA contributions at the rate of 5% of her salary. She is due to retire on 30 June 2010 at which time she will receive all her terminal benefits, having attained the normal retirement age. It is estimated that her accrued leave pay will amount to K7,500,000. This amount is made up of leave entitlement for the previous three years when she did not take any annual leave. She will also receive her severance pay of K45,000,000 and a lump sum pension from the company's pension scheme of K256,000,000.

Required:

Calculate the amount of income tax payable by Tandiwe for the tax year 2010/11, clearly explaining your answer. (4 marks)

(c) Papa Makiesse

Papa Makiesse who is resident and ordinarily resident in Zambia has invested in ordinary shares in a foreign company that is resident in a country called Domisinia, a country in which Papa Makiesse is domiciled. The currency of Domisinia is the Domisinian Dollar (D\$). He bought the shares on 1 April 2010 and he expects to receive the first dividend of D\$45,000 on 31 March 2011, when the exchange rate is expected to be K2,300 per D\$. The amount of D\$45,000 will be net of Domisinian withholding tax at the rate of 10%. In addition, Papa Makiesse also owns a house in Domisinia that has been let to Domisian tenants over the last five years. He always receives annual rent of D\$22,500 (net of Domisinian withholding tax of 10%) once annually in arrears. The rent for the year

ending 31 March 2011 will be received on 31 March 2011. When computing Zambian Income tax payable, credit is available for any foreign tax paid in Dominica.

The only Zambian income receivable by Papa Makiesse for the tax year 2010/11 is a dividend of K50,000,000 (gross) from a Zambian company that is not listed on the Lusaka Stock Exchange.

Required:

Calculate the income tax payable by Papa Makiesse for the tax year 2010/11, explaining briefly your treatment of the various transactions involved. (6 marks)

(d) LLN limited

LLN limited is a Zambian resident company that commenced to trade on 1 October 2008, providing internet and telephone services. The company prepared the first accounts for the eighteen (18) months period ended 31 March 2010. The company immediately changed its accounting date and prepared the next accounts for the thirteen (13) months period ended 30 April 2011.

On 1 July 2008, the company had acquired plant to be used in its trade at a cost of K290,000,000, inclusive of Value Added Tax. On 1 May 2010, The company bought machinery at a cost of K174,000,000, inclusive of Value Added Tax. Both the plant and the machinery were acquired from local vendors.

LLN limited obtained Value Added Tax registration on 1 October 2008 immediately it commenced trading.

The amounts of tax adjusted profits before capital allowances have been agreed as follows:

	K'000
Period ended 31 March 2010	960,000
Period ended 30 April 2011	679,000

Required:

Calculate the final taxable business profits and the company income tax payable for the tax years 2008/09, 2009/10 and 2010/11. (6 marks)

(Total: 20 marks)

Question 5

You should assume that today's date is 1 January 2011.

You have recently held a meeting with Towela and Kondwani who are both resident and ordinarily resident in Zambia. They each own 50% of the issued ordinary share capital of TK Limited, an unquoted trading company making up its accounts to 31 March each year. TK Limited was formed on 1 May 2005 with 5,000,000 K1 ordinary shares being issued at par value. Kondwani is both a director of and employed by TK Limited whereas Towela is neither employed by nor a director of this company. Both Towela and Kondwani already have other annual income of K60,000,000 each.

TK Limited has been reasonably successful and Towela now wishes to partially realise some of her investment in the company either by a direct sale to Kondwani or via a company purchase of its own shares. She is, however, currently undecided as to how many of her ordinary shares she will sell although this will be no less than 1,000,000 and no more than 1,800,000.

TK Limited's latest summarized statement of financial position is:

ASSETS	K' 000
Tangible non – current assets	215,000
Total current assets	<u>30,000</u>
Total assets	<u>245,000</u>
EQUITY AND LIABILITIES	
Ordinary share capital	5,000
Retained earnings	220,000
Total equity	225,000
Current liabilities	<u>20,000</u>
	<u>245,000</u>

Each TK Limited share currently has a market value determinable using the net asset valuation and this will be the price payable for each share in any sale. The Commissioner General has agreed to this method of valuation. It is anticipated that the share sale will occur on 31 March 2011 but it could be deferred until 31 May 2011.

You further ascertain the following.

- (1) Throughout 2010/11 both Towela and Kondwani were provided with new cars by TK Limited. Both cars use petrol and have a cylinder capacity of 2,000 cc and cost of K45,000,000. In addition both Towela and Kondwani are provided with all the petrol for private use.
- (2) On 1 July 2010 TK Limited paid some personal bills for Towela amounting to K5,000,000. It is probable that this amount will be written off by TK Limited at some point in the future.

Required:

Write a letter to Towela and Kondwani which is supported by relevant calculations:

- (a) Advising them of the tax implications for both themselves individually and for TK Limited arising from the provision of motor cars to Towela and Kondwani and the settling of some of Towela's personal bills by the company on the basis that Towela was not employed by TK Limited. (7 marks)
 - (b) Advising them of the tax implications for both themselves individually and for TK Limited arising from the provision of motor cars to Towela and Kondwani and the settling of some of Towela's personal bills by the company on the basis that Towela was employed by TK Limited. (5 marks)
 - (c) Advising them of the tax implications arising from the proposed sale of shares by Towela either directly to Kondwani or via a company purchase of own shares. (5 marks)
- Marks awarded for presentation, structure and format. (3 marks)

(Total: 20 marks)

Question 6

You should assume that today's date is 15 May 2010.

Imwiko, aged 42, is the managing director of Mwiza Enterprises Ltd, a private Zambian company specialising in house interior design and cleaning. He is wealthy in his own right and is married to Helen, who is 45 years old. They have two children – Namakau, who is 13, and Lubona who is 9.

