Zambia Institute of Chartered Accountants

Competence, Integrity and Virtue

QUESTION AND ANSWER
FOR
DECEMBER 2018

DIPLOMA IN TAXATION

TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C1: BUSINESS MANAGEMENT

MONDAY 10 DECEMBER 2018

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.

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.

Attempt all the FIVE (5) questions.

QUESTION ONE

(a) A written marketing plan helps entrepreneurs evaluate the market potential or a product, identify target audiences and access the market.

Required:

State the five (5) common components/elements of a marketing plan. (5 marks)

(b) Briefly discuss why modern management practitioners find it necessary to analyse an organisation's strengths and weaknesses along with its environmental opportunities and threats as a prerequisite to strategy formulation. (10 marks)

(c) Outline the general human resource management uses of performance appraisals or evaluations in organizations. (5 marks)

[Total: 20 Marks]

QUESTION TWO

(a) Internet Communication Technology (ICT) through Database Information Systems has revolutionalized the manner in which work is done in modern organizations.

Required:

i) Describe Database information systems and outline two (2) reasons why database management systems (DBMS) are widely used today. (4 marks)

ii) Giving appropriate examples, distinguish between data and information. (4 marks)

(b) Michael Porter's (1980) five (5) forces (factors) model is used to analyse the competitiveness of an industry or organisation in relation to shareholders' return.

Required:

(i) Briefly explain the five (5) competitive forces/factors that may influence shareholders' return. (10 marks)

(ii) Briefly explain how the five (5) competitive forces model may be used to make strategic business decisions. (2 marks)

[Total: 20 Marks]

QUESTION THREE

Sile Mining Company intends to open a uranium mine in one of the districts in Zambia. In the District, the major economic activity is farming and if the project is allowed some farmers will be displaced.

Required:

Briefly explain the following five (5) different stakeholders who would be interested in the planned mining activity and their respective interests.

(a) Community (4 marks)
(b) Government (4 marks)
(c) Pressure groups (4 marks)
(d) Potential investors (4 marks)
(e) Suppliers (4 marks)

[Total: 20 marks]

QUESTION FOUR

(a) Zambeef used to buy almost everything it used in its processes from the farms around Chisamba and other parts of Zambia, but in recent years Zambeef has managed to reach a stage where they are growing almost everything from their farms that is used to make their products and are able to reach their customers directly through different out lets located in different areas of the country.

Required:

(i) What do you call this strategic move made by Zambeef and briefly explain what the term means? (4 marks)

(ii) Briefly explain any four (4) benefits of such a move to the company. (8 marks)

(b) Mary is wondering whether to be a sole trader, own a public limited company or private limited company which she most prefers in comparison to the other but is not very sure about restrictions that are there in each type of business that would help her make a better choice.

Required:

Explain to Mary the major ownership restrictions that are in a private limited company in order for her to make a better business choice. (8 marks)

[Total: 20 Marks]

QUESTION FIVE

(a) In order for managers to achieve the integration of objectives, strategies and other plans, they must be familiar with the levels, and types of strategies that are there.

Required:

Explain the four (4) levels of strategy as recognized by Thomson. (8 marks)

(b) Peter explained to Kenny about the importance of control in organisations without which there would be confusion. Managers must prepare for the future by anticipating what may happen especially in this rapidly changing world.

Required:

Describe the type of organisational control that will make it possible for an organisation to cope with changes in the business environment. (4 marks)

(c) Managers at CB Company are about to formulate a new strategy for the period 2018-2022.

Required:

Explain to them the four (4) major elements of strategic formulation that will direct them through the strategic formulation process. (8 marks)

[Total: 20 Marks]

END OF PAPER

C1: BUSINESS MANAGEMENT - SOLUTIONS

SOLUTION ONE

a) Market Research and Analysis

i) This section of a marketing plan describes pertinent information about the potential market and helps entrepreneurs analyze whether a viable market exists. Strengths and weaknesses of the product and business are evaluated, as well as opportunities and threats presented in the marketplace. A target audience is identified and their values, preferences and ability to purchase are described. Characteristics of competitors and potential competitors are analyzed to help identify opportunities and threats. This part of the marketing plan is helpful in providing information about customers and competition used in developing a price

ii) **Marketing and Financial Goals and Objectives**

Goals and objectives for what an entrepreneur seeks to accomplish through marketing of the product are defined. These goals and objectives will help in focusing and evaluating marketing efforts and will help entrepreneurs in choosing a price after considering all the relevant factors

iii) **Marketing Mix**

The marketing mix describes the specific strategies developed to meet the needs and attract the target audience. Strategies are developed for the four P's of marketing (product positioning, price, place/ distribution and promotion) based on customer characteristics, values and preferences; business goals and objectives; and marketing budget.

iv) **Marketing Budget**

Spending on marketing activities, especially promotion, can vary widely, and few business owners have unlimited funds to spend. A marketing budget outlines costs associated with the marketing strategies developed in the marketing mix and other marketing expenses. Marketing costs must be considered in the cost of the product and are important to consider when setting a price to generate a profit.

v) **Evaluation of Market Response**

This section of the marketing plan describes the methods that will be followed to evaluate the market response to the marketing strategies. These evaluation methods will help entrepreneurs determine whether their marketing methods (and dollars) are working and working and if they are meeting their goals and objectives. If not, business owners can try to identify and correct problems. Business owners may track number of customers, total sales and average sales per customer, for example, before, during and after a promotional campaign. They may also wish to track sales of products at different price levels and times. These data may help producers identify when price changes may be necessary. Costs related to evaluating the market response will also impact price.

b) This question deals with SWOT Analysis

i) **Strengths** are those positive aspects or distinctive attributes or competencies, which provide a significant market advantage or upon which the organisation can build a competitive advantage. An example would be the present market positions of the company, staffing and skills, size, structure, managerial expertise, financial resources and so forth

ii) **Weaknesses_**are internal challenges that the organisation faces, preventing the successful implementation of the strategy. Some the weaknesses the firm may have include a weak financial base, poor production process being used by the company, weak human capital in the company and poor marketing systems. The strategy when developed shall aim to mitigate the impact the weaknesses have the company may have.

iii) **Opportunities** are general events in the external environment beyond the immediate control of the organisation but do have a bearing on the organisation. The opportunities are those events or trends that have are outside the control of the organisation but have a potential impact of reducing the competitiveness of the company in the market.

iv) **Threats** - These are again in the external environment and may include developments in science and technology, which the company is ill prepared to respond to. Threats may include situations where a new product is introduced that immediately makes the company's products obsolete, its distribution network irrelevant, new production methods that make the company's competitors more efficient and effective than the company. The strengths of the company combined with the opportunities may be used to neutralize the impact of the threats in the environment.

c) Generally, performance appraisals are seen as a mechanism for providing feed- back and determinant of reward allocation. General uses of performance appraisals by the human resources function include:

   i) Evaluations are important inputs in decisions of Performance appraisals promotion, transfer and termination

   ii) Performance appraisals identify training and evaluation needs. They help pinpoint employee skills and competences, which are currently deficient for staff development, can be used to remedy the situation.

   iii) Performance appraisal is used as criteria against which selection and development programmes are validated. Newly hired employees who perform poorly can be identified through performance evaluation.

   iv) Performance appraisals also provides a feedback to employees on how the organisation views their performance
   Performance appraisals/evaluations are also used as a basis for reward allocations. Thus who gets a merit increase or who gets a bonus for work output.

SOLUTION TWO

(a)

i)

- A database information system refers to a collection of records and files designed in such a way that it is possible for the whole of the user community to search and obtain a wide range of data and process it into standard and ad hoc reports.
- In a database, data is stored electronically in tables, and will be accessed by users via a piece of software called the database management system (DBMS). DBMS makes it possible for data stored on the database (on the server) to be shared among various workers. In addition, data on the data base provides for needs of different users and it can evolve to meet future needs of an organization.

ii) Data is raw unprocessed facts and figures that have no context or meaning. For example, keying into the computer 70,000 is data because the context or why the figure is keyed into the computer is not known. Information is processed data. It is data that has been assigned meaning. For instance, Appearing in the budget is information because it represents an activity or event to be carried out.

(b) **Michael Porter's five (5) competitive forces are:**

i)

- **Substitutes**. The threat that alternative products (or services) will equally satisfy customer needs
- **Potential entrants**. The threat posed by an outside organisation that may try to penetrate the market place. Examples of barriers include economies of scale, product differentiation, capital costs, switching costs, distribution channels
- **Buyer power**. The threat posed by the relative market forces that can be imposed by customers (for example relative size and number of buyers)
- **Supplier power**. The threat posed by the relative market forces that can be imposed by suppliers (for example, monopoly suppliers, switching costs, possible alternative products).
- **Competition and rivalry**. The inherent level of rivalry and competition in the industry between existing firms.

The five (5) forces model may be used to make strategic business decisions after to understand the inherent attractiveness of an industry by understanding the impact of each individual force on an organisation, actions may be taken to mitigate that force.

SOLUTION THREE

Stakeholders with an interest in Sile Mining Company

i) **Community:** The community and the leadership will have an interest of ensuring that first priority of employment is given to the locals. Also the community will be concerned with the safety of the people and environment during the mining activities. Another interest will be in the event where people are displaced how are they going to be compensated and alternative land to be given.

ii) **Government:** The interest of the government is to collect revenue through taxation and increase employment. It has also an interest of ensuring that there are relevant laws enacted to protect the safety and health of people and the general environment.

iii) **Pressure groups:** These are organizations that lobby and put pressure on government and business organisation to ensure that they act in the best interest of the public. Pressure groups will ensure that the government enact laws that will protect the people and environment. Will also ensure that the investor comply with the various laws of the country such as tax law, labour laws, environmental laws etc.

iv) **Potential Investors:** The potential investors are interested in the viability of the project through the projected cash inflows. They will critically study the business plan and investment appraisal to determine the viability of the business. This will help investors to make a decision either to invest or not.

v) **Suppliers:** These have an interest of supplying the company with the necessary materials required for production such as equipment, machinery, building materials, motor vehicles, labour etc

SOLUTION FOUR

a)

i) this move is called backward integration.it allows control over suppliers in order to improve the supply chain efficiency.

ii) the benefits of the backward integration strategy are: control of more of its supply chain, reduced dependency on suppliers, increases influence on customers, lowers costs and creates monopoly.

b) The main ownership restrictions in a private limited company are as follows:

i. Shares are offered to shareholders before anyone else.
ii. Shares are not sold at the stock ex change
iii. Shares do not exceed a fixed figure (commonly 50)
iv. It offers limited liability

SOLUTION FIVE

a) The four levels of strategy recognised by Thomson are:

i) Corporate strategy-is the business or the businesses a company should be in.

ii) Business strategy-strategies use to compete in industry e.g. generic strategies by Porter

iii) Functional strategy- means application of expert functions that will serve the needs of the business unit or organisation.

iv) Operating strategy- is meant to help find the best ways to operate in order to meet the daily targets. The processes used in organisations.

b) Feed forward type of control-the preventative type in nature. This is done before anything is done, through creating policies and procedures and rules that will eliminate behaviour and work practises that may cause undesirable results.it is meant to anticipate potential problems and take preventative actions to avoid their occurrence.

c) The following are the four (4) elements of the strategic formulation process:

i. Analysis of the organisation's mission and purpose based on planning premises, which justifies an organisation's existence.

ii. Analysis of the organisation's values and corporate culture, i.e. norms, values, attitudes, beliefs shared by organizational members.

iii. Analysis of the organisation's internal strengths and weaknesses, that is in relation to the organisation's competitors.

iv. Analysis of opportunities and threats in the environment, i.e. in relation to the organisation competitors

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C2: ECONOMICS & FINANCIAL MATHEMATICS

TUESDAY 11 DECEMBER 2018

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. Formulae are provided in a separate booklet.

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

Attempt all five (5) questions.

QUESTION ONE

(a) (i) With the aid of a diagram and using two (2) expansionary effects of fiscal policy, explain how expansionary influences will shift Aggregate Demand (AD) curve outward to the right. (4 marks)

(ii) Briefly explain how a decrease in personal disposable income influences Aggregate Demand (AD). (3 marks)

(b) Investment multiplier is defined as an increase in investment which leads to even more increase in income. Increase in savings leads to a decrease in multiplier. Explain how the multiplier process works. (4 marks)

(c) Central Bank independence can be defined as the Central Bank's operational and management independence from government. There are many arguments as regards the rationale for Central Bank independence. State any three (3) arguments in favor of Central Bank independence and any three (3) arguments against Central Bank independence. (6 marks)

(d) The Lusaka Stock Exchange (LuSE) has four (4) sets of rules for the regulation of the capital market. Outline any three (3) sets of rules of the Lusaka Stock Exchange. (3 marks)

[Total: 20 marks]

QUESTION TWO

(a) A public road is an example of a public good and the provision of education is an example of a merit good.

(i) Define a merit good. (1 mark)
(ii) Define a public good. (1 mark)
(iii) List any three (3) economic advantages of a well-functioning public road network. (3 marks)
(iv) State any three (3) economic advantages of an educated population in the country. (3 marks)

(b) Suppose a 25kg bag of second-hand clothes in Zambia sells at K100 and the price of a similar bag in Tanzania is 12,000 Shillings per bag, and the nominal exchange rate is 80 Shillings per K1.

(i) If you are a trader of second-hand clothes, how would you gain from this situation? (2 marks)
(ii) What would be the value of the gain per bag, both in Zambian Kwacha and Tanzanian Shilling? (3 marks)
(iii) What would happen to the price of second-hand clothes in each of the countries if other traders exploit the same opportunity as you have? (3 marks)

(c) Name the two (2) main tools used by the government in its fiscal stabilization policy and describe how they influence economic activity. (4 marks)

[Total: 20 marks]

QUESTION THREE

(a) The table below outlines the cash flows of an investment project for Mr Ndubeni:

Year	Cash Flow (K000)
0	-400
1	120
2	130
3	140
4	150

(i) Calculate the net present value of this investment, assuming 15% discount rate compounded annually. Is the investment worthwhile? (5 marks)

(ii) Calculate the net present value of this investment, assuming 8% discount rate compounded annually. Is the investment worthwhile? (5 marks)

(iii) List two factors that can make the size of the NPV in part (ii) become smaller. (2 marks)

(iv) Calculate the Internal Rate of Return of the above project using the results of (i) and (ii). (4 marks)

(b) Find the purchase price of a K2000, 4.25% bond, dividends payable annually, to be redeemed at par in eighteen (18) years when the investment rate is to be 6% annually. (4 marks)

[Total: 20 Marks]

QUESTION FOUR

(a) Determine the value of 'a' in a regression equation $y = a + bx$ given

$\sum x = 250,\ \sum y = 500,$ n = 10, b = 15 (4 marks)

(b) If $\sum x = 216$, $\sum x^2 = 10{,}435$, $\sum y = 550$, $\sum x^2 = 46{,}030$, $\sum xy = 19{,}630$, n = 10

(i) Calculate the correlation coefficient (4 marks)

(ii) Hence find the value of the coefficient of determination in percentage (2 marks)

(c) In how many years will K1,000 amount grow to K3,500 at 9.5% compounded every two months. (5 marks)

(d) A certain company is expected to pay K11,200 every six months indefinitely on a share of its preferred stock. Assuming that the money is worth 5.5% compounded semi-annually what should he be willing to pay for a share of the stock. (5 marks)

[Total: 20 Marks]

QUESTION FIVE

(a) A project requires an initial investment of K20 000. It will return an income of K3 000 payable at the end of each year for the next 7 years. What is the net present value (NPV) assuming a discount rate of 8%? (6 marks)

(b) A financial group can make investment of K3,500 now and receive K5,000 in two years' time. What is the internal rate of return? (6 marks)

(c) A bond has a face value of K1,000 with a time to maturity ten years from now. The yield to maturity of the bond is 10%.

(i) What is the price of the bond today, if it pays no coupons? (3 marks)

(ii) What is the price today if it pays 8% coupon rate semi-annually. (5 marks)

[Total: 20 Marks]

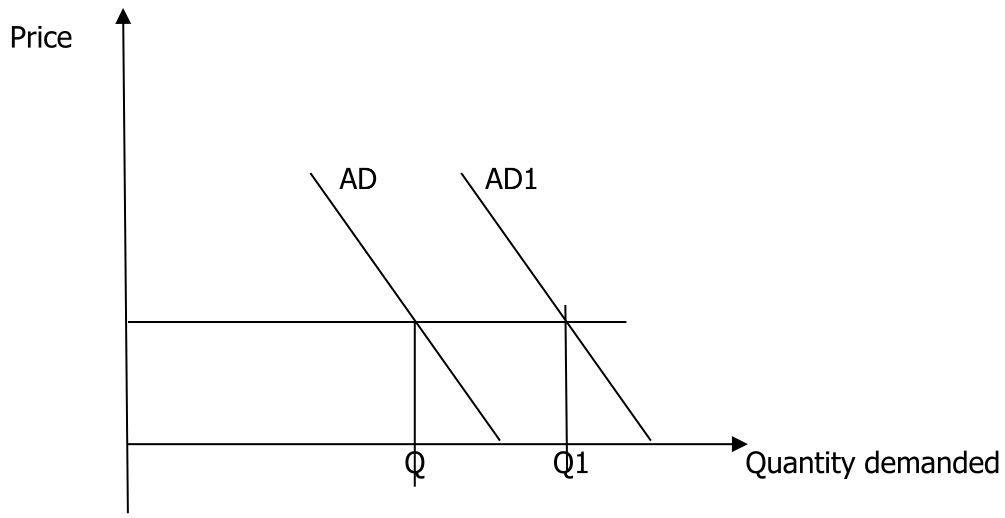
END OF PAPER

C2: ECONOMICS & FINANCIAL MATHEMATICS – SOLUTIONS

SOLUTION ONE

(a)

(i) Expansionary effects such as increases in government spending and tax reductions will shift the Aggregate Demand (AD) curve outward from AD to AD1. This is so because when government spending increases, consumers spend more, the demand increases Q to Q1 causing the AD curve to shift outward from AD to AD1.



(a)(ii) A reduction in disposable income of consumers reduces the demand for goods and services leading to a leftward shift of the AD curve.

(b) Multiplier process works as follows: When there is an increase in government expenditure, this increases national income by more than the initial investment. The multiplier also works in the opposite direction such that a decrease in public and private investment can lead to a decrease in national income.

(c) Any three (3) arguments against Central Bank independence:

(i) Undemocratic tendencies: when too much power is in the hands of unelected bank directors.
(ii) Independence has no provision to replace bad directors.
(iii) Independence of the Central Bank makes it difficult to coordinate fiscal and monetary policies as the Central Bank and parliament can have different agendas.

Any three (3) arguments in favour of Central Bank independence:

(i) Politicians may lack the economic expertise of bankers.
(ii) Political interference may pressure the Central Bank to buy new treasury bills financed by printing new money.
(iii) Since the Central Bank does not worry about reelection in that it can pursue unpopular but wise policies.

(d) Four (4) sets of rules for the regulation of the markets :

i) Rules of the exchange provide for membership requirements and conduct of members as well as disciplinary matters.

ii) Trading rules which regulate the manner in all trades and market transactions should be conducted.
iii) Clearing and settlement procedural rules which provide for the processes and procedures required for clearing and settlement for market transactions.
iv) Listing rules which provide for the criteria of listing securities on the LuSE as well as prescribe the conduct of listed backbone of investor protection guidelines and sets disclosure standards of price sensitive information by listed companies.

SOLUTION TWO

(a)

(i) A merit good is a good which is judged that an individual or society should have on the basis of some concept of need, rather than ability and willingness to pay

(ii) A public good is one that is both non-excludable and non-rivalrous in that individuals cannot be effectively excluded from use and where use by one individual does not reduce availability to others. It is provided without a profit motive usually by the government.

(iii)

- A good public road network can make transportation of goods and people faster and cheaper
- It can open up access to different markets by linking them
- It can facilitate more domestic and international trade
- It can improve competition
- It can enhance the economies of agglomeration
- It can boost economic growth

(iv)

- Education can improve the earnings or wages of the people
- It can also help to reduce the unemployment rate
- It can contribute to higher tax revenues for the government
- It can help to reduce the levels of income inequality
- It can lead to a healthier population
- It can improve civic and political participation in the country

(b)

(i) A trader can benefit from the situation by buying second-hand clothes from the country where second-hand clothes is relatively cheaper and reselling it in the country where the price of second-hand clothes is higher to make a bigger profit.

(ii) Price of second-hand clothes in Zambia = K100/bag
Price of second-hand clothes in Tanzania (in Zambian Kwacha) = 12000/80
Price of second-hand clothes in Tanzania (in Zambian Kwacha) = **K150/bag**

Price of second-hand clothes in Tanzania = TZS12000/bag
Price of second-hand clothes in Zambia (in Tanzanian Shilling) = 100*80
Price of second-hand clothes in Zambia (in Tanzanian Shilling) = **TZS8000/bag**

It is clear that the price of second-hand clothes in Zambia is lower than in Tanzania. A trader will gain a **K50** or **TSZ4000** if they decide to buy second-hand clothes in Zambia and reselling it in Tanzania.

(iii) If other traders are attracted by the gains from the cross-border reselling of second-hand clothes bought in Zambia, there will be more second-hand clothes being sold on the Tanzanian market. This increased supply of second-hand clothes in Tanzania will drive the price of second-hand clothes downwards in that country. Conversely, the higher demand for the cheaper Zambian second-hand clothes will push the price of the second-hand clothes up. The prices of second-hand clothes will continue to adjust until purchasing power parity is achieved between the two countries.

(c) The government uses **taxation** and **expenditure** tools for its fiscal stabilization policy.

Taxes are the aim source of government revenue. The government can use taxes to influence economic activity by increasing them to discourage too much activity in the economy while also collecting more revenue or by decreasing them to encourage more economic activity.

Government can also use its **expenditure** to either stimulate or dampen economic activity. By increasing its spending on goods and services, the government will increase domestic demand and thus increase the level of economic activity. When it desires to dampen activity it can reduce spending on goods and services.

SOLUTION THREE

Note: When future values are brought back to present values at a given rate of interest, the interest rate is referred to as the discount rate.

The present value of the cash outflow is the initial outlay of K400 000. The present value of cash inflows is calculated by summing the present value of each cash inflow as follows:

(i) Consider $r = 15\%$

$$\begin{aligned} NPV_A &= 120000(1.15)^{-1} + 130000(1.15)^{-2} + 140000(1.15)^{-3} + 150000(1.15)^{-4} \\ &= 104348.83 + 98298.68 + 92052.27 + 85762.99 = 380462.77 \end{aligned}$$

Thus the NPV is

$$380462.77 - 400000 = -19537.23$$

As the NPV is negative, the firm should not invest in this project.

(ii) Considering $r = 8\%$

$$\begin{aligned} NPV_B &= 120000(1.08)^{-1} + 130000(1.08)^{-2} + 140000(1.08)^{-3} + 150000(1.08)^{-4} \\ &= 111111 + 111454 + 111137 + 110254 = 443956 \end{aligned}$$

Therefore, the total present value over the four years is 443956

Thus the NPV is

$$443956 - 400000 = 43956$$

As the NPV is positive, the firm will invest in this project. Thus, the investment is cost effective at 8% discount rate compounded annually.

(iii) The size of the NPV in part (ii) will become smaller when

- The initial cost outlay increases
- The discount rate at which NPV is computed increases.

(iv)

$$IRR = \frac{(r_A \times NPV_B) - (r_B \times NPV_A)}{NPV_B - NPV_A} = \frac{(0.15 \times 43956) - (0.08 \times -19537.23)}{43956 + 19537.23} = 0.1285.$$

Therefore, the internal rate of return is approximately 12.85%.

(b)

$F = C = 2000$, $r = 4.25\%$, $i = 6\%$ and $n = 18$

SOLUTION FOUR

1. (a) (i) $a = \frac{\sum y}{n} - \frac{b\sum x}{n}$

$a = \frac{500}{10} - \frac{15\,(250)}{10}$

= 50 – 375

= -325

(b)(i) r = $\frac{n\sum xy - \sum x \sum y}{\sqrt{[n\sum x^2 - (\sum x)^2][n\sum y^2 - (\sum y)^2]}}$

r = $\frac{10\,(19630) - 216\,(550)}{\sqrt{[10\,(10435) - (216)^2][10\,(46030) - (550)^2]}}$

r = $\frac{77500}{\sqrt{57694 \times 157800}}$

r = $\frac{77500}{95415}$

r = 0.8122

(b) (ii) $r^2 = 0.8122^2$

= 0.6597

= 65.97%

(c) A = $P\,(1 + \frac{r}{m})^{mt}$

$3500 = 1000\,(1 + \frac{0.095}{6})^{6t}$

$(1.01583)^{6t} = 3.5$

$\text{Log } 1.01583^{6t} = \log 3.5$

$6t = \frac{\log 3.5}{\log 1.01583}$

t = 13yrs

(c) Pv = $\frac{A}{r}$

= $\frac{11200}{0.0275}$

= 407 272.73

SOLUTION FIVE

a.

$$NPV = -20000 + 3000(1.08)^{-1} + 3000(1.08)^{-2} + 3000(1.08)^{-3} + 3000(1.08)^{-4} + 3000(1.08)^{-5} + 3000(1.08)^{-6} + 3000(1.08)^{-7}$$

$$= -20000 + 3000(1.08)^{-1}\left[\frac{1-(1.08)^{-7}}{1-(1.08)^{-1}}\right] = -4380.89$$

b.

Internal rate of return occurs when NPV=0

$$-3500 + 5000(1+r) = 0$$

$$5000(1+r)^{-2} = 3500$$

Thus, $\Rightarrow (1+r)^2 = \dfrac{5000}{3500}$

$$\Rightarrow 1+r = \left(\frac{50}{35}\right)^{\frac{1}{2}}$$

$$\therefore \quad r = \left(\frac{10}{7}\right)^{\frac{1}{2}} - 1 = 0.19523$$

c.

i. The price today for a zero coupon bond is :

$$F(1+i)^{-n} = 1000(1.10)^{-10} = 1000(0.385.54) = 385.54$$

ii.

$F = 1000$, $r = 4\%$, $n = 20$, $i = 5\%$, $C = 1000$

$$Fair \quad \Pr ice = P = F \times r\left[\frac{\left(1-(1+i)^{-n}\right)}{i}\right] + \frac{C}{(1+i)^n}$$

$$= 1000(0.04)\left[\frac{1-(1.05)^{-20}}{0.05}\right] + \frac{1000}{(1.05)^{20}} = 498.49 + 376.89$$

$$= 875.38$$

END OF SOLUTION

TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C3: ACCOUNTANCY FOR TAX PRACTITIONERS

MONDAY 10 DECEMBER 2018

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.

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.

Attempt all five (5) questions in this paper.

QUESTION ONE

Mukapasa, a limited liability company, produced the following trial balance at 31 December 2017:

	Dr	Cr
	K'000	**K'000**
10% Preference shares, 50 ngwee each		1,000
Suspense		1,500
Share premium		1,000
Revaluation reserve as at 1 Jan. 2017		350
Ordinary shares of K1 each		11,000
12% Loan notes		2,500
Land at valuation	4,950	
Buildings at cost	3,500	
- depreciation to 1 January 2017		200
Plant and machinery at cost	2,200	
- depreciation to 1 January 2017		300
Inventory at 1 January 2017	2,100	
Receivables	8,750	
Cash in hand	4,520	
Payables		3,180
Bank		900
Administration expenses	2,640	
Selling and distribution expenses	2,920	
Dividends paid	350	
Loan note interest paid	150	
Sales revenue		26,000
Purchases	19,450	
Carriage inwards	150	
Carriage outwards	100	
Returns outwards		340
Discounts allowed and received	80	1,690
Retained earnings at 1 January 2017		1,900
	51,860	51,860

(**Note** that figures in the above **trial balance** are in **K'000 – thousands**)

The following additional information at 31 December 2017 is available:

(1) Inventory at the close of business has been valued at cost K1,940,000, while the net realisable value was K2,345,678.

(2) Prepaid administration expenses are K120,000 and accrued selling and distribution expenses K170,000.

(3) Mukapasa, uses revaluation model as allowed by IAS 16 Property, Plant and equipment. The independent specialist in land valuation based in Lusaka, has advised that the land should be revalued to K5,000,000 at 31 December 2017.

(4) Depreciation is to be provided as follows:

(i) Buildings at 4% per annum on their original cost.
(ii) Plant and machinery at 10% per annum of their carrying amount.

(5) Income tax of K1,080,000 is to be provided for the year. Ignore deferred tax.

(6) The 12% loan notes were acquired on the 1 of July 2017. K1,500,000 of the loan notes is redeemable by 31 December 2018 and K1,000,000 by 30 June 2025.

(7) A customer ceased trading owing the company K280,000; the debt is not expected to be recovered and an adjustment should be made.

(8) One (1) million new ordinary shares were issued at a premium of K0.5 on 1 October 2017. The proceeds have been left in a suspense account.

(9) The preference shares are irredeemable preference shares and preference dividends for the year, have not yet been accounted for.

Required:

Prepare the following, for Mukapasa's internal use:

(a) Statement of profit or loss and other comprehensive income for the year ended 31 December 2018. (10 marks)

(b) Statement of financial position as at 31 December 2018. (10 marks)

[Total: 20 Marks]

QUESTION TWO

Ratio analysis involves comparing one figure against another to produce a ratio, and assessing whether the ratio indicates a weakness or strength in the businesses' affairs. There are broadly three bases of comparison of ratios, these are: past periods, planned performance and other similar businesses in the same industry/ sector average.

The key to obtaining meaningful information from ratio analysis is comparison. This may involve comparing ratios over time within the same business to establish whether performance is improving or declining, and comparing ratios between the similar businesses to see whether the company you are analyzing is better or worse than others in sector. It must be stressed, however that each individual business must be considered separately, and a ratio that is meaningful for a manufacturing company may be completely meaningless for a financial institution.

Required:

(a) Explain the meaning of the following financial ratios:
(i) Current ratio (1 mark)
(ii) Return on capital employed (1 mark)
(iii) Gross profit margin (1 mark)

(b) Discuss three (3) limitations of ratio analysis to users of the ratios (3 marks)

(c) Zamratio Ltd Statement of profit or loss for the year ended 31 December 2017:

	K'000
Revenue	2,360
Cost of sales	(1,360)
Gross Profit	1,000
Expenses	(532)
Net profit before tax	468
Tax	(160)
Net profit after tax	308

Zamratio Ltd Statement of Financial Position as at 31 December 2017:

ASSETS	**K'000**	**K'000**
Non-current assets		
Property, plant and equipment		1,404
Current assets		
Inventory	294	
Trade receivables	206	
Cash at Bank	6	
		506
Total assets		**1,910**
Equity and Liabilities		
Ordinary shares K1 fully paid up		1,000
Retained earnings		512
Long-term loan		200
Current liabilities (All trade payables)		198
Total equity and liabilities		**1,910**

Interest is payable on the long-term loan balance at the year end at 5% per year. This has been included within the expenses in the Statement of profit or loss.

