**TAX 2 ADVANCED DIPLOMA SUGGESTED SOLUTIONS MAY 2014**

**QUESTION 1**

(a) (i) One common feature between exempt and zero rated supplies is that VAT is not payable in respect of both supplies. 1 mark

1. Main differences are:

- Exempt supplies are not subject to VAT; while ½ mark

- Zero rated supplies are subject to VAT ½ mark

- Input tax is not claimable in respect of exempt supplies

½ mark

while;

- Input tax is claimable in respect of zero rated supplies ½ mark

(b) Relief supplies are taxable supplies which are made to:

Individuals; ½mark

Organizations; and ½ mark Businesses ½ mark

specified in the Third Schedule to the VAT Act. ½ mark

The user of the goods and services that qualify as relief supply enjoys an advantage in that no VAT is payable because of the relief that is given. 1 mark

(c) (i) VAT paid on raw materials

Cost of raw materials inclusive of surtax = K1, 747,500 ½ mark

Rate of surtax = 16.5% ½ mark

VAT = K1, 747,500 x 16.5 ½ mark

116.5

= K247,500 ½ mark

(ii) Value of exports = K3,200,000 ½ mark

VAT thereon at 0% -\_\_\_ ½ mark

Total value of export sales K3,200,000

Value of local sales = K1,200,000 ½ mark

VAT thereon at 16.5% 198,000 ½ mark

Total value of local sales K1,398,000

Amount of VAT chargeable on total sales is K198,000

Vat on Export 0

VAT on locals sales 198,000

198,000

(iii) Output tax on export sales - ½

Output tax on local sales 198,000 ½ mark

Less input tax :

On Telephone charges 28,875 ½

On Electricity charges 23,925 ½

On Security charges 23,100 ½

On stationery 31,515 ½

Rental 41,250 ½

On raw materials 247,500½ 396,165 ½

Net output tax payable 198,165 ½ 5 marks

**TOTAL 15 Marks**

**QUESTION 2**

a) (i) Calculation of gains or losses

formula ar1 - ar2 ½

where a – amount of foreign currency ½

r1 – rate of exchange at the date of establishing liability ½

r2 – rate of exchange at the time of settling liability. ½

Payment for August 2013

$3million x K425 - $3milion x K400 ½

K1,275,000,000 – K1,200,000,000 = (K75,000,000) 1

Payment for Dec 2013

$2.5 million x K450 - $2.5 million x400 ½

K1,125,000,000 – K1,000,000,000 = (K125,000,000) 1

1. The loss is not deductible as there is limitation in deducting foreign exchange losses. The loss is unrealised. **1 mark**
2. Any five types of expenditure not allowable:
3. The cost incurred by any taxpayer in the maintenance of himself, his family or establishment;
4. Domestic or private expenses of the taxpayer including the cost of travel between the taxpayers residence and place of work;
5. Any loss of expense which is recoverable under any insurance contract or indemnity;
6. 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.
7. Income carried to any reserve fund or capitalised in any way;
8. 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;
9. Any expense in respect of which a subsidy has been or will be received;

1. Fringe benefit tax and any penalty chargeable thereon.

**Any 5 1 mark each = 5 marks**

1. Exempt interest income

- Interest on savings certificates issued by the Government or interest on so much of any tax reserve certificate as is accepted in payment of income tax.

- Interest received by or accrued to or in favour of any person from any public loan raised by the Government and issued subject to a condition that such interest shall be exempt from income tax in the hands of such person.

- Interest of up to K10,000 received by or accrued to or in favour of an individual from banks or stocks.

* 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 under the powers vested in him by Section 26 of Finance and Audit Act.
* Interest received by or accrued to or in favour of any person being a resident of Malawi from the 4.5% Africa Development Loan issued on 1 July 1960.

