TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C4: DIRECT TAXES

THURSDAY 16 JUNE 2016

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

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) 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. This question paper consists of FIVE (5) questions of twenty (20) marks each. You MUST attempt all the FIVE (5) questions.

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. **Cell Phones** are **NOT** allowed in the Examination Room.

6. 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.

7. All workings must be done in the answer booklet.

8. Present legible and tidy work.

9. Graph paper (if required) is provided at the end of the answer booklet.

10. A taxation table is provided on pages 2, 3 and 4 of this paper.

TAXATION TABLE FOR THE CHARGE YEAR 2016

Income Tax

Standard personal income tax rates

Income band	**Taxable amount**	**Rate**
K1 to K36,000	first K36,000	0%
K36,001 to 45,600	next K9,600	25%
K45,601 to K70,800	next K25,200	30%
Over K70,800		35%
Income from farming for individuals		
K1 to K36,000	first K36,000	0%
Over K36,000		10%
Gratuity		
K1 to K36,000	first K36,000	0%
Over K36,000		25%
Terminal benefits		
K1 to K35,000	first K35,000	0%
Over K35,000		10%

Company Income Tax rates

On income from manufacturing and other	35%
On income from farming	10%

Capital Allowances

Implements, plant and machinery and commercial vehicles:

Wear and Tear Allowance –	Plant used normally	25%
	Used in Manufacturing, Farming, Leasing	50%

Non- commercial vehicles

Wear and Tear Allowance	20%

Industrial Buildings:

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

Low Cost Housing	**(Cost up to K20,000)**	
Wear and Tear Allowance		10%
Initial Allowance		10%

Commercial Buildings

Wear and Tear Allowance	2%

Farming Allowances

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

Presumptive Taxes

Turnover Tax	3%

Property Transfer Tax

Rate of Tax on Realised Value of property other than mining rights	5%

Value Added Tax

Registration threshold	K800,000
Standard Value Added Tax Rate (on VAT exclusive turnover)	16%

Customs and Excise

Duty rates on:

1. Motor cars and other motor vehicles (including station wagons) principally designed for the transport of less than ten persons, including the driver:

Customs Duty:

Percentage of Value for Duty Purposes	30%
Minimum Specific Customs Duty	K6,000

Excise Duty:

Percentage of Value for Duty Purposes for Excise Duty Purposes	
Cylinder capacity of 1500 cc and less	20%
Cylinder Capacity of more than 1500 cc	30%

2. Pick-ups and trucks/lorries with gross weight not exceeding 20 tones:

Customs Duty

Percentage of Value for Duty Purposes	15%
Minimum specific Customs Duty	K6,000

Excise Duty:

Percentage of Value for Duty Purposes for Excise Duty Purposes	10%

3. Buses/coaches for the transport of more than ten persons

Customs Duty:

Percentage of Value for Duty Purposes	15%
Minimum Specific Customs Duty	K6,000

Excise Duty:

Percentage of Value for Duty Purposes for Excise Duty Purposes	
Seating Capacity of 16 persons and less	25%
Seating Capacity of 16 persons and more	0%

4. **Trucks/lorries with gross weight exceeding 20 tonnes**

Customs Duty:

Percentage of Value for Duty Purposes	15%

Excise Duty:

Percentage of Value for Duty Purposes for Excise Duty Purposes	0%

5. Surtax

On all motor vehicles aged more than five (5) years from year of manufacture	K2,000

QUESTION ONE

FOR THE PURPOSES OF THIS QUESTION, ASSUME THAT TODAY'S DATE IS 31st DECEMBER 2016.

Tondolo Musuma who was employed as the Finance Manager at Kalwilo Tours Ltd, a Zambian resident company, decided to go on early retirement, on 31 October 2016. The conditions of service were as follows:

Annual Salary	K288,000
Transport Allowance	15% of the basic salary
School Allowance	10% of the basic salary

She was accommodated in a company owned house for which she was paying no rent. If the house was rented to any other person, the company could have been charging monthly rentals of K6,500. The company maintains the house, and a total of K17,000 utility expenses were incurred in respect of the house occupied by Tondolo Musuma up to the date of retirement.

On 1 May 2016, Tondolo was paid a labour day award, as the most hard working and committed employee. The award comprised the following:

	K
Upright fridge	8,200
Cash	4,800
	13,000

Tondolo has been employed at Kalwilo Tours Ltd since the year 2000. In appreciation of her services, the company paid Tondolo a long-service award comprising Cash of K10,200, and a Desktop computer worth K6,900.