As part of his salary, Imwiko was given 300,000 shares in Mwiza Enterprises Ltd with an option to acquire a further 1,000,000 shares. The options were granted on 15 July 2009, shortly after the company started trading, and were not part of an approved share option scheme. The free shares were given to Imwiko on the same day.

The exercise price of the share options was set at the then market value of K20.00 per share. The options are not capable of being exercised after 10 years from the date of grant. The company has been successful, and the current value of the shares is now K60.00 per share. Another shareholder has offered to buy the shares at their market value, so Imwiko exercised his share options on 14 May 2010 and will sell the shares next week, on 22 May 2010.

With the company growing in size, Imwiko wishes to recruit high quality staff, but the company lacks the funds to pay them in cash. Imwiko believes that giving new employees the chance to buy shares in the company would help recruit staff, as they could share in the growth in value of Mwiza Enterprises Ltd. Imwiko therefore wishes to obtain approval of the company's share option scheme to make the scheme more attractive.

Imwiko has accumulated substantial assets over the years. The family house is owned jointly with Helen, and is worth K500,000,000. Imwiko has a K250,000,000 mortgage on the house. In addition, Imwiko has liquid assets worth K90,000,000 and Helen has shares in quoted companies currently worth

K100,000,000. Imwiko has no forms of insurance, and believes he should make sure that his wealth and family are protected. He is keen to find out what options he should be considering.

Required:

- (a) (i) State how the gift of the 300,000 shares in Mwiza Enterprises Ltd was taxed. (2 marks)
- (ii) Explain the taxation implications arising on the grant to and exercise by an employee of an option to buy shares in an unapproved share option scheme and on the subsequent sale of these shares. State clearly how these would apply in Imwiko's case. (5 marks)
- (iii) Explain the procedure that Imwiko would go through in order to obtain approval of the company's share option scheme. (3 marks)
- (b) Provide three (3) examples of personal financial planning protection products that would be of use in Imwiko's situation. Justify your selections by reference to the type of protection provided. (6 marks)
- (c) Briefly outline the tax consequences for Imwiko if the types of protection identified in (b) were to be provided for him by Mwiza Enterprises Ltd compared to providing them for himself. You are not required to discuss the company Income tax consequences for Mwiza Enterprises Ltd. (4 marks)

(Total: 20 marks)

Question 7

Peter is a thirty five year old single man with no children. James is also single, but he lives with his seven year old son. Peter and James will form a company called PJ limited whose share capital will be owned by Peter and James in the ratio of 60% to Peter and 40% to James and the company will commence trading on 1 April 2010. Both of them will work full time for the company as Executive Directors. They now want advice on where the ownership of their motor cars should be located once the company was formed.

Peter expects to drive 20,000 kilometres each year. His private mileage is 5,000 kilometres each year. The car which he currently owns personally has a market value of K48,000,000. He bought the motor car for K60,000,000 some two years ago and it has a cylinder capacity of 3,000 cc. The annual running costs of the car are K5,000,000, plus an additional K8,500,000 for petrol.

James expects to drive a total of 12,000 kilometres on business each year and private mileage is expected to be 8,000 kilometres. James' motor car has a market value of K32,000,000 and has a cylinder capacity of 2,500 cc. James bought his motor car for K45,000,000 a year ago. Annual running costs are K4,500,000 plus an additional K5,600,000 for diesel.

Peter and James are unsure whether they should retain ownership of their motor cars, and charge PJ Ltd an amount of K5,500 per business kilometre done, or if they should transfer the motor cars to PJ Ltd. PJ Ltd would pay Peter and James the market values of K48,000,000 and K32,000,000 respectively for the motor cars and would be responsible for the annual running costs of the motor cars plus all petrol and diesel costs. You may assume that the annual running costs for the company are the same as for Peter and James. Whether the cars are owned by Peter and James individually or by PJ Ltd, the mileage done by both Peter and James will still remain the same.

Required:

- (a) Describe the criteria that would be used to establish whether a motor car being driven by an employee or a Director would be classified as a pool car or a personal to holder car. (4 marks)
- (b) Discuss whether the motor cars to be used by Peter and James will be classified as personal to holder motor cars. (4 marks)
- (c) Evaluate whether it would be more tax efficient for Peter and James to retain ownership of their motor cars, or to transfer them to PJ Ltd. Support your answer by means of calculations and ignore the effects of VAT for this part of the question. (12 marks)

(Total: 20 marks)

END OF PAPER

JUNE 2011
L3 – ADVANCED TAXATION
SUGGESTED SOLUTIONS

Solution 1

(a) Grace and Lwangen Technologies Ltd

(i) **Employed:**

If Grace is employed, she will receive the following amounts from Lwangen Technologies Ltd:

	K
Salary (K15 million × 12)	180,000,000
Mileage allowance [K4,000 × (3,300 + 1,200)]	18,000,000
Additional payment (K2 million)	<u>24,000,000</u>
Total	<u>222,000,000</u>

(1 mark)

As an employee, Grace will be required to contribute 5% of her salary to the National Pension Scheme Authority (NAPSA). This contribution will be tax allowable up to K1,860,000.

(1 mark)

In addition, Grace will also be able to claim as a deduction, a proportion of travelling expense and capital allowances on the motor car. Expenses incurred in travelling to the premises of Lwangen will not be tax allowable. Those incurred in travelling to the premises of the clients of Lwangen will be tax allowable. Capital allowances will be restricted to the proportion relating to the mileage on travelling to the premises of clients.

(1 mark)

Grace will pay income tax on the balance of the income, with the first K9,600,000 being tax free.

(1 mark)

In the case of Lwangen Technologies Ltd, the company will be able to deduct the payments made to Grace as an employee as well as the employer's NAPSA contributions which will also be at the rate of 5% of the salary paid to Grace. In addition, the company will also claim capital allowances on the computer bought for use by Grace.