Required:

Calculate the following ratios for Zamratio Ltd for 2017:

(i) Return on capital employed (2 marks)
(ii) Net profit before tax to sales (2 marks)
(iii) Acid test ratio (2 marks)
(iv) Gross profit margin (2 marks)
(v) Trade receivables collection period (2 marks)
(vi) Trade payables payment period (2 marks)
(vii) Inventory holding period (2 marks)

[Total: 20 Marks]

QUESTION THREE

Chimwemwe is a sole trader who deals in building materials in Kawambwa, most of her transactions are credit transactions. She does not have sufficient accounting knowledge to prepare Receivables Control Account and the Payables Control Account. You have recently graduated as a tax practitioner with the Zambia Institute of Chartered Accountants (ZICA) and Chimwemwe has approached you for some assistance in preparing control accounts. She has provided you with the following details:

on 1 April 2017 the receivables ledger balances were K116,048 debit and K100,114 credit, and the payables ledger balances on the same date K112,470 credit and K100,210 debit. For the year ended 31 March 2018 the following particulars are available.

	K
Bonus Issue	50,000
Credit Sales	127,456
Ordinary dividends paid	123,456
Cash Sales	250,900
Carriage outwards	150,123
Credit Purchases	79,948
Cash Purchases	125,250
Share premium	765,432
Cash from trade accounts receivable	110,424
Cash to trade accounts payable	74,614
Discount received	2,950
Discount allowed	4,656
Unpresented cheques	2,500
Returns outwards	1,070
Returns inwards	2,004
Irrecoverable debts written off	652
Cash received in respect of debit balance in payables ledger	210
Allowances to customers on goods damaged in transit	424
Contra entry between receivables control account and payables control account	868
Increase in allowance for receivables	125
Bank charges	777
Rights issue	888

On 31 March 2018 there were no credit balances in the receivables ledger except those outstanding on 1 April 2017, and debit balances in the payables ledger stood at K100,000

Required:

(a) Explain four (4) key reasons why control accounts are prepared. (4 marks)

(b) Write up the Receivables Control Account and the Payables Control Account.

(16 marks)
[Total: 20 Marks]

QUESTION FOUR

Accounting concepts also known as accounting conventions, are broad basic assumptions which underly the periodic financial accounts of business enterprises. The rules guides preparers of financial statements as how to make entries as well as users to check whether the financial statements have been properly prepared.

Required:

(a) Explain the following accounting concepts and give an example of their use:

(i)	Going concern	(3 marks)
(ii)	Historical cost	(3 marks)
(iii)	Matching	(3 marks)
(iv)	Prudence	(3 marks)
(v)	Materiality	(3 marks)

(b) Using examples, explain three (3) differences between revenue expenditure and capital expenditure (5 marks)

[Total 20 Marks]

QUESTION FIVE

You are a financial accounting and tax consultant of the Zambia Institute of Chartered Accountants (ZICA) who conducts workshops and talks on various topics in Accounting, Auditing, public sector and various tax matters. On 20 December 2018 you are going to have a presentation during the 'Students' Forum', organised by CBU-ZICA student chapter to be held on Moba Hotel, Kitwe. The Training and Education Manager of ZICA would like to look at your presentation tomorrow (Tuesday) before it can be delivered to students.

Required.

Write brief notes on the following:

(a)	Preference shares	(4 marks)
(b)	Prime cost	(4 marks)
(c)	Limited liability	(4 marks)
(d)	Partnership agreement	(4 marks)
(e)	International Accounting Standards Board (IASB)	(4 marks)

[Total: 20 Marks]

END OF PAPER

C3: ACCOUNTANCY FOR TAX PRACTITIONERS – SOLUTIONS

SOLUTION ONE

(a) **Mukapasa : Statement of profit or loss and other comprehensive income for the year ended to 31 December 2018**

		K'000	K,000
Sales			26, 000
Less:	Cost of sales		
	Opening inventory	2, 100	
	Purchases (19,450 + 150 – 340)	19, 260	
	Closing inventory	(1, 940)	
			(19, 420)
Gross profit			6, 580
Add discount received			1, 690
			8, 270
Less	Expenses		
	Administration (2, 640 - 120)	2, 520	
	Selling and distribution (2, 920 + 170)	3, 090	
	Loan note interest (W2)	150	
	Preference dividends	100	
	Carriage outwards	100	
	Depreciation(W1 140+190)	330	
	Irrecoverable debt	280	
	Discount allowed	80	
			(6, 650)
Profit before tax			1, 620
Income tax expense			(1,080)
Profit for the year			540
Other comprehensive income:			
Gains on land revaluation (5,000 - 4, 950)			50
Total comprehensive income for the year			**590**

(b) **Statement of financial position as at 31 December 2018**

	Cost/valuations	Accumulated depreciation	Carrying amount
	K	**K**	**K**
Non-current assets			
Land (4, 950 + 50)	5, 000	-	5, 000
Buildings (Acc. Dep. =200 + 140 w1)*	3, 500	*(340)	3,160
Plant and mach. (Acc. Dep. 300+190 w1)**	2, 200	**(490)	1,710
	11, 200	830	9, 870
Current assets			
Inventory		1, 940	
Receivables (8, 750 - 280)		8, 470	
Prepaid administrative expenses		120	
Cash		4, 520	
			15, 050
Total Assets			**24, 920**

Equity and Liabilities

Equity

Ordinary share capital (11,000 + 1,000)		12, 000
Preference shares		1,000
Share premium (1,000 + 500)		1,500
Revaluation reserve (350 + 50 rev. gain)		400
Retained earnings(1,900 b/d+ 540 profit –350 div)		2, 090
		16, 990
Liabilities		
Non-current liabilities		
12% Loan notes		1, 000
Current liabilities		
Trade payables	3, 180	
12% Loan notes	1, 500	
Bank overdraft	900	
Preference divid	100	
Accrued selling and distrib expenses	170	
Income tax	1,080	

	6, 930
Total equity and liabilities	**24, 920**

Workings
All workings are in K'000

(W1) Depreciation

	K
Buildings 4% x K3, 500 =	140
Plant and machinery 10 % x (K2, 200 –K300)	190
	330

(W2) Loan note interest

K2, 500 @ 12% x 6/12= K150

(W3) To clear suspense account

Debit suspense by	K1, 500
Credit Share capital by	K1, 000
Credit Share premium by	K 500

SOLUTION TWO

(a)

(i) The **current ratio** is used to give an idea of the company's ability to pay back its short-term obligations (debts due within one year) with its short-term assets. The higher the ratio the more liquid a company is and the greater its capability of paying its short-term obligations.

(ii) **Return on capital employed** identifies how much profit the business has made from the capital invested in it. The capital includes both equity and long term capital.

(iii) The **gross profit margin** is the ratio of gross profit (gross sales less cost of sales) to sales revenue. It is the percentage by which gross profits exceed production costs. Gross profit margins reveal how much a company earns taking into consideration the costs that it incurs for producing its products or services.

(b)

- Ratios are only as reliable as the financial information from which they derive.
- Inflation can distort the information.
- It can be difficult to find a suitable benchmark with which to compare the ratios with, different companies operate in different industries each having different environmental conditions which means a comparison of two companies from different industries might be misleading.
- Ratio analysis explains relationships between past information while users are more concerned about current and future information.
- Financial accounting information is affected by estimates and assumptions. Accounting standards allow different accounting policies, which makes it difficult to compare ratios with the ratios of other companies.
- Interpretation requires thought and analysis.
- Different accounting periods.
- Different components used to calculate ratios, rendering comparison inappropriate.

(c) Zamratio Ltd for the year ended 2018

(i) Return on capital employed

$$= \frac{\text{Profit before interest and taxation}}{\text{Capital employed}} \times 100\%$$

Return on capital employed (468+10) /1,712 x 100 %= **27.9%**

(ii) Net profit before tax to sales

$$= \frac{\text{Net profit before tax}}{\text{Revenue}} \times 100\%$$

Net profit before tax to sales (468/2, 360) x 100 %=**19.8%**

(iii) Acid test ratio

$$= \frac{\text{Current asset } \textbf{less (-)} \text{ inventory}}{\text{Current Liabilities}}$$

Acid test ratio (506-294)/198 = **1.07:1**

(iv) Gross profit margin

$$= \frac{\text{Gross profit}}{\text{Revenue}} \times 100\%$$

Gross profit margin (1,000/2, 360) x 100% =**42.4%**

(v) Trade receivables collection period

$$= \frac{\text{Trade receivables}}{\text{Revenue}} \times 365\text{days}$$

Trade receivables collection period (206/2,360) x 365 = **32 days**

(vi) Trade payables payment period

$$= \frac{\text{Trade payables}}{\text{Credit Purchase/Cost of sales}} \times 365 \text{ days}$$

Trade payables payment period (198/1, 360) x 365=**53 days**

(vii) Inventory holding period

$$= \frac{\text{Average inventory}}{\text{Cost of sales}} \times 365 \text{ days}$$

Inventory holding period (294/1, 360) x365 = **79 days**

SOLUTION THREE

(a)The following are key reasons why control accounts are prepared (any four):

I. To provide checks on **the accuracy** of individual personal ledger balances; payables and receivables.
II. To complete the **double entry** for sales and purchases.
III. Assist in the **faster location of errors** a there are fewer entries to check against in the control accounts.
IV. Provides an **internal check where** there is separation of book-keeping duties
V. It's **faster and time efficient** to draw control accounts which are the totals accounts to arrive at the accounts payable and receivable than add each individual personal balances.
VI. To provide total receivables and total payables balances **more quickly** for producing a trial balance or statement of financial position.

(b)

Receivables Control Account

	K		**K**
Balance b/d	116,048	Balance b/d	100,114
Sales	127,456	Cash received	110,424
		Discount allowed	4,656
		Sales returns	2,004
		Bad debts	652
		Contra - payables	868
Balance c/d	100,114	Allowances on damages	424
		Balances c/f	124, 476
	343,618		**343, 618**

Payables Control Account

K		**K**	
Balance b/d	100, 210	Balance b/d	112,470
Payments to suppliers	74,614	Purchases	79,948
Discount received	2,950	Cash	210
Purchase returns	1, 070	Balance c/d	100,000
Contra – receivables control	868		
Balance c/d (balancing fig.)	12,916		
	192, 628		**192,628**

<u>SOLUTION FOUR</u>

(a)

(i) **Going concern**

Financial statements should be prepared on the assumption that a business will continue its operations for the foreseeable future (12 months following the date the Financial Statements are approved by the Board of Directors), unless there is evidence to the contrary. In other words, it is assumed that there is no intervention, or need, to sell off the non-current assets of the business.

Where the Directors are aware that the business will be unable to continue its operations for the foreseeable future the break up basis of preparation should be adopted in preparing the Financial Statements. For example when we consider asset valuations the usual basis of valuation of assets is historical cost, but if the entity is no longer a going concern and will be wound up, it is arguably more appropriate to value the assets at the forced sale price, since they will soon be sold.

(ii) Historical cost

The value of assets shown on the Statement of Financial Position should be based on their acquisition cost (historic cost), not to the value of the returns, which are expected to be realised.

Many argue that historic costs soon become outdated and so are unlikely to help in the assessment of current financial position and that recording assets at their current value would be more relevant, this is an IFRS convention. For example, many assets, particularly illiquid assets such as vehicles, plant & equipment and fixtures and fittings, are recorded on the statement of financial position according to the historical cost accounting convention. A notable exception to this rule is the recording of marketable securities, which are recorded according to their market value. Historical cost usually bears little or no relationship to the market value after an asset has been held for several years.

(iii) Matching

This asserts that profit is the excess of revenue over expenses for a period, not the excess of cash received over cash paid. Income and expenditure should be recognised in the accounting period to which they relate rather than the period in which cash is received or paid. This is also referred to as the accruals concept. For example, this gives rise to accruals and prepayments which accounts for the difference between cash flow and income statement information.

(iv) Prudence

Caution should be exercised when making accounting judgments. The application of this normally involves recording all losses as soon as they are expected to occur. However, profits are only recorded once they arise. It is designed to prevent an overstatement of financial position and performance. For example, where sales are made on a credit basis the question of the certainty of profits or incomes arises. If there is not a good chance of receiving money in full, no sales are made on credit anyway; but if, in the interval between the sale and the receipt of cash, it becomes doubtful that the cash will be received, prudence dictates that a full provision/allowance for the sum outstanding should be made. A provision/allowance being an amount, which is set aside via the statement of profit or loss.

(v) Materiality

Accounting information is material where its omission or misrepresentation will alter the decisions made by users of the financial statements; the threshold for materiality will differ from one business to the next. The main question that the materiality concept addresses is does the financial information make a difference to financial statement users. If not, the company doesn't have to worry about including it in their financial statements because it is immaterial.

Accounting for every single item individually in the accounts of a multi-million kwacha concern would not be cost-effective. A user would gain no benefit from learning that a stock figure of K200, 000 included K140 work-in-progress as distinct from raw materials. Neither would it make much difference that property cost K429, 998 rather than K430,000. Indeed, rounded figures give clarity to published statements. So, when they are preparing financial statements, accountants do not concern themselves with minor items. They attempt rather to prepare clear and sensible accounts. The concept of materiality therefore leaves itself open to the charge that accounts so prepared are not strictly accurate, but generally the advantages outweigh this shortcoming.

(b)

Capital expenditure is generally of a one-off expense, and its benefit is derived over several accounting periods, for example replacing a machine, whereas revenue expenditure is recurring and it is incurred repeatedly, for example repairing a building. Capital expenditure appears in the statement of financial position and is a debit to the non-current asset account and a credit to accounts payable or cash, whereas revenue expenditure brings benefit for shorter period and is a debit to the statement of profit or loss and a credit to accounts payable.

The whole of revenue expenditure is shown as an expense in the statement of profit or loss whereas a proportion of capital expenditure is shown in the income statement (depreciation) with the balance shown in the statement of financial position.

The effect of capital expenditure is long-term, its benefits are not exhausted within one year and are received for a number of years, whereas with revenue expenditure the benefit is received within one accounting year. Generally capital expenditure has physical assets, eg a building, except for intangible assets whereas revenue expenditure has no physical existence because it is used on items which are used in the business, e.g. electricity. With regards to assets, revenue expenditures are those that simply maintain an asset for regular use in company operations. For example, maintenance and repair of a computer server. Capital expenditures are for new assets or major improvements that extend the life of an asset. For example, a replacement, re-conditioned server.

SOLUTION FIVE

a. Preference shares:

These are shares which confer certain preferential rights to their holder and have right to a final dividend over ordinary shares. Further, priority right to ordinary shareholders to a return of their capital if the company goes into liquidation and do not normally carry a right to vote. There are four types of preference shares:

Cumulative preferred stock includes a provision that requires the company to pay preferred shareholders all dividends, including those that were omitted in the past, before the common shareholders are able to receive their dividend payments.

Non-cumulative preferred stock does not issue any omitted or unpaid dividends. If the company chooses not to pay dividends in any given year, the shareholders of the non-cumulative preferred stock have no right or power to claim such forgone dividends at any time in the future.

Participating preferred stock provides its shareholders with the right to be paid dividends in an amount equal to the generally specified rate of preferred dividends plus an additional dividend based on a predetermined condition. This additional dividend is typically designed to be paid out only if the amount of dividends received by common shareholders is greater than a predetermined per-share amount. If the company is liquidated, participating preferred shareholders may also have the right to be paid back the purchasing price of the stock as well as a pro-rata share of remaining proceeds received by common shareholders.

Convertible preferred stock includes an option that allows shareholders to convert their preferred shares into a set number of common shares, generally any time after a pre-established date. Under normal circumstances, convertible preferred shares are exchanged in this way at the shareholder's request. However, a company may have a provision on such shares that allows the shareholders or the issuer to force the issue. How valuable convertible common stocks are is based, ultimately, on how well the common stock performs.

b. Prime cost

This is an accounting terminology used in manufacturing accounting which denotes all production direct cost. Mainly direct production costs are made up of the following: direct material cost, direct labor cost and direct expenses if any. It's important to identify what prime cost is because these are costs that are incurred directly due to the production of the products and hence can be identified in the finished product. This means, these costs are only incurred by the producer because there is production therefore they are variable costs as they vary with output. Apart from the direct production costs, there are also the indirect manufacturing costs known as overheads.

c. Limited liability

This is a legal phrase which is very important in the formation and differentiation of business unities. This term is used in companies; private and public limited companies respectively. Limited liability means the owners of the company (shareholder's) liability is limited to the maximum of the share capital contributed or to be contributed to the business as capital nothing more nothing less. This means if a limited liability company goes into liquidation, shareholders will only lose up to the share capital contributed or to be contributed, if there is any unpaid up share capital by a shareholder, above that they cannot lose their personal properties. This scenario is opposed in unincorporated entities such as the sole trader and the partnership businesses.

d. Partnership Agreement

According to the partnership Act, a partnership is a business that subsists between two or more persons carrying on business with a view to profit. These persons are known as partners. These partners have to agree on terms and condition that will govern the business in a legal document known as the partnership agreement. Among the contents of the partnership agreement, the following are a few:

- Personal details of the partners
- Capital clause showing what each partner will contribute as capital into the business
- The rate of interests on capital and current account balances if any
- Salaries to be given to salaried partners if any
- How disputes are to be resolved; an arbitrator named if any

Therefore, the partnership agreement legally binds the partners together for the smooth running of the partnership business.

e. International Accounting Standards Board

This is an independent, nonprofit international body based in London whose sole mandate is to develop, issue and enforce in the, interest of the users of financial statements and the general public at large, international recognized accounting standards. The aim of IASB is to harmonize and regulate financial reporting among member countries. Zambia through the Zambia Institute of Certified Accountants (ZICA) is a member of IASB hence all financial statements and teaching of financial reporting is in accordance with these accounting standards–International Accounting Standards (IAS) and International Financial Reporting Standards (IFRS).

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C4: DIRECT TAXES

WEDNESDAY 12 DECEMBER 2018

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.

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.

Income Tax

Standard personal income tax rates

Income band	Taxable amount	Rate
K1 to K39,600	first K39,600	0%
K39,601 to 49,200	next K9,600	25%
K49,201 to K74,400	next K25,200	30%
Over K74,400		37.5%

Income from farming for individuals

K1 to K39,600	first K39,600	0%
Over K39,600		10%

Company Income Tax rates

On income from manufacturing and other	35%
On income from farming	10%
On income from mineral processing	30%
On income from mining operations	30%

Capital Allowances

Implements, plant and machinery and commercial vehicles:

Standard wear and tear allowance	25%
Wear and tear allowance if used in manufacturing and leasing	50%
Wear and tear allowance if used in farming and agro-processing	100%

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

ear and Tear Allowance	2%

Farming Allowances

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

Presumptive Taxes

Turnover Tax

Monthly turnover	Turnover Tax per month
K1to K4,200	3% of monthly turnover above K3,000
K4,200.01to K8,300	K225 per month+3% of monthly turnover above K4,200
K8,300.01 to K12,500	K400 per month+3% of monthly turnover above K8,300
K12,500.01 to K16,500	K575 per month+3% of monthly turnover above K12,500
K16,500.01 to K20,800	K800 per month+3% of monthly turnover above K16,500
Above K20,800	K1,025 per month+3% monthly of turnover above K20,800

Annual turnover	Turnover Tax per annum
K1to K50,400	3% of annual turnover above K36,000
K50,400.01to K99,600	K2,700 per annum+3% of annual turnover above K50,400
K99,600.01 to K150,000	K4,800 per annum +3% of annual turnover above K99,600
K150,000.01 to K198,000	K6,900 per annum+3% of annual turnover above K150,000
K198,000.01 to K249,600	K9,600 per annum+3% of annual turnover above K198,000
Above K249,600	K12,300 per annum +3% of annual of turnover above K249,600

Presumptive Taxes for Transporters

Seating capacity	Tax per annum	Tax per day
	K	K
Less than 12 passengers and taxis	900	2.40
From 12 to 17 passengers	1,800	4.95
From 18 to 21 passengers	3,600	9.90
From 22 to 35 passengers	5,400	15.00
From 36 to 49 passengers	7,200	19.50
From 50 to 63 passengers	9,000	24.60
From 64 passengers and over	10,800	29.55

Property Transfer Tax

Rate of Tax on Realised Value of Land, Land and Buildings and shares	5%
Rate of tax on the realized value on the transfer of intellectual property	5%
Rate of Tax on Realised Value on a transfer or sale of a mining right	10%

Attempt all FIVE (5) questions.

QUESTION ONE

(a) For the purpose of this question assume today's date is 30 April, 2018.

Mr. Dickson Wanga has been in employment from 1 February, 2018 in Mosesa Limited, a private company, at a monthly basic salary of K8,000. He has been attending a short computer course to update himself in order to use the internet and other basics of a computer. He has heard that the functioning of a computer software can be affected by a virus. And as such he is now not sure whether the computer generated payslips produced by the computer are correct. Therefore, he has asked you as a tax practitioner to re-check the pay as you earn calculations of the net pay for the month of April, 2018. The basic data on the payslips are as follows:

	K
Accumulated basic salary to 30 April, 2018	24,000
Accumulated pension deducted to 30 April, 2018 (5% of basic salary)	1,200
Accumulated PAYE deducted to 31 March, 2018	1,710

Required:

(i) Calculate the Pay As You Earn (PAYE) for April, 2018 assuming there are no changes to the basic salary and pension from the date of his employment. (5 marks)

(ii) Calculate the net pay for April 2018. (3 marks)

(b) Explain the following taxes giving one example of each of them:

(i) Revenue taxes
(ii) Capital taxes
(iii) Progressive taxes
(iv) Regressive taxes
(v) Direct taxes
(vi) Indirect taxes (12 marks)

[Total: 20 Marks]

QUESTION TWO

Chileshe, a sole trader, has been in business for many years supplying assorted stationery materials to manufacturing companies. He has always prepared financial statements to 31 December each year. For the year ended 31 December 2018, the summarized statement of profit or loss was as follows:

	K	K
Gross profit		86,840
Less expenses		
Depreciation	2,100	
Professional fees (note 1)	300	
Repairs and maintenance (note 2)	6,240	
Entertainment expenses (note 3)	4,000	
Motor car running expenses (note 4)	80	
Other operating expenses (note 5)	3,200	
		(15,920)
Operating profit		70 920
Royalties received (note 6)		30
Profit on disposal (note 7)		400
Net profit		71 350

The following additional information is provided:

Note 1: Professional fees

The professional fees were as follows:	K
Accountancy and audit fees	200
Legal fees in connection with issue of share capital	40
Legal fees in connection with a court action of not complying with safety legislation	35
Legal fees for recovery of loan relating to former employees	10
Legal fees for recovery of bad debts relating to trade debts	15
	300

Note 2: Repairs and maintenance

Repairs and maintenance comprise:	K
Repainting the main shop which was bought 5 years ago	2,800
Construction of a new shop	1,200
Other repairs and maintenance (all allowed)	2,240
	6,240

Note 4: Entertainment expenses

These include:	K
Entertaining suppliers and customers	3,800
Employees' Christmas party	200
	4,000

Note 4: Motor car running expenses

These expenses were incurred in connection with Chileshe's private motor car which he uses partly for business purposes. It has been agreed with the Commissioner General that Chileshe has 25% business use in the car.

Note 5: Other operating expenses

This includes loan to former employee written off amounting to K90 , trade debts written off amounting to K210 , increase in general provision for bad debts amounting to K320 and a donation to a local approved public benefit organization amounting to K60. The balance of K2,520 consist of revenue allowable expenses.

Note 6: Royalties

The gross amount of royalties received is shown, withholding tax has been deducted at source.

Note 7: Profit on disposal

Chileshe sold the old plant which he acquired at cost of K600 for K440 making a profit on disposal of K400. The income tax value of the plant at 1 January 2018 was nil.

Note 8: Capital allowances

Capital allowances on implements, plant and machinery have been agreed at K1,600 and on buildings at K1,300.

Required:

(a) Calculate, for Chileshe, the taxable business profit for the year ended 31 December 2018. (8 marks)

(b) Calculate the income tax payable by Chileshe for tax year 2018. (4 marks)

(c) Chileshe's friend, Kamwamba, who is employed by a Zambian manufacturing company, sold his motor vehicle which he had acquired at a cost of K40,000 for K32,000.

Kamwamba is now wondering whether the sale of his motor vehicle constitutes trading.

Required:
As Chileshe's tax consultant, explain any four (4) badges of trade used to establish whether the sale of the motor vehicle constitutes 'trade'. (8 marks)

[Total: 20 Marks]

QUESTION THREE

(a) Emmanuel has been a commercial farmer for several years now preparing accounts to 31 December each year. His statement of profit or loss for the year ended 31 December 2018 showed a net profit of K80,000 after charging depreciation of K34,000 from a turnover of more than K800,000. And capital allowances on farm implements, plant and machinery for the tax year 2018 have been agreed to at K40,500. During the tax year 2018 Emmanuel received royalties amounting to K17,000 (net).

Required:

Calculate the income tax payable by Emmanuel for the tax year 2018. (6 marks)

(b) Jacobe , a sole trader, commenced business on 1 May 2017 running retail shops. He will prepare his first accounts for a period ending 31 December 2018 and annually thereafter. During the period from 1 May 2017 to 31 December 2018, he will purchase the following assets:

Date of purchase	Asset	Original cost (K)
1 May 2017	Computers	11,200
26 July 2017	Motor car	55,000
30 June 2018	Office equipment	51,200
30 September 2018	Furniture	7,600

It has been agreed with the Commissioner General that Jacobe has private use in the motor car of 25% and computers 8%.

The adjusted business profit before capital allowances for the period from 1 May 2017 to 31 December 2018 will amount to K336,000.

Required:

(i) Explain the basic rules to be used when determining the basis of assessment for Jacobe's first period of trading. (4 marks)

(ii) Calculate the final taxable business profits for the relevant tax years. (10 marks)

[Total: 20 Marks]

QUESTION FOUR

Popo Limited is a Zambian resident company engaged in manufacturing. The company manufactures toy plastic guns and prepares accounts to 31 December each year. For the year ended 31 December 2018, the company prepared the following statement of profit or loss:

		K	K
Gross profit for the year			960,520
Profit on sale of property	(Note 1)		25,000
Bank interest (gross)	(Note 2)		5,200
			990,720
Less expenses:			
Audit fees		49,000	
Donation	(Note 3)	14,600	
Licenses, insurance and levies	(Note 4)	13,700	
Legal and profession fees	(Note 5)	5,800	
Rates		4,200	
Salaries and wages		64,020	
Consultation fees		45,000	
Entertainment	(Note 6)	20,100	
Office expenses		212,000	
Depreciation		84,000	
Fines and penalties	(Note 7)	8,900	
Loss on sale of motor vehicle		12,000	
Bad debts expenses	(Note 8)	7,100	
Other expenses (all allowed)		186,000	
			726,420
Net profit			264,300

The following additional information is available:

Note 1 Profit on sale of property

A piece of land which was acquired six years ago by the company at a cost of K15,000 was sold at an open market cost of K40,000.

Note 2 Bank interest

Withholding tax has been deducted at source.

Note 3: Donations comprised	K
Donation to a political party	8,400
Donation to approved public benefit organization	6,200
	14,600

The company received free advertisement in the organizations' magazines as a result of the donations it made.

Note 4: Licenses, insurance and levies

	K
Insurance of the company assets	7,600
City council levies	900
Motor vehicle insurance	4,400
Renewal of licenses	800
	13,700

Note 5: Legal and professional fees

	K
Collection of loans from former employees	2,600
Collection of trade debts	3,200
	5,800

Note 6: Entertainment

	K
Entertainment of customers	4,900
Labour Day awards	12,000
Entertaining suppliers	3,200
	20,100

Note 7: Fines and penalties

	K
Penalties for late payment of PAYE	7,100
Traffic fines by company drivers	1,800
	8,900

Note 8: Bad debts expenses

	K
Increase in specific provision for bad debts	2,400
Loan to former employees written off	6,200
Decrease in general provision for bad debts	(1,500)
	7,100

Note 9: Implements, plant and machinery

On 1 January 2018, the income tax values of implements, plant and machinery qualifying for capital allowances was nil. The company bought the following assets during the tax year 2018:

	(K)
Manufacturing equipment	34,000
Mitsubishi light truck	90,000
Toyota Prado car	75,000
Office equipment	38,000

Required:

(a) In relation to the piece of land which was sold in Note 1 above

(i) Explain the property transfer tax position of the company on the disposal of property. (2 marks)

(ii) Calculate the property transfer tax payable on the disposal of property. (2 marks)

(b) Calculate the capital allowances claimable by the company for the tax year 2018. (5 marks)

(c) Calculate the adjusted business profit for the year ended 31 December 2018. (7 marks)

(d) Calculate the company income tax payable for the tax year 2018. (4 marks)

[Total: 20 Marks]

QUESTION FIVE

(a) Apart from the taxation function of raising revenue for the government, explain any other five (5) functions of taxation in the economy. (10 marks)

(b) Kondwani and Basi are in partnership sharing profits and losses in the ration 2:1 after allowing for annual partnership salaries of K90,000 and K60,000 respectively. Basi resigned from partnership on 31 July 2018 and Naza joined the partnership on 1 August 2018. The partnership agreement, with effect from 1 August 2018 was changed. Profits and Losses were to be shared between Kondwani and Naza in the ratio 2:1 respectively with no salaries.

The year ended 31 December 2018 adjusted partnership business profit before capital allowances was K240,000. The capital allowances qualifying assets for the partnership were only office equipment and a Toyota Prado which were bought at K112,000 and K60,000 respectively.

Kondwani and Naza privately owns and uses their motor cars with original costs of K40,000 and K30,000 respectively. The agreed business use of these motor cars with the Commissioner General is 40%.

Required:

(i) Calculate the partnership's final adjusted taxable business profit for the tax year 2018. (3 marks)

(ii) Calculate the amount of profits on which each partner will be assessed for the tax year 2018. (7 marks)

[Total: 20 Marks]

END OF PAPER

C4: DIRECT TAXES - SOLUTIONS

SOLUTION ONE

Dickson Wanga – PAYE April 2018

(a)

			K
(i)	Accumulated basic salary to 30.04.2018		24,000
	(Accumulated taxable income)		
	Accumulated PAYE – 30.04.2018 Computation		K
	1st (K3,300 X 4 months) K13,200 @ 0%		-
	Next (K800 X 4 months) K3,200 @ 25%		800
	Balance	K7,600 @ 30%	2,280
		K24,000	
	Accumulated PAYE to 30.04.2018		3,080
	Accumulated PAYE to 31.03.2018		(1,710)
	PAYE April 2018		1,370
(ii)	Net pay – April 2018 Computation		
			K
	Basic salary		8,000
	Less – pension 5% - April 2018		(400)
	PAYE – April 2018		(1,370)
	Net pay April 2018		6,230

(b) Classification of taxes falls in the following categories:

(i) Revenue taxes which are levied on normal business revenue receipts. A revenue receipt is a receipt arising from a sale of a non-capital item. Items acquired with a view to subsequent resale or used in manufacturing are non-capital items e.g. Income Tax, PAYE, etc

(ii) Capital Taxes are taxes arising from a disposal of a capital item (i.e. non current asset) e.g. property transfer tax.

(iii) Progressive Taxes are taxes that represent a larger proportion of the person's income as that person's income rises. The average rate of taxation rises. The rates of tax for lower income levels are less than the tax rates for higher income levels e.g. PAYE.

(iv) Regressive Taxes are taxes that represent a small proportion of a person's income as the income of that person rises, the average rate of tax falls. VAT is a regressive tax because the rate of VAT is a same on the good whether that good is bought by a rich person or poor person.

(v) Direct Tax is a tax that is levied directly on income and gains. Normally a percentage of income is paid in the form of tax. e.g. PAYE, company income tax, P.T.T etc.

(vi) Indirect Tax is tax that is levied indirectly. It is imposed on expenditure and borne by the consumers. e.g. value added tax and customs and excise duty.

