

STRICTLY CONFIDENTIAL



2015 EXAMINATIONS

PROFESSIONAL LEVEL

PAPER B4: TAX COMPLIANCE

TUESDAY 9 JUNE 2015

TIME ALLOWED: 3 HOURS

SUGGESTED SOLUTIONS

1. (a)		K
NBM salary	560,000 x 6 = K3,360,000	
First	K300,000	tax = 9,000
Excess	K3,060,000 x 30%	= 918,000
Total		927,000
Tax paid in advance (K161,250 x 6 =		967,500
Tax refundable		<u>40,500</u>

(b)	Notes	K'000
Profit		11,000
Less sale of non-current assets		(5,000)
Add back		
Book value of disposed asset		3,500
Purchase of equipment	1	5,000
Depreciation	1	700
Salary	2	3,000
Light and heat = $\frac{3}{8} \times 2500$		937.5
Water = $\frac{3}{8} \times 1800$		675
Donation	3	400
Other expenses	4	6,000
Total		26,212.5
Less : capital allowance	5	(3,800)
Taxable profit		22,412.5
Taxable amount	K22,412,500	
First	300,000	tax 9000
Excess	K22,112,500 @ 30% =	K6,633,750
Total tax payable		K6,642,750
Less: PAYE	6	(K819,000)
Total tax payable		<u>K5,823,750</u>

Notes

1. Purchase of non-current asset is not an expense as capital allowances will be claimed on them.
2. Husband's salary is a private expense.
3. Donation to FAM is a non allowable expense.
4. The following expenses are not allowable

Land acquisition	K4,500,000	capital in nature
Travel expenses for family on holiday	K1,200,000	private expense
Provision for bad debts	K300,000	general provision

5.	Capital allowances agreed	K5,300,000	
	Less capital gain (5,000 – 3,500)	K1,500,000	
	Thus total capital allowances	K3,800,000	
6.	Husband's PAYE salary	K3,000,000	
	First	K300,000	Tax 9,000
	Excess over	K2,700,000 @ 30%	K810,000
	Total tax		K819,000

- (c) The husband will be responsible for the payment of the business tax. This is because this is not wife's earned income as the husband is employed in the business.

2. (a) (i) Capital allowances are deductions that a taxpayer may claim on the wear and tear of fixed assets bought and used in the taxpayer's trade or business.
- (ii) Capital allowances are given in place of depreciation and other capital expenditure which are not deductible for income tax purposes.

(b)	Tax payable by Mchape	K'000
	Net profit	46,000
	Add back	
	Cost of office improvements	3,950
	Fringe benefits tax	7,000
	Depreciation of admin vehicles	1,400
	Penalty for PAYE	1,000
	Traffic penalties	1,000
	Replacement of vehicle trailer	<u>9,000</u>
	Total	69,350
	Less capital allowances	<u>(9,750)</u>
	Taxable profit	59,600
	Tax at 30%	17,880

- (c) The taxation rules on the following:

- (i) Export processing zone (EPZ) and priority industries

The following are the tax implications

- (1) The corporate tax rate is reduced to 0% indefinitely for companies within the EPZ.
- (2) Corporate tax rate is reduced to 0% for a period of 10 years for priority industries.
- (3) After 10 years certain priority industries will continue to pay tax at a reduced rate of 15%.

(ii) Trading losses

- (1) A company may carry forward trading losses to offset them against the taxable profit of future periods.
- (2) There is no provision for carry backward losses.
- (3) Losses can be carried forward up to 6 years for trading operations other than, manufacturing, agriculture and mining industries. Companies within these stated areas can carry forward losses indefinitely.
- (4) The ability to carry forward losses is lost where there has been a change in the majority shareholding of a company.

SECTION B

3. (a) IFAC's fundamental principles of ethics

- (1) Integrity – a professional accountant should be straight forward and honest in all professional and business relationships.
- (2) Objectivity – a professional accountant should not allow bias, conflict of interest or undue influence of others to override professional or business judgment.
- (3) Professional competence and due care – a professional accountant should act diligently and in accordance with applicable technical and professional standards when providing professional services.
- (4) Confidentiality – a professional accountant should respect the confidentiality of information acquired as a result of professional and business relationship.
- (5) A professional accountant should comply with relevant laws and regulations and should avoid any action that discredits the profession.

(b) Terms used in anti money laundering

- (i) The control environment – The control environment determines the tone of an organization and how it operates. If an organization's tone is good all through the ladder, money laundering, as a crime, may be reduced.
- (iii) Risk assessment. This is the process through which management will respond to money laundering crimes. The response of an organization to money laundering crimes will determine its future occurrences.

(c) Fringe benefits tax

		K
Accommodation	1	570,000
Cook 15,000 x 12		180,000
Gardener	2	-
Guard	2	-
Interest	3	460,000
Total taxable benefits		1,210,000
Tax at 30%	$\frac{K1,210,000 \times 30}{100}$	363,000

Note

1. Salary 450,000
 First K25,000 tax = K750
 Thus net K25,000-750 = 24,250
 Therefore net 425,750
 Gross it up $425,750/.7 = 608,214$
 Plus 25,000
 Total salary per month 633,214
 12% of annual salary $= 633,214 \times 12 \times 12\%/100 = 911,828$
 Market value $= 95,000 \times 12 = 1,140,000$
 Higher of K1,140,000
 Therefore 50% K570,000

2. The cost of a gardener and a guard are not taxable benefit as the house is owned by the employer and is also within the estate.
3. Bank interest rate is 35% less 12% = 23% x K2,000,000 = K460,000.

4. (a) Income in general insurance

- Premium received in Malawi.
- Amounts, other than premiums, received in respect of short term insurance business
- The amount of the reserve allowed as a deduction in the previous year of assessment for unexpired risks at a percentage adopted by the insurer for such risks in relation to the general insurance.

