Zambia Institute of Chartered Accountants

Competence, Integrity and Virtue

QUESTION AND ANSWER
FOR
JUNE 2019
TAXATION PROGRAMME PAPERS

TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C1: BUSINESS MANAGEMENT

MONDAY 10 JUNE 2019

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.
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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.

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THE INVIGILATOR.

Attempt all five (5) questions.

QUESTION ONE

(a) Effective communication is said to be a two way system. With the use of a diagram describe the communication process that guarantees effective communication. (12 marks)

(b) Identify and explain the four elements of a marketing mix. (8 marks)

[Total: 20 Marks]

QUESTION TWO

(a) Chabota is a Human Resource Consultant who has been engaged by Kozo Mining Company as a recruitment agent.

Required:

Explain the reasons for Kozo Mining Company engaging Chabota as a recruitment agent. (8 marks)

(b) Distinguish between data and information. (4 marks)

(c) Explain how the political and legal External Environmental factors affect business operations. (8 marks)

[Total: 20 Marks]

QUESTION THREE

(a) Define the term stakeholder and list three (3) examples of stakeholders. (8 marks)

(b) Explain the three (3) common characteristics shared by Zamtel, Times of Zambia and Zambia Revenue Authority that promote the achievement of organizational objectives.

(6 marks)

(c) Peter has chosen to open a Private Limited Company and has declared that all the affairs of the company, including the issuance of shares will be done according to his wishes because it is his money after all. Advise Peter on the major restrictions on ownership that are there in a private limited company. (6 marks)

[Total: 20 Marks]

QUESTION FOUR

(a) Using a Zambian example, explain how rationalization can destroy a company.

(8 marks)

(b) In reference to (4a - above) suggest how rationalization can be discouraged.

(3 marks)

(c) Ethics emphasize that organizational loyalty should not stand above the law and social morality. Explain the statement in terms of:

(i) Seller and buyer relationship

(i) Auditing

(ii) Corporate social responsibility

(9 marks)

[Total: 20 Marks]

QUESTION FIVE

(a) Management by objectives (MBO) is a process of setting mutually agreed upon goals and using them to evaluate employee performance. What are the four (4) elements of MBO? (4 marks)

(b) Suppose you are appointed as managing director of ZESCO, how would the following benefit you as manager and the organization as a whole:

(i) Focus and flexibility

(ii) Improved coordination

(iii) Better control (9 marks)

(c) Mukalula would like to enter into good partnership with his subordinates to improve productivity and the general welfare in the organization.

Define this type of partnership and explain to him the four (4) conditions identified by Block that would make this partnership valid. (7 marks)

[Total: 20 Marks]

END OF PAPER

C1 BUSINESS MANAGEMENT 2019 SUGGESTED SOLUTIONS

SOLUTION ONE

(a) Communication is defined as the giving, receiving or exchange of information or ideas by writing, speech or visual means. Effective communication means the receiver understanding the message and giving feedback. The following are the stages in the **Communication process**

This article throws light upon the five main processes of communication. The processes are: 1. Sender 2. Transmission 3. Noise 4. Receiver 5. Feedback.

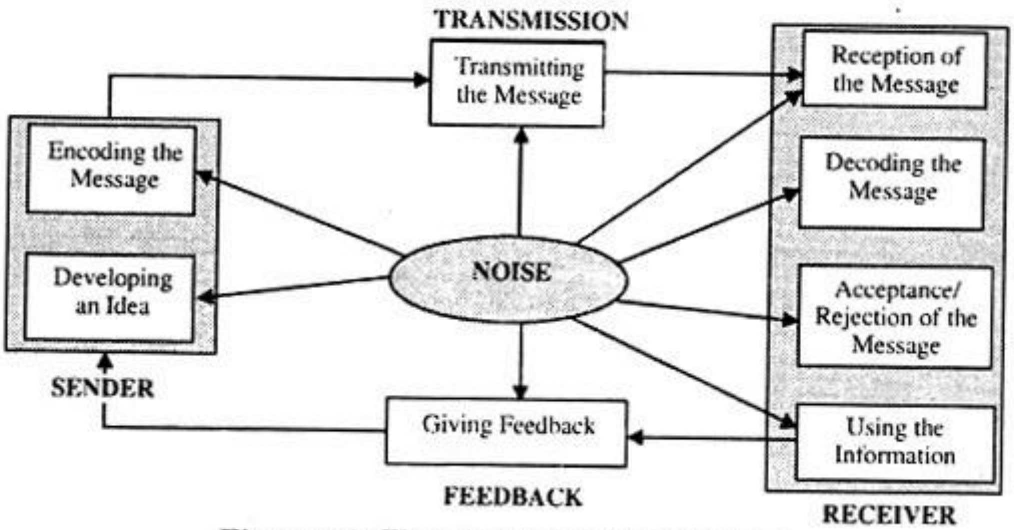

Figure 1.2: The Communication Process

i. **Sender:** This is the person who conceives the message to be transmitted to the party.

ii. **Encoding:** This is the translating of information to be transmitted into symbols that will be understood by the receiver. The symbols could be in the form of words, gestures or signs.

iii. **Channel:** This is the method of transmitting the message from the sender to the receiver such as a letter, telephone

iv. **Receiver:** This is the person who is the recipient of the message and encodes in order to understand and take necessary action.

v. **Decoding:** This is the process of interpreting the message and translating it into meaningful information by the receiver of a message.

vi. **Feedback:** This is the reply to the message that was sent after encoding it for the purpose of understanding.

(b) Marketing Mix Elements, also called the 4Ps are

i. **Product:** This is a good or service the business organization is offering to the target market. This will consists of quality, design, features, packaging etc
ii. **Price:** This is the amount of money customers are expected to pay for the goods or services. This will include list price, discounts, allowances, payment periods etc
iii. **Place:** This is the distribution channel that enables the goods to be readily available to the target market. This will include channel coverage, transport, warehousing etc
iv. **Promotion:** These are activities that communicate to customers on the benefits of the products on offer and persuade them to make a purchase. These activities are advertising, sales promotion, public relations and personal selling.

SOLUTION TWO

(a) **Reasons of Kozo Mining Company engaging Chabota as a recruitment Agent.**

(i) Because Chabota is an expert in human resource management therefore will employ the right workers for the vacant positions.
(ii) Because Kozo Mining Company has a human resource department which is not yet well established.
(iii) Using Chabota could be less costly
(iv) Because it's a foreign company not yet knowledgeable about the Zambian labour laws and market.

(b) **Data** this is unprocessed facts that have no meaning to the user. Therefore, it is raw in form. Examples are numbers, images

Information is processed data that is analyzed, interpreted to have meaning and useful for making decisions.

(c) Business decisions are strongly affected by new developments in the political environment. Political party in government formulates social and economic policies that affect the business operations. While the potential opposition parties also have political manifestos that spells out their social and economic ideologies. The stability in the political environment guarantees a stable business environment where business decisions are made with certainty. Government develops laws and regulations that governs on how business organizations must conduct their businesses. Laws are made to protect business organizations, consumers, the environment and employees. Business enterprises are expected to comply with several laws such as consumer protection laws, labor laws, company act, advertising laws etc.

SOLUTION THREE

a) Stakeholders of a business are sponsors, shareholders and all participants in the organization warfare. They all have an influence and are affected by the organization's decisions and actions.
These are:

Suppliers, Government, Media, Unions, Employees, Competitors, Customers and financial institutions.

b) The three common characteristics shared by Zamtel, Times of Zambia and Zambia revenue Authority are:
   i. Distinctive purpose- expressed in terms of goals and objectives the organization hopes to accomplish.
   ii. People- it is composed of people working together for a common purpose.
   iii. Deliberate structure-these are open and distinctive structures that enable people to work in clear work relationships with clear rule, regulations and job descriptions.

c) The following are the major ownership restrictions that are there in a private limited company:
   i. Shareholders cannot transfer their shares without offering them first to other shareholders for purpose,
   ii. Shareholders cannot offer their shares to the general public over a stock exchange
   iii. The number of shareholders cannot exceed a fixed figure (commonly 50).

SOLUTION FOUR

a) Rationalization for unethical: This is behavior convincing one -self that the unethical behavior displayed by some body is legal when it is not.

b) Rationalization of unethical behavior can be stopped by:

   i. When in doubt about a decision to be made or an action to be taken don't do it.
   ii. Look beyond short-run results to address longer term implications
   iii. Don't try to find out get convinced with factual evidence

c) *Seller and buyer:* all goods sold to customers must be of great standard to meet the value for money policy. And customers must be treated with respect and no deception in manufacturing of goods, and adverts weights etc.

   Auditing- there should be true representations of account statement and no cooking of books when giving such reports to those who may ask for them even for tax purposes.

   Corporate social responsibility means respect for all stakeholders and their needs and the general environment by keeping environmental sustainability in mind.

SOLUTION FIVE

a) The following are elements of MBO:

   i. Goal specificity
   ii. Participative decision making
   iii. An explicit time period
   iv. Performance feedback

b) The following are the benefits to the manager and organization:

   i. Focus and flexibility- it will help the subordinates and managers to remain attentive to the goals and objectives of the organization and flexibility will enable them to respond favorably to changes in the environment. This will lead to high productivity and great order in the organization.
   ii. Improved coordination- this is key to the development of personal talent as well as departmental contribution. It also encourages the spirit of unity and direction which are key to the development and success of an organization.
   iii. Better control-control of both human behavior and processes is very important in running of company affairs at all levels in order to improve efficiency and effectiveness. The benefit is that the manager will manage with much ease leading to order and high profitability.

c) Partnership according Block occurs when shifts from the leader to the group member, in a move from authoritarianism and towards shared decision making.

   The following are the four (4) things identified by Block that make partnership to exist.

   i. Exchange of purpose
   ii. A right to say no
   iii. Joint accountability
   iv. Absolute honest

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C2: ECONOMICS & FINANCIAL MATHEMATICS

TUESDAY 11 JUNE 2019

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

INSTRUCTIONS TO CANDIDATES

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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.

DO NOT OPEN THIS QUESTION PAPER UNTIL YOU ARE INSTRUCTED BY THE INVIGILATOR.

Attempt all five (5) questions.

QUESTION ONE

(a) Explain the withdrawals from the circular flow of income in the economy?

(6 marks)

(b) Describe any four (4) weaknesses of using National Income as a measure of economic welfare in a country (8 marks)

(c) Determine the equilibrium level of income (Y) and consumption (C), assuming a hypothetical consumption function and a given level of investment (I).

$$C = 100 + 0.75Y$$
$$\mathrm{I} = 200$$

(6 marks)

[Total: 20 Marks]

QUESTION TWO

(a) Explain any four (4) functions of money. (8 marks)

(b) Does a country always become better off when it has more money? Explain your answer (2 marks)

(c) Compare and contrast import tariffs and import quotas (Give any two (2) points) (2 marks)

(d) Explain any four (4) canons of taxation as given by Adam Smith and highlight their relevance to the Zambian tax system. (8 marks)

[Total: 20 Marks]

QUESTION THREE

(a) How long will it take a sum of money to double if it earns 4.5% annual interest, compounded quarterly (use logarithms) (6 marks)

(b) How much interest is earned in 12 years if K200 is deposited at the end of each month in a bank account that pays 12% interest compounded monthly? (6 marks)

(c) Determine the total interest charged (finance charge) on a 36 months K25,000 loan with monthly payments if interest is at a rate of 12% compounded monthly.

(6 marks)

(d) Define the term 'yield curve' (2 marks)

[Total: 20 Marks]

QUESTION FOUR

(a) A marketing professor at a large university is interested in the relationship between hours spent studying and total points earned in a course. Data collected on 10 students who took the course last semester is shown in the table below.

Hours Spent Studying	45	30	90	60	105	65	90	80	55	75
Total Points Earned	40	35	75	65	90	50	90	80	45	65

Compute the least–squares regression equation showing how total points earned is related to hours spent studying. (8 marks)

(b) According to the Central Statistical Office 40% of business travellers carry either a cell phone or a laptop. In a sample of 15 business travellers:

(i) What is the probability that exactly three (3) have a cell phone or laptop? (2 marks)

(ii) What is the probability that 12 of the travellers have neither a cell phone nor a laptop? (2 marks)

(iii) What is the probability that at least three (3) of the travellers have a cell phone or a laptop? (4 marks)

(iv) Airline passengers arrive randomly and independently at the passenger screening facility at a major international airport. The mean arrival rate is 10 passengers per minute.

(a) What is the probability of no arrivals in a 1 minute period? (2 marks)

(b) What is the probability that there are exactly three arrivals in a 1 minute period? (2 marks)

[Total: 20 Marks]

QUESTION FIVE

(a) Define the following terms:

(i) Annual Percentage Yield (APY) (1 mark)

(ii) Yield To Maturity (YTM) (1 mark)

(b) Mrs Sibeso invested K51,200 with an urban bank at 4.15% annual interest compounded monthly. Find the equivalent annual percentage yield (APY). (4 marks)

(c) 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? (4 marks)

(ii) Calculate the net present value of this investment, assuming 8% discount rate compounded annually. Is the investment worthwhile? (4 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)

[Total: 20 Marks]

END OF PAPER

C2 ECONOMICS & FINANCIAL MATHEMATICS SUGGESTED SOLUTIONS

SOLUTION ONE

(a) There are three withdrawals from the circular flow of income, namely

- Savings. Not all income received is spent, some of it is saved.....
- Taxation. Some of the income is paid to the government as tax....
- Imports. These are expenditures in another country, therefore withdrawing funds out of a country.....

(b) National income is considered to be a poor measure of economic welfare in a country for the following reasons

- It does not take into account how the national income is spent, whether it is in defence, by-elections e.t.c which does not affect the welfare of the people
- No allowance for inflation is made
- It is subject to double counting
- It does not take into account the social costs
- Incomplete information
- Does not take into account size of the population, hence the need to calculate the per capital income
- Unpaid services e.g. of a housewife, a mechanic repairing own car etc....

(c) For a closed economy, the equilibrium is $Y = C + S$

Since $S = I$ the equilibrium is $Y = C + I$

Substituting	$Y = 100 + 0.75Y + 200$
Like terms on one side	$Y - 0.75Y = 100 + 200$
Therefore	$0.25Y = 300$
Dividing both sides by 0.25	$0.25Y \div 0.25 = 300 \div 0.25$
	$Y = 1200$

SOLUTION TWO

a) The existence of money is essential to the working of the modern economy. This is because money serves functions that are important to the modern society. The functions of money are:

- Money as a medium of exchange: Money facilitates the exchange of goods. Buyers and sellers meet and trade easily without the convenience of the barter system.
- Money as a unit of account: Money acts as a common measure of the unit of account for goods and services. Money makes possible the operation of the price system.
- Money as a store of value: Money is the most convenient way of keeping income. Money is a store of wealth and can be converted almost immediately into a medium of exchange without loss of value.
- Money as a means for deferred payments: Money makes possible for payments to be deferred from the present to some future date. Borrowing and lending are simplified.

b) A country will not necessarily become better off when it has more money. What is more important is to have the increase in money supply with the productivity of the country so that there is not "too much money chasing too few goods", that is, inflation.

c) The following are the differences between tariffs and import quotas:

- A tariff is a tax on an import while a quota just limits the quantity of imports
- Tariff revenues accrue to the government while gains from a quotas accrue to importers
- Both are protectionist measures to restrict international trade
- Imports can continue flowing into the country under a tariff but for quotas, once the quotas is reached no more can be allowed

d) The following are the canons of taxation given by Adam Smith:

- **Equity:** This requires that taxes should be fair and should depend on an individual's ability to pay. This implies that the tax burden should be distributed according to people's ability to pay. Adam Smith thought that proportional taxes would satisfy this criterion, but nowadays it is generally accepted that progressive taxes are the most equitable type of tax. The argument is based on the idea that the principle of diminishing marginal utility applies to income. Capital gains tax was introduced on grounds of equity. It was felt that a capital gain tax obtained by speculation in share or commodity markets should be subject to taxation in the same way as income earned on the factory floor.
- **Certainty:** This is concerned with the amount to be paid, how where and when it should be paid. Taxpayers must know these in advance to avoid being cheated by tax collectors. A taxpayer should be able to assess his/her tax liability from information provided and should not be subject to tax demands made in an arbitrary fashion. In theory, the Zambian tax system satisfies these requirements – all necessary information is available to taxpayers, but the tax laws have become so complex and extensive that it is sometimes difficult for an average man to be certain of all his rights and responsibilities

- **Convenience**: Taxes must be collected in a convenient form and at a convenient time. The Pay As You Earn (PAYE) system of tax collection is probably the most convenient method in general use.
- **Economy:** The costs of collection and administration should be small in relation to the total revenue. This requirement often conflicts with that of equity. The "fairest" system of taxation would involve casting the net so widely and carefully that collection costs would be disproportionately high.

SOLUTION THREE

a) Let p be the initial investment and 2p be the terminal amount.

$$2p = p\left(\frac{1 + 0.045}{4}\right)^{4t}$$

$$2p = p\,(1 + 0.01125)^{4t}$$

$$\frac{2p}{P} = \frac{p\,(1.01125)^{4t}}{p}$$

$$2 = (1.01125)^{4t}$$

Taking logarithms on both sides.

$$|n\,(2) = 4t\,|n\,(1.01125)$$

$$4t = \frac{|n\,(2)}{|n\,(1.01125)} = \frac{0.69314718}{0.011187189}$$

$$4t = 61.95901222$$

$$t = 15.48975306$$

$\approx$ 15 years.

b) Here R = K200; r = .12/12 = 0.01; n = 12 x 12 = 144; S = ?

Using $S = \frac{R((1 + r)^n - 1)}{r} = \frac{200(1.01)^{144}}{0.01}$ = K63,812.31

Total Interest = K63,812.31 – 200(144)

= K63,812.31 – K28,800 = **K35,012.31**

c) Here A = K25 000; r = 0.12/12 = 0.01; n = 36; R = ?

Using $R = \frac{Ar}{(1 - (1 + r)^{-n}} = \frac{25\ 000(0.01)}{(1 - (1.01)^{-36}} = K830.36$

Finance Charge = nR –A = 36(830.36) – 25 000 = **K4 892.96**

d) A yield curve is simply a graphical depiction of the relationship between the yield on a class of securities for different securities.

SOLUTION FOUR

(a)

SN	x	y	x^2	xy	y^2
1	45	40	2025	1800	1600
2	30	35	900	1050	1225
3	90	75	8100	6750	5625
4	60	65	3600	3900	4225
5	105	90	11,025	9450	8100
6	65	50	4225	3250	2500
7	90	90	8100	8100	8100
8	80	80	6400	6400	6400
9	55	45	3025	2475	2025
10	75	65	5625	4875	4225
	$\sum x = 695$	$\sum y = 635$	$\sum x^2 = 53,025$	$\sum xy = 48,050$	$y^2 = 44,025$

$$\bar{x} = \frac{\sum x}{n} = \frac{695}{10} = 69.5$$

$$\bar{y} = \frac{\sum y}{n} = \frac{635}{10} = 63.5$$

$$SS_{xx} = \sum x^2 - \frac{\left(\sum x\right)^2}{n} = 53,025 - \frac{695^2}{10} = 4,722.5$$

$$SS_{xy} = \sum xy - \frac{\left(\sum x\right)\left(\sum y\right)^n}{n} = 48,050 - \frac{(695)(635)}{10} = 3,917.5$$

$$SS_{yy} = \sum y^2 - \frac{\left(\sum y\right)^2}{n} = 44,025 - \frac{635^2}{10} = 3,702.5$$

$$\hat{\beta}_1 = \frac{SS_{xy}}{SS_{xx}} = \frac{3917.5}{4722.5} = 0.83$$

$$\beta_0 = \bar{y} - \hat{\beta}_1\bar{x} = 63.5 - 0.83(69.5) = 5.82$$

The regression equation is given by
$\hat{y} = \hat{\beta}_0 + \hat{\beta}_1 x = 5.82 + 0.83x$

i.e. $\hat{y} = 5.82 + 0.83x$

(b)

i. We assume a Binomial distribution with parameters

$n = 15, p = 0.4$ and $q = 0.6$

$$P(X = x) = \binom{n}{x} p^x (1-p)^{n-x}$$

$$P(X = 3) = \binom{15}{3} (0.4)^3 (0.6)^{15-3}$$
$$= 0.0634$$

ii. Those customers who have either a laptop or a cellphone are three. So, 12 do not have. Therefore, we subtract the probability of the three who have from 1. Therefore, the required probability is

$$1 - 0.0634 = 0.9366$$

iii. $$P(X \geq 3) = 1 - P(X < 3)$$
$$= 1 - [P(X = 0) + P(X = 1) + P(X = 2)]$$

$$= 1 - \left[\binom{15}{0}(0.4)^0 (0.6)^{15} + \binom{15}{1}(0.4)^1 (0.6)^{14} + \binom{15}{2}(0.4)^2 (0.6)^{13}\right]$$

$$= 1 - [0.0005 + 0.0047 + 0.0219]$$
$$= 1 - 0.0271$$
$$= 0.9729$$

(c)

i. We assume a Poisson distribution with parameter $\lambda = 10$.

$$P(X = x) = \frac{e^{-\lambda}\lambda^x}{x!}$$

$$P(X = 0) = \frac{e^{-10}10^0}{0!} = 0.000045$$

ii. $$P(X = x) = \frac{e^{-\lambda}\lambda^x}{x!}$$

$$P(X = 3) = \frac{e^{-10}10^3}{3!} = 0.0076$$

SOLUTION FIVE

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- Taxation. Some of the income is paid to the government as tax....
- Imports. These are expenditures in another country, therefore withdrawing funds out of a country.....

(b) National income is considered to be a poor measure of economic welfare in a country for the following reasons

- It does not take into account how the national income is spent, whether it is in defence, by-elections e.t.c which does not affect the welfare of the people
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- It does not take into account the social costs
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- Does not take into account size of the population, hence the need to calculate the per capital income
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(c) For a closed economy, the equilibrium is $Y = C + S$

Since $S = I$ the equilibrium is $Y = C + I$

Substituting	$Y = 100 + 0.75Y + 200$
Like terms on one side	$Y - 0.75Y = 100 + 200$
Therefore	$0.25Y = 300$
Dividing both sides by 0.25	$0.25Y \div 0.25 = 300 \div 0.25$
	$Y = 1200$

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C3: ACCOUNTANCY FOR TAX PRACTITIONERS

MONDAY 10 JUNE 2019

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Attempt all five (5) questions in this paper.

QUESTION ONE

Sebenza PLC has provided you with the following trial balance for the year ended 30 September 2018.

Details	DEBIT	CREDIT
	K'000	K'000
Ordinary share capital (2,000,000 shares)		20,000
5% Preference share capital		6,000
Retained profit as at 1 October 2017		2,220
General Reserve		4,000
Purchases and Sales	96,500	125,470
Opening inventory as at 1 October 2017	1,300	
Land and buildings: cost (Land: K15,000,000)	20,000	
Accumulated depreciation		1,500
Motor vehicles: cost	13,000	
Accumulated depreciation		4,680
Equipment: cost	6,400	
Accumulated depreciation		1,600
Furniture and fittings: cost	4,600	
Accumulated depreciation		1,200
Trade receivables and payables	6,800	8,000
10% debentures		4,600
Administration expenses	5,550	
Selling and distribution expenses	4,630	
Finance expenses	230	
VAT payable		400
Bad debts	100	
Provision for doubtful debts		300
Dividend paid – preference shares	150	
- Ordinary shares	100	
Cash and cash equivalent	20,610	
TOTALS	179,970	179,970

You are also provided with the following additional information.

1. The company's policy is to depreciate non-current assets on cost as follows:
   - Buildings 10% on cost
   - Motor vehicles 20% reducing balance
   - Equipment 25% on cost
   - Furniture and fittings 15% on cost
2. Closing inventory was valued at K800,000 on 30 September 2018.
3. A further K200,000 trade receivables was found irrecoverable at 30 September 2018 and a provision of doubtful debts 5% should be made on the closing balance.

4. Adjustments on 30 September are required for the following expenses:
   - Electricity accrued K60,000
   - Insurance prepaid K54,000
5. Provision for income tax for the current year is K800,000.
6. The following were approved on 30 December 2018:
   - Increase the general reserve by K100,000
   - Pay a final dividend of 10 ngwee per ordinary shares held and the balance of preference dividend.
7. Provision should be made for outstanding debenture interest for the year ended 30 September 2018.

Required:

(a) Prepare the statement of profit or loss for the year ended 30 September 2018.

(9 marks)

(b) Prepare the statement of financial position as at 30 September 2018.

(11 marks)

[Total: 20 Marks]

QUESTION TWO

The Draft financial position provided below relates to Boomerang Limited, a firm specialized in manufacturing building tiles for the year ended 30 September, 2018. Boomerang Limited is a VAT registered trader.

The Accountant of Boomerang Limited has prepared the draft statement of financial position below but has left out a number of items because he is not sure about their accounting.

Boomerang Limited Statement of Financial Position as at 30 September, 2018.

	K	K
Non – Current asset:		
Property		500,000
Machinery		200,000
		700,0000
Current Assets:		
Inventory	35,000	
Receivables	60,000	
Bank	25,000	120,000
Total assets		820,000
Equity and Liabilities:		
Share capital K1		100,000
Share Premium		300,000
Retained profit		236,500
		636,500
Non - Current assets:		
10% Loan notes		120,000
Current Liabilities:		
Trade payables	40,000	
Tax payable	23,500	
		63,500
Total equity and liabilities		820,000

Additional information:

1. The land element in the total value of property is K100,000. The remaining amount relates to buildings and is depreciated at the rate of 5% per annum. This property was purchased exactly one year ago. At 30 September 2018, management decided to revalue the property to K700,000.

2. Machinery is depreciated at the rate of 20% per annum.

3. At the year end, it was discovered that the closing inventory contained a line of slow moving items which cost the company K1,500. These items will now only be sold at a net realizable value of K1,000 only.

4. During the year the company made a one for every five bonus issue on existing shares using the share premium account. This development was not accounted for by the new accountant.

5. The 10% loan note in the draft Statement of Financial Position was obtained on 1 October, 2014. The loan note is due for repayment on 30 September, 2018. No interest has been paid on the loan notes.

