



TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C1: BUSINESS MANAGEMENT

MONDAY, 9 DECEMBER 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. 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.

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

Attempt all five (5) questions.

QUESTION ONE

- (a) The Human Resource functions (HR) frequently conduct employee performance appraisals or evaluations as a management tool.

Required:

Explain the uses of employee performance appraisal or evaluations to management.

(8 marks)

- (b) Unethical behavior by both management and employees sometimes arise in workplaces.

Required:

Define ethics and explain three (3) unethical issues from the employer and employee side that may arise in work places.

(12 marks)

[Total: 20 Marks]

QUESTION TWO

- (a) Price is one of the elements of the marketing mix and is frequently used as a marketing strategy by marketing functions.

Required:

Explain how price is used as a marketing strategy using the following pricing strategies:

(i) 'penetrating pricing' strategy. (2 marks)

(ii) 'Price skimming' strategy. (2 marks)

- (b) Modern organizations stress the importance of hiring people who are team players.

Required:

Identify eight (8) functions of effective managers and explain how that enables them to manage teams in organizations.

(16 marks)

[Total: 20 Marks]

QUESTION THREE

- (a) There are a number of factors why delegation of power and authority is not always applied by some leaders in organizations.

Required:

Discuss the factors that act as obstacles to effective delegation. (10 marks)

- (b) Goals direct work behaviour, performance in an organisation and guarantees feedback to all concerned.

Required:

Explain **how goal setting** in organizations would motivate employees and increase productivity. (10 marks)

[Total: 20 Marks]

QUESTION FOUR

Mentoring and Coaching are some of the training methods used by business organizations to train staff.

Required:

- (a) By bringing out four (4) characteristics of each method, explain mentoring and coaching as training methods. (14 marks)

- (b) Job redesign helps improve individual and group performance in organizations.

Explain three (3) main areas of job redesign that would result in improved productivity. (6 marks)

[Total: 20 Marks]

QUESTION FIVE

- (a) Explain Corporate Social Responsibility (CSR) and explain how social and environmental disclosure by mining companies in Zambia constitutes social responsibility behaviour. (10 marks)

- (b) According to Douglas McGregor (1960), the assumptions of managers regarding their subordinates affect how they manage and motivate people in organizations.

Required:

Using McGregor's theory of motivation, discuss the concept of motivation and explain how management style is influenced by the assumptions they hold about their subordinates.

(10 marks)

[Total: 20 Marks]

END OF PAPER

C1 SOLUTIONS

SOLUTION ONE

(a) The purpose/ use of performance evaluation (appraisal) by management varies from one organisation to another. Generally, it is seen as a mechanism for providing feedback and determinant of reward allocation. Management uses performance evaluation or appraisal for general human resource management decisions.

- i) Performance evaluations are important inputs in decisions of promotion, transfer and termination.
- ii) Performance Evaluations help identify training and evaluation needs. They help pinpoint employee skills and competences, which are currently deficient for staff development, can be used to remedy the situation.
- ii) Performance evaluation is used as criteria against which selection and Development programmes are validated. Newly hired employees who perform poorly can be identified through performance evaluation.
- iv) Performance evaluation also provides a feedback to employees on how the organization views their performance.
- v) Performance evaluations are also used as a basis for reward allocations. Thus who gets a merit increase or who gets a bonus for work output

(b). Ethical problems/issues that may arise in work places fall into two categories

1 Ethical Issues that may arise from Employers' side

- i) Favoritism. This means that the employer may favor a particular person with regard to promotions and bonuses and evidently neglect other eligible employees. This conduct is considered highly unethical on the part of the employer.
- (ii). Sexual harassment is not legal/ethical/moral whether in the workplace or out of it. Harassing an employee sexually, or refraining from taking action against those who are involved in such offences, is strictly forbidden.
- (iii). Terminating an employee without any notice.
In some cases, for reasons like budget management, companies opt for mass firing to reduce the number of employees. Such terminations should be done after prior indications and notice of at least a month or two, so

that the person can find another job. Notice periods must be served to avoid confusion.

- (iv) Unnecessary delay in paying employee's statutory contributions (such as NAPSA) and gratuity after leaving the organization is a breach of professional ethics

2. Ethical issues/ problems employees' side

- (i) Lying to Supervisors/Management

Taking excessive leaves beyond the allowed number is a breach of ethical code/lying (covering a colleague) about a colleague who sneaks out with permission during working hours.

- (ii) Lying on reports/ falsifying records

Changing/ manipulating information to suit/ or justify one's actions.
Destroying data/information (espionage) is an unethical act.

- (iii). Stealing/Theft/pilfering

Some employees make use of office computer and printers for personal uses such as taking lengthy print outs, heavy downloading and even unnecessary net surfing etc. Personal work needs to be kept personal. Making long phone calls at the company's cost and taking home the company's assets. Some employees pocket tools and stationery such as staplers, pins, papers etc. to use them at home. This would have probably gone undetected by the cameras, but definitely is unethical.

- (iv). Conflict of interest

When interests regarding organizational and personal benefits clash, if personal benefits/interests are done at the expense of the organization, the act amounts to being unethical behavior.

- (v). Sexual harassment among fellow employees

Gestures, comments and language/communications that make other/fellow employees uncomfortable in work places.

SOLUTION TWO

- (a) The price of a product has to deliver a profit to the organization, but at the same time must be set at the right level for the consumer.
- (i). **'Penetrative pricing' strategy** is used when prices are deliberately pitched at a low level to persuade purchasers to buy. That is, this strategy is used to promote high sales volume. 'Penetrating pricing' often occurs in the early stages of the product life cycle.
 - (ii). **'Price skimming' strategy** is used when is prices are deliberately set very highly to maximize profits, even though this restricts demand. Price skimming is often used as a competitive weapon. It is used when the product or service already enjoy a large publicity and has a significant share of the market.
- (b). Management is about changing behavior of people and making things happen with and through people (team work). Successful modern management practice is premised on the principle of harmoniously mobilizing and motivating human resources to high productivity.

There are **eight (8)** identifiable managerial functions that enable managers to manage teams in organizations (expanded format of Henri Fayol's functional approach of 1916):

(i). **Planning**

Planning is the primary management function .Planning is the formulation of future courses of action. Plans and the objective on which they are based give purpose and direction to the organization, its subunits and contributing individuals. Planning involves the setting of objectives (what to do), formulation of a strategy (how to do) and implementation of strategy (when, whom) to achieve the set objectives. The planning process is best done through the participation of all key players in the organization to ensure ownership of the plan.

(ii). **Organizing**

Organizing involves the analysis of activities, identifying decisions and relationships required in the organisation, classifying and dividing work, creating the organisation structure and selecting staff to implement management strategies. Organizing may also be seen as a provision of material and human resources and building of the structure to carry out the activities of the organization.

Organizing is an essential ingredient of management as it is ensures that whatever is done, it is properly organized or arranged. Once things are properly organized or arranged, it becomes easier to implement and ensure that organizational objectives are achieved.

(iii). **Coordinating**

Coordination involves the unifying and harmonization of all activities and effort of the organisation to facilitate its work and success. It involves balancing and maintaining

the team by ensuring a suitable division of work and seeing that the tasks are performed in harmony and not in conflict. Through this function, the manager creates reporting relationships vertically and facilitates communication relationships horizontally.

(iv). **Leading**

Leading is the creation of an organisational climate, in which, people work willingly and effectively thus inspiring morale among employees. An essential part of management is coordinating the activities of people and guiding their efforts towards the goals and objectives of the organisation. This involves the process of leadership and choice of an appropriate form of action and behavior. Leadership is a central feature of organizational performance. A manager will not be able to single-handedly carry out all programs of the organisation and requires the support of other people in the organisation. The ability to lead people, or inspire and influence others to the desired direction for the achievement of objectives is one of the greatest challenges of leadership. Through effective motivation and communication, a manager creates a team out of people responsible for various jobs.

(v). **Controlling**

After planning, organizing and coordinating the various work processes, it is important that an evaluation is undertaken to compare actual performance against the set standards. This comparison will ensure satisfactory performance and progress and this record can be used as guide for future operations. Once deviations from set standards have been detected, they are reported to those

(vi). **Decision Making.**

Managers must choose among alternative courses of action wherever and whenever they make decisions. Making intelligent and ethical decisions in today's complex world is a major management challenge. Successful managers should possess skills and/or tools to enable them make decisions effectively and efficiently.

(vii). **Communicating.**

Today's managers are responsible for communicating to their employees the technical knowledge, instructions, rules, and information required to get the job done. Recognizing that communication is a two-way process, managers should be responsive to feedback and upward communications.

(viii). **Motivating.**

An important aspect of management today is motivating individuals to pursue collective objectives by satisfying needs and meeting expectations with meaningful work and valued rewards. Flexible work schedules can be motivational for today's busy employees. Leading managers become inspiring leaders by serving as role models and adapting their management style to the demands of the situation. The idea of vision among leadership is popular today.

SOLUTION THREE

- (a). Delegating means giving or conferring authority. When a manager grants authority to subordinates to accomplish a task, the process is delegation of authority in an organization. Delegating authority is necessary for efficiency in an organization.

The factors that affect the delegation of authority by managers/superiors in organizations could be categorized under **three (3) sub headings:**

- 1) Delegator or Superior's view /perceptions
- 2) Subordinate /delegant's aspect of view/perceptions
- 3) Organizational aspect

(1) the manager's perception of the subordinate staff. Failure to delegate often results from the manager's fear. For instance, the concerned manager may:

- (i) Fear that the subordinate is **not** capable of **doing a satisfactory good job**.
- (ii) Fear being blamed for the subordinate's **mistakes**.
- (iii) Fear **of being out witted/ classed**: fear that the subordinate may **do too good a job** and show the manager in a bad light.

(iv) **Fear of Subordinate Advancement**

Manager may not have interest in delegation of authority if he fears subordinate having good performance and competence. He may also oppose authority delegation, fearing that he may lose a good subordinate. Manager may also fear that the subordinate may be a contender for manager's post if he gets more authority.

(v) **Fear of Exposure**

Superior may not delegate enough authority for fear of exposure of his shortcomings as a manager. Hence, managers refrain from best practices in order to maintain their authority.

(vi) If manager /superior **love his authority**, he may not be effective in granting authority to subordinates. He will fear the advancement of subordinates.

(v) **Superior's Experience and Personality.**

Manager with autocratic tendencies might not want to delegate authority to subordinates. They draw feeling of being "in charge" or important by doing nearly everything and force subordinate employees to come to them frequently for decision approvals. Such managers/superiors would not want to share workload or delegate authority. Superior who works his way through the corporate ladder will be

more efficient in delegating authority to subordinates than autocratic managers.

(vi) **Exhibition of lack of confidence by subordinates:**

Delegating authority needs adequate amount of trust between the subordinates and superiors. Lack of confidence among subordinates can negatively affect delegation of authority.

2) Delegant's / subordinates Aspects/perceptions

If subordinates lack responsibility, it also negatively affects delegation of authority. Some factors that may hinder effective delegation pertaining to the subordinate include:

(i).Fearing Criticism

If subordinate thinks that the manager will take away all credit, he may not have interest in taking the authority.

(ii) Lack of Resources

Without proper information and resources, subordinates will hesitate in taking up authority given by the superiors. With scarcity of resources, unclear information, subordinates will not take up the authority for fear of doing an inefficient job.

(iii).Lack of rewards and Incentives

Without motivating factors like rewards and incentives, subordinates will have no interest in taking authority delegated by superiors.

(3) Organizational Aspect/structure

At times, organizational factors may hinder effective delegation. Organisations with **centralized** authority for instance, may not encourage delegating authority to subordinates whereas a **decentralized** management encourages delegation of authority.

(b). The basic premise of the goal theory is Management by objectives (**MBO**).

-Management by Objectives, MBO) asserts that people's goals or intentions play an important part in the determining of behavior. People strive to achieve goals in order to satisfy their emotions and desires. Goals guide people's responses and actions. Goals direct work behavior and performance and lead to feedback.

-MBO is a technique and philosophy of management based on converting an organizational objective into a personal objective on the presumption that establishing personal objectives makes an employee committed (motivated), which leads to better performance and productivity.

- MBO is a comprehensive managerial system that **integrates many key managerial activities in a systematic manner**, consciously directed towards the effective and efficient achievement of organizational objectives.

-MBO works from the "bottom up" as well as from the "top down." The result is a hierarchy of objectives that links objectives at one level to those at the next level. And for the individual employee,

-MBO provides specific personal performance objectives. Each person, therefore, has an identified specific contribution to make to his or her unit's performance. This **creates a platform for motivated output.** If all the individuals achieve their goals, then their unit's goals will be attained and the organization's overall objectives will become a reality. There are four ingredients common to MBO programs: goal specificity, participative decision making, an explicit time period, and performance feedback.

Thus, managers and employees have motivations of not only specific objectives but also stipulated periods in which to accomplish them.

-MBO seeks to give continuous feedback on progress toward goals so that individuals can monitor and correct their own actions. Continuous feedback, supplemented by more formal periodic managerial evaluations, takes place at the top of the organization as well as at the bottom.

SOLUTION FOUR

One contribution a manager is to motivate subordinates. This means give others a vision and drive to willingly put in more effort. This entails directing, encouraging and training subordinates.

Mentoring and Coaching are training methods are indeed gaining momentum in contemporary organizations.

(a).

Mentoring

Mentoring is a training process that uses a mixture of **inductive** (pushing it in or telling) and **deductive techniques** to increase an employee's ability or willingness in specific subject (motivation). A structured program is usually used. The mentor is usually an expert in the subject matter/field. A mentor plays the role of a counselor, net worker and facilitator.

Characteristics/ features of Mentoring

- a. Uses a mixture of deductive and inductive techniques
- b. The mentor must be an expert in the subject
- c. The prime beneficiary is the organization but the individual benefits as well;
- d. A mentoring program is measured in months.
- e. The mentor must be available almost on demand but at least on regular basis
- f. More formal but can include informality

Coaching

Coaching is a training process that uses deductive or drawing-out techniques to increase an individual's ability and willingness in a specific subject or field. The technique is used in a structured manner. The coach does not need to be an expert in the subject/field.

Characteristic/ features of Coaching

- a. Uses deductive techniques (drawing of conclusions from the point of view of coachee
- b. The coach does not have to be expert in the subject matter
- c. The prime beneficiary is the individual but the organization also benefits;
- d. A coaching session is measured in minutes or hours
- e. Can be an off the cuff session
- f. Usually informal but can be formal
- g. Respect for the coach is expected; and
- h. Rapport between the coach and the new employee is essential.

- (b).** Motivation is the urge/desire to take action to achieve something or to avoid something. It is the direction and persistence of action. Motivation is concerned with securing and sustaining (persistent) efforts of subordinate's/ employee's drive towards productivity or performance in organizations. It explains why people at work behave in the way they do in terms of their efforts and the directions they are taking. It describes what organizations can do to encourage people to apply their efforts and abilities in ways that will further the achievement of the organization's goals as well as satisfying their own needs.

In work environment, motivation aims at increasing morale and increasing productivity. Job redesign is process of restructuring the job in a bid to motivate the job holder and thus raise productivity.

It **encompasses three (3) main areas:**

- (a) Job rotation
- (b) Job enlargement
- (c) Job enrichment

Job rotation is the most common form of individual job redesign. It involves the moving of a person from one job or task to another. It is aimed at adding some variety and help remove boredom at least in the short term. This is more pronounced where the jobs are similar and routine.

Job enlargement involves increasing the scope of the job and the range of tasks that a person carries out. It may be achieved by combining a number of related operations at the same level. Job enlargement is horizontal job redesign. it makes a job structurally bigger and lengthens the time cycle of operations and may offer greater variety. Its motivational aspect is premised on the belief that it improves a person's intrinsic satisfaction or sense of achievement.

Job Enrichment is an extension of the more basic job rotation and job enlargement methods of job design. This method attempts to enrich the job by incorporating motivating or growth factors such as increased responsibility and involvement, opportunities for advancement and the sense of achievement.

Job enrichment involves vertical job enlargement. The motivational aspect of job enrichment are that it aims to give the person greater autonomy and authority over the planning, execution and control of their own work. This is the more reason why it is sometimes referred to as empowerment.

SOLUTION FIVE

(a). Definition of Corporate Social Responsibility (CSR)

Corporate social responsibility (**CSR**) also called corporate conscience or corporate citizenship is a form of corporate self-regulation integrated into a business model. CSR policy functions as a built-in, self-regulating mechanism whereby a business monitors and ensures its active compliance with the spirit of the law, ethical standards and international/national norms.

Put simply, Corporate social Responsibility (CRS) is company's sense of responsibility towards its stakeholders(the community and environment both ecological and social) in which it operates.

How social and environmental disclosure by Mining companies in Zambia constitute ethical behavior

Social responsibility is as a system of principles governing morality and acceptable conduct. Mines world over are governed by acceptable international standards. These mining standards are 'ethics' or expected corporate behavior to which mining companies are expected to comply. This compliance includes social **and environmental disclosure.**

Social responsibility is premised on fair operating practices, meaning business conduct of mining organization's dealings with others, including government agencies, employees partners, suppliers, contractors, competitors and the associations in which they are members.

Environmental disclosure may include advertisements or articles published detailing companies' activities, Annual Reports, Booklets or leaflets produced to address the social and environmental activities of the mining companies, CD reports, Community Reports environmental Reports, labeling of mining products to promote environmental and other concerns. This should include press releases, Supplements to the Annual Reports or produced at interim dates, Video tapes; and Websites regarding how mining companies promote or protect the environment.

A key issue in fair operating practices is anti-corruption. Corruption can result in the violation of human rights, the erosion of political processes, impoverishment of societies and damage to the environment.

This implies that if mining companies in Zambia slacken on their social responsibility, they would impinge on the rights of other stakeholders and this would invariably result in rampant disregard and degradation of the ecological and social environments.

Thus, for mining companies in Zambia to be socially responsible and uphold good corporate behavior (ethics), they will have to put in place robust anti-corruption policies and practices, backed up by senior management buy-in, staff training, reporting and accountability arrangements. This includes freedom of whistle blowing, where necessary.

(b). Motivation refers to the process/techniques used by leaders/ managers on Subordinates to willingly put in more effort towards achieving increased output/productivity

Douglas **McGregor** presented **two** (2) opposing **assumptions** held by managers about Employees. He asserted that the assumptions held by managers influence/affect how they manage and motivate subordinates. These opposing theories/assumptions are opposite ends of a continuum.

Theory X assumes that individuals have an inherent dislike for work and will avoid it if they can.

In accordance with this assumption/ theory, A **Theory X** employee is assumed to exhibit the following traits/characteristics:

- (a) Prefers to be directed,
- (b) Has little ambition,
- (c) Is resistant to change and gullible and consequently,
- (d) Must be coerced and controlled.

Thus, in order to motivate **employee X** to work hard, , the manager must assume close monitoring roles coupled with high extrinsic incentives and/or threats. Such employees should be given externally induced 'drives' to encourage them to work harder. Given that the theory assumes that **employee X** is assumed to do well in lower non managerial jobs, the manager should assign more roles or jobs that are non supervisory or managerial in nature. Routine and possibly less mentally demanding jobs would be suitable for employee X.

Theory Y asserts that work is as natural as play or rest. A **Theory Y employee** is assumed to exhibit the following traits:

- (a) Self direction
- (b) Self control
- (c) places an emphasis on self actualizing needs.

In contradistinction to **employee X**, **employee Y** could be motivated by being given (mentally) challenging, self directing tasks/jobs.

The manager may assume a democratic- consultative role when dealing with employee **Y** because they are intrinsically motivated.

Employee Y could be motivated by being given managerial /supervisory roles/ duties in the organization.

Theory X is a 'stick' (dictatorial management approach) whilst **Theory Y** seeks to encourage motivation by influencing the circumstances of work (democratic style/approach).



TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C2: ECONOMICS & FINANCIAL MATHEMATICS

WEDNESDAY, 11 DECEMBER 2019

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

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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. A mathematical/statistical formulae book **MUST** be provided to you. **Request for one if not given by the Invigilators.**
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) (i) Income elasticity of demand is the ratio of the percentage change in the quantity demanded of a good to a given percentage change in income. Suppose John's income has been increased by 20% and the quantity demanded of Vitumbuwa increased by 25%. Based on these data, state, giving reasons whether Vitumbuwa is a normal or an inferior good. (2 marks)
- (ii) Explain any three (3) factors that affect the Price elasticity of demand for a good in general. (6 marks)
- (b) Explain any four (4) benefits a company can derive from listing on a Stock Exchange like the Lusaka Stock (Securities) Exchange (LuSE). (12 marks)

[Total: 20 Marks]

QUESTION TWO

- (a) Describe Zambia's budget cycle bringing out the four (4) main stages. (12 marks)
- (b) Describe any four (4) advantages of direct taxes to Zambia Revenue Authority. (4 marks)
- (c) Define the following concepts:
- (i) Government debt (1 mark)
 - (ii) Compliance costs of a tax system (1 mark)
 - (iii) Administrative costs of a tax system (1 mark)
 - (iv) Tax base (1 mark)

[Total: 20 Marks]

QUESTION THREE

- (a) Based on past experience, 10% of the accounts of a large mining company are incorrect. If a random sample of 3 accounts is selected, calculate the probability that:
- (i) Exactly one account is incorrect? (3 marks)
 - (ii) At least one account is incorrect? (3 marks)
 - (iii) All three are correct? (3 marks)

- (b) A manager has to choose between mutually exclusive projects A, B and C. The cash flows of the three projects are shown below:

YEAR	PROJECTS(K)		
	A	B	C
1	70	94	80
2	55	60	40
3	88	70	75

The cost of capital is 3%. The initial cost of each project is K190.

Required:

Using the NPV method for project evaluation, which project should the manager choose?

(11 marks)

[Total: 20 Marks]

QUESTION FOUR

Trade Kings Ltd has recorded the following data on Production ('000 units) and Costs (K'000) of production for the last ten months.

Production (X):	10	4	6	9	10	8	5	7	11	12
Costs (Y) :	15	11	12	19	22	20	16	13	24	20
	Production			Costs						
Sums	82			172						
Sums of squares	736			3,136						

Required:

- (a) Find the appropriate regression equation (8 marks)
- (b) State the fixed costs of the factory (2 marks)
- (c) Plot a scatter diagram of the data (5 marks)
- (d) Predict the costs of production for next month when Output is scheduled to be 10,000 units. (5 marks)

[Total: 20 Marks]

QUESTION FIVE

- (a) At Zambian Breweries Plc , two Mosi beer tasters ranked eight bottles of Mosi beer as follows:

Beer	A	B	C	D	E	F	G	H
Tester X	3	7	1	8	5	2	4	6
Tester Y	3	8	2	7	4	1	5	6

Required;

- (i) Find Spearman's rank correlation coefficient for this data, correct to 3 decimal places. (6 marks)
- (ii) Interpret the results in (i) above, to management. (2 marks)
- (b) Find the accumulated value of an ordinary annuity of K2000 per year for 5 years if money is worth 9% compounded annually. (5 marks)
- (c) The salaries of employees at Kagem mining are normally distributed, with a mean of K14,000 and a standard deviation of K2,700.

Required:

Calculate the proportion of the employees who earn:

- (i) Less than K12,000 (3 marks)
- (ii) Between K11,000 and K19,000 (4 marks)

[Total: 20 Marks]

END OF PAPER

C2 ECONOMICS AND FINANCIAL MATHEMATICS

SUGGESTED SOLUTIONS

SOLUTION ONE

$$\begin{aligned} \text{a) i) Income Elasticity of demand} &= \frac{\text{Percentage Change in quantity demanded}}{\text{Percentage change in income}} \\ &= \frac{25\%}{20\%} = 1.25 \end{aligned}$$

Thus, since $E_y > 0$ Vitumbuwa is a normal good.

ii) The factors that affect elasticity of demand for any product are:

- **Substitutability:** A product with close substitutes has high elasticity compared to a product without close substitute. Education has no close substitutes hence has inelastic demand
- **Necessities versus Luxuries:** A necessity is a good consumed to sustain life while a luxury is a good which makes life easier and enjoyable. Education is now taken to be a necessity hence has inelastic demand
- **Percentage of income:** Small items in expenditure such as a box of matches tend to have inelastic demand compared to large items.
- **Time:** In the short run demand is inelastic while in the long run it is elastic as buyers can have many options to choose from.

b) Some of the main benefits of being listed on a stock exchange are that:

- It can be a source of long term finance:** Banks may not be willing to provide long-term finance, so, the companies needing such financing turn to the public, inviting people to lend them money or take a share in the business in exchange for future profits. This they do by issuing stocks and shares in the business through stock exchanges. By doing so, they can mobilise the savings of individuals and institutions. Thus, the stock exchange exists to provide a channel through which these savings can reach those who need finance.
- There is unlimited investment opportunity:** Everyone wants to save or invest in one form or another. The stock exchange provides a way in which money can be put to work. When the saver in shares needs his money back, he does not have to go to the company with whom he originally placed it. Instead, he sells his shares to some other who is seeking to invest his money through the Stock exchange.
- It fosters economic stability:** The economic stability of a country is essential for the growth of healthy industrial atmosphere and participations of people in productive economic investments. Capital is the lifeblood for industries. The government is providing the major equity for further expansion or to survive in a different economic condition. The stock exchange provides assistance to the enterprises by creating avenues for selling shares and stocks to the public to

generate funds. Thus, the stock exchange is a unique yardstick to assess the industrial activity and investment opportunities of a country.

- iv. **It provides investment opportunities to small savers:** The stock exchange is a system of arrangement which, in combination with other institutions, patterns the capital market of an economy. In a free economy, the stock exchange is the pivot of the money market. It thus provides investment opportunities to small savers. A flexible exchange rate is determined through the free interaction of market forces and without any government intervention.
- v. **It helps with raising of new capital:** Companies, however, do not get their shares listed on the stock exchange automatically and, though the actual listing fees payable to the stock exchange are not big, the cost to the company of meeting the exchanges may be considerable. A company willingly accepts these responsibilities because access to the stock exchange brings benefits in the form of better marketability for their shares and, thereby, assists in the raising of new capital.
- vi. **It is easy to participate:** The Stock exchange has no statutory authority, or monopoly, over anybody and no legal powers other than those which individual companies freely contract to give. Members of the stock exchange agree to abide by its rules as a condition of membership and companies do so by signing the listing agreement or general undertaking.

