STRICTLY CONFIDENTIAL

THE PUBLIC ACCOUNTANTS EXAMINATION COUNCIL OF MALAWI

2009 EXAMINATIONS

ACCOUNTING TECHNICIAN PROGRAMME

PAPER TC 10(B): TAXATION

(DECEMBER 2009)

TIME ALLOWED: 3 HOURS

SUGGESTED SOLUTIONS

SECTION A

BOTH QUESTIONS TO BE ANSWERED IN THIS SECTION

1. (a) MR TIMVERE'S TAXABLE INCOME TAX YEAR TO 30 JUNE 2008

	K'000	K'000
Profit before tax		2,550
Add back:		
Depreciation	510	
Donations to orphan care centre	20	
Church donations	60	
Fuels and lubricants 20% private	90	
Road permit and licences	8	
Vehicle maintenance	124	
Rent payable	300	
Penalties and fines	85	
Fringe benefits tax	155	
Legal expenses	35	
Withholding tax on bank interest	62.5	
		1449.50
Less:		3999.5
First 10000 bank interest	10	
Capital allowances	552.5	
Taxable income		562.5
		3437.00

(b) Net tax payable

	K	Tax	
Taxable income given	3,464,000		
Less : taxable at 0%	108,000	-	
	3,356,000		
Less : taxable at 15%	36,000	5,400	
	3,320,000		
Less : taxable at 30%	3,320,000	996,000	
		1,001,400	
Less Tax credits			
Withholding tax on interest	62,500		
Withholding tax on rent	15,000		
Provisional tax	290,000		
		367,500	
Net tax payable			633,900

2. (a) Calculation of accounting profits and accounting losses

	Proceeds	Net Book Value	Accounting Profit/(Loss)
	K'000	K'000	K'000
Plant and machinery	5,000	3,800	1,200
Motor vehicle	980	1,200	(220
Furniture & fittings	160	0	160

(b) Calculation of capital gains or capital losses

	Proceeds	TWDV	Capital Gain/(Loss)
	K'000	K'000	K'000
Plant and machinery	5,000	4,500	500
Motor vehicle	980	800	180
Furniture & fittings	160	185	(25)

(c) An accounting loss is an add back item in the tax computation it increases the taxable income or reduced computed loss

On the other hand, an allowable capital loss is a deductible item in the tax computation. It reduced the taxable income or increases computed losses

(d) Capital allowances computation

	Factory Buildings	Plant & Machinery	Motor Vehicles	Furniture & Fittings	Computer
	K'000	K'000	K'000	K'000	K'000
TWDV 31/6/07	74,000	34,000	22,600	6,700	-
Additions	-	9,200	3,700	-	460
	74,000	43,200	26,300	6,700	460
Disposals	-	(4,500)	(800)	(185)	-
	74,000	38,700	25,500	6,515	460
Less Investment All	-	(9,200)	-	-	-
Initial All	-	-	(740)	-	(92)
Annual All	(3,700)	(2,950)	(5,100)	(651.5)	(92)
	70,300	26,550	19,660	5863.5	276

(e) A capital loss is not tax deductible where it is not realized: or if realized, where it is in respect of an asset not used in trade or business

and:

there is no realized capital gain

SECTION B

TWO QUESTIONS ONLY TO BE ANSWERED FROM THIS SECTION

3. (a) (i) Mining expenditure is capital expenditure incurred in Malawi by a person carrying out or about to carry out mining operations in Malawi. The capital expenditure mentioned herein includes:

- Searching for or in discovering and testing or winning access to deposits of minerals.
- The acquisition of rights over such deposits other than from a person who has carried on mining operations in relation to such deposits.
- The provision of machinery and industrial buildings which would have little or no value if the mine ceased to be worked.
- The construction of buildings or works which would have little or no value if the mine ceased to be worked.
- The development, general administration and management prior to the commencement of mining operations.

(ii) Mining expenditure for the period to 30 June 2008

	K'000
Acquisition of mining site	4,000
Construction of site buildings	15,000
Acquisition of machinery	25,000
Testing of samples	5,000
General administration and management	16,000
	65,000

The whole MK61,000,000 will be deducted in the first year of assessment.

Second schedule of Taxation Act – Paragraph 12

(iii) Mining expenditure for the period to 30 June 2009

	K'000
Acquisition of rights	2,000
Additional site buildings	2,500
Motor vehicles	30,000
General administration	17,000
	51,500

The allowance shall be apportioned in such manner as the Commissioner General may determine to be just and reasonable between All Metals Ltd and New Metals Ltd.

e.g. : Share for All Metals $\frac{5}{12} \times 51500 = 21458$
Share for New Metals $\frac{7}{12} \times 51500 = 30042$

(b) Section 28

For purposes of determining the taxable income of any taxpayer, there shall be deducted from the assessable income of such a taxpayer.

