**DIPLOMA IN BANKING**

**TAXATION 1 [IOBM – D213] – MAY 2013 - Solutions**

**SECTION A [60 MARKS]**

**SOLUTION ONE**:

1. Taxation is defined as impositions **[½ Mark]** made by governing bodies **[½ Mark]** on the income and wealth of persons **[½ Mark]** under their jurisdiction **[½ Mark]**. Governing bodies include state, local authorities and central governments.
2. Four canons of taxation
   1. Equity **[½ Mark]**: a tax system should be designed so that its application is fair to all tax payers. Taxes should be fairly based on an individual’s ability to pay **[½ Mark]**.
   2. Certainty **[½ Mark]** : the government should be fairly certain of the amount of tax it is likely to yield **[½ Mark]**. Issues of incidence of tax and liability must be properly addressed.
   3. Convenience **[½ Mark]**: the payment of tax should be related to how and when people receive [and spend] their incomes**[½ Mark]**.
   4. Economy **[½ Mark]**: the cost of collection should be small in relation to the yield. **[½ Mark]**
3. Reasons why governments impose taxes on its citizens
   1. To raise revenue for the government **[½ Mark]**. This revenue is used to provide social services to its citizens like schools, hospitals etc but also pay civil servants **[½ Mark]**.
   2. To redistribute wealth **[½ Mark]**. The higher rates of income tax transfer income and wealth from well to do people to the poor in form of services which the government offers to the poor i.e. free hospital services. **[½ Mark]**
   3. To protect industries from competition **[½ Mark]**. Government levies duty on imported goods and services in such a way that local goods and services become cheaper than imported ones **[½ Mark]**.
   4. To discourage consumption of certain commodities which the government deems to be undesirable i.e. tobacco, alcohol etc. **[1 Mark]**
   5. To make adjustments to the economy by adjusting the taxation rates to deal with certain economic conditions**[1 Mark]**
4. Direct and indirect taxes
   1. Direct taxes are taxes that are charged on the income and wealth of a taxpayer. **[1 Mark]. Advantage:** They are fair and equitable because they are levied according to one’s ability to pay; tend to stabilise the economy automatically taking more money out of the system during a boom and less during a depression; less inflationary than indirect taxes. **[1 Mark for any one point from the list].**
   2. Indirect taxes are taxes that are charged on goods and services. **[1 Mark]. Advantage:** can be used to discourage consumption of undesirable products; it is a flexible instrument of economic policy as rates can be quickly and easily changes; it is more difficult to evade than direct taxes since they tax consumption. **[1 Mark for any one point from the list].**

**Question two:**

1. Only income that has a source in Malawi will be subject to tax in Malawi **[2 Marks]**
2. Comment on the following
3. Taxable, the source of salary is Malawi
4. Not taxable, the source of the interest is not Malawi
5. Taxable, the interest has a Malawi source
6. Not taxable, source not Malawi
7. Taxable, income has a Malawi source
8. Not taxable, source not Malawi

**[1 Mark for each**

1. Tax payer may appeal to the commissioner if he is aggrieved by:

Any assessment made upon him by the commissioner under this Act

Any decision of the commissioner in relation to an assessment

The determination of a reduction of tax under section 123

**[1 Mark for each total 3]**

1. Procedure by the special arbitrator

Shall have the power to summon and enforce prompt attendance of witnesses to hear and take evidence **[1 Mark]**

Where required may appoint assessors who will act only in advisory capacity **[½ Mark]**

Shall ensure that proceedings are not conducted in public and shall exclude or withdraw any persons whose attendance is considered not necessary**[½ Mark]**

May allow the appeal and amend the assessment, decision or determination in respect of which the appeal is made**[½ Mark]**

May disallow the appeal**[½ Mark]**

Shall set out findings of fact and decisions on points of law in written judgement**[½ Mark]**

Findings of fact in a judgement of the special arbitrator shall be final and conclusive**[½ Mark]**

**Question Three:**

1. Taxable income for Timba

K’ 000 K’ 000

Profit before taxation 2, 995.00 **[½]**

Add: Rent 470 **[½]**

Electricity and Water 327 **[½]**

Wages and Salaries 1,200 **[½]**

Depreciation 151 **[½]**

Repairs 189 **[1]**

Bad and doubtful debts 313 **[1]**

Amortisation of lease 10 **[½]**

Legal expenses 52 **[½]**

General expenses 120.23 **[1]**

Income Tax 133 **[½]** 2, 965.23

Less: Profit on sale of a car [100] **[½]**

Lease [300,000/25] **[1]** [12] **[½]**

Capital Allowances [1, 120]**[½]**  [1, 232.00]