**Any 4 1 mark each = 4 marks**

**( TOTAL 15 Marks)**

**QUESTION 3**

1. It is Malawi Revenue Authority **1 mark**
2. Because any person carrying out duties under the Taxation Act is required to observe secrecy i.e. is not supposed to reveal any matter that comes to his/her knowledge in the performance of his/her duties under the Act. **2 Marks**
3. The person working under MRA is allowed to give out information;
   1. Where the information is required by the Auditor General or any officer duly authorized by him for performance of official duties **1 Mark**
   2. Where information is required by authorized government officers of another country which has a double tax treaty with Malawi to enable it assess the tax position of a taxpayer. **1 Marks**
   3. Where the information is required by a taxpayer or duly authorized agent of taxpayer **1 Mark**
   4. Where the commissioner wishes to compile and publish statistics about the total amount of income received by any class of persons as declared in returns to the commissioner **1 Marks**
   5. Where information is required for the purposes of carrying out the Act into effect or for purpose of any prosecution for an offence committed in relation to any tax on income. **1 marks**
4. A capital gain is the excess of the amount realized on the disposal of a capital asset over its basis or adjusted basis. **1 mark**

A capital loss is the excess of the basis or adjusted basis of a capital asset over the amount realized on the disposal of the capital asset**. 1 mark**

(e) The four instances are gains arising from these transfers:

1 - between spouses or former spouses;

2 - to a spouse from an estate of deceased spouse; and

3 - on disposal of an individual’s principal residence;

4 - capital gains realized by an individual on the disposal of personal

and domestic assets not used in connection with any trade.

5 - from deceased parent to a child

**1 mark each= 5 marks**

**( TOTAL 15 Marks)**

**QUESTION 4**

1. (a) - Estate duty is a direct tax which is based on the wealth of an individual at the date of death  **1 Mark**

* Testacy means dying having left a will.  **1 Mark**
* Intestacy means dying without leaving a will  **1 Mark**

1. The canon of equity – the higher the value of the estate the higher the estate duty to be paid **.5 Mark**

The canon of certainty – there are “certain” tax rates provided by the Act, this will ensure that on any estate, one can be certain as to how much estate duty will be paid **.5 Mark**

1. Properties that are excluded

Any property held by the deceased as trustee for another person under a disposition not made by the deceased **1 Mark**

Any property held by the deceased as trustee for another person under a disposition made by the deceased more than three years before his or her death **1 Mark**

1. Types of domicile

**Domicile of origin 1 Mark**

* Every person receives at birth a domicile of origin.  **1 Mark**
* A legitimate child born during the lifetime of his father has his or her domicile of origin in the country in which his father was domiciled at the time of birth.  **1 Mark**

**Domicile of choice 1 Mark**

* Every independent person can acquire a domicile of choice by the nation of residence and intention of permanent or indefinite residence, but not otherwise.  **1 Mark**
* A person abandons a domicile of choice in a country by ceasing to reside there, and by ceasing to intend to reside there permanently or indefinitely, and not otherwise.  **1 Mark**

**Domicile of dependency 1 Mark**

* The domicile of a depend person is, in general the same, and changes (if at all) with the domicile of the person on whom he is, as regards his domicile, legally dependent.  **1 Mark**
* In particular, during minority, a child’s domicile of dependency changes to match that of the adult on whom the child is said to be dependent.  **1 Mark**

**9 Marks**

**Total 15 Marks**

**SECTION B (40 MARKS)**

**QUESTION 5**

(a) (i) Direct taxes are assessed on income or property with the expectation that the persons from whom the tax is collected lose purchasing power.

Indirect taxes are collected from producers or sellers in the expectation that they will pass it on to consumers.

(ii) Example of direct taxes are income tax and property tax (city rates) 2 marks

Examples of indirect taxes are

 Value added tax

 Customs duty

 Excise tax **2 marks any two**

1. To be allowed
   1. Premium or consideration in the nature of premium.

An allowance shall be made in respect of any premium or consideration in the nature of premium paid by the taxpayer 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 used in the production of income. **1 mark**

The 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 is granted provided that:

**1 mark**

(1) where the period for which the right of occupation or use is granted exceed 25 years, the deduction shall be one twenty fifth of such premium or consideration; and **1 mark**

(2) 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 in terms of this paragraph, then from the date he acquires such ownership he shall cease to be entitled to any allowance. **1 mark**

(b)

