STRICTLY CONFIDENTIAL

THE PUBLIC ACCOUNTANTS EXAMINATION COUNCIL OF MALAWI

2010 EXAMINATIONS

ACCOUNTING TECHNICIAN PROGRAMME

PAPER TC 10(B): TAXATION

(DECEMBER 2010)

TIME ALLOWED: 3 HOURS

SUGGESTED SOLUTIONS

SECTION A

BOTH QUESTIONS TO BE ANSWERED IN THIS SECTION

1. (a) Mr Kondwerani Taxable Income Tax Year to 30 June 2010

		K'000	K'000
Profit before tax			15,146
Add:	Underreported interest		90
	General expenses		250
Private motoring –	Fuels & lubricants		435
	– Road permit and licences		16.5
	– Vehicle maintenance		283.5
	Penalties and fines		
	– Late submission of return		45
	– Traffic offences		40
	Legal expenses		80
	Depreciation		560
	Fringe Benefits Tax		520
			17,466
Less:	Exempt bank interest	10	
	Capital allowances	1250	(1,260)
	Taxable income		16,206

Note to Markers : Not additional marks but workings for awarded marks.

Under Note 1

Determination of withholding tax on bank interest

Net interest: K360,000
Rate of withholding tax : 20%
Grossing up = $\frac{K360,000 \times 100}{80}$
Gross interest receivable = 450,000
Less: net interest received 360,000
Interest underreported 90,000

Under Note 3

Fuels & lubricants

Total cost: K1,450,000
30% thereon: $\frac{1,450,000 \times 30}{100}$
= 435,000

Note – Capital Allowances

30% of capital allowances in respect of motor vehicles is not deductible. This represents private use element.

(i) Note for Markers

Markers should award an extra 1 Mark to any candidate who makes reference to restricted capital allowances on account of motor vehicle private use.

Road Permit & Licences

Total cost: K55,000
30% thereon: $\frac{55,000 \times 30}{100}$

= K16,500

Vehicle Maintenance

Total cost: K945,000
30% thereon: $\frac{945,000 \times 30}{100}$

= K283,500

(ii) Since MRA clarified on interest that the whole interest is taxable if over K10,000 then full mark will be awarded if in both cases where the candidates takes out or does not.

(b)

	K	Tax K
Taxable income given	15,146,000	
Less taxable at 0%	120,000	-
	15,026,000	5,400
Less taxable @ 15%	36,000	
	14,990,000	4,497,000
Less taxable @ 30%	14,990,000	
	-	4,502,400
Total Tax		
Less: Withholding tax on interest	90,000	
Withholding tax on rentals	10,800	(2,900,800)
Provisional tax paid	2,800,000	1,601,600
Net Tax payable		

2. (b) The cost of the factory fence will be eligible for Capital Allowances because an industrial building is defined to include any protective fencing.

The three offices will not be eligible for capital allowances because they were not brought into use during the year under review.

(c) (i) Additional investment allowance, according to paragraph 4(2) of the second schedule to the Taxation Act is an allowance that is given to a taxpayer who is eligible for investment allowance and who invests in an area designated for the purpose of such additional allowance by the minister by order published in the gazette.

(ii) The allowance is 15% of the investment in addition to the normal allowance.

(d) The second schedule to the Taxation Act states that a taxpayer who incurs capital expenditure may get relief by way of capital allowances. There are three possible allowances.

Initial allowance given in respect of capital expenditure incurred in the year of assessment on the construction of new farm improvements, farm fencing, industrial buildings, railway lines, or additions or alterations to existing farm improvements, farm fencing industrial buildings etc used by the taxpayer for the purpose of his trade or for farming purpose.

Annual allowances claimed in respect of capital expenditure incurred in respect of farm improvements, farm fencing, industrial buildings, newly constructed commercial buildings, railway lines and articles, implements, machinery and utensils belonging to and used by the taxpayer for the purposes of his trade.

Investment allowances given to a taxpayer who is also a manufacturer on cost of new and used industrial buildings and plant and machinery.

SECTION B

ANSWER TWO QUESTIONS ONLY FROM THIS SECTION

3. (a) Taxable Income of Mr Daniel Damali

For the year to 30 June 2010

	K'000	K'000
Salary		7,200
Christmas bonus		260
Interest from National Bank		60
Rent from house in Zomba		550
Interest on loan to friend		10
Gratuity – see calculation below		4,625
		12,705
Less Expenses:		
City Rates	22	
Mortgage repayments	10	
Repairs & maintenance	55	
Tax free interest	10	
University appeal fund	15	
Tax free gratuity	40	(152)
Taxable income		12,553

Tax Computation

Taxable income above		K12,553,000		
Less	120,000	@ 0%	=	0
Next	36,000	@ 15%	=	5,400
Balance	12,397,000	@ 30%	=	3,719,100
Total				3,724,500

Working

Gratuity Calculation

Salary received to	30 June 2008	= 5,200,000
	30 June 2009	= 6,100,000
	30 June 2010	= 7,200,000
	Total	18,500,000
	25% thereon	= 4,625,000

Note to Markers

Candidates will earn full marks in either case where they leave out tax free interest or deduct.