- the amounts of any expenditure and losses (not being expenditure of a capital nature)
- wholly and exclusively and necessarily incurred by the taxpayer
- for the purposes of his trade or in the production of the income.

(c) To be allowed

(i) Premium or consideration in the nature of premium.

An allowance shall be made in respect of any premium or consideration in the nature of premium paid by the taxpayer for the right of use of plant or machinery or for the use, of any patent design trade mark, copyright or any other property which in the opinion of the Commissioner is used in the production of income.

The allowance shall not exceed for any year of assessment such portion of the amount so paid as is equal to the amount of the remium or consideration divided by the number of years for which the right is granted provided that:

(1) where the period for which the right of occupation or use is granted exceed 25 years, the deduction shall be one twenty fifth of such premium or consideration; and

(2) where the taxpayer acquires the ownership of land or buildings, plant or machinery, patent, design, trademark, or copyright or other property in respect of which an allowance has been made in terms of this paragraph, then from the date he acquires such ownership he shall cease to be entitled to any allowance.

(ii) Bad debts

- debts proved to be bad to the satisfaction of the Commissioner and

- which have become bad during the year of assessment if
- the amount of the debt is included in the current year of assessment or
- was included in any previous year in the taxpayer's assessable income

(iii) New business expenditure (of income derived from a manufacturing business

Allowed if

- It is incurred by the taxpayer, not more than 18 months before beginning the business, in the course of establishing the business.

- Would have been allowed as a deduction had it been incurred after the beginning of the business.

4. (a) (i) Direct taxes are assessed on income or property with the expectation that the persons from whom the tax is collected lose purchasing power (cannot be passed on).

Indirect taxes are collected from producers or sellers in the expectation that they will pass it on to consumers.

(ii) Example of direct taxes are income tax and property tax (city rates)

Examples of indirect taxes are
⇒ Value added tax
⇒ Customs duty
⇒ Excise tax

(b) (i) Rent payable MK480,000

Amount of withholding tax 10% x 480,000 = K48,000

No, it was not correctly operated as the tenant was supposed to deduct MK48,000 but only withheld K36,000.

Penalties

There are penalties applicable to the tenant and not the landlord these are:

- Failure to deduct tax makes one personally liable to pay the tax which was not withheld;
  plus 20% additional tax if paid late .

- Failure to operate a withholding tax scheme makes one guilty of an offence punishable by a fine of K1,000.

(ii) Penalties for underdeduction of PAYE are

- 20% of the tax payable
- and further additional 5% per month or part thereof.

(iii) Income tax computation

	K'000
Rent	480,000
Salary	1,400,000
	1,880,000
Less Rates	7,200
Subscription	35,000
	1,837,800

Tax Payable

1st	108,000 @ 0%	=	0
Next	36,000 @ 15%	=	5,400
Balance	1,693,800 @ 30%	=	508,140
			513,540

Tax payable		513,540
Less : withholding tax	36,000	
: PAYE tax	310,000	346,000
Net tax payable		167,540
Tax on estimated assessme		456,240
Tax over-estimated		288,700

5. (a) (i) According to Section 94A of the Taxation Act every employer
other than government
who provides fringe benefits
to any of his employees shall be liable to pay fringe benefits tax
On the total taxable value of such fringe benefit
At the rate specified from time to time.

These are only benefits provided to employees whose annual taxable income exceeds K60,000.

(ii) The fringe benefits tax can be reduced by:

- Not providing fringe benefits
- Letting employees contribute towards the benefit provided.
- Paying School fees direct to institution.
- Allocating housing accommodation belonging to the Employer

(b) The employer is advised as follows:

The return has not been correctly completed.

The return was only for March, returns should be for a quarter.

Housing benefit should be the higher of 10% of salary 650000 x 10% = K65,000 and K60,000. However, since employer owns the house only 50% is taxable.

Car benefit should be 15% of cost i.e. 15% x 4,500,000 x $\frac{1}{12}$ = 56250

School fees was paid directly to the school, thus only 50% is taxable i.e. K62,500.

(c) (i) It is called double taxation.

(ii) This arises because of:

- differences in bases of taxation in different countries
- some countries use source while others use residence when taxing revenue.

This can be mitigated or prevented by:

- Entering into double tax agreements with other countries.
- Provisions in the Taxation Act, that allow deducting foreign tax.