* 1. Bad debts

- debts proved to be bad to the satisfaction of the Commissioner and ½

- which have become bad during the year of assessment if ½

- the amount of the debt is included in the current year of assessment or ½

- was included in any previous year in the taxpayer’s assessable income ½

* 1. New business expenditure (of income derived from a manufacturing business\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

Allowed if

- It is incurred by the taxpayer, not more than 18 months before beginning the business, in the course of establishing the business. **1 mark**

- Would have been allowed as a deduction had it been incurred after the beginning of the business. **1 mark**

**SUGGESTED SOLUTION Q 5 c**

(c) (i) Computation of Taxable Income MK

Basic salary : 725,000 x 3 = 2,175,000 ½

Basic salary : 840,000 x 3 = 2,520.000 ½

Housing allowance: 4,695,000 x 20% = 939,000 ½

Clothing allowance: January 2013 = 72,500 ½

Vehicle maintenance allowance 550,000 x 6 = 3,300,000  **½**

Taxable income 9.006,500 ½

**3 marks**

(ii) Calculation of tax

Taxable income as computed above = 9,006,500

Less taxable at 0% = 240,000 ½

Less taxable at 15% = 60,000 9,000 ½

Balance at 30% = 8,706,500 2,611,950 ½

2,620,950 ½

**2 marks**

1. Calculation of additional tax or recoverable tax

Tax as computed in (ii) above = 2,620,950 ½

Less Tax paid through PAYE

Jan – March 263,000 = 789,000 ½

April – June 305,550 = 916,650 ½ 1,705,650

Additional tax payable 915,300 ½

**2 marks**

**(TOTAL 20 Marks)**

**QUESTION 6**

(a) There are two main types of clubs and associations which are

recognized under the Taxation Act and they are as follows:

1. Clubs which are formed or are operated solely or principally for

- social welfare ½

- civic improvement ½

- other similar purposes ½

- and which do not distribute any income to members ½

Those which are formed or operated solely or principally for

* pleasure ½
* recreation ½

(ii) Taxation = Treatment

The income of clubs, societies and associations which are formed or operated solely or principally for social welfare or civic improvement are exempt from tax. 1 mark

Certain types of income of clubs formed or operated solely or principally for pleasure or recreation is subject to tax. **1 mark**

(b) The taxable income of a taxable club or association is deemed to be an amount equivalent to 6¼% of all receipts or accruals to or in favour of the club or association for: 1 mark

- sales of goods ½

- cinematograph performances ½

- stage plays ½

- gambling machinery ½

(c) (i) Computation of taxable income for Chambo Sports Club – financial year ended 31 December 2013

|  |  |
| --- | --- |
| Sale of food  Sale of drinks  TV shows  Live band performances  Gambling machines  6¼% thereon ½ = | K’000  790 ½  1,650 ½  710 ½  460 ½  190 ½  3,800 ½  K237,500 1  **4.5 Marks** |

(ii) Tax Payable

|  |  |
| --- | --- |
| Taxable income  Rate applicable 30% ½  Amount 30% x 237,500 | K’000  237,500 ½    71,250 ½  **1.5 marks** |

1. The income will be assessed in the tax year to 30 June 2014. **1 Mark**

(c) Section 89(2) : If it appears to the Commissioner

(i) that any taxpayer is unable for any cause to furnish an accurate return of income, the Commissioner may accept the taxpayers’ estimate of the amount of his taxable income. 2 marks

(ii) the Commissioner may estimate the taxpayer’s income in the following cases:

(1) a taxpayer makes default in furnishing any return or information; or 1

(2) the Commissioner is not satisfied with the return or information furnished by the taxpayer. 1

(3) the Commissioner has reason to believe that a taxpayer is about to leave Malawi without furnishing a return or a satisfactory return. 1

**(TOTAL 20 Marks)**

**QUESTION 7**

a (i) 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 marks**

(ii) Liability to fringe benefit tax arises where an employer provides fringe benefits to an employee. **1 mark**

(iii) Every employer shall keep and maintain proper records showing:

- the nature of the fringe benefits provided. ½

- the names of employees to whom the benefits are ½

provided; and

- the taxable values of fringe benefits as determination in ½

accordance with these regulations.