(1 mark)

Self employed:

If Grace is self employed, she will be assessed on the following amount:

K

Income from Lwangeneni (K17.5 million x 12)	210,000,000	(1 mark)
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As the fee income from Lwangeneni exceeds K200,000,000 for the tax year 2010/11, she will be assessed to income tax as opposed to Turnover tax. Grace will not be required to pay NAPSA contributions under this alternative. (1 mark)

From the amount of K210,000,000, Grace will be able to deduct capital allowances and motor car expenses as follows:

Capital allowances:

Motor car (20% × K30 million × 4,500/18,000)	1,500,000	
--	-----------	--

Computer (25% × K15 million)	3,750,000	
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Motor car expenses:

(K9.8 million × 4,500/18,000)	2,450,000	
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Other allowable expenses	7,500,000	(2 marks)
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Grace will then pay income tax on the balance of the income with the first K9,600,000 being tax free.

Under this alternative, Lwangeneni will be allowed to deduct the K210,000,000 paid to Grace as a tax allowable expense when computing its taxable profits. The company will not be able to claim any capital allowances as the computer would then be owned by Grace. (1 mark)

Total for part a (i) = 10 marks

(ii) If Grace is employed, the after tax cash flows for Lwangeneni would be as follows:

K

Salary	180,000,000	(½ mark)
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Cap. Allow. on computer	3,750,000	(½ mark)
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Mileage allowance	18,000,000	(½ mark)
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Additional payment	24,000,000	(½ mark)
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Employer's NAPSA (5% x K180 million)	900,000	(½ mark)
--------------------------------------	---------	----------

	234,750,000	
--	-------------	--

Taxation saved at 35%	(82,162,500)	(½ mark)
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Net of tax cash flow	152,337,500	
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If Grace is self employed, the position for the company will be as follows:

	K	
Payment to Grace	210,000,000	(½ mark)
Taxation saved at 35%	<u>(73,500,000)</u>	(½ mark)
Net of tax cash flow	<u>136,500,000</u>	(½ mark)

Engaging Grace on a self employed basis results in a cash flow saving amounting to = K152,337,500 – K136,500,000 = K15,837,500. (½ mark)

From a taxation point of view, it is therefore beneficial to engage Grace on a self employed basis for a period of one year.

Total for part a (ii) = 5 marks

- (b) The distinction between employment and self-employment turns on whether Grace will have a contract of service (employee) or contract for services (self-employed). The main factors that will be considered in determining which applies are, but not limited to:
1. The degree of 'day to day' control exercised over Grace. Note this does not have to be actual control, merely the right to exercise this level of control.
 2. Whether Grace must work exclusively for LTL.
 3. Whether LTL must provide further work and Grace accept further work.
 4. Whether the work performed by Grace is an integral part of the business and not merely an accessory to it.
 5. Whether Grace takes financial risk and has the ability to profit from sound management.
 6. Whether Grace has the right to employ her own resources (e.g. hire staff, use her own equipment).
 7. Whether Grace can decide when she works to complete the project.

In the context of Grace's proposed engagement on a 'self-employed' basis with LTL it would appear that whilst the work may form an integral part of LTL's business the other factors appear favourable to the conclusion that she is correctly to be treated as self-employed rather than employed.

Providing the project is completed to schedule Grace can choose to work when she pleases. As well as satisfying point (6) above this also suggests that LTL does not have the right to exercise 'day to day' control over Grace. There is no requirement for Grace to work exclusively for LTL. In addition Grace has the right to delegate the work to her own staff and will use her own equipment

(computer and vehicle) over the course of the assignment. She also has the ability to profit from sound management in so far as she is working to a fixed price and can therefore benefit financially from early successful completion of the project. Equally a fixed price implies financial risk in that should the project take longer than anticipated Grace will need to spend further financial resources to complete the project.

On balance it would appear that in this case the evidence points towards self-employment although LTL would be well advised to seek agreement to this treatment from the Commissioner General at the outset.

(1 mark for each valid point up to a maximum of 5 marks in total)

Total for part (b) = 5 marks

Total marks for question One = 20 marks

Solution 2

- (a) A mining company is said to be thinly capitalized if it is financed by excessive Debt finance. Currently, a mining company is said to be thinly capitalised if its Debt to Equity ratio exceeds 3 : 1. (1 mark)

The legislation on thin capitalization is anti avoidance legislation aimed at preventing companies from reducing their tax liabilities through excessive interest payments. Therefore, if a mining company is thinly capitalised, then interest on the amount of debt in excess of the Debt : Equity ratio of 3 : 1 is not deductible for taxation purposes. (2 marks)

Total for part (a) = 3 marks

- (b) Musweu Mining Corporation

Computation of Company income Tax payable for the tax year 2010/11

	K' million	K' million	
Profit before taxation as per accounts	98,000		(½ mark)
Add back:			
Cost of sales capital expenditure:			
30% × 10% × K90,500 million	2,715		(½ mark)
Non – tax allowable revenue expenditure:			
20% × K34,450 million	6,890		(½ mark)
Excessive interest (working 1)	4,780		(½ mark)
		<u>14,385</u>	(½ mark)
Tax adjusted profit before loss relief		112,385	
Loss relief (working 2)		(5,640)	(½ mark)
Taxable Mining Profit		<u>106,745</u>	(½ mark)
Mining company income tax payable			
K106,745 million × 42.36%(working 3)		45,217	(½ mark)
Less provisional income tax paid		(40,180)	(½ mark)
Final company income tax payable		<u>5,037</u>	(½ mark)

Workings:

- 1 Excessive Interest calculation:

	K' million	
Total Interest paid	11,950	
Less allowable interest = 3 x 11,950/5	(7,170)	
Excessive interest	<u>4,780</u>	(½ mark)

2 Loss relief:

K' million

Mining loss as at 31 March 2010

$$(\$1,200,000 \times K4,650) \quad \underline{5,580} \quad (\frac{1}{2} \text{ mark})$$