(iii) Formula in the taxation Act

$ar_1 – ar_2$

Where *a* is the amount of foreign currency

r_1 is the rate of exchange at the date of establishing liability

r_2 is rate of exchange at the time of settling liability.

loss/gain on payment made in January 2009

18 x R7million – 22 x R7 million

126 million – 154 million

Loss K28 million

Loss/gain on payment made in June 2009

18 x 9	–	27 x 9
162 million	–	243 million
Loss		K81 million

(b) The loss is not deductible because it is unrealized.

6. (a) The conditions are as follows:

(i) Sums actually expended by the taxpayer during the year of assessment for repairs not being expenditure of a capital nature.

(ii) to any premises or part premises occupied for the purpose of his trade; or

(iii) resulting from the letting of property; or

(iv) of articles, implements, plant, machinery and utensils employed by him for the purpose of his trade.

(b) Treatment of items

(1) Carport enclosure not allowable, it is capital expenditure.

(2) Subdivision of bedroom an improvement so not allowable.

(3) Ceiling on the living room was a repair and therefore allowable.

(4) Repainting was a repair therefore allowable.

(5) Bathtub and toilet were an improvement and therefore capital, not allowed.

(6) A fence was an improvement and thus capital not allowable.

(c) Contract 36 Months

(i) Monthly salary 255,000 inclusive of House Allowance
Basic salary = ? less

$$= \frac{255{,}000x100}{125} = 204{,}000$$

Total basic for 36 months = 36 x 204 000 = 7,344,000
Gratuity = 25% x 7,344,000
= MK1,836,000

(ii) Tax payable on gratuity

Gratuity	=	K1,836,000
Less tax free	=	40,000
		K1,796,000
Tax at 30%	=	K538,800

(iii) Housing allowance portion (255,000 – 204,000) = MK51,000

Housing allowance for12 months 51000 x 12 = 612,000
Tax at 30% = K612,000 x 30%
= K183,600

(d) Where a taxpayer makes up his accounts for a period of 12 months ending on some other day other than 30 June:

- Commissioner may in his discretion accept such accounts for assessment in Respect of the assessment year ending on 30 June.

- Prior or subsequent to the closing date of such accounts and no part of such assessment shall be charged to tax in any other year of assessment.

- All subsequent accounts of the taxpayer shall, unless the Commissioner otherwise agrees, be made up for each succeeding period of 12 months ending on such other date.

7. (a) (i) A taxpayer may appeal to the Commissioner when he/she is aggrieved by:

(1) Any assessment made upon him by the Commissioner.

(2) Any determination by the Commissioner of a reduction in tax under the double tax relief arrangements (Sections 123 or 124 of the Taxation Act).

(3) Any decision of the Commissioner in relation to an assessment.

(ii) The Commissioner:

(1) May amend the assessment, decision or determination or disallow the appeal;

(2) Shall send to the applicant written notice of his decision on the appeal.

(3) Shall record any amendment of the assessment in the assessment register.

(b) (i) The penalty is reduced to an amount not exceeding the difference between the amount of the tax which should have been charged and that charged, if any.

This penalty is in addition to a standard penalty not exceeding K30,000.

(ii) The higher rate penalty is rarely charged because it is difficult to prove "intent to defraud".

(iii) - Making a false statement or giving false information when complying with any notice served on him under the Taxation Act;

- Making a false claim for repayment of any tax for any year of assessment;

- Preparing or maintaining false books or accounts or other records.

(c) Section 89(2) : If it appears to the Commissioner

(i) that any taxpayer is unable for any cause to furnish an accurate return of income, the Commissioner may accept the taxpayers' estimate of the amount of his taxable income.

(ii) the Commissioner may estimate the taxpayer's income in the following cases:

(1) a taxpayer makes default in furnishing any return or information; or

(2) the Commissioner is not satisfied with the return or information furnished by the taxpayer.

(3) the Commissioner has reason to believe that a taxpayer is about to leave Malawi without furnishing a return or a satisfactory return.

(d) The gross income comprises:

- premiums received in Malawi

- amounts other than premiums received in Malawi, in respect of short term insurance business and

- the amount allowed as a deduction in the previous year of assessment for unexpired risks at the percentage adopted by the insurer for such risks in relation to short term insurance business as a whole.

Allowable deductions include:

- premiums paid on re-insurance

- actual losses in Malawi less losses recoverable on re-insurance.
- Management expenses, other than those of capital nature.
- net commission after deduction of commission received on re-insurance.
- other expenditure (not capital) incurred in the production of income.
- an allowance approved by the Commissioner in respect of expenses incurred outside Malawi in connection with premiums and other amounts received in respect of short term insurance business.
- an amount of a reserve for unexpired risks in relation to his insurance business which is set aside at the percentage adopted by the insurers at the end of the year of assessment.

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