SOLUTION TWO

(a) Chileshe

Computation of taxable business profit for the tax year 2018

	K	K
Net profit		71,350
Add		
Depreciation	2,100	
Legal fees- share capital	40	
Legal fees- court action	35	
Legal fees- loan to former employee	10	
Construction of a new shop	1,200	
Entertainment expenses- customers	3,800	
Motor car expenses (K80 x 75%)	60	
Loan to former employee written off	90	
Increase in general provision	320	
		7,655
		79,005
Less:		
Royalties	30	
Profit on disposal	400	
Capital allowances on implements	1,600	
Capital allowances on buildings	1,300	
		(3,330)
Adjusted business profit		75,675

(b) Chileshe

Income tax payable for the tax year 2018

	K
Business profits	75,675
Add:	
Royalties	30
Total taxable profits	75,705
Computation	
First K39,600 @ 0%	0
Next K9,600 @25%	2,400
Next K25,200 @30%	7,560
Balance K1305 @37.5%	489
Income tax liability	10,449
Less:	
WHT- Royalties (30 x15%)	(5)
Income tax payable	10,444

(c) The badges of trade are as follows:

(i) **The Subject Matter of the realization**

Some assets are normally held as trading stock, while others are not. If the asset that has been sold is one which is normally held as trading stock, the presumption that a trade is being conducted is high.

(ii) **The Length of the Period of Ownership**

Trading stock is not normally held for a long period of time. As a result, if a person disposes of an asset that they held for a long period of time, the presumption that a trade is taking place is low.

(iii) **Frequency of Similar Transactions**

Trading is indicated by repeating transactions in the same subject matter. If the frequency of similar transactions is high, then the chances that trade is being conducted are high. Other budges of trade may have to be used to counter this presumption.

(iv) **Supplementary work and Marketing**

A trading motive is indicated where work is carried out to property to make it more marketable, or where steps are taken to find purchasers. If supplementary work is done on the asset, when sold it will give rise to a trading profit.

(v) **Circumstances giving rise to realization**

A forced sale to raise cash for an emergency indicates that the transaction is not trading in nature as it is a one off transaction aimed at enabling a person to raise money, and not expected to recur.

(vi) **The Intention**

Intention to trade clearly constitutes trading. However, intention to make a profit may not always indicate trading.

SOLUTION FOUR

(a) Emmanuel

Income tax payable for the tax year 2018

	Total income	farming income	Non-farming income
	K	K	K
Farming profits	80,000	80,000	-
Royalties (17,000 x 100/85)	20,000	-	20,000
Add:			
Depreciation	34,000	34,000	-
Total	134,000	114,000	20,000
Less:			
Capital allowances	(40,500)	(40,500)	-
Taxable income	93,500	73,500	20,000

Computation	
Non-farming income	0
Farming income	
(73,500 – 19,600) @ 10%	5,390
Income tax liability	5,390
Less:	
WHT- royalties (20,000 x 15%)	(3,000)
Income tax payable	2,390

(b) Jacobe

(i) In determining the basis of assessment, the commencement rules will be used. The first accounting period consist of 20 months (from 1 May 2017 to 31 December 2018). The first period will consist of 8 months and the second period 12 months.

First 8 months ended 31 December 2017: K336,000 x 8/20 = K134,400

Last 12 months ended 31 December 2018: k336,000 x 12/20= K201,600

The basis of assessment to be used is the current year basis. The profits for the period ended 31 December 2017 and 31 December 2018 will be taxed in the tax years 2017 and 2018 respectively.

(ii) Final taxable business profit for the tax years

	2017	2018
	K	K
Business profits	134,400	201,600
Less:		
Capital allowances (w1)	(10,826)	(25,526)
Adjusted business profits	123,574	176,074

Workings

Capital allowances for the tax years

2017	cost/ITV	Capital allowances
	K	k
Computers	11,200	
W&T @25%	(2,800) @92%	2,576
ITV	8,400	
Motor car		
Cost	55,000	
W&T @20%	(11,000)@75%	8,250
ITV c/f	44,000	
Total capital allowances		10,826
2018		
Computers		
ITV b/f	8,400	
W&T @25%	(2,800)@92%	2,576
ITV c/f	5,600	
Motor car		
ITV b/f	44,000	
W&T @20%	(11,000)@75%	8,250
ITV c/f	33,000	
Office equipment		
Cost	51,200	
W&T @25%	(12,800)	12,800
ITV c/f	38,400	
Furniture		
Cost	7,600	
W&T @25%	(1,900)	1,900
ITV c/f	5,700	
Total capital allowances		25,526

SOLUTION FOUR

(a) Property transfer tax

(i) The sale of land is subject to property transfer tax (PTT) based on the realized value. The realized value of land is the price at which it could, at the time of transfer, reasonably have been sold on the open market as determined by the Commissioner General.

(ii) The property transfer tax paid will be calculated at 5% of the realized value which is the higher of the open market value and the actual consideration received. The PTT will, therefore, be: K40,000 x 5% = K 2,000.

(b) Popo Limited

Capital allowances for the tax year 2018

	Cost/ITV	Capital allowances
	K	K
Manufacturing equipment		
Cost	34,000	
W&T @50%	(17,000)	17,000
ITV c/f	17,000	
Mitsubishi light truck		
Cost	90,000	
W&T @25%	(22,500)	22,500
ITV c/f	67,500	
Toyota Prado car		
Cost	75,000	
W&T @20%	(15,000)	15,000
ITV c/f	60,000	
Office equipment		
Cost	38,000	
W&T @25%	(9,500)	9,500
ITV c/f	28,500	
Total capital allowances		**64,000**

(c) Popo Limited

Adjusted business profit for the year ended 31 December 2018

	K	K
Net profit		264,300
Add		
Depreciation	84,000	
Loss on sale of motor vehicle	12,000	
Donation to political party	8,400	
Donation to approved public benefit org	6,200	
Collection of loan from former employees	2,600	

Entertainment of customers	4,900	
Entertaining suppliers	3,200	
Penalties for late payment of PAYE	7,100	
Loan to former employees written off	6,200	
		134,600
		398,900
Less:		
Decrease in general provision	1,500	
Capital allowances (b)	64,000	
Profit on sale of property	25,000	
Bank interest	5,200	
		95,700
Tax adjusted profit		303,200

(d) Popo Limited

Income tax payable for the tax year 2018

	K
Business profit	303,200
Add:	
Bank interest	5,200
Total taxable income	308,400
Income tax @ 35% (K308,400 x 35%)	107,940
Les:	
WHT- bank interest (K5,200 x 15%)	(780)
Income tax payable	107,160

SOLUTION FIVE

(a) The main role of taxation is to raise government revenue through compulsory taxing and levying of residents and organisations.

Other functions of taxation include:

(i) Redistribution of wealth – Taxes are used by government to redistribute income from higher to lower income households and thus remove the apparent inequalities that income is bound to bring among the country's citizenry i.e. the Government will generally collect higher taxes from the rich through progressive tax systems and redistribute the funds collected to the poor and thus prevent the poor from getting poorer and the rich getting richer at the expense of the poor.

(ii) Influencing economic activity in the country (economic regulation) – taxes are used to influence economic activity in the country. This can be done through giving tax incentives such as capital allowances to individuals and institutions that engage in activities that contribute towards economic growth and encouraging savings through imposition of low rates of withholding taxes on investment income.

(iii) To act as a fiscal tool to curb the effects of inflation – taxes ultimately reduce the disposable incomes of the tax payers and this in turn reduces their propensity to spend thus reducing the quantity of money in supply in the economy at any given time.

(iv) To protect the local Zambian industries from unfair foreign competition – The tariffs levied on imported goods aim at raising the prices of those goods that come from low production cost countries and as such would put local industries at a disadvantage in terms of pricing if no taxes were levied on them.

(v) Maintaining the well being of the environment – Taxes are used to maintain the well-being of the environment by imposing heavy taxes on income and gains arising from activities which are not friendly to the environment such as those contributing to global warm pollution etc.

(b) Partnership

(i)

Final adjusted taxable profit	K
Business profit before capital allowances	240,000
Less capital allowances	
Office equipment (K112,000 x 25%)	(28,000)
Toyota Prado car (K60,000 x 20%)	(12,000)
Final adjusted tazable profit	200,000

(ii) Allocation of profits for the tax year 2018

	Total	Kondwani	Basi	Nandiwe
First 7 months	K	K	K	K
Salaries	87,500	52,500	35,000	-
Balance 2:1	29,167	19,445	9,722	-
Total (200,000 x 7/12)	116,667	71,945	44,722	nil
Last 5 months				
Salaries	Nil	Nil	Nil	Nil
Profit sharing ratio 2:1	83,333	55,555	-	27,778
Totals (200,000 x 5/12)	83,333	55,555	nil	27,778
Totals	200,000	127,500	44,722	27,778
Less capital allowances				
Kondwani's car (K40,000 x 20% x 40%)		(3,200)	-	-
Nandiwe's car (K30,000 x 20% x 40%)		-	-	(2,400)
Partners' taxable profits		124,300	44,722	25,378

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C5: INDIRECT TAXES

THURSDAY 13 DECEMBER 2018

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.

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 page 2 only.

Taxation Table for paper C5 Indirect Taxation (December 2018 Examinations)

Value Added Tax

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

Customs and Excise
Customs and Excise duties on used motor vehicles

	Aged 2 to 5 years		Aged over 5 years	
Motor vehicles for the transport of ten or more persons, including the driver	**Customs duty**	**Excise duty**	**Customs duty**	**Excise duty**
	K	**K**	**K**	**K**
Sitting capacity of 10 but not exceeding 14 persons including the driver	17,778	22,223	8,889	11,112
Sitting capacity exceeding 14 but not exceeding 32 persons	38,924	0	13,840	0
Sitting capacity of 33 but not exceeding 44 persons	86,497	0	19,462	0
Sitting capacity exceeding 44 persons	108,121	0	43,248	0

	Aged 2 to 5 years		Aged over 5 years	
Motor cars and other motor vehicles principally designed for the transport of persons including station wagons and racing cars	**Customs duty**	**Excise duty**	**Customs duty**	**Excise duty**
	K	**K**	**K**	**K**
Sedans				
cylinder capacity not exceeding 1000 cc	12,490	10,824	7,136	6,185
Cylinder capacity exceeding 1000 cc but not exceeding 1500 cc	16,058	13,917	8,564	7,422
Cylinder capacity exceeding 1500 cc but not exceeding 2500 cc	16,545	21,508	8,423	10,950
Cylinder capacity exceeding 2500 cc but not exceeding 3000 cc	18,049	23,463	10,528	13,687
Cylinder capacity exceeding 3000 cc	22,561	29,329	12,032	15,642
Hatchbacks				
cylinder capacity not exceeding 1000 cc	10,705	9,278	7,136	6,185
Cylinder capacity exceeding 1000 cc but not exceeding 1500 cc	14,274	12,371	8,564	7,422
Cylinder capacity exceeding 1500 cc but not exceeding 2500 cc	15,041	19,553	8,423	10,950
Cylinder capacity exceeding 2500 cc but not exceeding 3000 cc	16,545	21,508	10,523	13,687
Cylinder capacity exceeding 3000 cc	19,553	25,419	12,032	15,642
Station wagons				
cylinder capacity not exceeding 2500 cc	16,545	21,508	9,024	11,731

Cylinder capacity exceeding 2500 cc but not exceeding 3000 cc	18,049	23,463	13,357	17,598
Cylinder capacity exceeding 3000 cc but not exceeding 2500 cc	22,561	29,329	18,049	23,463
SUVs				
Cylinder capacity not exceeding 2500 cc	21,057	27,374	9,024	11,732
Cylinder capacity exceeding 2500 cc but not exceeding 3000 cc	24,065	31,284	13,357	17,598
Cylinder capacity exceeding 3000 cc	28,577	37,150	18,049	23,463
	Aged 2 to 5 years		**Aged over 5 years**	
Motor vehicles for the transport of goods –with compression-ignition internal combustion piston engine (diesel or semi-diesel):	**Customs duty**	**Excise duty**	**Customs duty**	**Excise duty**
	K	**K**	**K**	**K**
Single cab				
GVW exceeding 1.0 tonne but not exceeding 1.5 tonnes	21,926	9,501	8,770	3,801
GVW exceeding 1.5 tonnes but not exceeding 3.0 tonnes	26,311	11,402	15,348	6,651
GVW exceeding 3.0 tonnes but not exceeding 5.0 tonnes	30,697	13,302	17,541	7,601
Double cabs GVW exceeding 3 tonnes but not exceeding 5 tonnes	30,274	0	24,119	10,452
Double cabs GVW exceeding 3.0 tonnes but not exceeding 5.0 tonnes, **with spark ignition internal combustion piston engine**	30,697	13,302	24,119	10,452
Panel Vans				
GVW exceeding 1.0 tonne but not exceeding 1.5 tonnes	15,348	6,651	8,770	3,801
GVW exceeding 1.5 tonnes but not exceeding 3.0 tonnes	17,541	7,601	15,348	6,651
GVW exceeding 3.0 tonnes but not exceeding 5.0 tonnes	21,926	9,501	17,541	7,601
Trucks				
GVW up to 2 tonnes	21,926	9,501	10,963	4,751
GVW exceeding 2.0 tonnes but not exceeding 5.0 tonnes	28,504	12,352	13,156	5,701
GVW exceeding 5.0 tonnes but not exceeding 10.0 tonnes	24,724	18,955	10,817	8,293
GVW exceeding 10.0 tonnes but not exceeding 20.0 tonnes	30,905	23,694	11,744	9,004
GVW exceeding 20 tonnes	51,898	0	19,461	0
GVW exceeding 20 tonnes, **with spark ignition internal combustion piston engine**	37,086	28,432	13,907	10,662

Customs and excise duty on new vehicles

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:	30%
	Excise duty:	
	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 tonnes:	
	Customs duty	15%
	Excise duty	10%
3	Buses/coaches for the transport of more than ten persons	
	Customs duty:	15%
	Excise duty:	
	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:	15%
	Excise duty:	0%

The minimum amount of customs duty on motor vehicles is K6,000.

Import VAT is added to the sum of VDP, customs duty and excise duty. It is determined at the standard rate of 16%

Attempt all FIVE (5) questions.

QUESTION ONE

Chitulike Limited was registered for Value Added Tax (VAT) five years ago, and is in the process of completing its VAT return for the month of March in the tax year 2018. The Company filed in its VAT return late last month and was penalised for late payment. As a tax adviser of Chitulike Ltd, you have been tasked by the management of the company to ensure that they pay the VAT for March on time.

You have been supplied with the following information for the month of March 2018:

1. Sales invoices totaling K256,000 were issued in respect of standard rated sales. Chitulike Limited offers its customers a 2.5% discount for prompt payment. Only 60% of the customers took up this discount.

2. On 15 March 2018, Chitulike Ltd received an advance deposit of K9,000 (VAT inclusive) in respect of a contract that is due to be completed during April 2018. The total value of the contract is K20,000.

3. Standard rated expenses amounted to K149,600. This includes K8,400 for entertaining customers.

4. On 31 March 2018, Chitulike Ltd wrote off K24,000 due from a customer as a bad debt. The debt was in respect of three invoices, each of K8,000, that were due for payment on 15 August 2016, 15 September 2016 and 15 December 2016 respectively.

5. On 1 January 2018 the company purchased a motor car costing K19,600 for the use of its sales manager. The sales manager is provided with this vehicle as a personal to holder car and the company incurred a cost of K150,000 on petrol in the month of March 2018. Both figures are inclusive of VAT.

6. During 2017, the company purchased a Toyota Hilux which is used by the Production manager. The company incurred K116,000 (VAT inclusive) on diesel for business purposes during March 2018.

Unless stated otherwise all of the above figures are exclusive of VAT.

Required:

(a) Calculate the amount of VAT payable by Chitulike Ltd for the month of March 2018. (10 marks)

(b) Explain any four (4) arguments for and any two (2) against the introduction of VAT. (6 marks)

(c) Explain what is meant by "taxable supplies" and state the rate(s) at which taxable supplies are charged. (4 marks)

[Total: 20 Marks]

QUESTION TWO

(a) Tambala imported a new 2500cc petrol driven Toyota Hilux costing US$6,200, He paid US$1,600 for freight costs up to port on the East Coast of Africa. US$600 was paid for insurance in transit up to the port on the East coast of Africa and US$120 inspecting of the motor vehicle before departure from Japan.

When the motor vehicle arrived at the port on the East coast of Africa, he paid an additional amount of US$500 and US$200 for transportation and insurance respectively from the East coast up to the point of entry at Nakonde.
He further paid fuel costs of K1,500 from Nakonde to Lusaka.
The ruling Bank of Zambia exchange rate was K9.85 to US$1 and the commissioner General's approved exchange rate was K9.50 per US$1.

Required:
Calculate the import duty and other related taxes paid by Tambala. (9 marks)

(b) Explain the circumstances under which Zambia Revenue Authority will invoke its rights to revalue the vehicles in order to determine the equitable transaction value in the country of supply. (2 marks)

(c) Explain the methods that are used to determine the Value for Duty Purpose. (6 marks)

(d) Explain the main advantages of the bonded warehouses. (3 marks)

[Total: 20 marks]

QUESTION THREE

Zamex Ltd will commence trading in the near future. The company is unsure of what type of business to start, and is considering three alternative types of business. These are (1) trading in mineral water in which case all sales will be standard rated (2), trading in mealie meal in which case all sales will be zero-rated for VAT, (3) selling educational materials, in which case all sales will be exempt from VAT.
For each alternative Zamex Ltd's sales will be K75,000 per month (exclusive of VAT), and standard rated expenses will be K10,000 per month (inclusive of VAT).

Required:

(a) For each of the three alternative types of business, explain whether Zamex Ltd will be required to register for value added tax and calculate the monthly amount of VAT payable or refundable. (8 marks)

(b) Explain any six (6) VAT obligations that Zamex Ltd will have if registered for VAT. (6 marks)

(c) Briefly explain how a cash discount offered to customers is treated for VAT purposes. (2 marks)

(d) Explain any four (4) circumstances that may lead to the cancellation of VAT registration. (4 marks)

[Total: 20 marks]

QUESTION FOUR

(a) Explain how the tax point for the following transactions is determined:

- (i) The supply of goods (3 marks)
- (ii) The supply of Services (2 marks)
- (iii) In relation to a Reverse Charge (2 marks)
- (iv) The lease rentals on an Operating lease (2 marks)

(b) Explain the matters which are considered by the Tax Appeals Tribunal as appeal cases from a VAT registered supplier. (5 marks)

(c) The purpose of introducing Duty Drawback system is to avoid double taxation. However this system suffers some challenges.

Required:

Explain any three (3) challenges of Duty Drawback system. (6 marks)

[Total: 20 marks]

QUESTION FIVE

(a) Zambia is a member of the Preferential Trade Area (PTA) for Eastern and Southern Africa which was established in 1981, as a first step towards higher forms of regional economic cooperation and integration to bring about sustainable growth and development of Member States.

Required:

- (i) Briefly explain Four (4) objectives of the Preferential Trade Area (PTA) (4 marks)
- (ii) Explain any five (5) contents of PTA strategy (5 marks)

(b) Zambia is also a member of Common Market for Eastern and Southern Africa (COMESA) and Southern Africa Development Communities (SADC) treaties which provide that goods shall be accepted as eligible for preferential tariff treatment if they originate in the Member States. Goods shall be accepted as originating in a member State if they are consigned directly from another Member State and comply with the origin conferring criteria.

Required:

- (i) Explain five (5) origin conferring criteria for the goods to be accepted as having been originated from a Member State. (10 marks)
- (ii) Explain the main aim of AGOA. (1 mark)

[Total: 20 marks]

END OF PAPER

C5: INDIRECT TAXES – SOLUTIONS

SOLUTION ONE

(a) Chitulike LTD

Computation of VAT payable for the month of March 2018

Output VAT			
Sales (256,000 x 60% x 97.5% X 16%)+ (256,000 x 40% x 16%)		40,346	2
Advance payment (9,000 X 4/29)		1,241	1½
		41,587	½
Input VAT			
Expenses (149,600 – 8,400) X 16%	22,592		1½
Bad debts (8,000 + 8,000) X 16%	2,560		1
Diesel (116,000 X 4/29) X 90%	14,400		2
	39,552		½
VAT PAYABLE		2,035	1

(b) Arguments for the introduction of VAT:

(i) It is invoice based and therefore uniform and uncomplicated, offering a sound financial management system with less collection weaknesses.

(ii) VAT has a self-policing nature thereby enhances compliance. VAT has elements of self-checking mechanisms to minimise evasion.

(iii) It gives the potential for a stronger home manufacturing industry and more competitive export prices.

(iv) The input credit mechanism gives registered business back much of the tax they pay on purchases and expenses used for making taxable supplies, and as a result, largely avoid the tax on tax character of sales tax.

(v) A wider tax base has resulted in less distortion of trade and greater sharing of costs of collecting it at various stages of the value chain and remitting it to the government.

(vi) Is internationally proven in developed and developing economies.

(vii) In view of the broad tax base, revenue yield is generally higher and stable and is less susceptible to fluctuations.

(viii) VAT is less complex than sales tax. There are two rates of VAT. The registration threshold eliminates small businesses to minimise administrative costs.

Arguments against the introduction of VAT:

(i) VAT is regressive like indirect taxes. Regressively is partially minimised by exempting most essential consumer items like food and health supplies

(ii) The claim that small businesses may find it difficult to maintain the required VAT records may be exaggerated. Proper business records are necessary for all businesses, big and small.

(c) Taxable supplies are goods or services sold by a taxable supplier. Not all taxable supplies are liable to VAT.
The VAT law separates supplies between taxable supplies and exempt supplies. VAT is charged on a taxable supply of goods and services made by a taxable supplier in the course or furtherance of a business.
Thus the supply of goods and services must qualify as a taxable supply for VAT to be charged. The business charging VAT must be a taxable supplier.

Taxable supplies are liable to VAT either at standard rate of 16% or at zero-rate 0%

SOLUTION TWO

(a)

		$
Cost		6,200
Freight		1,600
Insurance		600
Inspection		120
Transportation		500
Additional Insurance		200
VDP in US$		**9,220**
		K
VDP in K ($9,220 x K9.50)		87,590`
	Value	Taxes
	K	K
Value for duty purposes	87,590	
Customs duty @ 30%	26,277	26,277
	113,867	
Excise @ 30%	34,160	34,160
	148,027	
Import VAT @16%	23,684	23,684
	171,711	
Total taxes paid		84,121

(b) The following are the circumstances:

1. The vehicle is acquired in circumstances other than the usual course of business
2. The importer or customs clearing agent provide insufficient or unsatisfactory information

(c) The following are the methods:

1. Transaction value
   This is based on the price actually paid or payable including insurance, freight and other incidental costs to the extent that they are paid.
2. Transaction value of identical goods
   This is the price of identical goods imported by another importer into Zambia from the same source, including insurance, freight and other incidental costs
3. Transaction value of similar goods
   This is the price of similar goods imported by another importer into Zambia from the same source including insurance, freight and other incidental costs
4. Deductive value
   This is the price at which identical or similar goods are sold in their quantity in Zambia
5. Computed value
   This the price based on cost of production, insurance, freight and other costs incurred in the delivery of goods to Zambia.
6. Residual basis of value (fall back)
   This is the price arrived at by going through the above five methods flexibly.

(d) The following are the advantages of the Bonded Warehouses:

1. Goods can be stored without payment of duty, thus giving the importer enough time to source funds.
2. Some goods may sell slowly due to fluctuating demand, hence duty can be paid according to demand.
3. Constant supply of raw materials can be assured in manufacturing industry by importing in bulk and payments being made according to production demands.

SOLUTION THREE

(a) **Standard rated supplies**

Zamex Ltd will be required to register for VAT as it will be making taxable supplies of K225,000 per quarter (K75,000 X 3) which is in excess of the registration threshold of K200,000 per quarter and K900,000 per annum which is also above the threshold of K800,000 per annum.

VAT PAYABLE	**K**
Output VAT (K75,000 x 16%)	12,000
Less:	
Input VAT (K10,000 x 4/29)	(1,379)
VAT payable	10,621

Zero- rated supplies

Zamex Ltd is not required to register for VAT as it will be making zero-rated supplies, but will be permitted to do so as these are taxable supplies.

VAT PAYABLE	**K**
Output VAT (K75,000 x 0%)	0
Less:	
Input VAT (K10,000 x 4/29)	(1,379)
VAT refundable	(1,379)

Exempt supplies

Zamex Ltd will not be required or permitted to register for VAT as it will not be making taxable supplies.

Output VAT will not be charged and no input VAT will be recoverable.

(b) The following are the VAT obligations of Zamex Ltd:

(i) Notify ZRA when the business starts or circumstances change.
(ii) Display the VAT registration certificate
(iii) Charge VAT on taxable supplies
(iv) Complete and submit returns by the due date which is specified by ZRA and pay VAT promptly by the due date.
(v) Maintain sufficient records for at least 6 years
(vi) The VAT returns should be completed accurately and honestly and provide tax invoices.
(vii) Cooperate with ZRA officers
(viii) Provide information to ZRA officers.

(c) A cash discount is always deducted in arriving at the taxable value of the supply whether or not payment is made within the time stipulated.

(d) Circumstances which lead to the cancellation of VAT registration:

(i) Where there is a change in the legal status of any entity (eg a partnership is dissolved).
(ii) If the business ceases trading permanently.
(iii) If the business is sold.
(iv) If you registered as an intended trader and your intention to make supplies ceases.

SOLUTION FOUR

(a) The Tax point is, when:

(i) For goods it is earlier of the following:
1. The time when the goods are removed from the supplier's premises or made available to the purchaser to whom they are supplied or
2. The time when a payment is received
3. The time when a tax invoice is issued

(ii) The earliest (For Services)
1. The time when a payment is received
2. The time when a tax invoice is issued
3. The time when they are actually rendered or performed

(iii) In relation to reverse charge, the tax point is the earliest of the following
1. Time when a payment is made
2. Time when as an invoice is received from the supplier
3. Time when the services are actually rendered or performed

(iv) The tax point in relation to VAT on lease rentals is the earliest of the following times:
1. The time when the lease rental payment is received from the lessee
2. The time the lessor issues a tax invoice
3. The time the leasing services are rendered which is at the expiry of the lease

(b) The Revenue tribunal hears appeals from taxable suppliers in the following matters:

1. Registration of taxable suppliers or cancellation of registration or refusal to register a supplier
2. Tax assessed on any supply of goods/services or the importation of goods
3. Input tax that may be claimed by a taxable supplier
4. The application of any rule providing for the apportionment of disallowance of input tax
5. Notice requiring early payment of tax or security

(c) Disadvantages of Duty draw back System

1. Time consuming and demanding on the part of exporter
2. Administratively expensive on the part of the exporter as he has to keep huge piles of records,
3. Administratively expensive on the part of ZRA as they have to constantly upgrade the system
4. Demands for integrity of ZRA staff and the system itself which can be administratively expensive

SOLUTION FIVE

(a) Preferential Trade Areas

(i) The objectives of the PTA are as follows:-

i. To promote cooperation and integration covering all areas of economic activity, particularly trade and customs, industry, transport and communications, agriculture and monetary affairs.
ii. To raise the standards of living of the people of the region by fostering closer relations among Member States.
iii. To create a common market by the year 2000 in order to allow the free movement of goods, capital and labour within the sub-region.
iv. To contribute to the progress and development of all other African countries.

(ii) The following are the contents of the PTA strategy:

i. Reduction and elimination of trade barriers on selected goods traded within the area
ii. Cooperation in customs through simplification and harmonization of customs procedures and regulations
iii. Introduction of rules of origin to determine which goods will receive preferential treatment
iv. Granting of transit rights to all transporters when coming from or entering other Member States or third countries
v. Clearing and payments arrangements to promote trade in goods and services within the sub region
vi. Cooperation to develop coordinated and complementary policies and systems in transport and communications
vii. Cooperation in the field of industrial development in order to promote self-sustained industrialization within the PTA, to expand trade in industrial products and to bring about structural transformation of industry for the purpose of fostering the overall social and economic development of Member States

(b) COMESA and SADC

(i) Five (5) origin conferring criteria for goods to be accepted as originating from a Member State.

1. Goods wholly produced in a Member State (ie. No raw materials from outside the regions have been used in their manufacture).
2. Goods produced in a Member State and the CIF value of any foreign (that is non- COMESA or SADC) materials used does not exceed 60% of the total cost of all materials used in the production,

3. Goods produced in Member State whose value added resulting from the process of production accounts for at least 35% of the ex- factory cost of the goods.
4. Goods produced in a Member State designated in a list by the Council to be of particular importance to the economic development of the Member State and containing not less than 25% value added notwithstanding the provision in (c) above.
5. Goods satisfying the change of tariff heading resulting from their process of manufacture where some raw materials are imported.

(ii) The main aim of AGOA is to promote two-way trades between sub-Saharan Africa and the United States as well as to increase US investment into the sub-Saharan Africa.

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C6: LAW FOR TAX PRACTITIONERS

FRIDAY 14 DECEMBER 2018

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.

Attempt all FIVE (5) questions.

QUESTION ONE

(a) Mwila stayed on the Copperbelt because she had a good job with Kopala.com. Her mother, who lived in Lusaka, invited her to come and live with her because she was very lonely. She promised to pay her a monthly allowance of Kwacha 20,000 which would help her to further her Studies at the main University. There was no written contract or agreement as to that effect. Later the mother changed her mind and bought a house within Lusaka for the daughter to live in instead of the monthly allowance. She rented the rest of the rooms to raise money for herself, and she never paid the daughter the agreed monthly allowance. The daughter feels there is breach of contract.

Required:

With reference to the above scenario, explain whether a valid contract was formed between Mwila and her mother. (10 marks)

(b) State the position of the law in relation to the following:

(a) Agreements made between housemates which have nothing to do with the routine management of the house. (4 marks)

(b) Agreements made between husband and wife divorced or separated. (4 marks)

(c) Identify the two (2) presumptions applied by the courts when handling matters patterning to domestic contracts. (2 marks)

[Total: 20 Marks]

QUESTION TWO

(a) Discuss the rights of the buyer under hire purchase agreement. (5 marks)

(b) State two (2) types of cheques and two requirements for negotiability. (5 marks)

(c) Explain the information required from company promoters prior to the preparation of the Articles of Association. (3 marks)

(d) State the powers of trustees as provided for under section 21 of the Bankruptcy Act. (2 marks)

(e) Discuss the two (2) conditions which must be fulfilled before an assignment of a policy can be valid under insurance law. (5 marks)

[Total: 20 Marks]

QUESTION THREE

(a) With reference to the rules of statutory interpretation, explain the following:

(i) The literal rule (2 marks)

(ii) The contextual rule (2 marks)

(iii) The golden rule (2 marks)

(b) Explain the ***six stages*** of statute law-making process in the correct order from the time a bill is introduced in parliament to the time it is turned into law. (12 marks)

(c) State two (2) powers of the Lands Tribunal as created by Section 20 of the Lands Act Chapter 184 of the Laws of Zambia. (2 marks)

[Total: 20 Marks]

QUESTION FOUR

(a) Explain the duties of carriers under the contract of Sale. (8 marks)

(b) Differentiate between choses in action and choses in possession. (4 marks)

(c) State two (2) duties of a buyer under a contract of sale (2 marks)

(d) Nomsa and Stacey are about to enter or form a general partnership. Nomsa is not sure of what a general partnership entails and decides to approach you for advice. Please advise Nomsa on at least two differences between a general partnership and a Limited Company. (4 marks)

(e) Explain the remedies which are available for breach of contract of employment.