Taxable income 4, 728.23 **[½]**

1. Treatment of the following items
   1. Profit on sale of a car is not taxable instead any capital gain on disposal of a car is taxed through capital allowances. **[½ Mark]**
   2. Extension to the factory building for K120, 000 has been written back because it is capital in nature and therefore not an allowable deduction **[½]**. Repainting the house in which Timba and her family resides for K69, 000 is not an allowable expense because it is a private expense and not related to the business **[½].**
   3. Staff loans written off for K155, 000 have been added back because they are not trade debts **[½]**. General provisions for doubtful debts are not an allowable deduction for tax purposes **[½].**
   4. Legal expenses relating to the extension of the factory building are capital in nature and therefore not an allowable deduction hence added back. **[½]**
   5. Donation to peoples’ party for K120, 000 is not an allowable expense because peoples’ party is not on the list of institutions which the Minister has approved for this purpose. **[½]** Donation to Malawi Red Cross for K230 is added back even though the institution is on the list of approved organisation for this purpose because the amount is below K250. **[½]**

**Question Four:**

1. expenditures incurred in connection with:
2. Stumping, clearing and leveling of lands;
3. Works for the prevention of soil erosion;
4. Boreholes;
5. Wells;
6. Aerial and geographical surveys; and
7. Any water control works connected with the cultivation and growing of rice, sugar and such other crop that the Minister may approve

**[1 Mark for each up to 5 Marks]**

1. Tax payable

Salary [K4million \* 12] **[½]** = K48million**[½]**

House allowance [75% \* K48million] **[½]** = K35million**[½]**

Taxable income = K83million**[½]**

First K144, 000 0% 0 **[½]**

Next K 36, 000 15% 5, 400 **[½]**

Balance K82, 820, 000**[½]** 30% **[½]** 24, 846, 000**[½]**

24, 851, 400**[½]**

1. Expenditures not allowed
2. The cost incurred by any taxpayer in the maintenance of himself, his family or establishment;
3. Domestic or private expenses of the taxpayer including the cost of travel between the taxpayers residence and place of work
4. Any loss of expense which is recovere=able under any insurance contract or indemnity
5. Tax upon the income of the taxpayer or interest payable thereon whether charged in terms of this Act or any other law of any country whatsoever
6. Income carried to any reerve fund or capitalised in any way
7. Any expenses incurred in respect of any amounts received or accrued which are not included in the term income as defined in the taxation act
8. Any expense in respect of which a subsidiary has been or will be received
9. Fringe benefit tax and any penalty chargeable thereon

[**Any 5, I Mark each]**

**Question Five:**

1. Staff housing means any dwelling house erected for occupation by an employee engaged in the business or farming operations of a taxpayer who is a manufacturer or a farmer **[2 Marks]**
2. Staff housing must be occupied by
3. A full time employee **[1 Mark]**
4. Somebody who is not able to directly or indirectly control more than 5% of the voting rights attaching to all classes of shares of the company **[1 Mark]**
5. Expenditure incurred in connection with erecting a fence which will be used in the carrying on of farming operations **[1 Mark]**
6. Capital allowances
7. Tax written down value for machinery that sold

Sale proceeds K2, 350, 000 **[½]**

Loss K 800, 000 **[½]**

Tax Written down value K3, 150, 000 **[1]**

1. Gain loss on vehicle sold

Sale proceeds K5, 450, 000**[½]**

Tax written down value K1, 020, 000**[½]**

Gain K4, 430, 000 **[1]**

1. Capital Allowances

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Description | Factory buildings | Plant & Machinery | Motor vehicles | Furniture and Fittings |
|  | K’ 000 | | | |
| Opening TWDV | 28, 500 **[½]** | 10, 200 **[½]** | 25, 800 **[½]** | 2, 500 **[½]** |
| Additions | 7, 025 **[½]** | 9, 650 **[½]** | 10, 800 **[½]** | 950 **[½]** |
| Disposals |  | [3, 150] | [1, 020] **[½]** |  |
| Sub-total | 35, 525 **[½]** | 16, 700 **[½]** | 35, 580 **[½]** | 3, 450 **[½]** |
| Investment allowances | 7, 025 **[½]** | 9, 650 **[½]** |  |  |
| Initial allowances |  |  | 0 **[½]** |  |
| Annual allowances | 1, 425 **[½]** | 705 **[½]** | 7, 116 **[½]** | 690 **[½]** |

Factory building additions

Fencing 475, 000 **[½]**

Factory Building 6, 550, 000 **[½]**

7, 025, 000

**Question Six:**

1. reasons provisional tax system was introduced;

To ensure the government has an even flow of funds which can be used to ran its business

To reduce tax burden of companies as the amount is spread over a period

To level the playing ground with tax payers who enjoy the PAYE system advance payment facility