On retirement, Tondolo received Leave pay of K15,200, Compensation for loss of office of K48,500, Severance pay of K40,000, and a Pension of K340,000. Half of the pension was the Employers' pension refund, and the remaining half was the employee's contribution refund.

Tondolo received royalties of K29,750, dividends from Watu plc, a Zambian resident company, of K8,500, Management Consultancy Fees of K34,000, and bank interest of K12,000. These amounts represent the actual amounts received.

During the charge year 2016, Tondolo incurred the following expenses:

	K
School fees for her Children	49, 000
Medical insurance premiums	3, 750
Subscription to ZICA	4, 300
PAYE already paid	115, 294
Mortgage Interest	6, 500

Tondolo has always been contributing NAPSA at 5% of her basic salary.

Required:

(a) Calculate the Income tax payable by Tondolo Musuma for the tax year 2016.

(18 marks)

(b) Explain the tax treatment of the pension that Tondolo received on retirement.

(2 marks)

[Total: 20 Marks]

QUESTION TWO

(a) Zambia Revenue Authority (ZRA) uses tests to establish whether or not trade is being carried on. These tests are called badges of trade, which are indicators of the existence of trade.

Required:

Briefly explain the six (6) main badges of trade which can be used to establish whether or not trade exists. (12 marks)

(b) Turnover Tax is tax paid on turnover by all persons whose annual turnover is less than K800,000. It is charged at 3% of gross turnover.

Required:

(i) Explain any four (4) persons who are not required to pay turnover tax in Zambia. (4 marks)

(ii) Explain four (4) problems associated with turnover tax from tax payers' point of view. (4 marks)

[Total: 20 Marks]

QUESTION THREE

(a) Property Transfer Tax (PTT) is charged whenever a property is transferred and is charged at 5% of the realised value.

Required:

(i) Explain what property is and list four (4) assets which qualify as property for Property Transfer Tax purposes. (5 marks)

(ii) Explain how the Realised value for each of the properties listed above is determined. (4 marks)

(iii) Explain how transfers made to immediate family members are treated for Property Transfer Tax Purposes. (2 marks)

(b) Explain four (4) roles/ functions of taxation in the modern economy, apart from raising revenue for the Central Government. (4 marks)

(c) Explain the factors taken into account to determine whether or not an individual is a resident in the Republic of Zambia. (3 marks)

(d) Explain the difference between progressive taxes and regressive taxes. (2 marks)

[Total: 20 Marks]

QUESTION FOUR

Mambwe Mutolo started a business on 1 May 2015. She prepared the first set of accounts for the period of 20 months to 31st December 2016.

The tax adjusted business profit before capital allowances, for the period was K120, 000.

Assets that are used in business were acquired as follows:

Date	*Assets*	*Cost*
01/05/2015	Computer (Pentium)	K12, 000
01/05/2015	Motor Car	K39, 000
30/06/2015	Office Equipment	K15, 000
31/03/2016	Laptop Computer	K 8, 000
31/8/2016	Motor van	K60, 800

The car is used 20% private, while the computers are used 10% private.

Required:

(a) Calculate the Capital Allowances on any qualifying assets for the relevant charge years. (10 marks)

(b) Calculate the final amounts of taxable business profits for the relevant charge years. (5 marks)

(c) Calculate the final income tax payable by Mambwe Mutolo for the relevant tax years. (5 marks)

[Total: 20 Marks]

QUESTION FIVE

(a) Miss Charity Nyambe, a sole trader had the following income and expenses in the tax year 2016:

	K
Tax adjusted business profits before the following transactions	276,000
Subscriptions to trade journals	12,000
Rent paid (gross)	45,000
Royalties received (net)	17,000
Debenture interest received (gross)	20,000
Management consultant fees (gross)	5,000
Donations to a registered charity	15,000
Capital allowances	50,000
Building society interest on mortgage paid	2,000

Required:

Calculate the final income tax payable or refundable by Charity Nyambe for the tax year 2016. (10 marks)

(b) DKM LTD is a multinational company which was listed on the Lusaka Stock Exchange four (4) years ago.

In the tax year 2016, the company awarded indigenous Zambians more than 1/3 of the shares. This company is involved mainly in farming as the nature of its activities.