6. In September, 2018 management declared a dividend of 20 ngwee per share.

7. The provisional tax for the year is to be increased by K6,300.

Required:

(a) Prepare the adjusted revised retained earnings of Boomerang Limited for the year ended 30 September, 2018. (7 marks)

(b) Prepare the adjusted Statement of Financial Position as at 30 September, 2018. (13 marks)

[Total: 20 Marks]

QUESTION THREE

The following is a summary of the receipts and payments of the Miniview Rotary Club during the year ended 31 July 2018:

Miniview Rotary Club

Receipts and payments Account for the year ended 31 July 2018

	K		K
Cash and bank balance b/f	21,000	Secretarial expenses	16,300
Sales of competition tickets	43,700	Rent	140,200
Members subscripting	198,700	Visiting speaker expenses	127,500
Donations	17,700	Donations to charities	3,500
Refund of rent	50,000	Prizes for competitions	27,000
Balance c/f	1,300	Stationery and printing	17,900
	332,400		332,400

The following information is also available:

As at 31 July	2017	2018
	K	K
Equipment (cost K142 000)	97,500	78,000
Subscriptions in arrears	6,500	8,500
Subscriptions in advance	1,000	3,700
Owing to suppliers of competition prizes	5,800	6,800
Inventory of competition prizes	3,800	4,600

Required:

(a) Calculate the value of the accumulated fund of the Miniview Rotary Club as at 1 August 2017. (4 marks)

(b) Reconstruct the following accounts for the year ended 31 July 2018:

(i) The subscriptions account. (3 marks)
(ii) The competition prizes account. (3 marks)

(c) Prepare an income and expenditure account for the Miniview Rotary Club for the year ending 31 July 2018 and a statement of financial position as at 31 July 2018. (10 marks)

[Total: 20 Marks]

QUESTION FOUR

(a) You are an accountant at MJM Limited and you have been given the following list of items relating to the receivable and payable control accounts for the year ended 30 September, 2018:

	K
Receivable ledger control balance brought forward – 01.10.2017	4,500
Payable ledger control balance brought forward – 01.10.2017	3,000
Total sales (including cash sales of K5, 000)	55,000
Total credit purchases	35,000
Discount allowed	1,450
Discount received	1,700
Contra	6,000
Dishourned cheque paid on behalf of a supplier	2,100
Refund to supplier	4,800
Payments made to credit suppliers	17,000
Receipts from credit customers	32,000
Returns outwards	4,500
Returns inwards	10,050
Receivable ledger control balance carried down – 30.09.18	5,000
Payable ledger control balance carried down – 30.09.18	15,700

Required:

Write up the receivable and payable ledger control accounts for the year ended 30 September, 2018. (8 marks)

(b) The information provided below relates to Gulas manufacturing entity:

Details	K
Direct Labour	6,500
Work in progress – 1 July 2015	9,000
Work in progress – 30 June 2016	12,000
Raw material Purchases	99,000
Supervisors salary	20,000
Opening stock – raw materials	5,500
Closing stock – raw materials	3,500
Royalties	7,000
Electricity	3,800

Additional information:

1. Electricity accrued during the accounting period amounted to K950.
2. Management wishes to transfer the manufactured goods to the trading account at market value by adding a profit mark up of 40% to the cost of production.

Required:

(i) Calculate the cost of production for Gulas manufacturing enterprises (6 marks)

(ii) Calculate the market value of the manufactured goods. (2 marks)

(iii) Explain two differences between a merchandise and a manufacturing business. (4 marks)

[Total: 20 Marks]

QUESTION FIVE

BBB an electrical goods wholesaler, has three departments: Music, TV and Kitchen. The following is a summary of BBB's sales invoices during the first week of February 2018:

DATE	CUSTOMER	INVOICE NO.	DEPARTMENT	LIST PRICE LESS TRADE DISCOUNT	VAT	TOTAL
				K	K	K
Feb 1	M. Longo	403	TV	19,500	3,120	22,620
Feb 2	F. Rhodah	404	Music	5,500	880	6,380
Feb 3	M. Tubu	405	TV	4,900	784	5,684
Feb 5	T. John	406	Kitchen	2,050	328	2,378
Feb 7	F. Rhodah	407	TV	8,300	1,328	9,628
Feb 7	M. Longo	408	Music	12,200	1,952	14,152

The VAT rate 16%.

Required:

(a) Record the above transactions in a columnar book of original entry and post to the general ledger in columnar form. (11 marks)

(b) Write up the personal accounts in the appropriate ledger.
NB: Do not balance off any of your ledger accounts. (3 marks)

(c) From the information below for the year 2018, calculate the closing inventory that would be shown using FIFO, LIFO and AVCO methods: (6 marks)

	Bought	Sold
March	200 @ K200 each	December 240 @ K300 each
September	100 @ K220 each	

[Total: 20 Marks]

END OF PAPER

C3 ACCOUNTANCY FOR TAX PRACTITIONERS SOLUTIONS

SOLUTION ONE

a) SEBENZA PLC

STATEMENT OF PROFIT OR LOSS FOR THE YEAR ENDED 30 SEPTEMBER 2018

	K'000	K'000
Sales		125,470
Cost of sales (W1)		(97,000)
Gross profit		28,470
Administrative expenses (W2)	10,340	
Selling and distribution expenses	4,630	(14,970)
Operating profit		13,500
Finance expenses (W3)		(460)
Profit before tax		13,040
Income tax charge for year		(800)
Profit after tax		12,240

b) STATEMENT OF FINANCIAL POSITION AS AT 30 SEPTEMBER 2018

	K'000	K'000
Non-current assets:		
Property, plant and equipment (W4)		30,566
Current assets:		
Inventory	800	
Receivables (W5)	6,270	
Prepayments	54	
Cash and cash equivalents	20,610	
		27,734
Total assets		58,300
Capital and liabilities:		
Equity:		
Ordinary share capital		20,000
Preference share capital		6,000
General reserves (W6)		4,100
Retained profit (W7)		13,760
		43,860
Non-current liabilities:		
10% Debentures		4,600
Current liabilities:		
Trade payables	8,000	
Accruals (W8)	640	
VAT Payable	400	
Income tax payable	800	
		9,840
Total equity and liabilities		58,300

WORKINGS:

	K'000
W1. Cost of sales	
Opening inventory	1,300
Purchases	96,500
	97,800
Closing inventory	(800)
	97,000
W2. Administration expenses	
As per TB	5,550
Add: accrued electricity (note 4)	60
Less: prepaid insurance (note 4)	54
Depreciation: Buildings 5,000 x10%	500
Motor vehicles (13,000 – 4,680)x20%	1,664
Equipment 6,400 x 25%	1,600
Furniture & fittings 4,600 x 15%	690
Bad debts 100(TB) + 200 (note 3)	300
Increase in doubtful debt (W6)	30
	10,340
W3. Finance expenses	
Annual debenture interest 4,600 x 10%	460
Interest paid as per TB	230
Interest accrued as at 30/9/18	230

W4. Non-current assets

	Land	Buildings	M/vehicles	Equipment	F&F	Total
	K'000	K'000	K'000	K'000	K'000	K'000
Cost	15,000	5,000	13,000	6,400	4,600	44,000
Depreciation:						
Bal. 1.10.17	-	1,500	4,680	1,600	1,200	8,980
Depn (W3)	-	500	1,664	1,600	690	4,454
Bal. 30.9.18	-	2,000	6,344	3,200	1,890	13,434
NBV	15,000	3,000	6,656	3,200	2,710	30,566

W5. Trade receivables and provision for doubtful debt	K'000
Trade receivables as per trial balance	6,800
Less bad debt (note 3)	200
Balance as at 30/9/18	6,600
Doubtful debts provision 1/10/17 as per TB	300
Provision for doubtful debts 30/9/18 (6,600 x 5%)	330
Increase in provision	30
Trade receivables 30/9/18 (6,600-330)	6,270

W6. General reserves

As per TB 1/10/17		4,000
Transfer from retained profit (note 6)		100
Balance 30/9/18		4,100

W7. Retained profits

Balance as per TB		2,220
Add: profit for the year		12,240
Less: transfer to general reserve	100	
Less: preference dividend - interim paid(TB)	150	
- Final dividend^	150	
Ordinary dividend – interim(TB)	100	
- Final proposed*	200	(700)
Balance 30/9/18		13,760

^Preference dividend: 6,000 x 5% x ½ year

*Ordinary dividend 2,000,000 shares x 10n/ share

W8. Accruals

Electricity expense	60	
Interest on debentures (W3)	230	
Dividends payable (150 + 200) (W7)	350	640

SOLUTION TWO

(a) Boomerang revised Retained earnings

	K
Draft Retained earnings	236,500
Depreciation:	
Buildings (40,000*5%)	(20,000)
Machinery (200,000*20%)	(40,000)
Loss inventory valuation (1,500 -1,000)	(500)
Finance cost (120,000*10%)	(12,000)
Dividends (K120,000/K1*K0.2)	(24,000)
Additional Tax	(6,300)
	133,700

	K	K
Non-Current assets:		
Property at revalued amount		700,000
Machinery (200,000 - 40,000)		160,000
		860,000
Current assets:		
Inventory (35,000 – 500)	34,500	
Receivables	60,000	
Bank	25,000	
		119,500
Total assets		979,500
Equity and liabilities:		
Share capital (100,000 + 20,000)		120,000
Share premium (300,000 - 20,000)		280,000
Revaluation surplus		220,000
Retained earnings		133,700
		753,700
Current Liabilities:		
Payables	40,000	
Loan note	120,000	
Interest payable	12,000	
Tax	29,800	
Dividends	24,000	
		225,800
Total equity and liabilities		979,500

W1	K
Property	500,000
Depreciation (500,000-100,000)*5%	(20,000)
	480,000
Revaluation increase Balancing figure	220,000
New value	700,000

W2	K
Cost	200,000
Depreciation (200,000*20%)	(40,000)
CV	160,000

Bonus Issue	
1/5*100,000 *K1	20,000
DR Share premium	20,000
CR Share capital	20,000

SOLUTION THREE

(a) Accumulated funds 1st August 2017

	K	K
Equipment		97,500
Inventory of prizes		3,800
Arrears of subscriptions		6,500
Cash and bank		21,000
		128,800
Less: Subscriptions in advance	1,000	
Prize suppliers	5,800	
		(6,800)
		122,000

(b) (i) Subscriptions

		K			K
In arrears	b/d	6,500	In advance	b/d	1,000
In advance	c/d	3,700	Cash		198,700
Income and expenditure		198,000	In arrears	c/d	8,500
		208,200			208,200

(ii) Competition prizes

		K			K
Inventory	b/d	3,800	Accounts payables b/d		5,800
Cash		27,000	Inventory	c/d	4,600
Accounts payable	c/d	6,800	Cost of prizes given		27,200
		37,600			37,600

(c) Miniview Rotary Club
Income and Expenditure Account for the year ending 31st July 2018

Income:	K	K
Subscriptions		198,000
Ticket sales	43,700	
Less: cost of prizes	(27,200)	
		16,500
Donations received		17,700
		232,200
Less: Expenditure		
Rent (140,200 – 50 000)	90,200	
Visiting speakers expenses	127,500	
Secretarial expenses	16,300	
Stationery and printing	17,900	
Donations to charities	3,500	

Depreciation (97,500 – 78,000)	19,500	274,900
Excess of expenditure over income		42,700

Statement of financial position as at 31 July 2018

Non-current assets:	**K**	**K**
Equipment at cost	142,000	
Less: depreciation	64,000	78 000
Current assets:		
Inventory of prizes	4,600	
Arrears of subscriptions	8,500	13, 100
		91, 100
Current liabilities:		
Account payable for prizes	6,800	
Advance subscriptions	3,700	
Bank overdraft	1,300	(11,800)
		79,300
Accumulated funds:		
Balance 01 August 2017		122,000
Less excess of expenditure over income		42,700
		79,300

SOLUTION FOUR

Receivable ledger control account

	K		K
Balance b/f	4,500	Discount allowed	1,450
Sales (55,000-5,000)	50,000	Contra	6,000
		Bank	32,000
		Returns inwards	10,050
		Balance c/f	5,000
	54,500		54,500

Payable ledger control account

	K		K
Discount Received	1,700	Balance b/f	3,000
Contra	6,000	Purchases	35,000
Bank	17,000	Dishonoured cheque	2,100
Returns out	4,500	Refund	4,800
Balance c/f	15,700		
	44,900		44,900

(b) (i) Gulas Manufacturing account

	K	**K**
Opening inventory – Raw materials	55,00	
Purchases	99,000	
	104,500	
Less closing inventory – Raw materials	(3,500)	
Inventory consumed in production		101,000
Direct labour		6,500
Direct expenses – Royalties		7,000
Prime cost		114,500
Overheads		
Supervisors salary	20,000	
Electricity (3,800 + 950)	4,750	24,750
		139,250
Add: opening work in progress		9,000
Less: closing work in progress		(12,000)
Production cost		136,250

(ii) Transfer to Trading account K

Cost	136,250
Add: profit mark up at 40%	54,500
Market value	190,750

(iii)

- A merchandise business principally trades with finished goods only, but a manufacturing entity trades with raw materials, work in progress and finished goods.

- A merchandise business cost of sales largely constitutes purchases of inventory, but a manufacturing concerns cost of sales is largely based on the cost of production.

SOLUTION FIVE

(a) Columnar Sales Day book

DATE	2018	INV.NO.	TOTAL	VAT	MUSIC DEPT'	TV DEPT'	Kitchen. DEPT'
			K	**K**	**K**	**K**	**K**
Feb 1	M. Longo	403	22,620	3,120		19,500	
2	F. Rhodah	404	6,380	880	5,500		
3	M. Tubu	405	5,684	784		4,900	
5	T. John	406	2,378	328			2,050
7	F. Rhodah	407	9,628	1,328		8,300	
7	M. Longo	408	14,152	1,952	12,200		
			60,842	8,392	17,700	32,700	2,050

General ledger

Sales

	Feb 7	Music	TV	Kitchen.
		K	**K**	**K**
	2018 Total	17,700	32,700	2,050

Value Added Tax

	Feb 7	K
	2018 Sales	8,392

(b)

M. Longa

	K		K
Feb 1 sales	22,620		
7 sales	14,152		

F Rhodah

	K		K
Feb 2 sales	6,380		
7 sales	9,628		

M Tubu

	K		K
Feb 3 sales	5,684		

T John

	K	K
Feb 5 sales	2,378	

(c) FIFO closing inventory
60 x K220 = K13 200

LIFO inventory after each transaction

	RECEIVED	**ISSUED**	**K**	**Inventory after each transaction**	**K**
March	200 x 200				40 000
September	100 x 220				22 000
					62 000
December		100 x 220	22,000		
		140 x 200			
			78,000		(50,000)
Closing inventory				60 x 200	**12,000**

AVCO

	Received	**issued**	**Average cost per unit held**	**No. of Units inventory**	**Total value**
March	200 x 200		K200	200	K40 000
September	100 x 220		K206.67	300	K62 000
December		240	K206.67	60	K12 400

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C4: DIRECT TAXES

WEDNESDAY 12 JUNE 2019

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.

DO NOT OPEN THIS QUESTION PAPER UNTIL YOU ARE INSTRUCTED BY THE INVIGILATOR.

Taxation table

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	5.5% of norm value
From US$4,500 to less than US$6,000	6.5% of norm value
From US$6,000 to less than US$7,500	7.5% of norm value
From US$7,500 to less than US$9,000	8.5% of norm value
From US$9,000 and above	10% of norm value

Mineral Royalty on other minerals

Type of mineral	Mineral Royalty Rate
Base Metals (Other than Copper, Cobalt and Vanadium)	5% on norm value
Cobalt and Vanadium	8% of 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 4%

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%

Attempt ALL FIVE (5) questions.

QUESTION ONE

Monde and Nambe have been running a partnership business of manufacturing and selling iron sheets to the construction sector. The profits and losses are shared in the ratio 2:3 after allowing for annual partners' salaries of K45,000 each. The partnership's financial statements are prepared to 31 December yearly.

On 1 April 2019, Maputo was admitted to the partnership and with effect from that date the partnership agreement was changed as follows:

	Monde		Nambe		Maputo
Annual salaries	K34,000		K32,000		K30,000
Share of profits and losses	5	:	3	:	2

The statement of profit or loss for the year ended 31 December 2019 is as follows:

		K	K
Gross profit			1,388,590
Less expenses			
Professional and legal fees	(note 1)	125,110	
Rent and rates	(note 2)	84,290	
Repairs and renewals	(note 3)	15,880	
Electricity	(note 4)	32,840	
Gifts and entertainment	(note 5)	25,800	
Salaries & wages	(note 6)	123,460	
Other expenses	(note 7)	48,800	
Bad debts	(note 8)	17,140	
Total expenses			(473,320)
Net profit			915,270

The following notes have been given:

Note 1: Professional fees and legal fees

The professional fees were as follows:	K
Costs of preparing the income tax return	23,200
Legal fees in connection with acquisition of land	40,370
Legal fees in connection with a court action for not complying with environmental and safety legislation	35,970
Legal fees for recovery of loans relating to former employees	10,450
Legal fees for recovery of bad debts relating to trade debts	15,120
	125,110

Note 2: Rent and rates

One quarter of the expenditure for rent and rates relate to the houses occupied by the three partners and their families.

Note 3: Repairs and renewals

Of this expenditure, K6,250 was incurred on fitting the security cameras around business premises.

Note 4: Electricity and water

	K
Water for partners' houses	10,920
Electricity and water for the factory	11,200
Electricity for partners' houses	10,720
	32,840

Note 5: Gifts and entertainment	K
Entertaining suppliers	12,600
Gifts to customers of food hampers (costing K80 each)	13,200
	25,800

Note 6: Salaries & wages

Included in salaries and wages are partners' salaries paid as follows:

	K
Monde	10,350
Nambe	4,080
Maputo	9,030
	23,460

Note 7: Other expenses	K
Sundry allowable expenses	16,250
Donation to PMD, a political party	15,100
Theft of money by a manager	17,450
	48,800

Note 8: Bad debts	K
Increase in general provision for bad debts	12,440
Loan to former employee written off	16,200
Loan to former employee previously written off now recovered	(11,500)
	17,140

Note 9: Implements, plant and machinery

The partnership owns the following assets qualifying for capital allowances:

Asset	Purchase cost (K)	Date brought into use
Toyota Chaser	65,720	1 June 2015
Motor Van	46,570	1 Jan 2016
Toyota Corolla	49,040	1 May 2017
Computers	18,350	1 Oct 2018

Laptops	12,420	1 March 2019

All of the above assets are used wholly and exclusively in the partnership business except for the motor van and computers which are used by the partners for private purposes as follows:

Motor van	25%
Computers	30%

Required:

(a) Calculate the tax adjusted business profit for the partnership for the year ended 31 December 2019. (13 marks)

(b) Calculate the business profits on which each partner will be assessed for the year ended 31 December 2019. (7 marks)

[Total: 20 Marks]

QUESTION TWO

Kapotwe, a sole trader, has been in business for a number of years supplying assorted products both on cash and credit basis. The statement of profit or loss for the year ended 31 December 2019 is as follows:

		K	K
Gross profit			950,150
Less expenses			
Depreciation		10,300	
Rent and rates	(note 1)	57,500	
Repairs and renewals	(note 2)	15,880	
Utility expenses	(note 3)	34,200	
Legal expenses	(note 4)	28,300	
Salaries and wages	(note 5)	39,100	
Entertainment	(note 6)	59,600	
Bad debts	(note 7)	18,300	
Miscellaneous expenses	(note 8)	113,500	
Total expenses			(376,680)
Net profit			573,470

The following notes have been given:

Note 1: Rent and rates

One quarter (¼) of the expenditure for rent and rates relates to the houses occupied by Kapotwe and his family.

Note 2: Repairs and renewals

This includes K10,450 incurred on the second hand motor car. These repairs were necessary in order to put the car into a usable state. As at 31 December 2019, the motor car was still under repair and is expected to be brought into use in the month of March 2020. The remaining balance was incurred to remedy normal wear and tear of capital assets used for business purposes.

Note 3: Utility expenses

	K
Water bills for business premises	12,400
Electricity for business premises	10,500
Water & electricity for Kapotwe's residence	11,300
	34,200

Note 4: Legal and professional fees

	K
Legal fees in connection with acquisition of land	13,600
Legal fees in connection with recovery of loans from former employee	14,700
	28,300

Note 5: Salaries and wages

	K
Kapotwe's nominal salary	17,200
Employees' salaries	21,900
Total charge	39,100

Note 6: Gifts and entertainment

	K
Entertaining employees	17,400
Gifts of shopping vouchers given to customers (worth K200 each)	11,600
Entertaining suppliers	13,900
Entertaining customers	16,700
	59,600

Note 7: Bad debts

	K
Trade debts written off	21,000
Decrease in specific provision for bad debts	(8,800)
Increase in general provision for bad debts	11,300
Loan to former employee written off	17,200
Trade debts previously written off now recovered	(12,200)
Loans to former employee previously written off now recovered	(10,200)
	18,300

Note 8: Miscellaneous expenses

	K
Travelling from home to place of trade	41,500
Interest on overdue tax	34,600
Leasing and hire charges for assets used in the business	22,900
Interest on bank overdraft	14,500
	113,500

Note 9: Capital allowances have been agreed at K100,000

Required:

(a) Calculate the tax adjusted business profit for the Kapotwe for the tax year 2019. (9 marks)

(b) Calculate the final income tax payable by Kapotwe for the tax year 2019. (3 marks)

(c) Provisional income tax is one of the taxes paid by the Zambian taxable persons. The tax payer estimates this tax and pays it by the due dates to the Zambia Revenue Authority.

Required:

(i) Describe the types of taxable persons who are required to pay provisional income Tax. (4 marks)

(ii) Explain how Provisional Income Tax for the tax year 2019 should be calculated. (2 marks)

(iii) State the due dates for payment of provisional income tax for the tax year 2019. (2 marks)

[Total: 20 Marks]

QUESTION THREE

(a) An individual is required to pay tax to the Zambia Revenue Authority if he or she is resident and ordinary resident in Zambia.

Required:

(i) Explain the criteria used to determine whether an individual is resident and ordinary resident for tax purposes in Zambia. (2 marks)

(ii) List any four (4) persons who are resident and ordinary resident in Zambia but are exempted from the Zambian Income Tax. (2 marks)

(iii) Explain the meaning of the term domicile. (2 marks)

(b) Companies, like individuals, pay tax to the Zambia Revenue Authority (ZRA) if they are resident in Zambia. Zambian company income tax is only charged on such companies.

Required:

Explain the two (2) tests that the Zambia Revenue Authority uses to determine whether or not a company is resident in Zambia for tax purposes. (3 marks)

(c) The following company situations are given to you for expert tax advice:

(i) Ziko Limited is a company that was incorporated in Zambia. This is the headquarters of the company. The board of directors meet every week in a country called Mumba where the company has six (6) branches. (2 marks)

(ii) Mwansa Limited is a company that was incorporated in a country called Democratic Republic of Zumba. The company's board of directors hold its weekly meetings in a country called Duko. The company's major operations are in Zambia. (2 marks)

(iii) Mwami Sugar Estates is a company that is engaged in the growing of Sugar. The company was incorporated in a country called Mambo but it has a branch in Zambia. The board of directors hold its weekly meetings in Zambia and hold a meeting at least once in a year in Mambo. (2 marks)

Required:

Explain whether each of the above companies is resident in Zambia for taxation purposes.

(d) Turnover tax is one of the taxes that some tax payers pay in Zambia.

(i) State the type of income on which turnover tax is chargeable. (2 marks)

(ii) Describe the types of persons who are required to pay turnover tax. (2 marks)

(iii) State the due date for the payment of turnover tax. (1 mark)

[Total: 20 Marks]

QUESTION FOUR

(a) The Property Transfer Tax Act Cap 340 provides for a charge of Property Transfer Tax on the transfer of property. Property transfer tax is chargeable on the realised value of property that is transferred.

Required:

(i) Explain what constitutes property for property transfer tax purposes. (2 marks)

(ii) List any four (4) organisations that are exempted from paying property transfer tax. (2 marks)

(iii) List any four (4) documents that have to be provided for a property transaction to take place. (2 marks)

(b) Mervis had the following transactions for the tax year 2019:

(i) Sold 150,000 ordinary shares of K1.50 each in Zambezi Plc for K350, 000 on 30 June 2019. Zambezi Plc was listed on the Lusaka Securties Exchange in September 2018.

(ii) Sold a farming plot in Mkushi farming block for K350, 000, which was the open market value on 1 September 2019 which was bought from a prominent farmer in the same area on 15 February 2013 at a cost of K200,000.

(iii) Sold 1,500,000 ordinary shares of K1.00 each in Ndeke Ltd for K2, 000,000 on 17 March 2019. She bought these shares in the company in June 2017 immediately the company commenced operations.

(iv) Sold 350,000 ordinary shares of K1.00 each in Shoplight Plc for K400, 000 on 30 June 2019. Shoplight Plc was listed on the Lusaka Securities Exchange in September 2016.

Required:

Calculate the amount of any property transfer tax arising on each one of the above transactions and state the due date when it should have been paid. (4 marks)

(c) Governments throughout the world need money to run government activities. There are several other ways other than taxation through which the Government can raise revenue to fund government operations and capital projects.

Required:

Explain any four (4) sources of revenue for the central government apart from taxation. (4 marks)

(d) In order to establish whether a trade exists, the Zambia Revenue Authority considers Several considers several factors commonly known as the badges of trade.

Required:

Explain the six (6) badges of trade. (6 marks)

[Total:20 Marks]

QUESTION FIVE

(a) Briefly explain the meaning and tax treatment of premium income received in relation to rental income. (3 marks)

(b) Briefly explain how income of a tax payer is treated in the unfortunate case of the taxpayer passing on in a particular tax year. (3 marks)

(c) Charles Chideke who is now fifty-nine (59) years of age, has been employed as Operations and Business Development Manager on a renewable three (3) years contract, which is basically renewable at his own request because of his long good standing with the company. His current three-year contract is due to expire on 31 October, 2019. And it is now his intention that at the end of the current contract he will not be requesting for a renewal of the contract and instead wishes to venture into a trading business. According to his feasibility study, the project will require a start-up capital of about K400,000 which he expects to raise from his savings and terminal benefits.

