

**INSTITUTE OF BANKERS IN MALAWI**

**ADVANCED DIPLOMA IN BANKING EXAMINATION**

**SUBJECT: TAXATION 2 (IOBM –AD319)**

**Date: Wednesday, 19th November 2014**

**Time Allocated: 3 hours (08:00- 11:00 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**

1. Describe how annuities are taxed. *(2 marks)*
2. Mrs. Kadyampakeni paid K80, 000 to purchase an annuity from an established insurance company in Malawi. This entitled her to receive an annuity of K8, 000 per annum for 20 years. What is the annual taxable income in respect of the annuity if Mrs. Kadyampakeni:
3. Purchased the annuity using part of a terminal benefit which she received from an approved pension fund on retirement? *(2 marks)*
4. Used her savings to purchase the annuity?  *(2 marks)*
5. Define tax planning.  *(1 marks)*
6. Distinguish Tax Evasion from Tax Avoidance. (*2 marks)*
7. Individuals considering going into businesses, according to the taxation law in Malawi, have a choice to either go into business as unincorporated entities [i.e. Sole traders, partnerships etc] or incorporated entities [Limited Companies].

**Required:**

Explain how **each** entity treats the following for tax purposes:

1. Profits realized from the business. *(2 marks)*
2. Withdrawal of profits from the business. *(2 marks)*
3. Payment of tax. *(2 marks)*

**(Total 15 marks)**

**QUESTION 2**

1. Value Added Tax [VAT] in Malawi was introduced in 1989 under the Customs and Excise Tariff order then known as SURTAX. In 2001, the Surtax Act was passed. Surtax was renamed VAT with the passing of the VAT Act in 2005.

**Required**:

1. Name any **two** effects that the 2001 Surtax Act brought. *(2 marks)*
2. List any **four** situations that can lead to the cancellation of the VAT registration certificate. *(2 marks)*
3. Describe how goods are valued for Value Added Tax purposes. *(6 marks)*
4. An importer has imported two types of consignments separately. The first consignment was for bread flour which cost the importer K640,000 before any duties and discounts. The second consignment, which was for bakery equipment spares, cost the importer K1,500,000 before any duties and discounts.

The importer was however given a 5% discount on the bread flour, the first consignment because he was an appointed distributor of flour in the country. On the second consignment, that of spares for bakery equipment, he was given a cash discount of 10% because of bulk purchase.

**Required:**

Compute the value for duty purposes of the two consignments, giving reasons for your answers.  *(5 marks)*

**(Total 15 marks)**

**QUESTION 3**

1. Ng’ona Limited held a withholding tax exemption certificate for the year ended 31 December, 2013. Briefly describe the benefit to the company of having this certificate? (*2 marks)*
2. Moyo Life Assurance Company is a fast growing assurance company in down town Luchenza. Excerpts of the life assurance company’s financial statements for the year ended 31 December, 2012 reveal the following:

* Total investment income K9,548,000 [made up of K5,700,560 investment income from pension funds and the balance was from individual life policies].
* Commission for sales agents selling life policies to individuals K2,500, 000.
* Administration costs on the pension fund K600,000.
* Maintenance costs on property which the company incurred on buildings which were built using proceeds of individual life policies K1, 350,200.

**Required:**

1. State how investment income arising from the business of life assurance is treated for tax purposes according to Under Section 63(2). *(2 marks)*
2. Explain, in detail, how the taxable income of investment income from a business of life assurance that is liable to tax is determined.

(*3 marks)*

1. Compute the taxable income from the investment income of Moyo Life Assurance Company. *(8 marks)*

**(Total 15 marks)**

**QUESTION 4**

1. A taxpayer is allowed to deduct “deductible expenses” from his or her assessable income to determine Taxable income. Section 28[1] of the Taxation Act states the conditions which must be met for expenses to be deductible from assessable income.

**Required:**

List the major ingredients of deductible expenses according to Section 28[1] provide as far as deductibility of expenses is concerned. *(5 marks)*

1. A Terminal benefit as defined in the Fourth Schedule of the Taxation Act is subject to tax on payment. This is one example of a lump sum that employees may be given on cessation of employment.