(2 marks)

[Total: 20 Marks]

QUESTION FIVE

Hotel Foods has been running as a partnership business for the past 11 years. The owners Pula, Papu and Paka are excited after hearing that they can convert it into a private limited company which shall be called 'Hotel Foods Ltd'. The three want answers from you on the following issues:

Required:

(a) Give three (3) disadvantages of converting the business into a company limited by shares. (6 marks)

(b) Explain the purpose of Articles of Association to a limited liability company. (4 marks)

(c) State three (3) likely contents of the partnership deed Pula, Papu and Paka signed. (6 marks)

(d) Pula retired from the partnership last month, the partnership has continued having his name on the partnership's letterheads and contract documents. Papu and Paka came to you to consult over the implications of Pula's name on the above documents and you told them "*in this case, Pula will be considered a partner by estoppel*".

Explain what is meant by '*partner by estoppel*'. (4 marks)

[Total: 20 Marks]

END OF PAPER

C6 LAW FOR TAX PRACTITIONERS

<u>SOLUTION ONE</u>

a) Intention to create legal relation is central in contract law. The Law recognizes that often the parties do not intend to create a legally binding contract. The law therefore says that there must be an intention to create legal relations and make a distinction between social and domestic agreement. For example, in **Jones V Padavattan** (1969), Mrs. Jones offered a monthly allowance to her daughter if she would give up her job in the USA and come to England and study to become a barrister. Because of accommodation problems, Mrs. Jones bought a house in London, where the daughter lived and received rents from other tenants. They later quarreled and the mother sought repossession of the house. The Courts decided that there was no intention to create legal relations and that all the arrangements were just part of ordinary family life. Therefore, the mother was not liable on the maintenance agreement and could also claim the house. The same applies to the case at hand.

b) (i) the position of the law relating to housemates who have agreed on issues which are not related to the routine management of the house is that there is no intention to create legal relations, **Simpkins v Pays**.

(ii) the position of the relating to agreements between husband and wife when divorced or separated is that they are legally binding**, Meritt v Meritt.**

c) 1. In business transactions, the presumption is that there is intention to create legal relations by the parties,

2. In social or domestic arrangements, the assumption is that there is no intention to create legal relations.

SOLUTION TWO

a) (i) To exercise an option to buy the goods at the end of the hire purchase period on full payment.
(ii) A right to terminate the agreement and return the goods to the seller
(iii) To use the goods as a bailee at will subject to agreed restrictions

b)

Types of cheques;

Open Cheque, Crossed cheque, Bearer cheque and order cheque

Requirements for negotiability

- Must be signed by the drawer
- Must be unconditional
- Must be of fixed amount
- Must be payable on demand or at a definite future time
- Must be payable in money

c) The information to be obtained from promoters is

- Business Name
- Nature of business
- The amount of nominal capital whose minimum currently stands at k5,000.
- Any special requirement which deviates from the standard memorandum of association

d) To examine every proof of debt and admit or reject its validity.

e) Due to the privity of contract, the assignment of an insurance policy which in effect is a contract, requires the consent of the insurers. This legal position was fortified in the case of **Peters v General Accident Fire and Life Assurance Corp. Ltd (1938) 2 ALLER 267.**

The second condition is that the policy must be contemporaneous with the assignment of the subject matter of the insurance as was seen in the case of **North of England Oil cake Co. v. Archangel Marine Ins. (1875) LR 102 B 249**

SOLUTION THREE

(a) Explanation of rules of interpretation

(i) *The Literal Rule* – This principle states that words of a statute or any other document must be interpreted according to their natural and primary meaning adding to or taking away nothing from them. Thus if the words of a statute are in themselves precise, clear and unambiguous, no more is necessary than to expound those words in <u>their natural and ordinary sense</u>.

(ii) *The Contextual Rule* – This is a rule of interpretation that looks at the context words were said or in the light of the terms surrounding it.

(b) The six stages of statute law making are as follows:

- First Reading – This is a formal presentation of the Bill to parliament. The bill is merely introduced.
- Second Reading – At this stage, the minister or a member of parliament who has introduced it explains the purpose of the Bill and there is debate about the Bill.
- Committee Stage – At this stage the Bill is given to a specialised committee which will look at it in detail, make amends, etc
- Report Stage – At this stage the committee reports back to the House anything that the Committee State has done amendments.
- Third Reading – This is a review of the bill in its final state. This is the final stage in the House, once members are ok with it, it goes for presidential assent.
- Presidential Assent – The President if the final passing. Once he signs the Bill, it becomes law.

(c) Two powers of the Lands Tribunal would include:

- Power to make awards in matters relating land under the Lands Acts
- Power to make awards for payment of compensation
- Power to make awards in matters affecting land rights and obligations
- Power to make awards in any other matters that can be designed to the tribunal by a Minister.

SOLUTION FOUR

a) Duties

i) To carry all goods of the class he professes for anybody who delivers them to him , provided he has room in his carriage and the person offers to pay the proper charges.
ii) To carry the goods by his ordinary routes
iii) To deliver the goods to the consignee at the designated place
iv) To receive and carry all goods offered for carriage
v) To take utmost care of the goods from the moment of receipt to the place of destination
vi) To deliver the goods within reasonable time depending on the case by case basis.

b) A chose in action is essentially a right to sue. It is an intangible personal property right recognized and protected by the law, that has no existence apart from the recognition given by the law, and that confers no present possession of a tangible object. Another term is a thing in action. A chose in action, sometimes called a chose in suspense, in its more limited meaning, denotes the right to enforce payment of a debt by legal proceedings, obtain money by way of damages for contract, or receive recompense for a wrong. A chose in possession is an item of tangible personal property that can be physically possessed by the owner and can be transferred by delivery. Possession of a chose in possession is prima facie evidence of ownership**.**

Chose in possession is opposed to chose in action, and denotes not only the right to enjoy or possess a thing, but also the actual or constructive enjoyment of it. The possession may be absolute or qualified. It is absolute when the person is fully and completely the proprietor or owner of the thing; it is qualified when he "has not an exclusive right, or not a permanent right, but a right that may sometimes subsist and at other times not subsist.

c) Accept the goods and make payments

d) Limited companies are formed under the Companies Act, Cap 388. A partnership is formed under an agreement, the Partnership deed. There is separate existence between the company and members in a company, whereas a partnership and partners does not have this separation, and the firm and partners are one unit.

A company is responsible for its debts, and member's liability for the debts of the company is limited to the shares they have bought or have agreed to buy. In a partnership the liability is joint and several, meaning that the creditor may sue the firm or the individual partners or both the firm and partners.

e) Damages or compensation

- Re-employment or re-instatement
- An appropriate remedy depending on circumstances

SOLUTION FIVE

(a) The disadvantages of converting a partnership into a company limited by shares include ***inter-alia;***

In a Private Limited Company limited by shares, property belongs to the company not members, members have limited liability though thy can still be touched if the veil of incorporation is lifted., Members are separate from the company and this means higher legal regulation than in Partnerships. There is share capital, meaning members can contract with the company as they are separate from the company. This is different from Partnerships, they are largely bound by shareholder agreements.

Whilst in a Partnership, property belongs to individual partners and are collectively entitled to it, there is no separation between the partners and the firm, partners do not have limited liability, partners can incur liability on behalf of the company, etc

(b) *Articles of Association* – The purpose of articles of association to a limited liability company is to regulate the internal activities or the running of the company and the relationship between the company and its members. The articles form the core organizational structure of the company and the general meeting.

(c) Contents of a Partnership Deed include:

- Partnership name
- Names of partners
- Type of business activities
- Business address
- The amount of capital contributed by each partner
- The way in which profits and/or losses are to be shared
- Management and working arrangements
- Admission of new partners, removal of partner, resignation or death of a partner.

(d) Partnership by Estoppel – This is a partnership by implication or conduct. In this case, by Pula having his name on the letterheads after retiring, it means that he is still a partner and will be stopped (denied) from refusing that he is a partner by conduct because he has not removed his name from the documents despite retiring.

TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D1: BUSINESS INFORMATION MANAGEMENT

WEDNESDAY 12 DECEMBER 2018

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.

2. This question paper consists of **FOUR (4)** questions of Twenty Five (25) marks each. You must attempt all the **FOUR (4)** 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.

Answer all FOUR (4) questions.

QUESTION ONE

(a) Today Information Systems knowledge is essential for managers because most organisations need Information Systems to survive and prosper. Four powerful worldwide changes have altered the business environment. The first change is the emergence and strengthening of the global economy. The second change is the transformation of industrial economies and societies into knowledge and Information-based service economies. The third is the transformation of the business enterprise. The fourth is the emergence of the digital firm.

Required:

Outline the challenges in each of these emergences that may affect the business firm and their management. (8 marks)

(b) The Systems Development Life Cycle (SDLC) is a conceptual model used in project management that describes the stages involved in an Information System development project, from an initial Feasibility Study through maintenance of the completed application. Various SDLC methodologies have been developed to guide the processes involved.

Required:

List and explain each stage of the SDLC. (12 marks)

(c) Differentiate between Electronic Data Interchange (EDI) and Enterprise Resource Planning (ERP). (5 marks)

[Total: 25 Marks]

QUESTION TWO

(a) One of the projects your organisation has embarked on is to construct an Information System that will help in the effective and efficient operations to gain competitive advantage in the business environment.

Table 1.0 below shows the work activities necessary to achieve this objective.

Activity ID	Description	Duration (days)	Precedence
A	Presentation of project proposal	12	-
B	Conduct feasibility study	8	A
C	Distribute questionnaire	4	A
D	Fact finding analysis	3	A
E	System design	12	B
F	Implementation of developed system	18	C
G	Testing and changeover of system	5	C
H	Maintenance and review	4	E,F
I	Prepare operations manual	9	D,G
J	Train operators	6	H,I

Table 1.0

Required:

(i) Draw an appropriate network diagram, using the Activity On Node (AON) approach, by clearly showing the early start time, early finish time, late start time, late finish time, activity ID and duration. (15 marks)

(ii) Identify all the possible paths and stating the critical path in the network diagram. (5 marks)

(b) When an organization achieves one or more of its business objectives, operational excellence; new products, service and business models, customer/supplier intimacy and improved decision making.

Required:

Explain how the organization can achieve competitive advantage over other organizations (5 marks)

[Total: 25 Marks]

QUESTION THREE

(a) Explain e-commerce and state the infrastructure elements needed to support E-commerce. (10 marks)

(b) Explain the terms Confidentiality and Integrity in terms of computer security. (6 marks)

(c) Write short notes on any three (3) types of changeover methods (9 marks)

[Total: 25 Marks]

QUESTION FOUR

(a) The system's analyst must consider how best to elicit the requirements from the stakeholders when developing a system.

Required:

List any five (5) techniques that can be used to acquire information. (5 marks)

(b) Explain the Porter's value chain model and how it can lead to competitive advantage to an organisation. (12 marks)

(c) Explain any two (2) advantages and two (2) disadvantages of bespoke software. (8 marks)

[Total: 25 Marks]

END OF PAPER

D1: BUSINESS INFORMATION MANAGEMENT – SOLUTIONS

SOLUTION ONE

a) Outline the challenges in each of these emergences that may affect the business firm and their management.

- The four emergencies of the digital firm that pose a number of new challenges to business firms and management.

  1. **Globalization**
     - Management and control in a global marketplace
     - Competition in world markets
     - Global work groups
     - Global delivery systems

  2. **Transformation of Industrial Economies**
     - Knowledge and information based economies
     - Productivity
     - New products and services
     - Knowledge: a central productive and strategic asset
     - Time-based competition
     - Shorter product life
     - Turbulent environment
     - Limited employee knowledge base

  3. **Transformation of the Business Enterprise**
     - Flattening
     - Decentralisation
     - Flexibility
     - Location independence
     - Low transaction and coordination
     - Costs
     - Empowerment
     - Collaborative work and teamwork

  4. **Emergence of the Digital Firm**
     - Digitally enabled relationships with customers, suppliers and employees
     - Core business processes accomplished via digital networks
     - Digital management of key corporate assets
     - Rapid sensing and responding to environmental changes

b) The systems development life cycle (SDLC) is a conceptual model used in project management that describes the stages involved in an information system development project, from an initial feasibility study through maintenance of the completed application. Various SDLC methodologies have been developed to guide the processes involved.

List and provide sufficient explanation for each stage of the SDLC.

The systems development life cycle (SDLC) is a conceptual model used in project management that describes the stages involved in an information system development project. In general, an SDLC methodology follows these steps:

1. If there is an existing system, its deficiencies are identified. This is accomplished by interviewing users and consulting with support personnel.
2. The new system requirements are defined including addressing any deficiencies in the existing system with specific proposals for improvement.
3. The proposed system is designed. Plans are created detailing the hardware, operating systems, programming, and security issues.
4. The new system is developed. The new components and programs must be obtained and installed. Users of the system must be trained in its use, and all aspects of performance must be tested. If necessary, adjustments must be made at this stage.
5. The system is put into use. This can be done in various ways. The new system can phased in, according to application or location, and the old system gradually replaced. In some cases, it may be more cost-effective to shut down the old system and implement the new system all at once.
6. Once the new system is up and running for a while, it should be exhaustively evaluated.
7. Maintenance must be kept up rigorously at all times. Users of the system should be kept up-to-date concerning the latest modifications and procedures.

c) Differentiate between Electronic Data Interchange (EDI) and Enterprise Resource Planning (ERP).

Enterprise Resource Planning (ERP) is a type of system to facilitate the flow of information throughout the business functions within the organization and to manage all the interactions to the outside. ERP is a process by which a company manages and integrates the important parts of it business. Areas such as planning, purchasing, sales, human resource, etc.

Electronic Data Interchange (EDI) is the electronic exchange of business documents, such as orders, bills, and confirmations either through a third party or directly with a business partner. Businesses constantly order supplies from various suppliers, each order having a unit cost. EDI ordering can cut that cost by a factor of 10 percent per order, faster transmission of order, faster replenishment of supplies from time of order, strategic alliances with EDI suppliers and possible cost benefits, reduction in use of paper, reduction in errors and loss of documents

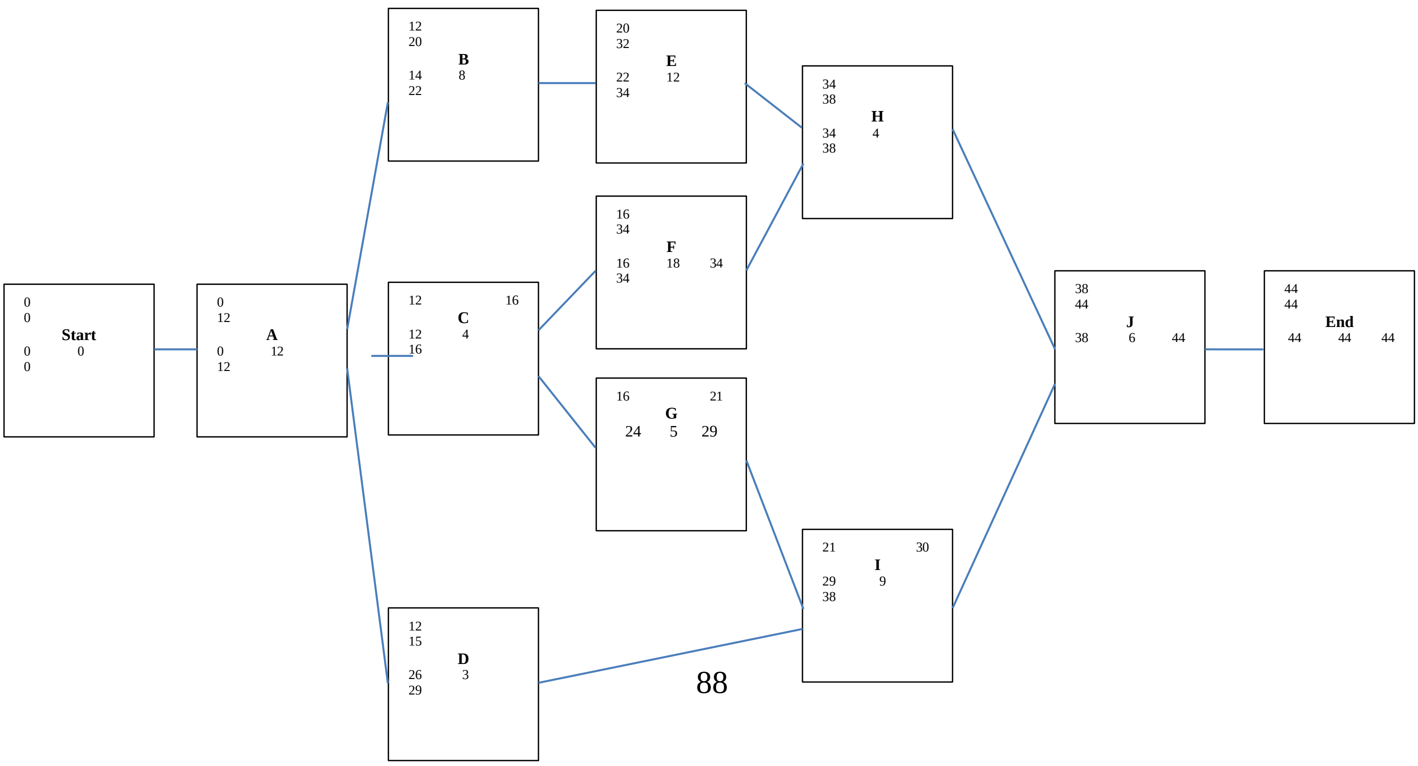
SOLUTION TWO

One of the projects your organisation has embarked on is to construct an information system that will help in the effective and efficient operations to gain competitive advantage in the business environment.

The table below shows the work activities necessary to achieve this objective.

Activity ID	Description	Duration (days)	Precedence
A	Presentation of project proposal	12	-
B	Conduct feasibility study	8	A
C	Distribute questionnaire	4	A
D	Fact finding analysis	3	A
E	System design	12	B
F	Implementation of developed system	18	C
G	Testing and changeover of system	5	C
H	Maintenance and review	4	E,F
I	Prepare operations manual	9	D,G
J	Train operators	6	H,I

i) Draw an appropriate network diagram, using the Activity On Node (AON) approach , by clearly showing the early start time, early finish time, late start time, late finish time, activity ID and duration



ii) Identify all the possible paths and stating the critical path in the network diagram

Possible paths in the network diagram

- A-B-E-H-J = 42 days
- A-C-F-H-J = 44 days (CRITICAL PATH)
- A-C-G-I-J = 36 days
- iv) A-D-I-J = 30 days

b) When an organization achieves one or more of its business objectives, operational excellence; new products, service and business models, customer/supplier intimacy and improved decision making.

Explain how the organization can achieve competitive advantage over other organizations doing things better than your competitor, charging less for superior products and responding to customers and suppliers in real time all add up to higher sales and higher profits that your competitors cannot match.

Being innovative, new products

SOLUTION THREE

a) Explain e-commerce and state the infrastructure elements needed to support e-commerce.

E-commerce refers to businesses running over the internet. The infrastructure elements needed to support e-commerce include hardware, software and networks; these include LANs, intranets and extranets, Virtual Private Networks, web technology such as web servers, web software, web-enabled databases and catalogues, webpage design and construction tools, e-commerce transaction processing software, etc (online payment system).

b) Explain the terms Confidentiality and Integrity in terms of computer security

Confidentiality in computer security means that the information on computer systems should be protected from unauthorised access. No unauthorised person should have to information while **integrity** means that the information should be trust worthy by protecting it from being altered by unauthorised individuals.

c) Write short notes on the types of changeover methods

i) System changeover methods

Direct changeover:

- This is a type of changeover method where there is a single point when the old system is scrapped immediately and is completely replaced by the new system
- It involves immediate and complete replacement of the old system with the new one.
- This changeover method carries more risks because if the new system fails it is difficult to go back to old system.
- However, it is the cheapest changeover method

Parallel changeover:

- In this changeover method both the old and the new systems are run side-by-side over a period of time using live data
- Data is input into both the old and the new system and the results are compared.
- Once satisfied with the new system, the old system is taken offline and the new system becomes active
- This changeover method offers lower risks but is the costliest

Pilot Changeover:

- This is where the new system is implemented at a selected location, called a test site, in a company while the rest of the company are using the old system.
- After successful operation the new system is rolled out to the rest of the organisation
- This changeover method offers lower risks and is cos effective

Phased-in changeover:

- This is a staged method of system implementation where only part of the overall system is changed.
- If a problem occurs, it is corrected before implemented the next stage until the entire system is fully implemented.
- This method is less expensive and risks or errors or failure are limited.

SOLUTION FOUR

a) The system's analyst must consider how best to elicit the requirements from the stakeholders when developing a system.

List any five (5) techniques that can be used to acquire information

Five (5) techniques to acquire information when developing a system

- Interviews
- Questionnaires
- Observation
- Sampling
- Record review

b) Explain the Porter's value chain model and how it can lead to competitive advantage to an organisation

Michael Porter's value chain model:
The task of any business is to deliver customer value at a profit. Porter's value chain is used to study the activities that are performed in the creation of a product or service by an organisation. The main purpose of the value chain model is to help organisations find, create or develop competitive advantages.
The model divides the activities into primary and support activities.

- Primary activities are those activities that relate directly to the physical creation, sale, maintenance and support of a product/service. Primary activities include:
  - Inbound logistics which involves the receiving, warehousing and inventory control of raw materials.
  - Operations include the value-adding activities used to turn a company's raw materials into a final product.
  - Outbound logistics involves activities needed to get the product to its customers for sale
  - Marketing and sales are the activities needed to get a buyer to purchase a product, and include channel selection, advertising and pricing.
  - Service are those activities that increase a product's value, including customer support and repair services.
- Support activities facilitate the efficiency of the primary activities as the form the basis of the organisation. Though usually seen as an overhead, they can be used to build up competitive advantage. Support activities include:
  - Infrastructure
  - HR
  - Technology
  - Procurement

These activities if well managed can make an organisation produce products of a value that exceeds the cost of producing thus giving them a competitive advantage over their rivals.

c) Explain any two (2) advantages and two (2) disadvantages of bespoke software

Bespoke software has the following advantages

- The system meets the specific requirements of the user
- Changes can easily be made
- The owner of the software is in control

However it has the following disadvantages

- Bound to have errors
- It is more costly to develop
- It may take more time to develop

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D2: FINANCIAL MANAGMENT

FRIDAY 14 DECEMBER 2018

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 **FOUR (4)** questions of Twenty Five (25) marks each. You must attempt all the **FOUR (4)** 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. 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. Formulae, Present Value, and Annuity tables are provided at the end of this question paper.

Attempt all FOUR (4) Questions.

QUESTION ONE

(a) The management of Mukaka Ltd is considering two mutually exclusive investment projects (A and B). Project A involves an initial investment of K100,000 with a residual value of K5,000 at the end of five years. Project B will initially cost K85,000 with a nil residual value at the end of five years.
Profits after depreciation for project A are forecast at K20,000 per annum. This figure is estimated to increase by K5,000 per annum beginning from year two until the end of the project. Project B is estimated to result in a K20,000 loss after depreciation in year one and profits after depreciation of K30,000 per annum for each of the next three years. The profit after depreciation for year 5 is estimated to be 50% higher than the previous year. Mukaka Ltd uses the straight line method of depreciation. The company cost of capital is 10% and both projects are expected to last for five years.

Required:
Calculate for each project;
(i) The Accounting Rate of Return (ARR)
(ii) The payback period
(iii) The Net Present Value (NPV)

Advise Mukaka Ltd which projects it should invest in under each alternative appraisal method (i), (ii) and (iii) above.

(19 marks)

(b) Mukaka Ltd management is considering financing the selected project from internal sources. This is due to the fact that Mukaka Ltd is a small unlisted company and it is likely to encounter difficulties in obtaining finance from external sources.

Required:
Discuss two (2) advantages of three internal sources of finance that Mukaka Ltd can use to finance the selected project.

(6 marks)
[Total: 25 Marks]

QUESTION TWO

Burma Plc has the following projected financial information for the next four years:

Year	1	2	3	4
Earnings before tax (K'm)	75.3	78.1	81.2	84.5

Burma Plc expects the earnings after tax to grow by 4% annually after the fourth year. The company has in issue one hundred million ordinary shares and a 11.5% bank loan with ten years to maturity. The company has just paid its annual dividend of 50 ngwee per share. Burma expects its dividend to grow by 4.5% per year.

Burma has an asset beta of 0.89. The risk free rate is 6.2% and equity premium of 8%. The capital structure is represented by 75% equity and 25% debt. Burma Plc pays corporate tax at the rate of 30% per year.

Required:

(a) Calculate the current weighted average cost of capital of Burma Plc. (6 marks)

(b) Estimate a range of values per share for Burma Plc using the cash flow valuation models. (11 marks)

(c) Discuss the usefulness of ratio analysis as an assessment tool for corporate failure. (8 marks)

[Total: 25 Marks]

<u>QUESTION THREE</u>

Bamako Ltd has the following capital structure.

		K'000
Ordinary shares of K5 each.		5,000
5% debentures of K100 each		1,000
Preference shares of K2.5 each		625
	Total	6,625

The ordinary shares and debentures are quoted at K8 and K70 each respectively. The preference shares are quoted at K3 each. The cost of ordinary shares is estimated at 12% while the cost of preference shares is estimated at 14%. The debentures are redeemable at K90 each in five years' time.
Ignore taxation

Required:

(a) Calculate the weighted average cost of capital of Bamako Ltd. (13 marks)

(b) The efficient market hypothesis attempts to explain share price movements on a stock exchange market. There are generally three forms of market efficiency.
Discuss the Three (3) forms of market efficiency. (6 marks)

(c) One of the most important objectives of a business is to make profits and enhance the wealth of shareholders. However non-financial objectives can also be important for a profit making entity.

Explain Three (3) non-financial objectives of a profit making company. (6 marks)

[Total: 25 Marks]

QUESTION FOUR

(a) Evaluate Five (5) sources of finance that are available to Small and Medium Enterprises (SMEs) in Zambia to finance non-current assets.

(10 marks)

(b) A private equity fund, Nova Ltd acquired 80% of the ordinary share capital of a Zambian SME, Post Microfinance Ltd on 31 December 2014 for K78 million. Its net assets on the acquisition date were K85 million.

Calculate the goodwill that will arise on the acquisition:

(i) If the Non-Controlling Interest (NCI) is valued using the proportion of net assets method.

(ii) If the NCI is valued using the fair value method, and the fair value of the NCI on the acquisition date is K19 million.

(10 marks)

(c) Explain any Five (5) possible ways Post Microfinance Ltd would benefit or be disadvantaged by obtaining a listing on a stock exchange, such as LuSE.