The terms of his current employment contract are as follows:

(i) Monthly basic salary of K45,000
(ii) Housing allowance per year of K78,000
(iii) Medical allowance of K4,000 per month
(iv) School fees allowance for his three minor children of K300 per child per month
(v) 25% gratuity on his cumulative basic salary
(vi) Quarterly education allowance of K8,400

In addition to the above, Charles was paid a long service award on 1 February 2019, in the form of a deep freezer costing K11,000.

Up to the end of his current contract, Charles made the following payments in the tax year 2019:

Donation to a political party of K4,000
Subscriptions to a professional body relevant to his job of K8,500
Donations to approved public benefit organization of K4,500
NAPSA contributions of K8,500
Approved pension scheme of K28,000
PAYE of K66,800
Medical expenses of K49,000.

Required:

(i) Calculate the final income tax payable by Charles for the 2019 tax year. (12 marks)
(ii) Calculate his take away package from the gratuity at the end of his contract. (2 marks)

[Total: 20 Marks]

END OF PAPER

C4: DIRECT TAXES SUGGESTED SOLUTIONS

SOLUTION ONE

(a) Monde, Nambe and Maputo

Tax adjusted business profit for the tax year 2019.

		K	K
Net profit as per accounts			915,270
Add:			
Legal fees in connection with acquisition of land		40,370	
Legal fees for violating environmental and safety legislation		35,970	
Legal fees for recovery of loans relating to former employees		10,450	
Rent and rates ¼ x K84, 290		21,073	
Repairs and renewals- fitting security cameras		6,250	
Water for partners' houses		10,920	
Electricity for partners houses		10,720	
Entertaining suppliers		12,600	
Gifts to customers of food hampers		13,200	
Partners' salaries:			
Monde		10,350	
Nambe		4,080	
Maputo		9,030	
Donation to PMD, a political party		15,100	
Theft of money by a manager		17,450	
Increase in general provision for bad debts		12,440	
Loan to former employee written off		16,200	
			246,203
			1,161,473
Less:			
Loan to former employee previously written off now recovered		11,500	
Capital allowances:			
Toyota Chaser 20% X K65, 720		13,144	
Motor Van	(25% X K46,570) X 75%	8,732	
Toyota corolla (20% X K49, 040)		9,808	
Computers	(25% X K18, 350) x 70%	3,212	
Laptops	(25% X K12, 420)	3,105	
			(49,501)
Taxable business profit			1,111,972

(b) Computation of assessable business profit for partners for the year ended 31 December 2019.

	Total	Monde	Nambe	Maputo
	K	K	K	K
01/01/2019-31/03/2019				
Salaries (3/12)	22,500	11,250	11,250	-
Balance (2:3)	255,493	102,197	153,296	-
3 months profit	277,993	113,447	164,546	-
01/04/2019-31/12/2019				
Salaries (9/12)	72,000	25,500	24,000	22,500
Balance (5:3:2)	761,979	380,989	228,594	152,396
9 months profit	833,979	406,489	252,594	174,896
Total	1,111,972	519,936	417,140	174,896

SOLUTION TWO

(a) **Kapotwe**

Adjusted business profits for the tax year 2019.

	K	K
Net profit as per accounts		573,470
Add:		
Depreciation	10,300	
Rent and rates ¼ x K57, 500	14,375	
Repairs and renewals- second hand motor car	10,450	
Kapotwe's nominal salary	17,200	
Water & electricity for Kapotwe's residence	11,300	
Legal fees- acquisition of land	13,600	
Legal fees- recovery of loans	14,700	
Gifts given to customers	11,600	
Entertaining suppliers	13,900	
Entertaining customers	16,700	
Increase in general provision for bad debts	11,300	
Loan to former employee written off	17,200	
Travelling from home to place of trade	41,500	
Interest on overdue tax	34,600	
		238,725
		812,195
Less:		
Capital allowances		(100,000)
Loans to former employees		(10,200)
Adjusted business profit		701, 995

(b) **Kapotwe**

Income tax payable for the tax year 2019

	K	Tax rate	K
Taxable amount	701,995		
First	(39,600)	0%	0
Sub-total taxable	662,395		
Next	(9,600)	25%	2, 400
Sub-total taxable	652,795		
Next	(25,200)	30%	7, 560
Balance taxable	627,595	37.5%	235,348
Total tax payable			245,308

(c) Provisional income tax

i. The types of taxable persons who are required to pay provisional income tax are:

- Individuals whose taxable income is above K39,600, where such income does not consist only of emoluments taxable under the PAYE system and also not covered by turnover tax
- Limited companies and other taxable bodies of persons which are expected to make profits where turnover tax is not applicable.

ii. The tax payer should estimate the taxable income at the start of the tax year in order to calculate provisional income tax for the tax year 2019.

The estimated taxable income would be the provisional taxable income for the tax year 2019.

Provisional income tax would then be computed on the provisional taxable income at the tax rate applicable in the tax year 2019.

iii For the tax year 2019, the dates when provisional income tax is payable is the end of each quarter of the tax year, but the Commissioner General gives a grace period of 10 days after the end of the quarter to which it relates.

Installment	Due date	Grace period
First	31 March 2019	10 April 2019
Second	30 June 2019	10 July 2019
Third	30 September 2019	10 October 2019
Fourth	31 December 2019	10 January 2020

SOLUTION THREE

(a) Taxable persons

(i) Residence

Individuals who normally live in Zambia are resident and ordinarily resident in Zambia.

Individuals who come to Zambia with the intention of remaining here for more than 12 months are deemed to be resident and ordinarily resident in Zambia from the date of arrival.

(ii) Persons resident and ordinary resident in Zambia but exempted from the Zambian Income Tax are:

- The Republican President on the Income received as President.
- Chiefs on income received from the government.
- Local Authorities.
- Approved Funds.
- Commonwealth Development Corporation
- Club, Society or association organised and operated only for social welfare or recreation, and improvement etc., if its income may not be received in any way by a member or shareholder.
- Registered trade Unions
- Political parties registered as a statutory society under the societies Act
- Other Persons listed in Part III of the second schedule of the Income Tax Act

(iii) Domicile

This concept relates to the place which an individual refers to as the permanent home. A person is domiciled in the country that is his or her permanent home. The two types of domicile are domicile of origin and domicile of choice.

(b) The criteria that the Zambia revenue Authority would use to determine whether a company is resident in Zambia for income tax purposes are:

(i) A company is resident in Zambia if it is formed or incorporated in Zambia.

(ii) If not incorporated in Zambia, a company is still Zambian resident if it is effectively managed in Zambia. A company is effectively managed in Zambia if its board of directors or other Central management board holds its meetings in Zambia. Primarily, a company's residence status for taxation purposes is determined using the incorporation test.

(c) The residences of the various companies, determined using the criteria explained in part (b) above are as follows:

(i) Ziko Limited is resident in Zambia as that is the country where it is incorporated. This is despite the fact that its business operations are carried out in a country called Mumba.

(ii) Mwansa Limited is resident in the Democratic Republic of Zumba as that is where it is incorporated. This is despite the fact that the company' Directors hold weekly meetings in Duko and that the company's major business operations are in Zambia.

(iii) Mwami Sugar Estates is resident in the country of Mambo as that is where it is incorporated. This is despite the fact that the board of directors holds its meeting in

Zambia, in most cases.

(d) Turnover tax

(i) Turnover tax is chargeable on earnings, income, revenue, takings, yield and proceeds.

(ii) Types of persons who are required to pay turnover tax are:

- All persons carrying on a business with an annual turnover of K800, 000 and less.

- All persons whose income consists of amounts, which are subjected to withholding tax, where withholding tax is not the final tax, provided the total income is not over K800,000 per annum**.**

(iii) The due date for the payment of turnover tax is on the 14th day following the end of the month to which the tax relates.

SOLUTION FOUR

(a) Property transfer tax

(i) Property constitutes the following:

i. Land, including any structure on it.
ii. Buildings, including any improvement thereon
iii. A share issued by a company incorporated in the Republic of Zambia which is not listed on Lusaka Stock Exchange
iv. Any mining rights
v. Any intellectual property

(ii) Organisations that are exempt from PTT are

i. Government of the Republic of Zambia
ii. Any foreign government
iii. Local authorities
iv. Registered trade unions
v. Registered political party
vi. Registered co-operative
vii. Registered club or association
viii. Approved pension fund or medical Aid Scheme
ix. Approved employee's savings scheme or fund.

(iii) Four documents that have to be provided for a property transaction to take place are:

- NRC/ certificate of incorporation of both the buyer and seller
- State/council
- Seller's TPIN
- Contract of sale/deed of gift or transfer
- Layers stamp when dealing as an advocate of either party
- Order of appointment of administrator/court order for all deceased cases
- Valuation report for all transactions involving amounts exceeding K500 000.

(b) The property transfer tax is as follows:

i. Zambezi Plc is a company that has listed its shares on the Lusaka Stock Exchange. Shares that are listed on Lusaka Stock Exchange are not chargeable property. Therefore, property transfer tax is not payable on the disposal of shares in Zambezi Plc.

ii. Land is chargeable property. The realised value is the greater of the open market value and the actual sales price. As the land was sold at the open market value, the price paid by the buyer is the realised value.
Property transfer tax paid = 5% X K350,000
= K17,500

The property transfer tax of K17,500 should have been paid within 14 days following the conclusion of the transaction.

iii. Shares in Ndeke Ltd are chargeable property because the company is not listed on the Lusaka Stock Exchange. The realised value is the greater of the nominal value and the open market value.
Property transfer tax paid = 5% X K2,000,000
= K100,000

The property transfer tax of K100,000 should have been paid within 14 days following the conclusion of the transaction.

iv. Shoplight Plc is a company that has listed its shares on the Lusaka Stock Exchange. Shares that are listed on Lusaka Stock Exchange are not chargeable property. Therefore, property transfer tax is not payable on the disposal of shares in Zambezi Plc.

(c) Sources of revenue are:

i) Privatisation of state owned enterprises: This is the process of transferring state owned enterprises to the private sector. Huge amounts of revenue can be raised where there are state owned enterprises to sell. Once all the state owned enterprises are sold, it would mean there would be no source of revenue for the Government. Privatization cannot therefore be relied upon as the sole source of revenue for the Government.

ii) Borrowing from the International Financial Institutions: The government can borrow from the International Monetary Fund (IMF), the World Bank and the International Bank for Reconstruction and Development (IBRD) to finance certain projects only. Amounts borrowed from these two institutions will normally have conditions attached to them and in addition, the amounts have to be serviced, normally at high interest rates. The government may not have funds to repay these amounts borrowed when they fall due.
As such, it is not possible to rely only on borrowing from the international financial institutions for the purpose of meeting all the recurring public expenditure.

iii) Issuing government securities/Domestic borrowing: Instead of borrowing from the international financial institutions, the government can be able to borrow locally through the issue of government bonds and treasury bills.
This method is costly. It leads to high interest rates and normally also causes inflation. Government can use this as a means to raise short term finance for a specific purpose.

iii) Donor funding: Various donor agencies have been set up that provide funding to poor countries. However, these donors provide funds for clearly defined projects and cannot provide the funds for the government to meet all the recurring public expenditure. In addition, donors can only be able to provide the funds if funds are available.

(d) The badges of trade are as follows:

i) Subject matter of realisation
Guidance has been provided that if the item sold is one which is normally held as a trading stock, the presumption that trade exist is high.

ii) The length of the period of ownership
Guidance has been provided that trading stock is not normally held for a long period of time. As a result, if a person disposes off an asset that he/she held for a long period of time it will be quite difficult to determine whether the asset had been held as trading stock. Assets held for long periods of time are normally investments.

iii) Frequency of similar transactions
If the frequency of the similar transactions is high, the presumption that trade exist is high.

iv) Circumstances giving rise to realisation
If the item was sold in order to raise some money to sort a financial pressure out, the presumption that trade exist is low.

v) Supplementary work and marketing
If the item sold was acquired in a bad state and some repairs done on the item, when sold the presumption that trade exist is high.

vi) The Tax payer's intention
Intention to trade clearly constitutes trading. However, intention to make a profit may not constitute trading. As such it has to been established as to whether a taxpayer sold an asset because the intention was to trade.

SOLUTION FIVE

(a) In respect of short leases, the amount of any premium received is taxable in the tax year when the lease was granted.

An amount received in respect of a long lease is capital and is not subjected to the similar provisions as premiums received in respect of short leases.

The amount assessable on the Landlord who charges a premium is the whole amount of premium, less its 2% for the entire lease term less one year.

(b) A deceased person is taxable on income that he or she had earned in the tax year up to the date of death.

Any income arising after the date of death is not taxable income of the deceased person. Such income form part of the Estate of the deceased person.

Income tax on the Estate of the deceased is a responsibility of the administrators of the Estate of that deceased person. Tax on the estate of the deceased is chargeable at the rate of 35%.

(c) Employment income

(i) Charles

Final income Tax Payable for the tax year 2019

Details	Calculation	Amount (K)
Basic salary	10*45,000	450,000
Housing Allowance	10/12*78,000	65,000
Medical allowance	10*4,000	40,000
School fees	3*300*10	9,000
Education allowance	8400*4*(10/12)	28,000
		592,000
Less:		
Professional subscriptions	8,500	
Donation to approved public benefit organisation	4,500	
		(13,000)
Taxable amount		579,,000
Tax computation	Tax Rate%	
First K39,600	0	0
Next K9,600	25	2,400
Next K25,200	30	7,560
Balance K504,600	37.5	189,225
	Income tax liability	199,185
	PAYE	(66,800)
	Tax payable	132,385

(ii) Gratuity Income:

Gratuity = 3 * K45,000* 12 * 25% = K405,000 [2 marks]

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C5: INDIRECT TAXES

THURSDAY 13 JUNE 2019

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

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading time. Use this time to carefully study the examination paper 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 in 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 2,3 and 4.

DO NOT OPEN THIS QUESTION PAPER UNTIL YOU ARE INSTRUCTED BY THE INVIGILATOR.

Taxation table for paper C5 - Indirect Taxes (June and December 2019 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 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**	**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	15,041	19,553	8,423	10,950

exceeding 2500 cc				
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 tonnesbut not exceeding 3.0 tonnes	26,311	11,402	15,348	6,651
GVW exceeding 3.0 tonnesbut 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 tonnesbut not exceeding 3.0 tonnes	17,541	7,601	15,348	6,651
GVW exceeding 3.0 tonnesbut 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 tonnesbut not exceeding 10.0 tonnes	24,724	18,955	10,817	8,293
GVW exceeding 10.0 tonnesbut not exceeding	30,905	23,694	11,744	9,004

20.0 tonnes				
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

(a) Explain the requirements for goods to be admitted into a COMESA or SADC country as originating in another member state. (2 marks)

(b) Explain the evidence required for exported goods to be zero rated. (4 marks)

(c) State the effective date of registration for both new and continuing businesses. (4 marks)

(d) Explain items that are restricted and prohibited to be imported into Zambia. (4 marks)

(e) Explain circumstances which may lead to a business to be deregistered for Value Added Tax (VAT). (6 marks)

[Total: 20 Marks]

QUESTION TWO

(a) Zambia is a member of the Preferential Trade Agreements (PTA) for Eastern and Southern Africa whose main aim is to regulate trade agreements so as to reduce tariffs for certain products to countries who sign the agreement. Although the tariffs are not necessarily eliminated, they are lower than countries not party to the agreement.

Required:

(i) State four (4) objectives of the Preferential Trade Agreements (PTA). (4 marks)

(ii) Explain any five (5) strategies that have been put in place by PTA in order to ensure that the objectives in (a) (i) above are achieved. (10 marks)

(b) A bonded warehouse is a building, an installation or an area licensed in terms of section 55 of the Customs and Excise Act in which goods may be stored without payment of duty.

Required:

(i) Explain four (4) conditions which should be met in order to seek approval of a bonded warehouse. (4 marks)

(ii) State two (2) advantages of a bonded warehouse. (2 marks)

[Total: 20 Marks]

QUESTION THREE

Pachikani Banda who was employed as a clerk in a commercial bank obtained a loan to buy a vehicle. He decided to import new BMW 6C saloon car from Japan, whose cylinder capacity is 3500cc on 5 January 2019. The price of the car was US$8,500. Freight charges paid was US$1,700 and insurance paid was US$130, this was up to the port of Dar-el-Salaam. US$ 110 was paid for inspecting the vehicle before departure from Japan.

Pachikani Banda further paid US$650 and US$220 for transportation and insurance respectively from Dar-el-Salaam to Nakonde. Other incidental costs of K2,500 were incurred from Nakonde to Lusaka.

The ruling Bank of Zambia exchange rate was K11.95 to US$1 and the Commissioner General approved rate was K11.80 to US$1

Required

(a) Calculate the import duty and other related taxes paid by Pachikani Banda. (9 marks)

(b) Explain the conditions to be met for customs to use the transaction value method in determining the value for duty purposes. (4 marks)

(c) State any four (4) documents which should be submitted in respect of a motor vehicle being imported into Zambia. (2 marks)

(d) Explain how making exempt supplies differs from making zero rated supplies for the purposes of VAT. (3 marks)

(e) Explain the circumstances which may lead Zambia Revenue Authority to invoke the right to revalue a motor vehicle being imported into Zambia. (2 marks)

[Total: 20 Marks]

QUESTION FOUR

Galtex Limited is a Zambian resident company which manufactures several types of paint which it sells to retailers and wholesalers. The Company has just engaged you as a Tax Consultant to assist in preparing VAT tax returns and also attend to other tax related matters.

You are provided with the following information relating to VAT return for the month of May 2019.

1. Statement of profit or loss for the month of May 2019

	K	K
Sales		66,000
Sales returns		(4,400)
		61,600
Purchases	38,400	
Purchases returns	(1,200)	
	37,200	
Bad debts written off	6,000	
Other expenses	9,600	
		(52,800)
Profit		8,800

2. The sales are all standard rated for VAT purposes.

3. The purchases are all standard-rated for VAT purposes.

4. The sales and purchases returns are all evidenced by credit notes issued and received.

5. The bad debts were written off in May 2019. Payment for the original sales was due by 2 September 2017.

6. A sales invoice for K12,000 excluding VAT had been omitted in error from the VAT return for the month of April 2019.

7. Included in other expenses figure is the cost of diesel fuel amounting to K4,700 for the Motor van which is used by the Sales Manager and the remainder of expenses are all standard rated for VAT. Both figures are VAT inclusive.

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

Required:

(a) Calculate the amount of VAT payable or refundable for the month of May 2019 and state when it is payable. (12 marks)

(b) Explain what is meant by cash accounting scheme and state the type of organizations that are allowed to account for VAT under this scheme.

(4 marks)

(c) Define the term 'taxable value'. (2 marks)

(d) Explain how a taxable value is determined for a supply that does not attract excise duty and the one which is liable to excise duty. (2 marks)

[Total: 20 Marks]

QUESTION FIVE

(a) The construction industry like many other industries is subjected to paying VAT on taxable supplies. However, the biggest challenge faced by organizations in this industry is determining the tax point because work may be carried out for an extended number of years. One of the difficulties is to determine the percentage of work completed because VAT is based on the certified value of the portion of work completed at each stage.

Most of the businesses consider the tax point as the time when goods or services are considered to be supplied or made available to a customer for VAT purposes.

Required:

Explain how the tax point for an organization operating in the construction sector is determined. (4 marks)

(b) Explain the following:

(i) Role of the Customs Services of ZRA in the exportation of goods. (3 marks)

(ii) Four (4) other documents that are required by the Customs Services Division to accompany form CE 20. (4 marks)

(c) Define "Duty Drawback System (DDB)" and the purpose of such a scheme in relation to any goods produced for export. (2 marks)

(d) Explain the challenges of the Duty Drawback system. (3 marks)

(e) Explain the term "Currency Declaration" in relation to the importation or exportation of currency notes in any currency in Zambia and its implications. (4 marks)

[Total: 20 Marks]

END OF PAPER

C5 INDIRECT TAXES SUGGESTED SOLUTIONS

SOLUTION ONE

(a) The importer/exporter of the goods concerned must present to the customs authority alongside the bill of entry a certificate of origin duly completed and signed in the exporting member state and certified by designated certifying authority of that member state.

(b) The evidence required for exports to be zero rated is:
- Commercial invoices
- Certified copies of documents presented to Zambian Customs at exportation
- Certified copies of customs import at the country of destination
- Proof of payment (settlement) if applicable

(c) The effective date of registration is the date when a business becomes registrable for VAT. This date is:

For a new business; the date of commencement of trading is the effective date of registration if the turnover thresholds are likely to be exceeded.

For a continuing business which has exceeded the turnover thresholds; the effective date of registration is one month of an application being made to ZRA for registration or from the date the application was received by the Commissioner General or if the application is not made within one month of first becoming liable to register, on the day following the first period during which the K800,000 threshold was exceeded.

(d) Items that are restricted and prohibited to be imported into Zambia are:
- Base or counterfeit coins
- Any goods which are indecent, obscene or objectionable
- Any goods which may tend to corrupt the morals of the inhabitants or any class of the inhabitants in Zambia
- Any goods the importation which is prohibited by, or under the authority of any law.

(e) Circumstances which may lead to a business to be deregistered for VAT are:
- If the business is sold or ceases to trade permanently
- If ZRA is satisfied that the trader is no longer making taxable supplies nor intending to make taxable supplies
- If there is a change in the legal status of the business –this may be a situation where a sole trader incorporates his business
- If a trader had applied for registration before commencing to trade and that trader fails to commence to trade on the expected date
- If a trader submits nil returns for twelve (12) consecutive standard periods
- When a trader voluntarily applies for deregistration as a result of the VAT exclusive turnover of taxable supplies falling below the registration threshold

SOLUTION TWO

(a) Preferential Trade Agreement:

(i) The objectives of 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 and
iv. To contribute to the progress and development of all other African countries.

(ii) The objectives in (a) (i) above can be attained by the following strategies:

i. Reduction and elimination of trade barriers on selected goods traded within the area.
ii. Introduction of rules of origin to determine which goods will receive preferential treatment.
iii. Granting of transit rights to all transporters when coming from or entering other member states or third countries
iv. Clearing and payments arrangements to promote trade in goods and services within the sub-region.
v. Cooperation to develop coordinated and supplementary policies and systems in transport and communications.
vi. 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.
vii. Cooperation in the area of agricultural development so as to raise production and supply of food to coordinate the export of agricultural commodities to harmonize programmes in agricultural production develop land and water resources, share agricultural commodities in the sub-region.
viii. Interventions to assist the least industrialized Member States e.g. through special consideration in allocating multinational industries. Thus the PTA has a broad and challenging mandate.

(b) Bonded warehouses

(i) The bonded warehouse should meet the following requirement for it to be approved as such:

i. The warehouse must be conveniently situated, i.e. within 20km from the controlling station.

ii. The warehouse must be secure and separate from retail outlets

iii. The doors must be strong (grilled doors are recommended) and have provision for a Customs lock.

iv. Access into the warehouse should be restricted; and however the license of a bonded warehouse is not transferable from one operator to another.

(ii) Advantages of a bonded warehouse

i. Goods can be stored without payment of duty, thus giving the importer enough time to source funds.

ii. Some goods may sell slowly due to fluctuating demand, hence duty can be paid according to demand.

iii. 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) Import duties

	US$
Cost price	8,500
Freight	1,700
Insurance	130
Inspection	110
Transportation	650
Insurance	220
Total	11,310

	Value	Taxes
	K	K
Value for Duty Purpose ($11,310x11.80	133,458	
Customs Duty (K133,458x 30%)	40,037	40,037
	173,495	
Excise Duty(K173,495x30%)	52,049	52,049
	225,544	
Import VAT (K225,544 x16%)	36,087	36,087
Total value	261,631	
Total Taxes Paid		128,173

(b) The following are the conditions:

i. There should be no restrictions in the use of the goods.
ii. There should be no conditions to deter the determination of the VDP.
iii. No part of the proceeds on resale would accrue to the seller, unless included in the value.
iv. No relationship exists to influence the value.

(c) The documents which should be submitted when importing a Motor vehicle into Zambia are:

- Invoice or letter of sale indicating the Price paid
- Bill of lading
- Freight statement (including overland costs from port)
- Insurance certificates
- Any other documents relevant to the purchase acquisition, shipment or importation of the vehicle,

(d) The main differences between making an exempt supplies and making zero rated supplies are:

- When determining whether a trader should register for VAT by reference to the level of turnover, the turnover of exempt supplies is not taken into account while the turnover of zero rated supplies is taken into account.

- A trader who makes only exempt supplies cannot register for VAT while a trader who makes only zero rated supplies can register for VAT.
- All the input VAT that is attributed to exempt supplies cannot be recovered while all the input VAT that is attributed to zero supplies is recoverable.

(e) The circumstances which will lead to Zambia Revenue Authority to Invoke the right to revalue the motor vehicle being imported in to Zambia are:

- When the importer or customs clearing agent provides insufficient or unsatisfactory information
- The vehicle is acquired in circumstances other than in normal course of business

SOLUTION FOUR

(a) GALTEX LTD

Computation of VAT payable for the month of May 2019

	K	K
Output VAT		
Standard-rated sales (66,000 x 16%)		10,560
Less sales returns (4,400 x 16%)		(704)
Understatement of output tax on previous month (12,000 x 16%)		1,920
		11,776
INPUT VAT		
Standard rated purchases (38,400 x 16%)	6,144	
Less purchases returns (1,200 x 16%)	(192)	
Standard rated expenses (4,900 x 4/29)	676	
Bad debt relief(6,000 x 16%)	960	
Diesel (4,700 x 4/29 x 90%)	583	
		(8,171)
VAT Payable		3,605

The due date for the payment of this tax is 16 June 2019

(b) The cash accounting scheme is a scheme under which VAT is accounted for based on cash payments and receipts. A trader who is under the scheme charges output VAT on cash received and recovers input VAT on payments made to suppliers. As such, the tax point for cash accounting scheme is the time when payment is made or received.

Currently only members of the Association of Building and Civil Engineering contractors (ABCEC) are eligible to use the Cash Accounting basis for VAT purposes.

(c) The taxable value is the price that is charged for goods and services onto which VAT is added at 16%.

(d) For goods and services which do not attract excise duty the VAT is on the net selling price excluding excise duty.

Goods and services which attract excise duty it is the net selling price plus excise duty.