SOLUTION TWO

a) The four main stages in the budget cycle in Zambia are drafting, legislative, implementation and audit. These are explained below:

- **Drafting Stage.** This starts with the finance ministry or treasury issuing guidelines to spending departments or agencies. Then the spending agencies submit budgets. This stage ends with negotiation and final decision by the executive.
- **Legislative Stage:** Here the budget is tabled before parliament. The parliamentary committees will consider the budget. Then parliament accepts, amends or rejects the budget.
- **The Implementation Stage:** Here the funds are apportioned to spending agencies to implement the agreed activities. This is followed by the finance ministry monitoring spending and further requests for adjustment budget if necessary.
- **The Audit Stage:** Here the Auditor General's office audits departmental accounts and performance and publishes an audit report which is reviewed by parliament.

b) **Direct taxes** are taxes that are levied on income and capital and are paid directly to the tax authority. Examples are personal income tax, corporation tax, capital gains tax, personal levy and social security contributions.

The following are the advantages of direct taxes over:

- Direct taxes afford a greater degree of progression hence are more equitable
- Direct taxes entail less expense on collection and as such are economical
- Direct taxes satisfy the canons of certainty, elasticity, productivity and simplicity
- Direct taxes create civil consciousness in people. When a person has to bear the burden of tax, he takes active interest in the affairs of the state.

c) Definitions:

- a. Government debt is the amount of interest-bearing debt issued by the government at a given point in time and arises from previous yearly deficits.
- b. Compliance costs are the costs incurred by the taxpayer in order to comply with tax obligations including seeking professional advice and assistance among others.
- c. Administrative costs are costs borne by a tax authority in tax collection, monitoring taxpayer, imposing fines and penalties, and resolving legal matters.
- d. A tax base is either the income or asset balance used to calculate a tax liability. To determine the tax liability, the tax base is multiplied by an applicable tax rate.

SOLUTION THREE

a) Binomial distribution with $p = 0.10$, $q = 0.9$ and $n = 3$.

$$\begin{aligned} P(X = 1) &= {}^3C_1(0.1)^1(0.9)^2 \\ \text{i.} \quad &= 3 \times 0.10 \times .81 \\ &= 0.243 \end{aligned}$$

$$\begin{aligned} P(X \geq 1) &= P(X = 1) + P(X = 2) + P(X = 3) \\ &= {}^3C_1(0.1)^1(0.9)^2 + {}^3C_2(0.1)^2(0.9)^1 + {}^3C_3(0.1)^3(0.9)^0 \\ &= 0.243 + 0.027 + 0.001 \\ \text{ii.} \quad &= 0.271 \end{aligned}$$

$$\begin{aligned} \text{iii.} \quad P(X = 0) &= {}^3C_0(0.1)^0(0.9)^3 \\ &= 1 \times 1 \times 0.729 \\ &= 0.729 \end{aligned}$$

(b)

Project A (k)

YEAR	CASH	DF	PV
0	(190)	1.0	(190)
1	70	0.971	67.97
2	55	0.943	51.87
3	88	0.915	80.52
		NPV =	10.36

Project B (k)

YEAR	CASH	DF	PV
0	(190)	1.0	(190)
1	94	0.971	91.27
2	60	0.943	56.58
3	70	0.915	64.05
		NPV =	21.90

Project C (k)

YEAR	CASH	DF	PV
0	(190)	1.0	(190)
1	80	0.971	77.68
2	40	0.943	37.72
3	75	0.915	68.63
		NPV =	(5.97)

Project Y is the Optimum project.

SOLUTION FOUR

The dependent variable Y, is cost, while the independent variable, X, is production.

$$\Sigma X = 82$$

$$\Sigma Y = 172$$

$$\Sigma X^2 = 736$$

$$\Sigma Y^2 = 3,136$$

$$\begin{aligned}\Sigma XY &= (10 \times 15) + (4 \times 11) + (6 \times 12) + (9 \times 19) + (10 \times 22) + (8 \times 20) + (5 \times 16) + (7 \times 13) + (11 \times 24) + (12 \times 20) \\ &= \mathbf{1,492}\end{aligned}$$

(a) The regression line is $Y = a + bx$, where $b = \frac{n\Sigma XY - \Sigma X \Sigma Y}{n\Sigma X^2 - (\Sigma X)^2}$

$$\begin{aligned} &= \frac{10 \times 1,492 - 82 \times 172}{10 \times 736 - 82^2} \\ &= \mathbf{1.2830} \end{aligned}$$

$a = \Sigma Y/n - b(\Sigma X/n)$

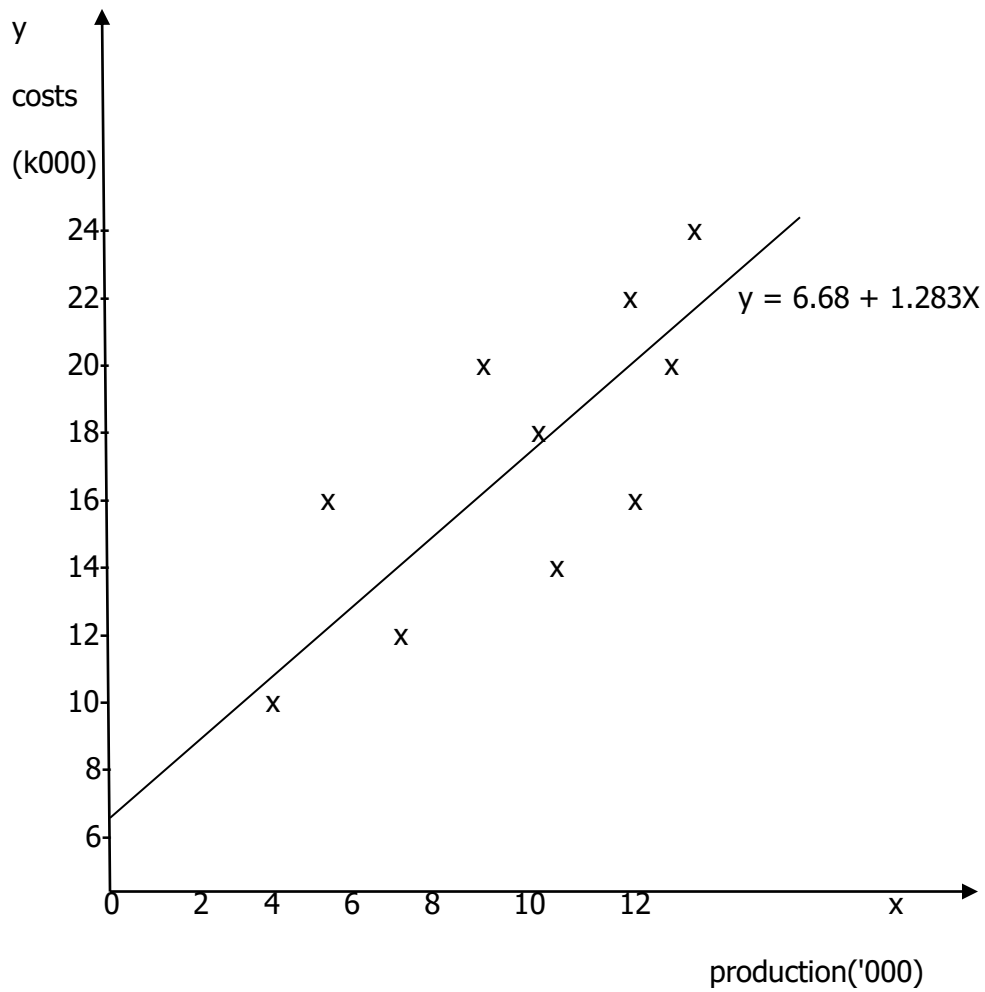
$$\begin{aligned} &= 172/10 - 1.2830(82/10) \\ &= 17.2 - 1.283 \times 8.2 \\ &= \mathbf{6.68} \end{aligned}$$

Therefore $Y = 6.68 + 1.283X$ ('000)

(b) When there is no production. i.e. $X = 0$ and $Y = 6.68$.

Fixed costs are = **K6,680**

(c) **Scatter diagram and regression line**



(d) If production is 10,000 units, then $X = 10$,

$$Y = 6.68 + 1.283 \times 10$$

$$= \mathbf{19.51}$$

Hence costs for next month will be **K19,510**

SOLUTION FIVE

(a)	(i)	A	B	C	D	E	F	G	H
	d	0	-1	-1	1	1	1	-1	0
	d ²	0	1	1	1	1	1	1	0

$$\sum d^2 = 6; \quad n = 8$$

$$\begin{aligned} \text{Rank correlation} &= 1 - \frac{6 \sum d^2}{n(n^2 - 1)} \\ &= 1 - \frac{6 \times 6}{8 \times 63} \\ &= \mathbf{0.929} \end{aligned}$$

(ii) There is a strong positive correlation between the two testers. i.e. there bottles which were ranked highly by X were also ranked highly by Y and those ranked low by X were also ranked low by Y.

(b)

$$A = R \frac{(1+i)^n - 1}{i}$$

Now $R = 2000$, $i = 0.09$ and $n = 5$. Thus ;

$$A = 2000 \frac{(1+0.09)^5 - 1}{0.09} = 11969.42$$

(c) (i) $z = \frac{x - \text{mean}}{\text{S.D}}$

$$\begin{aligned}
&= \frac{12,000 - 14,000}{2,700} \\
&= -0.74 \\
&= 0.2704 \text{ (from normal distribution tables)}
\end{aligned}$$

Hence, $0.5 - 0.2704 = \mathbf{0.2296}$

(ii)

$$\begin{aligned}
z &= \frac{11,000 - 14,000}{2,700} \\
&= 1.11 \\
&= 0.3665 \\
z &= \frac{19,000 - 14,000}{2,700} \\
&= 1.85 \\
&= 0.4678
\end{aligned}$$

Hence ; $0.3665 + 0.4678$
 $= \mathbf{0.8343}$



TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C3: ACCOUNTANCY FOR TAX PRACTITIONERS

MONDAY, 9 DECEMBER 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.

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

Attempt all five (5) questions in this paper.

QUESTION ONE

Chibwe and Muka are in partnership sharing profit and losses in the ratio 3:2. The following is their trial balance as at 30 September 2018.

	Dr K	Cr K
Buildings (cost K420 000)	320,000	
Fixtures at cost	16,400	
Provision for depreciation: fixtures		8,400
Account receivables	122,800	
Account payables		53,180
Cash at bank	12,260	
Inventory at 30 September 2017	125,480	-
Sales		726,222
Purchases	420,000	
Carriage outwards	6,820	
Discount allowed	1,240	
Loan interest: P Pule	7,800	
Office expenses	9,520	
Salaries and wages	115,618	
Bad debts	3,264	
Allowance for irrecoverable debts		2,800
Loan from P.Pule		130,000
Capitals: Chibwe		200,000
Muka		150,000
Current Accounts: Chibwe		8,200
Muka		2,400
Drawings: Chibwe	63,600	
Muka	56,400	
	<u>1,281,202</u>	<u>1,281,202</u>

Additional Information:

1. Inventory, 30 September 2018 K148,420
2. Expenses to be accrued office expenses K430, wages K1,440.
3. Depreciation fixtures 15% on reducing balance, buildings K10,000.
4. Reduce provision for irrecoverable debts to K2,500.
5. Partnership salary: K60,000 to Chibwe. Not yet entered.

6. Interest on drawings: Chibwe K1,800; Muka K1,200.
7. Interest on capital account balances 5%.

Required:

- (a) Prepare income statement for the year ended 30 September 2018, including appropriation accounts. (10 marks)
- (b) Prepare the statement of financial position as at 30 September 2018. (10 marks)
- [TOTAL: 20 Marks]**

QUESTION TWO

Muwenda runs a small courier business distributing parcels from Inter-city bus terminus to Kamwala and Lusaka central business areas. In January 2016, he purchased a motor bike at a cost of K280,000 and it has a life of 4 years with a residual value of K20,000. The depreciation policy is to charge depreciation on a month by month basis. Due to the high volume of business, he had to buy new tyres in March 2018 which cost K2,400. However, he decided to sell the motor bike on 30 September 2018 at a price of K100,000. His accounting period ends on 31 December.

He has approached your firm that does consultancy work to help him with some accounting treatments in preparing his financials.

Required:

- (a) Explain the following terms to Muwenda
- (i) Non-current asset
 - (ii) Depreciation
 - (iii) Residual value
 - (iv) Asset revaluation (4 marks)
- (b) Muwenda is wondering whether there is a difference in the treatment of the motor bike and tyres. Using your accounting knowledge, explain to him briefly the difference between capital expenditure and revenue expenditure and show how the two purchases will be treated in the books of accounts. (4 marks)
- (c) Show the motor vehicle account, provision for depreciation account for year ended 31 December 2016, 2017 and 2018 and disposal account for the year ended 31 December 2018 and extracts of the statement of profit or loss for the year ended 31 December 2018.

(12 marks)

[Total: 20 Marks]

QUESTION THREE

When Sepo extracted her trial balance for the month ended June, 2018, She discovered that the credit side was more than the debit side by K3,240. She then found out that the following errors had occurred in her books:

1. A VAT exclusive credit sale valued at K 1,500 was completely left out of the accounting records.
2. VAT exclusive Sales returns worth K3,000 were only recorded in the receivable ledger control account.
3. A purchase invoice for a VAT exempt supply which cost K4,100 was posted to both accounts as K1,400.
4. VAT Exempt Commission received amounting to K120 was debited to the commission received account.
5. VAT Exempt Motor vehicle repairs which cost K2, 000 was posted to the debit side of the motor van asset account.
6. VAT Exempt Stationery expenses valued at K1,800 were posted to the purchases account.

The standard VAT rate applicable to the above transactions is 16%

Required:

- (a) Explain four (4) reasons for extracting a trial balance (4 marks)
- (b) List and explain four (4) types of errors which cannot be detected by the trial balance. (4 marks)
- (c) For each error listed above, pass the relevant journal entry (Narratives are not required) (8 marks)
- (d) Write up and clear the suspense account (4 marks)

[Total: 20 Marks]

QUESTION FOUR

- (a) Entries are made in the books of original entry. The entries are then summarised and the summary information is entered, using double entry, to accounts kept in the various ledgers of the business.

Identify each of the recognised ledger divisions and describe, with examples, the account types that each division contains.

(3 marks)

- (b) Sindiwe owns and runs a stationery shop. The following transactions took place within the first week of June 2018 but were not recorded in the accounts. Sindiwe is a VAT registered trader.

01-Jun The business bank account had a bank balance of K80,000 and there was K2,000 cash in the business's office safe. Open accounts as relevant and simply show these as existing balances brought forward.

01-Jun Bought new stationery on credit from N Ngoshe and received an invoice for K18,560 inclusive of VAT.

01-Jun Sold goods to Punzila School on credit and sent an invoice for K13,920 including VAT.

02-Jun Sindiwe puts K20,000 into the business bank account. This is new money to his business.

02-Jun Purchased cleaning materials from MTC Wholesale and their cash invoice/receipt was K928 VAT inclusive.

03-Jun Sold more goods for K10,440 including VAT and all customers paid by cheque.

04-Jun Goods returned by Punzila School; Sindiwe issued a credit note for K2,320 including VAT.

05-Jun Sindiwe drew cash of K1,000 from the bank for business use.

06-Jun Punzila School settled their account by cheque and paid less settlement discount of 5%.

06-Jun Sindiwe got some cash for his daughter for use at school amounting to K200.

Required:

Open the relevant ledger accounts in the appropriate ledger divisions and correctly record each of the transactions stated above. You are NOT required to balance off the accounts.

The VAT rate applicable is 16%.

(17 marks)

[Total: 20 Marks]

QUESTION FIVE

You have been engaged to provide consultancy services to Kepi Plc through financial analysis. The following financial statements relate to Kepi Plc for the year ended 31 March, 2018 together with the associated comparatives:

Kepi Statement of profit or loss:

	2018 Km'	2017 Km'
Revenue	200	150
Cost of sales	(120)	(90)
	_____	_____
Gross profit	80	60
Distribution costs	(20)	(10)
Administration costs	(15)	(25)
	_____	_____
Profit from operations	45	25
Finance cost	(3)	(2)
	_____	_____
Profit before tax	42	23
Tax expense	(15)	(9)
	_____	_____
Profit for the Year	27	14
	_____	_____

Kepi Plc Statement of Financial position

	2018	2017
Assets		
Non-current assets	Km'	Km'
Property plant and equipment	1,500	1,300
Current assets		
Inventory	150	130
Receivables	80	50
Cash and cash equivalents	5	2
Total current assets	<u>235</u>	<u>182</u>
Total assets	<u>1,735</u>	<u>1,482</u>
Equity and liabilities		
Equity		
Share capital K1	200	200
Share premium	600	600
Revaluation surplus	100	-
Retained earnings	261	235
	<u>1,161</u>	<u>1,035</u>
Non- current liabilities		
5% Loan notes	500	300
Current liabilities		
Payables	59	138
Tax	15	9
Total current liabilities	<u>74</u>	<u>147</u>
Total equity and liabilities	<u>1735</u>	<u>1482</u>

Required:

- (a) Calculate the following ratios for kepi Plc:
- (i) Return on capital employed
 - (ii) Return on equity
 - (iii) Gross profit margin
 - (iv) Net profit margin
 - (v) Asset turnover
 - (vi) Current ratio

- (vii) Quick ratio
- (viii) Payable collection period
- (ix) Receivable collection period
- (x) Inventory days (10 marks)

(b) Using the ratios calculated above, comment on the performance and position of Kepi Plc. (10 marks)

[Total: 20 Marks]

END OF PAPER

C3 SUGGESTED SOLUTIONS

SOLUTION ONE

(a) Chibwe and Muka
Income Statement and profit and loss appropriation account for year ended 30th
September 2018

	K	K
Sales		726 222
Less: cost of goods sold		
Opening inventory	125 480	
Add: purchases	<u>420 000</u>	
	545 480	
Less: closing inventory	<u>(148 420)</u>	
Gross profit		<u>397 060</u>
		329 162
Add: reduction in allowance for irrecoverable debts		<u>300</u>
		329 462
Less: Salaries and wages (115 618 + 1 440)	117 058	
Office expenses (9 520 + 430)	9 950	
Carriage outwards	6 820	
Discount allowed	1 240	
Bad debts	3 264	
Loan interest	7 800	
Depreciation: Fixtures (16 400 – 8 400) x 15%	1 200	
Buildings	<u>10 000</u>	<u>157 332</u>
Net profit		172 130
Add: Interest on drawings: Chibwe	1 800	
Muka	<u>1 200</u>	<u>3 000</u>
		175 130
Less: Interest on capital: Chibwe	10 000	
Muka	<u>7 500</u>	<u>17 500</u>
		157 630
Less: Salary Chibwe	<u>(60 000)</u>	
Balance of profits		<u>97 630</u>
Share of profits: Chibwe	58 578	
Muka	<u>39 052</u>	<u>97 630</u>

(b) Statement of financial position as at 30th September 2018

<u>Non-current assets</u>	Cost K	Depn' K	N.B.V K
Buildings	420 000	110 000	310 000
Fixtures	<u>16 400</u>	<u>9 600</u>	<u>6 800</u>
	<u>436 400</u>	<u>119 600</u>	316 800
<u>Current assets:</u>			
Inventory		148 420	
Accounts receivables	122 800		
Less: Allowance irrecoverable debts	<u>(2 500)</u>	120 300	
Bank		<u>12 260</u>	<u>280 980</u>
			<u>597 780</u>
<u>Current liabilities:</u>			
Account payables	53 180		
Accruals	<u>1 870</u>		
Net current assets		55 050	
<u>Non-current liabilities:</u>			
Loan from P Pule		130 000	<u>185 050</u>
			<u>412 730</u>
<u>Financed by:</u>			
<u>Capital Accounts:</u> Chibwe		200 000	
Muka		150 000	
			350 000
<u>Current accounts:</u>			
	Chibwe K	Muka K	K
Balance 01 October 2017	8 200	2 400	
Add interest on capital	10 000	7 500	
Salary	60 000	-	
Balance of profits	<u>58 578</u>	<u>39 052</u>	
	136 778	48 952	
Less: Drawings	(63 600)	(56 400)	
Interest on drawings	<u>(1 800)</u>	<u>(1 200)</u>	
	<u>71 378</u>	<u>(8 648)</u>	<u>62 730</u>
			<u>412 730</u>

SOLUTION TWO

a) Explain terms

- i. *Non-current asset* – are assets which are acquired not for sale but for permanent use in the business.
- ii. *Depreciation* – the systematic allocation of the depreciable amount of an asset over its useful life due to wear and tear, obsolescence, or passage of time. The income statement is charged each year with part of the cost (depreciation expense) of the asset.
- iii. *Residual value* – is the estimated value of a non-current asset at the end of its useful life. This could represent the salvage value a business could obtain if they dispose of non-current asset at the end of its useful life.
- iv. *Asset revaluation* – reflecting, in the statement of financial position, the current monetary value of non-current assets like land and buildings which is in excess of their book value during periods of inflation.

b) Distinction between capital and revenue expenditure

- *Capital expenditure* is expenditure which results in the acquisition of non-current asset or an improvement in their earning capacity.
- A *motor bike* is a non-current asset that was bought for permanent use in the business; therefore, purchase of the same is capital expenditure.
- *Revenue expenditure* is expenditure which is incurred for the purpose of the trade (operations) and to maintain the existing earning capacity of non-current assets.
- Replacement of *tyres* is meant to maintain the motor bike's existing capacity so it is treated as revenue expenditure.

c) Double entry accounts

Motor vehicle (cost) account

		K'000			K'000
1/1/16	Bank	<u>280</u>	31/12/16	Bal c/d	<u>280</u>
1/12/17	Bal b/d	<u>280</u>	31/12/17	Bal c/d	<u>280</u>
1/1/18	Bal b/d	<u>280</u>	30/9/18	Disposal	<u>280</u>

Motor vehicle (Provision for depreciation) account

		K'000			K'000
31/12/16	Bal c/d	<u>65</u>	31/12/16	P&L (W1)	<u>65</u>
			31/12/17	Bal b/d	65
31/12/17	Balc/d	<u>130</u>	31/12/17	P&L	<u>65</u>
		130			<u>130</u>
			1/1/18	Bal b/d	130
30/9/18	Disposal	<u>178.75</u>	30/9/18	P&L (W1)	<u>48.75</u>
		<u>178.75</u>			<u>178.75</u>

Motor vehicle (Disposal) account

		K'000			K'000
30/9/18	MV Cost a/c	280.00	30/9/18	MV Prov. for Dpn a/c	178.75
			30/9/18	Bank	100
		<u>280.00</u>	30/9/18	P&L (loss) (W3)	<u>1.25</u>
					<u>280.00</u>

Muwenda Enterprises

Statement of Profit or Loss (extract) for the year ended 31 December 2018

	K'000
Gross profit	XXX
Expenses:	
Loss on disposal	1.250
Other expenses	XXX

Working 1 – Annual depreciation charge

$$ADC = \frac{\text{Cost} - \text{Residual value}}{\text{Useful life}} = \frac{K280,000 - K20,000}{4} = K65,000$$

$$\text{Useful life} = 4 \text{ years}$$

Depreciation expense for Jan – Sept. 2018

$$K65,000 \times \frac{9}{12} \text{ months} = K48,750$$

Working 3 – profit on disposal

Cost of motor bike	K280,000
Acc. Depn to 30.9.2018	<u>(178,750)</u>
Net Book Value	K101,250
Selling price	<u>K100,000</u>
Loss on disposal	<u>K 1,250</u>

SOLUTION THREE

(a) Four reasons for preparing the trial balance:

- Checking the arithmetic accuracy of double entry
- Assists accountants to detect some accounting errors
- Acts as an alternative source of information
- Acts as a basis for final accounts preparation

(b) Four errors which can be revealed by the trial balance

- Error of omission: a transaction was completely omitted
- Error of commission: the wrong account of the same class was used
- Error of principle: Capital expenditure was treated as revenue expenditure
- Entry reversal error : the double entry was done the other way round

(c) **Journal entry**

	DR	CR
Receivables	1,740	
Sales		1,500
VAT control account		240
Sales Returns	3,000	
Vat control	480	
Suspense		3,480
Purchases	2,700	
Payables		2,700
Suspense	240	
Sales commission		240
Motor Van repairs	2,000	
Motor van asset		2,000
Stationary	1,800	
Purchases		1,800

(d)

Suspense account			
	K		K
Balance b/f	3,240	Sales	3,000
		Returns	
Sales commission	240	VAT control	480
	<hr/>		<hr/>
	3,480		3,480
	<hr/>		<hr/>

SOLUTION FOUR

a) Ledger divisions

General Ledger – contains the double entry accounts of the business for assets and liabilities, capital and drawings, income and expenses, VAT, etc. e.g Bank account, Sales Account, Cleaning expenses account etc.

Receivables (Sales) Ledger – contains the accounts of trade receivables (customers with credit facilities) and records transactions as they appear on the customers' accounts, such as sales made on credit, sales returns, payments received and any discounts allowed.