(b) Calculation of Fringe Benefits Tax

Accommodation: greater of K45,000 x 12 = 540,000
and 12% x K7,200,000 = 864,000
Taxable value K864,000

Electricity and water = 8,500 + 6,000 = K14,500
Annual x 12 = K174,000

Cook, gardener and watchman = 9,000 + 8,000 + 5,000 = 22,000
x 12 = K264,000

School fees not taxable under fringe benefits tax as this was paid directly to employee and PAYE applies.

Car benefit = 7,500,000 x 15%
= K1,125,000 Taxable value

Tax Payable

Accommodation	=	864,000
Electricity & water	=	174,000
Cook, gardener & watchman	=	264,000
Motor vehicle	=	1,125,000
		2,427,000
Tax @ 30%	=	728,000

4. (a) (i) It means cash received upon the sale of an asset.

(ii) It means the open market price of the other asset on the date of the exchange.

(b) (i) For purpose 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.

(ii) An assessed loss of a business can be deducted from assessable income of the same business in a different year where deductions have been made in the year of assessment and the loss still remains, it can be carried forward to the next year of assessment so long as the person has not been adjudged bankrupt or has made conveyance or assignment of his property for the benefit of his creditors. (Section 42 of the Taxation Act).

(iii) For the purposes of determining the taxable income of any taxpayer, there shall be deducted from the assessable income of such taxpayer

the amount of any capital loss realized by the taxpayer in the year of assessment but to the extent only of either:

(1) the capital loss

(2) any capital gain realized by the taxpayer in that year of assessment whichever is lesser.

(Section 28 of the Taxation Act)

(c) Foreign exchange gains or losses arise

- When one has a foreign asset or liability in the course of business
- Which arises on a specific date but is settled on a different date.
- The exchange rate at the time of settling the transaction would not be the same as when the transaction was established.
- This would then bring in a loss or gain to a taxpayer.

(d) Foreign exchange gain or loss computation

Formula $a \times r_1 - a \times r_2$

Where a is the amount of the asset or liability on the day of establishing the transaction.

r_1 is rate at the date of establishing the asset or liability

r_2 is the rate on the date of settlement.

Therefore ($25,000×142) – ($25,000×155)

3,550,000 – 3,875,000

Loss = 325,000

(e) Realised foreign exchange gain K220,000 – fully taxable

Unrealised foreign exchange gain K95,000 – not taxable

Realised foreign exchange loss K125,000 – see comment below

Only K30,000 of the realized foreign exchange loss will be allowed 95,000 will be carried forward to the next year of assessment for a Maximum period of six years only.

5. (a) Under the Taxation Act, a taxpayer may make an appeal where such a taxpayer is aggrieved by:

- any assessment made upon him by the Commissioner General under the Taxation Act.
- any decision of the Commissioner General in relation to an assessment; or
- the determination of a reduction of tax under a double taxation agreement or under circumstances where there is no double Taxation Agreement.

(b) After carefully considering the issues raised in the appeal, the Commissioner General:

- May allow the appeal and amend the assessment, decision or determination or;

- may disallow the appeal;
- shall, in either case, send to the appellant written notice of his decision on the appeal
- shall record any amendment of the assessment in the assessment register.

(c) Any taxpayer who is aggrieved by the decision of the Commissioner General in relation to an appeal may appeal against such decision in the prescribed manner, to the Special Arbitrator.

The Special Arbitrator:

- Shall have powers of the high court;
- Shall have the power to summon and enforce the prompt attendance of witnesses to hear and take evidence;
- Where required, may appoint assessors who will act only in an advisory capacity;
- Shall ensure that proceeds are not conducted in public and shall exclude or withdraw any persons whose attendance is considered not necessary;
- May allow the appeal and amend the assessment decision or determination in respect of which the appeal is made;
- May disallow the appeal;
- Shall set out findings of fact and decisions on points of law in a written judgement.

Findings of fact in a judgement of the Special Arbitrator shall be final and conclusive.

(d) (i) Amount of taxable income in the original assessment:

Tax charged at 30% = K2,040,000

Taxable income = $\frac{2,040,000 \times 100}{30}$

= <u>6,800,000</u>

(ii) Amount of provisional tax paid

Penalty charged at 30% of underpaid provisional tax = 450,000

Underpaid provisional tax = $\frac{450,000 \times 100}{30}$

= <u>1,500,000</u>

Total taxed charged	2,040,000
Less underpaid provisional tax	1,500,000
Provisional tax paid	540,000

(iii) Calculation of penalty for underpaid tax in the amended assessment.