(5 marks)

[Total: 25 Marks]

END OF PAPER

Formula Sheet

Economic order quantity

$$= \sqrt{\frac{2C_0D}{C_H}}$$

Miller – Orr Model

$$\text{Return point} = \text{Lower limit} + (\frac{1}{3} \times \text{spread})$$

$$\text{Spread} = 3\left[\frac{\frac{3}{4} \times \text{transaction cost} \times \text{variance of cash flows}}{\text{interest rate}}\right]^{\frac{1}{3}}$$

The Capital Asset Pricing Model

$$E(r_i) = R_f + \beta_i(E(r_m) - R_f)$$

The asset beta formula

$$\beta_a = \left[\frac{V_e}{(V_e + V_d(1 - T))}\beta_e\right] + \left[\frac{V_d(1 - T)}{(V_e + V_d(1 - T))}\beta_d\right]$$

The Growth Model

$$P_o = \frac{D_0(1+g)}{(r_e - g)}$$

Gordon's growth approximation

$$g = br_e$$

The weighted average cost of capital

$$WACC = \left[\frac{V_e}{V_e + V_d}\right]k_e + \left[\frac{V_d}{V_e + V_d}\right]k_d(1-T)$$

The Fisher formula

$$(1+i) = (1+r)(1+h)$$

Purchasing power parity and interest rate parity

$$s_1 = S_0 x \frac{(1+h_c)}{(1+h_b)} \qquad f_0 = s_0 x \frac{(1+i_c)}{(1+i_b)}$$

Present Value Table

Present value of 1 i.e. $(1 + r)^{-n}$

Where r = discount rate
n = number of periods until payment

Discount rate (r)

Periods (n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0·990	0·980	0·971	0·962	0·952	0·943	0·935	0·926	0·917	0·909	1
2	0·980	0·961	0·943	0·925	0·907	0·890	0·873	0·857	0·842	0·826	2
3	0·971	0·942	0·915	0·889	0·864	0·840	0·816	0·794	0·772	0·751	3
4	0·961	0·924	0·888	0·855	0·823	0·792	0·763	0·735	0·708	0·683	4
5	0·951	0·906	0·863	0·822	0·784	0·747	0·713	0·681	0·650	0·621	5
6	0·942	0·888	0·837	0·790	0·746	0·705	0·666	0·630	0·596	0·564	6
7	0·933	0·871	0·813	0·760	0·711	0·665	0·623	0·583	0·547	0·513	7
8	0·923	0·853	0·789	0·731	0·677	0·627	0·582	0·540	0·502	0·467	8
9	0·914	0·837	0·766	0·703	0·645	0·592	0·544	0·500	0·460	0·424	9
10	0·905	0·820	0·744	0·676	0·614	0·558	0·508	0·463	0·422	0·386	10
11	0·896	0·804	0·722	0·650	0·585	0·527	0·475	0·429	0·388	0·350	11
12	0·887	0·788	0·701	0·625	0·557	0·497	0·444	0·397	0·356	0·319	12
13	0·879	0·773	0·681	0·601	0·530	0·469	0·415	0·368	0·326	0·290	13
14	0·870	0·758	0·661	0·577	0·505	0·442	0·388	0·340	0·299	0·263	14
15	0·861	0·743	0·642	0·555	0·481	0·417	0·362	0·315	0·275	0·239	15

(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0·901	0·893	0·885	0·877	0·870	0·862	0·855	0·847	0·840	0·833	1
2	0·812	0·797	0·783	0·769	0·756	0·743	0·731	0·718	0·706	0·694	2
3	0·731	0·712	0·693	0·675	0·658	0·641	0·624	0·609	0·593	0·579	3
4	0·659	0·636	0·613	0·592	0·572	0·552	0·534	0·516	0·499	0·482	4
5	0·593	0·567	0·543	0·519	0·497	0·476	0·456	0·437	0·419	0·402	5
6	0·535	0·507	0·480	0·456	0·432	0·410	0·390	0·370	0·352	0·335	6
7	0·482	0·452	0·425	0·400	0·376	0·354	0·333	0·314	0·296	0·279	7
8	0·434	0·404	0·376	0·351	0·327	0·305	0·285	0·266	0·249	0·233	8
9	0·391	0·361	0·333	0·308	0·284	0·263	0·243	0·225	0·209	0·194	9
10	0·352	0·322	0·295	0·270	0·247	0·227	0·208	0·191	0·176	0·162	10
11	0·317	0·287	0·261	0·237	0·215	0·195	0·178	0·162	0·148	0·135	11
12	0·286	0·257	0·231	0·208	0·187	0·168	0·152	0·137	0·124	0·112	12
13	0·258	0·229	0·204	0·182	0·163	0·145	0·130	0·116	0·104	0·093	13
14	0·232	0·205	0·181	0·160	0·141	0·125	0·111	0·099	0·088	0·078	14
15	0·209	0·183	0·160	0·140	0·123	0·108	0·095	0·084	0·074	0·065	15

Annuity Table

Present value of an annuity of 1 i.e. $\frac{1-(1+r)^{-n}}{r}$

Where r = discount rate
n = number of periods

Discount rate (r)

Periods (n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0·990	0·980	0·971	0·962	0·952	0·943	0·935	0·926	0·917	0·909	1
2	1·970	1·942	1·913	1·886	1·859	1·833	1·808	1·783	1·759	1·736	2
3	2·941	2·884	2·829	2·775	2·723	2·673	2·624	2·577	2·531	2·487	3
4	3·902	3·808	3·717	3·630	3·546	3·465	3·387	3·312	3·240	3·170	4
5	4·853	4·713	4·580	4·452	4·329	4·212	4·100	3·993	3·890	3·791	5
6	5·795	5·601	5·417	5·242	5·076	4·917	4·767	4·623	4·486	4·355	6
7	6·728	6·472	6·230	6·002	5·786	5·582	5·389	5·206	5·033	4·868	7
8	7·652	7·325	7·020	6·733	6·463	6·210	5·971	5·747	5·535	5·335	8
9	8·566	8·162	7·786	7·435	7·108	6·802	6·515	6·247	5·995	5·759	9
10	9·471	8·983	8·530	8·111	7·722	7·360	7·024	6·710	6·418	6·145	10
11	10·37	9·787	9·253	8·760	8·306	7·887	7·499	7·139	6·805	6·495	11
12	11·26	10·58	9·954	9·385	8·863	8·384	7·943	7·536	7·161	6·814	12
13	12·13	11·35	10·63	9·986	9·394	8·853	8·358	7·904	7·487	7·103	13
14	13·00	12·11	11·30	10·56	9·899	9·295	8·745	8·244	7·786	7·367	14
15	13·87	12·85	11·94	11·12	10·38	9·712	9·108	8·559	8·061	7·606	15

(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0·901	0·893	0·885	0·877	0·870	0·862	0·855	0·847	0·840	0·833	1
2	1·713	1·690	1·668	1·647	1·626	1·605	1·585	1·566	1·547	1·528	2
3	2·444	2·402	2·361	2·322	2·283	2·246	2·210	2·174	2·140	2·106	3
4	3·102	3·037	2·974	2·914	2·855	2·798	2·743	2·690	2·639	2·589	4
5	3·696	3·605	3·517	3·433	3·352	3·274	3·199	3·127	3·058	2·991	5
6	4·231	4·111	3·998	3·889	3·784	3·685	3·589	3·498	3·410	3·326	6
7	4·712	4·564	4·423	4·288	4·160	4·039	3·922	3·812	3·706	3·605	7
8	5·146	4·968	4·799	4·639	4·487	4·344	4·207	4·078	3·954	3·837	8
9	5·537	5·328	5·132	4·946	4·772	4·607	4·451	4·303	4·163	4·031	9
10	5·889	5·650	5·426	5·216	5·019	4·833	4·659	4·494	4·339	4·192	10
11	6·207	5·938	5·687	5·453	5·234	5·029	4·836	4·656	4·486	4·327	11
12	6·492	6·194	5·918	5·660	5·421	5·197	4·988	4·793	4·611	4·439	12
13	6·750	6·424	6·122	5·842	5·583	5·342	5·118	4·910	4·715	4·533	13
14	6·982	6·628	6·302	6·002	5·724	5·468	5·229	5·008	4·802	4·611	14
15	7·191	6·811	6·462	6·142	5·847	5·575	5·324	5·092	4·876	4·675	15

FINANCIAL MANAGEMENT D2: SUGGESTED SOLUTIONS

SOLUTIONS ONE

i) The Accounting Rate of Return

PROJECT A - ARR

Year	Profit
1	20,000
2	25,000
3	30,000
4	35,000
5	40,000
Total	**150,000**

Average profit = K150,000/5 = K30,000

Average investment (100,000 + 5000) /2

=105000 /2 = 52500

ARR= 30,000 /52500 X 100

= 57.14%

PROJECT B –ARR

Year	Profit
1	(20,000)
2	30,000
3	30,000
4	30,000
5	45,000
Total	**115,000**

Average profits = 115,000/5 = 23,000

Average investment (85,000 + 0)/2 = 42,500

ARR = 23,000 /42,500 X 100

= 54.1 %

Note: Credit will be given also for using initial investment method.

ii) The payback period

Annual depreciation	project A	project B
	(100,000 – 5,000)/5	(85,00 -0) /5
	= 19,000	= 17,000

Calculation of Cash flows:

	Project A	project B
1	20,000 + 19,000 =39,000	(20,000) + 17,000 = (3000)
2	25,000 + 19,000 = 44 000	30,000 + 17,000 = 47,000
3	30,000 + 19,000 = 49,000	30,000 + 17,000 = 47,000
4	35,000 + 19,000 = 54,000	30,000 + 17,000 = 47,000
5	40,000 +19,000 = 59,000	45,000 + 17,000 = 62,000

Calculation of Payback Period:

		Project A		Project B	
		Cashflow	Balance	Cash flow	Balance
Initial cost year	0	----	(105,000)	------	(85,000)
Profits	1	39,000	(66,000)	(3000)	(88,000)
	2	44,000	(22,000)	47,000	(41,000)
	3	49,000		47,000	
	4	54,000		47,000	
	5	59,000		62,000	

Pay back project A 2years and 22/ 49 2years and 41/ 47

2.45 years 2.87years

iii) The Net Present Value

Project A

Year	0	1	2	3	4	5
Cost	(105,000)					
Cash flows		39,000	44,000	49,000	54,000	59,000
Residual value	-	-	-	-	-	5,000
Net cash flow	(105,000)	39,000	44,000	49,000	54,000	64,000

Discount@ 10%	1	0.909	0.816	0.757	0.683	0.621
PV	(105,000)	35,451	36,344	36,799	36,882	39,744
NPV	**80,200**					

Project B

	0	1	2	3	4	5
Cost	(85,000)					
Cash flows		(3,000)	47,000	47,000	47,000	62,000
Discount@ 10%	1	0.909	0.826	0.751	0.683	0.621
PV	(85,000)	(27,27)	38,822	35,297	11,611	38,502
NPV	**36,505**					

Summary Results:

	Project A	project B	decision
ARR	57.14%	54.1%	project A
Pay back	2.45 years	2.87 years	project A
NPV	80200	36505	project A

b) Internal sources

i) Sale of assets which are currently not being used in the company

The first advantage of this form of finance is that the company is not burdened with the annual financing costs. Secondly, this will ensure that underutilized assets are disposed and eliminate the cost of maintenance. Sale of assets which are not being utilized will release funds which are currently tied up in fixed assets.

ii) Sale of assets which are currently being used and then leasing them back from the buyer

The main advantage is that this will give you access to some capital while you continue using the asset. Sale of assets which are not being utilized will release funds which are currently tied up in fixed assets.

iii) Use of retained earnings

Retained earnings has no immediate cost except the impact on shareholders if the dividends

SOLUTION TWO

a)

1. Cost of equity

Ba = Be x Ve/Ve+Vd(1-t)

0.89 = Be x 0.75/0.75 + 0.25(0.7)

Be = 1.1

Ke = 6.2% + 1.1(8%) = 15%

2. Cost of debt = 11.5%x (1-0.3) = 8.1%
3. WACC = 15%x0.75 +8.1%x0.25 =13.3% say 13%

b)

1. Using the Discounted cash flow method

Year	1	2	3	4
	K'm	K'm	K'm	K'm
Earnings before tax	75.3	78.1	81.2	84.5
Taxation @30%	(22.59)	(23.43)	(24.36)	25.35)
Net cash flow	52.71	54.67	56.84	59.15
Discount@13%	0.885	0.783	0.693	0.613
Present value	46.65	42.81	39.39	36.26

Total PV for 1-4 year = **K165.11million**

Cash flow beyond yr 4 = 59.15(1.04)/ 0.15- 0.04 = K559.23million x 0.613

= K342.81million

Total value of Company= K507.92million

Value per share = K507.92m/100m = K5.08 per share

Workings

2. Using the dividend valuation method

Po = K0.5 (1.045)/ 0.15 – 0.045 = K5 per share

The range is from K5 per share to K5.5 per share

c) Ratio analysis is a useful technique in assessing the performance of a company. This information is required by company stakeholders such as investors, suppliers, management, and financial institutions etc. Financial ratios can also be used to assess the risk factor involved for an investor and to predict the bankruptcy of a company. The liquidity and gearing ratios for example could be used for assessing whether the company is going through a financial distress. These ratios are assumed to be of greater importance in assessing if a business can pay back debt. The analysis that an investor gets from these ratios affect the decision making of their investment into any business.

Although ratio analysis can be a very useful technique, it has limitations.

i) Meaningful information is derived from ratio analysis by comparing ratios over time within the same business to assess whether a business is improving or declining or similar businesses (industrial average). However, comparable information may not be available. Sometimes industrial averages are used, which may hide wide variations in figures.

ii) Ratio analysis is normally based on the financial statements which are historical such that the information becomes out of date if the business has recently undergone substantial changes.

iii) Basing the decisions solely on ratio analysis can be catastrophic because there other items of information that are not contained in the financial statements.

SOLUTION THREE

a) Calculation of WACC

NPV at 10%

Year			DF (10%)	PV
0	market price	(70)	1	(70)
1 – 5	interest (5% x k 100)	5	3.791	19
5	redemption	90	0.621	56
		NPV		**5**

NPV at 15%

				DF (15%)	PV
Year	0	market price	(70)	1	(70)
	1 -5	interest	5	3.352	16.76
	5	redemption	90	0.497	44.73
				NPV	**(8.51)**

IRR = 10% + 5 / (5 + 8.51) X (15 – 10 %)

= 10 + 5/ 13.51 X 5

= 11.9 %

WACC

Source	market value	cost	cost x market value
Ordinary shares	8,000	0.12	960
Preference shares	17,500	0.14	2,450
Debentures	700	0.119	83.3
	26,200		3,493.3

WACC = 3,493.3 / 26,200 X 100 = 13.3 %

b) Three forms of market efficiency

i) Weak form; Under the weak form, share prices reflect all available information about past changes in share prices.

ii) Semi strong form; Under this form share prices reflect;
- All relevant information about past price movements and their implications and
- All knowledge which is available publicly

iii) Strong form ; Share prices reflect all information whether publicly available or not:
- From past price changes
- From public knowledge or anticipation
- From specialists 'insider knowledge

c) Non-financial objectives

i) The welfare of employees

The company might try to provide good wages and salaries, comfortable and safe working conditions, good training and career development, and good pensions. If redundancies are necessary, it may provide generous redundancy payments, or spend money trying to find alternative employment for redundant staff. All these measures have financial implications (reduce revenue and wealth for the shareholders) on the company.

ii) The welfare of management

Managers will often make decisions to improve their own circumstances, even though their decisions will incur expenditure and so reduce profits. High salaries, company cars and other perks are all examples of managers promoting their own interests.

iii) The provision of a service

Some companies may have major objectives that will include fulfilment of a responsibility to provide a service to the public. However, one may argue that providing a service is of course a key responsibility of government departments and local authorities.

iv) The fulfilment of responsibilities towards customers

A company's responsibilities towards customers may include providing in good time a product or service of a quality that customers expect, and dealing honestly and fairly with customers. Reliable supply arrangements, also after-sales service arrangements, are important. All these measures have financial implication (reduce revenue) on your company.

SOLUTION FOUR

(a)

Matching of funding

A general principle of financing is that the funding term should match the asset life. Therefore, non-current assets should normally be financed using long-term sources of funds.

Possible finance sources

The finance needs of SMEs will vary, with the size and type of non-current assets, ranging from photocopiers to new buildings, and therefore the relative amount of funds required, and the most appropriate form of funding will also vary. However, the following sources of finance could be considered by a small business.

(i) Retained earnings

Relatively small asset purchases, such as a new computer, can often be financed using cash arising from retentions, and thus no additional external funds will be required.

(ii) Leasing and hire purchase

These can also be considered for smaller assets. They can be used to spread the cost of
The asset over its useful life. The types of asset finance available include:

Operating leases - these are generally for a period less than the economic life of the asset. The risks and rewards of ownership remain with the lessor. However, in areas where there is a fast rate of technological change, such as computers, they have the advantage of giving flexibility to the lessee.
Finance leases - these generally cover the whole economic life of the asset, and the risks and rewards of ownership are transferred to the lessee.
Hire purchase - this is a form of installment credit, whereby the ownership of the goods pass to the customer on payment of the final credit installment.

(iii) Secured loan

Depending on the nature of the asset, it may be possible to obtain a secured bank loan (either medium or long-term) against an existing or the asset being purchased. Loans from the Citizen Economic Empowerment Commission (CEEC) are an example of a government initiative to help small businesses. The CEEC finances non-current assets based on viable business proposals.

(iv) Mortgage finance

This may be appropriate if the assets being acquired are land or buildings.

(v) Grants

A grant is a sum of money given to an individual or business for a specific project or purpose. A grant usually covers only part of the total costs involved. Grants to help with business development may be available from a variety of non-governmental organisations involved in business development, such as regional development agencies and some charitable organisations. These grants may be linked to business activity or a specific industry sectors such as agriculture or youth or women empowerment.

(vi) Venture capital
This form of finance may be appropriate for larger and established SMEs to finance expansion of their businesses and entry into new markets. Venture capital is essentially risk capital, and has the advantage that new equity funds are provided, generally for a restricted time period at the end of which the investor will seek an exit from the business. The benefit of this is that in the longer term the ownership structure of the business is unchanged.

(vii) Business angels
The company may have difficulty in obtaining equity finance, because of liquidity problems or because shareholders will find it difficult to sell their shares. SMEs may therefore grow by getting financing in form of either equity or debt from wealth family members, friends and individuals.

4(b)(i)

	K' million
Parent holding(investment) at fair value	78
NCI value at acquisition (20%x 85m)	17
	95
Less: fair value of net assets at acquisition	(85)
Goodwill on acquisition	10

4(b)(ii)

	K 'million
Parent holding(investment) at fair value	78
NCI value at acquisition	19
	97
Less: fair value of net assets at acquisition	(85)
Goodwill on acquisition	12

4(c)

Potential benefits would include:

Share transferability
As a listed company, its shares would be more liquid and therefore easier to transfer, which can facilitate Investment in the company.

Cost of capital
Shares in listed companies are perceived to be less risky than those in unlisted companies due to their marketability. This lower risk means that the returns required by shareholders will also be lower. As a result, the cost of capital for the listed company may be lower.

Company profile
Companies which are listed on a stock exchange have a higher profile among investors and the wider business community than unlisted companies. This higher profile may help to establish new contacts or to develop business opportunities.

Credit rating
A listed company would usually be viewed by the business community as being more creditworthy than an equivalent unlisted company. This may make it easier for the listed company to obtain loans or finance its expansion.

Share price
Shares that are traded on a stock exchange are closely scrutinized by investors who look at all the available information when assessing their worth. This results in efficiently priced shares, which will give confidence to investors when buying or selling shares.

Possible disadvantages would include:
Initial cost
The costs of floating a company on a stock exchange can be high. There will be fees paid to professional advisers, such as lawyers and accountants, and also underwriting fees which can often account for a large percentage of the total cost incurred.

Regulatory cost
After the initial listing, there are ongoing regulatory requirements that listed companies have to meet. Many of these regulations are there to ensure greater transparency of the company to its shareholders and this causes some of these additional costs.

Control
To obtain a stock exchange listing, a company must normally make a substantial amount of its share capital available to new investors. This would mean a loss of control for the existing shareholders of Post Microfinance Ltd.

Public scrutiny
Listed companies attract attention from investors and the media, which is rarely given to unlisted companies. Any negative press may have adverse effects on the company. Director decisions may also be heavily scrutinized and questioned by outsiders.

Takeover target
The existence of a public market for a company's shares means that a listed company is much more vulnerable to takeover than an unlisted company. This is particularly the case where there has been a fall in the share price and the shareholders are unhappy with the current level of returns.

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D3: BUSINESS TAXATION

WEDNESDAY 12 DECEMBER 2018

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.

2. This paper consists of **FOUR (4)** questions of twenty five (25) marks each. You MUST attempt all the **FOUR (4)** 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. You must write ALL your answers 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, 4,5 and 6 of this paper.

Taxation table for paper D3 – Business Taxation (December 2018 Examinations)

Income Tax

Standard personal income tax rates

Income band	Taxable amount	Rate
K1 to K39,600	first K39,600	0%
K39,601 to 49,200	next K9,600	25%
K49,201 to K74,400	next K25,200	30%
Over K74,400		37.5%

Income from farming for individuals

K1 to K39,600	first K39,600	0%
Over K39,600		10%

Company Income Tax rates

On income from manufacturing and other	35%
On income from farming	10%
On income from mineral processing	30%
On income from mining operations	30%

Mineral Royalty

Mineral Royalty on Copper

Range of Norm Price	Mineral Royalty Rate
Less than US$4,500	4% of norm value
From US$4,500 to less than US$6,000	5% of norm value
From US$6,000 and above	6% of norm value

Mineral Royalty on other minerals

Type of mineral	Mineral Royalty Rate
Base Metals (Other than Copper)	5% on norm value
Energy and Industrial Minerals	5% on gross value
Gemstones	6% on gross value
Precious Metals	6% on norm value

Capital Allowances

Implements, plant and machinery and commercial vehicles:

Wear and Tear Allowance –	Standard wear and tear allowance	25%
	Wear and tear allowance if used in manufacturing and leasing	50%
	Wear and tear allowance if used in farming and agro-processing	100%

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

Monthly turnover	**Turnover Tax per month**
K1to K4,200	3% of monthly turnover above K3,000
K4,200.01to K8,300	K225 per month+3% of monthly turnover above K4,200
K8,300.01 to K12,500	K400 per month+3% of monthly turnover above K8,300
K12,500.01 to K16,500	K575 per month+3% of monthly turnover above K12,500
K16,500.01 to K20,800	K800 per month+3% of monthly turnover above K16,500
Above K20,800	K1,025 per month+3% monthly of turnover above K20,800

Annual turnover	**Turnover Tax per annum**
K1to K50,400	3% of annual turnover above K36,000
K50,400.01to K99,600	K2,700 per annum+3% of annual turnover above K50,400
K99,600.01 to K150,000	K4,800 per annum +3% of annual turnover above K99,600
K150,000.01 to K198,000	K6,900 per annum+3% of annual turnover above K150,000
K198,000.01 to K249,600	K9,600 per annum+3% of annual turnover above K198,000
Above K249,600	K12,300 per annum +3% of annual of turnover above K249,600

Presumptive Tax for Transporters

Seating capacity	**Tax per annum**	**Tax per day**
	K	K
From 64 passengers and over	10,800	29.55
From 50 to 63 passengers	9,000	24.60
From 36 to 49 passengers	7,200	19.50
From 22 to 35 passengers	5,400	15.00
From 18 to 21 passengers	3,600	9.90
From 12 to 17 passengers	1,800	4.95
Less than 12 passengers and taxis	900	2.40

Property Transfer Tax

Rate of Tax on Realised Value of Land, Land and Buildings and shares	5%
Rate of tax on the Realised value on the transfer of intellectual property	5%
Rate of Tax on Realised Value on a transfer or sale of a mining right	10%

Value Added Tax

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

Customs and Excise duties on used motor vehicles

	Aged 2 to 5 years		Aged over 5 years	
Motor vehicles for the transport of ten or more persons, including the driver	**Customs duty K**	**Excise duty K**	**Customs duty K**	**Excise duty K**
Sitting capacity of 10 but not exceeding 14 persons including the driver	17,778	22,223	8,889	11,112
Sitting capacity exceeding 14 but not exceeding 32 persons	38,924	0	13,840	0
Sitting capacity of 33 but not exceeding 44 persons	86,497	0	19,462	0
Sitting capacity exceeding 44 persons	108,121	0	43,248	0

	Aged 2 to 5 years		Aged over 5 years	
Motor cars and other motor vehicles principally designed for the transport of persons including station wagons and racing cars	**Customs duty K**	**Excise duty K**	**Customs duty K**	**Excise duty K**
Sedans				
cylinder capacity not exceeding 1000 cc	12,490	10,824	7,136	6,185
Cylinder capacity exceeding 1000 cc but not exceeding 1500 cc	16,058	13,917	8,564	7,422
Cylinder capacity exceeding 1500 cc but not exceeding 2500 cc	16,545	21,508	8,423	10,950
Cylinder capacity exceeding 2500 cc but not exceeding 3000 cc	18,049	23,463	10,528	13,687
Cylinder capacity exceeding 3000 cc	22,561	29,329	12,032	15,642
Hatchbacks				
cylinder capacity not exceeding 1000 cc	10,705	9,278	7,136	6,185
Cylinder capacity exceeding 1000 cc but not exceeding 1500 cc	14,274	12,371	8,564	7,422
Cylinder capacity exceeding 1500 cc but not exceeding 2500 cc	15,041	19,553	8,423	10,950
Cylinder capacity exceeding 2500 cc but not exceeding 3000 cc	16,545	21,508	10,523	13,687
Cylinder capacity exceeding 3000 cc	19,553	25,419	12,032	15,642

Station wagons				
cylinder capacity not exceeding 2500 cc	16,545	21,508	9,024	11,731
Cylinder capacity exceeding 2500 cc but not exceeding 3000 cc	18,049	23,463	13,357	17,598
Cylinder capacity exceeding 3000 cc but not exceeding 2500 cc	22,561	29,329	18,049	23,463
SUVs				
Cylinder capacity not exceeding 2500 cc	21,057	27,374	9,024	11,732
Cylinder capacity exceeding 2500 cc but not exceeding 3000 cc	24,065	31,284	13,357	17,598
Cylinder capacity exceeding 3000 cc	28,577	37,150	18,049	23,463

	Aged 2 to 5 years		**Aged over 5 years**	
Motor vehicles for the transport of goods -with compression-ignition internal combustion piston engine (diesel or semi-diesel):	**Customs duty**	**Excise duty**	**Customs duty**	**Excise duty**
	K	**K**	**K**	**K**
Single cab				
GVW exceeding 1.0 tonne but not exceeding 1.5 tonnes	21,926	9,501	8,770	3,801
GVW exceeding 1.5 tonnes but not exceeding 3.0 tonnes	26,311	11,402	15,348	6,651
GVW exceeding 3.0 tonnes but not exceeding 5.0 tonnes	30,697	13,302	17,541	7,601
Double cabs GVW exceeding 3 tonnes but not exceeding 5 tonnes	30,274	0	24,119	10,452
Double cabs GVW exceeding 3.0 tonnes but not exceeding 5.0 tonnes, **with spark ignition internal combustion piston engine**	30,697	13,302	24,119	10,452
Panel Vans				
GVW exceeding 1.0 tonne but not exceeding 1.5 tonnes	15,348	6,651	8,770	3,801
GVW exceeding 1.5 tonnes but not exceeding 3.0 tonnes	17,541	7,601	15,348	6,651
GVW exceeding 3.0 tonnes but not exceeding 5.0 tonnes	21,926	9,501	17,541	7,601
Trucks				
GVW up to 2 tonnes	21,926	9,501	10,963	4,751
GVW exceeding 2.0 tonnes but not exceeding 5.0 tonnes	28,504	12,352	13,156	5,701
GVW exceeding 5.0 tonnes but not exceeding 10.0 tonnes	24,724	18,955	10,817	8,293
GVW exceeding 10.0 tonnes but not exceeding 20.0 tonnes	30,905	23,694	11,744	9,004
GVW exceeding 20 tonnes	51,898	0	19,461	0
GVW exceeding 20 tonnes, **with spark**	37,086	28,432	13,907	10,662

ignition internal combustion piston engine

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

K2,000

Customs and Excise on New Motor vehicles

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%

The minimum amount of customs duty on motor vehicles is K6,000.

Import VAT is added to the sum of VDP, customs duty and excise duty. It is determined at the standard rate of 16%

Attempt all FOUR (4) questions.

QUESTION ONE

G Bank Ltd is a Zambian resident company which was incorporated three years ago. G Bank Ltd is a wholly owned subsidiary of International Bank (IB) Plc, a company resident in a country known as Democratic Republic of Westland. The directors of International Bank Plc are considering offering 12,000 share options to the four directors of G Bank Ltd which will vest on 31 March 2021. Each director will be entitled to buy 3,000 shares on condition that they remain employees of G Bank Ltd up to the vesting date. The directors are aware that there are tax benefits arising from administering an approved employee share option scheme. The directors, therefore, wish to know the conditions which must be met for an employee share option scheme to be approved for tax purposes in Zambia.

The following is the summarized statement of profit or loss of G Bank Ltd for the year ended 31 December 2018:

		K'000
Interest income	(Note 1)	41,250
Interest expenses	(Note 2)	(21,450)
Net interest income		19,800
Provision for loan losses	(Note 3)	(1,900)
Net interest income after provision for loan losses		17,900
Non-interest income	(Note 4)	3,500
Non-interest expenses	(Note 5)	(12,840)
Income before income taxes		8,560
Income tax expense	(Note 6)	(2,996)
Income after tax		5,564

The following information is available:

1. **Interest income**

   This constitute interest from loans and overdrafts amounting to K29,980,000 and interest from various securities amounting to K11,270,000. Withholding tax deducted from interest income at source during the tax year 2018 amounted to K6,188,000.

2. **Interest expenses**

   This represent interest on deposits amounting to K11,200,000, interest paid to other financial institutions amounting to K7,290,000 and interest on debentures paid to debenture holders amounting to K2,960,000. The debentures were issued during the tax year 2018 and the proceeds were used to finance the acquisition of non-current assets.

3. **Provision for loan losses**

   This comprise loan losses written off amounting to K2,000,000, increase in general provision for loan losses amounting to K1,650,000 and loan losses previously written off now recovered amounting to K1,750,000.

4. **Non-interest income**

   This comprise fees from foreign exchange transactions amounting to K2,100,000, royalties amounting to K595,000 (net), rental income amounting to K585,000 (net) and profit on sale of equipment amounting to K220,000.

5. **Non-interest expenses**

This comprises the following:

	K
Depreciation	2,250,000
Salaries and wages	7,500,000
Donation to BN a political party	740,000
Donation to an amateur football club	750,000
Other revenue allowable expenses	1,600,000
	12,840,000

Salaries and wages include K780,000 salary for the managing director who is accommodated in a company owned house for which he pays no rent.

6. **Income tax expense**

The figure for income tax expense in the statement of profit or loss represents the provisional income tax paid by the company for the tax year 2018.

7. On 1 January 2018, the only asset qualifying for capital allowances was the equipment with an income tax value of K242,000. The equipment was sold for K600,000 reporting a profit on disposal of K220,000 referred to in note 4 above.

The company bought the following assets during the year 2018:

Office buildings	K12,400,000
Four (4) 3400cc BMW motor cars	K 5,700,000
Fixtures and fittings	K 1,500,000

Two (2) BMW motor cars are used by the Managing director and the Finance director respectively on personal-to-holder basis. It has been agreed with the Commissioner General that the private use in each car is 45%.

Required:

(a) Calculate the income tax payable by G Bank Ltd for the tax year 2018. (15 marks)

(b) Explain the conditions to be met for an employee share option scheme to be approved, for tax purposes, by the Commissioner General. (6 marks)

(c) Explain the tax benefits arising from an approved employee share option scheme to both the employer and the employees. (4 marks)

[Total: 25 Marks]

QUESTION TWO

(a) Emmanuel Kalindula has been in business for many years running his business as a sole trader. His annual turnover has always exceeded K800,000 and he prepares his financial statements annually to 31 December. His wife, Margaret Kalindula has always been assisting in the running of the business as a secretary and, therefore, treated as an employee. The annual salary for Margaret has been K225,000. Emmanuel has always drawn an annual salary of K375,000 from his business. Margaret contributes 5% of her salary as NAPSA contributions, with Emmanuel also contributing 5% of Margaret's salary as employer's NAPSA contributions.
On 1 May 2018, Emmanuel decided to start running the business as a partnership and with effect from that date, he engaged his wife, Margaret, as a partner. Under the terms of the partnership, profits and losses will be shared in the ratio 2:1 after annual partnership salaries of K375,000 and K275,000 for Emmanuel and Margaret respectively.

For the year ended 31 December 2018, the tax adjusted business profit amounted to K720,000. This profit is after all necessary adjustments but before capital allowances and salaries for Emmanuel and Margaret.

The following assets were acquired by the business during the tax year 2018:

	Cost
Office building	K210,000
Plant and machinery	K216,000
Motor van	K132,000

Emmanuel and Margaret have no other income.

Required:

Calculate the income tax payable by Emmanuel and Margaret for the tax year 2018.
(16 marks)

(b) B Ltd, a Zambian resident company, is a manufacturing company which is registered for VAT. During the quarter ended 31 December 2018, sales amounted to K520,000. 30% of the sales are exempt supplies while the remainder are all standard rated supplies. The purchases for the quarter amounted to K312,000. Of this amount 30% are exempt supplies while the remainder are all standard rated supplies.

The standard-rated operating expenses comprised the following:

	K
Petrol	17,400
Diesel	41,760
Overheads	46,748
Telephone and Internet services	20,416
Utility bills for directors accommodation	6,960
	133,284

The operating expenses are all inclusive of VAT.

The company bought a motor car and equipment on 23 November 2018 at a cost of K69,020 (VAT inclusive) and K32,944 (VAT inclusive) respectively.

Unless stated otherwise, all of the figures above are exclusive of VAT.

Required:

Compute the VAT payable by B Ltd for the quarter ended 31 December 2018. You should clearly show whether VAT is chargeable or claimable on each of the above items. (9 marks)

[Total: 25 Marks]

QUESTION THREE

Kafue Mining Corporation (KMC) Ltd is a company engaged in the extraction of copper in the Western province of Zambia. KMC Ltd is a wholly owned subsidiary of Consolidated Copper Mines (CCM) Plc, a multinational company.

The following is the statement of profit or loss of KMC Ltd for the year ended 31 December 2018.

		K'million
Revenue	(Note 1)	38,500
Cost of sales	(Note 2)	(25,025)
Gross profit		13,475
Operating expenses	(Note 3)	(6,064)
Profits from operations		7,411
Finance costs	(Note 4)	(700)
Investment income	(Note 5)	350
Profit before taxation		7,061
Income tax expense	(Note 6)	(2,118)
Profit for the year		4,943

The following information is available:

1. **Revenue**
   The gross sales figure is shown in the statement of profit or loss. The average copper price per metric ton for the year 2018 was US$4,800 as quoted at the London Metal Exchange (LME). Mineral royalty has not been accounted for in the above statement of profit or loss.

2. **Cost of sales**
   Included in cost of sales is depreciation of non-current assets amounting to K2,780 million, construction of road within the mine site amounting to K3,400 million, extension to the community hospital in a mine township amounting to K1,700 million and donation to the ministry of health towards the fight against the cholera epidemic amounting to K2,390 million. The balance comprises revenue expenses which are all allowable for tax purposes.

3. **Operating expenses**
   Included in operating expenses are annual salaries for the Chief Executive Officer, Chief Finance Officer and Operations Director of K1,300 million, K980 million and K900 million respectively. The balance of operating expenses constitutes revenue expenses which are allowable for tax purposes.
   The above directors are accommodated in company owned houses for which they pay no rent. The houses were acquired by the company four (4) years ago at a cost of K1,100 million each. The company is considering putting all the three (3) houses

on rent effective January 2019 at an annual gross rental of K200,000 each. The directors will then be paid housing allowance to enable them make personal arrangements regarding accommodation.

