

**INSTITUTE OF BANKERS IN MALAWI**

**ADVANCED DIPLOMA IN BANKING EXAMINATION**

**SUBJECT: TAXATION 2 (IOBM – D212)**

**Date: Wednesday, 9th November 2016**

**Time Allocated: 3 hours (13:30 – 16:30 Hours)**

**INSTRUCTIONS TO CANDIDATES**

1 This paper consists of **TWO** Sections, A and B.

2 Section A consists of 4 questions, each question carries 15 marks.

Answer **ALL** questions.

3 Section B consists of 4 questions each question carries 20 marks. Answer **ANY TWO** questions.

4 You will be allowed **10 minutes** to go through the paper before the start of the examination, you may write on this paper but not in the answer book.

5 Begin each answer on a new page.

6 **Please write your examination number on each answer book used. Answer books without examination numbers will not be marked.**

7 All persons writing examinations without payment will risk expulsion from the Institute.

8 If you are caught cheating, you will be automatically disqualified in all subjects seated this semester.

9 DO NOT open this question paper until instructed to do so.

**SECTION A (60 MARKS)**

Answer **ALL** questions from this section.

**QUESTION 1**

State the circumstances under which each of the following may be allowed as a deduction from taxpayers assessable income:

1. Bad debts  *(3 marks)*
2. Doubtful debts *(3 marks)*
3. Research and experiments  *(2 marks)*
4. Individual donations *(3 marks)*

Calculate the amount of realized capital loss which is deductible from assessable income in the following circumstances, assuming that the capital loss arises from the disposal of assets on which no capital allowances were given:

1. a taxpayer has a realized capital loss of K350,000 and there is no realized capital gain.  *(2 marks)*
2. a taxpayer has a realized capital loss of K225,000 and there is a realized capital gain of K150,000. *(2 marks)*

**(Total 15 marks)**

**QUESTION 2**

1. Give examples of any **three** types of expenditure incurred by farmers which are specifically allowable against income derived from farming activities. *(3 marks)*
2. Mlambe Insurance Limited is a Malawi resident company involved in general insurance business. The following financial information is available in respect of Dziko Insurance Limited for the year ended 30 June 2015:

K

Gross written insurance premiums received Fees and commissions received

Dividends received

Interest received from bank accounts

Rental income received

Profit on sale of property

Insurance premiums paid on reinsurance

Commissions paid

Staff costs

Depreciation

Impairment loss

Required:

6,520,000 2,265,000

865,000 125,000 325,000

69,500

(3,650,000)

(425,000)

(2,654,000)

(895,000) (759,000)

(b) Briefly state how each of the items listed above will be treated in the income tax computation of Dziko Insurance Limited. *(6 marks)*

(c) List any **six** types of income which are exempt from taxation under the Taxation Act. *(6 marks)*

**(Total 15 marks)**

**QUESTION 3**

Kadzuwa Limited, a highly profitable company, is considering employing an additional sales manager. Two alternatives have been proposed for the sales manager's remuneration package, as follows:

Salary Bonus

Commission on sales

Pension - employer's contribution

Pension - employee's contribution

Housing allowance

School fees

Use of a company car which will cost the company K6,500,000 to purchase (option 2 only)

Additional information:

Option 1

K

3,511,600

600,000

-

10% of salary

5% of salary

n/a

750,000

n/a

Option 2

K

2,450,000

n/a

2% of sales

10% of salary

5% of salary

800,000

n/a

Free use

1. Sales are expected to be K70 million per annum.

2. The school fees will be paid directly to the school.

**Required**

1. Prepare calculations to determine which of the options (1 or 2) will result in:

(i) the lower annual expenditure by Kadzuwa Limited; and *(6 marks)*

(ii) the higher after tax annual take home pay for the sales manager.

*(6 marks)*

1. Briefly comment on the results of your calculations in part (a)(i) and explain why as financial controller of Kadzuwa Limited you might advise against the adoption of the apparently 'lower cost' option. *(3 marks)*

**(Total 15 marks)**

**QUESTION 4**

In readiness for Christmas day on December 25 2015, a business lady had earlier on in October 2015, ordered 2, 500 Christmas Cards from United States costing US$2 per card. When they arrived, the business lady was requested to pay 25% customs duty, 15% excise duty and 16.5% value added tax. Despite the trade agreement between Malawi and United States. Assume the exchange rate applicable was K650 to US$1.

