STRICTLY CONFIDENTIAL

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN MALAWI

2016 EXAMINATIONS

PROFESSIONAL LEVEL

PAPER B4: TAX COMPLIANCE

WEDNESDAY 8 JUNE 2016

TIME ALLOWED : 3 HOURS
2.00 PM - 5.00 PM

SUGGESTED SOLUTIONS

SECTION A

1. (a) (i) The taxable income or assessed loss of an insurer in respect of short-term insurance business, other than life assurance, is determined by charging losses, expenses and deductions in respect of the short-term insurance business against:

(1) Premiums received in Malawi from carrying on short-term insurance.

(2) Amounts, other than premiums received in Malawi, from the carrying on of short-term insurance business.

(3) An amount of a reserve allowed as a deduction in the previous year of assessment for unexpired risks at a percentage that relates to the risks adopted for the short-term insurance business.

The losses, expenses and deductions which are allowable deductions from such income are:

(1) Premium paid on re-insurance.

(2) Actual losses in Malawi recoverable on re-insurance.

(3) Commissions paid in Malawi, net of commission on re-insurance.

(4) Expenditure other than of a capital nature incurred in Malawi in the production of income.

(5) An allowance for expenditure incurred in respect of premiums incurred outside Malawi which the Commission has approved.

(6) Reserve for unexpired risks at a percentage of the risks adopted by the insurer.

(ii) Tilitonse Insurance Company Limited

Computation of taxable income for the year ended 31 December 2014

	K	K
Profit before taxation		1,723,895
Add: items disallowed for tax purposes		
Provision for premium income (670,000 x 50%)	335,000	
Depreciation	365,000	
Donations – Chigodi Church	45,000	
Fringe benefits tax	25,000	
Interest on loans	60,300	
Write off of loan	156,000	986,300
		2,710,195
Profit on sale of plant and equipment	1,265,300	
Capital allowances	676,900	1,942,200
		767,995
Add: Capital gain		775,600
Taxable income		1,543,595

(b) The five general conditions that all traders dealing with goods and services that attract Excise tax must comply with, according to the customs and excise tax law:

(i) No other business should be conducted on the entered premises except with the permission of the Controller.

(ii) No other excisable goods may be kept on the entered premises except those manufactured on the premises.

(iii) All rooms, stores, plant, equipment and warehouses must be given distinguishing marks and numbers.

(iv) The licensee must provide office, sanitary or living accommodation for an officer or facilities for proper excise of the officers' functions as the Commissioner requires.

(v) The name of the licensee must be exhibited on a conspicuous place outside the entered premises.

(c) Any five circumstances that may necessitate the Commissioner General of the Malawi Revenue Authority to allow an importer to clear their goods at the inland port:

(i) Finance institutions are not available at the border.

(ii) Need to facilitate trade.

(iii) Carriers are not the owners of the goods and may not possess all the necessary documents for clearance at the border.

(iv) Customs clearing agents may not be available at the border.

(v) Security reasons

2. (a) Advice to Dulani and Phiso

(i) Partnership

	K	K
Profit before taxation		3,098,340
Add: Items disallowed for taxation:		

Salaries – Dulani				2,200,000	
– Phiso				1,400,000	
Depreciation				1,975,000	5,575,000
					8,673,340
Less: Capital allowances					1,370,000
Taxable profits					7,303,340

		Dulani		Phiso	Total
		K		K	K
Salary		2,200,000		1,400,000	3,600,000
Share of profit	60%	2,222,004	40%	1,481,336	3,703,340
		4,422,004		2,881,336	7,303,340
Tax up to K300,000		9,000		9,000	
Excess over K300,000 at 30% (4,422,004 – K300,000) ½		1,236,601.2			
(2,881,336 – K300,000)				774,400.8	
Total tax payable on partnership profits		1,245,601.2		783,400.8	
					2,029,002

PAYE on salary:

	Dulani	Phiso	
	K	K	
Salary	2,200,000	1,400,000	
First K300,000	9,000	9,000	
Excess over K300,000 at 30% (K2,200,000 – K300,000) ½	570,000		
(K1,400,000 – K300,000)	-	330,000	
	579,000	339,000	
			K918,000

(ii) Company

	K
Adjusted profit for tax (as in (i) above)	7,303,340
Less: Salaries	3,600,000
Profit adjusted for tax	3,703,340
Tax at 30%	1,111,002
Profit after tax	2,592,338
Dividend	1,296,169
Profit retained after dividend	1,296,169
Tax payable by company	
On company profits	1,111,002
Withholding tax on dividend (1,296,169 at 10%)	129,616.90
	1,240,618.9
Add: PAYE payable on salaries (as above)	918,000
	2.158,618.9

Based on the information in the question it would be better to operate as a partnership because the total tax payable on the profits will be lower in this case (since PAYE is a factor common to both options).