4. **Finance costs**

   This includes interest on loan payable to Zambian lending institutions. KMC Ltd's debt to equity ratio is 7:2.

5. **Investment income**

   This includes royalties of K102 million (net), profit on disposal of plant K205 million and dividends K43 million. Withholding tax has already been deducted at source where appropriate.

6. **Income tax expense**

   This represents provisional income tax paid by the company for the tax year 2018.

7. During the year 2018 KMC Ltd entered into the following capital transactions:

	Cost (proceeds)
	K'million
Bought new plant and Equipment	5,000
Constructed community school in the mine township	2,500
Bought two (2) 3600cc Toyota Land cruiser vans	
(Each costing K2,000 million)	4,000
Sold old plant	(680)

The old plant was acquired six (6) years ago at a cost of K1,600 million. The Toyota land cruiser vans are used by the Chief Executive Officer and the Chief Finance Officer on a personal-to-holder basis. It has been agreed with the Commissioner General that each director has 60% private use in their respective vans.

Required:

(a) Calculate the company income tax payable by KMC Ltd for the tax year 2018. (20 marks)

(b) Explain the taxation implications arising from change in accommodation policy for the directors in note 3 above. (5 marks)

[Total: 25 Marks]

QUESTION FOUR

David Kalembula is the managing director of DK Ltd, a Zambian resident company in which he holds 30% of the equity shares. DK Ltd is engaged in farming in the southern province of Zambia. David recently attended a tax payer sensitization workshop which was organized by the Zambia Revenue Authority under a theme "Promoting self-compliance to reduce penalties". During the workshop, a number of issues were discussed including loans to effective shareholders, liquidation of companies and hedging income. David did not fully understand what was discussed and has, therefore, requested you to shed more light on the above issues.

DK Ltd has enjoyed success since its incorporation and has grown significantly. DK Ltd is an equal opportunity employer, therefore, it employed fifteen (15) differently abled persons during the year 2018 on full time basis at an annual basic salary of K102,000 each. The

differently abled persons are all registered with the Zambia Agency for Persons living with Disabilities.
The company has always accommodated three directors in company owned houses for which they pay no rent. The directors accommodated are the Managing director, marketing director and finance director with annual gross emoluments of K520,000, K350,000 and K340,000 respectively. If rented, these houses could have been generating gross monthly rentals of K32,000 each. During the tax year 2018, DK Ltd bought a 3200cc Range Rover car at a cost of K640,000, 2900cc Toyota Prado car at a cost of K500,000 and 3000cc Mitsubishi Pajero car at a cost of K420,000. These motor cars are used by the managing director, marketing director and finance director respectively on personal-to-holder basis. It has been agreed with the Commissioner General that each director has a 45% business in the car.
The adjusted business profit of the company for the tax year 2018 has been calculated as K1,280,000. This profit is after all necessary adjustments but before capital allowances. The only asset held by the company on 1 January 2018 was a Toyota Light truck with an income tax value of K80,000. The Toyota Light Truck was acquired at a cost of K320,000. The company purchased irrigation equipment at a cost of K140,000 during the tax year 2018.

Required:

(a) Explain what may constitute a loan to an effective shareholder. (4 marks)

(b) Describe the liquidation process of a company. (5 marks)

(c) Explain the income tax implications of income (profit or loss) arising from hedging. (4 marks)

(d) Explain the taxation implications for DK Ltd of each of the following:

(i) Employing the fifteen differently abled persons. (2 marks)

(ii) Provision of free residential accommodation to the three directors. (2 marks)

(iii) Provision of personal-to-holder cars to the three directors. (2 marks)

Your explanation should be supported with appropriate calculations were appropriate.

(e) Calculate the company income tax payable for the tax year 2018. (6 marks)

[Total: 25 Marks]

END OF PAPER

D3: BUSINESS TAXATION - SOLUTIONS

SOLUTION ONE

(a) G Bank Ltd

Income tax payable for the tax year 2018

	K'000	K'000
Income before taxes		8,560
Add:		
Interest on debentures	2,960	
Increase in general provision for loan losses	1,650	
Depreciation	2,250	
Donation to political party	740	
Free accommodation (780 x 30%)	234	
Personal-to-holder cars (40,000 x 2)	80	
		7,914
		16,474
Less:		
Royalties	595	
Rental income	585	
Profit on sale of equipment	220	
Capital allowances (w1)	1,405	
		(2,805)
Adjusted business profit		13,669
Add:		
Royalties (595 x 100/85)		700
Taxable income		14,369
Income tax @35% (14,369 x 35%)		5,029
Less:		
Provisional income tax paid		(2,996)
Withholding tax on interest		(6,188)
WHT- Royalties (700 x 15%)		(105)
Income tax refundable		(4,260)

Workings

Capital allowances	K'000
Equipment: balancing charge (242 – 600)	(358)
Office buildings (12,400 x 2%)	248
BMW motor cars (5,700 x 20%)	1,140
Fixtures and fittings (1,500 x 25%)	375
Total capital allowances	1,405

(b) The employee share option scheme can be approved if it meets the following conditions:

1. The scheme must be established in Zambia and the employer must be carrying on business wholly or partly in Zambia.
2. The scheme should provide for participation of all eligible employees including directors
3. No employees should be allowed to buy more than 20% of the shares to be issued under the scheme
4. Only ordinary shares of the company should participate in the scheme

5. The scheme should entitle an employee to acquire a set number of shares at a fixed price
6. The employees must be restricted to a set period of time to use an option to buy shares.
7. The employees must be citizens or permanent residents of Zambia regardless of where they perform their duties.

(c) The tax benefits of an approved share option scheme are as follows:

1. Costs incurred by the employer to set up and administer the scheme will be allowed as a deduction in computing the company's adjusted business profits for tax purposes.
2. The income of an approved share option scheme will be exempted from tax
3. The employer will be exempted from paying property transfer tax on shares transferred under the terms of an approved share option scheme.
4. The benefit/gain for employees arising from allotment or acquisition of shares under an approved share option scheme is exempt from income tax.

SOLUTION TWO

(a) Emmanuel and Margaret
Income tax payable for the tax year 2018

	K	K
Business profit		720,000
Less:		
Capital allowances:		
Office building (K210,000 x 2%)	4,200	
Plant and equipment (K216,000 x 25%)	54,000	
Motor van (K132,000 x 25%)	33,000	
		(91,200)
Adjusted business profit		628,800

Allocation of business profits

	Total	Emmanuel	Margaret
First four (4) months	K	K	K
Profits (K628,800 x 4/12)	209,600	209,600	
Less: salary for Margaret (225,000 x 4/12)	(75,000)	75,000	
Employers NAPSA (75,000 x 5%)	(3,750)	(3,750)	
	205,850	130,850	75,000
1			
Last eight (8) months			
Salaries(375,000/275,000x8/12)	400,000	250,000	150,000
1			
Balance 2:1	19,200	12,800	6,400
1			
Profits (K628,800 x 8/12)	419,200	262,800	156,400
1			
Total	625,050	393,650	231,400

	Emmanuel	Margaret
Computation		
First K39,600 @0%	0	0
1		
Next K9,600 @25%	2,400	2,400
1		
Next K25,200 @30%	7,560	7,560
1		
Balance K319,250/K157,000 @37.5%	119,719	58,875
1		
Income tax payable	129,679	68,835
1		

(b) B Ltd

VAT payable for the quarter ended 31 December 2018

Output VAT	K	K	
Exempt supplies (K520,000 x 30%)		-	½
Standard-rated supplies (K520,000 x 70% x 16%)		58,240	1
		58,240	
Input VAT			
Exempt purchases: (K312,000 x 30%)	-		½
Standard-rated purchases (K312,000 x 70% x 16%)	34,944		1
Petrol (Irrecoverable)	-		½
Diesel (K41,760 x 4/29 x 90%)	5,184		
Overheads (K46,748 x 4/29 x 70%)	4,514		
Telephone and internet services	-		½
Utility bills for directors' accommodation	-		½
Motor car	-		½
Equipment (K32,944 x 4/29)	4,544		
		(49,186)	
VAT payable		9,054	

SOLUTION THREE

(a) **KMC Ltd**

Income tax payable for the tax year 2018

	K'million	K'million
Profit before tax	7,061	
Add:		
Depreciation	2,780	
Construction of road	3,400	
Extension to community hospital	1,700	
Finance costs (700 x x 0.5/3.5)	100	
Free residential accommodation:		
Chief executive officer (1,300 x 30%)	390	
Chief finance officer (980 x 30%)	294	
Operations Director (900 x 30%)	270	
		8,934
		15,995
Less:		
Royalties	102	
Profit on disposal	205	
Dividends	43	
Capital allowances (w1)	3,470	
Mineral royalty tax (38,500 x 5%)	1,925	
		(5,745)
Adjusted mining profit		10,250
Add:		
Royalties (102 x 100/85)		120
Total taxable income		10,370
Income tax on mining profits (10,250 x 30%)		3,075
Income tax on Royalties (120 x 35%)		42
Income tax liability		3,117
Less:		
Provisional income tax paid		(2,118)
WHT- Royalties (120 x 15%)		(18)
Income tax payable		981

Workings

Capital allowances	K'million
Old plant- balancing charge (0 – 680)	(680)
Community school (2,500 x 25%)	625
Toyota Land cruiser vans (4,000 x 25%)	1,000
New plant (5,000 x 25%)	1,250
Road (3,400 x 25%)	850
Community hospital (1,700 x 25%)	425
Total capital allowances	3,470

(b) The following are the taxation implications arising from change in accommodation policy:

1. The company will no longer be disallowed a free accommodation benefit, as a result, the adjusted business profit will reduce, thereby, reducing income tax payable.
2. The company will be allowed the housing allowances payable to the directors when computing the taxable business profit, which further reduce the taxable business profit.
3. The housing allowance will be an additional taxable emolument on each of the directors which will increase the pay as you earn.
4. The company will be required to pay withholding tax on the rental income at a rate of 10% which will be paid not later than 14^{th} day of the month following the month in which WHT relates.
5. The withholding tax will be the final tax. This means that the company will not be subjected to a further tax assessment.

SOLUTION FOUR

(a) A loan to an effective shareholder may constitute the following:
1. Any amount of money advanced
2. The extent of credit facilities advanced
3. The difference between the cost of providing any benefit or advantage and amount paid for such benefit or advantage when provided, whether such benefit is convertible into cash or not
4. The difference between the open market value, as determined by the Commissioner General, of an asset transferred and the amount paid for that asset at the date of transfer if the asset is transferred to an effective shareholder.

(b) The process of liquidation is as follows:
1. The liquidator should be appointed, and the trade ceases
2. The assets of the company are sold, the receivables collected and the liabilities paid
3. The corporation tax due on any profits and gains made on disposal of assets must be paid
4. The liquidator pays out the balance of the funds to the shareholders, and the shares are cancelled
5. The shareholders pay any tax due on the amounts received.

(c) The following are the taxation implications of hedging income:
1. Hedging is recognised as a separate source of income for taxation purposes
2. Any profit arising from derivatives shall be subjected to tax on the same basis as income from other sources
3. If a loss is incurred from hedging, that loss will be carried forward and only relieved against future profits from hedging arising in the following five years
4. The gain credited to statement of profit or loss is the taxable amount and any loss charged to the statement of profit or loss is the loss to be carried forward for taxation purposes.

(d) The taxation implications on DK Ltd are as follows:

Differently abled persons

(i) The company is entitled to an allowable deduction of K1,000 per annum per differently abled person employed. DK Ltd, therefore, claimed K15,000 (K1,000 x 15) for the tax year 2018.

(ii) Free residential accommodation
1. The company is disallowed a free accommodation benefit of 30% of the taxable emoluments payable to an employee provided with free residential accommodation.
2. Therefore, the company was disallowed a total of; (K520,000 x 30%) + (350,000 x 30%) + (K340,000 x 30%) = K363,000

Personal-to-holder cars

1. The company is disallowed a personal-to-holder benefit per annum which depends on the cylinder capacity of the motor cars.
2. The company was, therefore, disallowed a total personal-to-holder benefit of K120,000 (K40,000 per car as the cylinder capacity of the cars exceeded 2800cc)

(e) **DK Ltd**

Income tax payable for the charge year 2018

	K	K
Adjusted business profit		1,280,000
Less:		
Capital allowances:		
Range rover car (K640,000 x 20%)	128,000	
Toyota prado car (K500,000 x 20%)	100,000	
Mitsubishi pajero (K420,000 x 20%)	84,000	
Light trucks (K320,000 x 25%)	80,000	
Irrigation equipment (K140,000 x 100%)	140,000	
		(532,000)
Taxable farming profit		748,000
Income tax @10%		74,800

END OF SOLUTIONS

Zambia Institute of Chartered Accountants

TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D4: PERSONAL TAXATION

TUESDAY 11 DECEMBER 2018

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 **FOUR (4)** questions of Twenty Five (25) marks each. You must attempt all the **FOUR (4)** 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. Formulae, Present Value, and Annuity tables are provided at the end of this question paper.

Taxation table for paper D4 – Personal Taxation (December 2018 Examinations)

Income Tax

Standard personal income tax rates

Income band	**Taxable amount**	**Rate**
K1 to K39,600	first K39,600	0%
K39,601 to 49,200	next K9,600	25%
K49,201 to K74,400	next K25,200	30%
Over K74,400		37.5%

Income from farming for individuals

K1 to K39,600	first K39,600	0%
Over K39,600		10%

Capital Allowances

Implements, plant and machinery and commercial vehicles:

Wear and Tear Allowance –	Plant used normally	25%
	Used in Manufacturing and Leasing	50%
	Used in farming and agro-processing	100%

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

Monthly turnover	**Turnover Tax per month**
K1to K4,200	3% of monthly turnover above K3,000
K4,200.01to K8,300	K225 per month+3% of monthly turnover above K4,200
K8,300.01 to K12,500	K400 per month+3% of monthly turnover above K8,300
K12,500.01 to K16,500	K575 per month+3% of monthly turnover above K12,500
K16,500.01 to K20,800	K800 per month+3% of monthly turnover above K16,500
Above K20,800	K1,025 per month+3% monthly of turnover above K20,800

Turnover Tax per annum

Annual turnover	
K1to K50,400	3% of annual turnover above K36,000
K50,400.01to K99,600	K2,700 per annum+3% of annual turnover above K50,400
K99,600.01 to K150,000	K4,800 per annum +3% of annual turnover above K99,600
K150,000.01 to K198,000	K6,900 per annum+3% of annual turnover above K150,000
K198,000.01 to K249,600	K9,600 per annum+3% of annual turnover above K198,000
Above K249,600	K12,300 per annum +3% of annual of turnover above K249,600

Presumptive Tax for Transporters

Seating capacity	Tax per annum	Tax per day
	K	K
Less than 12 passengers and taxis	900	2.40
From 12 to 17 passengers	1,800	4.95
From 18 to 21 passengers	3,600	9.90
From 22 to 35 passengers	5,400	15.00
From 36 to 49 passengers	7,200	19.50
From 50 to 63 passengers	9,000	24.60
From 64 passengers and over	10,800	29.55

Property Transfer Tax

Rate of Tax on Realised Value of Land, Land and Buildings and shares	5%
Rate of Tax on Realised Value on a transfer of Intellectual Property	5%
Rate of Tax on Realised Value on a transfer or sale of a mining right	10%

Value Added Tax

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

Attempt all FOUR Questions.

QUESTION ONE

Josh Kalambo had been working for Dambo mining company since 2005. Throughout his employment with the company, he was entitled to the following:

Basic salary per annum	K183,600
Housing allowance per annum	K36,720
Transport allowance per annum	K18,360

Mr. Kalambo died on 31 July 2018 after a short illness, aged 54 years. His will leaves his assets split in the ratio of 5:3:2 for his three children Kalombo, Kabwili and Kabwibwi respectively. The assets comprised in Josh Kalambo's estate on that date were as follows:

	Open Market values (K)
Residential plots	300,000
Shopping complex	550,000
House	430,000
Bank deposit account	45,000
Building society account	60,000
Shares in Josh Ltd	80,000
Other chattels	50,000

During the tax year 2018, prior to his death, Mr. Kalambo paid Pay As You Earn amounting to K27,750, contributions to the National Pension Scheme authority amounting to K5,355 and made a donation to a local approved public benefit organisation amounting to K3,900. He also paid professional subscription fees amounting to K1,800 and utility bills of K5,400. Other income received by Mr. Kalambo, prior to his death included bank interest of K6,700 (gross), dividends from Josh Ltd of K10,200 (gross) and royalties of K30,000 (gross). Withholding tax was deducted at source where appropriate.

Required:

(a) Calculate the income tax payable by Mr. Kalambo for the tax year 2018. **(10 marks)**

(b) Calculate the tax payable on the estate left behind by Josh Kalambo, and calculate the inheritance due to Kalombo, Kabwili and Kabwibwi. **(7 marks)**

(c) Kalombo the elder daughter of the late Mr. Kalambo is aged 33 years. She wishes to invest all of her inheritance due from her father's estate into various investments within Zambia. However, she is not sure of what the taxation implications would be if she makes the following investment choices:

(i) Invest in ordinary shares of a company that is listed on the Lusaka Stock Exchange (LuSE). (2 marks)

(ii) Invest in the certificate of deposits of a bank listed on the Lusaka Stock Exchange (LuSE) (2 marks)

(iii) Invest in the loan notes of a company listed on the Lusaka Stock Exchange (LuSE). (2 marks)

(iv) Invest in ordinary shares of companies not listed on the Lusaka Stock Exchange (LuSE) (2 marks)

Required:

Explain the tax implications to Kalombo of investing in each of the above investment options.

[Total: 25 marks]

QUESTION TWO

For the purposes of this question assume that today's date is 20 December 2017 and that the earnings ceiling for NAPSA contributions purposes is K238,800 per annum.

Yizukanji is a self-employed Dental Surgeon. His business has grown rapidly over the last few years and he is struggling to keep up with his workload. On 1 January 2018, he is planning to bring a newly qualified Dental Surgeon, Zewelanji, into his business. He wishes to take on Zewelanji either as an employee or as a partner.

If Zewelanji is taken on as an employee, then the taxable business profit for the year ending 31 December 2018, is expected to be K860,000. This profit figure is before deducting capital allowances and expenses relating to the two individuals. The expenses relating to the two individuals will include a gross monthly salary of K9,000, a monthly housing allowance of K3,200 and a utility allowance of K1,800 per month, for Zewelanji, whilst Yizukanji will only be entitled to a gross monthly salary of K28,000.

The business owns a Toyota Corolla which was purchased in 2017, at a cost of K160,000 which has always been used wholly and exclusively for business purposes. From 1 January 2018, this car will be provided to Zewelanji who will use it both for business and private purposes. It has been estimated that his private use of the car will be 40%. Yizukanji will be required to pay employer's NAPSA contributions of 5% of Zewelanji's earnings. Zewelanji will also be required to pay employee's NAPSA contributions of 5% of his earnings. Yizukanji owns his own personal Toyota Allion motor car which he acquired a year ago at a cost of K180,000, which he uses both for use business and private purposes. The business use of the motor car is estimated to be 60%.

If Yizukanji involves Zewelanji in the business as a partner, then the taxable business profit for the year ending 31 December 2018 is expected to be K860,000. This profit figure is before deducting capital allowances and payment of expenses relating to the two individuals. The expenses relating to the two individuals will include a gross monthly salary of K9,000, a monthly housing allowance of K3,200 per month and a utility allowance of K1,800 per month, for Zewelanji, whilst Yizukanji will only be entitled to a monthly salary of K28,000.

The busines has a Toyota Corolla which he purchased in 2017, at a cost of K160,000 which has always been used for wholly and exclusively purposes. From 1 January 2018, this car will be provided to Zewelanji who will use it both for business and private purposes. It has been estimated that his private use of the car will be 40%. NAPSA contributions will not be payable by either Yizukanji or Zewelanji under this option. Yizukanji will use his own personal Toyota Allion motor car which he acquired a year ago at a cost of K180,000, both for use business and private purposes. The business use of the motor car is estimated to be 60%. Zewelanji will receive a 20% share of the new partnership's profits and losses, whilst Yizukanji will be entitled to the remaining 80%.

Required:

Calculate the income tax payable by Yizukanji and Zewelanji for the tax year 2016 on the basis that:

(a) Zewelanji is brought into the business as an employee. (10 marks)

(b) Zewelanji is brought into the business as a partner. (10 marks)

(c) Advise Yizukanji as to which of the two options is beneficial from a tax point of view. (5 marks)

[Total: 25 Marks]

QUESTION THREE

(a) Discuss any four (4) factors used to distinguish employees from self-employed contractors. (8 marks)

(b) **For the purposes of this part of the question you should assume that today's date is 15 December 2017.**

Mwansa is employed by QS plc as an IT Engineer, and is paid a salary of K375,000 per year. She makes NAPSA contributions of 5% of her gross pay. The earnings ceiling for NAPSA contributions purposes for the tax year 2018 is K238,800 per annum.

Mwansa uses her own personal Toyota Caldina motor Car which she acquired at a cost K300,000 in January 2017 for both employment and private purposes. She incurs travel expenses of K4,600 per month, which the company reimburses in full at the end of each month. QS plc provides IT services to a wide range of clients and Mwansa is sometimes required to travel directly from home to the premises of the clients QS plc has contracts with, to resolve IT problems faced by such clients as well as provide other services to the clients as directed by the company. She travels a total of 25,000 kilometres each year broken down as follows:

	Kilometres
Normal daily travel between home and QS plc's offices	6,000
Travel between QS plc's offices and the premises of QS plc's clients	10,000
Travel between home and the premises of QS plc's clients	2,000
Travel for personal purposes	7,000
	25,000

Mwansa is assisted by other IT personnel employed by QS plc. The total annual cost to QS plc of employing these employees is K37,800 per annum.

As an alternative to being employed on the terms described above in the tax year 2018, QS plc have offered Mwansa the opportunity to provide IT services to the company on a self-employed basis.

The details of the proposed arrangement for the year ended 31 December 2018 are as follows:

(1) Mwansa will commence being self-employed on 1 January 2018.

(2) Her gross annual income from QS plc will be K375,000. Mwansa will be allowed to provide IT services to other clients apart from QS plc and its clients. Her annual income from these other contracts is expected to be K198,000 per annum.

(3) Mwansa will use her own personal Toyota Caldina motor car which she acquired at a cost of K300,000 in January 2017, for both business and private purposes.

(4) Fuel and other motor car running expense will average K6,000 per month. Her total mileage for the tax year 2018 is expected to be 30,000 kilometres broken down as follows:

	Kilometres
Normal daily travel between home and QS plc's offices	6,000
Travel between QS plc's offices and the premises of QS plc's clients	10,000
Travel between home and the premises of QS plc's clients	2,000
Travel between home and other clients (Other than QS plc's clients)	5,000
Travel for personal purposes	7,000
	30,000

(5) Mwansa will be allowed to hire other appropriately qualified IT personnel to assist her perform her duties on a part-time basis whenever necessary. This will cost her K37,800 per annum.

(7) Other expenses she will incur wholly and exclusively for business purposes will amount to K8,600 per month.

(6) Mwansa will not be required to make any NAPSA contributions under this option.

Required:

(i) Assuming that Mwansa does **NOT** accept the offer from QS plc and continues to be employed by the company, calculate her income tax and employees NAPSA contributions payable in the tax year 2018. (6 marks)

(ii) Assuming that Mwansa accepts the offer to provide IT services to QS plc on a self-employed basis from 1 January 2018 onwards, calculate her income tax liability for the tax year 2018. (6 marks)

(iii) Advise Mwansa as to whether it will be beneficial to accept the offer to provide IT services to QS plc on a self-employed basis.

Your answer should be supported by a calculation of the amount by which Mwansa's income for the tax year 2018 (net of outgoings, income tax and any NAPSA contributions) will increase or decrease if she accepts the offer.

(5 marks)

[Total: 25 marks]

QUESTION FOUR

(a) Share options may be granted to the employees by the employers, which give employees the right, not an obligation, to buy or sell shares at a predetermined price in the future. Tax benefits only apply in cases where a share option scheme has been approved by the Commissioner General.

Required:

(i) Explain six (6) conditions to be met for the share option scheme to be approved by the Commissioner General. (6 marks)

(ii) Explain the tax benefits of an approved share option scheme to both the employer and the employees. (4 marks)

(b) **Assume that today's date is 31 December 2018 and the earnings threshold for the purposes of NAPSA contributions should be taken to be K238,800 per annum.**

Davison was born in Zambia in 1983 and has always lived in Zambia. He has been employed by Green Agric International Ltd a Zambian resident multinational company as a managing director. His annual salary has always been K240,000 and he is entitled to a medical allowance of 5% of his basic salary. He is provided with a 3200cc BMW motor car on a personal –to-holder basis which the company acquired at a cost of K230,000. The company has provided Davison with a company owned house for he pays no rent and the company pays for all the incidental costs (utility bills) relating to the accommodation which amounts to K3,200 per month. During the tax year 2018, Davison received royalties from his Zambian copyright of K34,000 (net) and bank interest from his deposit accounts he holds with Zambian banks of K8,600 (gross).

Davison has made investments in a country known as the republic of Dambia. The currency for the republic of Dambia is the Dambian dollar (D$). He holds shares in Dambian resident companies from which he received dividends of D$4,500 during the tax year 2018. The dividends were net of withholding tax at the rate of 25% deducted in Dambia. He also holds bank deposit accounts with Dambian resident banks and owns two (2) houses all situated in Dambia. During the tax year 2018, he received bank interest and rental income amounting to D$1,800 and D$6,400 respectively. The amounts of bank interest and rental income were net of withholding tax at the rate of 40% and 20% respectively deducted in Dambia. The amounts of foreign income were all credited to Davison's Zambian bank accounts.

Davison has always contributed NAPSA at 5% of his earnings. During the tax year 2018, pay as you earn deducted at amounted to K72,870.

There is no double taxation convention between Zambia and Dambia. When computing the Zambian income tax payable, credit is available for any foreign tax paid in Dambia. An exchange rate provided by the Bank of Zambia and approved by the Commissioner General averaged K8.50 per D$1 for the tax year 2018.

Required:

Calculate the income tax payable by Davison in the tax year 2018. (15 marks)

[Total: 25 marks]

END OF PAPER

D4: PERSONAL TAXATION – SOLUTIONS

SOLUTION ONE

(a) **Josh Kalambo**
Income tax payable for the tax year 2018

	K	K
Salary: K183,600 x 7/12		107,100
Housing allowance: K36,720 x 7/12		21,420
Transport allowance: K18,360 x 7/12		10,710
		139,230
Investment income		
Royalties		30,000
		169,230
Less:		
Donation to approved public benefit organisation	3,900	
Professional subscription	1,800	
		(5,700)
Taxable income		163,530
Computation		
First K39,600 @0%		0
Next K9,600 @25%		2,400
Next K25,200 @30%		7,560
Balance K89,130 @37.5%		33,424
Income tax liability		43,384
Less:		
PAYE		(27,750)
WHT: Royalties (30,000 x 15%)		(4,500)
Income tax payable		11,134

(b) **Kalambo's Estate**
Income tax payable

	Market value (K)
Residential plots	300,000
Shopping complex	550,000
House	430,000
Bank deposit account	45,000
Building society account	60,000
Shares in Josh Ltd	80,000
Other chattels	50,000
Total market value	1,515,000
Income tax @35%	(530,250)
Inheritance due to the beneficiaries	984,750
Kalombo: K984,750 x 5/10	K492,375
Kabwali: K984,750 x 3/10	K295,425
Kabwibwi: K984,750 x 2/10	K196,950

(c) The following are taxation implications of the investment options:

(i) Investing in ordinary shares of a company that is listed on the LuSE

(1) Dividends receivable are exempt from income tax, therefore, received gross.

(2) On disposal of the shares, property transfer tax is not payable as such shares are exempt from property transfer tax.

(ii) Investing in certificates of deposit

(1) Interest receivable is subjected to withholding tax at a rate of 15%. This is the final tax for individuals.

(2) On the disposal of certificates of deposit, property transfer tax is not payable as certificates of deposit are not property for the purposes of property transfer tax.

(iii) Investing in loan notes

(1) Interest receivable is subjected to withholding tax at a rate of 15% which is the final tax.

(2) On the disposal of loan notes, property transfer tax is not chargeable as loan notes are not property for the purposes of property transfer tax.

(iv) Investing in shares of companies not listed on the LuSE

(1) Dividends receivable are subjected to withholding tax at a rate of 15% which is the final tax.
(2) On disposal of shares, property transfer tax will be charged at a rate of 5% of the realized value.

SOLUTION TWO

(a) COMPUTATION OF INCOME TAX PAYABLE BY YIZUKANJI IF ZEWELANJI IS TAKEN ON AS AN EMPLOYEE

	K
Taxable profits before capital allowances	860,000
Less:	
Zewelanji's emoluments (K9,000+ 3,200 +K1,800) x 12	(168,000)
Employer's NAPSA contribution (K168,000 x 5%)	(8,400)
Capital allowances on:	
- Toyota Allion car (K180,000 x 20%) x 60%	(21,600)
- Toyota corolla motor car (K160,000 x 20%)	(32,000)
Final taxable business profits	630,000

Income Tax	
K39,600 x 0%	0
K9,600 x 25%	2,400
K25,200 x 30%	7,560
On excess K555,600 x 37.5%	208,350
	218,310

ZEWELANJI'S
PERSONAL INCOME TAX COMPUTATION FOR THE TAX YEAR 2018

	K
Salaries (K9,000 x12)	108,000
Housing allowance (K3,200 x12)	38,400
Utility allowance (K1,800 x 12)	21,600
	168,000

Income Tax	
K39,600 x 0%	0
K9,600 x 25%	2,400
K25,200 x 30%	7,560
K93,600 x 37.5%	35,100
	45,060

(b) COMPUTATION OF INCOME TAX PAYABLE IF ZEWELANJI IS TAKEN ON AS A PARTNER

	K
Taxable profits before capital allowances	860,000
Less:	
Capital allowances on Toyota corolla (K160,000 x 20%) x 60%	(19,200)
Final taxable business profits	840,800

ALLOCATION OF THE FINAL TAXABLE PARTNERSHIP PROFITS

	Total	Yizukanji	Zewelanji
	K	K	K
Salaries	444,000	336,000	108,000
Housing allowance	38,400	nil	38,400
Utility allowance	21,600	nil	21,600
Total Appropriations	504,000	336,000	168,000
Balance: 80:20	336,800	269,440	67,360
	840,800	605,440	235,360
Less capital allowances (K180,000 x 20%) x 60%	(21,600)	(21,600)	-
	819,200	583,840	235,360
Income Tax			
On First K74,400		9,960	9,960
On excess K509,440/K160,960 x 37.5%		191,040	60,360
		201,000	70,330

(c) COMPUTATION OF NET INCOME UNDER EACH OPTION

	Zewelanji engaged as an employee	Zewelanji engaged as a partner
	K	K
Total income	860,000	860,000
Income tax for:		
Yizukanji	(218,310)	(201,000)
Zewelanji	(45,060)	(70,330)
Zewelanji's NAPSA contribution	(8,400)	Nil
Employer's NAPSA	(8,400)	Nil
Net income	579,830	588,670

Based on the above analysis, it is more beneficial for Yizukanji to engage Zewelaji as a partner rather than as an employee as the net income under this option will be higher by: K588,670 – K579,830 = K8,840

SOLUTION THREE

(a) The following test are applied to distinguish employees from the self employed

(1) Type of contract

If there is a **contact of service**, it will indicate the existence of a legal relationship of master and servant. A **contract for services** will indicate the existence of self-employment.