Indexed Mining loss as at 31 March 2011

$$= K5,580 \text{ million} \times [1 + (4,700 - 4,650)/4,650]$$

$$= \underline{K5,640 \text{ million}} \quad (\frac{1}{2} \text{ mark})$$

The whole loss of K5,640 million will be relieved in full against the mining profits for the tax year 2010/11 as these profits are sufficient to absorb the mining loss. ($\frac{1}{2}$ mark)

3 Mining Company Tax rate

$$\begin{aligned} \text{Profit as a percentage of turnover} &= 106,745/234,900 \times 100\% \\ &= 45.44\% \quad (\frac{1}{2} \text{ mark}) \end{aligned}$$

$$\begin{aligned} \text{Mining Company Income tax rate, } y &= 30 + [a - (ab/c)] \\ &= 30 + [15 - (15 \times 8/45.44)] \\ &= 42.36\% \quad (\frac{1}{2} \text{ mark}) \end{aligned}$$

Total for part (b) = 8 marks

(c) Part (i)

MMC Mining Corporation

Mining company income tax computations for the tax years:

	2007/08	2008/09	2009/10	2010/11
	K' million	K' million	K' million	K' million
Mining Profits	Nil	23,780	89,340	110,245
Loss relief (working 1)	Nil	(23,780)	(89,340)	(24,481)
Net Taxable profits	Nil	Nil	Nil	85,764

Mining Company income tax payable (working 2)

$$35.51\% \times K85,764 \text{ million} \quad (\frac{1}{2} \text{ mark}) \quad 30,455$$

There are no taxable profits in the tax years 2007/08, 2008/09, 2009/10 and therefore, company income tax payable in each of these tax years is nil. ($\frac{1}{2}$ mark)

Workings

	K' million	
(1) Mining Loss relief		
Mining loss as b/f at 1 April 2008		
$K123,890 \text{ million} \times [1 + (4,340 - 4,120)/4,120]$	130,505	(½ mark)
Amount relieved in the tax year 2008/09	(23,780)	(½ mark)
Balance c/f as at 31 March 2009	106,725	
Mining loss b/f as at 1 April 2009		
$K106,725 \text{ million} \times [1 + (4,680 - 4,340)/4,340]$	115,086	(½ mark)
Amount relieved in 2009/10	(89,340)	(½ mark)
Balance c/f as at 31 March 2010	25,746	
Mining loss b/f as at 1 April 2010		
$K25,746 \text{ million} \times [1 + (4,450 - 4,680)/4,680]$	24,481	(½ mark)
Relieved in 2010/11	(24,481)	(½ mark)
Balance c/f as at 31 March 2011	Nil	
(2) Mining Company Income Tax rate Profit as a percentage		
of turnover	$= 85,764/678,434 \times 100\%$	
	$= 12.64\%$	(½ mark)
Mining company income tax rate, y	$= 30 + [15 - (15 \times 8)/12.64]$	
	$= 35.51\%$	(½ mark)

Total for part c (i) = 5 marks

- (ii) Under the current taxation regime in Zambia, a mining company pays company income tax at the rate of 30%, provided that its taxable income as a % of gross turn over in the tax year is not over 8%. A variable profit tax rate applies when a mining company's taxable income is over 8% and this tax rate is calculated using a standard formula. (1 mark)

It is argued that in this way, the mining companies contribute the maximum possible amount of revenue towards the national finance. On the other hand, it is also argued that this is not the case as the companies do not disclose all their income and as a result end up paying tax at 30% only. Many have proposed the re-introduction of wind fall tax to increase on the amount of revenue that should then be collected from mining companies. (2 marks)

Wind fall tax ensures that companies also pay tax when the metal prices exceed a standard metal price taken as an average over a specific period of time. The combined

effect of wind fall tax and variable profit tax would ensure that the maximum revenue is obtained from mining companies in Zambia. (1 mark)

Total for part c (ii) = 4 marks

Total marks for question Two = 20 marks

Solution 3

- (a) Tax evasion refers to the use of illegal means to avoid tax. Such means include failing to disclose the relevant amounts of income and other forms of fraud which the tax payers may engage in. The aim of the tax payer practicing tax evasion is to defraud the government of the revenue.(1 marks)
Tax evasion arise when taxes are perceived to be too high or unfair on the tax payers. Another cause of tax evasion may be intentional where the tax payer intentionally hides some income.

(1 mark)

Tax evasion is an offence and may be punishable by fines and/or imprisonment. (1 mark)

On the other hand, tax avoidance is concerned with identifying any loop holes in the taxes legislation, and using them to minimize or defer tax liabilities. Tax avoidance is, however difficult to define more thoroughly. (1 mark)

Tax avoidance is caused by tax payers planning their tax affairs so as to minimise or defer taxation liabilities. (1 mark)

Tax avoidance is not an offence, though, to discourage its practice, the government may issue anti-avoidance legislation. Anti-avoidance legislation aims at sealing the loop holes in the taxes legislation so as to prevent taxpayers from taking advantage of them, and thereby reducing their tax liabilities lawfully. (2 marks)

Total for part (a) = 7 marks

- (b) Hiring out of buses to LSK Company:

In respect of the hiring out of two buses to LSK company, Lubasi will receive K12.5 million per bus per month for the nine months period from 1 July 2010 to 31 March 2011 giving a total amount of:

(½ mark)

$$K12,500,000 \times 2 \text{ buses} \times 9 \text{ months} = K225,000,000$$

As this amount exceeds K200,000,000 for twelve months, Lubasi will be assessed to income tax on the profits from running the hiring out business of buses. The taxable income from this business in respect of the tax year 2010/11 will be as follows:

		K	K
Gross hiring income	(½ mark)		225,000,000
Less allowable expenses:			
Drivers' salaries			
(K2 million × 2 × 9)	(½ mark)	36,000,000	
Employer's NAPSA			
(5% x K36 million)	(½ mark)	1,800,000	