Payables (Purchases) Ledger – contains the accounts of trade payables (suppliers who grant credit facilities) and records transactions as they appear on the suppliers' accounts, such as purchases made on credit, purchase returns, settlement made to payables and any discounts received.

b) Record transactions in accounts in the ledger

GENERAL LEDGER

Cash Book

	Cash	Bank		Cash	Bank
	K	K		K	K
June 1 Balances b/f	2,000	80,000	June 2 Cleaning materials	928	
June 2 capital		20,000	June 5 Cash		1000
June 3 Sales		10,440	June 6 Drawings	200	
June 5 Bank	1,000				
June 6 Punzila School		11,020			

Trade payables control account

	June1 Purchases	18,560
--	-----------------	--------

Purchases account

June 1 Trade payables	16,000
(18,560X25/29)	

VAT Control account

	K		K
June 1 Trade payables	2,560	June 1 Trade receivables	1,920
June 2 Cleaning materials	128	June 3 Bank	1,440

June 4 Trade receivables 320

Trade receivables control account

	K		K
June 1 Sales	13,920	June 4 Sales returns	2,320
		June 6 Bank	11,020
		June 6 Discount allowed	580

Sales account

		June 1 Trade receivables	12,000
		June 3 Bank	9,000

Capital account

	K		K
		June 1 Bank	20,000

Sales returns account

June 4 Trade receivables 2,000

Cleaning materials account

	K		K
June 2 Cash	800		

Discount allowed account

	K		K
June 6 Trade receivables	580		

Drawing account

June 6 Cash 200

Sales ledger

Punzila School account

	K		K
June 1 Sales	13,920	June 4 Sales returns	2,320
		June 6 Discount allowed	580
		June 6 Bank	11,020

Purchases ledger

N.Ngoshe's account

June 1 Purchases

18,560

SOLUTION FIVE

(a) Ratio calculations

#	Formula	2018	2017
(i)	ROCE=PBIT/Capital employed	$45/[1161+500]*100\%$ =2.71%	$25/[1035+300]*100\%$ =1.87%
(ii)	ROE= Profit after tax /equity	$27/1161*100\%$ =2.33%	$14/1035*100\%$ =1.35%
(iii)	GPM=Gross profit/Sales	$80/200*100\%$ =40%	$60/150*100\%$ =40%
(iv)	NPM= PBIT/Sales	$45/200*100\%$ =22.50%	$25/150*100\%$ =16.67%
(v)	Asset Turnover =Sales/Capital employed	$200/1661*100\%$ 0.12 times	$150/1335*100\%$ 0.11 times
(vi)	Current Ratio=C-assets/C-liabilities	$235/74=$ 3.2 : 1	$182/147=$ 1.2 : 1
(vii)	Quick Ratio= C-assets-Inventory/C-liabilities	$235-150/74=$ 1.1: 1	$182-130/147=$ 0.35 : 1
(viii)	Payable days=Payables/COSx365	$59/120*365=$ 179 days	$138/90*365=$ 560 days
(ix)	Receivables days=Receivables/Sales x365	$80/200*365=$ 146 days	$50/150*365=$ 122 days
(x)	Inventory Turnover=COS/Inventory	$120/150=$ 0.8 Times	$90/130=$ 0.7 Times

(b) Comments

Performance

Revenue has increased by 33% (200-150/150) which is indicative of favorable response of the market to the offerings or products of the Kepi Plc over the recent period of two years.

Similarly, return on capital employed has improved from 1.87% to 2.71%. This increase could be attributed to a higher profit earned in the current year. The return of equity has followed suit, registering an increase of 73% (2.33%-1.35%/1.35%). It should be noted that Kepi Plc operates in a capital intensive market as evidenced through its lower returns on capital which falls well below 5%.

Gross profit margin has remained at 40% in the two financial periods under consideration. This implies that the company costs structure has not changed. The net profit margin has improved from 16.67% in 2017 to 22.50% in 2018. This may signify better control of the distribution and administration expenses of the company by management.

Finally the asset turnover has increased from 0.11 times to 0.12 times indicating that resources were utilized more efficiently in the current year.

A current ratio of 3.2 to 1 was observed in 2018 and this was better than the comparative ratio for 2017 of 1.2 to 1. It could be possible that the firm is currently in a better position to offset its current obligation. This requires investigation of the components of the current assets. The quick ratio for 2018 (1.1:1) is higher than that of 2017 (0.35:1). This implies that the firm may be holding fewer inventories in its current assets portfolio.

The company saw a worsening receivable collection period which rose from 122 days (2017) to 146 days (2018). This may lead to increased risk of irrecoverable debts and has the potential to negatively affect the company's ability to finance recurring obligations. Payables significantly reduced by 381 days (560-179). It is possible that suppliers demanded more favourable payment terms to continue dealing Kepi Plc. The inventory turnover for 2018 (0.8 times) is better than that of 2017 (0.7 times). This means the company is able to convert inventory into cost of sales fairly quickly.

THE END



TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C4: DIRECT TAXES

TUESDAY, 10 DECEMBER 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%
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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%
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Farming Allowances

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

Presumptive Taxes

Turnover Tax	4%
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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

- (a) As a way of broadening the tax base, the Zambia Revenue Authority introduced turnover tax.

Required:

- (i) State the circumstances under which a person will be assessed under turnover tax. (2 marks)
- (ii) State any four (4) types of persons that are not liable to turnover tax. (4 marks)
- (b) Self-employed persons are individuals that generally work for themselves as business owners, freelancers, or as independent contractors for another company while employed individuals are those that are employed by another person. The Zambia Revenue Authority uses several tests to determine whether an individual is employed or self-employed.

Required:

Explain any six (6) tests which are normally used by the Zambia Revenue Authority to distinguish between employment and self-employment. (6 marks)

- (c) Manyama Mutakwa had been employed by Chipepo Limited as a Mechanical Engineer at an annual basic salary of K178,000 on a three year, non-renewable contract from 1 July 2016 to 30 June 2019. The salary was payable on the last day of each month. He received a gratuity of 25% of his cumulative basic salary for the three year period. He was paid repatriation pay of K62,000 on expiry of contract. During the time of employment, he was entitled to the following allowances payable at the same time as the basic salary:

	K
Education allowance (per month)	1,400
Medical allowance (per month)	2,800
Transport allowance (per month)	1,800
Housing allowance (per annum)	75,000

On 1 May 2019, Mr. Manyama Mutakwa received a Labour Day award as the most industrious employee consisting of the following:

	K
Cash	6,250
Wrist watches	2,500
Bicycles	<u>5,000</u>
Total value of award	<u>13,750</u>

He made the following payments during the charge year 2019:

	K
Medical expenses	7,300
School fees for children	10,200
Pay As You Earn (PAYE)	8,500
NAPSA contributions	6,720
Subscriptions fee to Engineering Institute of Zambia	2,850
Subscription fee to the Golf club	<u>1,900</u>
Total payments made	<u>37,470</u>

Required:

Calculate the final amount of income tax payable by Mr. Manyama Mutakwa for the charge year 2019. (8 marks)

[Total: 20 Marks]

QUESTION TWO

- (a) Big and Small are in partnership sharing profits and losses in the ratio of 2: 3 respectively. On 1 April 2019, Medium was admitted to the partnership and with effect from that date, the profits and losses were to be shared between Big, Small and Medium in the ratio of 2: 3: 4 respectively. Salaries of the partners were K45,000 per annum for each partner up to 31 March 2019. From 1 April 2019, the partners' salaries were K72,000 per annum for both Big and Small and K48,000 per annum for Medium.

The profits and losses for the two (2) recent years are as follows:

Year ended 31 December 2018	Profit	K165,000
Year ended 31 December 2019	Loss	(K256,000)

Required:

Calculate the profits to be assessed on each partner for each of the tax years, 2018 and 2019. (13 marks)

- (b) Nsayama has been employed by Moono Limited at an annual salary of K105,000. He is also entitled to a car allowance of K25,000 per annum. The actual amounts of investment income received during the tax year 2019 after withholding tax was deducted at source were as follows:

Bank deposit interest	K108
Dividends from Mwandu Plc	K220
Royalties	K210

The following payments were made in the tax year 2019:

Pay As You Earn	K20,317
NAPSA	K5,250.

Required:

Calculate the final amount of income tax payable by Nsayama for the tax year 2019.

(7 marks)

[Total: 20 Marks]

QUESTION THREE

- (a) Briefly explain the income tax implications of the following transactions:
- (i) Plant and machinery purchased under a hire purchase agreement. (3 marks)
 - (ii) Plant and machinery purchased under an operating lease agreement. (3 marks)
- (b) State any four (4) types of income which is classified as investment income. (2 marks)
- (c) Kanyama Limited is a Zambian resident manufacturing. It listed its shares on the Lusaka Securities Exchange on 2 December 2018. The place of effective management of the company is in Zambia, despite the fact that only 40% of its shares were offered and taken by indigenous Zambians in January 2019.

In the year ending 31 December 2019, the statement of profit or loss of the company reported a loss of K359,000. The loss was arrived at after charging the following expenses:

1. Entertaining of employees K32,000.
2. Entertainment of overseas customers K310,000.
3. Entertainment of local customers K51,000.
4. Entertainment of suppliers K29,000.
5. Depreciation of manufacturing equipment and buildings K655,000.
6. Allowable revenue general expenses K78,000.
7. Salaries and wages K238,000 inclusive of the Managing Director's annual salary of K115,000.
8. Motor running expenses K25,100.
9. Plant maintenance costs K31,200.

The company paid provisional income tax of K102,050 during the tax year 2019. This was not included in computing the reported loss for the period given above.

Further details that relates to Kanyama Limited are as follows:

1. The Managing Director is provided with a personal to holder BMW motor car having a cylinder capacity of 2500cc and resides in a company owned house for which he pays no rent.
2. The company has employed three (3) differently abled persons as full-time receptionists.
3. Capital allowances for the tax year 2019 have been agreed with the ZRA Commissioner General to be K125,000.

Required:

Calculate the Company income tax payable/refundable by Kanyama Limited for the tax year 2019. (12 marks)

[Total: 20 Marks]

QUESTION FOUR

- (a) In Zambia, the tax year runs from 1 January to 31 December. However, entities are allowed to prepare accounts to a date of their choice. The current year basis of assessment and the preceding year basis assessment are normally used to determine basis periods. However, special rules are used to determine basis periods both in the year a trade commences and in the year it ceases.

Required:

Explain the following:

- (i) the commencement rules which are used to determine the basis period for the accounting period in which a trade commences. (3 marks)
- (ii) the cessation rules which are used to determine the basis period for the accounting period in which a trade ceases. (3 marks)
- (b) John Kampaundi has been running a very lucrative trading business for some time now. The tax adjusted profit, before capital allowances, for the year ending 31 December 2019 amounts to K1,400,065. This profit was, however, computed after taking into account the following items:
1. A speeding offence fine imposed on John of K300.
 2. Salaries and wages of K15,200.
 3. Penalty charged by ZRA for late payment of tax amounting to K7,500.
 4. Entertainment expenditure for customers of K20,000 and for suppliers of K20,300.
 5. Staff party expenses of K36,200.
 6. Repairs on the building which was acquired eight (8) years ago of K35,000.
 7. Specific provision of bad debts of K4,500.
 8. Increase in general provision for bad debts of K6,800.
 9. Profit on disposal of a non-current asset amounting to K12,800.
 10. Depreciation expenses of K55,400.

Additional information:

During the year ended 31 December 2019, John purchased a two-tonne light truck so as to improve the logistics of the business at a cost of K120,000.

The other non-current assets which belong to the business includes furniture and fittings which originally cost K35,400 (having an income tax value of K17,700 as at 1 January 2019) and a Toyota Corolla car costing K45,000 (having an income tax value of K9,000 as at 1 January 2019). The business use of this Toyota Corolla car is 85%.

A Motor Van which was purchased in 2014 at a cost of K75,000 was sold for K2,500 in 2019.

Required:

- (i) Calculate the maximum capital allowances claimable by John for the tax year 2019. (5 marks)
- (ii) Calculate the taxable business profit for the tax year 2019. (5 marks)
- (iii) Calculate the income tax payable for the tax year 2019. (4 marks)

[Total: 20 Marks]

QUESTION FIVE

- (a) Property Transfer Tax is tax which is chargeable on the realised value of property which is transferred between various parties.
 - (i) Explain what constitutes a transfer for the purposes of property transfer tax and what such a transfer includes. (3 marks)
 - (ii) List any five (5) persons who are exempt from property transfer tax. (5 marks)
- (b) Explain how the realized value for the following types of transfers of property is determined:
 - (i) Transfer of land and buildings. (3 marks)
 - (ii) Transfer of property to members of the immediate family. (2 marks)
 - (iii) Transfer of a mining right or an interest in a mining a right. (2 marks)
- (c) Sunga Bwino is a pragmatic investor who owns shares in various companies for speculative purposes. During the tax year 2019, the transactions in shares were as follows:
 - 1. On 25 October 2019, sold two million five hundred thousand (2,500,000) K1 shares in Kanyama Plc, a company that is listed on the LuSE, for K3,700,000 which he had invested in on 1 March 2017 at a cost of K2,300,000. The costs of disposal amounted to K15,000.
 - 2. On 27 November 2019, he sold 560,000 shares of K2 each held in Wako Limited for an open market value of K750,000. These shares were bought in June 2017. Wako Limited is not a listed company. Costs of transferring the shares was K7,560.

Required:

To calculate the amount of property transfer tax (if any) that will be payable on the above transactions (5 marks)

[Total: 20 Marks]

END OF PAPER

C4: SUGGESTED SOLUTIONS

SOLUTION ONE

(a) Turnover tax

(i) Persons who are liable to turnover tax are:

- i. Any person carrying on a business with an annual turnover of K800, 000 and less.
- ii. Any person whose income consists of amounts, which are subjected to withholding tax, where withholding tax is not the final tax.

(ii) Persons who are not liable to turnover tax are:

- i. Any person carrying on a business where the annual turnover is over K800, 000.
- ii. Any individual or partnership carrying on the business of public service vehicle for the carriage of persons.
- iii. Any Partnership carrying on business irrespective of whether the annual turnover is more than K800, 000.
- iv. Income of partners arising from the partnership since the partnership producing that profit is excluded from turnover tax.
- v. Any person whose business earnings are subjected to withholding tax where the withholding tax is the final tax.
- vi. Any person running a business where the annual turnover is not over K800, 000 but is voluntarily registered for Value Added Tax.
- vii. Any person who is involved in mining operations as provided under the Mines and Minerals Development Act.

(b) The matters which are normally taken into consideration by the Zambia Revenue Authority to distinguish between employment and self-employment are:

- i. **Contract:** Contract of service indicates the existence of a legal relationship of a master and servant. A contract for service indicates the existence of self-employment.
- ii. **Work performance:** Employees perform the duties assigned to them while self-employed may hire other people to perform the work for them. If the person does not have a right to hire assistants, then this is likely to be taken as employment but self-employed will normally have the right to hire their own helpers.
- iii. **Engagement and dismissal:** The employer will take on and dismiss employees. The employer will have a right or power to terminate the contract of service by giving the employees an appropriate notice. A self-employed person will normally

- enter into a contract with a client specifying the beginning and end. This contract normally ends when the work has been performed completely and accurately.
- iv. **Insurance:** Employers will normally provide cover for the actions of their employees because they are vicariously liable for the offences committed by their employees. Self-employed persons will have to provide for their own insurance needs. The hirer is not vicariously liable for the offences committed by the hired self-employed contractors.
 - v. **Exclusivity:** Employees normally work for one employer while self-employed work for a number of clients. The courts will also consider whether an individual's activity is fully integrated within the organisation. If this were the case, it would be difficult to prove that he or she is self-employed.
 - vi. **Control:** The work of an employee is controlled by the employer who will normally stipulate working hours, the place at which the duties are to be performed, how the work is to be performed and other conditions.
A self-employed person will decide when to perform the duties and how to perform them.
 - vii. **Payment and financial risk:** Employees are paid an agreed salary on a monthly or weekly basis and incur no form of financial risk. In order to earn an extra sum, employees will have to work overtime. Also, employees are going to get any other additional pay or variation in pay if they meet a set target in which case they may receive a bonus or a commission. Employees do not assume any form of financial risk and they cannot profit from sound management of the affairs.

Self-employed persons are normally paid from a proportion of the contract price based on the amount of work performed. They will also bear the full financial risk of their business. If they manage their affairs well, they are going to profit from them.

- viii. **Place of work:** Employees will normally be told where the duties are to be performed from. This is normally at the employer's premises or at the premises of the client. In most of the employments, the premises at which the duties are to be performed from are those of the employer.
Self-employed persons will perform the duties at a place of their choice.

(c) Mr. Manyama Mutakwa

Personal Income Tax Computation for 2019

	K
Basic pay (K178, 000 × 6/12)	89,000
Education Allowance (K1, 400× 6)	8,400
Medical Allowance (K2, 800×6)	16,800
Transport Allowance (K1, 800 × 6)	10,800

Housing allowance (K75, 000 x 6/12)	<u>37,500</u>
	162,500
Less:	
Subscription fees	<u>(2,850)</u>
Taxable income	<u>159,650</u>

Computation	Taxable amount	Tax rate	Tax payable
	K		K
	159, 650		
First	<u>(39, 600)</u>	0%	0
Sub-total	120,050		
Next	<u>(9, 600)</u>	25%	2, 400
Sub-total	110,450		
Next	<u>(25, 200)</u>	30%	7, 560
Balance	<u>85,250</u>	37.5%	<u>31,969</u>
Income tax liability		41,929	
Less:			
Pay As You Earn			<u>(8,500)</u>
Income Tax Payable			<u>33,429</u>

SOLUTION TWO

(a) Big, Small and Medium

Allocation of taxable business profits for the tax years

	Total	Big	Small	Medium	Marks
	K	K	K	K	
Period ended 31/12/2018					
Salaries	90,000	45,000	45,000		Nil
Balance (2:3)	<u>75,000</u>	<u>30,000</u>	<u>45,000</u>		<u>Nil</u>
	<u>165,000</u>	<u>75,000</u>	<u>90,000</u>	<u>Nil</u>	
Period ended 31/12/2019					
First 3 months					
Salaries	22,500	11,250	11,250		Nil
Balance (2:3)	<u>(86,500)</u>	<u>(34,600)</u>	<u>(51,900)</u>	<u>Nil</u>	
	<u>(64,000)</u>	<u>(23,350)</u>	<u>(40,650)</u>	<u>Nil</u>	
Last 9 months					
Salaries	144,000	54,000	54,000	36,000	
Balance (2:3:4)	<u>(336,000)</u>	<u>(74,667)</u>	<u>(112,000)</u>	<u>(149,333)</u>	
	<u>(192,000)</u>	<u>(20,667)</u>	<u>(58,000)</u>	<u>(113,333)</u>	
Total	<u>(256,000)</u>	<u>(44,017)</u>	<u>(98,650)</u>	<u>(113,333)</u>	

(b) Maybin

Personal Income Tax Computation for the tax year 2019

Earned Income:		K
Salary		105,000
Car allowance		<u>25,000</u>
		130,000
Investment Income		
Royalties (K210 X 100/85)	<u>247</u>	
		130,247
<u>Less:</u>		
Less Tax Free Income	<u>(39,600)</u>	
		<u>90,647</u>
Income Tax		
25% X K9, 600		2,400
30% x K25, 200		7,560
37.5% x K55,847	<u>20,943</u>	
Income tax liability		30,903
<u>Less:</u>		
Pay As You Earn		(20,317)
WHT on Royalties: 15% x K247	<u>(37)</u>	
Income tax payable		<u>10,549</u>

SOLUTION THREE

(a) Taxation implications

- (i) If an item of plant and machinery is acquired under a hire purchase agreement, then
- (1) capital allowances are available to the buyer based on the cash price of the item. The item will be treated as if it was acquired at the time the hire purchase contract was entered into for cash.
 - (2) Hire purchase interest paid is an allowable expense as a finance charge.
- (ii) If the asset is acquired under an operating lease,
- (1) it is the legal owner (Lessor) of that item of plant and machinery that enjoys the benefit of capital allowances and
 - (2) the lessee is allowed to deduct lease rentals from the profits.

(b) Examples of investment income include

- i. Bank and building society interest,
- ii. Interest received on Government bonds (GRZ bonds)
- iii. dividends received from Zambian companies
- iv. Royalties,
- v. Rent and Premiums from letting of property.

(c) Kanyama Limited

Taxable business profit for the tax year 2019.

Details	K	K	K
Loss per financial accounts			(359,000)
Adjustments:	+	-	
Entertainment of o/s customers	310,000 1/2		
Entertainment of local customers	51,000 1/2		
Entertainment of suppliers	29,000 1/2		
Depreciation	655,000 1/2		
Personal to holder car charge	30,000 1		
Company house benefit (115,000 X30%)	34,500 1		
Differently abled allowance		3,000 1	
Capital allowances		125,000 1/2	<u>+981,500</u>
	1,109,500	128,000	<u>622,500</u>

Tax at a concession rate of 35%-5% = 30% of K622,500

= K186,750

Less provisional tax 102,050

Tax payable
84,700

Marks to be awarded as follows:

Loss per financial accounts

Adjustments:

Entertainment of o/s customers

Entertainment of local customers

Entertainment of suppliers

Depreciation

Personal to holder car charge

Company house benefit (115,000 X30%)

Differently abled allowance

Capital allowances

Tax rate

Income tax

Provisional tax

Tax payable

QUESTION FOUR

(a) Basis period

(i) The rules applicable on commencement of business are as follows:

If the first accounting period is made up of exactly twelve months or less, then the normal rules apply. That is, the current year basis (CYB) or the preceding year basis (PYB) may apply depending on when the period ends.

If the first accounting period is made up of more than twelve months, then that period should be split into two notional accounting periods for tax purposes. The first period should consist of less than twelve months while the second period should consist of exactly twelve months.

The profits for the whole period should be allocated to the two notional accounting periods on a time basis.

(ii) The rules which are applied are as follows:

If the last accounting period is exactly twelve months long, then the CYB and PYB will apply depending on the end of the accounting period.

If the last accounting period is less than twelve months, then the profits of that accounting period are assessed in the tax year following the one in which the profits of the second last accounting period are assessed.

If the last accounting period is made up of more than twelve months, then that period is split into a twelve months' period ending on the normal accounting date and a short accounting period ending on the date of cessation. The profits of the long accounting period should be allocated to the two resulting periods on a time basis.

The tax year in which the profits of the twelve months' period are to be assessed is determined using the normal rules of CYB and PYB. The profits of the last accounting period (the one with less than twelve months) are to be assessed in the following tax year.

(b) Sole trader

(i) Capital allowances for the tax year 2019

Date of purchase	2019	b/f	b/f	b/f	TOTAL
Description	Light truck	Furniture and fittings	Toyota car	Motor Van	
CA Rate	25%	25%	20%	25%	
Cost	120,000	35,400	45,000	75,000	
ITV b/f		17,700	9,000	Nil	
Disposal proceeds	-	-	-	(2,500)	
CA/Charges	30,000 1	8,850 1	9,000 1	(2,500) 1	45,350 1
Divided use	-	-	85%	-	

adjustment					
CA claimed	30,000	8,850	7,650	(2,500)	44,000
ITV C/f	90,000	8,850	-		

(ii) John Kampaundi
Adjusted taxable profit

Profit before adjustments			1,400,065
Adjustments:	+	-	
Capital allowances		44,000...1/2	
Speeding offence fine	300...1/2		
ZRA penalty	7,500...1/2		
Entertainment of customers and suppliers (K20,000 + K20,300)	40,300...1/2		
General provision for bad debts	6,800...1/2		
Profit on disposal of non-current asset		12,800...1/2	
Depreciation	55,400...1/2	56,800...1/2	+53,500
Total	110,300		
Taxable profit			1,453,565...1

Marks to be awarded as follows:
 Profit before adjustments
 Capital allowances
 Speeding offence fine
 ZRA penalty
 Entertainment of customers and suppliers
 General provision for bad debts
 Profit on disposal of non-current asset
 Depreciation
 Taxable profit

(iii) John Kampaundi
Income tax payable for the tax year 2019

Amount	Tax rate	Tax (K)
First K39,600	0	0
Next K9,600	25%	2,400
Next K25,200	30%	7,560
Balance K1,379,165	37.5%	<u>517,187</u>
Income tax payable		<u>527,147</u>

Marks to be awarded as follows:
 First K39,600
 Next K9,600
 Next K25,200

Balance K1,379,165
Income tax payable

SOLUTION FIVE

(a) Property transfer tax

- (i) A transfer of property occurs when there is a change in the ownership of that property. Therefore, a transfer includes the following:
 - i. A disposal of property,
 - ii. A disposal of a part of the property (a part disposal as in the case of shares),
 - iii. A gift of the property (in the case of family members generally)
- (ii) Organizations which are exempt from property transfer tax includes the following:
 - i. The Government of the Republic of Zambia;
 - ii. Any Foreign Government;
 - iii. Such International Organisations, Foundations or Agencies as the Minister of Finance approves for this purpose;
 - iv. Charitable Organisations or Trusts registered under Section 41 of the Income Tax Act Cap 323 as a Charitable Organisation, as the Minister of Finance approves for the purpose;
 - v. Any Cooperative Society registered under the Cooperative Societies Act;
 - vi. Local Authorities;
 - vii. Registered Trade Unions;
 - viii. Club, Society or Association registered under Section 41 of the Income Tax Act Cap 323 as a Charitable Organisation, as the Minister of Finance approves for the purpose;
 - ix. Approved Pension Fund or Medical Aid Society
 - x. Approved Employees' Savings Scheme or Fund;
 - xi. Political Party registered as a statutory society under the Societies Act.

(b) (i) Land and building

The realised value of land and buildings is taken as the higher of:

- i. **The contract price agreed upon by the transferor and the transferee**
- ii. **The Open market value**

(ii) Transfers to immediate family members

The realised value of such property is the actual price received by the transferor, if any. Therefore such transfers will be treated as having a realised value of nil if no price has been charged.

(iii) Mining rights/interest in mining rights

In a transfer of mining rights or an interest in mining rights, the realised value shall be the higher of:

- i. The actual price of the mining right or an interest in mining rights at the time of the transfer; or
- ii. The value as determined by the Commissioner General.