In the tax year 2016, the following incomes and expenses were received and paid:

	K
Donations and subscriptions to:	
Approved charities paid	30,000
Telephone bills paid	10,000
Farming profits	725,000
Non-farming incomes (profits)	55,000
Debenture interest received (gross)	35,000
Bank interest received (gross)	20,000
Treasury bill interest received (gross)	4,000
Rent paid	70,000

Required:

Calculate the income tax payable by the company for the tax year 2016. (10 marks)

[Total: 20 Marks]

END OF PAPER

JUNE 2016: DIRECT TAXES (C4)
SOLUTIONS

SOLUTION ONE

(a) TONDOLO MUSUMA

INCOME TAX PAYABLE FOR THE CHARGE YEAR 2016

	K
Salary: K288,000 X 10/12	240,000
Transport allowance: K240,000 X 15%	36,000
School allowance: K240,000 X 10%	24,000
Utility expenses	17,000
Long-service award	10,200
Leave pay	15,200
	342,400
Investment income	
Royalties: K29,750 X 100/85	35,000
Mgt. consultancy: K34,000 X 100/85	40,000
	417,400
Less allowable deductions	
NAPSA: (K240,000 X 5%) = K12, 000 restricted	(3,060)
Subscription to ZICA	(4,300)
Taxable income	410,040
Tax Computations:	
First K36, 000 @ Nil	-
Next K9, 600 @25%	2, 400
Next K25, 200 @ 30%	7, 560
Balance of K339,240 @ 35%	118, 734
Total	128, 694

Less:		
PAYE		(115,294)
WHT- Royalties: K35,000 X 15%		(5,250)
Commission K40,000 X 15%		(6,000)
		2,150
Terminal benefits:		
Compensation for loss of office	48,500	
Severance pay	40,000	
	88,500	
Exempt amount	(35,000)	
Balance	53,500 @10%	5,350
Income tax payable		7,500

(b) Tax treatment of pension:

The pension received by an employee on early or normal retirement is exempted from income tax.

SOLUTION TWO

a. The following are the badges of trade:

I. **The subject matter of realization**
The nature of the goods sold is considered. If the goods sold are normally held as trading stock then the presumption that one is in trade is very high.

II. **The length of the period of ownership**
The goods that are held as trading stock are held for a short period of time. If the goods sold were held by the tax payer for a short period, the presumption that a trading transaction took place will be high.

III. **The frequency of similar transactions**
If the tax payer engages in similar transactions more often, the presumption that there is trade going on is high.

IV. **Supplementary work and marketing**
If goods are acquired when there are in poor state and supplementary work is carried out to improve the goods by making them more marketable, then the presumption that there is trade is high when the goods are sold.

V. **Circumstances giving rise to realization**
The circumstances giving rise to a transaction are considered. If a tax payer sold goods in order to sort out a financial problem, the presumption that there is trade is low.

VI. **The tax payer's intention**
The intention to make a profit does not always constitute trade, but the intention to trade purely consists of trade.

b. (i) Persons not required to pay Turnover tax :

1. Any person whose annual turnover is more than K800,000.
2. Any person whose annual turnover is less than K800,000 but has registered voluntarily for Value Added Tax (VAT).
3. Any person carrying on the mining operations in the Republic of Zambia.
4. Any partnership irrespective of whether or not the turnover is more than K800,000.
5. Any person whose income constitutes income generated from partnership or partnership profits.

(ii) The following are the problems of Turnover tax:

1. Turnover tax is paid irrespective of whether a profit is made or not.
2. Expenses are not taken into account when calculating the taxable income.
3. No capital allowances are claimed on assets used wholly and exclusively for business purposes.
4. There is no carrying forward of losses by a person under turnover tax.

SOLUTION THREE

a. (i) Property is an immovable asset, which does not include any chattels, and it includes:

I. Any Land in Zambia (including any building on that land)
II. Any Building, structure, or other improvements thereon.

III. Any share issued by a company in Zambia that is not listed on the Lusaka Stock Exchange.
IV. Mining rights.

(ii) Realised value is an amount on which Property Transfer Tax is charged. As a general rule, the realised value of any property is the higher of:

I. The contract price agreed upon by the transferor (the person transferring ownership) and the transferee (the person receiving ownership), and
II. The open market value of the property.

For shares, the realised value is the higher of:

I. The open market value of those shares, and
II. The nominal value of the shares

(iii) A member of the immediate family is any of the following; a spouse, own blood child, duly adopted child or step child. Where a person transfers property to a member of the immediate family, the realised value of such property is the actual price received by the transfer, otherwise the realised value will be nil, if no price has been received, PTT would not be payable.

b. The following are the roles of taxation in addition to raising revenue for the central Government:

I. **Influencing economic activity**
The government uses taxes to influence the level of economic activity in the country. This is done through tax incentives provided to individuals and institutions engaged in activities that contribute towards economic growth. e.g. tax holiday.

II. **Redistribution of income and wealth**
In the country, there are people who earn higher income than others. The Government, therefore, uses progressive tax system to redistribute income and wealth.