Running expenses		
(K2.5 million × 2 × 9)	(½ mark)	45,000,000
Capital allowances on buses		
(25% × K95 million × 2)	(½ mark)	<u>47,500,000</u>
		(130,300,000)
Taxable income	(½ mark)	<u>94,700,000</u>

Use of a bus in public passenger transportation

The bus that will be used in the public transport business will generate revenue that will be subjected to presumptive taxation as Lubasi is an individual running such a business. Lubasi will therefore not be subjected to normal income tax assessments on the income from the bus being used in the public transport business. As the bus has a seating capacity of 30 passengers, the daily tax payable is K10,000. As there will be twenty four working days in each month, the total amount of presumptive tax that will be paid in the tax year 2010/11 will amount to: $K10,000 \times 24 \times 8 = K1,920,000$. Presumptive taxes for public service transporters are only payable for each day that the vehicle is operational. (½ mark)

As Lubasi will be liable to presumptive tax on the bus used to transport passengers, he will be unable to claim capital allowances on that bus. He will also not be able to claim as deductions the motor vehicle running expenses he will be incurring together with the salaries payable to the driver of the said bus. (½ mark)

Lubasi as an employee

As Lubasi will take up employment, he will be assessed to income tax under the Pay As You Earn system in respect of his emoluments from employment. The NAPSA contribution payable by Lubasi will be an allowable expense against the emoluments from employment. (½ mark)

From all of the activities that Lubasi will engage in, the income tax payable for the tax year 2010/11 will be as follows:

Lubasi

Personal Income Tax computation for the tax year 2010/11

		K
Emoluments from employment (K3 million × 6)	(½ mark)	18,000,000
Less NAPSA (5% × K18,000,000)	(½ mark)	(900,000)
		17,100,000
Profits from the hiring business	(½ mark)	94,700,000
	(½ mark)	111,800,000

Income tax		
0% × K9,600,000		Nil
25% × K6,420,000		1,605,000
30% × K33,180,000		9,954,000
35% × K62,600,000		21,910,000
Total Income tax		33,469,000
Add Presumptive tax		<u>1,920,000</u>
Total tax payable		<u>35,389,000</u>

(½ mark)

Lubasi will have a net income for the tax year 2010/11 as follows:

		K	K
Income from the hire business	(½ mark)		225,000,000
Income from employment	(½ mark)		18,000,000
Income from the public service vehicle business			
(K500,000 × 24 × 8)	(½ mark)		96,000,000
Total income			<u>339,000,000</u>
Less payments:			
Lubasi's NAPSA	(½ mark)	900,000	
Lubasi's NAPSA as employer of:			
Hired out buses	(½ mark)	1,800,000	
Public Service Transport bus			
(K2 million × 8 × 5%)	(½ mark)	800,000	
Total tax payable by Lubasi	(½ mark)	35,389,000	
Drivers salaries for:			
Hired out buses	(½ mark)	36,000,000	
Public Service transport bus			
(K2,000,000 × 8)	(½ mark)	16,000,000	
Motor vehicle running expenses for:			
Hired out buses	(½ mark)	45,000,000	
Public service transport bus			
(K2,500,000 × 8)	(½ mark)	20,000,000	
Total payments			<u>(155,889,000)</u>
Net income after all expenses			<u>183,111,000</u>

Total for part (b) = 13 marks

Total marks for question three = 20 marks

Solution 4

- (a) Mailess will have a turnover of less than K200 million per annum. As a result of this, she will be subjected to Turnover tax at the rate of 3% of his turnover. This will amount to K4,500,000 ($3\% \times$ K150 million). (1 mark)

The revenue expenditure incurred wholly and exclusively for the purposes of the business of K65 million per annum will not be deductible from the turnover when computing turnover tax. (1 mark)

The equipment that will be purchased at a cost of K24 million, will attract annual wear and tear allowances of K6,000,000 ($25\% \times$ K24 million) on a notional basis. This means that the amounts of wear and tear allowances will be deductions from cost but not from turnover or profit as well. (1 mark)

Mailess may not be able to claim loss relief in case any losses are incurred in the future. However, since expenditure is expected to be less than turnover in all the years, it is not likely that any losses could arise. (1 mark)

Total marks for (a) 4 marks

- (b) Thandiwe will be subjected to income tax on all the emoluments earned during the period of employment as well as on the terminal benefits. Her income tax payable for the tax year 2010/11 will be as follows:

	K	K
Salary ($K30 \text{ million} \times 3/12$)		7,500,000
Accrued leave pay		7,500,000
		15,000,000
Less NAPSA ($5\% \times$ K7.5 million)		<u>375,000</u>
Taxable income		<u>14,625,000</u>
Income tax payable on regular emoluments		
$K9,600,000 \times 0\%$		0
$K5,025,000 \times 25\%$		<u>1,256,250</u>
		1,256,250
Terminal benefits	45,000,000	
Less exempt amount	(25,000,000)	
Taxable amount	<u>20,000,000</u>	
Income tax at 10%	<u>2,000,000</u>	
Total income tax payable		<u>3,256,250</u>

The lump sum pension of K256,000,000 is exempt from income tax.