**Required:**

Explain the tax rules governing the taxation of terminal benefits as per the fourth schedule of the taxation Act.*(5 marks)*

1. Thabwa retired from employment on 31st March 2013 and received a terminal benefit from an approved pension fund of K10,000,000 out of which she bought an annuity from a life assurance company in Malawi worth K3,500,000 and intended to invest the balance in property. Her other taxable income for 2012/2013 [salary, taxable interest and rent from her Chilomoni house amounted to K3,538,400.

**Required:**

Calculate the tax payable on the terminal benefit. (*5 marks)*

**(Total 15 marks)**

**SECTION B (40 MARKS)**

Answer **ANY TWO** questions from this section

**QUESTION 5**

1. Mr. Sly Chigwechokha was a prominent entrepreneur based in the thriving location of Chimoka dealing in all sorts of hardware goods. Unfortunately, on 4th February, 2014, he died in a car accident as he was coming back from his business errands. At the time of his death, the value of his estate was put at K15,201,000. This estate comprised cash in hand and at the bank, real properties, motor vehicles, plant and equipment, furniture and fixtures just to mention a few.

A review of various important documents in possession of the deceased revealed that included in the total valuation of the estate of K15,201,000 was property situated in Namiwawa valued at K6,000,000 which his late sister had left for her children but was being administered by him [late Mr Chigwechokha] as a trustee. Also included in the estate were two houses valued at K2,000, 000, located in Ndola Lines and K5,000,000, situated in Chibavi, which Mr. Chigwechokha had made a disposition to his mother and father on 6th July, 2012 and 20th January, 2010 respectively, but they were still is his possession and custody at the time of his death.

**Required**:

1. Define estate duty. *(1 mark)*

In determining the values of the estate for Estate duty purposes, certain properties are excluded.

**Required:**

1. Name any **two** types of properties that are excluded. *(2 marks)*
2. Compute estate duty payable on the estate of late Mr. Sly Chigwechokha; give reasons for any treatment of the amount that you take. *(9 marks)*

The Taxation Act allows a taxpayer to deduct both foreign exchange losses and capital losses from assessable income in order to arrive at taxable income.

**Required:**

1. State situations where the deductions of each of the losses i.e. foreign exchange losses and capital losses are restricted. *( 2 marks)*
2. Name the limitations in each of the two losses i.e. foreign exchange losses and capital losses. *(3 marks)*
3. State the circumstances where the restrictions or limitations do not apply in each of the two losses i.e. foreign exchange losses and capital loss. *(3 marks)*

**(Total 20 marks)**

**QUESTION 6**

1. List any **four** types of expenditures that are specifically disallowed for tax purposes in line with section 45 of the Taxation Act. *(4 marks)*
2. The Taxation Act gives the Commissioner General of Malawi Revenue Authority discretionary powers since the administration of the Taxation Act requires constant use of common sense.

**Required:**

1. Why are discretionary powers to the Commissioner General important? *(2 marks)*
2. On which matters do the discretionary powers address? *(1 marks)*
3. Give any **four** examples of expressly stated discretionary powers of the Commissioner. *(4 marks)*
4. Chipelenganya Cooperative Limited is a women member cooperative which was formed long time ago by women from Ntopwa in Bangwe. The main objective was to pool resources together so that they can be giving each other loans from the pool at a modest interest rate. One of the rules of the cooperative is that the members share all the interest at the end of each financial year.

To boost its income base, the cooperative also procures and sells produce whose profits are also shared as dividends by members at the end of each financial year. The cooperative has now grown so big that it owns property like vehicles, furniture and equipment and is doing very well at the moment.

The gross turnover of the cooperative for the year ended 31 December, 2012 amounted to K28, 200, 000. Expenses which the cooperative incurred for the same period were as follows:

* Cost of produce which has been sold during the year amounted to K19, 835, 200.
* Distribution and selling expenses amounted to K4, 980, 000.
* Included in the figure of distribution and selling expenses were specific provision for doubtful debts of K500, 400, general provisions for doubtful debts of K300, 000, loss on disposal of an old furniture of K25, 450 and depreciation for motor vehicles of K251, 340.