SOLUTION FIVE

(a) The tax point is determined as the earlier of:

i. The time when interim certificates are issued and payment made on the amount involved (creating a tax point and tax liability for the amounts involved)
ii. The time when any part payments, including interim or advance payments also create a tax point.
iii. The time when the building services are completed. The tax point in this case will be the issue of a compliance certificate, which then creates a tax point for any remaining payments due.
iv. The time when the tax invoice issued for work/payments not covered under the above points.

(b) Exportation of goods

(i) The role of the Customs Services Division is to control all exports to ensure that the enforcement of national legislation concerning export prohibition and restrictions. Restricted goods can only be exported after obtaining an export permit from the concerned ministries or relevant government departments.

The Customs also collects information needed for preparation of national trade statistics.

(ii) The other documents required by the Customs to accompany form CE 20 are:

i. <u>Certificate of origin for exports</u> into member countries that have ratified particular preferential trade agreements with Zambia**.** These certificates can be obtained from Customs International Policy Office in Lusaka and Assistant Commissioner Customs Services Ndola office.

ii. <u>Certificate of origin known as VISA</u> is needed for exports to the USA under AGOA programme.
iii. <u>Permits</u>, e.g. Quality certificates from Veterinary department (meat and livestock), phytosanitary certificate from Mount Makulu Research station (seed, plants and fruits), permit for gemstone exports and Timber verification certificate for timber exports.
iv. <u>Other supporting documents</u> such as packing list, consignment note, cargo manifest, commercial invoice, airway bill, bill of lading, insurance, and any other document relevant to the exports.

(c) Duty Drawback system

Duty Drawback system is an export support program designed by the government that enables local manufacturers to get back any taxes incurred either directly or indirectly on any goods produced for export.

The purpose of duty drawback is to avoid double taxation**.** The Government pays back the direct and implied taxes through the ZRA upon proof of export by the producer.

(d) The following are the challenges:

i. One challenge of duty drawback to the exporters is the need to keep detailed records to support every claim for drawback from ZRA.

ii. The system must be designed so that it will work smoothly and refund the correct amount in a reasonable time. This requires periodic review of the system.

iii. The other challenge is the integrity and commitment of staff at the ZRA DDB unity as well as the integrity of the data used to calculate the duty drawback coefficients.

(e) Currency declaration:- any person importing into or exporting from Zambia currency notes, in any currency, exceeding in value of Five Thousand United States Dollars shall make a declaration in the Customs and Excise Currency Declaration Form (CE 10) as provided for under section 41A of Customs and Excise Act.

The implication is that, where a person refuses to make a declaration or makes an incorrect or false declaration, and is found with currency notes in excess of the specified amount, the currency notes in excess of that amount shall be seized and forfeited to the state.

END OF SOLUTION

TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C6: LAW FOR TAX PRACTITIONERS

FRIDAY 14 JUNE 2019

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.

DO NOT OPEN THIS QUESTION PAPER UNTIL YOU ARE INSTRUCTED BY THE INVIGILATOR.

Attempt all FIVE (5) questions.

QUESTION ONE

(a) Jambano and Jembano decided to start a business in Soda Manufacturing, they did supply hospitals and clinics with the view of helping them disinfect their apparatus. Unfortunately one of their employees mixed the chemicals wrongly resulting in a bad product produced. They emitted the said substance into a nearby communal dam. This was done because the earlier occupants of the communal land had consented to all activities of the company, including reasonable disposal of garbage and emissions provided they provide jobs for the locals and build hospitals for them. This the company did as promised. However, following this latest development, the enraged villagers have commenced an action against them in Negligence and Nuisance for emission of toxic gases stating that there was no such contract between the company and themselves or even their ancestors. You have been retained as a lawyer for the company.

Required:

(i) State the defense you would invoke in the defense of the company (1 mark)

(ii) Explain to the villagers what constitute negligence. (4 marks)

(iii) Jambano and Jembano also signed a lease with the property owner trading as Zeinnin Investment. Explain to them the essential features of a leasehold estate. (5 marks)

(b) Explain also to Jambano and Jembano the conditions precedent for agency by ratification to stand at law. (2 marks)

(c) Jembano also wants to know at least three (3) most important elements of a valid contract. Explain to him**.** (3 marks)

(d) Discuss "stoppage in transit" under the Sale of Goods Act. (3 marks)

(e) Explain how collective bargaining affect an individual contract of employment. (2 marks**)**

[Total: 20 Marks]

QUESTION TWO

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

(b) With regard to cheques, explain the requirements for negotiability. (5 marks)

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

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

(e) Discuss the two 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 Sources of Law in Zambia, Explain how each of the following is a source of law in Zambia:

(i) The Constitution of Zambia (3 marks)

(ii) Judicial Precedence (Case Law) (3 marks)

(iii) Custom (African Customary Law) (3 marks)

(b) Write notes on the following:

(i) Supreme Court of Zambia (2 marks)

(ii) Innocent Misrepresentation (2 marks)

(iii) The Doctrine of *Res Judicata* (2 marks)

(c) A Carrier (transporter) of goods has both duties and liabilities to the owners of the goods as soon as the goods are under his control.

State any five (5) duties of the carriers arising from the contract to 'carry and deliver' the goods. (5 marks)

[Total: 20 Marks]

QUESTION FOUR

(a) Write notes on each of the following:

(i) Holder in Due Course (2 marks)

(ii) Promissory notes (2 marks)

(iii) 'Ambiguity Rule' in the negotiation of cheques (2 marks)

(iv) Class meeting (2 marks)

(v) Floating charge (2 marks)

(b) Robinson is an agent for Kipi Motors Ltd. He buys cars, busses and any other property that his Principal – Kipi Motors Ltd authorises him to buy. All major contracts have to be ratified by Kipi Motors Ltd before they are effected.

Dubai Luxury Cars Ltd offered to sell a 72 seater luxury bus to Robinson, who identified himself as Kipi Motors Ltd's agent. Robinson accepted the offer 'subject to the approval by his principal's management'. It took the management two months to sit and approve the purchase of the bus from the date Robinson was given the offer. Meanwhile, 7 days before Kipi Motors Ltd's Management's meeting to approve the deal, Dubai Luxury Cars Ltd revoked the offer.

Kipi Motors Ltd have decided to sue Dubai Luxury Cars Ltd for breach of contract and have come to you for advice on the way forward.

Required:

(i) With the aid of examples, explain whether the suit will succeed. (6 marks)

(ii) Distinguish between a sleeping partner and a nominal partner (4 marks)

[Total: 20 Marks]

QUESTION FIVE

Joe a night watchman went to UTH in the early hours of the morning complaining of vomiting. A doctor in the casualty department failed to examine him but sent him away without treatment, telling him to come back later in the day if was still unwell. He died 4 hours later due to arsenic poisoning.

Required:

(a) With reference to the above scenario, explain whether UTH will be liable for Joe's death. (5 marks)

(b) Explain the three (3) things a plaintiff has to prove to succeed in his claim for evidence. (15 marks)

[Total: 20 Marks]

END OF PAPER

C6 LAW FOR TAX PRACTITIONERS SUGGESTED SOLUTIONS

SOLUTION ONE

a) Consent is one of the defenses they can rely on in this matter. The villagers consented to all the activities taking place. Also just as the law permits an injured party to bring a lawsuit to stop a nuisance, the law provides land owners and users with certain *defenses*–legally permitted excuses–to avoid liability for nuisance claims. In many tort cases and situations, the consent of the injured party (given before or, in certain cases, after the injury) constitutes a defense and therefore prevents the injured party from recovering damages in a lawsuit against the person who caused the harm. Generally speaking, an activity is not a nuisance when a person undertakes the action in accordance with or in reliance upon a statute (a law) which grants specific authority for that action. A defendant sued for nuisance can claim "reliance on statutory authority" as a defense.

A tort is a civil wrong, and normally between individuals, whose remedy is compensation. The elements of tort are; **Duty**, breach of **duty**, **causation**, and injury. In order to claim damages, there must be a breach in the **duty** of the defendant towards the plaintiff, which results in an injury.

Essential features of leasehold estate are;

i) Gives the right to exclusive possession

ii) It is for a definite term

iii) Creates a landlord and tenant relationship

b) -The agent must have contracted as such on behalf of the principal who has been identified

- The agent must profess at the time of making the contract that he was acting on behalf of the principal who will subsequently ratify the contract.

c) The essential features of a valid contract are; Offer, acceptance and Consideration. If these three elements are found, the contract is established at law.

d) Stoppage in transit is one of the seller's real remedies where the buyer defaults in payment for the goods. The unpaid seller enjoys special rights to stop goods being delivered to an insolvent buyer. The rights are statutory rights set out in The Sale of Goods Act and the principal provisions are as follows:

- "When the buyer of goods becomes insolvent the unpaid seller who has parted with the possession of the goods has the right of stopping them in transit, that is to say, he may resume possession of the goods as long as they are in the course of transit, and may retain them until payment or tender of the price."
- "Goods are deemed to be in the course of transit from the time when they are delivered to a carrier ... for the purpose of transmission to the buyer, until the buyer or his agent in that behalf takes delivery of them from the carrier."
- "The unpaid seller may exercise his right of stoppage in transit either by taking actual possession of the goods or by giving notice of his claim to the carrier ... in whose possession the goods are."
- "When notice of stoppage in transit is given by the seller to the carrier... in possession of the goods, he must redeliver the goods to, or according to the directions of the seller, and the expenses of the re-delivery must be borne by the seller."

- "Once the goods have been received by the carrier for carriage the merchant shall not be entitled either to impede, delay, suspend or stop or otherwise interfere with the intended manner of performance of the carriage for any reason whatsoever including but not limited to the exercise of any right of stoppage in transit conferred by the merchant's contract of sale *or otherwise*".The clause purports to override rights under the Sale of Goods Act -"or otherwise" but the follow on clause below suggests that the clause above may not always be enforced against the shipper.

- "The merchant shall indemnify the carrier against all claims, liabilities, loss, damages, costs, delay, attorney fees and/or expenses caused to the carrier, his subcontractors, servants or agents or to any other cargo or to the owner of such cargo during the carriage arising or resulting from any stoppage (whether temporary or permanent) in the carriage whether at the request of the merchant, or in consequence of any breach by the merchant of this clause, or in consequence of any dispute whatsoever in respect of the goods".

<u>This solution is comprehensive hence the student does not need to write everything but something among the points above</u>

e) Collective bargaining is the process of negotiations between the company and representatives of the union. The goal is for management and the union to reach a contract agreement, which is put into place for a specified period of time. Once this time is up, a new contract is negotiated. In this section, we will discuss the components of the collective bargaining agreement. It affects the rights of an employee in two way which include;

- Express incorporation into the contract without the need of further agreement
- Incorporation of results of collective agreements as part of custom and practice

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) The bill to be transferred ;

- Must be Signed by the drawer or maker
- Must be unconditional
- Must be of fixed amount
- Must be Payable on demand or 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 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**

<u>SOLUTION THREE</u>

(a) How each of the following is a source of law in Zambia

(i) *The Constitution of Zambia:-* The Constitution of Zambia is the most important law in the land and binds all persons in Zambia, as well as all organs of the State. It is a source of law in that all other laws must come from the constitution, i.e they must not be contrary to the Constitution in that if they did, to the extent of those other laws' contradiction, they are void.

(ii) *Judicial Precedence (Case Law):-* This is law resulting from decisions made by judges in the superior courts of law when deciding on cases. Decisions by Superior Courts' judges are binding on all lower courts and will have to be followed when dealing with similar cases in future. It becomes a Source of Law in that, the legal principles declared by a superior judge in a case become law to be followed by lower courts in arriving at decisions, until such decisions or legal principles are overruled by the higher courts or legislation.

(iii) *Custom (African Customary Law):-* A Custom is a set of rules, norms and values which are developed by a way or type of life of a people in a particular community or area. It is normally not written and traditional in nature, applicable to a particular tribe, village, or area. Customary law is a source of law in that where there is no legislation or law passed by parliament or, judicial precedence, the custom of the community fills the gap and it is binding. This is the law usually used in local courts.

(b)

(i) *The Supreme Court of Zambia:-* It is one of the highest courts of the land (before the amendment of the Constitution in January 2016, that brought about the Constitutional Court, which is equivalent to the Supreme Court). The Supreme Court is a court of final appeal, i.e its decisions are final and cannot be appealed anywhere else. Decisions of the Supreme Court are binding on all the lower courts (except the Constitutional Court on which they are simply persuasive).

(ii) *Innocent Misrepresentation:-* This is a statement which the maker honestly and reasonably believes to be true. It is a false statement which is neither fraudulent nor negligent, but made in the belief that it is true. The basic remedy is rescission of the contract.

(iii) *Doctrine of Res Judicata*:- This is a rule or doctrine that, a final judgment, on the merits by a court having jurisdiction, is conclusive between the parties to a suit as to all matters that were litigated or that could have been litigated in that suit.

This means that, if the reasons or merits upon which a decision was arrived at are good, such a decision will be followed in future cases of similar nature and it will be conclusive on all matters similar to it until overruled.

(c) Five Duties of carriers include the following:

(i) To carry all goods of the class he professes to carry 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 route and with reasonable diligence and without unreasonable deviation or delay.

(iii) To deliver the goods to the consignee at the place designated by the consignor, unless the consignee requires delivery at another place, when he may deliver them accordingly.

(iv) To receive and carry all goods offered for carriage as long as the carrier is not exposed to extra ordinary danger.

(v) To take utmost care of goods from the moment of receipt to the place of destination.

(vi) To deliver the goods within a reasonable time depending on the case by case basis.

SOLUTION FOUR

a) Write brief notes on each of the following:

(i) *Holder in Due Course:-* This is a person who takes a negotiable instrument for value, in good faith, and without notice that it is overdue or defective.

(ii) *Promissory Note:-* This is a promise to pay a sum of money and may be used as a form of security for a loan.

Or A promissory note is ' an unconditional promise made in writing by one person to another, signed by the maker, engaging to pay on demand or at a fixed or determinable future time, a sum certain in money to, or to the order of, a specified person or to bearer'.

(iii) *The Ambiguity* Rule in the negotiation of cheques means that, whilst it is the duty of the banker to honour his customer's cheques, such cheques must be regular, properly drawn by the customer and un ambiguous so as not to be misleading to the drawee/ acceptor or not to be used to facilitate fraud.

(iii) *Floating Charge:-* This is a charge where the chargee's rights are not attached to a specific property (shifting fund of assets) and the charge (business) is fee to use them in any way until they crystalise into a fixed charge on default or wounding up of business.

(iv) *Class meetings:* These are meetings of a particular class of shareholders. For example preference shareholders may have their own meetings excluding other shareholders.

(b) (i) Advice to Kipi Motors would be as follows:

The agency relationship between Robinson and Kipi Motors Ltd is an agency by ratification. An agency by ratification occurs where for a contract to be valid, the principal must approve. The agent must have been contracted on behalf of the a principal who has been identified at the time of the contract. In the case of ***Watson v. Davies (1931) ICU 455*** – An agent entered into a contract with a third party for the purchase of property. The offer was subject to the approval by a Board of the Charity (management), the agent acted for. Before the approval, the third party revoked the offer. It was held that, 'an acceptance of the offer that is subject to approval by the principal was a nullity until ratified. There was no binding contract for the Board of the Charity (or Principal)l to sue'.

Thus in this case, Kipi Motors Ltd would not succeed in their legal action against Dubai Luxury Cars Ltd as the revocation of the offer was done before ratification, that is, seven (7) days earlier than Kipi Motors Ltd's ratification. This means that, there was no binding contract from the time of the offer until ratification, which happened, which should have been done before revocation.

(ii) A ***Sleeping Partner*** is also known as a *Dormant Partner*. He does not take an active role or takes no part in the management of a partnership even though he has contributed towards the capital for a share in profits and losses. On the other hand, a ***Nominal Partner*** is a partner by name only. He may have retired, but his name has not yet been removed from the partnership letterheads and documents (Stationery and Notice).

SOLUTION FIVE

a. Causation is the action of causing something. Therefore, tortious liability is dependent on making a connection between the defendant's wrongful act and the damage suffered by the claimant. This is established by applying the "but for test", that but for the defendant having breached the duty of care, the claimant would not have suffered the injury. Joe died from arsenic poisoning, hence forth, UTH will not be liable in that the doctor's negligence did not cause his death.

b. The tort of negligence has three ingredients and to succeed the plaintiff must show the following:

   The existence of the duty of care which was owed to him by the defendant- whether the duty of care exists or not is a question of law for the judges to decide. In Donoghue v Stevenson Lord Atkins formulated what has now become the classic test for establishing a duty of care known as the 'neighbour test.' When he said, ''you must take reasonable care to avoid acts or omissions which you can reasonably foresee to be likely injure your neighbour. Who then is my neighbour? The answer seems to be persons who are closely and directly affected by acts that I ought to reasonably have them into contemplation as being affected." This test is objective and not subjective and the effect of its application is that a person is not liable for everything which results from his carelessness; there must be a duty of care. This was illustrated in Bourhil v Young , a pregnant fish wife alighted from a tramcar while she was removing her fish basket from the tramcar. Young a motor cyclist driving carelessly but unseen by her past the tram and collided with a motor car some 15 yards away. Young was killed. The plaintiff heard the collision and after young's body was taken away she approached the scene of the accident and saw a pool of blood she suffered nervous shock. The House of Lords held her action against young's personal representatives failed because he owed no duty of care he could not reasonably anticipate would suffer injury as a result of his conduct on the highway.

   A person only owes a duty of care to persons whom he reasonably foresees to injure. Road users owe a duty of care to their fellow road users; manufacturers owe a duty of care to their consumers (Donoghue v Stevenson), in this case, the appellant's friend purchased a bottle of ginger beer from a retailor in paisley and gave it to her. The appellant consumed some of the ginger beer and her friend was replenishing the glass, when according to the appellant, the decomposed remains of a snail came out of the bottle. The bottle was made of dark glass so that the snail could not be seen until most of the contents had been consumed. The appellant became ill and served a writ on the manufactures claiming damages. The question before the House of Lords was whether the facts outlined above constituted a cause of action in negligence. The House of Lords held by a majority of three to two that they did. It was stated that a manufacturer of products which are sold in such a form that they are likely to reach the ultimate consumer in the form in which they left the manufacture with no possibility of intermediate examination, owes a duty to the consumer to take reasonable care to prevent injury. This rule has been broadened in subsequent cases so that the manufacture is more often where defective chattels cause injury. Doctors owe a duty of care to their patients (Edna Nyasalu v UTH) and parents owe a duty of care to their children who are under the age of 21.

Breach of duty- this may be found were the defendant fails to meet the standard required by law. In Edina Nyasalu v A-G, the plaintiff claimed damages for injury sustained as a patient at UTH, while under the care and attention of a qualified medical doctor. The claim arose out of the medical doctor's failure to administer the test or inquire orally as to whether the patient was allergic to penicillin. This resulted in the patient experiencing cardiac arrest and brain damage rendering the patient now abnormal. It was contended that the doctor had been negligent in not performing the standard procedure and thus was in breach of duty of care he owed to the patient. It was held that the doctor owes a duty of care to patients which when in breach will result in his liability once it has been established that the defendant owes the plaintiff a duty of care. Duty of care is decided by the standard of the defendant's behaviour. The behaviour has to be that of the reasonable person. In Baugna v Fenlope , the defendant's hay stock caught fire due to poor ventilation. The defendant had been warned on numerous occasions that this would happen if he left the hay stock; the defendant argued that he had used his best judgement and he did not foresee the risk of fire. The court held that his best judgement was not enough he was to be judged by a standard required which is that of a reasonable man; the standard required is that of an average prudent man in the eyes of the court.

However, it should be noted that if precautions are taken by the defendant to prevent damage, the defendant will not be liable. In DENIALS V. WHITE & SONS LIMITED Husband and wife sued the first defendants who were manufacturers of mineral water in negligence. The plaintiff had been injured because of the first defendant's Lemonade which he had purchased from a public house contained carbolic acid, evidence showed that the manufacturer exercised all possible care to see that no injurious material got into the lemonade. The court held that the manufactures were not liable in negligence because the duty was not the one to ensure that goods were perfect but only take reasonable care to see that no injury was caused to the actual consumer, this duty had been fulfilled.

However, when the person has undertaken a duty which requires extra ordinary skill, he will be expected to use a higher standard of care e.g. one would expect from a surgeon the degree of skill appropriate to a reasonable competent member of his profession. Furthermore, the court will take into account the importance of the objective which the defendant was trying to achieve. In Watt v Hertfordshire County Council , A fireman was injured by a heavy jack which slipped while being carried in a lorry which was going to the scene of an accident. The lorry was not equipped to carry such a heavy jack but it was required to free a woman who had been trapped in the wreckage. No proper vehicle was available and it was held that the fire authority was not liable. The court will also take into account whether it was practicable and necessary for the defendant to have taken the precautions which the plaintiff alleged should have been taken. In Latimar v A.E.C. Ltd , A heavy rainstorm flooded a factory and made the floor slippery. The occupiers of the factory did all they could to get rid of the water and make the factory safe, but the plaintiff fell and was injured. He alleged negligence in that the occupiers did not close down the factory. It was held that occupiers of the factory were not liable. The risk of injury did not justify the closing down of the factory.

[Total: 20 Marks]

END OF SOLUTIONS

Zambia Institute of Chartered Accountants

TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D1: BUSINESS INFORMATION MANAGEMENT

WEDNESDAY 12 JUNE 2019

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.

DO NOT OPEN THIS QUESTION PAPER UNTIL YOU ARE INSTRUCTED BY THE INVIGILATOR.

Answer all FOUR (4) questions.

QUESTION ONE

Software testing is important and if not done properly, critical issues can be faced in the live environment.

Required:

(a) Explain the software testing hierarchy. (12 marks)

(b) Financial information must be shared digitally between buyers, suppliers, financial institutions and regulatory agencies. Security of these operations is becoming an increasing concern in order to prevent fraud and theft. The three types of financial data security that are necessary to have are as follows:

(i) Authentication
(ii) Integrity
(iii) Confidentiality

Explain the terms indicated above? (6 marks)

(c) Computer controls are built into the system to secure computerised processing.

(i) Describe what you understand by computer processing security controls. (3 marks)

(ii) Distinguish between Data Integrity and Systems Integrity. (4 marks)

[Total: 25 Marks]

QUESTION TWO

The main difference between *outsourcing* and *insourcing* IT services is the cost and convenience.

When considering whether to outsource or not, several questions arise; including issues of knowledge management.

Required:

(a) What is outsourcing and what are its advantages to an organization? (7 marks)

(b) In relation to Knowledge Management Techniques and Technologies explain the following and outline three (3) advantages and two (2) disadvantages of each

(i) Centers of Excellence. (6 marks)

(ii) Knowledge Storage Tools . (6 marks)

(c) Explain any three (3) technical limitations of E-Commerce. (6 marks)

[Total: 25 Marks]

QUESTION THREE

Information is the blood line of very organisation. Without good and quality information, the operations of any organisation may be adversely affected.

(a) Define information and explain how it helps in carrying out the managerial functions.

(10 marks)

(b) Elaborate the characteristics of quality information. (8 marks)

(c) Explain the importance of aligning IS/IT strategy with Business strategy of an organisation. (4 marks)

(d) State any three (3) technologies that can be used for collaborative work. (3 marks)

[Total: 25 Marks]

QUESTION FOUR

In recent years, academics and accountants have demonstrated a great deal of interest in strategic accounting. However, the diffusion process for strategic accounting has not been intense. As the digital economy evolves, the need to understand how organizations are responding to e-business is paramount.

(a) Accountants in organizations committed to enhance their e-business must confront two challenges, the connection of accounting to new e-business strategies and the links between strategic accounting and shareholder value.

(i) Explain how these challenges can be met by the accountant and ensure that their current skills set are aligned with company needs. (10 marks)

(iii) State five (5) criteria for selecting the appropriate system methodology. (5 marks)

(b) Car retailing is becoming increasingly competitive and profit margins on new car sales to the general public are being squeezed. Most new cars are sold by main dealers committed to one car manufacturer and selling new and used cars, servicing cars and hiring out cars. The main dealer will also provide service for fleet cars, which will have been bought in bulk by large companies direct from the manufacturer at a discount.

Explain any five (5) ways how the concept of Data Mining could be exploited by a large main dealer who has a string of garages associated with a number of different car manufacturers. (10 marks)

[Total: 25 Marks]

END OF PAPER

D1 BUSINESS INFORMATION MANAGEMENT SOLUTIONS

SOLUTION ONE

a)

- Unit Testing
  A level of the software testing process where individual units of a software are tested. The purpose is to validate that each unit of the software performs as designed
- Integration Testing
  A level of the software testing process where individual units are combined and tested as a group. The purpose of this level of testing is to expose faults in the interaction between integrated units
- System Testing
  A level of the software testing process where a complete, integrated system is tested. The purpose of this test is to evaluate the system's compliance with the specified requirements
- Acceptance Testing
  A level of the software testing process where a system is tested for acceptability. The purpose of this test is to evaluate the system's compliance with the business requirements and assess whether it is acceptable for delivery.

b) The three types of financial data security that it is necessary to have are:

- Authentication – allows only certain people the access to information
- Integrity – allows only authorized people to make changes to information.

- Confidentiality – keeps information encrypted so that only the owners can decipher their information.

c) Computer control built to secure computerised processing

i) Explain the term Security controls
Security can be defined as the protection of data from accidental or deliberate threats which might cause unauthorised modification, disclosure of data, and the protection of the information system from the degradation or non-availability of services.

ii) Distinguish between Data Integrity and Systems Integrity
Data integrity in the context of security is preserved when data is the same as in the source documents and has not been accidentally or intentionally altered, destroyed or disclosed.
On the other hand, Systems integrity refers to system operation conforming to the design specification despite attempts (deliberate or accidental) to make it behave incorrectly.

Data will maintain its integrity if it is complete and not corrupted; meaning data input controls, various checks, processing controls and various output and back-up controls are in place. **[Total: 25 Marks]**

SOLUTION TWO

a) Outsourcing is a business strategy that moves some of an organization's functions, processes, activities and decision responsibility from within an organization to outside providers.