Salary	(½ mark)
Accrued leave pay	(½ mark)
NAPSA	(½ mark)
Taxable regular income	(½ mark)
Income tax on regular income	(½ mark)
Taxable terminal benefits	(½ mark)
Income tax on terminal benefits	(½ mark)
Exemption of lump sum payment	(½ mark)
Total marks for (b)	4 marks

- (c) Papa Makiese's foreign dividend income is chargeable to income tax in Zambia. His foreign rent is exempt from Zambian income tax. Dividends received from Zambian companies are subjected to a 15% withholding tax and this is the final tax. As a result, the only income that will be chargeable to Zambian income tax is the foreign dividend income. (1 mark)

The taxable foreign dividend is the gross amount which will amount to:

	K'000
Taxable income D\$45,000 × 100/90 × K2,300	<u>115,000</u>
Zambian income tax on the	
First K49.2 million	11,589
On balance (K115 – K49.2) million × 35%	<u>23,030</u>
	34,619
Less double taxation relief	<u>(11,500)</u>
Income tax payable	<u>23,119</u>

Workings

1. Double taxation relief is the lower of:

(i) Actual foreign tax paid = $10\% \times K115,000,000$
= K11,500,000

- (ii) Zambian tax on foreign income calculated as:

$$\frac{\text{Foreign income}}{\text{Total assessable income}} \times \text{Zambian tax charge}$$

$$\frac{115,000,000}{115,000,000 + 50,000,000} \times K34,589,000$$

$$= K24,128,394$$

Taxable foreign dividend	(1½ mark)
Zambian income tax on foreign dividend	(½ mark)
Calculation in working 1 (i)	(½ mark)
Calculation in working 1 (ii)	(1½ mark)
Identification of double taxation relief amount	(½ mark)
Final income tax payable	(½ mark)
Total marks for (c)	(6 marks)

(d) Capital allowances will be claimed as follows:

	Capital Allowances	
2008/09	K'000	
Plant:		
Wear and tear allowance		
$25\% \times 25/29 \times K290 \text{ million}$	<u>62,500</u>	(½ mark)
2009/10		
Wear and tear allowance on plant	<u>62,500</u>	(½ mark)
2010/11		
Wear and tear allowance on plant	62,500	(½ mark)
Wear and tear allowance on machinery		
$25\% \times 25/29 \times K174 \text{ million}$	<u>37,500</u>	(½ mark)
Total capital allowances for 2010/11	<u>100,000</u>	(½ mark)

The profit for the eighteen months period ended 31 March 2010 is split into two, each amount relating to a notional accounting period as follows:

Period from 1 October 2008 to 31 March 2009:

Tax adjusted profit	$= 6/18 \times K960,000,000$	
	<u>$= K320,000,000$</u>	(½ mark)

The adjusted profit figure of K320,000,000 will be assessed in the tax year 2008/09. (½ mark)

Period from 1 April 2009 to 31 March 2010:

Tax adjusted profit	$= 12/18 \times K960,000,000$	
	<u>$= K640,000,000$</u>	(½ mark)

The tax adjusted profit figure of K640,000,000 will be assessed to income tax in the tax year 2009/10. (½ mark)

Following the change of accounting date, resulting in accounts being prepared for the thirteen period ended 30 April 2011, the basis of assessment also changes to the preceding years basis. The thirteen months' period becomes the basis period for the tax year 2010/11.

Final taxable profits and company income tax payable are as follows:

	2008/09	2009/10	2010/11	(½ mark)
	K'000	K'000	K'000	
Tax adjusted profit	320,000	640,000	679,000	
Less capital allowances	(62,500)	(62,500)	(100,000)	
Taxable profit	257,500	577,500	579,000	(½ mark)
Company Income tax at 35%	90,125	202,125	202,650	(½ mark)

Total for part (d) = 6 marks

Total marks for question four = 20 marks

Solution 5

Licentiate & Co
Private Bag DMH16
Kitwe
1 January 2011
The Director
TK Limited
P.O. Box 1234
Kitwe

Dear Sir/Madam

RE: TAXATION IMPLICATIONS OF SHAREEHOLDERS' TRANSACTIONS

Following on our recent meeting, we are writing to explain the taxation implications of the various transactions Towela and Kondwani will engage in. The letter sets out the taxation implications for both Towela and Kondwani and for TK limited as follows:

- (a) In respect of the motor car provided for use by Kondwani, TK limited will be assessed to taxation on a car benefit. This benefit depends on the motor car's cylinder capacity. For motor cars which have a cylinder capacity of 2,000 cc, the annual taxable benefit is K15,000,000. As the motor car is owned by TK limited, TK limited will be able to claim capital allowances on the motor. The amount of capital allowance for the tax year 2010/11 will be K9,000,000 ($20\% \times K45,000,000$). In addition to the capital allowances, TK limited will also be able to deduct the cost of petrol provided in the motor car. Ignoring the cost of petrol as it is not available, the additional taxable income for the company as a result of providing the motor car to Kondwani will be: (2 marks)

		K
Car benefit chargeable	(½ mark)	15,000,000
Less capital allowances	(½ mark)	(9,000,000)
Additional taxable income	(½ mark)	6,000,000

Additional company income tax would be = $35\% \times K6,000,000 = K2,100,000$. (½ mark)

There will be no tax implications for Kondwani in respect of the motor car provided for his use. (½ mark)

The provision of a motor car for use by Towela who is a shareholder but not an employee or Director of TK limited would be treated as a payment of a dividend to the shareholder. Towela is an

effective shareholder in TK limited. The company will not be able to claim any capital allowances on the motor car used by Towela as the car would not have been in business use. (½ mark)

The company will be required to pay income tax on the cost of fuel provided for use by Towela. In addition, the company will also pay income tax on the amount paid for Towela's personal expenses. The amount of income tax payable on the personal expenses would be = $35/65 \times K5,000,000 = K2,692,308$. (1 mark)

As a result, the total additional tax payable by TK limited would be = $K2,100,000 + K2,692,308 = K4,792,308$. (1 mark)

Total for part (a) = 7 marks

- (b) If Towela was employed by TK limited, the taxation implications of the provision of the motor car for use by Kondwani would still be the same as above. (½ mark)

In respect of the motor car provided for use by Towela as an employee of TK limited, there will be an additional taxable income for the company of K15,000,000, being the car benefit in respect of the provision of a personal to holder motor car. The company will be able to deduct the cost of petrol provided for use by Towela. Capital allowances to be claimed by TKL limited would be the same as those claimed on Kondwani's motor car of K9,000,000. (2 mark)