(2) Work performance

Employees must perform the duties assigned to them themselves while the self-employed may hire other people to perform the work for them. If a person does not have a right to hire helpers, that is likely to lead to the conclusion that there is employment. The self-employed will normally have a right to hire their own helpers.

In contracts of service, personal performance is always required while in the case of contracts for services, there may be a requirement for personal performance or there may not be one. In other words, personal performance is not normally a must in contracts for services.

(3) Control

The work of an employee is controlled by the employer who will normally stipulate working hours, the place at which the duties are to be performed, how the work is to be performed and other conditions.

A self-employed person will decide when to perform the duties and how to perform them. Where there is an absence of the right of control, employment may still be present.

(4) Payment and financial risk

Employees are paid an agreed salary on a monthly or weekly basis and incur no form of financial risk. In order to earn an extra sum, employees will have to work overtime. Also, employees are going to get any other additional pay or variation in pay if they meet a set target in which case they will receive a bonus or a commission.

Employees do not assume any form of financial risk and they cannot profit from sound management of the business' affairs. Self-employed persons are normally paid a proportion of the contract price based on the amount of work performed. They will also bear the full financial risk of their business. If they manage their affairs well, they are going to profit from them.

(5) Place of work

Employees will normally be told where the duties are to be performed from. This is normally at the employer's premises or at the premises of the client.In most of the employments; the premises at which the duties are to be performed from are those of the employer.

Self-employed persons will perform the duties at a place of their choice. If the person performing duties can only do so at the employer's chosen premises, then that person is an employee. If the person can choose a place from where to perform the duties, that person is self-employed.

(6) Tools and equipment

An employer will provide the tools and equipment which the employees are to use. However, the fact that the employer does not provide the tools and equipment will not be conclusive. In certain types of employment, the employees will normally be required to provide their own tools and equipment.

Self-employed individuals will provide their own tools and equipment.

(7) Correction of work

Employees will normally rectify any faulty work during the normal working hours and they will still be paid for those hours. Self-employed persons will rectify any faulty work outside the contract time and they will not be paid for that extra work.

If the person performing duties is not paid for the time spent on correcting work, then that person is self-employed. On the other hand, if the person is paid for the time spent on correcting work, then that person is an employee.

(8) Engagement and dismissal

The employer will take on and dismiss employees. The employer will have a right or power to terminate the contracts of employment by giving the employees an appropriate notice.

A self-employed person will normally enter into a contract with a client specifying the beginning and end. The contract normally ends when the work has been performed completely and accurately.

(9) Insurance

Employers will normally provide insurance cover for the actions of their employees. This is because they are vicariously liable for the offences committed by their employees.

Self-employed persons will have to provide for their own insurance needs. The hirer is not vicariously liable for the offences committed by the hired self-employed contractors.

If the person who is performing the duties takes insurance cover personally, then that person is self-employed. But, if insurance cover is not taken by the person performing the duties personally, then that person is an employee. The employer will have taken insurance cover on behalf of that employee.

(10) Exclusivity

Employees normally work for only one employer. A self-employed person will normally work for a number of clients.

The courts will also consider whether an individual's activity is fully integrated within the organisation. If this were the case, it would be difficult for an individual to prove that he/she is self-employed.

(b) (i) MWANSA'S
PERSONAL INCOME TAX COMPUTATION FOR THE TAX YEAR 2018 IF SHE CONTINUES WITH EMPLOYMENT

	K	K
Salary		375,000
Reimbursement of travel expenses		
(K4,600 x 12)		55,200
Gross income		430,200
Less allowable travel expenses		
(K55,200 x 10,000/25,000)		(22,080)
Less Capital allowances on Toyota Caldina		
[(K300,000 x 20%) x 10,000/25,000]		(24,000)
		384,120
Income Tax		
On first K74,400		9,960
On excess K309,720 x 37.5%		116,145
		126,105

The NAPSA contributions payable will be:

K238,800 x 5% = K11,940

(ii) MWANSA'S
COMPUTATION OF THE INCOME TAX LIABILTY FOR THE TAX YEAR 2018 IF SHE CONTINUES WITH EMPLOYMENT

	K	K
Income from QS plc		375,000
Income from other clients		198,000
Gross income		573,000
Less:		

Capital allowances on Toyota Motor car		
(K300,000 x 20%) x 23,000/30,000	46,000	
Motor car running expenses		
(K6,000 x 12) x 23,000/30,000	55,200	
Hire of part time-employees	37,800	
Other expenses (K8,600 x 12)	103,200	
		(242,200)
		330,800
Income Tax		
On first K74,400		9,960
On excess K256,400 x 37.5%		96,150
		106,110

COMPUTATION OF NET INCOME FOR MWANSA IF SHE IS:

	AN EMPLOYEE	SELF-EMPLOYED
	K	K
Gross income	430,200	573,000
Income tax payable	(126,105)	(106,110)
Employee's NAPSA contributions	(11,940)	-
Motor car expenses	(55,200)	(72,000)
Hire of part-time employees	-	(37,800)
Other expenses	-	(103,200)
Net income	236,955	253,890

Based on the above calculations, it appears that it will be beneficial for Mwansa to be engaged on a self-employed basis because this option gives a higher net income by K19,935 (K253,890 – K236,955).

SOLUTION FOUR

(a) Share option schemes

(i) The following are the conditions to be met for a share option scheme to be approved:

(1) The scheme must be established in Zambia and the employer must be carrying on business wholly or partly in Zambia
(2) The scheme should provide for participation of all eligible employees (including the directors)
(3) An employee participating in the scheme should not acquire more than one fifth (1/5) or 20% of the shares to be issued under the scheme
(4) Only ordinary shares of the company may participate in the scheme
(5) The scheme entitles an employee to acquire a set number of shares at a predetermined fixed future price
(6) The employee must be restricted to a set period of time to use an option to buy the shares
(7) The employees must be citizens or permanent residents of Zambia regardless of where they perform the duties from

(ii) The following are the benefits of an approved share option scheme:

To the employer:

(1) The costs incurred in setting up and operating the scheme are tax deductible.

(2) There is no property transfer tax on the shares transferred under the scheme.

(3) The income of the scheme is not chargeable to income tax

To the participating employees:

(1) There is no Income Tax charge when the share options are granted at an exercise price that is less than the market value at the time of grant.

(2) There is no income tax charge when the share options are exercised.

(b) DAVISON
PERSONAL INCOME TAX COMPUTATION FOR THE TAX YEAR 2018

	K	K
Salary		240,000
Medical allowance (K240,000 x 5%)		12,000
Accommodation expenses (K3,200 x 12)		38,400
		290,400
Royalties (K34,000 x 100/85)		40,000
		330,400
Foreign income		
Dividends $4,500 x 100/75 x K8.50	51,000	

Bank interest $1,800 x 100/85 x K8.50	25,500	
		76,500
Taxable income		406,900
Income Tax		
First K39,600 @0%		0
Next K9,600 @25%		2,400
Next K25,200 @30%		7,560
Balance K332,500 @37.5%		124,688
Income tax liability		134,648
Less:		
PAYE	72,870	
WHT-royalties (K40,000 x 15%)	6,000	
Double taxation relief		
Dividends (w1)	12,750	
Bank interest (w2)	8,438	
		(100,058)
Income tax payable		34,590

Workings

Double taxation relief:

(1) Dividends

Foreign tax paid: K51,000 x 25% = K12,750

Equivalent Zambian tax

$\frac{Gross\ foreign\ income}{Total\ assessable\ income}$ X Zambian tax charge

$\frac{K51,000}{K406,900}$ X K134,648

= K16,877

The double taxation relief is therefore K12,750 which is the lower of the Zambian equivalent tax.

(2 marks)

(2) Bank interest

Foreign tax paid: K25,500 x 40% = K10,200

Equivalent Zambian tax

$\frac{Gross\ foreign\ income}{Total\ assessable\ income}$ x Zambian tax charge

$\frac{K25,500}{K406,900}$X K134,648

= K8,438

The double taxation relief is therefore K8,438 which is the lower of the foreign tax paid.

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D5: INTERNATIONAL TAXATION

THURSDAY 13 DECEMBER 2018

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.

2. This question paper consists of **FOUR (4)** questions of Twenty Five (25) marks each. You must attempt all the **FOUR (4)** 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.

Taxation table for paper D5 – International Taxation (December 2018 Examinations)
Income Tax

Standard personal income tax rates

Income band	Taxable amount	Rate
K1 to K39,600	first K39,600	0%
K39,601 to 49,200	next K9,600	25%
K49,201 to K74,400	next K25,200	30%
Over K74,400		37.5%

Income from farming for individuals

K1 to K39,600	first K39,600	0%
Over K39,600		10%

Company Income Tax rates

On income from manufacturing and other	35%
On income from farming	10%
On income of Banks and other Financial Institutions	35%
On income from mineral processing	30%
On income from mining operations	30%

Mineral Royalty

Mineral Royalty on Copper

Range of Norm Price	Mineral Royalty Rate
Less than US$4,500	4% of norm value
From US$4,500 to less than US$6,000	5% of norm value
From US$6,000 and above	6% of norm value

Mineral Royalty on other minerals

Type of mineral	Mineral Royalty Rate
Base Metals (Other than Copper)	5% on norm value
Energy and Industrial Minerals	5% on gross value
Gemstones	6% on gross value
Precious Metals	6% on norm value

Capital Allowances

Implements, plant and machinery and commercial vehicles:

Wear and Tear Allowance –	Plant used normally	25%
	Used in Manufacturing and Leasing	50%
	Used in farming and agro-processing	100%

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

Monthly turnover	Turnover Tax per month
K1to K4,200	3% of monthly turnover above K3,000
K4,200.01to K8,300	K225 per month+3% of monthly turnover above K4,200
K8,300.01 to K12,500	K400 per month+3% of monthly turnover above K8,300
K12,500.01 to K16,500	K575 per month+3% of monthly turnover above K12,500
K16,500.01 to K20,800	K800 per month+3% of monthly turnover above K16,500
Above K20,800	K1,025 per month+3% monthly of turnover above K20,800

Annual turnover	Turnover Tax per annum
K1to K50,400	3% of annual turnover above K36,000
K50,400.01to K99,600	K2,700 per annum+3% of annual turnover above K50,400
K99,600.01 to K150,000	K4,800 per annum +3% of annual turnover above K99,600
K150,000.01 to K198,000	K6,900 per annum+3% of annual turnover above K150,000
K198,000.01 to K249,600	K9,600 per annum+3% of annual turnover above K198,000
Above K249,600	K12,300 per annum +3% of annual of turnover above K249,600

Presumptive Tax for Transporters

Seating capacity	Tax per annum	Tax per day
	K	K
From 64 passengers and over	10,800	29.60
From 50 to 63 passengers	9,000	24.70
From 36 to 49 passengers	7,200	19.70
From 22 to 35 passengers	5,400	14.80
From 18 to 21 passengers	3,600	10
From 12 to 17 passengers	1,800	5.0
Less than 12 passengers and taxis	900	2.50

Property Transfer Tax

Rate of Tax on Realised Value of Land, Land and Buildings and shares	5%

Rate of Tax on Realised Value on a transfer or sale of a mining right	10%
Rate of Tax on Realised Value on a transfer of Intellectual Property	5%

Value Added Tax

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

Customs and Excise
Customs and Excise duties on used motor vehicles

	Aged 2 to 5 years		Aged over 5 years	
Motor vehicles for the transport of ten or more persons, including the driver	**Customs duty K**	**Excise duty K**	**Customs duty K**	**Excise duty K**
Sitting capacity of 10 but not exceeding 14 persons including the driver	17,778	22,223	8,889	11,112
Sitting capacity exceeding 14 but not exceeding 32 persons	38,924	0	13,840	0
Sitting capacity of 33 but not exceeding 44 persons	86,497	0	19,462	0
Sitting capacity exceeding 44 persons	108,121	0	43,248	0

	Aged 2 to 5 years		Aged over 5 years	
Motor cars and other motor vehicles principally designed for the transport of persons including station wagons and racing cars	**Customs duty K**	**Excise duty K**	**Customs duty K**	**Excise duty K**
Sedans				
cylinder capacity not exceeding 1000 cc	12,490	10,824	7,136	6,185
Cylinder capacity exceeding 1000 cc but not exceeding 1500 cc	16,058	13,917	8,564	7,422
Cylinder capacity exceeding 1500 cc but not exceeding 2500 cc	16,545	21,508	8,423	10,950
Cylinder capacity exceeding 2500 cc but not exceeding 3000 cc	18,049	23,463	10,528	13,687
Cylinder capacity exceeding 3000 cc	22,561	29,329	12,032	15,642
Hatchbacks				
cylinder capacity not exceeding 1000 cc	10,705	9,278	7,136	6,185
Cylinder capacity exceeding 1000 cc but not exceeding 1500 cc	14,274	12,371	8,564	7,422
Cylinder capacity exceeding 1500 cc but not exceeding 2500 cc	15,041	19,553	8,423	10,950
Cylinder capacity exceeding 2500 cc but not exceeding 3000 cc	16,545	21,508	10,523	13,687
Cylinder capacity exceeding 3000 cc	19,553	25,419	12,032	15,642

Station wagons				
cylinder capacity not exceeding 2500 cc	16,545	21,508	9,024	11,731
Cylinder capacity exceeding 2500 cc but not exceeding 3000 cc	18,049	23,463	13,357	17,598
Cylinder capacity exceeding 3000 cc but not exceeding 2500 cc	22,561	29,329	18,049	23,463
SUVs				
Cylinder capacity not exceeding 2500 cc	21,057	27,374	9,024	11,732
Cylinder capacity exceeding 2500 cc but not exceeding 3000 cc	24,065	31,284	13,357	17,598
Cylinder capacity exceeding 3000 cc	28,577	37,150	18,049	23,463
	Aged 2 to 5 years		**Aged over 5 years**	
Motor vehicles for the transport of goods –with compression-ignitioninternal combustion piston engine (diesel or semi-diesel):	**Customs duty**	**Excise duty**	**Customs duty**	**Excise duty**
	K	**K**	**K**	**K**
Single cab				
GVW exceeding 1.0 tonne but not exceeding 1.5 tonnes	21,926	9,501	8,770	3,801
GVW exceeding 1.5 tonnes but not exceeding 3.0 tonnes	26,311	11,402	15,348	6,651
GVW exceeding 3.0 tonnes but not exceeding 5.0 tonnes	30,697	13,302	17,541	7,601
Double cabs GVW exceeding 3 tonnes but not exceeding 5 tonnes	30,274	0	24,119	10,452
Double cabs GVW exceeding 3.0 tonnes but not exceeding 5.0 tonnes, **with spark ignition internal combustion piston engine**	30,697	13,302	24,119	10,452
Panel Vans				
GVW exceeding 1.0 tonne but not exceeding 1.5 tonnes	15,348	6,651	8,770	3,801
GVW exceeding 1.5 tonnes but not exceeding 3.0 tonnes	17,541	7,601	15,348	6,651
GVW exceeding 3.0 tonnes but not exceeding 5.0 tonnes	21,926	9,501	17,541	7,601
Trucks				
GVW up to 2 tonnes	21,926	9,501	10,963	4,751
GVW exceeding 2.0 tonnes but not exceeding 5.0 tonnes	28,504	12,352	13,156	5,701
GVW exceeding 5.0 tonnes but not exceeding 10.0 tonnes	24,724	18,955	10,817	8,293
GVW exceeding 10.0 tonnes but not exceeding 20.0 tonnes	30,905	23,694	11,744	9,004
GVW exceeding 20 tonnes	51,898	0	19,461	0
GVW exceeding 20 tonnes, **with spark ignition internal combustion piston**	37,086	28,432	13,907	10,662

engine

Customs and excise duty on new vehicles

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:	30%
Excise duty:	
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 tonnes:

Customs duty	15%
Excise duty	10%

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

Customs duty:	15%
Excise duty:	
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:	15%
Excise duty:	0%

The minimum amount of customs duty on motor vehicles is K6,000.

Import VAT is added to the sum of VDP, customs duty and excise duty. It is determined at the standard rate of 16%

Attempt all the FOUR (4) Questions.

QUESTION ONE

For the purpose of this question, you should assume today's date is 5 November 2018.

Dodgers International Ltd, a Zambian resident trading company, is wholly owned by Francis Nambi and his wife Rosette Kabibi in equal proportions.

The Chief Executive Officer, Abraham Nambi, who is the young brother to Francis Nambi has been informed by the Board Chairperson, Charles Mwansa that effective 1 January 2019, Dodgers International Ltd will buy 80% shares in Haya Ltd, a company resident in a country called Jomia, which has a consistent dividend payout ratio of at least 60%. Jomia is one of the countries listed on the Organisation for Economic Co-operation and Development (OECD) list of tax havens. This will be sufficient to resolve the cash flow problems being experienced. It also means the future tax obligations could be significantly reduced.

The tax adjusted business profit for Dodgers International Ltd for the year ended 31 December 2018, is expected to be K400,000 (inclusive of the gross foreign dividends from Haya Ltd). The foreign dividend will be K20,400 net of 40% withholding tax. Jomia will reduce the WHT rate to 0% effective 2019. The company income tax rate in Jomia is 5%.

Dodgers International Ltd has a property in Zambia which is let at a gross rent of K36,000 per annum. The five year rental agreement started on 1 March 2016.

Abraham Nambi is concerned that the company could be suspected of International Tax Avoidance or Evasion. In addition, the danger of money laundering offences would be high once shares are bought in Haya Ltd. Abraham Nambi is a respected retired professional accountant. He is aware that double taxation agreements could provide opportunities for International Tax Avoidance. He is, however, not sure of the tax treatment of any excess foreign tax, which remains unrelieved after applying the unilateral credit relief.

Required:

(a) Discuss six (6) functions of double tax agreements, and how they can provide opportunities for international tax avoidance. (11 marks)

(b) Explain whether money laundering could encourage companies to engage in tax evasion. (8 marks)

(c) Calculate the amount of the excess of foreign tax over the Zambian tax charge for 2018 for Dodgers International Ltd and state its tax treatment. (6 marks)

[Total: 25 Marks]

QUESTION TWO

Garlic Ltd is a manufacturing enterprise resident in a country known as Farmland. Garlic Ltd manufactures garlic source. The currency of farmland is FL$ and the company income tax rate at which Garlic Ltd pays tax in Farmland is 3%. Garlic Ltd acquired 100% of the issued ordinary share capital of BM Ltd, a Zambian resident company, on 31 October 2017. BM Ltd's business is growing of garlic and its main customers are local manufacturers of garlic source and households.

On 1 January 2018 the directors of Garlic Ltd directed BM Ltd to transfer 60% of its total production of garlic to its parent, Garlic Ltd, in Farmland at a price of FL$8 per kg. This directive enabled Garlic Ltd to boost its production of garlic source and increased revenues in Farmland. During the year ended 31 December 2018, BM Ltd produced 180,000 Kg of garlic at a production cost of K60 per kg. During the year ended 31 December 2018, BM Ltd incurred administration expenses amounting to K2,400,000. These expenses are all revenue in nature and allowable for tax purposes. Other costs incurred by BM Ltd during the year to 31 December 2018 were finance costs amounting to K700,000. The open market price of garlic during the year 2018 averaged FL$10 per Kg.

On 1 April 2018, BM Ltd obtained a loan of K1,500,000 from Garlic Ltd at an annual interest rate of 40%. BM Ltd has accounted for the interest payable to Garlic Ltd and is included in the finance costs figure of K700,000. On 1 April 2018 the open market rate of interest on loans from local lenders averaged 22%. BM Ltd has always maintained its gearing ratio below 50%. As a result of the loan from its parent, the debt to equity ratio for BM Ltd increased to 2:1.

For the purpose of taxation BM Ltd is classified as a farming company and pays Zambian income tax on its profits at a rate of 10%. The exchange rate during the tax year 2018 as quoted by the Bank of Zambia and approved by the Commissioner General averaged K10.50 per FL$1.

Required:

(a) Explain what is meant by transfer pricing and its international taxation consequences to the Government. (5 marks)

(b) Explain what is meant by thin capitalization and describe the taxation implications for the company that is thinly capitalized. (4 marks)

(c) Explain the tax consequences for BM Ltd to the Government of the following transactions:

(i) Transfer of goods to Garlic Ltd at a transfer price of FL$8. Justify your answer with calculations. (4 marks)

(ii) The loan obtained from Garlic Ltd at an interest rate of 40% per annum. justify your answer with calculations. (5 marks)

(d) Calculate the company income tax payable by BM Ltd for the tax year 2017.
(7 marks)

[Total: 25 marks]

<u>QUESTION THREE</u>

(a) The practice of international tax avoidance by multinational enterprises makes the government lose company tax revenue due to the shifting of profits and income from higher tax countries to low-tax countries. According to the OECD, international tax competition is lowering tax rates and making government expenditure more efficient worldwide. The OECD also reported that some countries have introduced harmful tax practices that encourage non-compliance with tax laws of other countries.

Required:

(i) Explain four (4) factors for the identification of tax havens as defined by the OECD. (8 marks)

(ii) Explain four (4) co-operations models between revenue authorities in order to work to their mutual benefit. (8 marks)

(b) Describe the origin principle and destination principle for indirect taxes as they apply in international taxation. (3 marks)

(c) Explain three (3) different ways in which a cross-border merger may be effected.
(6 marks)

[Total: 25 marks]

QUESTION FOUR

The Government of the Republic of Zambia (GRZ) recognises that foreign missions innovative policies for addressing the challenges of climate change and agribusiness offer an opportunity for economic diversification in Zambia with a positive impact on poverty reduction, creating more and better jobs, increased productivity and sustainable income. The Ministry of Commerce, Trade and Industry (MCTI), on behalf of the Government and working with other key Ministries such as Foreign Affairs, Mines, Agriculture and Livestock and Fisheries, has taken a leading role in this area.

A technical committee is currently reviewing the rules addressing Border Tax Adjustments (BTAs), tax treatment of foreign missions and taxation of Zambian residents with overseas business and investment income. The findings will form part of a detailed report which will be debated by Parliament. The necessary enabling legislation shall be passed to operationalize this strategy.

Christine Musa worked in a country called Blueland for three (3) years ending on 31 May 2018. She was paid an annual salary equivalent to K360,000. This was never paid through a Zambian bank account. Upon her arrival in Zambia on 1 June 2018, she started working for Copper Ltd, a Zambian resident company. She was entitled to an all-inclusive monthly salary of K50,000. On 4 October 2018, she bought a personal computer for K25,000, which she was required to use in the performance of the duties of employment. The agreed business use is 40%.

On 2 December 2018, she received foreign interest of K6,000, net of 20% withholding tax charged in Blueland. Income tax deducted from her emoluments for the charge 2018 totalled K101,975. Christine Musa made NAPSA contributions amounting to K17,500 during 2018.

The Commissioner General has agreed to give any available double taxation relief by unilateral credit relief, since there is no taxation agreement between Zambia and Blueland.

Required:

(a) (i) Explain the Border Tax Adjustments (BTAs) in accordance with OCED working party. (2 marks)

(ii) Briefly explain why BTA is somewhat a confusing term. (2 marks)

(iii) Explain the destination principle. (2 marks)

(b) Explain the tax treatment of foreign missions. (4 marks)

(c) Explain the tax treatment and calculation of income tax of resident individuals in Zambia with overseas business and investments. (6 marks)

(d) Calculate the final income tax paid by Christine Musa in the tax year 2018, and state the due date. (9 marks)

[Total: 25 marks]

END OF PAPER

D5: INTERNATIONAL TAXATION

SOLUTION ONE

(a) Double Taxation Agreements (DTA) and International Tax Avoidance (ITA).
Double Taxation Agreements (Treaties) are agreements between two states which are designed to:

1. Protect against the risk of double taxation where the same income is taxed in two states.
2. Provide certainty of treatment for cross-border trade and investment.
3. Present excessive foreign taxation and other forms of discrimination against business interests abroad.
4. Protect the government's taxing rights and protect against attempts to avoid or evade tax.
5. They also contain provisions for the exchange of information between national t axation authorities.
6. Seek to encourage and maintain an international consensus on cross-border economic activity and promote international trade and investment.

Tax avoidance is concerned with identifying any loopholes in the tax legislation, and using them to minimise or defer tax liabilities. It is, however, difficult to define tax avoidance more thoroughly. Tax avoidance is not an offence, though, to discourage its practice, Governments may issue anti-avoidance legislation.
International Tax Avoidance (ITA) in cross-border transactions is a growing problem for countries worldwide. With business becoming increasingly international, there is a greater need for coherent structures that facilitate cross-border transactions and help protect economies that are increasingly fragile and reliant on one another. An example of such a structure is the double tax treaty networks which are designed to prevent international double taxation.
However, Double Taxation Agreements (DTA) poses a particular problem. This is because they provide opportunities for taxpayers to avoid domestic tax obligations and receive undue benefits under the treaty.
This would be the case where someone acts through a company created in another country to obtain benefits that would not be available directly to the individual alone. International tax avoidance poses a threat to the integrity of domestic tax system and the flow of revenue governments receive from them.
Hence, to counter-act undesirable avoidance, countries do enact general and specific anti-avoidance rules to protect their domestic interests.

(b) Money laundering and Tax evasion.
Money laundering is the **generic term** used to describe the process by which criminals disguise the original ownership and control of the proceeds of criminal conduct by making such proceeds appear to have derived from a legitimate source.
Illegal arms sales, smuggling, and the activities of organized crime; including for example drug trafficking can generate huge amounts of proceeds. Embezzlement, insider trading, bribery and computer fraud schemes can also produce large profits and **create the incentive** to 'legitimise' the ill-gotten gains through money laundering.
Tax evasion is 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 taxpayers may engage in. Tax evasion is an offence and may be punishable by fines and/or imprisonment.

Money laundering has a negative impact on tax revenue. When a criminal activity generates substantial profits, the individual or group involved must find a way to control the funds **without attracting attention** to the underlying activity or the persons involved. Non- disclosure of any taxable profits is effectively money laundering. Criminals do this by disguising the sources, changing the form, or moving the funds to a place where they are less likely to attract attention. This generally makes it difficult for tax authorities to make **accurate tax assessment** and **collect the correct taxes.** Money launderers may also bribe the various enforcement officers.

(c) Dodgers International Ltd

Computation of excess of foreign tax over Zambian tax charge on foreign income for 2018

Foreign tax on foreign income 40/60 x K20,400 = K13,600

Zambian tax charge on foreign income (W1)

$\frac{34,000}{436,000}$ x 143,600 = K11,198

The double taxation relief is the lower of the foreign tax on foreign income of K13,600 and the Zambian tax charge on foreign income of K11,198. Hence, the double taxation relief is K11,198.

Excess of foreign tax over Zambian tax charge K13,600 – K11,198 = K2,402.

The excess of foreign tax over the Zambian tax charge of K2,402 represents the effect of a higher rate of foreign tax, and no further double taxation relief is available. **½**

Working

Zambia income tax charge

Dodgers International Ltd

	K
Tax adjusted business profit (400,000 – 34,000)	366,000
Foreign dividend (20,400 x 100/60)	34,000
Taxable income	400,000
Zambian income tax charge	
400,000 x 35%	140,000
WHT 36,000 x 10%	3,600
Total	143,600

Total assessment income K400,000 + K36,000 = K436,000

SOLUTION TWO

(a) Transfer pricing is the general term used to refer to the problem of allocating profits by a multinational enterprise among the parts of a corporate group.

This involves pricing of goods and services supplied within the group between the parent company and its foreign subsidiary or between two foreign subsidiaries.

Transfer pricing is used by companies with subsidiaries located in counties with lower tax rates (tax havens) to divert profits in order to lower tax liabilities of the group. It is necessary to allocate profits among the companies in the group because under international taxation norms a country will tax a non-resident company only on profits sourced in that country.

This would result in reduced taxable business profits and tax liabilities of the whole group and result in loss of significant amounts of tax revenue for the government.

Transfer pricing rules are enacted to act as anti-avoidance rules meant to protect tax revenues for the government. These rules prevent a company to transfer goods from one country to another at a price lower than the market price of those goods.

(b) Thin capitalization is when a company is financed by debt finance provided by a related company (parent or subsidiary) in excess of its arm's length borrowing capacity of that company.
The fact that interest is usually deductible for the borrower, when computing taxable business profits, excessive debt finance results in excessive interest expenses being charged to profits which reduces the taxable profits and tax liabilities.

In Zambia a company is thinly capitalized if its debt: equity ratio exceeds the standard ratio of 3: 1; meaning that the proportion of debt in the capital structure should exceed equity by more than 3 times for a company to be thinly capitalized.

If the company is thinly capitalized, as an anti-avoidance tax measure, the interest payable on the debt in excess of 3: 1 is added back to the taxable profits.

(c) Transfer pricing implications for BM Ltd are as follows:

(i) **Transfer of goods**

When BM Ltd transferred goods to Garlic Ltd for less than the market value, the taxable profits of BM Ltd reduced by the difference between transfer price and market price of the goods.
The difference is:

	K
Market price (180,000kg x 60% x \$10 x K10.50)	11,340,000
Transfer value (180,000kg x 60% x \$8 x K10.50)	(9,072,000)
Decrease in taxable profits	2,268,000

The difference of K2,268,000 should be added back when computing the taxable business profits for BM Ltd.

(ii) **Loan from Garlic Ltd**

When the loan is provided by a related party resident in a foreign country, the rate of interest on that loan should reflect the local market interest rates.

BM Ltd obtained a loan from its parent at an interest rate of 40% when the local lending rates on the market averaged 22%. This means that the taxable profits of BM Ltd would be reduced by the difference between the actual interest paid and the interest that they should have paid if the loan was borrowed from within Zambia.

The difference is:

	K
Actual interest paid (K1,500,000 x 40% x 9/12)	450,000
Interest based on market rates (K1,500,000 x 22% x 9/12)	(247,500)
Decrease in taxable profits	202,500

The decrease in Zambian taxable profits of K202,500 should be added back when computing the taxable business profits of BM Ltd.

(d) BM Ltd

Income tax payable for the tax year 2018

	K	K
Revenue (11,340,000 + (180,000 x 40% x $10 x K10.50)		18,900,000
2		
Less		
Cost of production (180,000kg x K60)	10,800,000	
1		
Administration expenses	2,400,000	
1		
Finance costs (K700,000 – K202,500)	497,500	
1		
		(13,697,500)
Taxable business profits		5,202,500
1		
Income tax @ 10%		520,250
1		

SOLUTION THREE

(a) (i) The following are the factors used to identify a tax haven:

- No or only nominal taxes
  It means that there is no or nominal tax on the relevant income, usually capital. This is the first necessary condition to identify a tax haven but it is not sufficient because a country may be competing fairly or adopting preferential regime.
- Lack of effective exchange of information
  Tax havens typically have in place laws or administrative practices under which businesses and individuals can benefit from strict secrecy rules and other protections against scrutiny by tax authorities thereby preventing the effective exchange of information on tax payers benefiting from the low tax jurisdiction.
- Lack of transparency
  Lack of transparency may be attractive for those who want to hide the origins of their income or keep them undeclared in their source countries. For example the details of the regime and/or its application are not apparent, or there is inadequate regulatory supervision or financial disclosure.
- No substantial activities
  The jurisdiction facilitates the establishment of foreign owned entities without the need for a local substantive presence. This is what makes doubtful how small islands can host billions of dollars in foreign direct investment if they apparently do not have the necessary resources to yield production.