**Required:**

1. What does CIF mean? *(1½ marks)*
2. Calculate the landed cost of the 2, 000 Christmas cards in Malawi. *(8½ marks)*
3. Assuming that the business lady has information to the effect that according to the trade agreements between Malawi and United States governments, she was not supposed to pay import duties except for value added tax and that she wants to appeal, which three players would be involved in the appeal case assuming the case has gone all the way to the last player? *(3 marks)*
4. Why is it important to have appeals procedures in the Taxation system? *(2 marks)*

**(Total 15 marks)**

**SECTION B**

Answer **ANY TWO** from this section

**QUESTION 5**

The First and Second Schedules to the VAT Act specify the goods and services which are exempt and zero-rated, respectively.

**Required:**

(i) State one common feature between exempt and zero rated supplies, with reference to liability to VAT. *(1 mark)*

(ii) State the main differences between exempt and zero rated supplies.

*(2 marks)*

(b) When does a taxable supply become a relief supply and what advantage, if any, is enjoyed by the user of the goods and services that qualify as relief supplies? *(3 marks)*

(c) Under what circumstances does a taxable person qualify for input tax deduction in respect of taxable supply of motor vehicles or motor vehicle spare parts? *(4 marks)*

(d) A manufacturer incurred business expenditure during the year to 31 December 2015 as follows:

|  |  |  |
| --- | --- | --- |
| Nature  Telephone charges  Electricity charges  Security charges  Stationery  Rent | Cost  K  150,000  75,000  90,000  122,000  50,000 | VAT paid  K  24,750  12,375  18,850  20,130  8,250 |

In addition, raw materials were purchased at a cost of K1, 3980,000 inclusive of VAT.

During the same year, revenue from exports of manufactured products and from local sales, exclusive of VAT, was K2.5 million and K2.2 million respectively.

**Required:**

(i) Calculate the amount of VAT paid on raw materials. *(2 marks)*

(ii) Calculate the amount of VAT chargeable on total sales*. (3 marks)*

(iii) Calculate the net amount of VAT (output tax) payable or recoverable, as the case may be, taking into account the input tax paid. *(5 marks)*

**(Total 20 marks)**

**QUESTION 6**

.(a) (i) What term is used to describe the levying of income tax by more

than one country on the same income of a taxpayer? *(1 mark)*

(ii) How does this arise and how can it be mitigated or prevented in Malawi? *(4 marks)*

(b) Godagoda General Suppliers is a firm operating in Malawi. In April 2015 the firm became indebted to a supplier based in the United States of America in the sum of $55,000 on account of merchandise supplied.

$20,000 was paid in August 2015 and another $25,000 was paid in December 2015. The balance of $10,000 was included in the accounts for 31December 2015 at K7 million using an exchange rate of $1 = K700.

**Required:**

(i) Using the formula specified in the Taxation Act, calculate the foreign exchange gains or losses on the transactions given above to be claimed for the year of assessment to 31 December 2015. Assume the following exchange rates were in use:

April 2015 : $1 = Malawi Kwacha K650

August 2015 : $1 = Malawi Kwacha K715

December 2015 : $1 = Malawi Kwacha K700

*(4 marks)*

(ii) State whether the foreign exchange loss on the outstanding $10,000 which has been converted to K7 million and included in the accounts to 31 December 2005 is an allowable deduction. Give reasons for your answer.  *(2 marks)*

1. Certain types of expenditure incurred by farmers during a year of assessment, which would normally be accounted for as capital expenditure, are fully deductible from the taxable income.

**Required:**

(i) Define water control work in the context of section 58 of the Taxation Act.

*(2 marks)*

(b) Farmers will normally be “seasonal income earners” in the context of payment of provisional tax.

**Required:**

1. When must a normal taxpayer pay provisional tax? *(1 mark)*

(ii) Define “seasonal income” in the context of the legislation concerning the payment of provisional tax. *(2 marks)*

1. What proportion of the taxpayer’s income should be “seasonal income” to allow advantage to be taken of the special concessions available for the payment of provisional tax by seasonal income earners? *(1 mark)*

(iv) When should a taxpayer earning the appropriate proportion of seasonal income pay provisional tax? *(2 marks)*

1. Describe the benefit to the taxpayer of the concession regarding provisional tax payments available to a taxpayer such as a farmer whose income is seasonal to the required proportion. *(1 mark)*

**(Total 20 marks)**

**QUESTION 7**

Mr Kadale runs a transport business and has provided you with the following information for the year ended 30 June 2015.