The amount spent on payment of Towela's personal bill of K5,000,000 would be tax deductible when computing TK limited's taxable profit. (½ mark)

Ignoring the costs of fuel, which are not provided, the additional taxable income for TK limited would be as follows:

		K
Motor car benefits (K15 million × 2)	(½ mark)	30,000,000
Less:		
Capital allowances (K9 million × 2)	(½ mark)	(18,000,000)
Towela's personal expenses	(½ mark)	(5,000,000)
Additional taxable income		7,000,000
Additional company income tax would be = $35\% \times K7,000,000 = 2,450,000$.		(½ mark)

Total for part (b) = 5 marks

- (c) In respect of the proposed sale of some Towela's shares to Kondwani, there will be property transfer tax payable, whether the shares are sold directly to Kondwani or sold via a company purchase of own shares. (1 mark)

The realised value per share, based on the net asset basis of valuation as agreed with the Commissioner General is = Total Net Assets

Total Issued shares

$$= \frac{245 \text{ million} - \text{K}20\text{million}}{5 \text{ million shares}} = \text{K}45.00 \quad (2 \text{ marks})$$

If Towela sells 1,000,000 shares, the realised value would be = $\text{K}45 \times 1,000,000 = \text{K}45,000,000$. On this basis, she will be required to pay property transfer tax of = $3\% \times \text{K}45,000,000 = \text{K}1,350,000$. (½ mark)

If Towela sells 1,800,000 shares, the realised value would be = $\text{K}45 \times 1,800,000 = \text{K}81,000,000$. Property transfer tax payable would be = $3\% \times \text{K}81,000,000 = 2,430,000$. (½ mark)

If the sales and transactions are completed on 31 March 2011, the amounts of property transfer tax would be payable by 14 April 2011. In case the transactions are completed on 31 May 2011, the amounts of property transfer tax would be payable by 14th June 2011. (1 mark)

Total for part (c) = 5 marks

It is hoped that the above explanations would be useful. We will still be available to provide any further guidance that may be required.

Yours faithfully,

Licentiate & Co

Presentation and style = 3 marks**Total marks for question five = 20 marks**

Solution 6

(a) Shares and share option scheme

- (i) As the share option scheme is not an approved scheme, the 300,000 shares given to Imwiko have a realised value that is equal to their market value of K6,000,000 ($K20.00 \times 300,000$). (1 mark)
- (ii) Property transfer tax would have been paid on the realised value. The amount of property transfer tax paid was = K180,000 ($3\% \times K6,000,000$). (1 mark)

Total for part a (i) = 2 marks

(i) Exercising of share options

The share option is not part of an approved scheme, and will not therefore enjoy the benefits of such a scheme. There are three events with tax consequences – grant, exercise and sale. (½ mark)

1. Grant. If options over shares are granted with an exercise price that is less than market value, an income tax charge can arise on the difference between the market price per share and the exercise price. (½ mark)

In Imwiko's case, the options were issued with an exercise price equal to the then market value. No income tax charge therefore arose on grant of the share options. (½ mark)

2. Exercise. On exercise, the individual pays the agreed amount in return for a number of shares in the company. The price paid is compared with the open market value at that time, and if less, the difference is charged to income tax (½ mark)

In Imwiko's case on exercise, the difference between market value (K60) and the price paid (K20) per share will be taxed as income. Therefore, K40,000,000 [$1,000,000 \times (K60 - K20)$] will be taxed as income. (1 mark)

3. Sale. On the sale of shares in an unlisted company, property transfer tax is payable on the realised value of the shares sold. The shares have a realised value for the property transfer tax purposes that is equal to the higher of their nominal value and the open market value. (1 mark)

In Imwiko's case, on the sale of the shares acquired under the share option scheme, Imwiko will pay property transfer tax of K1,800,000 [$3\% \times (1,000,000 \times K60)$]. (1 mark)

Total for part a (ii) = 5 marks

- (iii) In order to obtain approval of the share option scheme, a written application will have to be made to the Commissioner General by the trustees or the employer, where trustees have not been appointed. Such an application should be accompanied by a copy of the instrument constituting the scheme and the rules of the scheme. (1 mark)
- Upon receipt of the application, the Commissioner General will consider whether the scheme has met the necessary conditions for approval and if so, he will approve the scheme and communicate in writing that the scheme has been approved. If the conditions are not met, the Commissioner General will not approve the scheme and he will still communicate in writing that the scheme has not been approved. (2 marks)

Total for part a (iii) = 3 marks

(b) Protection products

Imwiko is still working and has a mortgage to support. He therefore needs to protect not only his assets but also cover any debt, or the ability to repay. The following protection policies are relevant to Imwiko's situation.

(i) Life assurance (2 marks)

This is a form of insurance that pays out on a chargeable event, usually death. The main types are:

1. Term Assurance which provides cover for a fixed term with the sum assured payable only on death. No investment benefits or payments arise on survival.
2. Whole of Life Assurance where the policy provides life protection. The sum assured is payable on death at any time and usually some form of investment benefit will accrue in the form of a surrender value.

A qualifying policy will give a tax-free lump sum that could, for example, be used to repay the mortgage.

(i) Permanent health insurance (2 marks)

Permanent health insurance policies are designed to provide the policyholder with a benefit if he or she is unable to work through sickness or if he or she needs medical expenses or long-term care.

This would provide Imwiko with an income in the event of illness – again useful given his mortgage, and would avoid the need to liquidate other assets to pay the mortgage or ongoing costs.

(iii) Critical illness insurance (2 marks)

These policies provide a capital sum where a critical illness (from a large range listed in the policy) is diagnosed. For the same reasons above, Imwiko should consider this in conjunction with permanent health insurance.