Expenses in general insurance

- Premiums paid on re-insurance
- Actual losses in Malawi less losses covered on re-insurance
- Management expenses, other than those of capital nature
- Net commission after deducting commission received
- Other expenditures incurred in the production of income other than those of capital nature.

(b)

		K
Taxable income		43,000,000
Expenses	w1	<u>(30,100,000)</u>
Taxable profits		<u>12,900,000</u>
Tax at 30%		3,870,000

Other income is not taxable such as: premiums received, pension investment income

W1

The lesser of:

E1 = $\frac{1}{4}$ of K50,000,000 + K30,000,000 = K42,500,000

E2 = 70% of K43,000,000 = K30,100,000

(c) Amounts to be included for tax purposes will be

	2014	2013
	K	K
Gains	12,000,000	30,000,000
Losses	11,000,000	30,000,000
The lesser of	2014	2013
Gains	12,000,000	30,000,000
Losses	8,000,000	33,000,000
Bd/cfwd	3,000,000	3,000,000
Total deductible	11,000,000	30,000,000

(d) The following gains and losses are not recognized for tax purposes

- (i) Gains on transfer between spouses
- (ii) Gains on transfer between former spouses
- (iii) Gains on transfer to a child from an estate of a deceased parent
- (iv) Gain on disposal of an individual's principal residence
- (v) Gain on disposal of personal or domestic assets not used in connection with trade.

5. (a) (i) Basic scheme means a scheme applicable to retailers supplying taxable goods only.
- (ii) Point of sale scheme means retailers supplying both taxable and non taxable goods. Goods will be separated and VAT will apply only on taxable supplies.

- (iii) Apportionment scheme is where the retailer cannot, at the point of sale, distinguish between taxable and non-taxable goods. The taxable goods are only an estimated value using an agreed apportionment method with the commissioner.

(b)	Mtheto Ltd	K
	Output VAT	
	Sales for VAT = 90% x K175,000,000 = K157,500,000	
	At 16.5%	= K25,987,500
	Input VAT	
	Bought materials for production	(80,000,000)
	Electricity for factory	(24,000,000)
	Machine consumables	(70,000,000)
	Total	174,000,000
	At 16.5%	28,710,000
	Output VAT	25,987,500
	Less: Input VAT	(28,710,000)
	VAT refundable	2,722,500

Note

1. Only 90% is subject to VAT as 10% is exported
2. Electricity for accommodation (5,000)
This is not used in production and
Water for the factory (13,000)
This is zero rated for VAT

(c) Offences relating to VAT

- (i) False invoicing – the person should pay any amount of VAT shown on the invoice within 7 days.
- (ii) Failure to issue VAT invoice – penalty is 10 times the value of VAT involved.
- (iv) Failure to submit VAT return – penalty is K20,000 and a further K1,000 for each day the return is not submitted.
- (v) Failure to pay VAT due – penalty will include interest to be charged at bank rate plus a quarter of the rate for the period VAT remains unpaid if a person fails to pay VAT on the due date.
- (vi) Cheque for VAT that is returned by the bank for insufficient funds – penalty 30% of the cheque amount.
- (vii) Failure to apply for registration or to notify the Commissioner of the change of his business or failure to apply for cancellation. If failure is deliberate or due to recklessness, penalty includes fine of K100,000 plus 5

years imprisonment. For any other reason, penalty includes fine of K20,000 and 12 months imprisonment.

6. (a) Definitions

(i) Testate succession

This is when property belonging to someone who died will come under the ownership of another person or other persons and that person left a will to that effect.

(ii) Intestate succession

When a deceased person did not leave a will or left a will which is successfully challenged, he/she is said to have died intestate.

(iii) Executor

This is the person named in the will as having the responsibility of carrying out the deceased wishes after his death.

(iv) Probate

Is the process of proof before the High Court that the documents comprising the will, on which the executor proposes to act, do in fact constitute the valid last Will and testament of the deceased.

(vi) Dutiable property

This is property liable to estate duty

(b)	Note	K
Duty payable on the deceased estate		
Malawi houses	1	122,000
House in Mozambique	2	-
Toyota Corolla		65,000
Bank accounts		23,000
Investments	3	<u>23,000</u>
Total dutiable amount		233,000
Duty at 9%		20,970
Estate duty at highest point previous = 200,000 x 8%		16,000
Excess of principal value at 100%		<u>33,000</u>
Total		49,000
Thus the total duty to be paid will be		20,970

Note

1

Houses in Malawi

Lilongwe

K50,000

Zomba

72,000

Total

122,000

2

House in Mozambique is not dutiable since it is real property situated outside Malawi.

3

All investment are included in the calculation as Mr Kango was domiciled in Malawi.

- (c) Turnover tax is tax payable by small taxpayers with a turnover of less than K10 million.

This turnover tax is payable monthly on the turnover realized at a rate of 2%. This is final tax. Any withholding tax deducted on such taxpayers is credited on assessment.

However, if an SME is a registered company, the company will be requested to pay full corporate tax even if the turnover is less than K10 million.

If the SME is a partnership and the individual total turnover is less than K10 million, then it can also pay turnover tax. But if one of the partners has another business and his aggregate turnover is more than K10 million, then the rest of the partners are supposed to pay the normal tax, not turnover tax, even if their turnover is less than K10 million.

Turnover tax is optional. An SME may have a turnover of less than K10 million and decide not to register for turnover tax but instead pay the normal tax.

Turnover tax is not applicable to taxpayers within the definition of special trade as in section 58.

Turnover tax is not applicable on rentals and any other income which is subject to final withholding tax e.g. dividends.

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END