The accountant had computed capital allowances for the financial year in question and this amounted to K2, 403, 200.

**Required:**

1. Define Turnover in line with section 60 [4] on Consumer’s cooperative society commonly referred to as other cooperatives. *(2 marks)*
2. State how the taxable income and the related tax of a taxable cooperative is determined. *(3 marks)*

1. Compute the tax liability for Chipeleganya Cooperative Limited for the year ended 31 December, 2012, on the basis that it fits the definition of Consumer cooperatives, which are commonly referred to as other cooperatives [not agricultural cooperatives].  *(4 marks)*

**(Total 20 marks)**

**QUESTION 7**

1. State any **three** situations where fringe benefit tax is not payable even though the employee is enjoying the benefit in line with the definition of the Act.

*(3 marks)*

1. Give **three** examples of loans that are liable for fringe benefits tax and **three** types of loans that are not liable to fringe benefits tax. *(3 marks)*
2. Chigodi Limited, a local registered company, manufactures plastic bags in different sizes for sell. The company did extremely well for the year ended 30 September 2013. As such, to avoid paying more tax on this profit, the financial controller fraudulently claimed an export allowance of K2,450,000 when in fact the company did not fulfill the requirements for such an allowance; more so, the company never exported any of their products during the year. With his fraudulent act, the company paid corporation tax of K6,600,000 to the Malawi Revenue Authority.

**Required:**

1. State the due date for submission of a company’s tax return. *(1 mark)*
2. What should be the amount of tax that a company should pay as it submits its income tax return in line with section 84c? *(2 marks)*
3. Compute the correct tax that Chigodi Limited could have paid. Give reasons. *(3 marks)*
4. Explain the penalty that a taxpayer who, with the intent to defraud, makes a deduction which is not allowed or claims an allowance to which he is not entitled, is liable to.  *(4 marks)*
5. Compute the penalty that Chigodi Limited will pay in respect of the tax for year ended 30 September, 2013. *(4 marks)*

**(Total 20 marks)**

**QUESTION 8**

1. Name any **four** functions of the Malawi Revenue Authority. *(2 marks)*
2. Define the terms “reorganization” and “qualified reorganization” for purposes of the Taxation Act.  *(5 marks)*
3. State any **two** advantages that come as a result of having a reorganization approved by the Commissioner as a qualified reorganization.*(2 marks)*
4. Kakowa Limited is a subsidiary of an international company from Mauritius, However, Kakowa Limited is registered for all taxes that are operational in Malawi since it is based and operates in Malawi. The following transactions took place at the company [Kakowa] during the financial year ended 30 June 2013.
5. On 19th December, 2012, the company remitted, through, Standard Bank, an amount of K10 million to their parent company in Mauritius. The amount was made up of K8 million being an amount that the parent company had lent them and K2 million was the interest that accrued on the amount that Changalume borrowed from the parent company.
6. On 14th August, 2012, the company paid Khwisa trading K22, 600 for supply of tomatoes, and other foodstuffs to the company which were being used to provide meals for its staff [Khwisa trading does not have a withholding Tax Exemption Certificate].
7. On 1st August, 2012, the company paid K600, 000 to Mrs. Namiyangu Bangwe being advance payment for rental for the General Managers’ house in New Naperi. Mrs. Namiyangu Bangwe has a Withholding Tax Exemption Certificate].
8. The actual taxable profits for Kakowa Limited for the year ended 30 June, 2013 amounted to K125, 400, 250. Kakowa Limited paid K15, 000, 000 provisional tax during the year ended 30 June 2013 [in respect of these profits].

**Required:**

1. In respect of items (i) to (iii),State the relevant taxes that should have been withheld by Kakowa Limited from the payments and also the amount that the payees should have been paid. Give reasons for your stand. *(6 marks)*
2. As regards item IV, compute the provisional tax that should have been paid by Kakowa Limited and also state the monetary consequences of not following the rules, where applicable. *(5 marks)*

**(Total 20 marks)**

**END OF THE EXAMINATION PAPER**