Note: Marks will also be given for other relevant protection products.

Total for part (b) = 6 marks

(c) Provision of protection: company or individual

If any of the policies are taken out and paid for by Imwiko personally, then there will be no tax relief on the premiums, but neither will there normally be any tax payable on the proceeds or benefits received. (1 mark)

If Mwiza Enterprises Ltd were to pay the premiums on a policy taken out by Imwiko, and of which he was the direct beneficiary, then this will constitute a benefit, on the grounds that the company will have satisfied a personal liability of Imwiko's. Accordingly, income tax will be payable on the benefit. (1 mark)

If, however, Mwiza Enterprises Ltd were to decide to offer protection benefits to their employees on a group basis (and not just to Imwiko), then it would be possible to avoid a charge under the benefits rules and/or obtain a lower rate of premium under a collective policy. (2 mark)

Total for part (c) = 4 marks

Solution 7

- (a) For the purposes of taxation, a motor car is classified as a pool car if:
- (i) It is not available for use by one employee or director to the exclusion of all others.
 - (ii) It is not normally kept overnight at, or near the residence of one employee or director.
 - (iii) It is specifically meant for business use, with any private use being incidental to the business use.

The motor car being so driven should be owned by or leased by the employer for the purpose of provision for use by employees and/or directors.

(1 marks for each valid point up to a maximum of 4 marks)

- (b) In respect of Peter and James, the two motor cars will be for the exclusive use of Peter and James for both business and private use. In addition, and most likely, the motor cars will be kept at their respective homes over night and no other employee will normally be allowed to use any of the two motor cars for private purposes. If the two motor cars will be transferred to PJ Limited, then they will be personal to holder motor cars on the grounds mentioned above. Ownership will change to the company once the company has bought the motor cars from Peter and James. (2 marks)

On the other hand, if the two motor cars will not be transferred to PJ Limited, then they will not be personal to holder motor cars for taxation purposes. On this basis, the two motor cars will be private motor cars being used for business purposes in employment. (2 marks)

Total for part (b) = 4 marks

- (c) In order to establish whether Peter and James should retain ownership of their motor cars or transfer them to PJ limited, it is necessary to consider the amounts of taxation benefits arising under each of the two alternatives. (½ mark)

If Peter and James retain ownership of their motor cars, then the tax positions will be as follows:

PJ Limited

The payment of mileage allowances paid to Peter and James will be tax allowable. The amounts pay able and the tax saved will be:

		K
Mileage allowance paid to:		
Peter: $20,000 - 5,000 = 15,000 \times K5,500$	(½ mark)	<u>82,500,000</u>
James: $12,000 \times K5,500$	(½ mark)	66,000,000
Total mileage allowances paid		<u>148,500,000</u>
Company Income Tax saved $35\% \times K148.5 \text{ million}$	(½ mark)	<u>51,975,000</u>

The additional amounts of income tax payable by Peter and James on the mileage allowances receivable after deducting allowable expenses are as follows:

		Peter	James
		K	K
Mileage allowances received	(1 mark)	82,500,000	66,000,000
Less:			
Motor car expenses:	(1 mark)		
Peter ($15,000/20,000 \times K5,000,000$)		(3,750,000)	
James ($12,000/20,000 \times K4,500,000$)			(2,700,000)
Fuel for motor cars	(1 mark)		
Peter ($15,000/20,000 \times K8,500,000$)		(6,375,000)	
James ($12,000/20,000 \times K5,600,000$)			(3,360,000)
Capital allowances on motor cars	(1 mark)		
Peter ($15,000/20,000 \times 20\% \times K60,000,000$)		(9,000,000)	
James ($12,000/20,000 \times 20\% \times K45,000,000$)			(5,400,000)
		<u>63,375,000</u>	<u>54,540,000</u>
Less tax free amount		<u>(9,600,000)</u>	<u>(9,600,000)</u>
		<u>53,775,000</u>	<u>44,940,000</u>
Additional income tax payable			
25% x K6,420,000		1,605,000	1,605,000
30% x K33,180,000		9,954,000	9,954,000
35% x K14,175,000		4,961,250	
35% x K5,340,000			1,869,000
		<u>16,520,250</u>	<u>13,428,000</u>

(1 mark)

The net saving in taxation is as follows:

	K	K
Saving in company income tax		51,975,000
Less additional income tax payable		
Peter	<u>16,520,250</u>	
James	13,428,000	<u>(29,948,250)</u>
Net saving in taxation		<u>22,026,750</u>

(1½ mark)

The total additional costs amount to K23,600,000 and this exceed the tax saving resulting in an extra cost of K1,573,250.

(½ mark)

If Peter and James transferred ownership of their motor cars to PJ limited, then the position will be as follows:

PJ limited

The company will be assessed on the benefit arising because the motor cars will be classified as personal to holder motor cars. However, the company will be able to claim deductions for motor car expenses as well as capital allowances on the motor cars. The position will be as follows:

	K	K
Taxable benefits on motor cars: (½ mark)		
Peter's motor car		20,000,000
James' motor car		<u>15,000,000</u>
		35,000,000
Less allowable expenses:		
Motoring expenses: (½ mark)		
Peter's car (K5,000,000 + K8,500,000)	13,500,000	
James' car (K4,500,000 + K5,600,000)	10,100,000	
Capital allowances: (1 mark)		
Peter's car (20% × K48,000,000)	9,600,000	
James' car (20% × K32,000,000)	<u>6,400,000</u>	
Total allowable expenses		<u>(39,600,000)</u>
Reduction in PJ limited's taxable income		<u>(4,600,000)</u>
Savings in company income tax 35% × K4,600,000		<u>1,610,000</u>
		(½ mark)

From the above analysis, it appears that Peter and James should transfer ownership of the cars to PJ Limited. (½ marks)

Total for part (c) = 12 marks

Total marks for question Seven = 20 marks