Advantages: (any reasonable answers similar to the following)

- Cost Savings
  There can be significant cost savings when a business function is outsourced. Employee compensation costs, office space expenses and other costs associated with providing a work space or manufacturing setup are eliminated and free up resources for other purposes.
- Focus on Core Business
  Outsourcing allows organization to focus on their expertise and core business. When organizations go outside their expertise, they get into business functions and processes that they may not be as knowledgeable about and could potentially take away from their main focus.
- Improved Quality
  Improved quality can be achieved by using vendors with more expertise and more specialized processes.
  Customer Satisfaction
  The advantage of having a vendor contract is they are bound to certain levels of service and quality.
- Operational Efficiency
  Outsourcing gives an organization exposure to vendor specialized systems. Specialization provides more efficiency that allows for a quicker turnaround time and higher levels of quality.
  (3 marks to a complete definition/ explanation and 6 marks to at least 3 advantages)

b) Knowledge Management Techniques and technologies

i) Centre of Excellence

Centres of excellence, or knowledge centres, are formal centralised organisations whose jobs also consist of synthesising and distributing the firm's knowledge. The knowledge centres continually digest the firm's experience." These centres of excellence can help to centralise knowledge codification and help relieve some of the burden of knowledge capture from operating units. Additionally, centres of excellence often maintain databases of their work and sometimes publish their findings in white papers which are shared with the firms' stakeholders as a means to transfer knowledge.

Advantages:
Provides the firm with the opportunity for knowledge break through; enables the firm to formalise knowledge leadership in a particular area; centralises knowledge capture; creates visibility for firm and experts in practice areas.

Disadvantages:

Maintaining centres of excellence can be expensive and benefits can be difficult to measure.

ii) Knowledge Storage tools

Also known as content databases, allow a firm to electronically collect and store information. Examples of such storage tools include knowledge databases (Lotus Notes) as well as corporate intranets which serve as a repository of project files and other knowledge created by users. The latest knowledge storage tools differ from earlier database or file systems in that these newer tools have more sophisticated organisational structures which allow users to more easily identify and locate desired information. In addition, the internet has allowed for global access to such knowledge databases so that employees can store and retrieve information on a worldwide basis.

Advantages:

Knowledge storage tools enable the firm to store explicit knowledge in multiple formats. Well-designed tools also offer substantial flexibility And ability to integrate functionality with other knowledge management tools.

Disadvantages:

These tools are often expensive and require substantial user training. If the tools are not easy to use, it may also be difficult to encourage employee use and adoption.

c) Explain any three (3) technical limitations of E-Commerce

- Lack of sufficient system's security, reliability, standards, and communications protocols. This compromises the integrity of data and systems.
- Insufficient telecommunication bandwidth. This may slow down an otherwise fast-paced environment.
- The software development tools are still evolving and changing rapidly. Therefore, there is need to consistently change the tools used in E-Commerce.
- Difficulties in integrating the internet and electronic commerce software with some existing applications and databases.
- The need for special web servers and other infrastructures, in addition to the network servers (additional costs).
- Possible problems of interoperability, meaning that some E-commerce software does not fit with some hardware, or is incompatible with some operating systems or other components.

[Total: 25 Marks]

SOLUTION THREE

a) Information and how it supports managerial functions

- Information is data that has been processed to add meaning and value. Information is structured and organised in a way that it can be used to plan and make decisions.

- Managerial functions are planning, organizing, directing and controlling. Each of these functions need information in order for it to be performed effectively.

- **Planning:** in planning managers determine the of the organization by coming with goals and objectives. In order to plan effectively, managers need reliable information from both inside and outside the organization.

- **Organizing:** requires coming up with the relevant structure that will drive the organization activities effectively to meet the goals outline in the planning function. Again, information is required to enable manager bring to life the plans of the organization.

- **Directing:** in directing, managers manage the workforce through means of motivation, proper leadership, effective communication as well as coordination. To do this manager will require proper information.

- **Controlling:** managers need to continuously check results against goals and to do so they need reliable information

b) Characteristics of good information:

Accurate: Free and fair from bias
Complete: facts and figures should not be concealed or missing
Cost effectiveness: against the cost of obtaining it
Understandable: address the needs of the users. They should comprehend
Reliable/ Relevant: Communicated to the right receivers. From reliable source
Accessible: Be there for use
Timely: Should be given out when required
Easy to use: Should not be complex for the users

c) Importance of aligning IT/IS strategy to Business strategy

This is more than just aligning an IT/IS strategy to a business strategy but putting all into one document.
IT has become a very key business function for the benefit to all business expectations. This enables the business to reduce costs, standardize processes, enhance productivity, improve workflow and communications, sustain repeated services, improve risk control, implement new business strategies, etc.

d) Collaborative technologies include:
   - Email
   - Instant messaging
   - Video conferencing
   - Mobile phones
   - Virtual meetings
   - Screen sharing
   - Blogs
   - Discussion boards

[Total: 25 Marks]

SOLUTION FOUR

a) Organisations that use e-business to increase efficiency and effectiveness have to migrate through increasingly turbulent environments.

The complexity is enhanced by the new economy, which affects accountants in two broad areas; the volume of moving data within and beyond traditional enterprise boundaries and the complexity of business relationships. Most accountants realise that the changes brought about by e-business will require a reorganisation of business processes. The necessity of linking strategic accounting processes with e-business strategy was identified as an important issue.

i)

- Develop decision-making ability and keep up to date with business skills as well as balance skills
- Develop new business intelligence tools that can assemble, analyse and manage the intelligence elements needed to explore, expose and exploit the customer information assets
- Companies which understand that their customers are their greater assets and which have committed to a strategy that focuses on those customer, will benefit from being customer centric. Develop behavioural and change management skills to play an important role in strategy development

ii) Criteria's for selecting the appropriate system methodology

- Clear user requirements
- Familiarity with technology
- Complexity of a system
- Reliability of a system
- Time schedule
- Schedule visibility

b) In data mining, the data in a data warehouse are processed to identify key factors and trends in historical patterns of business activity that may otherwise go undetected. This can be used to help managers make decisions about strategies changes in business operations to gain competitive advantage in the market place. The car dealer can use data mining software to develop more accuracy in marketing and pricing its products and services. For some customers there may be so many data points that traditional analytic approaches are not appropriate. The result can lead to a number of potential strategies for reaching profitable customers. Hidden data patterns may show that certain profile customers are more likely to purchase certain types of vehicle and maintenance services.

Possible patterns/trends: profiles of customers against profiles of car purchased

- Time between purchases.
- Loyalty of customers to particular manufacturers.
- The impact of the launch of new models on purchasing patterns.
- Time between servicing extended warranties.
- The customising of customer requirements.
- Delivery times
- Hire car details as opposed to purchase of cars
- Methods of payment used

[Total: 25 Marks]

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D2: FINANCIAL MANAGMENT

FRIDAY 14 JUNE 2019

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.

DO NOT OPEN THIS QUESTION PAPER UNTIL YOU ARE INSTRUCTED BY THE INVIGILATOR.

Attempt all FOUR (4) Questions.

QUESTION ONE

The Directors of OYA Plc recently had a meeting where they observed that the company's performance for the past two years was excellent and the wealth of the shareholders has increased. Below is the summary financial information for OYA Plc, covering the past two years.

	2018	2017
	K'm	K'm
Revenue	75	67.9
Cost of sales	27.9	26
Operational costs	31	29
Profit before interest and tax	16.1	12.9
Interest	1.6	1.9
Tax	4.35	3.3
Profit after interest and tax	10.15	7.7
Dividends payable	4.8	3.2
Equity	40	35
Long term debt	14.1	17.6
Number of shares in issue (million)	14	14
P/E ratio (average for year)		
OYA Plc	13.9	12.8
Industry	15.0	14.8

Required

(a) Assess the financial performance of OYA Plc using profitability, debt, and shareholders' investment ratios. (20 marks)

(b) Explain the meaning of shareholder wealth maximisation. (5 marks)

[Total: 25 Marks]

QUESTION TWO

Granti Ltd is considering investing in a new machine with the following financial information:

Description	**Year 0**	**Year 1**	**Year 2**	**Year 3**	**Year 4**
	K'm	K'm	K'm	K'm	K'm
Profit(Loss)	-	28	(5)	15	10
Initial investment	(100)	-	-	-	-
Scrap value of machine (net)	-	-	-	-	12

It is the policy of Granti Ltd to evaluate new investment costing below K105 million using the accounting rate of return and payback period. The company has a target accounting rate of return of 30% and a payback period of two (2) years. The company depreciation policy requires that straight-line method is used for plant and machinery. The initial working capital required is K5 million.

Required:

(a) Calculate the accounting rate of return using average investment and advise on the acceptability of the investment.
(7marks)

(b) Calculate the payback period and advise on the acceptability of the investment.
(8marks)

(c) Explain the reasons a company may hold on to cash and the dangers it may face by holding on to cash. (10 marks)

[Total: 25Marks]

QUESTION THREE

MPU Inc. a Zambian company is considering investing in a machine worth K5.2 million to be used in the production of environmental friendly paper bags. The machine has a life span of four years. The scrap value of the machine is estimated to be K400,000 after tax at end of year four. The company has estimated production costs to be as follows:

(i) Current variable costs are K8.1 per unit and;

(ii) Fixed costs are K1.6 million per year

The company expects to produce and sell 200,000 units per year. A unit is equivalent to a box containing 25 paper bags. The estimated current selling price is K25 per unit. Included in the fixed costs is depreciation of K0.3 million per year. The selling price and variable expenses will increase annually by 10% and 8% respectively. The company is financed by 60% equity and 40% debt based on market values. The company asset beta is 0.87 and the equity premium is 8%. The risk free rate is 5% and MPU Ltd pays corporate tax at the rate of 30% per year. The Pretax cost of debt is 8%.

Required:

(a) Calculate the NPV of the project and advise whether the investment is financially acceptable.

(14 marks)

(b) Calculate the Internal Rate of Return (IRR) of the project and advise whether the investment is financially acceptable. (5 marks)

(c) Explain the difference between overtrading and overcapitalisation. (6marks)

[Total: 25Marks]

QUESTION FOUR

MAEU Group of companies is a parent company with ten (10) subsidiaries spread across the country. During the year MAEU sold materials to a subsidiary company, HBK Ltd, for K700,000 making a mark-up of one third. Only 25% of these goods were sold before the end of the year, the rest were still in stock. HBK, Ltd purchases most of its materials from MAEU except for a certain type of material which is bought from a specialised supplier.

HBK Ltd purchases 25,000 units of a special material each year from a single supplier. At the moment, the company obtains the special material in batch sizes of 600 units. The material costs K60 per unit and the cost of ordering a new batch from the supplier is K70. The cost of holding inventory is K15 per unit plus an interest cost equal to 10% of the purchase price of the special material.

Required:

(a) Explain the reasons consolidated financial statements are useful to the users of financial statements (as opposed to just the parent company's separate (entity) financial statements). (10 marks)

(b) Explain the reason it is necessary to eliminate unrealised profits when preparing group financial statements. (5 marks)

(c) Calculate the economic order quantity and the annual savings which would be obtained if this order quantity replaced the current order size for HBK Ltd. (10 marks)

[Total: 25 Marks]

Formula Sheet

Economic order quantity

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

Miller – Orr Model

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

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

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

END OF PAPER

D2 FINANCIAL MANAGEMENT SUGGESTED SOLUTIONS

SOLUTION ONE

a) Ratio analysis

The performance of OYA Plc:

	2018	2017
Profitability		
ROCE (PBIT/Long-term capital):	16.1/ (40 + 14.1) = 29.75%	12.9/ (35+17.6) = 24.52%
Debt		
Gearing (Debt/Equity):	14.1/40 = 35.25%	17.6/35 = 50.28%
Interest coverage (PBIT/Interest):	16.1/1.6 = 10	12.9/1.9 = 6.8
Shareholders' investment		
EPS:	10.15/14 = K0.725	12.9/14 = K0.55
Share price (P/E x EPS):	13.9 x K0.725 = K10.1	12.8 x 0.55 = K7.04
Dividend per share:	4.8/14 = K0.34	3.2/14 = K0.23
Dividend yield (DPS/Share price)	0.34/10.1 = 3.37%	0.23/7.04 = 3.27%

Based on the above computations, the performance of the company has reasonably improved and shareholders would be happy.

Growth of income
The company has grown in terms of turnover and profits. Turnover has grown by 9.47% ((75 – 67.9)/67.9 x 100%) and return on capital employed has increased from 24.52% to 29.75%. There may be some concern over operational costs which has increased by 6.9% ((31–29)/29 x 100%).

Gearing
The financial risk that the shareholders are exposed to does not appear to be a problem area as gearing has decreased from 50.28% to 35.25% and interest cover has also increased from 6.8 to 10 which more than sufficient.

Shareholder return
The shareholders' investment ratios all indicate that shareholders' wealth has increased. The share price has increased by 43.46% ((10.1 – 7.04)/7.04 x 100%). The total shareholder return is (Pl – Po + PI)/Po = (3.06+0.34)/7.04 = 48.3%. This is return should be sufficient to meet the shareholder's expectations. The P/E ratio reflects the market's expectation of the share's future prospects and this has improved from 12.8 to 13.9.

b) Shareholders wealth is maximized when their value is increased through undertaking profitable investments (investments which gives positive NPV). The value of shareholders can be measured by the stock prices and dividend earned by shareholders. If a company undertakes profitable investment, it would be to generate a healthy return on invested capital hence increase the value. If this value is created over the long term, the share price increases and the company can pay larger cash dividends to shareholders.

SOLUTION TWO

a) Average Profits= 28+(-5) +15+10/4 = 12
   Average investment = 100+12/2 = 56
   ARR = 12/56 x 100% = 21.42%
   The project should not be undertaken because it gives an ARR which is below the target rate of 30% as per company policy.

b) Payback period

   Depreciation = 100-12/4 = 22

Year	1	2	3	4
	K'm	K'm	K'm	K'm
Profit(Loss)	28	(5)	15	10
Add: Depreciation	22	22	22	22
Cash flow	50	17	37	32

Year	Cash flow (K'm)	Balance
0	(100)	(100)
1	50	(50)
2	17	(33)
3	37	2

Payback period = 2.89 years
The project should not be undertaken because it gives a payback period of 2.89years which is higher than the company policy of 2 years.

c) Reasons for holding cash
   i) Speculative motive: The speculative motive is the need to hold cash in order to be able to take advantage of, for example, bargain purchase opportunities that might arise, attractive interest rates and (in case of international firms) favourable exchange rate fluctuations.
   ii) Precautionary motive: This need to hold cash for a safety supply to act as a financial reserve. In other words, precautionary motive is the desire to hold cash in order to be able to deal effectively with unexpected events that require cash outlay.
   iii) Transaction motive: The need to hold cash to satisfy normal disbursement and collection activities associated with a firm's ongoing operations.

However, holding cash has an opportunity cost which is the interest income that would be earned in the next best use such as investing in marketable securities.

SOLUTION THREE

i) NPV

Year	0	1	2	3	4
Selling price		27.50	30.25	33.28	36.60
Variable costs		8.75	9.45	10.20	11.02
Contribution per unit		**18.75**	**20.80**	**23.07**	**25.58**
Units		200,000	200,000	200,000	200,000
Contribution		**3,750,400**	**4,160,432**	**4,614,267**	**5,116,508**
Fixed costs		1,300,000	1,300,000	1,300,000	1,300,000
Taxables cash flow		2,450,400	2,860,432	3,314,267	3,816,508
Tax@30%		(735,120)	(858,130)	(994,280)	(1,144,952)
Investment Machine	(5,200,000)	-	-	-	400,000
Net Cashflow	(5,200,000)	1,715,280	2,002,302	2,319,987	3,071,556
Disc@11%	1.000	0.901	0.812	0.731	0.659
Present value	**(5,200,000)**	**1,545,467**	**1,625,869**	**1,695,910**	**2,024,155**

NPV 1,691,401

ii) IRR	0	1	2	3	4
Net Cashflow	(5,200,000)	1,715,280	2,002,302	2,319,987	3,071,556
Dis@30%	1	0.769	0.592	0.455	0.350
Present values	(5,200,000)	1,319,050	1,185,363	1,055,594	1,075,045

NPV (564,948)

IRR= L% + NPVL/NPVL+NPVH x (H%-L%)
IRR = 25.24%

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

0.87 = Be x 0.6/0.6 + 0.4(1-0.3)

Be=1.28

Cost of equity = 5% + 1.28(8%) = 15.24%

Cost of debt = 8% x (1-0.3) = 5.6%

WACC = (15.24% x 0.6) + (5.6% x 0.4) = 11%

i)

Overtrading happens when a business expands too quickly without having the financial resources to support such a quick expansion. If suitable sources of finance are not obtained, overtrading can lead to business failure. Importantly, overtrading can occur even if a business is profitable. It is an issue of working capital and cash flow. Overtrading is, therefore, essentially a problem of growth. It is particularly associated with retail businesses who attempt to grow too fast.

Overtrading is most likely to occur if:

- Growth is achieved by making significant capital investment in production or operations capacity before revenues are generated
- Sales are made on credit and customers take too long to settle amounts owed
- Significant growth in inventories is required in order to trade from the expanding capacity
- A long-term contract requires a business to incur substantial costs before payments are made by customers under the contract

Over capitalisation is when the working capital of the company is too high – which means a company has issued more debt and equity than its assets are worth. An overcapitalized company might be paying more than it needs to in interest and dividends.

SOLUTION FOUR

a) Usefulness of consolidated financial statements

The main reason for preparing consolidated accounts is that groups operate as a single economic unit, and it is not possible to understand the affairs of the parent company without taking into account the financial position and performance of all the companies that it controls. The directors of the parent company should be held fully accountable for all the money they have invested on their shareholder's behalf, whether that has been done directly by the parent or via a subsidiary.

There are also practical reasons why parent company accounts cannot show the full picture. The parent company's own financial statements only show the original cost of the investment and the dividends received from the subsidiary. As explained below, this hides the true value and nature of the investment in the subsidiary, and, without consolidation, could be used to manipulate the reported results of the parent.

- The cost of the investment will include a premium for goodwill, but this is only quantified and reported if consolidated accounts are prepared.
- A controlling interest in a subsidiary can be achieved with a 51% interest. The full value of the assets controlled by the group is only shown through consolidation when the non-controlling interest is taken into account.
- Without consolidation, the assets and liabilities of the subsidiary are disguised.
  - A subsidiary could be very highly geared, making its liquidity and profitability volatile.
  - A subsidiary's assets might consist of intangible assets, or other assets with highly subjective values.
- The parent company controls the dividend policy of the subsidiary, enabling it to smooth out profit fluctuations with a steady dividend. Consolidation reveals the underlying profits of the group.
- Over time the net assets of the subsidiary should increase, but the cost of the investment will stay fixed and will soon bear no relation to the true value of the subsidiary.

b) Elimination of unrealized profit

Unrealised profits arise when group companies trade with each other. In their own individual company accounts profits and losses will be claimed on these transactions, and goods bought from a fellow group company will be recorded at their invoiced cost by the purchaser.

However, consolidated accounts are drawn up on the principle that a group is a single economic entity. From a group point of view, no transaction occurs when goods are traded between group companies, and no profits or losses arise. Revenue and profits will only be claimed when the goods are sold onto a third party from outside of the group.

c)

$$\sqrt{\frac{2 * A * Cp}{Ch}}$$

EOQ = $\sqrt{\frac{2 \times 25{,}000 \times 70}{15 + (60 \times 0.10)}}$

= 408 units

Annual Costs:

	Proposed		Current
Holding costs (408/2 X 15)	4,284	(600/2 x 21)	6,300
Ordering costs (25,000/408 x 70)	4,289	(25,000/600 x 70)	2,917
Total cost	8,573		9,217

The annual cost saving would be K464 (9,217 – 8,573)

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D3: BUSINESS TAXATION

WEDNESDAY 12 JUNE 2019

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.

DO NOT OPEN THIS QUESTION PAPER UNTIL YOU ARE INSTRUCTED BY THE INVIGILATOR.

Taxation table

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	5.5% of norm value
From US$4,500 to less than US$6,000	6.5% of norm value
From US$6,000 to less than US$7,500	7.5% of norm value
From US$7,500 to less than US$9,000	8.5% of norm value
From US$9,000 and above	10% of norm value

Mineral Royalty on other minerals

Type of mineral	**Mineral Royalty Rate**
Base Metals (Other than Copper, Cobalt and Vanadium)	5% on norm value
Cobalt and Vanadium	8% of 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 4 %

Presumptive Tax for Transporters

Seating capacity	**Tax per annum** K	**Tax per day** 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**	**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	21,926	9,501	17,541	7,601

5.0 tonnes

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 FOUR (4) questions.

QUESTION ONE

(a) George Banda settled in Chipata District of Eastern Province after retiring from the Lopane Ltd where he worked as a miner. He set up a business as a sole trader in January 2017 dealing in hardware and general merchandise. He later convinced his wife, Margaret, to join him as a partner in January 2019.They agreed to be sharing profits and losses in the ratio of 3:2 after allowing for annual salaries of K30,000 and K20,000 for George and Margaret respectively.

The statement of profit or loss for the year ended 31 December 2019 is as follows:

		K	K
Gross Profit			315,000
Profit on sale of motor car			2,500
Bank interest received			700
			318,200
Less Expenses			
Staff wages		80,150	
Rent and rates		6,200	
Depreciation		7,000	
Light and heat		20,200	
Motor car expenses	(note1)	3,400	
Telephone		760	
Postage and stationery		10,400	
Repairs and renewals	(note 2)	4,750	
Miscellaneous expenses	(note 3)	3,470	
Bad debts written off	(note 4)	2,050	
Son's wages	(note 5)	2,500	
Advertising		10,500	
			(151,380)
Net profit			166,820

The following further information is provided:

1. Motoring Expenses
   One fifth of motoring expenses relates to private motoring by George.

2. Repairs and renewals

	K
Painting shop internally	1,600
Plant repairs	1,300
Construction of extensions to stores	1,850
	4,750

3. Miscellaneous expenses

	K
Donation to a political party	210
Subscription to Chamber of Commerce	170
Entertaining customers	800
Christmas gifts to suppliers- (Bottles of whisky costing K70 each)	700
Payment of employee in lieu of notice	120
Legal expenses- debt collection	130
Sundry expenses – all allowable	1,340
	3,470

4. Bad debts account

Dr	K		Cr K
Trade debts written off	1,020	Balance b/f	
Balances c/f :		General reserve	2,000
General reserve	4,050	Specific reserve	3,700
Specific reserve	4,880	Trade debts written off now recovered	2,200
		Profit and loss	2,050
	9,950		9,950

5. George had employed a casual worker on an annual salary of K1,900. The work he was doing was equal to what George's son did.
6. George withdrew goods from stock costing K3,800 for use by his family. He estimates that his profit percentage on turnover is 20%.
7. In 2019, they acquired a Nissan car for K35,000 to replace a Toyota corolla which they disposed off at K30,000 in January 2019. He had acquired the Toyota Corolla at a cost of K25,000 in 2017. The income tax value of the Toyota Corolla was K15,000. The private use of the Nissan motor car was 20%. In the same year of 2019, they purchased some furniture for the small office at K15,000.

   They also purchased a good second hand Canter light truck for K60,000 in 2019 used exclusively for business.

Required:

Calculate the income tax payable by George and Margaret for the tax year 2019.

(16 marks)

(b) Zaira Ltd, a wholly owned Zambian manufacturing company is registered for VAT with the Zambian Revenue Authority.

(1) During the year 2019, it made sales to registered customers amounting to K1,020,000 out of which 60% were standard-rated sales while the rest were zero-rated sales.

(2) The company sold standard-rated furniture which was in excess to its requirement for K150,000 (VAT inclusive).

(3) The purchases for the period amounted to K612,000. Of this amount 40% are exempt while the rest are standard-rated.

(4) Standard rated expenses were as follows:

	K
Entertaining customers	100,000
Petrol	100,000
Diesel	80,000
Stationery	30,000
Utility bills	20,000

Utility bills were incurred in respect of company premises which are used wholly and exclusively for business.

Unless stated otherwise all the figures are exclusive of VAT.

Required:
Calculate the VAT payable for the year ended 31 December 2019. (9 marks)

[Total: 25 Marks]

QUESTION TWO

Choma Copper Mines (CCM) Plc is a Zambian resident company engaged in the mining of copper in Zambia. CCM Plc is a 70% owned subsidiary of FCM Plc, a multinational company. CCM Plc prepared the following statement of profit or loss for the year ended 31 December 2019:

		K
Revenue	(Note 1)	23,400,000
Cost of sales	(Note 2)	(15,502,500)
Gross profit		7,897,500
Operating expenses	(Note 3)	(4,212,000)
Profit before interest and tax		3,685,500
Other income	(Note 4)	120,000
Profit before tax		3,805,500
Income tax expense	(Note 5)	(1,141,650)
Profit for the period		2,663,850

The following additional information is available:

1. The figure for revenue in the statement of profit or loss represents the norm value based on the average price quoted on the London Metal Exchange. The price of copper during the tax year 2019 averaged $4,400 per metric tone.

2. Cost of sales include mineral royalty tax paid during the tax year 2019, depreciation of non-current assets K1,240,000, amortization of intangible assets of K1,053,000, construction of a hospital in the mine township K2,600,000 and repairs to a mining plant acquired ten (10) year ago. The balance consists of revenue expenses which are all allowable for tax purposes.

3. Operating expenses include expenditure on entertaining employees of K520,000, entertaining suppliers K1,260,000 and interest on late payment of provisional income tax of K263,000. The balance consists of revenue expenses which are all allowable for tax purposes.

4. Included in other income is interest on Government bonds of K80,000 (gross) and rental income of K40,000 (gross).

5. The income tax expense in the statement of profit or loss represent the provisional income tax paid during the tax year 2019.

6. The only assets qualifying for capital allowances on 1 January 2019 were as follows:

	Income tax values	Original costs
	K	K
Mining Equipment	2,000,000	4,000,000
Motor cars	300,000	500,000
Office equipments	200,000	800,000

All the assets were acquired from Zambian vendors and paid for in Zambian kwacha.

7. CCM Plc has had the following trading results for the past two (2) years:

Year ended 31 December	2017	2018
	K	K
Tax adjusted mining profit/(loss)	(2,140,000)	2,200,000

The following average exchange rates have been approved by the Commissioner General:

Year 2017	K9.75
Year 2018	K11.20
Year 2019	K11.10

CCM Plc maintains its financial statements in United States dollars.