(c) Property transfer tax payable

K

i. No property transfer tax is payable in relation to listed companies

ii. Disposal proceeds 750,000

Nominal value of the shares 560,000 X K2 1,120,000

$$\text{PTT} = 5\% \times \text{K}1,120,000 \\ 56,000$$

END OF SOLUTION



TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C5: INDIRECT TAXES

THURSDAY, 12 DECEMBER 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 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 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 (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

Motor vehicles for the transport of ten or more persons, including the driver	Aged 2 to 5 years		Aged over 5 years	
	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

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

Cylinder capacity exceeding 2500 cc but not exceeding 3000 cc	16,545	21,508	10,523	13,687
Cylinder capacity exceeding 3000 cc	19,553	25,419	12,032	15,642

Station wagons

cylinder capacity not exceeding 2500 cc	16,545	21,508	9,024	11,731
Cylinder capacity exceeding 2500 cc but not exceeding 3000 cc	18,049	23,463	13,357	17,598
Cylinder capacity exceeding 3000 cc but not exceeding 2500 cc	22,561	29,329	18,049	23,463

SUVs

Cylinder capacity not exceeding 2500 cc	21,057	27,374	9,024	11,732
Cylinder capacity exceeding 2500 cc but not exceeding 3000 cc	24,065	31,284	13,357	17,598
Cylinder capacity exceeding 3000 cc	28,577	37,150	18,049	23,463
	Aged 2 to 5 years		Aged over 5 years	

Motor vehicles for the transport of goods –with compression-ignition internal combustion piston engine (diesel or semi-diesel):

	Customs duty	Excise duty	Customs duty	Excise duty
	K	K	K	K
Single cab				
GVW exceeding 1.0 tonne but not exceeding 1.5 tonnes	21,926	9,501	8,770	3,801
GVW exceeding 1.5 tonnes but not exceeding 3.0 tonnes	26,311	11,402	15,348	6,651
GVW exceeding 3.0 tonnes but not exceeding 5.0 tonnes	30,697	13,302	17,541	7,601
Double cabs GVW exceeding 3 tonnes but not exceeding 5 tonnes	30,274	0	24,119	10,452
Double cabs GVW exceeding 3.0 tonnes but not exceeding 5.0 tonnes, with spark ignition internal combustion piston engine	30,697	13,302	24,119	10,452

Panel Vans

GVW exceeding 1.0 tonne but not exceeding 1.5 tonnes	15,348	6,651	8,770	3,801
GVW exceeding 1.5 tonnes but not exceeding 3.0 tonnes	17,541	7,601	15,348	6,651
GVW exceeding 3.0 tonnes but not exceeding 5.0 tonnes	21,926	9,501	17,541	7,601

Trucks

GVW up to 2 tonnes	21,926	9,501	10,963	4,751
GVW exceeding 2.0 tonnes but not exceeding	28,504	12,352	13,156	5,701

5.0 tonnes				
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 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%
5. The minimum amount of customs duty on motor vehicles is K6,000.
6. 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 three (3) advantages and two (2) disadvantages of registering for VAT under voluntary registration. (5 marks)
- (b) Explain how a tax point is determined in the construction industry. (4 marks)
- (c) Explain what is meant by the "Principles of Estoppel" in VAT cases and give two examples when this may occur and its implications. (6 marks)
- (d) State the eligibility of foreign tourists visiting Zambia to a refund of VAT paid on goods purchased from approved retailers which they exported from Zambia. (3 marks)
- (e) A tax point is the time when a supply is deemed to have taken place.

Required:

- (i) Explain how the basic tax point is determined. (2 marks)

[Total: 20 Marks]

QUESTION TWO

- (a) Define Excise duty (1 mark)
- (b) The Customs Services Division of the Zambia Revenue Authority (ZRA) has a number of functions relating to trade taxes which includes revenue collection.

Required:

- (i) State six (6) taxes collected by the Customs Services Division and the basis on which each tax is levied. (6 marks)
- (ii) Briefly explain the meaning of the term exporter and how goods can be exported. (4 marks)
- (c) The Government of the Republic of Zambia has seen the need to ensure that the amount of gases are reduced by instituting certain taxes and one mechanism that is considered or implemented to reduce the amount environmental gases is carbon tax.

Required:

- Explain the meaning and purpose of the surtax on Carbon Emissions. (3 marks)

- (d) In the recent past leasing transactions have become popular where a firm can obtain the use of certain non-current assets for which it must pay a series of contractual, periodic, tax deductible payments. The leasing industry offers various leasing services, some of which are taxable supplies.

Required:

- (i) Define the term sale and lease back (1 mark)
(ii) Explain the VAT treatment for a finance lease to both the lessor and the lessee. (3 marks)
(iii) Describe the term partial exemption in relation to leased assets, non-lease assets and other business expenses. (2 marks)

[Total: 20 Marks]

QUESTION THREE

Tye Tye Ltd is a VAT registered Zambian resident company which supplies mining equipment and other consumables.

The following were transactions which the company undertook during the month of January 2019.

- (i) The company bought a new Toyota Hilux for the sales manager for K150,000 (VAT inclusive) in order to improve the sales of the company.
(ii) The company made total sales to registered suppliers amounted to K250,000, of which 90% were standard rated, 5% zero rated and the remainder were Exempt supplies.
(iii) The company incurred standard rated expenses amounting to K100,000 for which K90,000 was spent on diesel used for business purposes while the rest was spent on telephone bills.
(iv) The company sold an old Toyota Hilux for K40,000 (VAT inclusive).
(v) The company spent K80,000 on entertainment broken down as follows:

	K
• Entertainment expenditure for suppliers (VAT inclusive)	50,000
• Entertainment expenditure for customers (VAT inclusive)	20,000
• Entertainment expenditure for employees (VAT inclusive)	10,000

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

Required:

- (a) Calculate the amount of VAT payable/repayable by Tye Tye Ltd for the month of January 2019. (10 marks)
- (b) Explain the conditions which must be met for input VAT on a taxable supply to be recoverable. (5 marks)
- (c) Explain the steps that should be followed in claiming Bad Debt Relief. (5 marks)

[Total: 20 Marks]

QUESTION FOUR

- (a) James Mufweba deals in second hand vehicles imported from Japan and sells them in Lusaka. In March 2019, he imported a second-hand 18 seater mini bus at a cost of \$3,500 which was manufactured 6 years ago. He paid insurance charges of \$300, freight charges of \$500 and other incidental costs from Durban up to Chirundu border post in Zambia amounting to \$450. He incurred transportation costs from Chirundu to Lusaka amounting to K15,000.

The bus reached Chirundu border post on 25 March 2019 and all the import taxes were paid. On the date of arrival at the border, the Commissioner General advised that the exchange rate to be used was K10.40 to US\$1. However, most of the Bureau currency dealers had quoted their exchange rate at K11.05 to US\$1.

Required:

- (i) Calculate the Value for Duty Purposes of the Mini-bus. (3 marks)
 - (ii) Calculate the total import taxes paid by James on the importation of the vehicle. (4 marks)
 - (iii) Explain how the Value for Excise Duty purposes on imported goods is determined. (2 marks)
- (b) The Customs services Division of Zambia Revenue Authority (ZRA) is responsible for collecting duties and enforcing exports and import controls. It has a number of functions relating to trade taxes.

Required:

Explain any four (4) functions of the Customs Services Division. (8 marks)

- (c) The Zambia Revenue Authority gives new and returning residents rebates upon meeting the criteria.

Required:

Explain briefly three (3) conditions which should be met in order for new and returning residents to qualify for this rebate. (3 marks)

[Total: 20 marks]

QUESTION FIVE

- (a) Describe the circumstances under which a trader may be permitted to use the extended VAT periods to account for Value Added Tax. (2 marks)
- (b) Explain any four (4) items on which input VAT is irrecoverable. (4 marks)
- (c) Explain the importance of VAT inspection visits. (3 marks)
- (d) Explain the powers of the Customs and Excise Division Officers. (5 marks)
- (e) Explain matters which are emphasized when inspecting a bonded warehouse. (6 marks)

[Total: 20 Marks]

END OF PAPER

C5: INDIRECT TAXES

SUGGESTED SOLUTIONS

SOLUTION ONE

(a) Advantages

- i.** The trader will be able to reclaim Input VAT on expenses as long as that input VAT is recoverable.
- ii.** The impression of a substantial business will be given since traders should only register if the turnover is substantially high.
- iii.** There will be a need to maintain VAT records and meet compliance requirements.

Disadvantages

- i.** Non-VAT registered clients will suffer increased costs, but clients registered for VAT will not be affected as they can set the input tax against their output tax.
- ii.** Penalties and interests are chargeable for non-compliance. i.e if the VAT is not paid and returns submitted on time

(b) A tax point in the construction industry is determined as follows:

- When interim certificates are issued and payment made on the amount involved
- Any part payments including interim or advance payments made
- Completion of the building services and compliance certificate issued
- Issuance of a tax invoice for work/payments other than those mentioned above

(c) The principle of Estoppel is a bar or impediment preventing a party from asserting a fact or a claim inconsistent with a position that party previously took, either by conduct or words, especially where a representation has been relied or acted upon by others.

Examples:

1. Where there is a dispute about the amount owed by the taxpayer to ZRA if the parties agree to a particular sum and the sum is paid and it turns out that the amount paid is less than what the debtor owed, ZRA cannot claim the amount.
2. Where a taxpayer is claiming a VAT refund from ZRA of a stated sum, and ZRA agrees to settle the amount. In the course of time the Taxpayer discovers that the actual amount of the refund is actually higher than that agreed. The taxpayer will be stopped from claiming the higher amount because he agreed to a smaller refund.

(d) The eligible tourist permitted to get a refund of VAT is a person who:

Is not a resident of Zambia (i.e has not been in Zambia for more than 6 months out of the previous 24); or

Does not hold a Zambian passport.

The definition of a tourist also includes a visitor to Zambia on business who business who fulfils the above conditions.

(e) Tax point

The basic tax point is determined as follows:

- For goods - when goods are made available, delivered or collected by the customer; and
- For services - when services are rendered to the customer.

SOLUTION TWO

- (a) Excise duty is a tax on particular goods or products, domestic or imported.
- (b) Taxes and exportation
 - (i) Six taxes collected by the Customs Services Division are:
 - i. Customs duty – tax on goods imported
 - ii. Excise duty – tax on some imported goods as well as goods manufactured in the country of a luxury nature.
 - iii. Import VAT – VAT on imports at the entry point into Zambia based on Value for Duty purposes.
 - iv. Fuel levy – tax on fuel, eg petrol and diesel
 - v. Dumping duty – tax on goods which are imported into Zambia which unfairly disadvantage Zambian goods as such the tax is meant to protect Local industries from unfair competition.
 - vi. Surtax on carbon emissions.
 - (ii) An exporter is any person in Zambia who takes goods or cause goods to be taken out of Zambia and includes any employee or agent of such person and the owner of such exported goods.

Goods can be exported or accepted for carriage for export after such entry or other acceptable documentation has been delivered to Customs by the exporter or agent, and duly processed. Exportation can be done by Road, Rail, Air Pipeline, and Water (sea).

- (c) **Surtax on Carbon Emissions:**
Meaning:

The carbon tax is an environmental tax on emissions of carbon dioxide. Carbon dioxide is considered to be at the heart of greenhouse gas

Purpose of the carbon tax:

To protect the environment by penalizing emissions of carbon dioxide, which may cause global warming.

- (d) Leasing
 - (i) In a sale and lease back arrangement a business buys an asset and sells it to a leasing company. The business then enters into a lease with the leasing company so as to continue using the asset it earlier sold.
 - (ii) **Lessor:**

The invoice can be used to claim input tax the lessor had been charged by the seller. On his part the lessor charges VAT on the lease rentals paid by the lessee.

Lessee:

The lessee pays periodic/monthly lease rentals whilst using the asset. He pays VAT on the capital element of the lease rental. The lessee can claim back the VAT incurred provided that he is registered for VAT and the asset under lease is not a motor car.

(iii) **Partial exemption**

Partial exemption rules do not apply to the leasing industry. The lessor is entitled to reclaim the full input tax incurred on the leased assets, non-lease assets and other business expenses.

SOLUTION THREE

(a) TyeTye Ltd

VAT payable for the month of January 2019

	K	K
Output VAT		
Standard-rated sales		
K250,000 X 90% X 16%		36,000
Zero-rated sales: K250,000 X 5% X 0%		0
Sale of Toyota Hilux K40,000 X 4/29		<u>5,517</u>
		41,517
Input VAT		
Toyota Hilux K150,000 X 4/29	20,690	
Diesel K90,000 x16%x 90%	12,960	
Telephone bills,(Input VAT irrecoverable)	-	
		<u>(33,650)</u>
VAT Payable		<u>7,867</u>

(b) The following are the conditions which must be met for input VAT on a taxable supply to be recoverable:

- i. At the time the supply was made the trader must have been a registered for VAT purposes.
- ii. The supply must have been made to a taxable person making the claim.
- iii. The person making the claim must use the goods or services for business purposes. Personal expenses will not qualify for relief.
- iv. The supply must be supported by evidence, which is normally in form of a Tax invoice.
- v. The VAT should not be that is not recoverable.
- vi. The amount of VAT recoverable should be that which is accurately calculated and that amount should be accurately relates to the supply.

(c) The following are the steps that should be followed in claiming bad debt relief:

- i. The supplier must make a claim from the administrator/Receiver/liquidator for inclusive amount that he is owed by the insolvent debtor.
- ii. Obtain a written statement from the administrator/Receiver/liquidator to the effect that the debtor is insolvent and that he cannot pay the debt.
- iii. Claim a credit for the amount of VAT remitted in respect of the bad debt by adding the bad debt to the input tax incurred on domestic purchase.
- iv. Zambia Revenue Authority has to be satisfied that claims to Bad debts Relief are correct, suppliers claiming Bad Debts Relief should retain a copy of the tax invoice issued to the debtor in connection with the supply that later became bad debt.
- v. Evidence that the VAT being claimed as Bad Debt Relief had been remitted to Zambia Revenue Authority.

SOLUTION FOUR

(a) Import taxes

(i) **Computation of value for duty purposes (VDP)**

	\$
Cost	3,500
Insurance	300
Freight	500
Incidental costs	<u>450</u>
CIF Value	4,750
Exchange rate	<u>K10.40</u>
Value for Duty purposes	<u><u>K49,400</u></u>

(ii) **Computation of import taxes paid**

	Values K	Taxes paid K
Value for duty purposes	49,400	
Customs duty	<u>13,840</u>	13,840
	63,240	
Excise duty	<u>0</u>	0
	63,240	
Import VAT @16% x K63240	<u>10,118</u>	10,118
	<u>73,358</u>	
Total taxes paid		<u>23,958</u>

(iii) The value for the purpose of assessing excise duty on imported goods shall be the value for duty purposes plus customs duty on the goods.

(b) The Customs Services Division of the Zambia Revenue Authority has a number of functions relating to trade taxes. These include:

i. **Revenue collection**

The Division is responsible for collection of Customs duty, Excise duty, Import VAT, Fuel levy and dumping duty.

ii. **Protecting local industry**

The Division is responsible for protecting Zambian industries from unfair competition using various means under Customs and Excise Act, e.g. levying protective duties to discourage excessive importation of targeted goods, offering rebate of duty on raw materials used in the manufacture of certain goods specified in the Act and exercising alternative duty rates such that a higher amount is levied.

iii. **Prevention of smuggling**

Smuggling takes place when goods are imported or exported without being cleared by the Customs so that trade taxes are not charged on them. Goods smuggled present unfair competition to those that are subjected to Customs and Excise duties.

iv. **Providing trade data and statistics**

The Zambia Revenue Authority (ZRA) is obliged to provide trade data to the Government through certain agencies such as the Bank of Zambia, Central Statistical Office. This information is used for various purposes including planning and policy formulation.

v. **Protecting the public from harmful goods**

The Division is also charged with other functions such as protecting the public by seizing dangerous goods such as narcotic and psychotropic substances, pornographic materials; protecting plant and animal life by ensuring compliance with the laws of the Republic.

(c) The following are the conditions which should be met to qualify for the rebate:

- i. The person claiming rebate has been resident outside Zambia for a period of not less than two (2) years before the date of arrival in or returns to Zambia.
- ii. The effects were the property of that person before the date of departure for Zambia from the previous country of residence.
- iii. The effects must be imported at the time of arrival in Zambia or within six (6) months from the date of arrival of that person.

SOLUTION FIVE

- (a) Traders may be granted extended VAT periods of three months instead of accounting for VAT on a monthly basis in situation when traders business is not continuous on a daily basis.

If the trader were to follow the normal Tax period in such cases there could be several months when they would submit returns where there are no supplies on which VAT payments on which VAT payments or recoveries might be based

- (b) the following are the items on which input VAT is irrecoverable:
- i. Motor cars that are not wholly for business; unless it is acquired e.g for resale by a car dealer.
 - ii. Business entertainment expenses.
 - iii. Expenses incurred on domestic accommodation for directors.
 - iv. Telephone bills and internet services..
 - v. Cost of petrol.
 - vi. Cost of diesel; only 90% is recoverable.
 - vii. Domestic refrigeration equipment.
- (c) The following is the importance of inspection visits:
- i. Since VAT is a self-assessment tax, the inspectors will make visits from time to time in order to check on whether the traders are performing their obligations properly.
 - ii. VAT inspection visits serve as deterrent to fraud
 - iii. They provide opportunity for any problems which have arisen as regards VAT to be sorted out.
- (d) The Customs and Excise officer's Powers are:
- i. To stop and search any person including any person within or upon any ship aircraft or vehicle, whom he has good reason to suspect of having secreted about him or in possession any dutiable goods or any goods in respect of which there has been a contravention of the law.
 - ii. Any officer may enter any shop, office, store, structure or enclosed area for making such examination and enquiry as he considers necessary,
 - iii. Demand for any book, document or thing which is required under the law
 - iv. Examine and make extracts from and copies of such books and documents
 - v. Take with him onto such premises an assistant who may be a police officer
- (e) The matters which are emphasized when inspecting a bonded warehouse are:
- i. The warehouse must be conveniently situated, that is within 20km from the controlling office.
 - ii. The warehouse must be secure and separate from retail outlets.
 - iii. The doors must be strong (grilled doors are recommended) and have provisions for a Customs lock.
 - iv. Access into the warehouse must be restricted: and however the license of a bonded warehouse is not transferable from one operator to another.



TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C6: LAW FOR TAX PRACTITIONERS

FRIDAY, 13 DECEMBER 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

Mathew has a piece of land in Chalala. On 7 February he wrote to Jack offering to sell his farm at 40,000. Jack's agent called Mathew and made an offer of K30,000. On 20 February, Mathew wrote that he could not take up Jack's offer. On 25 February Jack wrote accepting the offer which was made on 7 February by Mathew. Mathew refused to sell his land and Jack has commenced a legal action against him.

Required:

- (a) With the aid of authorities explain whether a valid contract was formed between Mathew and Jack. (10 marks)
- (b) Identify five essential elements of a valid contract. (10 marks)

[Total: 20 Marks]

QUESTION TWO

- (a) (i) Explain the duties and liabilities of carriers under the contract of Sale. (8 marks)
- (ii) The understanding of the Zambian Judiciary is essential for justice delivery in Zambia. Explain the functions of the judiciary. (4 marks)
- (iii) State two duties of a buyer under a contract of sale. (2 marks)
- (b) Nomsa and Stacey are about to form a partnership. Nomsa is not sure of what a partnership entails and decides to approach you for advice.
- Explain to Nomsa on at least three disparities between a Partnership and a Limited Company, and the duties of a partner in a partnership. (4 marks)
- (c) List any 2 remedies that are available for breach of contract of employment.

(2 marks)

[Total: 20 Marks]

QUESTION THREE

Explain each of the following:

- (i) 'Consideration must move from the promisee' (4 marks)
- (ii) Privity of contract (4 marks)
- (iii) Wrongful dismissal (4 marks)
- (iv) Collective agreement (4 marks)
- (v) Receivership (4 marks)

[Total: 20 Marks]

QUESTION FOUR

(a) Thelma has been negotiating and concluding commercial transactions on behalf of Mandy for three (3) years. Thelma is no longer interested in this relationship, however she does not know how to relieve herself as she is scared of the legal implications considering that the parties signed a formal document.

- (i) Identify the relationship which exists between the parties. (2 marks)
 - (ii) Explain to both parties on at least 3 ways they can terminate their relationship. (3 marks)
- (b) Identify five duties of an employee towards his employer. (5 marks)
- (c) Identify the three conditions that must be fulfilled by the seller before the right of stoppage in transit can be exercised. (3 marks)
- (d) Kwacha finance co. delivered a car to a car-dealer, under an agreement which was described as a hire purchase agreement. The agreement provided for the dealer to hold the car as Bailee with an option to buy to be exercised by the dealer on full payment of installments when property in the car would pass.

However, before property could pass, the dealer sold the car to a third party.

- (i) Considering the characteristics of a hire purchase, explain whether this agreement is a hire purchase or not. (2 marks)
- (ii) Assuming the above agreement is not a hire purchase agreement, explain the nature of agreement. (5 marks)

[Total: 20 Marks]

QUESTION FIVE

(a) Identify four powers of the official receiver. (8 marks)

(b) With reference to insurance contracts, explain the term Umberimae fidei. (6 marks)

(c) Identify six (6) sources of law. (6 marks)

[Total: 20 Marks]

END OF PAPER

C6 SUGGESTED SOLUTIONS

SOLUTION ONE

- a. For a contract to subsist, certain elements must exist for instance acceptance. Acceptance is assenting to the terms of an offer. The contract comes into effect once the offeree has accepted the terms presented to the terms. The acceptance must be made while the offer is still open. Acceptance must be absolute and unqualified. If the offeree attempts to vary the terms offered, this will be treated as counter-offer. A counter offer is an offer that varies or intends to change the terms of the offer. A counter offer rejects the original offer, which cannot be subsequently accepted. A counter-offer terminates the original. For instance in **Hyde v Wrench**, Wrench offered to sell his farm to Hyde for 1,000 pounds. Hyde replied with a counter offer of 950 pounds, which was refused. Hyde then said that he was prepared to meet the original offer of 1,000 pounds. Wrench rejected and Hyde sued him for breach of contract. The court held that no contract had been formed. The counter offer of 950 pounds had the effect of rejecting Wrench's original offer. Therefore, there is no valid contract between Mathew and Jack because Jack counter offered Mathew's original offer.
- b. I. Offer- an offer is a definite promise to be bound by the terms once the offeree accepts.

II Acceptance- acceptance is the approval of the terms presented by the offeror in the offer.

III.Consideration- consideration is a price paid for the promise made in an offer.

I. Capacity is the capability to enter in a valid contract.
II. Legality- legality implies that the activities under the contract should be legal.

SOLUTION TWO

Duties

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

Liabilities

The common carrier is liable for all losses except those caused by the following events; Act of God, the king's enemies, inherent vice in the goods carried and negligence of the person whose goods are married.

- ii) The functions of the Judiciary include the administration of justice through resolving disputes between individuals or between individual and the state, interpreting the constitution and the laws of Zambia, promoting the rule of law, and protecting the human rights of individuals and groups.
- iii) Accept the goods and make payments

- b) Limited companies are formed under state law, in Zambia under Companies Act No. 10 of 2017. Different states have different requirements, but in general, a limited company can be owned by a single person in other jurisdictions, by multiple people or even by multiple corporations and other limited companies in Zambia. Owners are called *members*, and their ownership interest is described in a document called the articles of organization. States usually authorize multiple kinds of limited companies, depending on what the firm does. These include limited liability companies and limited liability partnerships. The most important distinction between partnerships and limited companies has to do with who ultimately is responsible for the debts of the business. In a partnership, at least one of the owners is personally liable for those debts. That means that if the business can't pay its debts, the creditors can try to get their money back by suing an owner or trying to seize the owner's personal assets, such as homes, cars and

bank accounts. In a general partnership, **all** partners are fully liable for the business's debts.

In a limited partnership, only **some** partners are personally liable. These are the *general partners*. Other partners, known as *limited partners*, are not personally responsible for business debts. However, limited partners generally don't play an active role in running the business. The "limited" in a limited company refers to liability. Responsibility for debts lies with the company itself, so none of the owners is personally liable. Their potential losses are limited to what they've invested in the company, but no more.

c)

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

SOLUTION THREE

- (i) *Consideration must move from the promisee* - This means that the promisee (one who was promised) is the only person who can enforce the promise if they themselves, and not a third party provided consideration.
- (ii) *Privity of Contract* – This legal principle means that only a party to a contract can sue and be sued upon it. Third parties do not acquire rights or obligations, but acquire such rights in exceptional situations to mitigate the harsh outcomes of a harsh rule.
- (iii) *Wrongful Dismissal* – This is a kind of dismissal from employment without following the laid down procedure. This kind of dismissal does not include the reason for dismissal. An action for wrongful dismissal is a common law action for compensation to the ex-employee for losses suffered for wrongful termination of the contract of employment.
- (iv) *Collective Agreement* – This is a voluntary agreement negotiated voluntarily between employers or associations of employers and employees or associations of or representing employees in which are laid down the conditions of employment and remuneration for employees. Collective agreements can be incorporated into the employment contracts either expressly or impliedly.
- (iv) *Receivership* – receivership is a process of realizing the company assets which are a subject of a floating charge and selling them so that its creditors are paid off. The process is arrived where a company fails to pay its debts and a Receiver is appointed to oversee the company until it is able to make profit and pay off its debts.

SOLUTION FOUR

- a. Agency relationship
- b. Agent can renounce the authority by giving notice, principle can revoke the authority by giving notice and mutual consent of the parties.
- c. I. To obey lawful orders
 - I. To exercise care
 - II. To exercise confidentiality
 - III. To account for employees property
 - IV. To work willfully.
- d. I. The seller must be an unpaid seller.
 - II. The buyer must be insolvent.

III. The goods must be in course of transit.

- e. I. It is not a hire purchase agreement.
 - III. It is a conditional sale agreement since it has all the characteristics of a conditional sale contract. The major distinctive feature between hire purchase and conditional sale is that the parties in a conditional sale agreement are committed to buy and sell at the outset whilst a hire purchase agreement only gives the customer an option to buy after all installments have been paid. This means that in a conditional sale agreement, the customer has agreed to buy the goods from the outset and hence can pass good title to a third party. It was unlikely for the car dealer not to exercise the option of buying the car.

SOLUTION FIVE

- a. I. he shall have perpetual succession as a corporate sole by the name of the official receiver and may sue or be sued in his corporate name.
II Appoint or terminate the appointment of a special manager of the debtor's estate or business in the interest of the creditors.

III Appoint a deputy official receiver.