Mr Kadale income and expenditure account – year ended 30 June 2015

|  |  |  |  |
| --- | --- | --- | --- |
| Transport revenue  Add: Sundry income  Less: Salaries & wages  General expenses  Vehicle maintenance  Repairs: office equipment  Advertisements  Rent payable  Water  Depreciation  Licenses  Electricity  Fuels & lubricants  Profit before tax | Note  2  3  4  4 | K’000    1,100  220  190  125  850  245  115  560  85  48  720 | K’000  10,275  462  10,737  4,258  6,479 |

|  |  |
| --- | --- |
| Notes   1. Sundry Income : K462,000   This is arrived as follows  Sale of obsolete spares  Add: bank interest (net of 20% WHT)  Less: Traffic fines | K’000  362  250  (150)  462 |

(2) Salaries and wages: K1,100,000

Salaries include payment of K350,000 to Mrs Kadale for her services

rendered to the business.

Mr Kadale has paid his employees their gross salaries without PAYE deduction and has not operated the PAYE scheme since the business commenced in April 2013, although registration for that purpose was done soon after operations began.

|  |  |
| --- | --- |
| (3) General expenses :    Local business travel  Cleaning materials  Donation to local church  Office refreshments | K220,000  K’000  84  66  40  30  220 |

(4) Vehicle maintenance, fuel and licences

1. Vehicle maintenance includes K145,000 in respect of repairs to private car used by Mr Kadale for private purposes.
2. K420,000 of fuels and lubricants related to the wife’s vehicle for private use.
3. K25,000 of the licences relates to personal vehicles.

(5) Capital allowances

These were computed and amounted to K752,000.

**Required:**

(a) (i) Compute Mr Kadale’s taxable income for the year ended 30 June 2015.  *(5½ marks)*

1. Advise Mr Kadale of the consequences of not operating a PAYE scheme.

*(3 marks)*

1. State any offences stipulated in the Taxation Act under PAYE for which a person may be liable to a fine (deduction and payment rules).

*(2 marks)*

(b) (i) Define the term ‘fringe benefit’ for purposes of the Taxation Act. *(1 mark)*

(ii) An employee makes a contribution in respect of a fringe benefit provided to the employee by his or her employer. In what way does such a contribution affect the employee on one hand and the employer on the other hand? *( 2½ marks)*

1. If an employer provides housing to an employee and the house belongs to the employer, certain Fringe Benefits Tax advantages may be enjoyed by the employer. State **two** of these advantages. *(2 marks)*

(c) How does liability to non-resident tax arise and at what rate is the tax charged?  *(4 marks)*

**(Total 20 marks)**

**QUESTION 8**

(a) Withholding tax from specified payments and provisional tax are both tax collection schemes which are used to encourage payment of tax in advance of the assessment of tax liabilities.

Required:

Describe the two tax schemes named above using the guidelines given below. For each scheme, state:

(i) By whom it is operated.

1. How the tax (to be paid) is determined.
2. When the tax is to be paid to the Revenue Authorities.

(iv) What penalties are imposed for non-compliance. *(10 marks)*

(b) Details of income for an individual who was in employment for 6 months only (Jan 2015 to June 2015 were as follows:

1. Basic salary

K125,000 per month for three months to March 2015

K160,000 per month for three months to June 2015.

1. Housing allowance

20% of basic salary, paid together with salary.

3. Clothing allowance K70, 000 for every six months payable in January and July each year.

4. Motor vehicle maintenance allowance K72, 000 per month paid together with salary.

PAYE tax was deducted at a rate of K30,750 per month for three months to March 2015 and K41,250 per month for three months to June 2015.

**Required:**

(i) Compute the taxable income of the individual for the tax year to 30 June 2015. *(4 marks)*

1. Calculate the amount of tax due and payable on the income in (i) above, assuming the total income was

MK1, 528,000 for the tax year to 30 June 2015. *(6 marks)*

**(Total 20 marks)**

**END OF EXAMINATION PAPER**

**Income Tax Rates: Individuals - Annual**

Cumulative Tax Rate MK

0 – 240, 000 0% 0

240, 001 – 300, 000 15% 9,000

300, 001+ 30% –

**Investment Allowances**

New 100%

Second hand 40%

**Provisional Tax Penalty Rates**

If the amount of Provisional Tax unpaid as a percentage of total tax liability

**Penalty**

Does not exceed 10%. Nil.

Exceeds 10% but does not exceed 50%. 25% of the unpaid amount of provisional tax.

Exceeds 50%. 30% of the unpaid amount of provisional tax.

**END OF EXAMINATION PAPER**