8. The following indexation formula is provided:

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

Required:

(a) Show how the loss incurred by CCM Plc during the year ended 31 December 2017 will be relieved in the year 2018 stating the amount of loss, if any, remaining at 31 December 2018. (5 marks)

(b) Calculate the adjusted mining profit for CCM Plc for the tax year 2019. (14 marks)

(c) Calculate the amount of income tax payable by CCM Plc for the tax year 2019. (6 marks)

[Total: 25 Marks]

QUESTION THREE

(a) Explain the company income tax and property transfer tax treatment of group of companies. (4 marks)

(b) Describe any four (4) conditions to be met in order for a loss incurred by one company to be surrendered to another company. (4 marks)

(c) Enock Mwala, a sole trader, runs a farming business preparing his accounts to 31 December each year. His statement of profit or loss for the year ended 31 December 2019 showed a net profit of K212,750 from a turnover of above K800,000. This profit figure was arrived at after the following:

1. Salaries and wages of K220,000. This figure includes his nominal salary of K50,000, and his niece's salary of K25,000. His niece assists him in the business as a secretary. Other employees with similar duties as of his niece are paid a salary of K16,000.
2. Operating expenses of K420,000. This figure include expenditure on entertaining customers of K36,000, legal fees incurred in defending title to business assets of K72,000 and rentals for his house of K21,700. The balance consists of revenue expenses which are all allowable for tax purposes.

Other information

1. Mr Mwala paid provisional income tax for the tax year 2019 amounting to K17,300, this has not been included in computing the net profit figure for the year shown above.

2. During the tax year 2019, he incurred the following capital expenditure:

	K
Farm tractor	30,000
Construction of two dwelling houses (each costing K17,000)	34,000
Borehole	22,000

3. As at 1 January 2019, he had no assets on which he could claim capital allowances.

Required:

Calculate the income tax payable by Enock Mwala for the tax year 2019.

(9 marks)

(d) Project Bank Plc, a Zambian resident company, made a net profit as per statement of profit or loss for the year ended 31 December 2019 of K920,000. This profit was arrived at after charging administration expenses of K680,000 and general expenses of K1,400,000. Administration expenses included depreciation of non-current assets of K120,000 and the Managing Director's salary of K300,000 (who is accommodated in a company owned house). The balance consists of revenue expenses which are all allowable for tax purposes.

General expense include increase in general provision of loan losses of K117,200, irrecoverable loans written off amounting to K307,600 and increase in specific provision of loan losses K52,000. The balance consists of revenue expenses which are all allowable for tax purposes.

Capital allowances on business assets have been agreed at K250,000. During the tax year 2019, the bank paid provisional income tax and withholding tax on interest income of K59,700 and K67,500 respectively.

Required:
Calculate the income tax payable by Project Bank Plc for the tax year 2019.

(8 marks)

[Total: 25 Marks]

QUESTION FOUR

DAN Limited is a Zambian resident company engaged in retailing. The company is owned by four (4) Zambian entrepreneurs each with a shareholding of 25% each. The company has always prepared its financial statements to 28 February each year. The statement of profit or loss for the year ended 28 February 2019 reported a taxable profit before capital allowances of K517,200. On 1 March 2019, the company decided to change its accounting date to 31 December and prepared its financial statements for ten (10) months to 31 December 2019 reporting a taxable business profit before capital allowances of K511,700 for this period. The company will, thereafter prepare its financial statements annually to 31 December.

The only assets qualifying for capital allowances were as follows:

Date of purchase	Asset	Cost (K)
21 February 2018	Administration building	410,000
02 April 2018	Delivery van	68,000
01 October 2018	Motor car	96,000
01 March 2019	Office equipment	63,000

The directors are considering providing loans to each shareholder of up to K100,000.

Required:

(a) Explain the basis of assessment for the periods ended 28 February 2019 and 31 December 2019. (5 marks)

(b) Calculate the final taxable profits for each of the tax years 2018 and 2019. (13 marks)

(c) Assuming the income tax rates for the tax year 2019 apply to 2018, calculate the income tax payable by the company for each of the tax years 2018 and 2019. (3 marks)

(d) Explain the taxation treatment for the company of loans made to effective shareholders. (4 marks)

[Total: 25 Marks]

END OF PAPER

D3: BUSINESS TAXATION SUGGESTED SOLUTIONS

SOLUTION ONE

(a) George and Margaret

Income tax payable for the tax year 2019

	K	K
Net Profits as per accounts		166,820
Add:		
George- Son's wages (2,500 – 1,900)	600	
Depreciation	7,000	
Motor Car expenses (1/5 X K3,400)	680	
Repairs and renewals		
(construction of extended stores)	1,850	
Donation to a Political Party	210	
Entertaining suppliers	800	
Christmas Gifts- Bottles of whisky	700	
Increase in general provision	2,050	
Goods for personal use (100/80 X 3,800)	4,750	
		18,640
		185,460
Less:		
Profit on sale of motor car	2,500	
Bank interest received	700	
Capital allowances (W1)	14,350	
		(17,550)
Adjusted business profit		167,910

Workings

1. Capital Allowances:

Nissan Car (K35,000 X20%) x 80%	5,600
Toyota corolla car balancing charge	
(15,000- 25,000)	(10,000)
Office furniture (K15,000 X 25%)	3,750
Canter light Truck (K60,000 X 25%)	15,000
Total capital allowances	14,350

Allocation of business profits

	Total	George	Margret
	K	K	K
Salaries	50,000	30,000	20,000
Balance (3:2)	117,910	70,746	47,164

	167,910	100,746	67,164

Computation

First K39,600@0%	0	0
Next K9,600@25%	2,400	2,400
Next K25,200/K17,964@30%	7,560	5,389
Balance K26,346@37.5%	9,880	-
Income tax payable	19,840	7,789

(b) VAT payable for the year ended 31 December 2019

Output VAT	K	K
Sales to registered customers		
Standard rated customers (K1,020,000 X 60% X 16%)		97,920
Zero rated customers (K1,020,000 X 40% X 0%)		0
Standard rated furniture (K150,000 X 4/29)		20,690
		118,610
Input VAT		
Exempt purchases (K612,000 X 40%)	-	
Standard rated purchases (K612,000 X 60% X 16%)	58,752	
1		
Entertaining customers (irrecoverable)	-	
Petrol (irrecoverable)	-	
Diesel (K80,000 X 90% X 16)	11,520	
Stationery (K30,000 X 16%)	4,800	
Utility bills (K20,000 X 16%)	3,200	
		78,272
VAT payable		40,338

SOLUTION TWO

(a) Loss relief for the tax year 2018

	K
Adjusted mining profit	2,200,000
Less:	
Loss brought forward (W1)	(1,100,000)
Taxable mining profit	1,100,000

Workings:

(1) Loss should be indexed using the average exchange rate during the year 2017 and 2018.

$(1 + (\frac{K11.20 - K9.75}{K9.75}) \text{ x K2,140,000}$

= K2,458,256

The loss to be relieved should be restricted equivalent to 50% of the adjusted business profit. Since the adjusted profit for the tax year 2018 is K2,200,000, only K1,100,000 (K2,200,000 x 50%) will be relieved against the profits. The balance of the loss should be carried forward to the tax year 2019. i.e K2,458,256 – K1,100,000 = K1,358,256

(b) CCM Plc

Adjusted Mining profit for the tax year 2019

	K	K
Profit before tax		3,805,500
Add:		
Mineral royalty tax (K23,400,000 x 5.5%)	1,287,000	
Depreciation	1,240,000	
Construction of hospital	2,600,000	
Entertaining suppliers	1,260,000	
Interest on late payment of provisional tax	263,000	
Amortisation	1,053,000	
		7,703,000
		11,508,500
Less:		
Interest on Government bonds	80,000	
Rental income	40,000	
Capital allowances (W2)	1,950,000	
		(2,070,000)
Adjusted mining profit		9,438,500
Less:		
Loss brought forward (W3)		(1,346,129)
Final taxable mining profit		8,092,371

Workings

(2) Capital allowances

	K
Mining equipment (K4,000,000 x 25%)	1,000,000
Motor cars (K500,000 x 20%)	100,000
Office equipments (K800,000 x 25%)	200,000
Hospital (K2,600,000 x 25%)	650,000
Total capital allowances	1,950,000

(3) Loss brought forward

$(1 + (\frac{K11.10 - K11.20}{K11.20}) \text{ x } 1{,}358{,}256$

= K1,346,129

Since the indexed loss is less than 50% of the adjusted mining profit, the whole loss will be relieved in the tax year 2019.

(c) CCM Plc

Income tax payable for the tax year 2019

	K
Taxable mining profit	8,092,371
Non-mining income	
Interest on government bonds	80,000
Total taxable income	8,172,371

Computation

Mining profit @30% x K8,092,371	2,427,711
Non-mining income @35% x K80,000	28,000
Income tax liability	2,455,711
Less:	
Provisional income tax paid	(1,141,650)
Withholding tax: K80,000 x 15%	(12,000)
Income tax payable	1,302,061

SOLUTION THREE

(a) Income tax

Each member of the group is required to register for income tax and pay income tax individually on its taxable business profits.

Property transfer tax

All properties transferred by one company to the other member of the group is deemed to have a realised value of nil as long as the Commissioner General is satisfied that such a transfer was made for the purpose of internal reorganization of the group.

(b) The following conditions must be met for a loss to be surrendered to another company:

(i) The company making the transfer of the loss must have been incorporated outside the Republic of Zambia.

(ii) The old company must have been carrying on its principal business in the Republic of Zambia.

(iii) The old company should be voluntarily wound up in the country where it is incorporated.

(iv) The old company must have incurred a loss in the period which is not more than five (5) years prior to formation of new company.

(v) The new company must have been incorporated in Zambia for the purpose of acquiring the business and property of the old company.

(c) Enock Mwala

Income tax payable for the tax year 2019

	K	K
Net profit		212,750
Add:		
Mwala's salary	50,000	
Niece's excess salary (K25,000 – K16,000)	9,000	
Entertaining customers	36,000	
Rental Mwala's house	21,700	
		116,700
		329,450
Less:		
Capital allowances (W1)		(86,000)
Taxable profit		243,450
Computation		
First K39,600 @0%		0
Balance K203,850 @10%		20,385
Income tax liability		20,385
Less:		

Provisional income tax		(17,300)
Income tax payable		3,085

Workings

Capital allowances	K
Farm tractor (K30,000 x 100%)	30,000
Dwelling houses (K17,000 x 100%) x 2	34,000
Borehole (K22,000 x 100%)	22,000
Total capital allowances	86,000

(d) Project Bank plc

Income tax payable for the tax year 2019

	K	K
Net profit		920,000
Add:		
Depreciation	120,000	
Free accommodation benefit		
(K300,000 x 30%)	90,000	
Increase in general provision	117,200	
		327,200
		1,247,200
Less:		
Capital allowances		(250,000)
Taxable profits		997,200
Income tax @35% (K997,200 x 35%)		349,020
Less:		
Provisional income tax		(59,700)
Withholding tax		(67,500)
Income tax payable		221,820

SOLUTION FOUR

(a) The basis of assessment is a set of rules for establishing a basis period. A current year basis or preceding year basis of assessment may be used.

The current year basis is used to make income tax assessments for business profits where accounts are prepared to a date falling between 1 April and 31 December (inclusive).

The preceding year basis is used to make income tax assessments for business profits where accounts are prepared to a date falling between 1 January and 31 March inclusive.

Therefore, for the year ended 28 February 2019, the basis of assessment is the preceding year basis which is the tax year 2018, whereas for the ten (10) months ended 31 December 2019, the basis of assessment is the current year basis which is the tax year 2019.

(b) DAN Limited

Adjusted business profit for the tax years

	K	K
Profit before capital allowances	517,200	614,040
Capital allowances (W2)	(44,400)	(60,150)
Taxable business profit	472,800	553,890

Workings

1. Adjusted business profit for the tax year 2019

   Since a continuing business should pay tax on the profits made for at least twelve (12) months, the company's profits will be expanded into a notional twelve (12) months period for the purpose of determining the taxable profit for the tax year 2019.

   The income tax payable for the tax year 2019 will be computed on the expanded profit. The difference between the actual profit and the profit on which tax will be calculated is known as overlap profit. The expanded profit for the tax year 2019 will be as follows:

   K511,700 x 12/10 = K614,040

   The overlap profit of K102,340 (K614,040 – K511,700) to be relieved in the final tax year.

2. Capital allowances for the tax year

2018	Cost/ITV	Capital allowance
	K	K
Administration building		
Cost	410,000	
Wear & Tear @2% (K410,000 x 2%)	(8,200)	8,200
Income tax value c/f	401,800	
Delivery van		
Cost	68,000	
Wear & Tear @25% (K68,000 x25%)	(17,000)	17,000
Income tax value c/f	51,000	
Motor car		
Cost	96,000	
Wear & Tear @ 20% (K96,000 x 20%)	(19,200)	19,200
Income tax value c/f	76,800	----------
Total capital allowances		44,400
2019		
Administration building		
Income tax value b/f	401,800	
Wear & Tear @2% (K410,000 x 2%)	(8,200)	8,200
Income tax value c/f	393,600	
Delivery van		
Income tax value b/f	51,000	
Wear & Tear @25% (K68,000 x 25%)	(17,000)	17,000
Income tax value c/f	34,000	
Motor car		
Income tax value b/f	76,800	
Wear & Tear @20% (K96,000 x 20%)	(19,200)	19,200
Income tax value c/f	57,600	
Office equipment		
Cost	63,000	
Wear & Tear @25% (K63,000 x 25%)	(15,750)	15,750
Income tax value c/f	47,250	----------
Total capital allowances		60,150

(c) DAN Limited

Income tax payable for the tax years	2018	2019
	K	K
Taxable business profits	472,800	553,890
Income tax @35%	165,480	193,862

(d) Income tax is assessed on the grossed up amount of the loan at the highest rate of tax for an individual for the charge year in which the loan is made. For the tax year 2019, the grossed up amount of the loan would be taxed at 37.5%. (2 marks)

If the loan is repaid by the effective shareholder during the charge year, then the tax on the repaid loan is treated as an excess tax which may be repaid to the company if the claim for a repayment is made. (1 mark)

If the loan is written off, then the amount of the loan written off is treated as taxable income of the effective shareholder. Tax paid cannot be refunded unless the effective shareholder pays tax on the additional taxable income. (1 mark)

END OF SOLUTION

Zambia Institute of Chartered Accountants

TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D4 – PERSONAL TAXATION

TUESDAY 11 JUNE 2019

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

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading time. Use this time to carefully study the examination paper 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 in 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 and 3

DO NOT OPEN THIS QUESTION PAPER UNTIL YOU ARE INSTRUCTED BY THE INVIGILATOR.

Taxation table

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 4%

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	9.90
From 12 to 17 passengers	1,800	4.90
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 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%

Attempt all FOUR (4) Questions.

QUESTION ONE

Safeli was born in Zambia on 1 April 1976 and had always lived in Zambia until 31 December 2011, when he left Zambia for employment with a multinational company, in a country known as New Englande. Safeli resigned from his position with the foreign multinational company on 31 December 2018 and then decided to return to Zambia on 30 April 2019.

On his return to Zambia, he took up employment with a Zambian resident company on 1 June 2019, on a three year contract at an annual salary of K132,000. He was accommodated at a local hotel from 1 June 2019 to 30 July 2019 after which he was required to find his own accommodation. The company paid K9,000 per month on his behalf in respect of board and lodging expenses he incurred during this period.

On 1 August 2019, Safeli shifted into a rented house and the company paid him a settling in allowance of K5,000. The company further undertook to pay his rental bills for the house amounting to K3,500 per month, together with the incidental expenses in connection with the accommodation of K1,500 per month from 1 August 2019 to 31 December 2019.

On 1 June 2019, the company provided him with a personal to holder car with a cylinder capacity of 2500cc and paid for all motor car running expenses which amounted to K2,500 per month. His private use in the motor car for the tax year 2019 is estimated to be 60%.

On 20 June 2019, the company reimbursed him K15,000 in respect of the cost of the medical treatment for his sick wife which he had incurred earlier that month. He made life assurance premium payments of K600 per month. Pay As You Earn deducted from his emoluments for the tax year 2019 amounted to K20,263.

Safeli holds shares in a Zambian company which is listed on the Lusaka Securities Exchange, from which he earned dividends of K18,000 (gross) during the tax year 2019. He also holds a fixed deposit account with a Zambian bank which earned fixed deposit interest of K9,000 (gross) in the tax year 2019.

Whilst in New Englande, Safeli made various investments in companies resident in that country. On 31 December 2019, he received the following income from his investments in New Englande:

Dividends from quoted shares of companies in New Englande	K16,250
Interest income from debentures of companies in New Englande	K6,000
Rental income from property let out in New Englande	K27,000

Both interest and rental income from New Englande are net of withholding tax at the rate of 25% deducted in New Englande, whilst Dividend income is net of withholding tax at the rate of 35% deducted in New Englande. There is no double taxation agreement between Zambia and New Englande. When computing Zambian Income Tax payable, credit is available for any foreign tax paid in New Englande.

Required:

(a) Explain why Safeli will be regarded as resident and ordinarily resident in Zambia in the tax year 2019. (2 marks)

(b) Explain the tax treatment of the following investment income received by Safeli from Zambian sources in the tax year 2019:

(i) Dividends from the company listed on the LuSE.

(ii) Fixed deposit interest from the Zambian Bank.

(2 marks)

(c) Explain the tax treatment of the following benefits provided to Safeli by his employer in the tax year 2019:

(i) Payment of his board and lodging fees.
(ii) Payment of rentals and incidental costs for his accommodation.
(iii) Provision of Personal to holder motor car.
(iv) Payment of motor car running expenses in relation to the personal to holder motor car.

(v) Reimbursement of the costs for medical treatment.

(5 marks)

(d) Calculate the income tax payable by Safeli for the tax year 2019. (10 marks)

(e) Describe three methods that can be used to give double taxation relief to a Zambian resident individual receiving income from foreign sources. (6 marks)

[Total: 25 Marks]

QUESTION TWO

For the purposes of this question, you should assume that today's date is 31 December 2018. You should ignore NAPSA contributions in this question.

James Chisengu recently graduated from the Zambian University where he was pursuing a Bachelor's Degree in Business Administration. He intends to start running his own business on 1 January 2019 using the money he inherited from his father's estate as capital. His business will involve the supply of stationery to individual customers and orgainsations.

He expects the monthly sales to average K62,500 throughout the tax year 2019. The only expenses he expects to incur are salaries for his two employees of K5,000 per month for each employee, and the rentals for the office building and the shop of K8,500 per month. He will buy a motor van at a cost of K160,000 which will be used exclusively for business purposes, and a motor car at a cost of K90,000 which car will be driven by James for both business and private purposes. It has been agreed with the Commissioner General that private mileage is expected to be 40%.

James intends to register his business with Zambia Revenue Authority (ZRA) for tax purposes, but he is not sure of how he will be assessed to taxation in the tax year 2019, and whether or not he will be required to pay provisional income tax.

Required:

(a) Explain the circumstances under which a trader may be required to pay turnover tax and five (5) persons who are not required to pay turnover tax. (7 marks)

(b) Explain the persons who are required to pay provisional income tax and the due dates for the payment of provisional income tax. (6 marks)

(c) Advise James on the type and amount of tax he will be required to pay for the tax year 2019. Your answer should include an explanation of the tax treatment of the salaries, rentals and the motor van and motor car which James intends to buy during the tax year 2019. (12 marks)

[Total: 25 Marks]

QUESTION THREE

Okra Mulembwe was employed at Chembe Fisheries Ltd, a Zambian resident company, as a Production Manager. He retired on 31 August 2019, on attaining the normal retirement age. His conditions of service were as follows:

Salary per annum	K300,000
School allowance per annum	30% of the basic salary
Transport allowance per annum	10% of the basic salary

Mulembwe received a long-term service award during the tax year 2019 consisting of cash amounting to K10,500 and a wrist watch valued at K2,500. On 1 May 2019, Mr. Mulembwe was nominated as the most committed manager, and was paid a labour day award comprising an upright fridge worth K6,750 and cash of K5,800.

He was accommodated in a company owned house for which he paid no rent. If the house was rented out to any other person, the company could have been charging monthly rentals of K7,000. Maintenance expenses totaling K22,000 were paid by the company for the tax year 2019 in respect of the house occupied by Mulembwe up to the date of retirement.

On retirement, he received repatriation pay of K40,000, compensation for loss of office of K25,000, pension refund of K420,000 and leave pay of K17,600.

During the tax year 2019, Mulembwe paid medical insurance premiums of K10,300, school fees for his children of K16,700, Pay As You Earn of K127,190, professional subscription to a Production Association of K5,200 and a donation to an approved public benefit organisation of K4,200. He also paid NAPSA contributions of 5% of his basic salary.

Mr. Mulembwe received royalties of K34,000 (net), rental income of K31,500 (net) and bank deposit interest of K10,000 (gross).

Required:

(a) Explain the tax treatment of the repatriation pay, compensation for loss of office, pension and leave pay received by Mulembwe on retirement. (4 marks)

(b) Compute the income tax payable by Mulembwe for the tax year 2019. (15 marks)

(c) Explain the tax treatment of the following:

(i) Labour day awards (2 marks)
(ii) Long-term service awards (2 marks)
(iii) Rental income (2 marks)

[Total: 25 Marks]

QUESTION FOUR

(a) Explain the differences between tax avoidance and tax evasion. (4 marks)

(b) **For the purpose of this question assume that today's date is 31 December 2018.**

Mwandila has run a trading business as a sole trader for many years, preparing accounts to 31 December each year. The annual turnover from the business has always exceded K800,000. He is planning to expand the business further and wishes to involve his brother Wamundila in running the business with effect from 1 January 2019, either as an employee, or as a partner. Regardless of whether Wamundila is engaged as an employee or as a partner, a delivery van will be purchased by the business on 1 January 2019 at a cost of K60,000 to be used wholly and exclusively for business purposes.

The following additional information relating to each alternative is available:

(1) If Wamundila is engaged as an employee, he will be entitled to a monthly salary of K12,000 and a utility allowance of K1,000 per month. He will be required to contribute 5% of his basic salary as his employee's NAPSA contribution. Mwandila as his employer will also pay employer's NAPSA contributions of 5% of his basic salary on his behalf. Mwandila's own monthly salary will be K18,000.

Mwandila will use his own personal motor car which he will purchase on 1 January 2019, at a cost of K90,000 partly for business purposes and the business use of the motor car is expected to be 60%.

The tax adjusted profit before capital allowances is expected to be K741,000. The profit figure is before accounting for the remuneration packages for both Mwandila and Wamundila as well as employer's NAPSA contributions. The earnings ceiling for NAPSA contributions purposes for the tax year 2019 is K257,712 per annum.

(2) If Wamundila is introduced to the business as a partner, he will be required to invest K80,000 into the business as capital on 1 January 2019 on joining the business. Mwandila's own capital account balance at 1 January 2019 will be K160,000.

Mwandila will be entitled to a monthly salary of K18,000, whilst Wamundila will be entitled to a monthly salary of K12,000 and a utility allowance of K1,000 per month. Each individual will additionally be entitled to interest on capital of 10% per annum calculated on the opening balance of his capital account. Profits and losses will be shared in the ratio of 2:1 respectively. No NAPSA contributions will be payable under this alternative.

Mwandila will use his own personal motor car which he will purchase on 1 January 2019 at a cost of K90,000 and partly for business purposes which is expected to be 60%.

The tax adjusted profit before capital allowances is expected to be K741,000 under this alternative. The profit figure is also before accounting for salaries for Mwandila and Wamundila and before interest on each individuals's opening capital balance.

Required:

Calculate the income tax that will be paid by Mwandila and Wamundila in the tax year 2019 if:

(i) Wamundila is taken on as an employee. (9 marks)

(ii) Wamundila is taken on as a partner (9 marks)

(iii) Advise Mwandila and Wamundila as to which of the above options is beneficial from a tax point view. (7 marks)

[Total: 25 Marks]

END OF PAPER

D4: PERSONAL TAXATION SUGGESTED SOLUTIONS

SOLUTION ONE

(a) An individual is regarded as resident and ordinarily resident in Zambia in the following circumstances:

- If he or she is physically present in Zambia for a period of not less than 183 days in a charge year.
- The individual who normally lives in Zambia or comes to Zambia with the intention of remaining for a period which will exceed 12 months, is regarded as resident and ordinarily resident from the date of arrival.

Safeli will therefore be regarded as being resident and ordinarily resident in Zambian for the tax year 2019 because:

- He will be physically present in Zambia for a period exceeding 183 days in the tax year 2019 and
- By taking up employment with a Zambian company on a three year contract, it is clear that he has intentions of staying in Zambia for a period of more than twelve months.

(b) Tax treatment of investment income from Zambian sources

(i) Dividends received by Safeli from the LuSE listed company will not be subjected to any tax because dividends from companies listed on the LuSE are exempt from withholding tax.

(ii) Fixed deposit interest from the Zambian bank will not be subjected to any withholding tax because fixed deposit interest from a Zambian Bank is exempt from tax.

(b) Tax Treatment of Benefits provided to Safeli:

(i) No income tax will be assessed on Safeli in respect of the boarding and lodging expenses paid on his behalf. The benefit is exempt from income tax.

(ii) Payment of rentals and incidental costs in relation to the living accommodation will gives rise to taxable benefits. The amounts paid on his behalf will be added to other emoluments and be taxable under PAYE.

(iii) Provision of a personal to holder motor is an exempt benefit for employees and therefore, no tax will be assessed on Safeli in respect of this benefit.

(iv) No tax will arise in respect of motor car running expenses paid on Safeli's behalf, as this benefit relates to the personal to holder motor car and therefore is also exempt from income tax.

(v) Reimbursement of medical expenses is exempt from income and no tax will be assessed Safeli.