IV. Administer oaths.

- b. Umberrimeafidei also known as utmost good faith, this may be defined as a positive duty voluntarily to disclose, accurately and fully, all facts material to the risk being proposed, whether requested or not. The Marine Insurance Act 1906 UK defines a material fact as every circumstance which would influence the judgment of a prudent of a prudent insurer in fixing the premium or determining whether he will take the risk. The principle applies fully in long term business. If a fact is material, it must be disclosed even if no directly relevant question is asked in the proposal form or as part of a medical examination.

- c. I. The constitution
II. Statute law or Legislation
III. Case law
IV. Equity
V. Common law
VI. Treaties



TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D1: BUSINESS INFORMATION MANAGEMENT

WEDNESDAY, 11 DECEMBER 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

TECH Company Limited (TCL) is a Zambian owned company considering expansion into the African southern region in the next few years.

Feasibility studies and an assessment and evaluation of the competitive strength of TCL are being carried out.

Required:

- (a) Explain the five (5) forces of a strategic model for competitive analysis. (10 marks)

Many system development projects are never finished. If they are finished, some are under or over budgeted. Some projects never satisfactorily accomplish their goals.

- (b) Outline five (5) challenges you might face in a system development project?

(10 marks)

- (c) Explain how the identification of critical success factors (CSF) for a business can be used to improve the design of information systems. (5 marks)

[Total: 25 Marks]

QUESTION TWO

Most organisations are using automated offices and information systems for efficiency, effectiveness and competitive advantage.

Required:

- (a) Briefly explain the following terms:

(i) Total Quality Management (TQM) (5 marks)

(ii) Key Performance Indicators (KPI) (5 marks)

- (b) Explain any three (3) features of an automated office. (9 marks)

- (c) The main difference between outsourcing and insourcing IT services is the cost and convenience. When considering whether to outsource or not, several questions arise. Explain each of the following questions:

- (i) Is the system known enough to manage the outsourced service agreement? (3 marks)
- (ii) Are the Organizational requirements likely to change? (3 marks)

[Total: 25 Marks]

QUESTION THREE

Senior management in an organisation need to make certain strategic decisions in respect of information technology (IT). They particularly want to know whether the IT function should be centralised or decentralised, its administrative location in the organisation and how it should be controlled financially.

As an external consultant engaged by the managing director, your first task is to make a presentation to senior management.

Required:

- (a) Analyse the arguments for and against centralisation/decentralisation. (12 marks)
- (b) An Executive Information System (EIS) has been defined as 'a computer-based system under the direct control of the executive, which provides the executive with current status information on conditions internal and external to the organization'.

Explain clearly at least five (5) the characteristics of an EIS, identify why these characteristics discriminate such a system from other information systems used by management. (10 marks)

- (c) Explain the term 'globalisation' when applied to business? (3 marks)

[Total: 25 Marks]

QUESTION FOUR

The Internet and the services that run on it have come as a big advantage to business organisations and managers. You have been hired as an officer in the tax department of a company. You have realised that most of your colleagues are not very conversant with issues of technology.

- (a) Explain the following terms to your colleagues and advise when each is suitable to use.
 - (i) Internet
 - (ii) Intranet
 - (iii) Extranet (12 marks)
- (b) What is identity theft? (1 mark)

- (c) Computer Based Information Systems (CBIS) will flatten the organizational structure. Explain. (12 marks)

[Total: 25 Marks]

END OF PAPER

D1 SOLUTIONS

QUESTION ONE

a) Students briefly describe the five (5) forces of a strategic model for competitive analysis.

Five competitive forces are:

- Potential for new entrants to enter the market: Profitable markets attract new entrants, which erodes profitability. Unless incumbents have strong and durable barriers to entry, for example, patents, economies of scale, capital requirements or government policies, then profitability will decline to a competitive rate
- Rivalry among existing firms: The driver is the number and capability of competitors in the market. Many competitors, offering undifferentiated products and services, will reduce market attractiveness.
- Pressure of substitutes: Where close substitute products exist in a market, it increases the likelihood of customers switching to alternatives in response to price increases.
- Bargaining power of buyers: This is driven by the: number of buyers in the market; importance of each individual buyer to the organisation; and cost to the buyer of switching from one supplier to another. If a business has just a few powerful buyers, they are often able to dictate terms.
- Bargaining power of suppliers: This is driven by the: number of suppliers of each essential input; uniqueness of their product or service; relative size and strength of the supplier; and cost of switching from one supplier to another.

b) Some challenges you might face in a system development project

- It's very difficult to determine the requirements of a system which include data, procedures, communications and processing requirements
- The requirements are always changing, even as the system is being developed. The bigger the system, the longer the project, the more requirements change
- Scheduling and budgeting are difficult to determine. In order to forecast labour costs, you must forecast labour hours
- Technology will change throughout the system development process. Should you stop the project and incorporate new technology or continue on without it
- As development teams become larger, the average contribution per worker decreases and causes diseconomies of scale, i.e. adding more people to a late

project only makes the project later.

c) Critical Success Factors (CSF)

- CSF is an objective stated in such a way that a failure to achieve it implies total failure of the organisation to which the CSFs
- Identify the CSFs for the organisation
- Identify the key decisions that must be made if that CSF is to be achieved
- Identify the information requirements of the decision maker if they are to make that decision effectively
- These information requirements determine the design of the information system, as it must provide this information in a form that can be used by decision makers, when required.

SOLUTION TWO

a)

i) Total Quality Management:

- This is the philosophy that seeks to integrate all organizational functions to focus on meeting customer needs and organizational goals
- It is an organization wide effort of detecting and reducing or eliminating errors.
- TQM is a description of culture, attitude and organization of a company that strives to provide customers with products and services that meet their needs
- In doing so, both management and employees become involved in the continuous improvement of the production of goods and services.
- TQM views an organization as a collection of processes
- The simple objective of TQM is "Do the right things, right the first time, every time".

ii) Key Performance Indicators

- Key Performance Indicators are a set of quantifiable measures that a company uses to gauge its performance over time.
- They are used to determine the company's progress in achieving its strategic and operational goals
- KPIs are deemed crucial to the success of an organizations.
- KPIs differ from organization to organization based on business priorities.
- Without KPIs it would be difficult for an organization's management to evaluate how the organization is performing and make changes if necessary.

b) An automated office will have the following features

- A **computer** used for data processing and storage and some application will run on the computer
- A **facsimile** This is a device that codes and encodes documents so they can be transmitted over telephone lines used
- **Voice Mail:** allows someone to leave a voice message for one or more people. A computer in a voice mail system converts analog voice into digital form which can be stored in a voice mailbox
- **Teleconferencing:** allows a telephone or video meeting between participants in two or more locations.
- **Email:** Allow people to send mails using the internet

c) Discussing the outsourcing questions as follows:

i) Is the System known enough to manage the outsourced service agreement?

If the organisation knows very little about a technology it may be difficult to know what constitutes good service and value for money. It may be necessary to recruit additional expertise to manage the relationship with the other party.

ii) Are the organizational requirements likely to change?

Organisations should avoid tying themselves into a long term outsourcing agreement if requirements are likely to change. If any of the reasons the outsourcing

arrangement was entered change, then there is a likelihood of excesses and unwanted expenditures and procedures.

SOLUTION THREE

a) Arguments for centralisation

- **Consolidated results** – all information is in one place enabling financial reports to be consolidated and evaluated without centralisation this is not always possible because of differences in system design, coding schemes and data formats
- **Economies of scale** – an organisation may be able to purchase one large computer with extensive processing capabilities, in place of several small computers, centralisation will also mean a reduction in duplication of work and better control of analysis and programming activities
- **Personnel** – centralisation may reduce staff turnover, it also means the establishment of one staff of a large size, thus lessening the problems of shortages and turnover, and leads to less dependence on a few individuals. Turnover is normally reduced because of improved interaction due to the wider variety of staff and the improved range of facilities, software and applications
- **Ease of control** – Top management will have the availability of a uniform reporting system, allowing for better control of operating divisions.

Arguments for decentralisation

- **Familiarity with local problems** – Each office can devise a solution to cope with its particular problems as they are more aware of local organisational problems
- **Rapid response** – staff can respond quickly to local needs when they have more control over scheduling their resources, they are aware of development and production requirements and do not have to compete with other departments for the computer facilities
- **Profit and loss responsibility** – Decentralisation of computer facilities allows costs to be decentralised to users, this makes users more aware of computer cost to their department because these costs affect the department's profitability

The following can be taken into account:-

i) **Centralised computer departments are best suited when**

- Dealing with organisational functions such as payroll
- Information is required by top-level management
- Work not required immediately can be done more economically centrally
- Functions are too small to justify their own equipment and staff
- Where some information must be held centrally (e.g. on-line airline reservations)

ii) **Decentralised computer departments are best suited when**

- There is no particular advantage or reason to centralise (e.g. stand-alone inventory systems)
- Immediate response is required
- The impact of downtime would be damaging

b) Characteristics of an EIS

- Easy to use, screen-based systems with mouse, icons and touch-screen facilities, giving easy access to data
- Presentation aids, by pictorial or graphical means, so that information can be conveyed without too many trivial choices of scale, colour and layout
- Summary level data, captured from the organisation's main systems, which might involve integrating the executive's desk top micro with the organisation's mainframe
- A facility which allows the executive to drill down from higher to lower levels of information
- Data manipulation facilities such as comparison with budget or prior year data external information that can be superimposed onto the organisation's information
- Tools for analysis, including ratio analysis, forecasts, what if analysis and trends
- A template system which allows the same type of data

c) Globalisation is the tendency of organisation, products and services to proliferate without regard to national boundaries. Organisations are increasingly recognising the world as their target market, and products and services are being marketed with consistent selling messages in all markets using the internet

SOLUTION FOUR

a)

i) **Internet:** The Internet is a global network of computer networks, computers and other computing devices. It is a global communications system where any user with a computer and internet connectivity can communicate with any other suitably equipped computer the world.

One can use the internet to put information that can be accessed by the general public

ii) **Intranet:** is a private network within an organization that uses internet technology such as web browsers, servers. TCP/IP network protocols to provide an internet environment but within the organization in order to share information, communicate, collaborate etc. the intranet is not open to the public.

The intranet is used to communicate within the organization.

iii) **Extranet:** these are networks that use the internet technologies to connect the intranet of an organization to selected outsiders such as customers, suppliers and business partners.

The extranet is used when the organisation wants to extend its internal network to some authorized outside for business efficiency

b) Identify Theft: This is the scheme devised by criminals in order to gain access legally into the system by cloning or masquerading as legitimate users. In short it means stealing someone's details and use them in a malicious way.

c) Flattening of an organization structure will be as a result of job losses due to robotics and artificial intelligence (AI). (Explain more on AI).



TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D2: FINANCIAL MANAGMENT

FRIDAY, 13 DECEMBER 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 following statement of financial position (extract) relates to NJM Ltd:

	K'm
Equity:	
Ordinary shares K1 par value	20
Long-term liabilities:	
9% Convertible bond	30
10% Bank loan	<u>3</u>
	<u>33</u>
Equity and Liabilities	<u>53</u>

The current market price of ordinary shares is K5.2 per share and convertible bond K108 per K100 bond. NJM Ltd expects share prices to rise in the future at an average rate of 5% per year. The convertible bond can be redeemed at par in six years' time, or converted into 16 shares of NJM Ltd per K100 bond. NJM Ltd has an equity beta of 1.24 and pays corporate tax at the rate of 30% per years. The government bond is 5% and the equity risk premium is 8.5%.

Required:

- (a) Calculate the current weighted average cost of capital (WACC) using the market values as weighting factors. (15 marks)
- (b) Explain the advantages and disadvantages of Net Present Value (NPV) and Internal Rate of Return (IRR) as methods of investment appraisal. (10 marks)

[Total: 25 Marks]

QUESTION TWO

TPIN Plc is considering an investment in KVV Ltd. The capital structure of KVV Ltd is as follows:

- (a) 12 million A voting ordinary shares.
(b) 11 million B non-voting ordinary shares.

Both classes of shares have the same dividend rights. TPIN Plc is considering acquiring either 8 million A ordinary shares or a combination of 9 million B and 5 million A ordinary share.

TPIN Plc has currently 20 million issued share capital and posted an operating profit of K16 million during the just ended financial year. The company pays tax at the rate of 30% per year. TPIN Plc has a 10% bond in the capital structure amounting to K20 million. The financial analysts have projected a 13.5 P/E ratio for the company. However, the average P/E ratio for the industry is projected at 13.0.

Required:

- (a) Describe the appropriate group accounting for KWV Ltd if TPIN Plc acquired either 8 million A ordinary shares or a combination of 9 million B and 5 million A ordinary share. (7 marks)
- (b) Calculate the current share price and value of TPIN Plc. (8 marks)
- (c) Discuss the usefulness of ratio analysis as an assessment tool for corporate failure. (10 marks)

[Total: 25 Marks]

QUESTION THREE

The primary objective for FCK Ltd is to maximize the shareholder’s wealth. Therefore, the Board of Directors have made it known to the Management that all the financial management decision made should be in line with this objective. In the recent past, the company has recorded a healthy financial position. The summarised Statement of Financial Position of FCK Ltd as at 31 December was as follows:

	K'000	K'000
Non-current assets		16,550
Current assets	7,000	
Creditors falling due within one year	<u>(5,700)</u>	
Net current assets		1,300
9% irredeemable loan notes		<u>(7,100)</u>
		<u>10,750</u>
Ordinary share capital (25n shares)		2,500
7% preference shares (K1 shares)		1,000
Share premium account		1,400

Retained earnings

5,850
10,750

The current price of each ordinary share is K2 ex dividend. The dividend of 15ngwee is payable during the next few days. The expected rate of growth of the dividend is 8% per annum. The current price of the preference shares is 90 ngwee per share and the dividend has recently been paid. The loan notes interest has also been paid recently and the loan notes are currently trading at K95 per K100 nominal. The company pays corporate tax at the rate of 25% per year. Assume that FCK Ltd issued the loan notes one year ago to finance a new investment involving the construction of a shopping mall.

Required:

- (a) Calculate the gearing ratio for FCK Ltd using Book values and Market values. (8 marks)
- (b) Calculate the company's weighted average cost of capital (WACC), using the respective market values as weighting factors. (10 marks)
- (c) Explain the relationship between investment, financing and dividend decisions that you would be required to make as a Financial Manager. (7 marks)

[Total: 25 Marks]

QUESTION FOUR

MOB Ltd has in issue two million shares. A dividend of K8.02 per share for 2018 has just been paid. The pattern of recent dividends is as follows:

Year	2015	2014	2017	2018
Dividends per share (ngwee)	686	824	778	802

MOB Ltd also has in issue 15% bonds redeemable in five years' time with a total nominal value of K80 million. The market value of each K1,000 bonds is K1,110. The gearing level is 30%. The current risk-free rate of return is 5% and the equity risk premium is 8%. MOB Ltd pays corporate tax at the rate of 30% per year and has an asset beta of 0.91.

MOB Ltd has bought 1.5 million shares in GTD Inc. a company quoted on the securities exchange market. GTD Inc. has a total of 3 million issued share capital.

Required:

- (a) Calculate the current share price of MOB Ltd. (10 marks)

(b) Explain the conditions which should be satisfied for GTD Inc. to be considered as either an "associate" or a "subsidiary" of MOB Ltd.

(10 marks)

(c) Distinguish between weak form and semi-strong form of stock market efficiency.

(5 marks)

[Total: 25 Marks]

END OF PAPER

Formula Sheet

Economic order quantity

$$= \sqrt{\frac{2C_n D}{C_H}}$$

Miller – Orr Model

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

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

The Capital Asset Pricing Model

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

The asset beta formula

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

The Growth Model

$$P_0 = \frac{D_0(1+g)}{(r_e - g)}$$

Gordon's growth approximation

$$g = b r_e$$

The weighted average cost of capital

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

The Fisher formula

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

Purchasing power parity and interest rate parity

$$s_1 = S_0 \times \frac{(1+h_c)}{(1+h_b)} \qquad f_0 = S_0 \times \frac{(1+i_e)}{(1+i_b)}$$

Present Value Table

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

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

		<i>Discount rate (r)</i>										
<i>Periods</i>		1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
(n)												
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

Periods (n)	Discount rate (r)										
	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

D2 SUGGESTED SOLUTIONS

SOLUTION ONE

Cost of equity = $5\% + 1.24(8.5\%) = 15.54\%$

Cost of Convertible Bond:

Conversion value = $P_0(1+g)^n \times \text{No. of share}$
 $= 5.2(1+0.05)^6 \times 16$
 $= 111.5 \text{ per share}$

Interest = $9\% \times 100 (1-0.3) = 6.3$

Year		CF	Dis@10%	PV	Disc@5%	PV
0	MV	(108)	1.000	(108)	1.000	(108)
1-6	Int	6.3	4.355	27.44	5.076	31.98
6	Redeem	111.5	0.564	<u>62.89</u>	0.746	<u>83.18</u>
	NPV			<u>(17.67)</u>		<u>7.16</u>

Cost of debt = $a\% + \frac{NPV_a}{NPV_a - NPV_b} (b\% - a\%)$
 $5\% + \frac{7.16}{7.16 + 17.67} \times 5\%$
 $= 6.44\%$

Cost of bank loan = $10\% \times (1-0.3) = 7\%$

Market Values:

	K'm	%
Equity (20 x 5.2)	104	74.6
Convertible (30 x 108/100)	32.4	23.24
Bank Loan	<u>3</u>	<u>2.16</u>
Total	<u>139.4</u>	<u>100</u>

WACC = $(15.54\% \times 0.746) + (6.44\% \times 0.2324) + (7\% \times 0.0216) = 13.24\%$

(b) NPV

Advantages

Theoretically the NPV method of investment appraisal is superior to all others. This is because it:

- considers the time value of money
- is an absolute measure of return
- is based on cash flows not profits
- considers the whole life of the project
- should lead to maximisation of shareholder wealth.

Disadvantages

- It is difficult to explain to managers
- It requires knowledge of the cost of capital
- It is relatively complex.

Advantages and disadvantages of IRR

Advantages

The IRR has a number of benefits, e.g. it:

- considers the time value of money
- is a percentage and therefore easily understood
- uses cash flows not profits
- considers the whole life of the project
- means a firm selecting projects where the IRR exceeds the cost of capital should increase shareholders' wealth.

Disadvantages

- It is not a measure of absolute profitability.
- Interpolation only provides an estimate and an accurate estimate requires the use of a spreadsheet programme.
- It is fairly complicated to calculate.
- Non-conventional cash flows may give rise to multiple IRRs which means the interpolation method can't be used.

SOLUTION TWO

- a) It is the voting shares that give Hercules the influence in Samson. With 60% of the voting shares Hercules should control Samson. Samson should therefore be treated as a subsidiary. As Hercules has less than 50% of the voting share this time it probably will not be able to control Samson. Samson will not be a subsidiary but may be treated as an associate.
- b) Current share price:

	K'm
Profit before interest and tax	16
Interest (10% x K20m)	<u>(2)</u>
Profit before interest and tax	14
Tax@30%	<u>(4.2)</u>
Profit after tax	<u>9.8</u>

EPS (K9.8m/20)=K0.49 per share

Share price = K0.49 x 13.5= K6.62per share

Value of TPIN Plc = K6.62 per share x 20m = K132.4million

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

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

- i) Meaningful information is derived from ratio analysis by comparing ratios over time within the same business to assess whether a business is improving or declining or similar businesses (industrial average). However, comparable information may not be available. Sometimes industrial averages are used, which may hide wide variations in figures.
- ii) Ratio analysis is normally based on the financial statements which are historical such that the information becomes out of date if the business has recently undergone substantial changes.
- iii) Basing the decisions solely on ratio analysis can be catastrophic because there are other items of information that are not contained in the financial statements.

SOLUTION THREE

a) Gearing Ratio

Book Values

Equity:	K
Ordinary Share	2,500
Share Premium	1,400
Retained earnings	<u>5,850</u>
Total	<u>9,750</u>

Debt:

9% irredeemable debt	7,100
Preference shares	<u>1,000</u>
Total	<u>8,100</u>

$$\text{Gearing} = 8,100 / (9,750 + 8,100) \times 100\% = 45.4\%$$

Market Values:

Equity:	K
Ordinary Share (2,500/0.25 x 2)	20,000
Total	<u>20,000</u>

Debt:

9% irredeemable debt (7,100x95/100)	6,745
7% Preference shares (1000x0.9)	<u>900</u>
Total	<u>7,645</u>

$$\text{Gearing} = 7,645 / (20,000 + 7,645) \times 100\% = 27.65\%$$

b) Cost of Capital

$$\text{Cost of equity} = \frac{D_0(1+g)}{P_0} + g = \frac{0.15(1+0.08)}{2} + 0.08 = 16.1\%$$

$$\text{Cost of loan notes} = \text{Interest}(1-t)/\text{Mv of debt} = 6.75/95 \times 100\% = 7.1\%$$

$$\text{Cost of Preference Shares} = \text{Div.}/\text{Mv of pref} = 0.07/0.9 \times 100\% = 7.8\%$$

Market values (weighting factors)

	K	%
Equity (10,000 x K2)	20,000	72.3
Loan notes	6,745	24.4
Preference shares	<u>900</u>	<u>3.3</u>

Total 27,645 100

$$\begin{aligned} \text{WACC} &= (16.1\% \times 0.723) + (7.1\% \times 0.244) + (7.8\% \times 0.033) \\ &= 13.67\% \end{aligned}$$

c)

A financial manager will be required to make decisions relating to investment, financing and dividends as well as management of risk. As you make these decisions, the overriding goal is to ensure that the shareholder's value is maximized.

- ❑ *Investment decisions:* As a financial manager you will need to determine what assets to invest in. The decision making process involves selecting viable projects by applying investment appraisal techniques depending on the nature of business the firm is involved in (e.g. Agriculture, mining, retailing or manufacturing)

- ❑ *Financing decisions:* After having selected the investment, you need to decide how the investment(s) will be financed. Firms have three options regarding where they source finances. They can source them internally by using retained earnings, borrowing from the Debt capital market or Issuing stocks (Ordinary Shares). In making the decision to use a specific source of finance you will need to determine the period of investment (long-term or Short-term), use of funds for either Capital investment or Working Capital requirements. You will also need to consider the desired capital structure for your firm (That is, the balance between equity and debt used in financing the assets of the firm).

- ❑ *Dividend decisions:* As a financial manager you will be involved in determining a dividend policy for your firm. The dividend policy describes how the returns from the investment are distributed to shareholders as dividends including the mode of payment.

SOLUTION FOUR

a)

$$B_a = B_e \times V_e / (V_e + V_d(1-t))$$
$$0.91 = B_e \times 0.7 / (0.7 + 0.3(1-0.3))$$

$$B_e = 1.18$$

$$\text{Cost of equity} = 5\% + 1.18(8\%)$$
$$= 14.44\%$$

$$\text{Dividend growth} = \sqrt[3]{8.02/6.86} - 1$$
$$= 5.3\%$$

$$\text{Current Price}(P_0) = \frac{D_0(1+g)}{K_e - g} = \frac{8.02(1+0.053)}{0.1444-0.053}$$
$$= \text{K}93.39 \text{ per share}$$

b)

A subsidiary is an entity that is controlled by another entity known as the parent. Control is usually established based on ownership of more than 50% of the voting power of the subsidiary.

However there are other situations in which control can exist. This is when Lonrho has power:

- i) To govern the financial and operating policies of Trimble under a statute or an agreement.
- ii) To appoint or remove the majority of the members of the board of directors.
- iii) Over more than half of the voting rights by virtue of agreement with other investors.
- iv) To cast the majority of votes at a meeting of the board of directors.

An associate is an entity over which the investors have significant influence and that is neither a subsidiary nor an interest in a joint venture.

Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

Lonrho plc can be assumed to have significant influence over Trimble Ltd if it owns between 20% to 50% of the shares of Trimble Ltd.

- c) Stock market efficiency usually refers to the way in which the prices of traded financial securities reflect relevant information. Weak-form efficient is where the share prices fully and fairly reflect past information. Investors cannot generate

abnormal returns by analysing past information, such as share price movements in previous time periods.

Semi-strong form of market efficiency is where share prices fully and fairly reflect public information as well as past information. Investors cannot generate abnormal returns by analysing either public information, such as published company reports, or past information.

Formula Sheet

Economic order quantity

$$= \sqrt{\frac{2C_n D}{C_H}}$$

Miller – Orr Model

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

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

The Capital Asset Pricing Model

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

The asset beta formula

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

The Growth Model

$$P_0 = \frac{D_0(1+g)}{(r_e - g)}$$

Gordon's growth approximation

$$g = b r_e$$

The weighted average cost of capital

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

The Fisher formula

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

Purchasing power parity and interest rate parity

$$s_1 = S_0 \times \frac{(1 + h_c)}{(1 + h_b)} \qquad f_0 = S_0 \times \frac{(1 + i_e)}{(1 + i_b)}$$

Present Value Table

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

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

		<i>Discount rate (r)</i>										
<i>Periods</i>		1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
(n)												
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

Periods (n)	Discount rate (r)										
	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



TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D3: BUSINESS TAXATION

WEDNESDAY, 11 DECEMBER 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%
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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%
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Farming Allowances

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

Presumptive Taxes

Turnover Tax	4%
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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

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

Motor cars and other motor vehicles principally designed for the transport of persons including station wagons and racing cars	Aged 2 to 5 years		Aged over 5 years	
	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

- 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%
- Pick-ups and trucks/lorries with gross weight not exceeding 20 tonnes:
 - Customs duty 15%
 - Excise duty 10%
- 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%
- 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) Explain the meaning of the following terms in the context of the taxation of mining operations in Zambia:

- (i) Norm value (3 marks)
- (ii) Gross value (2 marks)

(b) Tika Tika Ltd is a Zambian resident company involved in the mining of copper in the North Western Province of Zambia.