III. **Maintaining the wellbeing of the environment.**
Heavy taxes are imposed on income arising from activities which are not friendly to the environment. Therefore, these activities are discouraged by higher tax rates.

IV. **Protection of local industries**
Taxation is also used as a means of protecting local industries from unfair foreign competition. This is achieved by imposing higher tax rates on imported goods and giving tax incentives to exporters of goods and services.

c. The Income Tax Act states that, for the purposes of Income Tax, an individual is treated as a resident in the Republic of Zambia if:
   I. He/ She is physically present in Zambia for more than 183 days excluding the day of arrival and departure
   II. The purpose of being in Zambia is for twelve (12) months and above, the individual will be regarded as a resident in Zambia.
   III. An individual has intentions to live in Zambia permanently, and then from the date of arrival he/ she will be regarded as a resident in Zambia.

d. Progressive taxes are taxes whose marginal rates of tax increase as the level of income increases whereas Regressive taxes are taxes whose marginal rates decrease as the level of income increases.

SOLUTION FOUR

(a)

COMPUTATION OF CAPITAL ALLOWANCES FOR TAX YEAR 2015

	K
1. Computer	
Wear & tear allowance (12000 x.25x.90)	2,700
2. Motor Car	
Wear & tear allowance (39,000 x. 20x.80)	6,240
3. Office Equipment	
Wear & tear allowance (15,000 x.25)	3,750
TOTAL CAPITAL ALLOWANCES	12,690

COMPUTATION OF CAPITAL ALLOWANCES FOR TAX YEAR 2016

	K
1. Computer	
Wear & tear allowance (12,000x.25x.90)	2,700
2. Motor car	
Wear & tear allowance (39,000x.20x.80)	6,240
3. Office equipment	
Wear & tear allowance (15,000x.25)	3,750
4. Laptop computer	
Wear & tear allowance (8000x.25x.90)	1,800
5. Motor van	
Wear & tear allowance (60,800x.25)	15,200
TOTAL CAPITAL ALLOWANCES	29,690

(b)

W1 allocation of profits according to basis period rules on commencement

Period 1

8/20x120,000= K48,000

Period 2

12/20x120,000= K 72,000

TAX YEAR	2015	2016
	K	K
ALLOCATED PROFITS	48,000	72,000
CAPITAL ALLOWANCES	12,690	29,690
TAXABLE PROFITS	35,310	42,310

(C)

Mambwe Mutolo

Computation of income tax payable for tax years:	2015	2016
	K	k
Taxable profits	35,310	42,310
Less tax free pay	35,310	36,000
Taxable income	-	6,310
Tax liability		
Next 6,310x.25	-	1578
Income tax payable	-	1578

SOLUTION FIVE

(a)

MISS CHARITY NYAMBE

COMPUTATION OF INCOME TAX PAYABLE FOR TAX YEAR 2016

	K	K
PROFITS	276,000	
LESS CAPITAL ALLOWANCES	50,000	
		226,000
ADD		
INVESTMENT INCOMES		
GROSS ROYALTIES (17000X100/85)	20,000	
GROSS MGT CONS FEES	5,000	
		25,000
GROSS INCOME		251,000

LESS ALLOWABLE DEDUCTIONS			
Donations to a registered charity		15,000	
Subscriptions		12,000	
			27,000
ASSESSABLE INCOME			224, 000
LESSTAX FREE PAY			36, 000
TAXABLE INCOME			188, 000
TAX LIABILITY			
NEXT	9,600X .25	2,400	
NEXT	25,200 X .30	7,560	
EXCESS	153,200X.35	53, 620	
			63, 580
LESS TAX SURFERED			
WHT ON ROYALTIES		3,000	
WHT ON MGT FEES		750	
			3,750
INCOME TAX PAYABLE			59,830

(b)

DKM LTD

COMPUTATION OF INCOME TAX PAYABLE FOR TAX YEAR 2016

	TOTAL	Non Farming Income	Farming Income
	K	K	K
PROFITS	780,000	55,000	725,000
ADD INVESTMENT INCOMES			
DEBENTURE INTEREST	35,000	35,000	-
BANK INTEREST	20,000	20,000	-
TAXABLE INCOME	835,000	110,000	725,000

TAX LIABILITY

Non Farming Income (35-5)= 30%X110,000	33,000
LESS TAX SUFFERED at source	
WHT-DEB INTEREST (35,000X.15)	5,250
WHT-BANK INTEREST (20,000X.15	3,000
INITIAL TAX PAYABLE	24,750
ADD TAX ON FARMING	
FARMING INCOME (10-5)=5%X725,000	36,250
FINAL INCOME TAX PAYABLE	61, 000

END OF SOLUTIONS