	K
Total tax on partnership profits	2,029,002
Less: PAYE	918,000
Tax on profits	1,111,002

(b) Other factors that should be taken into account are:

The availability of lower income tax rates (0%/15%) in the case of a partnership if profits are very low.

The additional withholding tax payable on dividends paid which is not available for offset in the case of a limited company.

The extent to which the actual personal tax situation (other income) of the individual partners/shareholders will affect the overall cash available.

Expenditure which would be allowed in the case of a company but disallowed for a partnership, for example:

Salaries paid to owners

- Rental expenses paid for working owners.
- Expenditure deemed of personal nature (but will be subject to fringe benefits tax).

SECTION B

ANSWER THREE QUESTIONS ONLY FROM THIS SECTION

3. (a) Capital gains and losses are accounted for in the taxable income of a company to the extent that they are realized from the sale or disposition of capital assets on or after 1 April 1992.

The exact treatment will depend on whether or not capital allowances were claimed on the assets. Where capital allowances have been claimed the gain or loss equals the sale proceeds less the tax written down value. Where capital allowances have not been claimed, the gain or loss will be equal to the sales proceeds less the adjusted cost base using the 1999 inflation factor.

Capital losses arising on assets on which capital allowances have been claimed will be offset against the total taxable income, but where capital allowances have not been claimed, capital losses can only be offset against the capital gains on similar assets in the same period and any excess must be carried forward.

(b) Calculation of gains/losses

		K
(i)	Sale of house	
	Purchase 2005 at cost	3,280,500
	Conversion to 2014 value K3,280,500 x 2.023	6,636,451.5
	Sale proceeds	9,500,000
	Capital gain	2,863,548.5
(ii)	Sale of shares in Chihole Limited	
	550,000 shares at K5.00	2,750,000
	Conversion to 2014 value – factor 1.6530 (2,750,000 x 1.6530)	4,545,750
	Sales proceeds 550,000 at K8	4,440,000
	Loss	(105,750)
	Listed investments	
	NICO Ltd shares – no capital gain as held for more than 12 months	
	Illovo Ltd shares – no capital gain as held for more than 12 months	
(iii)	NBM Ltd shares (held less than 12 months)	
	Cost 600,000 at K15.00	9,000,000
	Conversion factor – 1 (Converted value)	9,000,000
	Sale proceeds 600,000 at K45	27,000,000
	Capital gain	18,000,000

(c) Had these transactions been entered into by an individual, the tax implications would have been as follows:

Sale of a house: if the house were considered to be the main residence, then the capital gain would not be taxable. If not, the gain would be taxed as per the calculation in (b), above.

Sale of unlisted shares – same as for a company i.e. as in (b) above.

Sale of listed investment – same as for a company i.e. as in (b) above.

(d) Any person shall be liable for a penalty not exceeding K30,000 if he:

(i) fails to furnish or makes default in furnishing to the Commissioner a return of income in respect of any year of assessment; or

(ii) omits from his return of income in respect of any year of assessment any amount which should have been included therein; or

(iii) in his return of income in respect of any year of assessment deducts of sets off any amount, the deduction or setting off of which, is not allowed under the Act, or

(iv) claims any allowance in respect of any year of assessment, which he is not entitled to claim under this Act.

4. (a) A taxable person may deduct from output tax any value added tax chargeable on goods and services purchased in Malawi or imported into Malawi, used wholly, exclusively and necessarily in the course of business.

However, input tax may not be claimed:

(i) where it relates to exempt supplies by the taxable person. If the taxable supplies are less than 5% of the total supplies, a taxpayer may not claim any input tax for the period.