(ii) The following are the cooperation models:

- Joint investigation teams. These enables agencies with a common interest to work together in an investigation. I t also enables an investigation team to draw on a wider range of skills and experience from investigations with different backgrounds and training.
- Inter-agency intelligence centers. These are typically established to centralize processes for information gathering and analysis for a number of agencies. They focus on a specific geographical area or type of criminal activity, or have a wider role in information sharing.
- Secondments and co-location of personnel. These are an effective way of enabling skills to be transferred while allowing personnel to build contacts with their counterparts in another agency.
- Shared databases, dissemination of strategic intelligence products such as newsletters and intelligence briefs, joint committees to coordinate policy in areas of shared responsibility.

(b) The origin principle for indirect taxation espouse that internationally traded commodities are taxed at the rates prevailing in the country where goods are produced, and this is the country receiving the tax revenue.
Under the origin principle, exports are taxed and imports are exempted, so that in equilibrium, the home country’s consumer must be indifferent between paying for domestically produced goods and for those imported.

The destination principle espouse that internationally traded commodities are taxed at the rates prevailing in the country where final consumption takes place, this being the country which obtains the tax revenue.

(c) A cross-border merger may be effected in the following ways:

i. Merger by absorption; whereby an existing company acquires all the assets and liabilities of its wholly owned subsidiary. On being dissolved and without going into liquidation, the subsidiary transfers all of its assets and liabilities to the parent.

ii. Merger by acquisition; whereby a company (other than a company formed for the purpose of the operation) acquires all of the assets and liabilities of another company in exchange for the issue to the members of the transferor company securities or shares in the acquiring company, either with or without cash payment.

iii. Merger by formation of new company; whereby two or more companies (on being dissolved without going into liquidation) transfer all of their assets and liabilities to a successor company that they form in exchange for the issue to their members of securities or shares representing the capital of that new company, with or without cash payment.

SOLUTION FOUR

(a) Border Tax Adjustments (BTAs) and their limitations.

i. According to the Organisation for Economic Cooperation and Development (OECD) Working Party, BTAs are any fiscal measures that put into effect the destination principle in whole or in part.

The OECD's careful treatment of BTAs illustrates that they are not a novel concept to international trade. However, BTAs have only recently been considered as an innovative policy option for addressing the challenges of climate change. The concept of climate change BTAs is as follows: carbon-taxing countries would levy import fees on goods that non-carbon-taxing countries manufacture. The motivating factor for these measures is – at least in theory – internalize the real costs of producing goods and services with respect to international climate change regulation, thereby leveling the playing field between producers of like products from different countries.

ii. The term 'Border Tax Adjustment' is somewhat confusing because it suggests that a fiscal measure is applied at the border, which is not always the case. Although in many cases imports are taxed on entry, certain countries apply a tax to imports after the goods have crossed the border and have been sold to other merchants or consumers. Moreover, the OECD has noted that certain tax systems do not tax exports at all and make no adjustment at the border. Considering these varying tax systems, the OECD Working Party has recommended the replacement of the term 'Border Tax Adjustments' with 'tax adjustments applied to goods entering into international trade'.

iii. The destination principle or basis espouses that internationally traded commodities are taxed at the rates prevailing in the country where final consumption takes place, this being the country which obtains the tax revenue. In other words, BTAs relieve exported products of some or all of the tax the exporting country charged on similar domestic products in the home market and enables the importing country to charge some or all of the tax on imported products that it charges on similar domestic products.

A BTA would tax imported goods the equivalent of what the producers would have had to pay to produce them in the home market they are entering. Under this system, domestic producers in countries with carbon taxes will not face costly climate change measures that foreign producers do not face in their home countries. An alternative approach would be to impose taxes on imported goods that are equivalent to the enforcement of emissions allowance trading. Therefore, in order to import products from a nation that does not comply with the carbon taxes applied in the importing country, an importer of goods would be required to purchase emission rights in his home country, compensating for the difference.

(b) Tax treatment of Foreign Missions

The purpose of the foreign office in any contracting state is to serve the diplomatic and consular communities stationed in the local country, and to control their activities. All services are based on the principal of reciprocity. In other words, no privileges are granted to foreign officials by the local country unless its diplomatic mission personnel receive the equivalent privileges in that country.

Foreign Office responsibilities include the Diplomatic Tax Exemption Program, which provides sales and use, occupancy, food, airline, gas and utility tax exemptions to eligible foreign officials on assignment in a foreign country.

Tax exemption privileges for foreign diplomats, consular officers, and staff members are generally based on two treaties; the Vienna Convention on Diplomatic Relations and the Vienna Convention on Consular Relations.

Not all foreign missions and their personnel are entitled to tax exemption, because the privilege is based on reciprocity and not all foreign countries grant such tax exemption to foreign embassies and their personnel.

(c) Tax treatment and calculation of income tax for residents with overseas businesses and investments.

Resident individuals with overseas businesses and investments will receive returns from their foreign investments in the form of interest, dividends and royalties. For purposes of their taxation, this income will be included in the word-wide income that the resident receives for taxation. Normally, these incomes will be taxed at source by way of withholding tax by the source country.

A resident individual may be required to pay tax both in the country of origin and the domestic country and will be able to claim relief – 'foreign tax credit relief' from double taxation.

World-wide income for residents will be taxed based on the tax rules obtaining in the country of residence of the individual. Personal allowances will be given to all individual taxpayers on a whole-year basis to any individual who is resident for part of or all of the tax year.

Confining personal reliefs to residents of a country does not infringe the nondiscrimination rules of tax treaties, which generally seek to ensure that residents and non-residents are treated alike under the tax law of the country.

The reliefs are recognised as part of the residence jurisdiction of the taxing country, so that residents and non-residents are not treated as being in the same circumstances, which is a threshold condition for the application of the nondiscrimination principle.

As tax treaties otherwise do not deal with personal reliefs, the tiebreaker rule in the tax treaty that addresses dual residence will not carry over into domestic law for this purpose. Hence, a dual resident will be entitled to the personal reliefs in more than one country, and a special rule in domestic law limiting entitlement to reliefs in such cases is necessary.

(d) Calculation of Personal Final Income Tax payable.

Christine Musa

Personal Final Income tax payable computation – 2018

	K	K
Salary (50,000 x 7)		350,000
Foreign interest (6,000 x 100/80)		7,500
		357,500
Less:		
Capital allowance (25% x 25,000 x 40%)		(2,500)
Taxable income		355,000
Income Tax		
First K39,600 x 0%		0
Next K9,600 x 25%		2,400
Next K25,200 x 30%		7,560
Balance K280,600 x 37.5%		105,225
		115,185
Less:		
Double Taxation Relief (DTR) (W1)		(1,500)
		113,685
Less:		
Tax already paid – PAYE		(101,975)
Final income tax payable		11,710

The due date for the payment of the final income tax is 21st June, 2019.

WORKING

Double Taxation Relief (DTR)

Lower of:

(i) Foreign tax paid on interest = K7,500 x 20% = K1,500

(ii) Zambian tax charge on foreign income =

$$\frac{\text{Gross foreign interest}}{\text{Total assessable income}} \times \text{Zambian tax charge}$$

$$= \frac{7{,}500}{355{,}000} \times 115{,}185 = \text{K}2{,}433$$

Therefore the DTR is K1,500, which is the lower amount

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D6: TAX AUDIT AND INVESTIGATIONS

MONDAY 10 DECEMBER 2018

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.

2. This question paper consists of **FOUR (4)** questions of Twenty Five (25) marks each. You must attempt all the **FOUR (4)** 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.

Taxation table for paper D6 – Tax Audits and Investigations (December 2018 Examinations)
Income Tax
Standard personal income tax rates

Income band	**Taxable amount**	**Rate**
K1 to K39,600	first K39,600	0%
K39,601 to 49,200	next K9,600	25%
K49,201 to K74,400	next K25,200	30%
Over K74,400		37.5%

Income from farming for individuals

K1 to K39,600	first K39,600	0%
Over K39,600		10%

Capital Allowances

Implements, plant and machinery and commercial vehicles:

Wear and Tear Allowance –	Plant used normally	25%
	Used in Manufacturing and Leasing	50%
	Used in farming and agro-processing	100%

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

Monthly turnover	**Turnover Tax per month**
K1to K4,200	3% of monthly turnover above K3,000
K4,200.01to K8,300	K225 per month+3% of monthly turnover above K4,200
K8,300.01 to K12,500	K400 per month+3% of monthly turnover above K8,300
K12,500.01 to K16,500	K575 per month+3% of monthly turnover above K12,500
K16,500.01 to K20,800	K800 per month+3% of monthly turnover above K16,500
Above K20,800	K1,025 per month+3% monthly of turnover above K20,800

Annual turnover	Turnover Tax per annum
K1to K50,400	3% of annual turnover above K36,000
K50,400.01to K99,600	K2,700 per annum+3% of annual turnover above K50,400
K99,600.01 to K150,000	K4,800 per annum +3% of annual turnover above K99,600
K150,000.01 to K198,000	K6,900 per annum+3% of annual turnover above K150,000
K198,000.01 to K249,600	K9,600 per annum+3% of annual turnover above K198,000
Above K249,600	K12,300 per annum +3% of annual of turnover above K249,600

Presumptive Tax for Transporters

Seating capacity	Tax per annum	Tax per day
	K	K
Less than 12 passengers and taxis	900	2.40
From 12 to 17 passengers	1,800	4.95
From 18 to 21 passengers	3,600	9.90
From 22 to 35 passengers	5,400	15.00
From 36 to 49 passengers	7,200	19.50
From 50 to 63 passengers	9,000	24.60
From 64 passengers and over	10,800	29.55

Property Transfer Tax

Rate of Tax on Realised Value of Land, Land and Buildings and shares	5%
Rate of Tax on Realised Value on a transfer of Intellectual Property	5%
Rate of Tax on Realised Value on a transfer or sale of a mining right	10%

Value Added Tax

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

Attempt all FOUR (4) questions.

QUESTION ONE

Justina Banking Ltd is resident in Zambia. During the tax year 2018, the company was visited by PAYE Audit Inspectors. The Managing Director knows that the Zambia Revenue Authority (ZRA) has the legal authority to audit any individual or business. However, he is not sure of the importance of the legal framework.
Justina Banking Ltd prepares its accounts to 31 December each year. The following summarised statement of profit or loss has been obtained from the Finance Director:

Justina Bank Ltd
Statement of profit or loss for the year ended 31 December 2018

	Notes	K'000
Interest income	1	54,590
Interest expense		(12,000)
Net interest income		42,590
Provision for loan losses	2	(7,340)
Net interest income after provision for loan losses		35,250
Non-interest income	3	5,000
Net interest and other income		40,250
Non-interest expenses	4	(14,250)
Income before taxes	5	26,000
Income tax expense		(7,000)
Income after tax		19,000

The following information is available:

1. Interest income
   Withholding tax deducted at source amounted to K1,500.
2. Provision for loan losses

This comprises the following:	K'000
Irrecoverable loans written off	3,340
Increase in specific provision for loan losses	6,000
Decrease in general provision for loan losses	(2,000)
Total	7,340

3. Non-interest income

This consists of the following:	K'000
Dividends from an unlisted Zambian company (net)	85
Unrealised trading gain	1,230
Royalties (gross)	1,000
Rental income (net)	175
Total	2,490

4. Non-interest expenses

This includes the following:	K'000
Depreciation	1,300
Loss on disposal of assets	5,400
Entertaining auditors	2,112
Employer NAPSA contributions	72
Other allowable business expenses	5,366
Total	14,250

5. The income tax expense represent the provisional income tax paid for the tax year 2018.
6. The only assets qualifying for capital allowances were as follows:

	Original cost	Income tax value 1 January 2018
	K'000	K'000
Purpose-built cash-in-transit van	400	300
Managing Director's personal-to-holder motor car (3000 cc)	600	360
ATM machines	15,120	7,560

No balancing charges or allowances arose on the disposal of assets.

Required:

(a) Briefly discuss the importance of the tax legal framework and state the key elements as it relates to the audit function. (3 marks)
(b) State four (4) possible reasons for PAYE Audit Inspections. (4 marks)
(c) Explain the issue of tax rebates relating to PAYE (3 marks)
(d) Calculate company final income tax payable by Justina Banking Ltd for the tax year 2018 and state the due date. (15 marks)

[Total: 25 marks]

<u>QUESTION TWO</u>

You are a Tax auditor in the Zambia Revenue Authority (ZRA) and have been assigned to conduct an investigation into tax liability of Bruno & Sons. The detail of the investigations concerns an outstanding dispute between the (ZRA) and Bruno & Sons. The financial statements for Bruno shows, a tax liability of K158m.
However this was different from K245m which ZRA had expected from Bruno & Sons. The dispute had dragged on for some time. This forced Bruno & Sons to obtain an injunction, restraining (Z.R.A), not to reposes and dispose of its assets.
During the planning meeting, the audit senior highlighted the need to use either a System based approach or a Risk based approach in order to carry out an in-depth tax investigation. Other issues that were discussed at the same meeting involved obtaining specific information that could be used and help to obtain evidence that management at Bruno Ltd could have hidden. Preliminary findings indicated that certain important records were not kept properly and this could have attracted penalties and fines under the Income Tax and VAT act.

Required:

(a) Explain four (4) differences between a system based and risk based approaches to a forensic investigation. (8 marks)
(b) Explain how a Tax auditor can verify information from third parties of Bruno & Sons (4 marks)
(c) State five (5) types of record that Bruno & Sons need to keep under the Income Tax and VAT ACT. (5 marks)
(d) Explain the difference between a tax audit and a tax investigation. (4 marks)
(e) Briefly explain the following tax audit terms:
    (i) Single issue audits (2 marks)
    (ii) Policeman theory (2 marks)

[Total: 25 marks]

QUESTION THREE

For the purpose of this question, assume that today's date is 31 December 2018.
Following the privatisation of the mining industry, the government has been receiving a number of requests for investments in this sector from different mining companies both within and outside Zambia. One of the companies that successfully set up its mining operations on the Copperbelt is Bine Mining Ltd. Like all mining companies, it expected that Bine Mining Ltd would abide by the mines and minerals Act of No 7 of 2008 of the laws of Zambia. The act defines what constitutes mining and gives guidance on the tax effects of certain transactions pertaining to the preparation of financial statements for the mining firms**.** Other details contained in the Mines and Minerals Act, explain how loans relationships with shareholders, Tax losses from mining operations and capital expenditure are treated in the financial statements of a mining company. In addition, Bine Mining Ltd maintains its financial statements in United States dollar. The exchange rate is the bank of Zambia mid-rate for December 2018 and Bine Mining Ltd's year-end accounting period is 31 December, 2018.
The exchange rate for 2017 was K9.24 USD and K10.24/USD on 31 December, 2018.

Required:

(a) Explain how the following items can be treated in the financial statements of Bine Mining Ltd. Calculations are required in part (ii) below:
- (i) Loan relationships with shareholders. (5 marks)
- (ii) Taxation of mining losses brought forward from 2017 which amounted to K102,000. (5 marks)

(b) Explain how the following are treated for tax purposes when a family extracts profit from their business:
- (i) Interest or rental income (1 mark)
- (ii) Pension contribution (2 marks)
- (iii) Salaries (2 marks)

(c) Explain the reasons for the introduction of separate reporting for capital expenditure for each mining company. (5 marks)

(d) Explain briefly the tax implication for the following types of leases:
- (i) Operating lease (3 marks)
- (ii) Finance lease (2 marks)

[Total: 25 marks]

QUESTION FOUR

Analle Ltd operates a retail store selling spares and accessories for the car market. Its annual turnover has averaged K672,000 and is not expected to exceed K720,000 in future. The company is currently under investigation by Zambia Revenue Authority (ZRA). The tax investigators have obtained the following information from management which they consider reliable and will be used to carry out further investigations:

1. In March 2018 the Cashier banked K46,000. This was less by K5,000 which was unaccounted for. The Cashier is on suspension and the case hearing will be held next week.
2. The balances for March 2018 were as follows:

	1 March 2018	31 March 2018
	K	K
Bank	4,000	4,400
Cash-in-hand	1,500	1,200
Receivables	2,200	3,140

3. The following expenses were paid out in cash from the till:

	K
Wages for casual workers	900
Bonus for George Mbulo*	4,000
Cleaning materials	720
Entertaining customers	880
Miscellaneous expenses	220

*George Mbulo earns a salary of K6,000 per month.

The accounting profit for March 2018 was K12,300 and tax paid was K1,380. The Managing Director is not willing to pay any additional taxes which may be revealed by the tax investigation.

Required:

(a) Explain three (3) main reasons for a Tax Investigation. (6 marks)

(b) Explain the following indirect audit techniques used to verify income.

(i) Source and application of funds method (2½ marks)

(ii) Bank deposits and cash expenditure method (2½ marks)

(c) Using the information given in the scenario, compute:
The correct turnover for Analle Ltd for March 2018. (11 marks)

(d) Explain any three (3) methods which the Zambia Revenue Authority (ZRA) could use to recover the additional revealed by a tax investigation. (3 marks)

[Total: 25 marks]

END OF PAPER

D6: TAX AUDIT AND INVESTIGATIONS - SOLUTIONS

SOLUTION ONE

(a) Legal framework

A tax audit is one of the most sensitive contacts between the taxpayer and a revenue body. The presence of an auditor in a taxpayer's private dwelling or business premises, coupled with the exploration of private and business issues and the gathering of information from taxpayer's books and records, or just the disruption of day-to-day workflow, represents a burden on the taxpayer and may be seen by some as an unwarranted intrusion into their affairs. Notwithstanding this, tax audits remain the only effective method for ascertaining additional facts or verifying provided information.

Legal frameworks are essential to provide integrity in the way tax administration carry out audits and to ensure that taxpayers' rights are properly protected. As such, in many jurisdictions the taxpayer may request a review of any proposed assessment or an explanation of the audits techniques used and adjustments being proposed. This request may be made to the revenue body or an independent third party body.

The key elements of such a legal framework as it relates to the audit function are:

- Taxpayer's record keeping obligations
- Giving tax officials access to taxpayers' books and records
- Giving tax officials access to third party information sources
- Obtaining information from other countries' revenue bodies
- Powers of revenue bodies to amend returns, and
- Sanctions for non-compliance

(b) PAYE Audit Inspection

The ZRA officials for the following possible reasons make the PAYE Audit Inspection visits. To provide clients, i.e., employers, with any information that might be relevant to the implementation and operation of a successful PAYE system

- To quantify outstanding taxes
- To charge tax penalties and interest on tax
- To provide tax education where necessary on the correct operation of PAYE
- To ensure that all payments which are supposed to be taxed are taxed and taxed correctly
- To calculate tax on emoluments which might have been left out on gross pay
- To ensure that employers are in compliance with their obligations, as required by law to deduct tax under PAYE on emoluments paid to their employees

(c) (i) Tax Rebates (Refunds)

Tax Rebates might occur under any of the following circumstances:

- Where an over deduction of PAYE has occurred
- Where an employee leaves employment during the charge year
- Where an employee makes a donation to an approved charitable Institution etc

Where any of the above possible circumstances has occurred, the taxpayer can approach the ZRA to make a Tax Rebate Claim. The Taxpayer in this case is required to complete the Income Tax Return (ITF 1A) accompanied by IFT/P13 (1) which is completed by the former employer.

Relevant points include:

- **Circumstances**
- **Tax rebate claim**
- **Completion of relevant forms**

(d) Company income tax computation

Justina Bank Ltd

Computation of taxable business profit - 2018

	K'000	K'000
Income before taxes		26,000
Add:		
Depreciation	1,300	
Loss on disposal of assets	5,400	
Entertaining auditors	2,112	
Personal-to-holder car	40	
		8,852
		34,852
Less		
Decrease in general loan provision	2,000	
Dividend	85	
Unrealised trading gain	1,230	
Royalties	1,000	
Rental	175	
Capital allowances (W1)	4,000	
		(8,490)
Taxable business profits		26,362

Computation of final company income tax payable - 2018

	K'000
Taxable profits	26,362
Royalties	1,000
Taxable income	27,362
Company income tax	
K27,362 x 35%	9,577
Less:	
WHT on interest income	(1,500)
WHT on royalties (1,000 x 15%)	(150)

Provisional income tax	(7,000)
Final company income tax payable	927

Due date 21 June 2019

Working

1. Capital allowances

	K
Purpose-built Cash-in-transit van	
K400,000 x 25% =	100,000
Managing Director's car	
K600,000 x 20% =	120,000
ATM machines	
K15,120,000 x 25% =	3,780,000
Maximum capital allowances	4,000,000

SOLUTION TWO

a) (i) A risk based audit refers to the application of audit techniques which are responsive to risk factors in a tax payer's environment, while a systems based approach uses audit techniques based on the assumption that the companies have internal control systems which will constitute or form a reliable base for the records and books for the tax payer.

(ii) In a risk based approach, the auditor applies judgement to determine what level of risk pertains to different areas of a client's system and then comes up with appropriate audit tests.

(iii) Risk based approaches can be cost effective as only selected areas that are based on risk analysis are undertaken, while system based , cover different systems internal controls such as IT system, financial accounting system or payroll systems.

(iv) Risk based approaches can be used in forensic audits so as to come up with recommendations that can prevent future occurrence of detected risks. The objective of a systems based approach is to assess the effectiveness of internal controls in tax payer's accounting system

(b) When conducting an audit, the auditor should consider all possible sources of information as some of it, comes from the tax payer's dealings with third parties. Thus the tax auditor can request the tax payer for information from suppliers and customers, to deliver or to make available for inspection any books and records or information and explanations in relation to the tax payer that may be relevant to the tax audit. The information that should be submitted must be relevant and material in determining the tax liability of a tax payer. They should provide information setting out the entire assets and liabilities on a specified date.

(C) (i) Source documents such as receipts, invoices, vouchers.

(ii) Accounting records either manual or electronic containing assets and liabilities, revenues and expenses.

(iii) Banks statements

(iv) Cash books

(v) Relevant journals.

(d) Tax audit is when an auditor carries out an inspection of the records kept by an organisation to justify the computation of the tax liability payable by the organisation, whereas a tax investigation is carried out by an auditor when there is suspicion of malpractices committed by an organisation.

(e) (i) Single issue audits:- Single issue audits are confined to one item of potential non-compliance that may be apparent from examination of a taxpayer's return. Given their narrow scope, single issue audits typically takes less time to perform and can be used to review large numbers of taxpayers involved in similar schemes to conceal non-compliance.

(ii) Policeman theory:- this theory claims that the auditor is responsible for searching, discovering and preventing fraud. In the early 20th Century this was certainly the case. However, more recently the main focus of auditors has been to provide reasonable assurance and verify the truth and fairness of financial statements.

SOLUTION THREE

(a)

(i) A debit or credit relating to a loan relationship maybe recognised in equity or shareholders' funds ,rather than in the profit and loss account (or income statement)or the statement of total recognised gains and losses or statement of changes in equity , if Bine Mining Ltd issued a perpetual debt which does not give creditors automobiles right to repayment and Bine Mining Ltd does not lose contractual right to handle or loses at a later date, under 1AS 32,it may be classified as equity in order to differentiate it from a financial liability. This means the interest paid will be treated as a dividend. However, for the purpose of taxation, the debt finance will be one representing a loan relationship, rather than interest.

(ii) When Bine Mining Ltd incurred a mining loss; it should be carried forward and relieved against future profits from mining business. The loss can be carried forward for a period of ten (10) years. In order to maintain the real values of losses in the mining sector, Bine Mining Ltd should use the indexation formula as indicated below:
Indexed loss =1+ [(R2- R1)/R1 X mining loss b/forward.
1+ (10.24-9.24)/9.24 x K102m =K113.04m
Since Bine ltd maintains its financials in dollars, the indexation allowance will be granted. This allowance is provided since the financial statements were maintained in kwacha.

(b) (i) When a member of a family has loaned money to the company or own property occupied by the company, the payment of interest or rent can be a way of extracting cash without incurring the additional cost, which would be payable on salary.

(ii) A family can make pension contribution into a member's scheme. This can be an efficient method of cash extraction of pension benefits. It will be taxed when they are drawn and the member might not be eligible to take cash out of a pension until some years down the line. However, the law, under section 37 of the Income Tax Act, provides for an exemption from tax on pension contribution to approved funds owned by Government or approved by ZRA.

(iii) This is a common idea of diverting income to another family member, perhaps a spouse or child who might be a non-or basic rate tax payer. To be defensible in the event of ZRA challenge, any individual's total remuneration package must be proportionate to the work performed for the company and an arm's length salary.

(c) (i) In computing taxable income from mining activities, capital expenditure is tax deductible at a rate of 25% of the original expenditure incurred on a mine that is in regular operations. However, the expenditure is restricted (ring-fenced) to respective mines were separate and distinct mining operations are carried out by a mining company in mines which are not contiguous. There is an exception were even if the mining operations are separate and distinct and the mining operations are not contiguous, then a mining qualifies to be an 'existing mine 'as defined by Income tax Act. An existing mine is defined as:

(1) Any mine that has a production commencement date before 1 April 2008
(2) Any mine that is not in regular production but whose development commenced before 1 April 2008, or
(3) A combination of (a) and (b)

Therefore capital expenditure relating to non-existing mines has to be reported in separate financial statement. This is meant to 'ring fence' costs of loss making mining from diluting profits from profit making mines of a company.

(d)(i) An operating lease agreement is similar to rental payments. In this case, the lessee has that right to use the asset in return for monthly lease payments over the life of lease. The lessor still owns the asset and capital allowances can only be claimed by the owner (landlord. The lessor is also responsible for the maintenance of the assets and any incidental expenses that are connected with the cost of operations of the same assets. Other expenses such as lease rentals, with include both capital and interest portions, are recorded as lessor's gross income.

(ii) Finance lease-a finance lease is an agreement which allows the legal ownership of the leased asset to be transferred from the lessor to the lessee on full payments of all lease payments. The acquirer or lessee of this asset is then allowed to claim capital allowances each year of assessment under the agreement.

SOLUTION FOUR

(a) Reasons tax investigation

Most tax investigations begin because the Zambia Revenue Authority (ZRA) has reason to believe that some aspect of the taxpayer's return or business accounts is wrong. Tax investigation can be carried out on taxpayers who do not submit returns but are in receipt of taxable income as this is also tax evasion.

They may have received a tip off, some figures in the tax return may not tally with other information they have, or the return may have been sent in late.

A tax investigation can also be part of a tax dispute. This means that either the taxpayer or ZRA does not agree with the amount of taxes paid or due. ZRA tries to resolve tax disputes without going to court and is open to discussion with the taxpayer and/or the accountant about his tax affairs. If a decision is made by ZRA tax officials and the taxpayer does not agree with the decision, it is possible to make an objection to the Commissioner General against the decision and if the taxpayer is still dissatisfied with the decision they may appeal in writing to the Tax Appeals Tribunal Tax (TAT).

(b) Indirect audit techniques used to verify income

In the SME sector, in particular, there is a greater risk that the auditor will see no clear audit trail or adequate records to support a proper calculation of the tax liability. Indirect methods of verification and recalculation of profits are therefore essential tools to bring audits to an effective conclusion. Some of the methods used include:

(i) Source and application of funds method (also known as the T – account method) – involves reconstructing income to determine the actual tax liability and is an analysis of a taxpayer's cash flows and comparison of all known expenditures with all receipts for the period. Net increases and decreases in assets and liabilities are taken into account along with non-deductible expenditures and non-taxable receipts. The excess of expenditures over the sum of reported and non-taxable income is unreported taxable income.

This method is based on the theory that any excess expenses items (applications) over income items (sources) represent an understatement of taxable income. Only the net increase or decrease in assets and liabilities are considered along with other expenditures and receipts.

The Source and Application of Funds Method is recommended in the following situations:

1. The review of a taxpayer's return indicates that the taxpayer's deductions and other expenditures appear out of proportion to the income reported

2. The taxpayer's cash does not all flow from a bank account which can be analysed to determine its source and subsequent disposition

3. The taxpayer makes it a common business practice to use cash receipts to pay business expenses

(ii) Bank deposits and Cash expenditure Method – computes income by showing what happened to a taxpayer's funds. It is based on the theory that if a taxpayer receives money, only two things can happen: it can either be deposited or spent. This method is based on the assumptions that:

1. Proof of deposits into bank account, after certain adjustments have been made for non-taxable receipts, constitutes evidence of taxable receipts

2. Outlays, as disclosed on the return, were actually made. These outlays could only have been paid for by credit card, cheque or cash. If outlays were paid by cash, then the source of that cash must be from a taxable source unless otherwise accounted for. It is the burden of taxpayer to demonstrate a non-taxable source for this cash

The Bank Deposit and Cash Expenditures Method can be used in the examination of both business and non-business returns. It may supply leads to additional unreported income, not only from the amounts and frequency of deposits, but also by identifying the sources of such deposits.

(c) Turnover, Difference in tax, Additional income tax and tax saving

(i) Turnover for March 2018

Correct Turnover	K
From receivables (W1)	46,940
Further cash sales from (W2)	11,420
Correct turnover for March 2018	58,360

Workings

1. Credit sales and part of the cash sales

Receivables Account

	K		K
Balance b/d	2,200	Cash banked	46,000
Sales	46,940	Balance c/d	3,140
	49,140		49,140

2. Further cash sales

Cash and Bank Account

	Cash	Bank		Cash	Bank
	K	K		K	K
Balance b/d	1,500	4,000	Under-banking	5,000	
Receivables		46,000	Wages for casual workers	900	
Cash sales			Bonus for George Mbulo	4,000	
(balancing figure)	11,420		Cleaning materials	720	
			Entertaining customers	880	
			Miscellaneous expenses	220	
			Other payments		45,600
			(Balancing figure)		
			Balance c/d	1,200	4,400
	12,920	50,000		12,920	50,000

Alternatively, further cash sales can be computed as follows:

	K
Payments in cash out of the till:	
Wages for casual workers	900
Bonus for George Mbulo	4,000
Cleaning materials	720
Entertaining customers	880
Miscellaneous expenses	220
	6,720
Under-banking	5,000
Closing balance of cash in hand	1,200
	12,920
Less: opening balance of cash in hand	(1,500)
Further cash sales	11,420

(d) Tax Recovery from defaulting taxpayers

Tax due from defaulting taxpayers is collected using one or more of following:

1. Firstly, an immediate demand letter is issued.
2. Secondly, if payment is not forthcoming, the following orders may be raised, one after the other:

(i) The Garnish Order – this is a recovery of tax through an agent. It is an order from the ZRA directing a third party, especially the tax payer's bankers, to withhold all or any part of the money/property belonging to the tax payer and to pay such money directly to the ZRA. Garnishment has so far proved to be the most controversial method.

(ii) Warrant of Distress – is where goods and/or chattels are removed immediately or later on and then disposed of by public auction. The proceeds are used to pay off the outstanding tax and the costs of the levy. This does not apply to goods/chattels of the state and statutory bodies like the Bank of Zambia and the Zambia Railways, whose enabling Act contains a protective clause.

(iii) Charge on land – this means lodging a caveat/charge on the land owned by the taxpayer so that land cannot be sold or transferred without ZRA's consent

END OF SOLUTIONS