- and such records shall be made available for inspection

at anytime by the Commissioner or any authorized public ½

officer. **2 marks**

(iv) Fringe benefits tax is due for payment not later than (14) fourteen days after the end of each quarter. **1 mark**

b (i) (1) Housing allowance of K95,000 per month is taxable in the hands of the employee because it is paid in cash**. 1 mark**

(2) School fees of K175,000 per term will be taxed in the hands of the employer as it is paid directly to the institution**. 1 mark**

(3) The tax burden falls on the employer as this is a fringe benefit.**1 mark**

(4) No liability on vehicle insurance as it is covered together with the motor vehicle benefit. **1 mark**

The employee bares the tax burden for the vehicle running costs as they are paid to him in cash.  **1 mark**

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

1. Cost for the quarter = K175,000 ½

Taxable value 50%, paid to institution = K87, 500 ½

Tax for the quarter at 30% = 87,500 x 30% = 26,250 1 mark

1. Liability to non-resident tax arises where:
   1. income is payable to a person, not being a person resident in Malawi; 1

(ii) the income is from a source in Malawi; 1

(iii) the income is not attributable to a permanent establishment belonging to the recipient of the income. ½

The tax is calculated at the rate of 15% of the gross amount of the income. ½

1. Non -resident tax is not payable in respect of:

- Income and other amounts which are exempt from tax under the provisions of the first schedule; 1½

- any pension or annuity payments 1½

Note To Markers

Any mention of the items listed under the first schedule would deserve one

mark and suffice for the first part. To get full marks candidates should also

mention the pension or annuity payment.

**(TOTAL 20 Marks)**

**QUESTION 8**

1. (i) Every person carrying on a business shall keep sufficient records of his

income and expenditure to enable his assessable income and allowable deductions to be readily ascertained. 1½ marks

1. Such records shall be retained for at least 7 years after the completion of the transaction, acts or operations to which they relate. 1 Mark

Exemptions are:

1. Where the Commissioner has notified the taxpayer that preservation of the records is not required: or ½

(2) Where a company has gone into liquidation and has finally been ½ dissolved.

**Section 54(i) of the Taxation Act**

(iii) - Commissioner discretion. ½

* Acceptance of accounts. ½
* 30 June prior or subsequent. ½
* And no part of such assessment shall be charged to tax. ½
* In any other year of assessment. ½
* All subsequent accounts. ½

- Unless the Commissioner otherwise agrees. **½** - Each succeeding period of 12 months. ½

**4 marks**

**Section 54(i) of the Taxation Act**

1. **Withholding tax from specified payments**

This scheme is commonly known as ‘Withholding Tax’.

1. By whom it is operated.

The scheme is operated by every person who makes any payment **½**

which has been specified for this purpose the 14th Schedule of the Taxation Act. **½**

1. Determination of tax

The tax is determined by using rates which are given in the 14th schedule for the nature of payment specified. **1 mark**

1. When is the tax paid

The tax is supposed to be paid to the Revenue Authorities within 14 days from the end of the month in which such deduction was made. **1 mark**

1. Penalties

For late payment

20% of the tax not paid on time **1 mark**

For non deduction

The operator becomes personally liable to pay the tax not deducted.**½**

1. **Provisional Tax**
2. By whom it is operated.

This is operated by every person who is chargeable with income tax **1**

Whose annual income is estimated to exceed K300,000. **1**

Such income not being from employment, or pension or both employment and pension from which PAYE has been deducted. **1**

1. Determination of tax

The tax is determined by the taxpayer who estimates at the beginning of the year of assessment, the taxable income for the year. The tax is payable in quarterly instalments. **1 mark**

1. When is the tax paid

The tax is paid to the Revenue Authorities within 25 days after the end of the quarter. **1 mark**

1. Penalties

For non payment

- There is no penalty where the tax not paid does not

exceed 10% of the total tax liability. 1

- There is a penalty of 25% of the unpaid tax where the unpaid tax exceeds 10% but does not exceed 50% of the total tax liability. 1

- There is a penalty of 30% of the unpaid tax where the unpaid tax exceeds 50% of the total tax liability. 1

**(TOTAL 20 Marks)**