(ii) after expiration of 12 months from the date the right to claim arose.

(iii) in respect of motor vehicles or motor vehicle spare parts unless the taxable person is in the business of dealing or hiring of motor vehicles or selling motor vehicle spare parts.

Note: Motor vehicles and motor vehicle spare parts used wholly, exclusively and necessarily for the business qualify for input tax deduction.

(iv) in respect of entertaining, including restaurant meals and hotel expenses, unless the taxable person is in the business of providing entertainment.

(v) in respect of the personal portion of expenditure in cases where the expenditure/ purchase is partly for business and partly for personal use.

(b) Calculation of Value Added Tax (VAT) payable to the Malawi Revenue Authority

	Amount K	Rate %	VAT	Notes
Output tax				
Sales	3,556,500			
Less: Sales of fresh fish	(300,000)		0	Exempt
Value at less than market value	(55,000)			
Other taxable sales	3,201,500	16.5	528,247.5	
Market value of sales to general manager	105,000	16.5	17,325	Market value
Interest	285,000	Exempt		
Output tax			545,572.5	
Input tax				
Purchases	850,500			
Less: Fish purchases	(165,000)		0	Exempt
Taxable purchases	685,500	16.5	113,107.5	
Rent	425,000			
Less: House rent	(180,000)		0	Exempt
	245,000	16.5	40,425	
Salaries	4,180,000		0	Not a supply
Electricity	245,000			
Less: Paid to the general manager	(45,000)		0	Fringe benefit
	200,000	16.5	33,000	
Water charges	565,000	0	Exempt	
Consultancy charges	770,000	16.5	127,050	Supplier not registered but VAT payable by importer
Packaging materials	65,000	16.5	10,725	
Furniture and fittings	188,000			
Less: Labour	(34,500)			Supplier not registered
	153,500	16.5	25,327.5	
Staff welfare – coffin	55,000		0	Exempt
			349,635	
VAT payable			195,937.5	

(c) Changu Ltd, a company registered in Malawi, would pay tax as follows:

K16,430,200 x 30% = K4,929,060

(d) If Changu Ltd was a foreign registered company, it would pay tax as follows:

K16,430,200 x 35% = K5,750,570

(e) (i) Liability to non-resident tax arises where :

- Income is payable to a person, not being a person resident in Malawi.
- The income is from a source in Malawi.
- The income is not attributable to a permanent establishment belonging to the recipient of the income.

(ii) The tax is calculated at a rate of 15% of the gross amount of income.

5. (a) (i) Under the Taxation Act, a taxpayer may make an appeal where such 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 the double taxation agreement or under circumstances where there is no double taxation agreement. **(Section 97(1) of the Taxation Act). 1**

(ii) 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 the appellant written notice of his decision on the appeal;
- shall record any amendment of the assessment in the assessment register.

(b) (i) Tax evasion refers to efforts by individuals, firms, trusts or other entities to evade tax through illegal means.

(ii) Dangers of tax evasion:

- One can be imprisoned
- One can pay penalties
- One can have their assets impounded by MRA

(iii) Importance of tax compliance:

- Government gets enough revenue which it can use to provide goods and services to its citizens (education, health, roads, medicines etc) and
- Government gets enough resources which it can use to run its affairs including paying salaries for teachers, buying stationery, paying for utilities etc.

(c) Waiver of secrecy

(i) Where the information is required by the Auditor General or any officer duly authorized by him for the performance of official duties.

(ii) Where information is required by authorized government officers of another country which has a double tax treaty with Malawi to enable it to assess the tax position of a taxpayer.

(iii) Where the information is required by the taxpayer or a duly authorized agent of the taxpayer.

(iv) Where the Commissioner wishes to compile and publish statistics about the total amount of income received by any class of persons and declared in returns to the Commissioner.

(v) Where the information is required for the purpose of carrying the Act into effect or for the purpose of any prosecution for an offence committed in relation to any tax on income.

(d) Examples of income that is exempt under the first schedule of the Taxation Act:

(i) Income of Land and agricultural banks specifically established by any law of Malawi to foster and control primary production, manufacture, or marketing of any commodity or stabilizing of any price of any commodity.

(ii) Income of a registered trade union.