(d) SAFELI'S INCOME TAX COMPUTATION FOR THE YEAR 2019

	K	K
Emoluments from Zambia employment		
Salary (K132,000 × 7/12)		77,000
Rental (K3,500 x 5)		17,500
Incidental expense (1,500 × 5)		7,500
Settling allowance		5,000
		107,000
Foreign income		
Dividend (K16,250 x 100/65)	25,000	
Debenture Interest income (K6,000 x 100/75)	8,000	
		33,000
		140,000

Income Tax:
39,600 @ 0%
9,600 @ 25% 2,400
25,200 @ 30% 7,560
65,600 @ 37.5% 24,600
Total 34,560

Less Double Taxation Relief on:		
Dividends from New Englande (W1)	6,171	
Debenture interest from New Englande (W2)	1,975	
		(8,146)
Less PAYE		(20,263)
Income tax payable		6,151

Workings

(1) *Double taxation on the foreign dividend income*

Double taxation on the foreign dividend income will be the lower of:

(i) Actual amount of foreign tax on the dividends which will amount to:

K25,000 × 35% = K8,750 and;

(ii) The Zambian Tax Charge:

$$\left(\frac{K25,000}{K140,000}\right) x\ K34,560$$

= K6,171

DTR will therefore be K6,171 being the lower amount.

(2) *Double taxation on the foreign debenture interest income*

Double taxation on the foreign debenture income will be the lower of:

(i) Actual amount of foreign tax on the debenture which will amount to:

K8,000 $\times$ 25% = K2,000 and;

(ii) The Zambian Tax Charge:

$$\left(\frac{K8{,}000}{K140{,}000}\right) x\ K34{,}560$$

= K1,975

DTR will therefore be K1,975 being the lower amount

(e) Method of giving double taxation relief

Treaty Relief

This method applies where a double taxation agreement has been signed between Zambia and the foreign country involved as specified in the agreement. The agreement will normally provide for full recovery of any foreign tax covered by the agreement, by means of a tax credit to a Zambian resident individual, against the Zambian income tax, as long as the relief does not exceed the equivalent Zambian tax charge. In some cases, the treaty may provide that income is only chargeable to income tax in one of the two countries, or that the foreign income is charged to tax in one country, with the tax being apportioned between the two countries.

Unilateral Credit Relief

This method of giving double taxation relief applies when there is no treaty between Zambia and the foreign country in which case relief is given for foreign tax unilaterally in the republic of Zambia. This is achieved by crediting the amount of foreign tax suffered against the Zambian income tax on the foreign income, provided that the amount of foreign tax being credited against the Zambian tax does not exceed the Zambian tax on that foreign income. This means that the amount of foreign tax available for credit is taken as the lower of the actual amount of foreign tax paid to foreign tax authorities and the Zambian tax chargeable on the foreign income.

Unilateral Expense Relief

This type of double taxation relief is also given where there is no treaty between the countries concerned. Double taxation relief is given by treating the amount of foreign tax paid as an allowable expense in the country in which the foreign income is received.

SOLUTION TWO

a) Turnover tax is tax paid on turnover by persons in business whose annual turnover or sales is K800,000 or less.
and if the trader's income is subjected to withholding tax where withholding tax is not the final tax.

The following persons are not required to pay turnover tax includes:

1. Any person carrying on any business with an annual turnover of more than K800,000.
2. Partnerships carrying on any business irrespective of whether the annual turnover is K800,000 or less.
3. Partners' income from partnership is also excluded from turnover tax. This is because it is the partnership that carried on business and not the partners.
4. Any person whose business earnings are subjected to withholding tax which is final.
5. Any person running a business where the annual turnover is less than K800,000 but is voluntarily registered for Value Added Tax (VAT)
6. Any person involved in mining operations as provided for under the Mines and Development Act.

b) Provisional income tax is tax paid on estimated taxable business profit by the following persons:

1. Any person carrying on any business whose annual turnover is more than K800,000.
2. Any person whose income does not constitute income generated from employment.
3. Any person whose taxable income is more than the annual tax free amount of K39,600.
4. Any person in business whose annual turnover is less than K800,000 but has voluntarily registered for Value Added Tax (VAT)

Provisional income tax is paid in four equal installments due on the following dates:
1st installment: 31 March
2nd installment: 30 June
3rd installment: 30 September
4th installment: 31 December

c) **Advice to James Chisengu**

Type of Tax to be paid by James

The type of tax that James will be required to pay for the tax year 2019 is turnover tax because his annual estimated income is less than K800,000.

Treatment of Expenses

i. **Salaries**

James expects to incur total salaries of K120,000 (K5,000 X 2 X 12). Salaries are, under normal circumstances, are allowable expenses when computing the taxable business profits. However, in this case salaries will not be deducted when computing turnover tax because turnover tax is computed on gross earnings.

ii. **Rental expenses**

Total rentals for the tax year 2019 are expected to be K102,000 (K8,500 X 12). The rental expenses will not be deducted when computing the turnover tax because turnover tax is calculated on the gross earnings.

iii. **Motor Van and Motor Car**

Since James will be required to pay turnover tax for the tax year 2019, calculated on gross earnings, capital allowances will be claimed notionally for the tax year 2019 on the motor car and van.

NOTIONAL CAPITAL ALLOWANCES FOR THE CHARGE YEAR 2019

	COST/ITV	**NOTIONAL CA**
	K	K
Motor Van		
Cost	160,000	
W &T@25%	(40,000)	40,000
ITV c/f	120,000	
Motor Car		
Cost	90,000	
W & T@20%	(18,000) X60%	10,800
ITV c/f	72,000	
Total notional capital allowances		50,800

iv. **James Chisengu**

Tax payable for the tax year 2019

	K
(K62,500 – K50,800) X 4% X 12	5,616
Total turnover tax payable	5,616

SOLUTION THREE

a) The benefits received on retirement will be taxed as follows:
Repatriation pay, Compensation for loss of office, pension refund are all terminal benefits (pension benefit). Therefore, all these payments will be exempted from tax.

Leave pay does not meet the definition of pension benefit, therefore, it is added to other emoluments and taxed under the Pay As You Earn system in the month in which it is received.

b) OKRA MULEMBWE
PERSONAL INCOME TAX COMPUTATION FOR THE CHARGE YEAR 2019

	K	K
Salary: K300,000 X 8/12		200,000
School allowance: K200,000 X 30%		60,000
Transport allowance: K200,000 X 10%		20,000
Long-service award		10,500
Maintenance expenses		22,000
Leave pay		17,600
		330,100
Investment Income		
Royalties: K34,000 X 100/85		40,000
		370,100
Less:		
Professional subscription	5,200	
Donation to approved public benefit organisation	4,200	
		(9,400)
Taxable income		360700
Income Tax		
First K74,400		9,960
Balance K286,300 @ 37.5%		107,362
Tax liability		117,322
Less:		
PAYE		(127,190)
WHT-Royalties (K40,000 X 15%)		(6,000)
Income tax refundable		(15,868)

(c) i) Labour day awards

Labour day awards received by an employee whether in cash or in kind are exempted from income tax.

ii) Long-term service award

If the long-term service award is received in cash is taxed under the Pay As You Earn system in the month in which it is received. However, if the long-term service award is in Kind, it is exempt from tax.

iii) Rental Income

Rental income is subjected to withholding tax at a rate of 10% which is the final tax.

iv) Bank Interest

The bank deposit interest received by individuals is exempt from income tax.

SOLUTION FOUR

(a) Tax avoidance involves a taxpayer taking advantage of loopholes or weaknesses and mismatches in tax law to minimise or defer tax liabilities, thereby obtaining a tax advantage that was not originally intended by tax legislation.

Tax avoidance is legal and not an offence, but it defeats the intention or purpose of the law and therefore, to discourage its practice, the Government may issue anti-avoidance tax legislation. Anti-avoidance legislation aims at sealing the loopholes in the tax legislation so as to prevent taxpayers from taking advantage of them, and thereby reducing their tax liabilities lawfully.

Tax evasion refers to the use of illegal means to avoid or reduce tax liabilities. The aim of the taxpayer practising tax evasion is to defraud the Government of the revenue.

Tax evasion arises when taxes are perceived to be too high or unfair on taxpayers. However, it can also be just deliberate where the taxpayer intentionally hides some income. Tax evasion is an offence and may be punishable by fines and/or imprisonment.

(b) (i) COMPUTATION OF INCOME TAX PAYABLE BY MWANDILA IF WAMUNDILA IS TAKEN ON AS AN EMPLOYEE

	K
Taxable profits before capital allowances	741,000
Less:	
Wamundila's emoluments	
(K144,000 + 12,000)	(156,000)
Employer's NAPSA contribution	
(K144,000 x 5%)	(7,200)
Capital allowances:	
- On deliverey Van (K60,000 x 25%)	(15,000)
- On Mwandila's motor car (K90,000 x 20%) x 60%	(10,800)
Final taxable business profits	552,000
Income Tax	
On First K74,400	9,960
On excess K477,600 x 37.5%	179,100
	189,060

WAMUNDILA'S
PERSONAL INCOME TAX COMPUTATION FOR THE TAX YEAR 2019

	K
Salaries	144,000
Utility allowance	12,000
	156,000
Income Tax	
On the first K74,400	9,960
On the excess(K156,000 –K74,400) x 37.5%	30,600
	40,560

(ii) COMPUTATION OF INCOME TAX PAYABLE IF WAMUNDILA IS TAKEN ON AS A PARTNER

	K
Taxable profits before capital allowances	741,000
Less:	
Capital allowances on delivery van	
(K60,000 x 25%)	(15,000)
Final taxable business profits	726,000

ALLOCATION OF THE FINAL TAXABLE PARTNERSHIP PROFITS

	Total	Mwandila	Wamundila
	K	K	K
Salaries	360,000	216,000	144,000
Utility allowance	12,000	nil	12,000
Interest on capital	24,000	16,000	8,000
Total Appropriations	396,000	232,000	164,000
Balance 2:1	330,000	220,000	110,000
	726,000	452,000	274,000
Less capital allowances			
(K90,000 x 20%) x 60%	(10,800)	(10,800)	-
	715,200	441,200	274,000
Income Tax			
On First K74,400		9,960	9,960
On excess			
K366,800/K199,600 x 37.5%		137,550	74,850
		147,510	84,810

(iii) COMPUTATION OF NET INCOME UNDER EACH OPTION

	Wamundila engaged as an employee	*Wamundila engaged as a partner*
	K	K
Total income	741,000	741,000
Income tax for:		
Mwandila	(189,060)	(147,510)
Wamundila	(40,560)	(84,810)
Wamundila's NAPSA contribution	(7,200)	Nil
Employer's NAPSA	(7,200)	Nil
	496,980	508,610

Based on the above analysis, it is more beneficial for Mwandila to engage Wamundila as a partner rather than as an employee as the net income under this option will be higher by: K508,610 – K496,980 = K11,630

END OF SUGGESTED SOLUTIONS

Zambia Institute of Chartered Accountants

TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D5: INTERNATIONAL TAXATION

THURSDAY 13 JUNE 2019

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.

DO NOT OPEN THIS QUESTION PAPER UNTIL YOU ARE INSTRUCTED BY THE INVIGILATOR.

Taxation table for paper D5– International Taxation (June and December 2019 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	5.5% of norm value
From US$4,500 to less than US$6,000	6.5% of norm value
From US$6,000 to less than US$7,500	7.5% of norm value
From US$7,500 to less than US$9,000	8.5% of norm value
From US$9,000 and above	10% of norm value

Mineral Royalty on other minerals

Type of mineral	Mineral Royalty Rate
Base Metals (Other than Copper, Cobalt and Vanadium)	5% on norm value
Cobalt and Vanadium	8% of 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 4%

Presumptive Tax for Transporters

Seating capacity	**Tax per annum** K	**Tax per day** 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**	**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%

ALL FOUR (4) questions are Compulsory and MUST be attempted.

QUESTION ONE

Until 31 August 2019, Mary Kituku had been employed by Lwendo Ltd as an Assistant Accountant. Her annual basic salary was K192,000 paid monthly on the last day of each month. On 15 September 2019, Mary Kituku was awarded a four (4) year scholarship by the government of the Republic of Zambia to pursue a bachelor's degree in accountancy in a country called Kutanga. She left Zambia on 1 October 2019.

During her employment with Lwendo Ltd she was also entitled to the following allowances:

	K
Transport allowance per month	1,200
Housing allowance per month	3,000
Medical allowance per annum	6,000

The expenses that Mary Kituku incurred in the tax year 2019, in respect of which she wishes to make a claim for deduction against the emoluments are PAYE K23,500, NAPSA K6,400 and subscription to ZiCA K2,150.

The government of Republic of Zambia will pay Mary Kituku a general purpose allowance of $5,200 per month for the entire four (4) years. The government of the Republic of Zambia is aware that globalisation has impacted on nearly every aspect of modern life and wants to take maximum advantage of the opportunities available to develop various sectors of the economy, including human capital. Opponents of globalisation have warned the government not to underrate the risks of globalisation on the Zambian economy.

The Double Taxation Agreement (DTA) signed between Kutanga and Zambia has a clause on Students, Apprentices and Business Trainees which state that payment made for the sole purpose of maintenance, education or training shall be exempt from tax.

The applicable exchange rate as advised by the Commissioner General is K13 per $1.

Required:

(a) Explain whether Mary Kituku would be regarded as being resident and ordinarily resident in Zambia for the tax year 2019. (3 marks)

(b) Describe the income tax implications of the general purpose allowance of $5,200.

(2 marks)

(c) Calculate the income tax payable in Zambia by Mary Kituku for the tax year 2019. (12 marks)

(d) Explain the risks of globalisation on the Zambian economy. (8 marks)

[Total: 25 Marks]

QUESTION TWO

(a) The OECD Model Convention gives detailed guidance on various taxation aspects. Countries are encouraged to take these guidelines into account when drafting their domestic rules and regulations.

The guidelines on tax havens, thin capitalization and withholding tax (WHT) have been well received by most countries, including Zambia, since they account for over 20% of the tax leakages in most countries. However, it is very difficult to achieve meaningful results without co-operation between revenue authorities globally.

Required:

(i) Using the OECD guidelines, explain the criteria for identifying tax havens. (8 marks)

(ii) State the main co-operation models between revenue authorities. (4 marks)

(iii) Explain the term "thin capitalisation". (4 marks)

(b) Impala Plc is a multinational company operating in Zambia through its wholly owned Zambian subsidiary. The subsidiary has a debt: equity ratio of 7:1. The interest paid during the tax year 2019 was K5,600,000.

Investment income earned from Zambian sources by Impala Plc during the tax year 2019 was as follows:

	K
Royalties	90,000 (gross)
Bank interest	85,000 (net)
Dividends from a company listed on LuSE	400,000 (gross)
Rent	180,000 (net)

Required:

(i) Calculate the interest to be disallowed when computing the tax adjusted profit for the year ended 30 June 2019. (3 marks)

(ii) Calculate the amount of Withholding Tax (WHT) paid by Impala Plc for the tax year 2019 on investment income. (6 marks)

[Total: 25 Marks]

QUESTION THREE

Thole Plc a Zambian resident Company specialises in the manufacture and supply of various types of heavy duty equipment to the Mining industry. The Company directly owns all of the issued share capital in three companies listed below:

(i) Mwanza Plc incorporated in Zambia, with directors' meetings held in China.
(ii) Kim Ltd incorporated in Germany, with directors' meetings held in Zambia where the Head Office is situated.
(iii) Victoria Ltd incorporated in Zimbabwe, with directors' meetings held in Zimbabwe.

Thole Plc has a strategy of carrying out all its operations in foreign countries through permanent establishments. This has resulted in significant tax savings for the group.

On 3 March 2019, Mwanza Plc listed its shares on the Lusaka Stock Exchange and offered 45% of its shares to indigenous Zambians. The company's taxable profit for the year ended 30 November 2019 was K4,500,000 before any adjustment for the six (6) differently-abled persons employed by the company on a permanent basis.

The Managing Director of Mwanza Plc owns properties in Zambia and overseas. He has heard that it may be advisable to transfer his properties before his death to minimise estate taxes. He is interested in knowing the taxes on estates, inheritances or gifts as explained in the OECD Model Double Taxation Convention on Estates and Inheritances.

Required:

(a) Explain the residence position of Thole Plc's subsidiaries. (6 marks)

(b) Define permanent establishment using the OECD Model Convention, and give eight (8) examples of permanent establishments. (5 marks)

(c) Explain the features of taxes on estates, inheritances or gifts using the OECD Model Double Taxation Convention. (8 marks)

(d) Calculate the company income tax payable by Mwanza Plc for the tax year 2019.

(6 marks)

[Total: 25 marks]

QUESTION FOUR

You are a Senior Manager of Zambia Revenue Authority (ZRA), mainly responsible for advising the Commissioner General (CG) on transfer pricing and human rights. The following notes have been left for your attention.

1. Frog Plc is a Zambian resident company. It has four (4) subsidiaries, two (2) of these are resident in Zambia and the other two (2) are overseas subsidiaries. The Managing Director of Frog Plc has appealed against an assessment of K196,000 additional tax on intra-group sales to one of the non-resident subsidiaries. During the year 2019, Frog Plc sold goods for $60,000 to one of its non-resident subsidiaries. The arm's length market price was $100,000. The approved exchange rate by the Commissioner General was K13 per $ but Frog Plc used an exchange rate of K14 per $1, which was mid-rate given by their bankers. Review the computation before we respond.

2. I have been invited by Zambia Institute of Chartered Accountants (ZiCA) to present a paper on European Convention on Human Rights and Taxation. You must provide me with the relevant details for the presentation as a matter of urgency.

Required:

(a) (i) Define transfer pricing and state its tax implications in Zambia. (5 marks)

(ii) Explain advance pricing arrangements. (2 marks)

(iii) State four (4) problems of arm's length principle in relation to transfer pricing. (4 marks)

(b) Re-compute the additional amount of income tax payable under self-assessment in Frog Plc using the transfer pricing rules. (4 marks)

(c) Discuss European Convention on Human Rights (ECHR) and Taxation in relation to:

(i) Property right and taxation (5 marks)

(ii) Freedom of travel and taxation (5 marks)

[Total: 25 Marks]

END OF PAPER

D5 INTERNATIONAL TAXATION SUGGESTED SOLUTIONS

SOLUTION ONE

(a) **Resident and ordinarily resident**

An individual is regarded as being resident in Zambia if he or she is physically present in Zambia for a period of not less than 183 days in a charge year.

Ordinary residence implies residence with some degree of continuity, ignoring temporary absences. It refers to an individual who normally lives in Zambia ignoring temporary absences. Such an individual is treated as being resident and ordinarily resident in Zambia. An individual who lives in Zambia or comes to Zambia with the intention of remaining in Zambia for a period which will exceed 12 months, is regarded as resident and ordinarily resident from the date of arrival. An individual who comes to Zambia with the intention of establishing permanent residence in Zambia is regarded as a resident.

Mary Kituku will therefore be regarded as being resident and ordinarily resident in Zambia for the tax year 2019 as she was physically present in Zambia for a period of more than 183 days in the tax year 2019 and lives in Zambia.

(b) **Income tax implications of the general purpose allowance**

The Double Taxation Agreement (DTA) signed between Kutanga and Zambia has a clause on Students, Apprentices and Business Trainees which state that payment made for the sole purpose of maintenance, education or training shall be exempt from tax. Hence the general purpose allowance of $5,200 will not be taxable in either country.

In the absence of DTA, the general purpose allowance could have been taxed under PAYE.

(c) **Calculate the income tax payable in Zambia**

Mary Kituku

Personal income tax computation for the tax year 2019

		K
Salary	192,000 X 8/12	128,000
Transport allowance 1,200 X 8		9,600
Housing allowance 3,000 X 8		24,000
Medical allowance 6,000 X 8/12		4,000
		165,600

Less:

Subscription to ZiCA	(2,150)
Taxable income	163,450
Income tax	
First K39,600 X 0%	0
Next K9,600 X 25%	2,400
Next K25,200 X 30%	7,560
Next K89,050 X 37.5%	33,394
Income tax liability	43,354
Less tax already paid:	
PAYE	(23,500)
Income tax payable	19,854

N.B. NAPSA contributions are no longer deductible.

(d) **Risks of globalisation on the Zambian economy**

The risks of globalisation on the Zambian economy include:

i. Interdependence: Globalisation leads to interdependence between nations, which could cause regional or global instabilities, if local economic fluctuations end up impacting a large number of countries relying on them.
ii. National sovereignty: Some see the rise of nation states, multinational or global firms and other international organisations as a threat to sovereignty. Ultimately, this could cause some leaders to become nationalistic or xenophobic.
iii. Equity Distribution: The benefits of globalisation can be unfairly skewed towards rich nations or individuals, creating greater inequalities and leading to potential conflicts both nationally and internationally as a result.
iv. Tariffs and other forms of Protectionism: The 2008 economic crisis led many politicians to question the merits of globalisation. Since then, global capital flows fell from $11 trillion in2007 to a third of that figure in 2012. While some of that may be, cyclical in nature, many countries implemented tariffs and other forms of protectionism designed to contain risk in their financial systems and make crises less damaging, although this was at a cost of forgoing the benefits of globalisation.

SOLUTION TWO

(a) Criteria for identifying tax havens

The OECD has defined four factors for the identification of tax havens as follows:

- **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 a preferential regime.
- **Lack of effective exchange of information** – tax havens typically have in place laws or administrative practices under which business and individuals can benefit from strict secrecy rules and other protections against scrutiny by tax authorities thereby preventing the effective exchange of information on taxpayers benefiting from the low tax jurisdiction.
- **Lack of transparency** – for example, the details of the regime and/or its application are not apparent, or there is inadequate regulatory supervision or financial disclosure. 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; and
- **No substantial activities** – the jurisdiction facilities 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.

(b) The main co-operation models between revenue authorities

Some of the main co-operation models between revenue authorities are:

- Joint investigation teams
- Inter-agency intelligence centres
- Secondments and co-location of personnel
- Other strategies based on the use of shared databases, dissemination of strategic intelligence products such as newsletters and intelligence briefs, joint committees to coordinate policy in areas of shared responsibility, and inter-agency meetings and training sessions to share information on trends in financial crime, guidance on investigative techniques and best practice in managing cases.

(c) Thin capitalisation

Thin capitalisation is the practice of excessively funding a branch or subsidiary with interest-bearing loans from related parties rather than with share capital. The fact that interest is usually deductible for the borrower and taxed to the non-resident lender at low rate of withholding tax (or not at all in some cases) while in most cases company profits funding dividends are fully taxed makes the practice attractive tax wise to a non-resident investor. Although it is possible to deal with these problems under the arm's length principle, taxpayers and tax administrators often want more guidance on the level of permissible loan funding for a subsidiary than to be told that related party loans can be made up to the point and on the terms that an independent third-party lender would allow, having regard to the other liabilities of the subsidiary. Thin capitalisation rules seek to deal with this problem by denying deductions for interest in defined cases.

(d) Computation of disallowed interest

Disallowed interest

Interest is only allowable as an expense where the debt equity ratio does not exceed 3:1. When the amount of debt obtained results in this ratio being exceeded, then interest on the excess debt is not an allowable deduction. Hence, the disallowed interest in this case is:

		K
Total interest paid		5,600,000
Less: allowable interest	(3/7 X 5,600,000)	(2,400,000)
Excessive interest which is disallowed		3,200,000

(e) WHT computations for the tax year 2019

		K
Royalties	90,000 X 15%	13,500
Bank interest	85,000 X 15/85	15,000
Dividends from a company listed on LuSE		0
Rent	180,000 X 10/90	20,000
Total WHT		48,500

SOLUTION THREE

(a) **Residence position of each subsidiary**

(i) Mwanza Plc incorporated in Zambia, with directors' meetings held in China

Mwanza Plc will be resident in Zambia as it is incorporated in Zambia. The location of the director's meetings is irrelevant in this case.

(ii) Kim Ltd incorporated in Germany, with directors' meetings held in Zambia

Kim Ltd will probably be resident in Zambia since directors' meetings are held in Zambia. This is because a company will be Zambian resident if its effective management is exercised in Zambia regardless of where it is incorporated. Normally effective management depends on where the directors meet. However, if, the major policy decisions affecting Kim Ltd were in fact made by Germany, then this would not be the case, and Kim Ltd would be non-Zambian resident.

(iii) Victoria Ltd incorporated in Zimbabwe, with directors' meetings held in Zimbabwe

Victoria Ltd will probably be resident in Zimbabwe and not Zambia as it is not incorporated in Zambia and the effective management would normally be exercised in Zimbabwe as this is where the directors hold their meetings. If, despite this, the effective management in reality was exercised in Zambia, Victoria Ltd would be resident in Zambia.

(b) **Permanent establishment using the OECD model convention**

Permanent establishment means a fixed place of business through which the business of an enterprise is wholly or partly carried on. The term "permanent establishment" shall include:

(i) a place of management;
(ii) a branch;
(iii) an office;
(iv) a factory;
(v) a workshop;
(vi) a warehouse, in relation to a person providing storage facilities for others;
(vii) a mine, an oil or gas well, a quarry or any other place of extraction or exploitation of natural resources; and
(viii) an installation or structure used for the exploration for natural resources.

Non-resident companies are taxable if they have a permanent establishment in a country.

(c) **The OECD Model Double Taxation Convention on Estates and Inheritances**

The OECD Model text does not give a definition of estates, inheritances or gifts. The key phrases in the description of the taxes covered are: taxes imposed on transfers of property by reason of death, on the one hand, and taxes on transfers for no, or less than full, consideration.

The most straightforward common feature of taxes on estates, inheritances and gifts is that they are levied upon the transfer of property; the terminology employed throughout the Model refers to unilateral transfers to heirs, donees, legatees or other beneficiaries.

Article 1 of the OECD Model lays out the estates, inheritances, and gifts covered, providing that "the treaty only applies to those estates and inheritances where the deceased was domiciled in one of the states, or in the case of gifts, where the donor was so domiciled." The treaty thus focuses on property rather than persons, namely property which forms part of the estate of, or a gift made by, the resident of a contracting state.

Estate, inheritance and gift taxes in various countries are levied on the basis of nationality of the deceased/donor. Some countries use the concept of residence of the donor/deceased to determine the jurisdictional basis of inheritance and gift taxes. Yet other countries see the residence of the recipient as the basis on which to levy inheritance or gift taxes. Conversely, tax burdens in several countries tie into the location of immovable property transferred upon death or by way of gift.

Pursuant to the text of Article 1 (2) ("*taxes on the corpus of the estate*"), estate taxes are such taxes that are levied on the estate itself. This approach is taken in countries such as the USA, UK, Korea and New Zealand, and is rooted in the frequent use of testamentary trusts in these countries, where determining the value of each beneficiary's interest may be difficult.