During the year of 2019 the average quoted selling price of copper was more than US\$6,000 per metric tonne on the London Metal Exchange. For the year ended 31 December 2019, the summarised statement of profit or loss is as follows:

		K'million	K'million
Sales	(Note 1)		195,000
Less cost of sales	(Note 2)		<u>(98,170)</u>
Gross profit			96,830
Less Expenses:			
Depreciation		1,900	
Professional fees	(Note 3)	400	
Repairs and maintenance		6,300	
Patent royalty	(Note 4)	3,000	
Other Operating expenses	(Note 5)	<u>3,300</u>	
		(14,900)	
Operating profit			81,930
Bank interest received	(Note 6)		80
Profit from sale of Equipment			51
Income Tax expense	(Note 7)		<u>(2,116)</u>
Net Profit			<u>79,945</u>

The following additional information is provided:

Note 1- Sales

The figure shown is the gross sales of copper during the year based on the average London Metal Exchange cash price per metric tonne.

Note 2- Cost of sales

Included in the cost of sales is expenditure on the construction of a road within the mine site amounting to K2,300 million, extension to the community school in a mine township amounting to K1,800 million and a donation to the Ministry of Health towards the fight

against malaria amounting to K1,500 million. The balance comprises revenue expenses which are all allowable for tax purposes.

Note 3- Professional fees

The professional fees were as follows:

	K'million
Accountancy and audit fees	265
Legal fees in relation with issue of share capital	50
Legal fees in connection with court action for not complying with environmental legislation	40
Legal fees for recovery of bad debts relating to former employee	25
Legal fees for recovery of bad debts relating to trade debts	<u>20</u>
	<u>400</u>

Note 4 -Patent royalty

Tika Tika Ltd acquired a patent used in copper processing for a period of 15 years. The whole amount paid has been charged to the statement of profit or loss.

Note 5-Other operating expenses

Included in operating expenses is K190 million incurred for entertaining customers, K80 million for entertaining employees and a donation of K70 million to an approved public benefit organization.

Also included are annual salaries for the Chief Executive Officer, Chief Financial officer and Operations Director of K1,200 million, K900 million and K860 million respectively.

The above directors are accommodated in company owned houses for which they do not pay rent.

Note 6- Bank interest received

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

Note 7- Income tax expense

This represents provisional income tax paid by the company for the tax year 2019.

Note 8-Mineral royalty

Mineral royalty has not been accounted for in the statement of profit or loss presented above.

Note 9- Implements, plant and machinery

In order to improve efficiency in its operations, Tika Tika Ltd engaged into the following transactions:

	Cost (proceeds) K'million
Bought two 3000cc Toyota Hilux's vans (single cabs) each costing K250 million	500
Bought new mining equipment	7,000
Sold old equipment	(520)

The old Equipment was acquired six (6) years ago at a cost of K1,100 million

The Toyota Hilux vans were used by the Chief Financial Officer and Director of Operations on a personal to holder basis. It has been agreed with the Commissioner General that each director has 40% private use in their respective vans.

Required:

Calculate the company income tax payable by Tika Tika Ltd for the tax year 2019.
(20 marks)

[Total: 25 Marks]

QUESTION TWO

PAC Ltd is a value added tax registered Zambian resident manufacturing company which was incorporated 10 years ago by four (4) entrepreneurs. It prepares its financial statements to 31 December each year. Due to a rapid increase in the cost of raw materials used in the production process, the company has experienced significant reduction in profit in the recent years. Therefore, the directors of PAC Ltd have decided to cease trading on 31 August 2019. The company will prepare its last accounts for the period commencing 1 January 2018 to 31 August 2019. The tax adjusted profit before capital allowances for this final period of trading will be K461,160.

On 31 August 2019, all the assets of the company will be sold at their market values and all the liabilities settled. The income tax values of the assets qualifying for capital allowances at 1 January 2018 were as follows:

	Income tax value K	Original cost (VAT exclusive) K
Factory building	125,000	250,000
Administrative building	64,000	80,000
Manufacturing plant	80,000	160,000
Mitsubishi Fuso truck	35,000	140,000

Computers	30,000	60,000
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On 31 August 2019, the company expects to receive the following proceeds (market values) from sale of its assets:

	Proceeds (Inclusive of VAT)
	K
Factory building	406,000
Administrative building	208,800
Manufacturing plant	104,632
Mitsubishi Fuso truck	29,000
Computers	28,420

Required:

- Explain, using appropriate calculations, the value added tax implications of the disposal of business assets on 31 August 2019. (5 marks)
- Explain, using appropriate calculations, the property transfer tax implications of the disposal of business assets on 31 August 2019. (3 marks)
- Calculate the final taxable business profits for the years 2018 and 2019 explaining the basis of assessment for the final accounting period commencing 1 January 2018 to 31 August 2019. (17 marks)

[Total: 25 Marks]

QUESTION THREE

- Ezron Ltd is a company which is under voluntary liquidation and your firm has been appointed the liquidator. On 1 June 2019 your company made the first distribution amounting to K300 million. The statement of financial position on that date was as shown below:

ASSETS	K(million)
<i>Non-Current assets</i>	
Property (note 1)	500
<i>Current Assets</i>	
Cash and cash equivalents	<u>700</u>
	<u>1,200</u>
EQUITY AND LIABILITIES	
<i>Equity</i>	

Ordinary Share Capital (K1 each)	600
Share Premium	200
Retained earnings (note 2)	<u>400</u>
	1,200
Liabilities	<u>Nil</u>
Total equity and liabilities	<u>1,200</u>

Additional information:

- (1) Property represents the fair market value of land and buildings which are yet to be sold.
- (2) K50 million of the retained earnings represent capital profits (i.e. arising from the sale of capital assets).

Required:

- (i) Explain what constitutes a dividend for taxation purposes and compute the amount that will be regarded as dividend, from the distribution that was made on 1 June 2019. (10 marks)
 - (ii) Calculate the amount of withholding tax on the dividend you have computed in (a) (i) above. (2 marks)
- (b) NGD Ltd is a Zambian resident company engaged in manufacturing. The company manufactures chemicals used by mining companies and is registered for Value Added Tax (VAT). The company is considering acquiring manufacturing equipment at an expected cost of K1,948,800 (VAT inclusive). The following financing options for the purchase of the equipment are being considered:

Option One

To obtain a bank loan of K1,948,800 at an interest rate of 29% per annum to finance the acquisition of the equipment. The loan is repayable over a period of five years.

Option Two

To lease the equipment under an operating lease, paying annual lease rentals of K389,760, VAT inclusive. The lease agreement is renewable at the end of each year.

Option Three

To lease the equipment under finance lease, paying a deposit of K249,600 on 1 July 2019, followed by four annual lease rentals of K125,000. The implicit rate of interest will be 12%.

Required:

Explain the income tax and VAT implications of each of the above options of acquiring the manufacturing equipment. Your explanation should include appropriate calculations.
(13 marks)

[Total: 25 Marks]

QUESTION FOUR

PZG Bank Plc is a fast growing and rapidly expanding commercial bank incorporated five years ago. It is listed on the Lusaka Stock Exchange.

The following is a summarised statement of profit or loss for the year ended 31 December 2019:

		K'000
Interest income	(Note1)	58,250
Interest expenses	(Note 2)	<u>(20,180)</u>
Net interest income		38,070
Provision for loan losses	(Note 3)	<u>(2,100)</u>
Net interest income after provision for loan losses		35,970
Non-interest income	(Note 4)	3,650
Non- interest expenses	(Note 5)	<u>(12,950)</u>
Income before income taxes		26,670
Income tax expense	(Note 6)	<u>(10,385)</u>
Income after tax		<u>16,285</u>

The following information is available:

Note 1-Interest income

40% of the interest income comprises interest income which was subjected to withholding tax at the rate of 15% and this was deducted at source during the tax year 2019.

The balance of the income constitutes overdrafts amounting to K30,000,000 and interest from various securities amounting to K4,950,000.

Note 2-Interest expenses

This constitutes interest on debentures paid to debenture holders amounting to K2, 700,000, interest on deposits amounting to K10,090,000 and interest paid to other financial institutions amounting to K7,390,000. The debentures were issued during the tax year 2019 and the proceeds were used to finance the acquisition of non-current assets.

Note 3- Provision for loan losses

Provision for loan losses comprises the following:

	K'000
Increase in general provision	1,500
Decrease in specific provision	(300)
Irrecoverable loans written off	1,400
Loans written off now recovered	<u>(500)</u>
	<u>2,100</u>

Note 4 Non- interest income

This constitutes foreign exchange gains translations during the year amounting to K2,300,000. Rental income of K650,000 (net), profit on disposal of equipment amounting to K280,000 and Royalties amounting to K420,000 (net).

Note 5- Non- interest expenses

This comprises the following

	K'000
Donation to a political party	650
Donation to an approved Hospice	700
Depreciation	3,500
Salaries and wages	7,400
Other allowable operating expenses	<u>700</u>
	<u>12,950</u>

Note 6- income tax expense

The figure for taxation in the income tax statement represents the provisional company income tax paid by the company in respect to the tax year 2019.

Note 7- Implements, plant and machinery

The company entered into the following capital transactions during the year 2019:

(i) It purchased the following assets:

	K'000
3 heavy duty photocopying and printing machines (K100,000 each)	300
3 Toyota Hilux vans – single cabs (costing K300,000 each)	900
Fixtures and fittings	1,200
Toyota Prado 3000cc	130
5 Note counting machines (K28,000 each)	140

The Toyota Prado was used by the Chief Operations Officer on a personal-to-holder basis. It has been agreed with the Commissioner General that the private use is 40%.

- (ii) During the year 2019, the company sold a Nissan motor car for K75,000. The Nissan motor car was acquired in the tax year 2018 at a cost of K70,000. At 1 January 2019, the income tax value of the car was K56,000.

Required:

- (a) Calculate the income tax payable by PZG Bank Plc for the tax year 2019. (17 marks)
- (b) Advise the directors of PZG Bank Plc of the taxation implication of using equity finance and debt finance both from the view point of the company and that of an individual investor. (8 marks)

[Total: 25 Marks]

END OF PAPER

D3: SUGGESTED SOLUTIONS

SOLUTION ONE

- (a) (i) Norma Value
This is the
- The cash price quoted on the LME multiplied by the quantity of mineral sold or recovered; or
 - The monthly metal bulletin cash price multiplied by the quantity of mineral sold or recovered; or
 - Cash price as quoted on any metal exchange approved by the Commissioner General quantity of mineral sold or recovered.
- (1 mark per valid point up to a maximum of 3 marks)

- (ii) Gross value

The sales value FOB from the point of export from Zambia.

- (b) TikaTika Ltd

Income tax payable for the tax year 2019

	K'Million	K'million
Profit before tax		79,945
Add:		
Depreciation	1,900	
Construction of the road	2,300	
Extension to community school	1,800	
Legal fees-share capital	50	
Legal fees- court action	40	
Legal fees-former employees	25	
Patent royalties (3,000-200)	2,800	
Entertaining customers	190	
Free residential accommodation:		
Chief executive officer (1,200 X 30%)	360	
Chief financial officer (900 X 30%)	270	
Director of Operations (860 X 30%)	258	
Income tax expense	<u>2,116</u>	
		<u>12,109</u>
		92,054
Less:		
Bank interest	80	
Profit on sale of motor car	51	
Capital allowances (W1)	<u>805</u>	
		<u>(936)</u>
Adjusted taxable mining profit		91,118

Add Bank interest	<u>80</u>
Total taxable income	<u>91,198</u>
Income tax on mining profits (91,118 X 30%)	27,335
Bank interest (80 X 35%)	<u>28</u>
Income tax liability	27,363
Less	
Provisional income tax paid	(2,116)
WHT on bank interest paid (80 X 15%)	<u>(12)</u>
Income tax payable	<u>25,235</u>

Workings

Capital allowances	K'million
Toyota Hilux (500 X 25%)	125
New mining equipment (700 X 25%)	175
Old Equipment-balancing charge (0-520)	(520)
Construction of road (2,300 X 25%)	575
Extension of community school (1,800 X 25%)	<u>450</u>
Total capital allowances	<u>805</u>

(a) Thin capitalisation

- i. A company is said to be thinly capitalised when if it is financed by excessive debt finance in excess of its arm's length borrowing capacity.
- ii. Currently a mining company is said to be thinly capitalized if its debt to equity ratio exceeds 3:1.
- iii. The motivation for companies to borrow excessively is the fact that interest expense is an allowable deduction which reduces the tax payable.
- iv. The legislation on thin capitalisation is anti-avoidance legislation aimed at preventing companies from reducing their tax liabilities through excessive interest payments.
- v. In order to ensure that mining companies are not financed by excessive debt relative to their equity base, interest on the excess debt where the Debt: Equity ratio exceeds 3:1 is not allowable.

SOLUTION TWO

- (a) Value added tax will be charged on the sale of business assets and the VAT payable will be as follows:

	K
Factory building: $K406,000 \times 4/29$	56,000
Administrative building: $K208,800 \times 4/29$	28,800
Manufacturing plant: $K104,632 \times 4/29$	14,432
Mitsubishi Fuso truck: $K29,000 \times 4/29$	4,000
Computers: $K28,420 \times 4/29$	<u>3,920</u>
Total VAT payable	<u>107,152</u>

- (b) There will be no property transfer tax implications on the sale of manufacturing plant, Mitsubishi Fuso truck and computers as implements plant and machinery do not qualify as property.

Property transfer tax will be payable on the sale of the factory building and administrative building on the realised value of the buildings. The property transfer tax will amount to:

	K
Factory building: $K406,000 \times 25/29 \times 5\%$	17,500
Administrative building: $K208,800 \times 25/29 \times 5\%$	<u>9,000</u>
Total property transfer tax	<u>26,500</u>

- (c) The cessation rules will be used to determine the basis of assessment for the final period of trading. The final accounting period should be split into two notional accounting periods with the first period consisting of exactly twelve months and the last period consisting of less than twelve months.

i.e

1 January 2018 to 31 December 2018: $K461,160 \times 12/20 = K276,696$

1 January 2019 to 31 August 2019: $K461,160 \times 8/20 = K184,464$

The basis of assessment for the first twelve (12) months period ended 31 December 2018 is the current year basis which is the tax year 2018.

The profits of the last short accounting period should be assessed in a tax year that follows the tax year in which the profits of the last full accounting period were assessed, which is the tax year 2019.

PAC Ltd

Adjusted business profit for the tax years

	2018	2019
	K	K
Profits before capital allowances	276,696	184,464
Less:		
Capital allowances (W1)	<u>(144,100)</u>	<u>279,800</u>
Taxable business profits	<u>132,596</u>	<u>464,264</u>

Workings**Capital allowances for the tax years**

<u>2018</u>	K	K
Factory building		
ITV b/f	125,000	
W&T @5%	<u>(12,500)</u>	12,500
ITV c/f	<u>112,500</u>	
Administrative building		
ITV b/f	64,000	
W&T @2%	<u>(1,600)</u>	1,600
ITV c/f	<u>62,400</u>	
Manufacturing plant		
ITV b/f	80,000	
W&T @50%	<u>(80,000)</u>	80,000
ITV c/f	<u>Nil</u>	
Mitsubishi Fuso truck		
ITV b/f	35,000	
W&T @25%	<u>(35,000)</u>	35,000
ITV c/f	<u>Nil</u>	
Computers		
ITV b/f	30,000	
W&T @25%	<u>(15,000)</u>	15,000
ITV c/f	<u>15,000</u>	
Total capital allowances		<u>144,100</u>

2019

Factory building		
ITV b/f	112,500	
Disposal proceeds (restricted to cost)	<u>(250,000)</u>	

Balancing charge		(137,500)
Administrative building		
ITV b/f	62,400	
Disposal proceeds (restricted to cost)	<u>(80,000)</u>	
Balancing charge		(17,600)
Manufacturing plant		
ITV b/f	Nil	
Disposal proceeds (K104,632 x 25/29)	<u>(90,200)</u>	
Balancing charge		(90,200)
Mitsubish Fuso truck		
ITV b/f	Nil	
Disposal proceeds (K29,000 x 25/29)	<u>(25,000)</u>	
Balancing charge		(25,000)
Computers		
ITV b/f	15,000	
Disposal proceeds (K28,420 x 25/29)	<u>(24,500)</u>	
Balancing charge		<u>(9,500)</u>
Total net balancing charge		<u>(279,800)</u>

SOLUTION THREE

(a) (i) A dividend under the Income Tax Act includes:

- (1) Any profits distributed whether in cash or otherwise, except capital profits earned before or during the winding up or liquidation proceedings in the case of a company being liquidated.
- (2) Profits, redeemable shares capable of redemption by conversion debentures or security, awarded to shareholders in the case of a company which is not being wound up or liquidated.
- (3) A reduction of capital which is returned to shareholders more than the original amount of the shares whether the excess was given in cash or otherwise.
- (4) In the event of a reconstruction of a company any cash or value of any asset which is given to the shareholders in excess of the nominal value of the shares held by shareholder(s) before reconstruction.

COMPUTATION OF AMOUNT OF DIVIDEND

The amount that will be regarded as taxable dividends, from the distribution which was made on 1 June 2019 will be computed as shown below:

$$\begin{aligned}\text{Dividend} &= \frac{\text{Undistributed Revenue Profit} \times \text{Liquidation Dividend}}{\text{Share Capital} + \text{Share Premium Account} + \text{Total Undistributed Profit}} \\ &= \frac{(K400\text{m} - K50\text{m}) \times K300\text{ m}}{K600\text{m} + K200\text{m} + K400\text{m}} \\ &= \underline{K87.5\text{ m}}\end{aligned}$$

(ii) COMPUTATION OF WHT PAYABLE ON THE DIVIDEND

The amount of the WHT on the dividend computed above will be:

$$K87.5\text{ m} \times 15\% = \underline{K13.125\text{ m}}$$

(b) **Option one**

- (1) The company will be able to claim capital allowances at the rate of 50% per annum on the VAT exclusive cost of the equipment.

The amount of the allowance will be:

$$K1,948,800 \times 25/29 \times 50\%$$

$$= \underline{K840,000}$$

- (2) The interest on the bank will not be an allowable deduction when computing the taxable business profits, as interest on debt obtained for the purposes of acquiring capital assets is not allowable.
- (3) The company will be able to recover input VAT on equipment.

The amount recoverable input VAT will be:

$$K1,948,800 \times 4/29$$

$$= \underline{K268,800}$$

Option Two

If the equipment is acquired under an operating lease agreement, the implications will be as follows:

- (1) The company will not be able to claim capital allowances on the asset.
- (2) The VAT exclusive rentals will be allowable in computing taxable business profits.
- (3) The amount of the recoverable input VAT on the rentals will be:

$$K389,760 \times 4/29$$

$$= \underline{K53,760}$$

Option Three

If the equipment is acquired under a finance lease, the following will be the Income tax and VAT implications:

- (1) The company will be able to claim capital allowances at the rate of 50% on the VAT exclusive cost of the equipment.

The amount of the capital allowance will be:

$$K1,948,800 \times 25/29 \times 50\%$$

$$= \underline{K840,000}$$

- (2) The finance charge (interest) will be an allowable deduction when computing the taxable business profits.

(3) The company will be able to claim input VAT on the equipment.

The amount of the recoverable input VAT will be

$$K1,948,800 \times 4/29$$

$$= \underline{K268,800}$$

SOLUTION FOUR

(a) PZG Bank Plc		
Income tax payable for the tax year 2019		
	K'000	K'000
Income before taxation		26,670
Add:		
Interest on debentures	2,700	
Increase in general provision	1,500	
Donation to a Political Party	650	
Depreciation	3,500	
Personal-to holder- car	<u>40</u>	
		<u>8,390</u>
		35,060
Less:		
Rental income	650	
Profit on sale of equipment	280	
Royalties	420	
Capital allowances (W1)	<u>647</u>	
		<u>(1,997)</u>
Adjusted business profit		33,063
Add:		
Royalties (420 X 100/85)		<u>494</u>
Taxable income		<u>33,557</u>
Income tax (33,557 X 35%)		11,745
Less:		
Withholding tax on interest (58,250 X 40% X 15%)		(3,495)
WHT-Royalties (494 X 15)		(74)
Provisional income tax paid		<u>(10,385)</u>
Income tax refundable		<u>(2,209)</u>

Workings

Capital allowances	K'000
Photocopying and printing machine (300 X 25%)	75
Toyota Hilux (900 X 25%)	225
Fixture and fittings (1,200 X 25%)	300
Note counting machines (28,000 X 25%) x 5	35
Toyota prado car (k130 X 20%)	26
Nissan car balancing charge (56-70)	<u>(14)</u>
Total capital allowances	<u>647</u>

(b) The following are the tax implications

(i) The implications of equity finance

From the company's point of view:

- i. Fees incurred on issuing share capital are not allowable for tax purposes.
- ii. The cost of making distribution to shareholders is not allowed for tax purposes.
- iii. Dividends are not allowable for tax purposes.

From the view point of an investor:

- i. The dividends receivable by the investor are subjected to withholding tax at the rate of 15% which is a final tax.
- ii. Property transfer tax would arise on transfer of shares by the investor in company that is not listed on the Lusaka stock exchange.

(ii) Tax implications of debt finance

From the company's point of view:

- i. Interest on loans taken to finance the business is allowable provided the loans are not for capital purposes.
- ii. Incidental costs of obtaining medium or long term business loans are allowable when computing business profits.

(iii) From the individual investor point of view:

- i. For an individual interest received will be subjected to a withholding tax which is final tax.
- ii. There are no property transfer tax implications on transfer of loans between investors.

END OF SUGGESTED SOLUTIONS



TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D4 – PERSONAL TAXATION

TUESDAY, 10 DECEMBER: 2019

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

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading time. Use this time carefully 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 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%
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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%
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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 the FOUR (4) questions.

QUESTION ONE

Chiwama and Kawama married in 1985 in Zambia. They had their first born son Chilufya in 1987 and immediately left Zambia for employment in a country known as Lukania in the same year, where Chilufya lived with his parents.

Whilst in Lukania, Chiwama was employed by a Lukanian resident company. He resigned from his position in Lukania on 31 March, 2019. His annual Salary from Lukanian employment was equivalent to K240,000 gross in the tax year 2019. Lukanian tax amounting to K21,000 was deducted in Lukania from the employment income he received in the tax year 2019.

Chiwama returned to Zambia with his entire family on 20 April 2019. On 1 May 2019, he took up employment with a Zambian resident company.

The following additional information relates to tax year 2019:

- (1) Chiwama's annual salary from employment with the Zambian company is K144,000. He is also entitled to a utility allowance of K3,000 per month and a housing allowance of K4,000 per month.
- (2) He was provided with free meals from the staff canteen worth K500 per month. In the tax year 2019, the company also paid his life insurance premiums of K700 per month and annual college fees for his children totaling K30,000.
- (3) He made the following payments from his employment income from Zambian sources:

Trade Union subscriptions	K250 per month
NAPSA contributions	K600 per month
Annual Golf club membership fee	K5,000
Donations to approved public benefit organization	K800 per month
Total PAYE from Zambian employment income	K33,600

- (4) Chiwama received the following income from various investments he holds in Zambia:

Copyright royalties	K22,100 (net)
Building society interest	K3,600 (gross)
Dividends from LuSE Listed Company	K12,000 (gross)

- (5) Chiwama holds various investments in Lukania. These include properties that are let out on a commercial basis in Lukania, shares in Lukanian resident companies and fixed deposit accounts with Lukanian resident banks. The currency of Lukania is known as the Lukanian dollar (P\$). On 31 December 2019, the following investment income was credited to his Zambian bank account in respect of these investments:

Dividends from Lukanian companies	P\$1,240
Fixed deposit interest from Lukanian Banks	P\$1,125
Rental income from property let out in Lukania	P\$22,500

The amount of the dividends was net of withholding tax at the rate of 38% deducted in Lukania and the amount of the fixed deposit interest and rental income was net of withholding tax at the rate of 25% deducted in Lukania.

- (5) There is no double taxation agreement between Zambia and Lukania. When computing Zambian income tax payable, credit is available for any foreign tax paid in Lukania. An exchange rate of K12.00 per P\$1 should be used where relevant.

Required:

- (a) Explain three methods of giving double taxation relief to a Zambian resident receiving income from foreign sources. (6 marks)
- (b) Calculate the income tax payable by Chiwama for the tax year 2019. You should assume that credit against Zambian income tax is available in respect of the attributable income tax from Lukania. (19 marks)

[Total: 25 Marks]

QUESTION TWO

For the purposes of this question, you should assume that today's date is 31

December 2019.

Cindy commenced business three (3) years ago as a retailer. She has always prepared financial statements annually to 31 December. Her annual turnover has always been less than K800,000. In the hope of diversifying her business, Cindy intends to buy a thirty-two (32) seater Higer bus and a fifteen (15) seater Toyota Hiace bus at a cost of K200,000 and K120,000 respectively. The two (2) vehicles will be used in the business of public transportation of passengers. The busses will be in operation six (6) days a week, four (4) weeks in a month throughout the tax year 2019. The tickets sales per day are expected to be K3,200 and K220 for the Higer bus and Toyota Hiace respectively. Cindy expects to incur total operating expenses amounting to K7,400 per month. The buses will commence operations on 1 March 2019.

Cindy is concerned about her health as she is suffering from kidney failure. She is not sure of what to do in order to protect her children from any adverse financial effect that might arise due to her sickness getting worse or death. Cindy is aware that she can take on critical insurance or life assurance although she does not understand what they are.

Required:

- (a) Describe any two (2) types of persons who are required to pay turnover tax and any four (4) types of persons who are **not** required to pay turnover tax. (6 marks)
- (b) Explain the benefits of presumptive tax for transporters over the regular assessed system. (10 marks)
- (c) In relation to Cindy's intended transportation business, calculate the total amount of tax payable for the tax year 2019. (3 marks)
- (d) In relation to personal financial protection products, explain to Cindy the meaning and taxation implications of critical illness insurance and whole of life assurance. (6 marks)

[Total: 25 Marks]

QUESTION THREE

Mildred Kapimpa had been working for Monze Ltd, a construction firm, as Operations Manager. On 30 April 2019, she decided to go on an early retirement. The conditions of service provided for an annual salary of K216,000, housing allowance of K64,800 per annum and transport allowance of K21,600 per annum. She always contributed to NAPSA at 5% of her basic salary. On retirement, she was paid accrued leave pay of K15,000, severance pay K40,000 and pension of K412,000. Mildred paid tax under pay as you earn of K93,202 up to 30 April 2019 when she retired.