(iii) Income of clubs, societies and association formed or operated solely or principally for social welfare, civic improvement or other similar purposes, if the receipts or accruals are not divided amongst the members.

(iv) Pension and provident funds.

(v) Income of statutory corporations, bodies and associations as may be specified by the Minister [Statutory corporations that are liable to tax are those in the Commercial Category e.g. Electricity Supply Corporation of Malawi (ESCOM), Blantyre Water Board (BWB), Agricultural Development and Marketing Corporation (ADMARC) and Lilongwe Water Board (LWB)].

(vi) Any amount received as a war disability pension paid out of public funds.

(vii) Interest received by or accrued to, or in favour of any person from any stock or bonds issued by the Government which the Minister has directed shall be exempt from tax.

(viii) Interest up to K10,000 received by or accrued to or in favour of an individual.

(ix) Income on any sums deposited with an institution registered under the Building Societies Act or the Banking Act.

(x) Income from stock, bonds or promissory notes raised by or on behalf of the Government.

(xi) Capital gains realized by an individual on the disposal of personal and domestic assets not used in connection with any trade.

(xii) Capital gains on shares traded on the stock exchange if the shares have been held by the taxpayer for at least a year.

(xiii) The gratuity, pension and other benefits granted by the Government to a former vice president.

(xiv) The salary and emoluments of the president and vice president received from the Government in respect of their offices as president and vice president respectively; the former and vice president's gratuities, pensions and other benefits.

(xv) Any scholarship, bursary or similar educational endowment paid to a person receiving full time instruction at a university, college, school or other educational establishment approved by the Minister.

(xvi) Amount up to K50,000 of any amount paid by an employer to an employee who has been declared redundant, not being notice pay or commutation of leave.

(xvii) Allowances given to members of the national assembly.

6. (a) Mapala Limited
Capital allowances for the year ended 31 December 2014.

	TWDV 1 Jan 2014	Additions	Disposals	Total	Allowances Investment (100%)	Initial (20%/40%)	Annual	Total Allowances	TWDV 31 Dec 2014
	K	K	K	K	K	K	K	K	K
Factory building	13,500,600	16,544,500		30,045,100	16,544,500		675,030	17,219,530	12,825,570
Motor vehicle (saloon)	1,800,700	-	(1,200,000)	600,700	-		120,140	120,140	480,560
Plant and equipment	9,750,700	4,865,500		14,616,200	4,865,500		975,070	5,840,570	6,815,640
Computers	4,500,000	865,000		5,365,000		346,000	2,146,000	2,492,000	2,873,000
Motor lorries	12,681,465	17,265,000		29,946,465		3,453,000	5,989,293	9,442,293	20,504,172
	42,233,465	39,540,000	(1,200,000)	80,573,465	21,410,000	3,799,000	9,905,533	35,114,533	43,498,942

Note: As the cost of the office (K4,920,500 is more than 20% of the cost of the industrial building (21,465,000 x 20% = K4,293,000), it is excluded from the qualifying cost of the industrial building. (K21,465,000 – 4,920,500 = K16,544,500).

Balancing allowance Motor vehicles sold	K	Tax written down value of motor vehicle	K
Sale proceeds	2,550,000	Cost January 2013	1,500,000
Tax written down value	1,200,000	Annual allowances (20%)	(300,000)
Balancing charge	1,350,000		1,200,000

Summary of allowances

Investment	21,410,000
Initial	3,799,000
Annual	9,905,533
Balance charge	(1,350,000)
Total allowances	33,764,533

(b) (i) (1) Housing rent of K450,000 per month is taxable in the hands of the employer because it is paid directly to the landlord.

(2) School fees of K875,000 per term will be taxed in the employee since is paid directly to the employee.

(3) The tax burden on use of motor vehicle falls on the employer as this is a fringe benefit.

(4) No liability on vehicle insurance as it is covered together with the motor vehicle benefit.

The employee, will bear the tax burden for the vehicle running costs as they are paid to him in cash.

(5) The cost of the gardener will be a taxable benefit to be borne by the employer.

(ii) Fringe benefit tax for housing

Taxable value

Housing: K450,000 x 3 = K1,350,000 Tax : K1,350,000 x 30% = K405,000

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