While estate, inheritance and gift taxes share the features of transfer taxes, estate taxes distinguish themselves in that the estate tax is levied on the entire taxable estate, which will usually include the money used to pay the tax, while gift taxes and inheritance taxes apply only to the value that is being transferred. The estate is often treated as a legal person under domestic law and the tax is based on value transferred, with graduated rates depending on the value. The deceased's property is thus not taxed at the beneficiary level but rather before transfer of the property is complete. Estate taxes as levied on the transferor are seen to be based upon the power to transmit in that their basis is the net value of the transferor's estate.

Inheritance taxes tie in with the transfer event as well, but may be levied either at the transferor or at the beneficiary level. They are calculated based on the decrease in value at the transferor level, or the family or marital relationship between transferor and beneficiary and/or value received by the beneficiary.

Provided that the taxes are imposed by reason of death, it is immaterial whether they are imposed on property bequeathed by the deceased or on property transferred during the transferor's lifetime where under the law of one or both of the contracting states; the property transferred is subject to estate tax at the moment of death of the transferor. Such transfers are thus not classified as gifts under the Model treaty, as the treaty ties in with the point in time at which the tax arises.

(d) Calculation the company income tax payable

Mwanza Plc
<u>Company income tax for the tax year 2019</u>

	K
Profit (given)	4,500,000
Less:	
Allowance for differently-abled persons 6 X K1,000	(6,000)
Taxable income	4,494,000
Company income tax	
4,494,000 X 28% (W1)	1,258,320

Working

1. Tax rate

	%
Normal company income tax rate	35
Listing reduction	(2)
Share offering reduction	(5)
Tax rate for Mwanza Plc	28

SOLUTION FOUR

(a) **Transfer pricing and human resources**

(i) Transfer pricing is the general term used to refer to the problem of allocating profits among the parts of a corporate group. It is mainly used by multinationals in performance measurement and tax avoidance schemes. A transfer price which group companies need to charge other group companies for goods and services provided is determined by the group.

The transfer price determined by the group could impact adversely on the tax revenue for the country, especially when non-resident group companies are involved. Transfer pricing rules act as an anti-avoidance measure to protect the tax revenue.

The tax implication is that when sales are made to a non-resident group company at undervalue, then an arm's length price should be substituted for the transfer price when computing taxable. Under self-assessment, this adjustment should be made by the company concerned. The rules also apply if purchases are made from a non-resident group company at an overvaluation.

The transfer pricing rules prevent companies from transferring profits to a non-resident group company (in a country with a low tax rate), and correspondingly reducing profits chargeable to tax in a country with a high tax rate.

(ii) Advance Pricing Arrangements enable a company to agree in advance with the revenue authority (e.g Zambia Revenue Authority (ZRA)) that its transfer pricing arrangements are acceptable. This is one of the possible solutions to the problems of arm's length principles. Hence there will be no need for a self-assessment adjustment. This facility is voluntary and companies cannot be forced to use it.

(iii) The following are some of the problems of arm's length principles:

- Lack of comparable prices
- Lack of information
- Risk of effective double taxation through disagreement over transfer price (& weakness of mutual agreement procedures)
- Huge information demands.

(b) Additional income tax

		K
Market value of the goods sold ($100,000 X K13)		1,300,000
Actual price paid for the goods sold ($60,000 X K14)		(840,000)
Additional taxable income on intra-group sales		460,000
Additional company income tax payable	460,000 X 35%	K161,000

(c) Property right, Freedom of travel and taxation

(i) Property right and Taxation

The provisions of the European Convention of Human Rights (ECHR) relating to the property right of individuals and the taxation power of government on the said rights are sufficiently clear. The provision is protocol "Annex I" to the ECHR which guarantees the property right reads as follows: "Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law. The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or secure the payment of taxes or other contributions or penalties". This article ensures protection of the property rights of individuals, while acknowledging the taxation right of governments.

(ii) Freedom of travel and taxation

The 2nd clause of Article 2 of Protocol 4 in the ECHR states that everyone can freely move within a country once lawfully there and have a right to leave any country.

The 3rd clause of the Convention stipulates that the said right may be subject to limitations in order to maintain national security, public security, public order, or to prevent crime or to protect well-being, morals and the rights and freedoms of others. In the Reiner case, where the conclusion drawn from the interpretation by the court indicates that in order to prohibit a person from travelling due to tax liability, such a prohibition should be based on applicable law, aimed at a legitimate end and be proportionate to the targeted objective. In other words, any prohibition on travelling abroad should primarily be for the public benefit. What is important here is the amount of liability: it would be inconvenient to implement a ban on leaving the country on someone with a small tax liability. Above all, any impact on the possibility of collecting the tax liability upon leaving the country or any casual link between leaving the country and impossibility of collection are also taken into consideration by the court.

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D6: TAX AUDIT AND INVESTIGATIONS

MONDAY 10 JUNE 2019

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.

DO NOT OPEN THIS QUESTION PAPER UNTIL YOU ARE INSTRUCTED BY

THE INVIGILATOR.

Taxation table for paper D6– Tax Audit and Investigations (June and December 2019 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	5.5% of norm value
From US$4,500 to less than US$6,000	6.5% of norm value

From US$6,000 to less than US$7,500	7.5% of norm value
From US$7,500 to less than US$9,000	8.5% of norm value
From US$9,000 and above	10% of norm value

Mineral Royalty on other minerals

Type of mineral	**Mineral Royalty Rate**
Base Metals (Other than Copper, Cobalt and Vanadium)	5% on norm value
Cobalt and Vanadium	8% of 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 4%

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**	**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%.

All FOUR (4) questions are compulsory and MUST be attempted.

QUESTION ONE

Chitumbo recently received a legal-sized envelope from the Zambia Revenue Authority telling her that she and her husband were being audited. Like any other red-blooded Zambian, she panicked. She had heard the horror stories of people losing their entire incomes after going through an audit. Chitumbo called the Zambia Revenue Authority office designated in the letter, and scheduled a time to meet an auditor in her office.

Getting Ready for the Audit

Chitumbo prepared by gathering documents. The Zambia Revenue Authority had sent her an Information Document Request listing what they wanted to see: copies of tax returns and profit and loss statements for their businesses. Chitumbo had multiple returns for separate businesses. She had prepared all the returns herself and she decided to work with the auditor on her own, without representation. She reviewed all the profit and loss statements and compared them to her tax returns line by line. And she found a few entries in wrong places. The positions of the erroneous entries did make a difference to the bottom line.

The First Meeting

When the auditor showed up at Chitumbo's office for their first meeting, she told him upfront about the mistakes she had found on one of the tax returns. The auditor noted the errors and went on like it was not a big deal. After the auditor had examined over the documents she had organized, he gave her another project. He wanted her to add up every bank deposit and compare it to her declared income

Sorting Through Bank Statements

Chitumbo pulled out all her bank statements for the year and she created a spreadsheet. She and her spouse had multiple bank accounts, and they were in the habit of flipping money back and forth between the account she used most often and another one. She looked at each deposit on each statement and typed the information into her spreadsheet, reviewing everything again and again and flagging all the transfers from one account to the other. The purpose of the spreadsheet was to explain how the totals on her bank statements were more than the amount of income they declared on the tax returns. A few years down the road, some deposits were hard to remember without a bit of research.

Identifying Receipts

The auditor also had a list of deductions he specifically wanted to look at, so Chitumbo had to find receipts as well. Some of them were long gone and fortunately some of those she found were for things she had not claimed on a tax return. Maybe the deductions she had not claimed would balance out the deductions she could not find receipts for.

The Outcome

The audit ended up going on for a few months and she spent all that time looking for documents, organizing them, and explaining them to the auditor. Eventually, she received another letter from the Zambia Revenue Authority which indicated that no changes were going to be made to her returns. The auditor could have charged her additional tax and even penalties, and he had chosen not to do so.

Required:

(a) From the tax point of view, explain the difference between revenue expenditure and capital expenditure. (5 marks)

(b) Explain five (5) specific deductions you would request from Chitumbo and state why you would request for such deductions. (5 marks)

(c) From the scenario, explain what Chitumbo did right that influenced the outcome of the audit. (5 marks)

(d) Explain any five (5) key principles that the auditor should take into account in order to come up with a quality tax audit with regard to Chitumbo's case.

(5 marks)

(e) State five (5) taxpayers' obligations under tax audit and investigation.

(5 marks)

[Total: 25 marks]

QUESTION TWO

The Zambia Revenue Authority (ZRA), consists of various divisions such as the Domestic Taxes Divisions and the Customs Services Divisions. It also has an audit function that is in charge of making tax assessments and to consider whether a tax payer is compliant or not. In order to effectively and efficiently carry out its functions, the tax audit function uses approved tax models so that tax revenue targets are achieved. ZRA has also introduced tax manuals that would guide the tax audit in carrying out its roles smoothly. Apart from using approved audit manuals the tax auditor, is expected to keep and maintain audit documentation which are commonly referred to as working papers. Some working papers are of continuing importance while others relate to current audit review. In order to broaden the tax base, ZRA has included on its list companies such as those in the telecommunication industries. This includes subscribers and dealers of airtime as they are also expected to contribute to the building of the nation through taxation.

Required:

(a) Explain any FIVE (5) roles of the audit function of ZRA. (5 marks)

(b) Briefly describe how a functional model operates as an essential part of a tax audit. (5 marks)

(c) Explain briefly THREE (3) reasons for using audit manuals and list down any four (4) items that an audit manual could contain. (5 marks)

(d) Explain three (3) reasons why tax auditors need to maintain audit working papers and list down any Two (2) items that they could contain. (5 marks)

(e) Explain the differences between the treatment of discount to air time dealers and subscribers for tax purposes. (5 marks)

[Total: 25 Marks]

QUESTION THREE

The Zambia Revenue Authority (ZRA) is a statutory body that is mandated to collect tax revenue on behalf of the Government. However to collect the much needed revenue from individuals and business entities, It needs to have both adequate human and financial resources. These resources are needed in order to strategically manage audits of different segments of the tax payer. In order to effectively manage these segments , a number of practices and procedures have been developed by the Organization for Economic Co-operation Development (OECD).These practices have been developed in order to enhance the quality of planning, monitoring, and evaluation so that there is an optimum maximization of tax revenues.

Required:

(a) Briefly explain four (4) elements that can contribute to the operational management and the audit function. (8 marks)

(b) Explain the difference between performance objective and performance measurement. (4 marks)

(c) Discuss four (4) output measures that can be used to benchmark and evaluate an effective output measure. (8 marks)

(d) Explain any five (5) indirect methods the tax auditor can use to verify income. (5 marks)

[Total: 25 Marks]

QUESTION FOUR

You are a Tax Audit Manager at the Zambia Revenue Authority and have been tipped that Bwembya, Cheswa and Mukwapu who are running a partnership business have not been paying tax in their individual capacities. To this end you have demanded that the partners submit the latest partnership accounts for your investigations and the following details about the partnership have been availed to you so as to ascertain the tax assessment for each of the partners.

Bwembya and Cheswa have been in partnership selling traditional brooms and share profits and losses in the ratio 3:2 respectively. This was after allowing for annual salaries of K60,000 each. Their financial statements are prepared annually to 31 December.

On 1 March 2019, Mukwapu was admitted to the partnership and, from that date the partnership agreement changed. The profits and losses and partners salaries were to be provided for as follows:

	Bwembya	Cheswa	Mukwapu
Salaries per annum	K42,000	K60,000	K72,000
Share of balance of profit	1	2	3

The partnership's statement of profit or loss for the year ended 31 December 2019 was as follows:

	Notes	K	K
Sales			600,000
Cost of sales			(240,000)
Gross profit			360,000
Less:			
Repairs to buildings	1	59,000	
Wages and salaries	2	60,000	
Rent and rates	3	20,000	
Motor running expenses	4	10,000	
Legal costs	5	5,400	
Depreciation		6,500	
Provision for income tax		9,000	
Sundry expenses	6	5,300	
			175,200
Net profit for the year			184,800

The following information is also available:

Note 1: Repairs to buildings

Included in repairs to buildings is an amount for extensions amounting to K16, 500

Note 2: Wages and salaries

Included in the amount of wages and salaries are salaries for Bwembya and Cheswa of K19,000 and K13, 000 respectively.

Note 3: Rent and rates

Included in rent & rates is rent paid for partners' houses amounting to 60%.

Note 4: Motor running expenses

The partners used their private motor cars in the business and estimated private usage as follows:

	Private mileage %	K
Cheswa	30	5,000
Bwembya	20	3,200
Mukwapu	25	1,800
		10,000

Note 5: Legal costs

The amount comprised the following:

Defending titles to existing non-current assets	K2,000
Defending dangerous driving offence by partner	K1,000
Appeal against previous tax year's penalties	K2,400
	K5,400

Note 6: Sundry expenses

Donation to PAT Political party	K3,000
Subscriptions to association of Broom makers	K2,300
	K5,300

Additional information:

The partner's motor running expenses referred to in note 4 above have extra details as follows:

	Purchases cost	Date purchased
Cheswa	K20,000	2 October 2017
Bwembya	K30,000	1 November 2017
Mukwapu	K25,000	19 June 2018

It has been agreed with the Commissioner General that capital allowances on partnership assets for the tax year amounted to K12,400.

Required:

As a tax auditor;

(a) Calculate the partnership's tax adjusted business profit for the tax year 2019 before division between the partners. (9 marks)

(b) Calculate the amount of business profits on which each partner will be assessed for the tax year 2019. (16 marks)

[Total: 25 Marks]

END OF PAPER

D6 TAX AUDIT AND INVESTIGATION SUGGESTED SOLUTIONS

SOLUTION ONE

(a) The distinction of capital from revenue expenditure for tax purposes is crucial. A capital expenditure is an amount spent to acquire or significantly improve the capacity or capabilities of a non-current asset, such as equipment or buildings. Usually the cost is recorded in the statement of financial position. Capital expenditure is generally not allowable as a deduction in computing taxable business profits. Depending on the nature of the capital expenditure however, it may be possible to claim capital allowances, which would reduce the tax liability.

On the other hand, revenue expenditure is an amount that is spent for an operating expense that will be matched immediately with the revenues reported on the current period's statement of profit or loss. For tax purposes only revenue expenditure that is wholly and exclusively incurred for business purpose is allowable for deduction. Expenditure that is used over the short-term and is recurring is associated to revenue expenditure, while expenditure that is used over the long time such as buildings and usually one-off expenditure is associated to capital expenditure.

(b) Five specific deductions

i. **Salaries and wages**
Verification of salary and wages deduction is important especially in a family business like Chitumbo's as it helps the auditor in determining if salaries are being paid to the taxpayer, spouse, children, relatives, or domestic servants. Tax Statements should be reconciled to the payroll accounts to validate the salaries.

ii. **Medical insurance**
Family businesses have the tendency of including personal medical insurance in tax computation. Therefore, when medical insurance is claimed as a business deduction, the auditor should ascertain whether it covers employees, rather than the personal cost for Chitumbo's family.

iii. **Insurance**
Insurance is another deduction taxpayers claim anyhow, It's therefore important for auditors to ask taxpayers for a breakdown of insurance payments. Verify that personal life insurance and medical insurance have not been deducted here in the case of Chitumbo's business.

iv. **Legal and professional fees**
The broad classification of "legal and professional" embraces many types of services; there is a tendency to assume that all such expenses are deductible. To the contrary, these charges are subject to a variety of tax treatments and accordingly each charge should be considered on its individual merits.

v. **Rent expense**

Rental expenses are generally allowable provided they relate to Chitumbo's business as stipulated under Section 29 (1)b ITA.

vi. **Travel and entertainment**

Auditors should be alert for cash expenditures and checks payable to owners and employees closely related by blood or marriage to the owners (Chitumbo) as this is common in family businesses.

(c) The following is what Chitumbo did right:

i. Transparency: She was honest with the auditor and the auditor observed this from the beginning which is crucial.
ii. Accessibility: She offered the audit to take place at her work place so the auditor could have a tour of the business and have an idea of the operation.
iii. Documentations: She gave him bank statements so he had proof of payment even though the receipts were lost.
iv. Credibility: She established credibility with the auditor as an honest person she was frank with the auditor.
v. Good impression: The auditor determined early that Chitumbo had nothing to hide and developed confidence in her from the way she managed the all process.

(d) The following are the principles:

i. Accuracy-the tax auditor needs to interpret fairly the law relating to tax audit in order ascertain the correctness and accuracy of information contained in the records of the tax payer.
ii. Efficiency-In this particular case the ZRA staff should use few resources but come up with sufficient audit evidence that ultimately help to save meager resources at their disposal.
iii. Objective- it is important that all decisions that have been made are clearly based on tangible and factual evidence.
iv. Transparency-Zambia Revenue Authority staff needs to have an open discussion with all tax payers in order to hear their side so as to resolve all issues relating to findings of a tax audit.
v. Fairness-It is important that an audit is technically and professionally correct in accordance with domestic laws and be consistent with prevailing policies and procedures.

(e) The following are the obligations:

i. Filling of returns on appropriate due dates
ii. Accuracy of Returns. i.e declaring the correct amount of taxable income
iii. Timely payment of taxes
iv. Issuance and demand of fiscal receipts/tax invoices
v. Cooperation with ZRA officers

SOLUTION TWO

(a) The following are the roles that can be undertaken by an Audit function:

i. Audits are the primary treatments that are carried out for those tax payers that resist tax administration efforts aimed at the tax payer to voluntarily declare all of their tax liabilities.

ii. Audits serve as reminders to tax payers of the consequences of non-compliance to tax laws.

iii. It increases confidence in the minds of the tax payer and the general population that not one individual is targeted and that any non-compliant is dealt with.

iv. It helps to collect data on who is not compliant so that tax audit experts can plan well for the next audits.

v. It helps the Revenue body to collect enough taxes as tax payer's fear to be punished once they are identified.

(b) The Organisation for Economic Cooperation Development (OECD), has come up with a number of models that could be used by a tax agency such as ZRA in order to manage its tax activities properly. A functional model is just one of them.

i. In a function model, members of staff are grouped into specific functions or departments for the purpose of achieving organizational goals.

ii. The grouping of experts into functions such accounting, registration, information processing, auditing, collection and appeals to ensure that maximum attention is given to complex and specific issues.

iii. It gives greater standardisation and simplifies computations and attends to specific needs of the tax payer.

iv. As various specialists are grouped, it ensures that efficiency is improved since specialist performing similar or related tasks have been put in the same department. The model also provides single points of access for tax payer's inquiries, unified system for tax payments.

v. Lastly it also helps to integrate direct and indirect taxes such as VAT and Income tax.

(c) An audit manual gives guidance to the tax auditor so that they can apply standardized procedures to non-compliance and assessments.

They do help tax auditors to conduct quality audits as they now have access to approved procedures, policies and tools in order for them to be efficient.

This helps to achieve consistency and a correct interpretation of the tax legislation for the tax payer. Further it helps the tax auditor in the interpretation of information when it is requested by an external interested party.

Contents of an audit manual

i. Tax legislation and its interpretations

ii. National policies and compliance strategy

iii. Operational management and quality assurance and quality controls

iv. Case management techniques.

(d) Working papers are the documents that tax auditors use in the course of their duties. They contain details about the tax payer's details of continuing importance.

Such information is usually static and does not change easily such as tax payer's names and location of business premises.

Other working papers contain information which is currently being used by the tax auditor. They help tax auditors that are dealing with cases to have a record of what was audited in case such information could be used during an inquiry in a tax tribunal.

The papers also provide input evidence for tax an audit report to be compiled.

Good working papers could contain the following:

i. The method being applied on a continual basis
ii. Clarity of purpose
iii. Complete cross references
iv. Numbered pages with identifications of a tax payer
v. Should show evidence of all significant verification activities, detailing what was actually done.
vi. The papers need to be filled in the correct compartments.

(e) Airtime dealers are businesses that buy airtime in bulk from manufacturers. They are given discounts that are deducted from the sales of a manufacturer. Since this discount is not recorded in the books of a manufacturer, it is not reflected in the tax return and therefore not taxable.

Similarly, a discount given to a subscriber or customer of airtime dealer will not be included in the tax return of a subscriber and consequently not taxable. It reduces the cost of purchases. This is because it won't appear in the financial records of the subscriber(taxpayer)

SOLUTION THREE

(a) The collection of tax revenue is an important role of the ZRA. The collection of these taxes comes with challenges as not every business is willing to pay its share of tax burden. Therefore a tax audit is important so that the tax payer is scrutinized. However, a lot of financial resources are needed in order to ensure that strategic functions of mobilizing resources are achieved. The following are the four elements of a good operational management for tax audit:

(i) **Delegation**-this is a process of transferring powers that are available to the lower organs of ZRA. This will ensure autonomy to officer so that they can manage the collection of revenue without undue interference. Delegation is important because officers at the head office can manage to conduct all the functions relating to tax administration throughout the country by themselves.
As a result, certain officers are mandated to carry out this function on behalf of head office. The powers delegated to these officers should be documented and well managed so that the level of integrity in the tax administration is preserved.

(ii) **Auditor supervision**-the members of staff that are involved in the tax administration are not left without being supervised. This ensures that the duties that ZRA officers discharge are diligently and that quality of the audit is preserved. The supervision of the audit for quality purposes should take into account the geographical and political structure of the organization within the country .The segmentation and classification of the tax payer is mainly done on the basis of turnover and type of tax or trade that different tax payers are engaged in.

(iii) **Team leaders**-in order to ensure that the tax audit is carried out in an efficient and effective manner, there will be a need for team leaders to be involved in all phases of the audit including assigning cases, reviewing workloads and ensuring correct procedures are followed. They are in charge of reviewing and sign off all the work that members of the team are assigned to do. Team leaders ensure consistency in the application of delegated authority, audit standards as well as interpretation of tax laws. They are team leaders in initiating and championing of training and development of tax auditors. They further mediate any dispute that can arise between the tax auditor and tax payer and ensures that auditors carry out their work correctly and efficiently.

(iv) **Intensity and scope of the audit**-ZRA should clearly identify the scope of the tax audit by having a clear policy which intensifies the audits that are being conducted. For it to manage tax operations effectively, the tax audit should not focus on 'single issues' audits that can bring in huge amounts of income but take into account , quality and other missed opportunities had they conducted an depth tax audits. Widening and intensifying tax audits will give confidence to the tax payer so that they don't feel that they are the only ones that are being targeted.

(b) Performance objectives are critical milestones that are set by the tax auditor before embarking on the tax audit. These milestones have been set so that at the end of the tax audit, the output can be measured against the set objectives. The measurements consist of methods that are used in order to measure the outcome of the intended objectives, a past audit evaluation and then be carried out so that improvements can be made during the next audit cycle.

(c) The following are the main output measurements that are provided so that a benchmark and a standard are compared so that a tax payer's position is properly assessed.

(i) Yield and productive measures-a tax audit is expected to result into a discovery of an amount or a nil discovery of revenue. Yield measures are monetary measures that can measure the effectiveness of audit techniques that tax auditors are using. However the following are some of the challenges that tax auditors face when using pure and productivity measures. It is important to specify a point at which assessed penalties and taxes that result from an audit can be measured and this could and this should be done after an appeal process that has been concluded.
Yield measures can only be effective if at least some additional amounts or benefits have resulted from an audit. However a nil audit indicates that a tax audit has not helped to reduce any non-compliance. Lastly it does not indicate that tax audit has discovered all understatements of tax liability

(ii) Time measures: are measures that are used to estimate the time it will take to conduct an audit or a number of audits over period of time for planning purposes

(iii) Volume and coverage measures-this is a measure that relates the quality of an audit to be undertaken. The quantity refers to the size, numbers or a percentage of the target population. The presence of a tax audit is enough to have a deterrent effect of the audit activity. However when considering volume, numbers and how large a population of a tax payer can be.it is important that to take quality into account and not just how large the population of the tax payer is

(iv) Quality measures-these are measures that are included in the output measures in order to ensure that the audits are of good quality. This includes the allocation of experienced staff

(d) The following are the indirect methods:

i. Source and application of funds method
This is an analysis of taxpayer's cash flows and comparisons of all known expenditures with all receipts for the period.

ii. Bank deposits and cash expenditure method
This method computes income by showing how the taxpayer's funds were spent. It is based on a theory that the money received by the taxpayer can either be spent or deposited.

iii. Mark-up method
This method uses percentages or ratios typical for the business under examination in order to make the actual determination of the tax liability.

iv. Unit and volume method
This method determines income by applying the sales price to the volume of business done by the tax payer.

v. The net worth method

This method is based on the theory that increases in a taxpayer's net worth during a tax year, adjusted for non-deductible expenditure and non-taxable income must result from taxable income

SOLUTION FOUR

(a) Cheswa, Bwembya and Mukwapu
Adjusted business profit for the tax year 2019

	K	K
Net profit as per accounts		180,800
Add:		
Depreciation	6,500	
Repairs –extensions	16,500	
Partners salaries & wages:		
Cheswa	19,000	
Bwembya	13,000	
Rent and rates (60% X 20,000)	12,000	
Motor running expenses:		
Cheswa(30% x5,000)	1,500	
Bwembya(20% x 3,200)	640	
Mukwapu(25% x 1,800)	450	
Legal costs:		
Dangerous driving	1,000	
Appeal for penalties	2,400	
Provisional taxes	9,000	
Donations to political party PAT	3,000	
		84,990
		269,790
Less:		
Capital allowances		(12,400)
Adjusted business profit		257,390

(b) Cheswa, Bwembya and Mukwapu

	TOTAL	CHESWA	BWEMBYA	MUKWAPU
First 2 months	K'000	K'000	K'000	K'000
Salaries (2/12)	20,000	10,000	10,000	---
Balance (3:2)	22,898	13,739	9,159	---
	42,898	23,739	19,159	---
Last 10 months				
Salaries (10/12)	145,000	35,000	50,000	60,000
Balance (1:2:3)	69,492	11,582	23,164	37,746
	214,492	46,582	73,164	94,746
Total	257,390	70,321	92,323	94,412

Less capital allowances:

Cheswa (K20, 000 x20% X 70%)	(2,800)	(2,800)		
Bwembya (K30, 000 x20% x80%)	(4,800)		(4,800)	
Mukwapu (K25, 000x 20% x75%)	(3,750)			(3,750)
Totals	246,040	67,521	87,523	90,996

END OF SOLUTIONS