Tax charged in the original assessment		2,040,000
Less: Tax discharged		215,000
Tax charged in the amended assessment		1,825,000
Less provisional tax paid		540,000
Underpaid provisional tax		1,285,000
% of unpaid tax on total tax:		$\frac{1,285,000 \times 100}{1,825,000}$
	=	70.4%
∴ Rate to be used for penalty	=	30%
Amount of penalty	=	1,285,000 x30%
	=	385,500

6. (a) According to Section 41 of the Taxation Act, there shall be allowed the amount of any expenditure which:

- is incurred by the taxpayer, not more than eighteen months before beginning the business, in the course of establishing the business, and;
- is incurred by a manufacturing business;
- would have been allowed as a deduction had it been incurred after the beginning of the business;

(b) Deductions under section 58 of the Taxation Act:

(i) the stamping, leveling and clearing of lands;

(ii) works for the prevention of soil erosion;

(iii) boreholes;

(iv) wells;

(v) aerial and geophysical surveys;

(vi) any water control work in connection with the cultivation and growing of rice, sugar or such other crop as the Minister may approve.

(c) "Water control work" includes any canal, channel, dyke, furrow and any flood control structure whether of permanent nature or otherwise.

"Water conservation work" means any reservoir, water dam or embankment constructed for impounding water.

(d) No deduction shall in any case be made in respect of any of the following:

- the cost incurred by a taxpayer in the maintenance of himself, his family or establishment;

- domestic or private expenses of the taxpayer including the cost of travel, between the taxpayers residence and place of work;

- any loss or expense which is recoverable under any insurance contract or indemnity;
- tax upon the income of the taxpayer or interest payable thereon whether charged in terms of this Act or any law of any country whatsoever;
- income carried to any reserve fund or capitalized in any way;

- any expense incurred in respect of any amounts received or accrued which are not included in the term "income" as defined in this Act;

- any expense in respect of which a subsidy has been or will be received;

- fringe benefits tax and any penalty chargeable thereon.

(e) The expenditure on a building used as a warehouse is allowable subject to conditions below:

According to Section 34:

- An allowance shall be made in respect of any premium or consideration in the nature of premium paid by any taxpayer for the right of use or occupation of land or buildings, or 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 of similar nature, where such land, building, plant, machinery, patent, design, trade-mark, copyright; or property is used for the production of income is derived but such allowance shall not exceed for any year of assessment such portion of the amount so paid as is equal to the amount of the premium or consideration divided by the number of years for which the right of occupation or use is granted.

  Provided:

  (a) Where the period for which the right of occupation or use is granted exceeds 25 years the deduction shall be one twenty fifth of such premium or consideration.

  (b) 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, then from the date he acquires such ownership he shall cease to be entitled to any allowance under this paragraph in respect thereof.

(ii) 20 year lease = $\frac{K32,000,000}{20}$ = 1,600,000

32 year lease = $\frac{K32,000,000}{25}$ = 1,280,000

7. (a) (i) Complete copies of all notices of assessment made shall be filed in the office of the Commissioner and shall constitute the register of assessments for purposes of the Act.

(ii) Every taxpayer shall be entitled to copies certified by or on behalf of the Commissioner of his own notice of assessment.

(iii) The information of taxpayers is supposed to be confidential and that is why it is not open for public inspection.

(b) Calculation of cost of an imported car:

Total cost in $ = 9,800
Rate of exchange given = K157 to $1
Cost in Malawi Kwacha = 9800 x 157 = 1,538,600
Value for duty purposes (VDP) = K1,538,600

Customs Duty = 1,538,600 x 40%
= 615,440

Excise tax = (VDP + Duty) x 25%
= (1,538,600 + 615,440) x 25%
= 538510

VAT = (VDP+D+E) x 16.5%
= (1538600+615440+538510) x 16½%
= 444270.75

Total cost = (VDP+D+E+VAT)
= (1538600+615440+538510+444270.75)
= 3,136,820.75

(c) Liability to non-resident tax arises where:

(i) Income is payable to a person; not being a person resident in Malawi;

(ii) The income is from a source in Malawi;

(iii) The income is not attributable to a permanent establishment belonging to the recipient of the income.

The tax is calculated at the rate of 15% of the gross amount of income.

(d) Types of income which do not attract non-resident tax are:

- income and other amounts exempt from tax under the provisions of the First Schedule to the Taxation Act; and

- any pension or annuity payment.

(e) 'Person resident in Malawi' includes:

(i) Any individual present in Malawi for an aggregate of 183 days or more in any twelve months period commencing or ending in the year of assessment concerned;

(ii) A partnership established under any written law of Malawi;

(iii) A company which is incorporated in Malawi.

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