On 1 July 2019, she started running her own business providing civil engineering services and will be preparing financial statements to 31 December each year. Her first accounts were prepared for six (6) months to 31 December 2019. She acquired a motor car at a cost of K130,000 and machinery at a cost of K210,000 on 24 July 2019. The motor car will be used by Mildred 45% for private purposes and the remainder for business purposes. She will pay salaries for employees amounting to K30,300 per month and other business operating expenses amounting to K31,220 per month and she will be required to contribute 5% of her employees' salaries as employer's NAPSA contributions. The sales revenue from her business averages K145,000 per month.

On 1 June 2019, Monze Ltd decided to hire the services of Mildred as a self-employed contractor on a one off contract for a period of nine (9) months from 1 June 2019 to the end of February 2020. The contract price was agreed at K378,000 payable to Mildred in nine (9) equal monthly installments. In the performance of the duties at Monze Ltd, Mildred was to provide her own tools and equipments. The terms of the contract were that Mildred will be required to perform the services at Monze Ltd's premises everyday from Monday to Thursday for at least five (5) hours per day, and she will be assisted by Monze Ltd's staff whenever necessary. As a result of this contract, Mildred has decided that she will only be spending four (4) hours at her new business from Monday to Thursday and the whole day on Friday and Saturday attending to

a wide range of clients. Monze Ltd has not employed another operations manager to replace Mildred.

On 30 December 2019, Monze Ltd was visited by the Zambia Revenue Authority to conduct a Pay As You Earn audit. The auditors queried Mildred's self-employed status in respect of the contract she signed with Monze Ltd on 1 June 2019.

Required:

- (a) Explain the reasons why the Zambia Revenue Authority queried Mildred's self-employed status in respect of the contract she signed with Monze Ltd on 1 June 2019.

(4 marks)

- (b) Explain the factors that Mildred and Monze Ltd would use to defend Mildred's self-employed status in respect of the contract she signed with Monze Ltd. (4 marks)

- (c) Calculate the income tax payable by Mildred for the tax year 2019. (17 marks)

[Total: 25 Marks]

QUESTION FOUR

Zambian companies may set up employee share option schemes in which employees may participate under applicable conditions.

- (a) Explain what you understand by an 'employee share option scheme' (2 marks)

- (b) Explain the tax benefits for both the employee and the employer of a share option scheme that is approved for tax purposes. (4 marks)

- (c) Explain the requirements to be met for the approval of an employee share option scheme. (7 marks)

- (d) **For the purposes of this part of the question, you should assume that today's date is 31 December 2018 and that the ceiling for the purposes of NAPSA contributions is K257,712 per annum.**

Thandiwe, is the 99% shareholder and Managing Director of Thandie Fashions Limited, a company making up its accounts to 31 December each year. Thandiwe has run this business for several years. After a successful year to date the company's business profits for the year ended 31 December 2019, have been forecast at K900,000 after a gross salary for Thandiwe of K200,000. Apart from this salary, Thandiwe currently has no other income.

Thadiwe is seeking advice concerning the payment to her of a further lumpsum payment of K100,000 (gross) in addition to her salary before 31 December 2019. She has suggested that this additional payment could either be in the form of a cash bonus payment or a cash dividend.

Required:

Explain the income tax and NAPSA implications if:

- (i) The additional payment of K100,000 were to take the form of an additional salary. (8 marks)
- (ii) The additional payment was to take the form of a cash dividend payment. (4 marks)

[Total: 25 Marks]

END OF PAPER

D4 SUGGESTED SOLUTIONS

SOLUTION ONE

(a) Double taxation relief for foreign tax suffered may be available in one the following ways:

(i) Treaty relief

Treaty relief is available in cases where the President of the Republic of Zambia has entered into an agreement with the foreign countries. Where there is a treaty, then DTR is given according to the provisions of that treaty.

- In some cases, the treaty may provide that income is only charged to income tax in one of the two countries,
- or income is charged to tax in one country, with the tax being apportioned between the two countries.
- A double taxation agreement may well provide for full recovery of any foreign tax covered by the agreement, by means of a tax credit to a Zambian resident taxpayer, against the Zambian tax liability, as long as the relief does not exceed the equivalent Zambian tax charge.

(ii) Unilateral credit relief

This applies where there is no treaty relief because Zambia has not signed an agreement with the foreign country involved.

Relief is given for foreign tax unilaterally in the Republic of Zambia. The relief is given by deducting from the Zambian income tax, the lower amount of

- The foreign tax paid that is attributed to Zambian income and
- The Zambian income tax payable on that source.

(iii) Unilateral expense relief

This relief applies where there is no treaty in place and also where the use of using credit relief is not beneficial.

Relief is given by deducting the foreign tax from the foreign income before including it in the Zambian income tax computation as an allowable expense.

(b) CHIWAMA

PERSONAL INCOME TAX COMPUTATION FOR THE TAX YEAR 2019

	K	K
<u>Income from Zambia employment</u>		
Salary (K144,000 x 8/12)		96,000
Utility allowance (K3,000 x 8)		24,000
Housing allowance (K4,000 x 8)		32,000
Life insurance premiums (K700 x 8)		5,600
College fees		<u>30,000</u>
		187,600
Less allowable deductions:		
Donations to public benefit organisation (K800 x 8)		<u>(6,400)</u>
		181,200
<u>Investment income from Zambia Sources</u>		
Copyright royalties (K22,100 x 100/85)		<u>26,000</u>
		207,200
<u>Income from Lukania</u>		
Employment income (K240,000 x 3/12)	60,000	
Dividend income (P\$1,240 x 100/62) x K12	24,000	
Fixed deposit Interest (\$1,125 x 100/75) x K12	<u>18,000</u>	
		<u>102,000</u>
Total assessable income		<u><u>309,200</u></u>
<u>Income Tax</u>		
K39,600 x 0%		nil
K9,600 x 25%		2,400
K25,200 x 30%		7,560
K234,800 x 37.5%		<u>88,050</u>
Zambian Tax Charge		98,010
Less: DTR on income from foreign sources		
- Employment income from Lukania (W1)	19,019	(W1)
- Dividends (W2)	7,608	(W2)
- Fixed deposit interest (W3)	<u>4,500</u>	(W3)
		(35,773)
Less PAYE		<u>(33,600)</u>
Income Tax payable		<u><u>28,637</u></u>

Workings

1. Double taxation relief on employment income from Lukania:

This will be the lower of:

- (i) The foreign tax paid on the income of K21,000
- (ii) The Zambian Tax Charge computed as:

$$\left(\frac{K240,000 \times 3/12}{K309,200}\right) \times K98,010$$
$$= K19,019$$

2. Double taxation relief on the dividends from foreign sources:

This will be the lower of:

- (i) The foreign tax paid on the dividends:
K24,000 x 38% = K9,120; and
- (ii) The Zambian Tax Charge computed as:

$$\left(\frac{K24,000}{K309,200}\right) \times K98,010$$
$$= K7,608$$

DTR will therefore be K7,608 being the lower amount.

3. Double taxation relief on the fixed deposit interest from foreign sources:

This will be the lower of:

- (i) The foreign tax paid on the interest:
K18,000 x 25% = K4,500; and
- (i) The Zambian Tax Charge computed as:

$$\left(\frac{K18,000}{K309,200}\right) \times K98,010$$
$$= K5,706$$

DTR will therefore be K4,500 being the lower amount.

SOLUTION TWO

(a) The following persons are required to pay turnover tax

- (i) Any person whose annual business turnover is less than K800,000
- (ii) Any person whose income is subjected to withholding tax where withholding tax is not the final tax.

Persons who are not required to pay turnover tax includes:

- (i) Any person carrying on a business where the annual turnover is above K800,000.
- (ii) Any individual or partnership carrying on the business of public service vehicle for the carriage of persons.
- (iii) Any partnership carrying on business irrespective of whether the annual turnover is over or not over K800,000.
- (iv) Any person whose business earnings are subjected to withholding tax where the withholding tax is the final tax.
- (v) Any person carrying on mining operations as provided under the Mines and Minerals Development Act.

(b) The following are the benefits of presumptive taxes over the regular assessed system includes:

- (i) Simplified process
The process of dealing with taxes has been simplified. There is no requirement to file returns keeping proper business records and taxes payable are predictable and, therefore, resulting in easing the cash flow planning process.
- (ii) Cash flow friendly
Operators find it fairly easy to pay taxes on a daily basis because the amounts look small and do not seriously disrupt their daily cash flow position.
- (iii) No need for professional consultancy services
Paying presumptive taxes is straight forward. Therefore very little intellectual or professional effort is required.
- (iv) Equity
All transporters are only expected to pay their presumptive tax depending on the seating capacity of the motor vehicle.
- (v) Allowance for breakdowns
Presumptive taxes are only paid when the motor vehicle is on the road during the tax accounting period.

(c) Cindy

Presumptive tax payable for the tax year 2019

Higer bus (K14.80 x 6 x 4 x 10)	K 3,552
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Toyota Hiace: (K4.90 x 6 x 4 x 10)	<u>1,176</u>
Total tax	<u>4,728</u>

(d) Critical illness insurance:

Meaning:

Under this type of insurance, the lump sum benefit is payable on the diagnosis of one from a list of life threatening conditions. The seven core conditions are; cancer, coronary artery bypass, surgery, heart attack, kidney failure, major organ transplant, multiple sclerosis and stroke.

Tax implications

When paid personally, the insurance premiums are not allowable for tax purposes and benefits are exempt from tax.

When the employer insures the cost of his employees' salaries, the premiums are allowable as trading expenses, and the policy proceeds are taxable as trading income.

Whole of life assurance

Meaning:

A whole of life policy pays out the sum assured as a lump sum on the death of the life/lives assured to the grantee, who need not necessarily be the life assured or his/her beneficiaries whenever death occurs.

Tax benefits:

- The premiums are not allowable if paid personally
- And the policy proceeds are exempted from tax.
- When the employer insures the lives of employees, the premiums paid are treated as allowable expenses and the policy proceeds are taxable as trading income.

SOLUTION THREE

- (a) The following are the reasons why the tax auditors have queried Mildred's self-employed status:
- (i) Mildred seems to be controlled by Monze Limited because she has been given stipulated hours to work and the days.
 - (ii) Mildred will be assisted by Monze Limited's other staff whenever necessary which shows that she is an employee.
 - (iii) Mildred is paid on a monthly basis. This shows that Mildred is an employee of Monze Limited since she is remunerated just like an employee.
 - (iv) Monze Limited has not employed another operations manager to replace Mildred. It can therefore be assumed that Mildred and Monze Limited have reached an agreement which allows Mildred to do her own business whilst working for Monze Limited.
- (b) The following are the factors Mildred and Monze Limited would use to defend Mildred's self-employed status:
- (i) Mildred and Monze Limited signed a one off fixed contract specifying the beginning and the end which shows that she is self-employed.
 - (ii) Mildred provides her own tools and equipments necessary for her to perform the duties at Monze Limited.
 - (iii) Mildred and Monze Limited agreed upon a fixed contract price which was to be paid on a monthly basis. This shows that she is self-employed.
 - (iv) Mildred does not exclusively work for Monze Limited because she has a wide range of clients at her firm.

(c) Mildred Kapimpa

Income tax payable for the tax year 2019

	K
Business profits (w1)	424,990
Salary: $K216,000 \times 4/12$	72,000
Housing allowance: $K64,800 \times 4/12$	21,600
Transport allowance: $K21,600 \times 4/12$	7,200
Accrued leave pay	15,000
Income from Monze Limited: $K378,000 \times 7/9$	<u>294,000</u>
Taxable income	<u>834,790</u>

Income Tax

First K39,600 @0%	0
Next K9,600 @25%	2,400
Next K25,200 @30%	7,560
Balance K760,390 @37.5%	<u>285,146</u>

Income tax liability	295,106
Less:	
PAYE	<u>(93,202)</u>
Income tax payable	<u>201,904</u>

Workings

Taxable business profit for the tax year 2019

	K	K
Revenue K145,000 x 6		870,000
Less:		
Salaries: K30,300 x 6	181,800	
Other operating expenses: K31,220 x 6	187,320	
Employer's NAPSA: K181,800 x 5%	9,090	
Capital allowances:		
Motor car: K130,000 x 20% x 55%	14,300	
Machinery: K210,000 x 25%	<u>52,500</u>	
		<u>(445,010)</u>
Taxable business profit		<u>424,990</u>

SOLUTION FOUR

- (a) An employee share option scheme is an option open to employees of a company to own shares in the company they work for. And as such the employees have the right but not the obligation, to buy shares in the company at a future date at a pre-determined fixed price.
- (b) The benefits of operating an approved share option scheme to the employer are as follows:

Benefits for employers

- (1) Costs incurred by the employer to set up and administer the scheme will be allowed as a deduction in computing the company`s profits for tax purposes.
- (2) The income of an approved share option scheme will be exempt from tax
- (3) The employer will be exempt from paying property transfer tax on shares transferred under the terms of an approved share option scheme.

Benefit for employees

The employees benefit is that of being allotted shares under an approved share option.

- (c) For the Commissioner General to approve a share option scheme, the following requirements must be met:
 - (1) The scheme must be established in Zambia and the employer must be carrying on business wholly or partly in Zambia.
 - (2) The scheme should provide for the participation of all eligible employees (including directors).
 - (3) An employee participating in the scheme should not acquire more than one fifth (20%) of the shares to be issued under the scheme.
 - (4) Only ordinary shares of the company may participate in the scheme.
 - (5) The scheme entitles an employee to acquire a set number of shares at a fixed price.
 - (6) The employee must be restricted to a set period of time to use an option to buy shares.
 - (7) The employees must be citizens or permanent residents of Zambia regardless of where they perform their duties.

- (c) (i) If the additional payment were to take the form of an additional salary, the following will be the income tax and NAPSA implications:
- (1) An additional salary will be an allowable expense when computing the company's taxable profits.
 - (2) As a result, an additional salary will result in a saving in company income tax at the rate of 35% which will amount to $35\% \times K100,000 = K35,000$.
 - (3) On this additional salary, Thandiwe will be assessed to income tax at the rate of 37.5%, as her existing income is already above K74,400 for the tax year 2019. Therefore, the additional income tax that she will be K37,500.
 - (4) Additional NAPSA contributions will be payable by both the company and Thandiwe as the existing salary of K200,000 is below the NAPSA contributions ceiling of K257,712.
 - (5) The additional NAPSA contributions payable will be

Additional employee's NAPSA contribution payable by Thandiwe

$$K57,712 \times 5\% = K2,885.60$$

Additional employee's NAPSA contribution payable by Thandiwe Ltd

$$K57,712 \times 5\% = K2,885.60$$
- (iii) If the additional payment were to take the form of a dividend, the income tax and NAPSA implications would be as follows:
- (1) The dividend payment will not be an allowable expense when computing the company's taxable income. The dividend will therefore be paid out of profits which will have been subjected to company income tax.
 - (2) The dividend will be subjected to withholding tax at the rate of 15% and this will amount to $15\% \times K100,000 = K15,000$ which is final.
 - (3) NAPSA contributions will not be payable by either the company or Thandiwe as dividends are not earnings for the purposes of NAPSA contributions.
 - (4) This means the payment of K100,000 as a dividend will increase the amount of taxation payable by the amount of withholding tax of K15,000.

END OF SOLUTIONS



TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D5: INTERNATIONAL TAXATION

THURSDAY, 12 DECEMBER 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 (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%
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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%
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Farming Allowances

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

Presumptive Taxes

Turnover Tax	4%
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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

Motor vehicles for the transport of ten or more persons, including the driver	Aged 2 to 5 years		Aged over 5 years	
	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

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

exceeding 1500 cc				
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 tonnesbut not exceeding 10.0 tonnes	24,724	18,955	10,817	8,293
GVW exceeding 10.0 tonnesbut 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

International trade is the purchase, sale or exchange of goods and services across national borders (Wild, Wild and Han, 2006). It produces many benefits to countries and individuals. Following the liberalisation of the Zambian economy in 1990, a number of companies were privatised mainly to improve their ability to compete internationally. Nambi Ltd is a Zambian resident company owned by a Multinational Company resident in a country called Francia. During the tax year 2019, Nambi Ltd reported a profit of K2,700,000, which was arrived at after deducting the following expenses:

	K
Depreciation of non-current assets	1,800,000
Entertaining auditors	15,000
NAPSA paid on behalf of employees	900,000

Other information

- (i) Nambi Ltd received dividends of K70,000 (net) and rental income of K80,000 (net) from its investments in Francia. A withholding tax (WHT) rate of 30%, apply to all investment income in Francia.
- (ii) Nambi Ltd received Bank interest of K170,000 (gross) from a Zambian bank.

Required:

- (a) Explain the mercantilism theory of international trade. (4 marks)
- (b) Explain four (4) benefits of international trade. (4 marks)
- (c) Explain the origin and destination bases for indirect taxes in international trade. (3 marks)
- (d) Explain the differences between treaty relief and unilateral credit relief as methods of giving double taxation relief. (4 marks)
- (e) Compute the income tax payable by Nambi Ltd for the tax year 2019, using unilateral credit relief. (10 marks)

[Total: 25 Marks]

QUESTION TWO

- (a) Johnson Kabwe was born in Zambia and died aged 73, on 1 May 2019. The Zambia Revenue Authority (ZRA) on 19 May 2019 launched an investigation to establish the correct value of the chargeable estate. The investigation was in response to information received from a close friend to Johnson Kabwe.

The investigation was concluded in July 2019 and ZRA has since established that at the date of his death Johnson owned the following assets:

- (i) Agricultural land and properties in Lilayi area (Zambia), valued at K8,200,000. The land was purchased on 3 May 1980 for K40,000.
- (ii) Commercial Property in South Africa worth \$2,000,000.
- (iii) Various chattels in Zambia valued on 1 May 2019 at K70,000.
- (iv) Residential property in Mauritius valued at \$500,000.
- (v) A shopping mall in Tanzania valued at \$6,000,000.

There was a significant mismatch between the value of the estate and the taxes paid by Johnson Kabwe over the years. However, Johnson Kabwe's wife confessed to the investigators that her husband was involved in money laundering activities which he used to evade tax.

The Commissioner General has advised an exchange rate of K11 per \$1. All the Double Taxation Agreements between South Africa, Mauritius, Tanzania and Zambia state that estate tax will only apply in the country where the deceased person was domiciled.

Required:

- (a) Define money laundering, giving four (4) examples of money laundering activities. (5 marks)
- (b) Explain any four (4) recommendations made by the Financial Action Task Force (FATF) which national governments should implement to effectively deal with international tax avoidance and evasion involving money laundering. (8 marks)
- (c) Calculate the tax payable on the estate left by Johnson Kabwe. (8 marks)
- (d) Explain why the use of joint investigation teams by Zambia Revenue Authority (ZRA) may increase the chances of discovering undeclared assets. (4 marks)

[Total: 25 Marks]

QUESTION THREE

Pinkie Nkhwazi is resident in Zambia although domiciled by choice in a country called Hulaya. She is one of the directors in Muchinga Plc, a Zambian resident company. She joined Muchinga Plc on 1 March 2019.

On 1 January 2019, Muchinga Plc acquired all the ordinary shares in Lunga International Ltd, a company which is incorporated in Hulaya. The directors of Lunga International Ltd hold their board meetings in Hulaya. Hulaya is a developing country which has very attractive incentives for Foreign Direct Investment (FDI).

Pinkie Nkhwazi received the following income from her investments during the tax year 2019:

- (i) Rental income of K16,500 from her house in Hulaya. This amount is net of 20% Hulayan withholding tax.
- (ii) Dividends of K30,000 (gross) from shares in a company resident in Hulaya. Withholding tax at the rate of 15% was deducted in Hulaya.

Pinkie Nkhwazi was paid an all inclusive monthly salary of K65,000. The PAYE deducted by Muchinga Plc was K188,175.

Zambia is currently negotiating a Double Taxation Treaty with Hulaya. You should assume that credit against Zambian income tax is available in respect of the foreign attributable income tax from Hulaya.

Required:

- (a) Explain the importance of Foreign Direct Investment (FDI). (6 marks)
- (b) State any four (4) main incentives for Foreign Direct Investment (FDI) given by countries. (4 marks)
- (c) State six (6) main roles of Double Taxation Treaties. (6 marks)
- (d) Compute Pinkie Nkhwazi's income tax payable for the tax year 2019. (9 marks)

[Total: 25 Marks]

QUESTION FOUR

You are the tax adviser to Ndalul Ltd, a company resident in Zambia. Ndalul Ltd manufactures and sells copper ornaments in Zambia. On 1 June 2019, Ndalul Ltd formed a 100% subsidiary, Kapulu Ltd, incorporated in a country called Qhoma. The currency of Qhoma is Qhoman Dollar (Q\$). During the year 2019, Ndalul Ltd exported copper ornaments components to its subsidiary (Kapulu Ltd) at a price of \$285,000. The open market value of the copper

ornaments components was \$300,000. This arrangement has been questioned by the Zambia Revenue Authority (ZRA).

The company income tax rate in Qhoma is 5% while Ndalul Ltd pays Zambian company income tax at 35%. The ZRA recently strengthened the section which deals with transfer pricing and all members of staff were adequately trained in the OECD Transfer Pricing guidelines which were used to develop the Zambian transfer pricing regulations. To encourage compliance with transfer pricing regulations, the government of the Republic of Zambia has increased the penalty fee for non-compliance from K3,000 to K24,000.

During the tax year 2019, Ndalul Ltd made a tax adjusted profit of K457,000 before any adjustments for the exports of copper ornaments components to Kapalu Ltd which totalled \$285,000. The provisional tax paid by Ndalul Ltd was K105,000. Kapalu Ltd made a profit of \$16,000 and no dividends were declared. In addition, Ndalul Ltd also received the following income from Zambian sources:

	K
Royalties (gross)	17,000
Rent (net)	9,000

The applicable average exchange rate advised by the ZRA Commissioner General is K12 per \$1.

Required:

- (a) Explain the OECD transfer pricing guidelines, especially for developing and transition countries which lack tax administrative capacity. (6 marks)
- (b) Advise the tax implications arising from the invoicing of copper ornaments components at their normal trade selling price less a discount of 5%. (4 marks)
- (c) Explain whether Kapalu Ltd's profit will be subject to Zambian company income tax during the charge year 2019. Ignore any regulations related to Controlled Foreign Company (CFC). (5 marks)
- (d) Calculate the company income tax for Ndalul Ltd for the charge year 2019.

(10 marks)

[Total: 25 Marks]

END OF PAPER

D5 SUGGESTED SOLUTIONS

SOLUTION ONE

(a) Mercantilism theory

This theory states that nations should accumulate financial wealth through exports and discouraging imports. This would be achieved through:

1. Trade surpluses,
2. Colonisation
3. Government intervention and

And these three things could work together.

For example, trade surpluses were maintained through the colonization of underdeveloped territories for their raw materials. The country would colonise these underdeveloped countries, and ship the raw materials from these undeveloped countries to their home country and then process them into finished goods which they would export around the world.

The Government interventions occur when the colonizing governments ban certain imports or impose a tariff on these imports. In the meantime, the colonizing government would subsidise their own industries to expand exports.

(b) Benefits of international trade

The benefits of international trade include:

(i) **Export of surplus resources**

Countries that have a surplus of resources to their needs can take advantage to export them. However, a country with a deficit of a raw material must either import or accept restrictions on its economic prosperity and standard of living.

(ii) **Increase competition:**

International trade increases competition amongst suppliers in the world's markets.

(iii) **Creation of larger markets:**

International trade creates larger markets for a firm's output, and so some firms can benefit from economies of scale by engaging in export activities.

(iv) **Political harmony:**

There may be political advantages to international trade because the development of trading links provides a foundation for closer political links.

(c) **Origin and destination bases for indirect taxes in international trade.**

The origin principle or basis

This is a case where internationally traded commodities are taxed at the rates prevailing in the country where goods are produced, and it is in this country that the tax revenue is received. Under the origin principle, exports are taxed and imports are exempted, so that in equilibrium, the home (foreign) country's consumer must be indifferent between paying for domestically produced goods and for those imported.

Destination principle or basis

This is a case where internationally traded commodities are taxed at the rates prevailing in the country where final consumption takes place, and this is the country where the tax revenue will be received.

(d) Difference between treaty and unilateral credit relief

Treaty relief

This method of giving double taxation relief applies where a double taxation agreement has been signed between Zambia and the foreign country involved. The double taxation agreement specifies how the relief should be given.

This being the case, 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.

And as such, relief is given for foreign tax unilaterally in the Republic of Zambia. The amount of foreign tax suffered against the Zambian income tax on the foreign income is credited, provided that the foreign income tax being credited against the Zambian tax does not exceed the Zambian income tax on that foreign income. Meaning 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.

(e) Computation of income tax payable using unilateral credit relief

Nambi Ltd

Adjustment of accounting profits for the charge year 2019

K

K

Profit per accounts		2,700,000
Add:		
Depreciation on non-current assets	1,800,000	
Entertaining auditors	<u>15,000</u>	
		<u>1,815,000</u>
Adjusted business profits		<u>4,515,000</u>

Computation of company income tax payable for the tax year 2019

			K
Business profits			4,515,000
Foreign dividends	70,000 X 100/70	100,000	
Bank interest			<u>170,000</u>
Taxable income			<u>4,785,000</u>
Income tax			
K4,785,000 X 35%			1,674,750
Less: Double Taxation Relief (DTR) (W1)			<u>(30,000)</u>
			1,644,750
Less: WHT on Bank interest 15% X 170,000			<u>(25,500)</u>
Company income tax payable			<u>1,619,250</u>

Working

1. Double Taxation Relief (DTR)

Lower of:

(i) Foreign tax paid on dividend = $K100,000 \times 30\% = \underline{K30,000}$

(ii) Zambian tax charge on foreign income =

Gross foreign dividend x Zambian tax charge

Total assessable income

$$4,785,000 = \frac{100,000 \times 1,674,750}{1,000,000} = \underline{K35,000}$$

Therefore the DTR is K30,000, which is the lower amount.

N.B. Rental income from foreign sources is exempt from Zambian tax and therefore the rentals received by the company amounting to K80,000 will not be subjected to Zambian income tax.