1. Advance payments include

Withholding tax – payable not later than 14 days from the end of the month in which the deduction was made**[1 Mark]**

PAYE – payable not later than 14days from the end of the month in which PAYE was recovered **[1 Mark]**

1. Objectives of penalties

Enforce tax rules

Source of revenue for the government

Enforce compliance of rules

**[1 Mark for each total 3]**

1. Circumstances where penalties may not serve purpose

When they are not being enforced by the authority

When they are too high

When they are waived even with flimsy reasons

**[1 Mark for each total 3]**

1. A fringe benefit is an asset, service or other benefit in kind provided by an employer to an employee where such benefit includes an element of personal benefit to the employee **[2 Mark]**
2. Liability to fringe benefits tax arises where an employer provides fringe benefits to an employee**[1 Mark]**
3. An employer who provides fringe benefits to employees is liable to pay the fringe benefits tax**[1 Mark]**
4. Fringe benefits tax is due for payment not later than 14 days after the end of each quarter **[1 Mark]**
5. Comments

Amount of fringe benefits tax paid = k215, 200

Date paid was 25 th January 2013 instead of by 14 January 2013**[1]**

This attracts a penalty of 20% of the amount**[1]**

Penalty = [20% \* K215, 200] **[1]** = K43, 040**[1]**

This amount will have to be paid by the company for remitting fringe benefits tax late

**Question Seven:**

1. Registrable for vat when that person makes taxable supply of goods or services and**[½]**

Whose business turnover is or exceeds K6millin per annum **[½]** or

If the person makes taxable supply of goods or services but sales turnover does not exceed the prescribed limit **[½]**

may apply for registration if he can satisfy the Commissioner general that his business may suffer if he was not registered for VAT**[½]**

1. Vat on expenditure

Security expenses [16.5%/116.5% \* 23, 300] = 3, 300 **[1 Mark]**

Legal expenses [16.5%/116.5% \* 58, 250] = 8, 250 **[1 Mark]**

Stationery expenses [16.5%/116.5% \* 163, 100] = 23, 100**[1 Mark]**

Office furniture [16.5%/116.5% \* 205, 040] = 29, 040**[1 Mark]**

Office rentals [16.5%/116.5% \* 60, 580] = 8, 580**[1 Mark]**

Electricity [16.5%/116.5% \* 6, 757] = 957**[1 Mark]**

Salaries = 0**[1 Mark]**

Water = 0**[1 Mark]**

Postal services = 0**[1 Mark]**

1. Sales value

Net vat gross

Export 1, 000, 000 0 **[½]** 1, 000, 000**[½]**

Local 5, 000, 000 825, 000**[½]** 5, 825, 000**[½]**

Total 6, 000, 000 825, 000 6, 825, 000

1. Amount payable:

Output vat 825, 000**[½]**

Input vat 73, 227**[½]**

751, 773**[1 Mark]**

1. Advantages of vat credit system

Government receives revenue earlier**[1 Mark]**

Vat invoice and import bill of lading create an “audit trail” for policing the system**[1 Mark]**

Associated businesses are registered to counter transfer pricing**[1 Mark]**

1. Disadvantages of vat credit system

False invoicing**[1 Mark]**

Inflation or deflation of credit or debit invoices**[1 Mark]**

Value manipulation for appropriation**[1 Mark]**

**Question Eight:**

1. It enables customs officer to establish the correct rate of duty in accordance with preferential provisions of the Customs Tariff**[1 Mark]**

It enables them to establish whether goods are subject to Open General Licence [OGL] importation that does not require an import licence of specific licence

It also enables customs officer to correctly collect trade statistics for the national statistical office

1. Percentage content of manufacture
   * 1. Final Value of final product = K3, 000, 000

Imported value element = K2, 500, 000

Content of Manufactured = K 500, 000 **[1 Mark]**

% ntage = [500, 000/3, 000, 000 \* 100] **[1 Mark]**

= 16.7% **[1 Mark]**

* + 1. South Africa **[1 Mark]**

Because the percentage of manufacture is less than 25% **[1 Mark]**

1. Functions of a customs officer
   * 1. To receive and process monthly returns and excise remittances
     2. To send reminders to excise traders in arrears of payments
     3. To visit excise traders and verify the correctness of excise returns
     4. To advise the commissioner of any irregularities or omissions by excise traders

**[1 Mark each, total 4 Marks]**

1. Principles of customs valuation
2. Customs value should not be arbitrary, fictitious or based on the value of indigenous goods
3. It should be real and based on the actual value of the imported goods
4. It should also derive from a sale in the ordinary course of business under fully competitive conditions
5. If no actual value can be established, it should be based on the nearest ascertainable equivalent of such value

**[2 Marks each, total 8 marks]**