SOLUTION TWO

(a) Money laundering

Money laundering is a case where criminals disguise the original ownership and control of the proceeds of criminal conduct by making such proceeds appear to have been derived from a legitimate source.

When a criminal activity generates substantial profits, the individual or group involved tries to find ways and means of handling the funds without attracting attention to the underlying activity or the persons involved. Criminals can do this by disguising the sources, changing the form, or moving funds to a place where they are less likely to attract attention.

Examples of money laundering activities include:

- (i) Secrecy over transactions
- (ii) Excessive use of wire transfers
- (iii) Transactions routed through several jurisdictions
- (iv) Large currency or bearer instrument transactions

(b) Recommendations

The recommendations made by the Financial action Task Force (FATF) which national governments should implement to effectively deal with international tax avoidance and evasion involving money laundering includes:

- i. Demanding full transparency from financial institutions to provide all information concerning their activities in offshore supervisory authorities. In this respect financial institutions must be discouraged or, if necessary, prohibited from operating in territories that feature on the black lists of the FATF, OECD and the World Bank's StAR (Stolen Assets Recovery Initiative).
- ii. Establishing an interconnected and well integrated system of legal shareholder registries encompassing economic blocs and their member states, which will feature all necessary information concerning the shareholders of corporations operating within the economic blocs. This registry may be complemented with a risk-based index that will factor in some of the most suspicious aspects of a corporation's operations. This information on this registry should be available to authorities on demand and all corporations should be expected to provide information concerning their beneficial owner, at the moment they are asked or within a prescribed timeframe.
- iii. Creating a regularly-updated beneficial owner registry. Information of this kind should be either exchanged or coordinated across member states without any obstacle, so that instances of fiscal dumping would be avoided and variances in national legislation would not offer a window of opportunity to criminals and to those who make use of legal

loopholes in a manner that is sophisticated, structured and systematic, suggesting that their intention is clearly malevolent, to abuse the system rather than conduct normal operations.

- iv. Strengthening the requirements on the function of corporate directors. Directors should be held accountable for failing to take reasonable steps to prevent money-laundering, this should apply regardless of whether they are nominees or not. Information of this sort should, for issues of transparency and democratic legitimacy be made publicly available to the citizens, journalists and NGOs among all others, so that an additional layer of social scrutiny may be placed over corporations.
- v. Reconsidering and reinforcing the rules regarding the due diligence that corporate registries and financial institutions should perform, always on an accurate risk-based approach, in an attempt to verify that all information pertaining to the beneficial ownership is correct and that no margin for fraudulent or corrupt activity is allowed.
- vi. Introducing requirements for enhanced due diligence in cases where politically exposed people are identified, with the option of rendering void or otherwise limiting the transaction in question.
- vii. Forming a Financial Intelligence Unit (FIU) whose role shall be to monitor, assess and analyse suspicious transaction reports and contracts. This entity could operate within the context of the Single Supervisory Mechanism that would be incorporated within the range of responsibilities of the Central Bank.

(c) Calculation of estate tax

Johnson Kabwe

Computation of tax payable on the estate

	K
Agricultural land and properties	8,200,000
Commercial Property \$2,000,000 X K11	22,000,000
Various chattels	70,000
Residential property \$500,000 X K11	5,500,000
Shopping mall \$6,000,000 X K11	<u>66,000,000</u>
Chargeable estate	<u>101,770,000</u>
Estate tax 101,770,000 X 35%	<u>35,619,500</u>

N.B. Johnson Kabwe is domiciled in Zambia by birth and therefore according to the Double Taxation Agreements, all the assets are taxed in Zambia.

(d) Joint investigation teams

These enable agencies with a common interest to work together in an investigation in addition, to sharing information which enables an investigation team to draw on a wider range of skills and experience from investigators of different backgrounds and training. And Joint investigations may avoid duplication arising from parallel investigations, and increase efficiency by enabling officials from each agency to focus on different aspects of an investigation, depending upon their experience and legal powers.

SOLUTION THREE

(a) Importance of Foreign Direct Investment (FDI)

FDI is defined as an investment in a business by an investor from another country where the foreign investor has control over the company purchased. According to the Organisation of Economic Cooperation and Development (OECD), control is achieved by owning 10% or more of the business. Businesses that make FDI are often called Multinational Corporations (MNCs) or Multinational Enterprises (MNEs).

Therefore, the importance of FDI includes the following:

Improved economic growth:

An increase in FDI may be associated with improved economic growth due to the influx of capital and increased tax revenues for the host country. Host countries often try to channel FDI into new infrastructure and other projects to boost development.

Greater competition:

Greater competition from new companies can lead to productivity gains and greater efficiency in the host country and it has been suggested that the application of foreign entity's policies to a domestic subsidiary may improve corporate governance standards.

Transfer of soft skills:

Furthermore, foreign investment can result in the transfer of soft skills through training and job creation, the availability of more advanced technology for the domestic market and access to research and development resources.

Employment opportunities:

The local population may be able to benefit from the employment opportunities created by new businesses.

(b) Incentives for Foreign Direct Investment (FDI)

FDI incentives include the following:

- (i) Low corporation tax and individual income tax rates
- (ii) Tax holidays
- (iii) Other types of tax concessions
- (iv) Preferential tariffs
- (v) Special economic zones
- (vi) Export Processing Zones (EPZ)
- (vii) Free land or land subsidies
- (viii) Relocation and expatriation

- (ix) Infrastructure subsidies
- (x) Research and Development support

(c) Role of Double Taxation Treaties

Double Taxation Treaties are agreements between two states which are designed to:

- (i) Protect against the risk of double taxation where the same income is taxed in two states.
- (ii) Provide certainty of treatment for cross-border trade and investment.
- (iii) Prevent excessive foreign taxation and other forms of discrimination against business interests abroad.
- (iv) Protect the government's taxing rights and protect against attempts to avoid or evade tax.
- (v) They also contain provisions for the exchange of information between national taxation authorities.
- (vi) Seek to encourage and maintain an international consensus on cross-border economic activity and to promote international trade and investment.

(d) Computation of income tax payable

Pinkie Nkhwazi

Personal income tax computation for the charge 2019

		K
Salary 65,000 X 10 months	650,000	
Foreign dividends	<u>30,000</u>	
Taxable income		<u>680,000</u>
Income tax		
First K39,600 X 0%		
Next K9,600 X 25%		2,400
Next K25,200 X 30%	7,560	
Balance K605,600 X 37.5%	<u>227,100</u>	
		237,060

Less: Double Taxation Relief (DTR) (W1) (4,500)

232,560

Less: PAYE (188,175)

Final income tax payable 44,385

Working

1. Double Taxation Relief (DTR)

Lower of:

(i) Foreign tax paid on dividend = $K30,000 \times 15\% = \underline{K4,500}$

(ii) Zambian tax charge on foreign income =

Gross foreign dividend x Zambian tax charge

Total assessable income

680,000 = $\underline{30,000} \times \underline{237,060} = \underline{K10,459}$

Therefore the DTR is K4,500, which is the lower amount.

N.B. Rental income from foreign sources is exempt from Zambian tax and therefore the rentals received by Pinkie Nkhwazi will not be subjected to Zambian income tax.

SOLUTION FOUR

(a) OECD Transfer Pricing Guidelines

In order to achieve the application of the international arm's length principle in practice, the tax administration starts with the accounts of the local branch or subsidiary, makes the usual adjustments to reflect differences between financial accounting and tax rules, and then makes such further adjustments in accordance with the arm's-length principle as necessary.

The increasing integration of the activities of corporate groups, the growing importance of unique intra-group intangibles and services, and the sophistication of their financing operations mean, however, that application of the arm's-length standard is becoming more difficult, both conceptually and practically. The problems have been addressed in part by the OECD, which has expanded its guidance on this issue. The OECD standards represent the internationally accepted norms giving content to the arm's-length principle.

The problem that transfer pricing currently represents for developing and transition countries is one of administrative capacity. The development of advance pricing arrangements with the encouragement of the OECD may simplify the administrative task of transition and developing countries in the future by supplying readily applicable formulae for various economic sectors.

Transfer pricing adjustments on the arm's-length principle have traditionally been viewed as involving price only and not the reconstruction of transactions in the sense of disregarding the nominal transaction between the related parties and substituting another arrangement for tax purposes. The transfer pricing guideline, while recognising that adjusting prices of actual transactions is the norm; do permit tax administrations to recharacterise transactions in two exceptional circumstances:

- (i) Where the economic substance of a transaction differs from the norm
- (ii) Where the "arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises behaving in a commercially rational manner and the actual structure practically impedes the tax administration from determining an appropriate transfer price".

Countries are enacting general provisions in their tax laws directed against tax avoidance, which give powers to reconstruct transactions. It seems to be increasingly accepted by the OECD that such rules are not in conflict with tax treaty obligations and can be applied to international transactions.

(b) **Transfer pricing**

The invoicing of copper ornaments components by Ndalul Ltd at the normal trade selling price less 5% discount will have the effect of reducing Ndalul Ltd's taxable business profits, and hence Zambian income tax. The sales are at an undervaluation to a non-resident subsidiary, and so Ndalul Ltd should substitute a market price for the transfer price when calculating its profits chargeable to Zambian income tax. The market price will be an "arm's-length" one that would be charged if the parties to the transaction were independent of each other.

(c) **Kapalu Ltd's liability to Zambian income tax**

According to the Income Tax Act, a company is liable to Zambian income tax if it is resident in Zambia. Kapalu Ltd is not resident in Zambia since it was incorporated in a foreign country and the directors' board meetings are not held in Zambia. Kapalu Ltd will therefore not be liable to Zambian income tax.

The position would have been different if a branch or agency in Qhomawa was involved. Kapalu Ltd is effectively trading with Zambia and as such will not be liable to Zambian income tax on profits made during 2019. Ndalul Ltd is resident in Zambia and will be taxed on its worldwide income. This means dividends paid by Kapalu Ltd will be liable to Zambian tax subject to any double taxation relief which may be available.

d) **Ndalul Ltd: Calculation of company income tax for tax year 2019**

K	
Business profits (W1)	637,000
Royalties <u>17,000</u>	
Taxable income	<u>654,000</u>
Income tax	
K654,000 X 35%	228,900
Less tax already paid:	
Provisional tax	(105,000)
WHT on royalties 17,000 X 15%	<u>(2,550)</u>
Company income tax payable	121,350
	=====

Workings

1. Business profits

	\$	K
Tax adjusted profits (given)		457,000
Adjustment for intra-group sales		
Open market value		300,000
Less: Actual sales	<u>(285,000)</u>	
Additional taxable profit	<u>15 000</u> x \$12	<u>180,000</u>
		<u>637,000</u>
Taxable business profits		<u>472,000</u>

N.B. The WHT of 10% on rent is a final tax and therefore rentals are not subject to further assessment. This is why rent has not been included in the computations above.



TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D6: TAX AUDIT AND INVESTIGATIONS

MONDAY, 9 DECEMBER 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 (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 K 9,600	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%

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%
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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%
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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

Motor vehicles for the transport of ten or more persons, including the driver	Aged 2 to 5 years		Aged over 5 years	
	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

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

Customs and excise duty on new vehicles

- 1 Motor cars and other motor vehicles (including station wagons) principally designed for the transport of less than ten persons, including the driver:
Customs duty: 30%

Excise duty:	
Cylinder capacity of 1500 cc and less	20%
Cylinder capacity of more than 1500 cc	30%
2	Pick-ups and trucks/lorries with gross weight not exceeding 20 tonnes:
	Customs duty 15%
	Excise duty 10%
3	Buses/coaches for the transport of more than ten persons
	Customs duty: 15%
	Excise duty:
	Seating capacity of 16 persons and less 25%
	Seating capacity of 16 persons and more 0%
4	Trucks/lorries with gross weight exceeding 20 tonnes
	Customs duty: 15%
	Excise duty: 0%

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

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

Attempt all FOUR (4) Questions.

QUESTION ONE

There has been a lot of tax avoidance by some dishonest traders and as such, the Zambia Revenue Authority has been conducting investigations in an effort to stopping the scourge.

Required:

- Explain Five (5) circumstances under which a Tax Investigation will be initiated. (5 marks)
- State any four (4) criminal activities that would bring about tax investigation by ZRA. (4 marks)
- Briefly explain the term Transfer pricing and the arm's length concept. (6 marks)
- Discuss why due consideration should be given before a transfer pricing investigation is instituted and state three (3) factors ZRA should consider prior to the investigation. (6 marks)
- Give four (4) reasons why tax audit activities are important in achieving the Zambia Revenue Authority's Mission. (4 marks)

[Total: 25 marks]

QUESTION TWO

- The managing Director for DTR Mining Plc has expressed worries about the introduction of Goods and Services Tax (GST) which has replaced Value added Tax (VAT) in Zambia. He

has however cautioned the Government of Zambia that the move will affect the mining sector as Mines will be incurring losses which will lead to many employees losing their jobs.

Required:

- (i) Briefly justify losses indexation under Mines and Development Act No 7 of 2007 of the law of Zambia. (4 marks)
- (ii) Discuss how the real values of the losses incurred from the mining operations are treated. (4 marks)

(b) The government of the Republic of Zambia through the Zambia Revenue Authority has been trying to broaden the tax base in order to increase revenue for the Central government, and has accordingly put in place measures to ensure that tax is charged on airtime, network switch and so on.

Required:

Explain the tax treatment of the following:

- (i) Roaming charges (6 marks)
- (ii) Discounts to Air time dealers (3 marks)
- (iii) Network switch expenditure (3 marks)

(c) Give five factors that determine prices of Bonds (5 marks)

[Total: 25 Marks]

QUESTION THREE

Mrs. Lengwe, retired from her full time job as an accountant, and was considering forming a business of her own. However, she was not sure of whether she would form a sole trader ship, a partnership or a limited company. She has also head of a company limited by guarantee but did not know whether it was very different from one known as a limited liability company she later settled for a limited liability company which was manufacturing bunker beds for students in tertiary institutions. Two years into operations, the business began to face a lot of competition from established companies in the same industry. The competitors were able to source raw materials for their products cheaply and had a huge market share for their products. Apart from competition, her company did not have sufficient working capital and frequently delayed in meeting her short term obligations such as payments to suppliers and NAPSA contribution for a few employees.

Required:

- (a) Explain to Mrs. Lengwe the differences between a limited liability company and a company limited by guarantee. (7 marks)
- (b) Explain to Mrs. Lengwe four (4) methods that she can use to extract profits from her business. (8 marks)
- (c) Explain any Five (5) methods that she could use to finance her capital requirements. (10 marks)

[Total: 25 Marks]

QUESTION FOUR

As the cost of running businesses in Zambia increases, a good number of tax payers are looking for ways of either evading or avoiding payment of taxes to the Zambia Revenue Authority (ZRA). They have resorted to schemes that have resulted in hiding incomes so that they can understate the taxes due. This is being done both by those in informal and the formal sectors.

Required:

- (a) List seven (7) sources of information that a tax auditor can use to discover hidden income of a tax payer. (7 marks)
- (b) Briefly explain any four (4) assets that could to be transferred when a business is transformed in a limited company. (4 marks)
- (c) Explain the difference between Desk tax audit and Field tax audit. (4 marks)
- (d) Tax audits can vary in their scope and intensity to which they are conducted. The scope and nature of any tax audit depends on the available evidence pointing to the likely risks of non-compliance and tax payer's prior history.

Required:

Explain any five (5) types of tax audits.

(10 marks)

[Total: 25 Marks]

END OF PAPER

D6 SOLUTIONS

SOLUTION ONE

- (a) A tax investigation may be instituted under the following circumstances:
- i. Where Tax fraud or tax evasion is reported or suspected in connection with a tax payer
 - ii. Where a business perpetually reports tax losses
 - iii. Tax payer's return is wrong or omission of income
 - iv. A tip off received by the tax agency about a particular taxpayer concerning figures in the tax return that may not tally with other information they have
 - v. Filing in returns late may also bring about tax investigation
 - vi. Tax dispute may also bring about tax investigation. This means that either the taxpayer or the tax agency does not agree with the amount of taxes paid or due.
 - vii. Where the taxpayer does not allow access to their records
- (b) Four (4) criminal activities that would bring about tax investigation by ZRA
- i. Deliberately underreporting or omitting income,
 - ii. Overstating the amount of allowable expenditure
 - iii. Keeping two sets of books
 - iv. Making false entries in books and records
 - v. Claiming false deductions
 - vi. Hiding or transferring assets or income

(c) **Transfer pricing**

In taxation and accounting, transfer pricing refers to the rules and methods for pricing transactions within and between enterprises under common ownership or control. Because of the potential for cross-border controlled transactions to distort taxable income, tax authorities in many countries can adjust intragroup transfer prices that differ from what would have been charged by unrelated enterprises dealing at arm's length.

Arm's length principle

The "arm's-length principle" of transfer pricing states that the amount charged by one related party to another for a given product must be the same as if the parties were not related.

An arm's-length price for a transaction is therefore what the price of that transaction would be on the open market. In general, determining the true taxable income of a controlled taxpayer, the standard to be applied in every case is that of a taxpayer dealing at arm's length with an uncontrolled taxpayer.

A controlled transaction meets the arm's length standard if the results of the transaction are consistent with the results that would have been realized if uncontrolled taxpayers had engaged in the same transaction under the same circumstances (arm's length result).

- (d) A transfer pricing enquiry is usually complex and involving .Therefore, it can become a costly exercise both for a revenue authority and a taxpayer. It should therefore not be taken lightly and without giving due consideration to the possible complexities.

The Zambia Revenue Authority should consider the following factors prior to its investigation:

- i. Time: The transaction or case in question should be analysed assessed if at all the tax agency has enough time to allocate it to and the value of the case.
- ii. Materiality: The Zambia revenue Authority before embarking on the investigation, they have to look at the significance and impact the transaction will have in terms of revenue collection
- iii. Cost-Benefit analysis factor: The tax agency should assess whether the benefit of doing the investigation will be more than the cost to be incurred, if that is the case then the Authority would consider the investigation worth doing.
- iv. Competent Officer: The Zambia Revenue Authority should ensure have well trained staff and more proficiency in transfer pricing area due to its complexity.

- (e) Reasons why tax audit activities are important in achieving the Zambia Revenue Authority's Mission:

- i. Educating tax payers-Tax audits does not only focus on examining taxpayers' records but also making them knowledgeable about tax matters, and help them understand their rights and obligation so they make decision that will not compromise the tax laws, thus may lead to improved compliance and maximise Revenue collection by ZRA.
- ii. Compliance-By reminding the tax payer of the risks of non-compliance and instilling confidence in the tax payer, consequently, this leads to revenue optimisation.
- iii. Detection of non-compliance-Omissions and understatements can be detected through a tax audit activities and penalties charged that boost tax revenue collection.
- iv. Data: During tax audit process details are gathered and certain pattern of risk that emerges are documented that ZRA can prevent from happening in future.
- v. Gather intelligent information-the information on tax evasion and avoidance can be used to come up with counter measures such as strict inspections and anti-tax squads can be set up.
- vi. Identify areas of the law: that requires clarification-audits may bring to light areas of the tax law that are causing confusion and problems to large numbers

SOLUTION TWO

(a) Mining companies

(i) Justification of losses indexation in the mines

The Income Tax Act provides for indexation of losses because mining companies are allowed to keep books of accounts in the United States Dollars where at least 75% of their gross sales is in form of foreign earnings earned from outside Zambia.

Hence, in order to avoid exchange losses since their tax return is submitted in kwacha, indexation for capital allowances and losses is provided for.

(ii) How real values of the losses incurred in the mines are treated

Real values of the losses once incurred in the mines they are carried forward and relieved against the future profits arising from the same business.

In the case of mines, losses are carried forward for a maximum period of 10 years unlike the five years period allowed for other businesses.

(b) Telecommunication sector.

(i) To start with, when looking at the tax treatment of Roaming charges, it is important to establish where the income which arises from this service facility is recorded or accrued.

When the roaming charges are receivable by a company resident here in Zambia, then that income will be subjected to the Zambian laws regarding VAT and income tax. Otherwise they will not be chargeable.

This is so because making a call to someone on a roaming facility entails charging both the person making the call as well as the one retrieving the cost.

(ii) A discount is deduction from the sales made to a customer by airtime manufacturer according to some form of agreement. Therefore it will be deducted from the sale and it will not form part and parcel of the sale.

(iii) Network switch expenditure will be treated as part of a cost of making an outward bound telephone call when ascertaining the cost of accessing telephone services. The caller will be billed as such.

(c) Factors that determine prices of Bonds:

Bond price is the present discounted value of future cash stream generated by a bond. It refers to the sum of the present values of all likely coupon payments plus the present value of the par value at maturity.

A bond price is determined by the following five factors:

- i. Par Value
- ii. Coupon rate
- iii. Prevailing interest rates
- iv. Accrued interest
- v. Credit rating of the issuer

SOLUTION THREE

- (a) A company is a legal person that is created at law. It can be formed by registration or by royal charter. In Zambia most companies are formed by registration through PACRA and can either be limited by guarantee or by Limited Liability Company.

Company limited by guarantee

A company limited by guarantee is usually formed for non-commercial purposes. It can also be referred to as a non-profit making organization. Common examples are clubs and societies.

Members who have formed these companies do make a firm promise or guarantee to pay a certain amount of money should the company go into liquidation or insolvency.

The members themselves do not have an economic right in relation to the company. The company can be with or without a share capital and can be publicly traded or privately controlled

A limited company

This is a company that is formed by members who have shares in the company. The shareholders are expected to have some economic right in the company in form of dividends.

However the liabilities of the company cannot be extended to the private assets of the shareholders in case the company is in liquidation.

- (b) Mrs. Lengwe can extract profit from the business by the following methods:

- i. Salary or dividends
Salaries are fixed amounts that are earned and paid to employees. The employee gets a fixed sum per annum which is paid on monthly basis. On the other hand a dividend is paid to a shareholder for the shares that have been bought. In this case Mrs. Lengwe can be paid dividends since she is a shareholder.
- ii. Interest or rent
The amount of dividend paid can be converted into a loan which can later accrue interest on it. Rentals can also be a source of income if part of the business premises can be sub-let. Alternatively, Mrs. Lengwe can also put her private assets on rent and earn a portion of income that can be added to increase her shareholding.
- iii. Pension contribution
In case of Mrs. Lengwe, the business is likely to be a family type, she can therefore authorise the company to pay a certain amount into the pension scheme which can then be used during her old age.
- iv. Diverting income

Mrs. Lengwe can divert her income to an immediate familiar member. The diversion can be allowed if only it is proportional to the work being undertaken by Mrs. Lengwe.

(c) The following are the common sources of finance that can be used to finance the business:

i. Ordinary shares or Equity

These are shares that are issued to the owners of the company and have a nominal value of K1.00 each. The shares do not guarantee a constant flow of dividend to shareholders. The ordinary shareholders may not get any dividends in arrears whenever the company makes a loss in a particular year.

ii. Preference shares

These can be a source of finance which are issued at the stock exchange. They rank higher than ordinary shares and carry a fixed rate of dividend and are paid first before ordinary members. They have the advantage of not being diluted as they do not carry voting rights and if they are cumulative type, can be paid in arrears if they did not get dividends in the previous year.

iii. Loan stock

This is a type of debt or loan owed to the company and the interest is paid at a stated coupon yield on this amount. The loan stock has a nominal value in which the debt owed by the company, and interest is paid by stated 'coupon yield' on the amount. Debentures are form of loan stock which are legally defined as written acknowledgement of a debt incurred by a company. It contains provisions about details of payments and eventual repayment of the loan capital.

iv. Retained earnings

These are amounts of profits that remain after operational costs, interest, and taxation have been paid. It is the money which is reinvested into profitable projects. Retained earnings have an advantage not attracting cost of issues and do not carry any charge.

v. Sales of tangible assets

When a company has excess assets that are not being used, it can sell these assets in order to generate capital for investing in profitable business portfolio.

SOLUTION FOUR

(a) In order to discover any income that could have been hidden, the auditor needs to collect certain information as given below:

- i. Tax return (Income Tax, VAT and Property Transfer Tax)
- ii. Savings accounts and money market funds
- iii. Checking accounts statements and cancelled cheques
- iv. Life style analyses
- v. Bank statements to analyses deposits of cash and cheques, ATM, withdrawals and which cheques are written to
- vi. Cash flow procedures in a business
- vii. Credit card receipts for purchases
- viii. Offshore accounts
- ix. Loan applications and personal net worth statements at banks.

(b) The following assets are expected to be transferred from the business to the Limited Company:

- i. Assets net of liabilities need to be transferred to limited company when the business transfer takes place.
- ii. A lease of premises which is in the name of the sole traders or partners which will need to be assigned to the limited company.
- iii. Any regulatory approvals which the business requires will need to be obtained again in the name of the Limited company.
- iv. Employees will transfer under the labour law provisions, but will need to have letters confirming the positions under labour and employment Acts.
- v. Any fiancée contracts which are in the name of the sole trader or partners will need to be transfer to the limited company.

(c) A desk audit involves reviewing the accounting records and other records as well as any tax returns already submitted by the taxpayer to the Zambia revenue authority. This audit is performed from the office of the tax auditor.

A field audit on the other hand involves a visit by the tax auditor at the premises of the taxpayer in order to obtain further knowledge relating to the business being conducted by the tax payer.

(d) The following are the types of tax audits:

- i. Full tax audits
This is a comprehensive examination of all information relevant to the calculation of a taxpayer's tax liability for a given period, in order to determine the correct tax liability for the whole tax return.
- ii. Limited scope (issue based) audits

- This is a tax audit performed on specific issue on a tax return or particular tax scheme arrangement employed by the tax payer, mainly to examine the key potential risk areas of non-compliance
- iii. Single issue audits
This is a tax audit confined to one item of potential non-compliance that may be apparent from examination of a taxpayer's return.
 - iv. Deregistration audits
This is a tax audit conducted when a business is pending deregistration from a VAT registered trader.
 - v. Education audits
This a tax audit conducted normally when there is a major change in the tax legislation that is complex
 - vi. Credibility audits
This is a tax audit conducted normally to check the correctness of a tax refund or claim filed by the tax payer.

END OF SOLUTIONS