TAXATION PROGRAMME EXAMINATIONS

CERTIFICATE LEVEL

C5: INDIRECT TAXES

FRIDAY 19TH DECEMBER 2014

TOTAL MARKS – 100: TIME ALLOWED: THREE (3) HOURS

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading time. Use it to study the examination paper carefully so that you understand what to do in each question. You will be told when to start writing.

2. This question paper consists of FIVE (5) questions of twenty (20) marks each. You MUST attempt all the FIVE (5) questions.

3. Enter your Student number and your National Registration Card number on the front of the answer booklet. Your name must **NOT** appear anywhere on your answer booklet.

4. Do **NOT** write in pencil (except for graphs and diagrams).

5. The marks shown against the requirement(s) for each question should be taken as an indication of the expected length and depth of the answer.

6. All workings must be done in the answer booklet.

7. Present legible and tidy work.

8. Graph paper (if required) is provided at the end of the answer booklet.

9. A taxation table is provided on page 2 only.

TAXATION TABLE FOR THE CHARGE YEAR 2014

1	**Value Added Tax**	**(Rate %)**
	Registration threshold K800,000	
	Standard Value Added Tax Rate (on VAT exclusive turnover)	16
2	**Customs duty**	
	Duty rates on:	
	(i) **Motor cars and Motor vehicles (including station wagons) principally designed for the transportation of less than ten persons, including the driver**	
	Customs duty	25
	Excise duty:	
	Cylinder capacity of 1,500cc and less	20
	Cylinder capacity of more than 1,500cc	30
	(ii) **Pick-up trucks/lorries with gross weight not exceeding 20 tonnes**:	
	Customs duty	15
	Excise duty	10
	(iii) **Buses/coaches for the transportation of more than ten persons**	
	Custom duty	15
	Excise duty:	
	Seating capacity of 16 persons and less	25
	Seating capacity of 16 persons and more	0
	(iv) **Trucks/lorries with gross weight exceeding 20 tonnes**	
	Customs Duty	15
	Excise Duty	0

Note: The minimum amount of customs duty on motor vehicles in categories from (i) up to (iii) above is K2,000.

ATTEMPT ALL FIVE (5) QUESTIONS

QUESTION ONE

(a) Explain the purpose of a bonded warehouse and state **three (3)** advantages for an importer of using a bonded warehouse. (5 marks)

(b) Describe the circumstances under which a person may be required to make a currency declaration and explain the consequences of a person failing to make such a declaration.

(4 marks)

(c) Explain the objectives of the duty draw back system. (2 marks)

(d) State the conditions that must be met for an exporter to successfully claim for duty drawback. (3 marks)

(e) Noah imports luxury clothing from Dubai for resale in Zambia through his retail outlets in Kitwe. He recently imported luxury clothing from Dubai which he purchased at a price of US$28,000. Freight charges were US$11,100. Insurance costs in transit to the port of Dar-es- Salaam in Tanzania were US$3,300, whilst clearing and other incidental costs from Dar-es-Salaam to the Nakonde Border Post amounted to US$3,500. He incurred a further US$2,000 to transport the goods from Nakonde to Kitwe.

Customs duty at the rate of 25% was charged on the consignment. Excise duty is not applicable. The exchange rate provided by the Commissioner General at that time was K6.20 per US$ but the exchange rate quoted in the local commercial banks was K6.10 per US$.

Required:

(i) Calculate the customs value (VDP) of the imported goods. (3 marks)

(ii) Calculate the total import taxes paid on importation of the goods. (3 marks)

[Total: 20 marks]

QUESTION TWO

(a) Explain what is meant by reverse charge (reverse VAT) and describe how the tax is levied. (3 marks)

(b) Explain how the tax point for the following transactions is determined:

(i) Lease rentals for assets under operating leases.

(ii) Sales under hire purchase. (3 marks)

(c) State any **four (4)** conditions which must be met for a business to claim bad debt relief. (4 marks)

(d) Describe the procedure a business must follow in order to claim bad debt relief from the Zambia Revenue Authority. (5 marks)

(e) Describe the operation of the cash accounting scheme and state the main advantages of the scheme. (5 marks)

[Total: 20 marks]

QUESTION THREE

(a) Explain how the principle of estoppel is applied on disputes relating to claims for VAT refunds and VAT payments made by tax payers to the Zambia Revenue Authority.

(3 marks)

(b) JYT Trading, is business registered for Value Added Tax, which makes taxable supplies to other businesses which are registered for VAT and the general public. The company had the following transactions in the month of October 2014.

(1) Sales for the month totalled K4,500,000 which included standard rated sales of K2,600,000 and zero rated supplies of K1,900,000. 60% of the standard rated sales were made to customers who are not registered for Value Added Tax.

(2) Purchases for the month totalled K1,800,000 which included standard rated purchases of K1,300,000, zero rated purchases of K300,000 and exempt purchases of K200,000. 30% of the standard rated purchases were obtained from vendors who are not registered for Value Added Tax.

(3) Standard rated expenditure incurred during the month totalled K783,000 (VAT inclusive) which comprised the following items:

	K
Purchase of motor car	232,000
Purchase of motor van	174,000
Motor car expenses	69,600
Entertainment expenses for customers	37,120
Entertainment expenditure for suppliers	48,720
Staff refreshments	52,200
Diesel for motor vans	41,760
Petrol for motor cars	47,560
Expenses on directors accommodation	15,080
	783,000

All the motor vehicles shown above are used wholly and exclusively for business purposes.

(4) The company sold standard rated fixtures which were in excess to its requirements for K34,000.

(5) Unless specifically stated, all the above persons are registered for Value Added Tax and the transactions are stated exclusive of Value Added Tax.

Required:

Calculate the amount of Value Added Tax (VAT) payable by the company for the month of October 2014. Your answer should clearly indicate whether VAT will apply at the standard rate, zero rate or be irrecoverable on each of the above items.

(12 marks)

(c) Describe **five (5)** circumstances which may result in a business being de-registered for VAT. (5 marks)

[Total: 20 marks]

QUESTION FOUR

(a) Foreign tourists visiting Zambia may be permitted to get a refund of VAT on goods which are exported from Zambia, where such tourists purchase those goods from approved Zambian retailers, under the VAT Refund Scheme for Tourists.

Required:

(i) State the conditions which must be met for a tourist to be eligible to claim VAT on purchased goods under the VAT Refund Scheme for Tourists.

(2 marks)

(ii) State the supporting evidence that an eligible tourist must provide to obtain a refund of VAT incurred, under the VAT Refund Scheme for Tourists. (2 marks)

(iii) Describe the types of retailers who may be permitted to participate under the scheme. (3 marks)

(b) State any four (4) duty concessions available to businesses operating in the manufacturing sector under the Customs and Excise Act. (4 marks)

(c) Explain the differences between import tariffs and trade quotas and state the advantages that import tariffs have over trade quotas. (5 marks)

(d) Sichone who runs a public passenger transportation business purchased a twenty eight seater Rosa bus at a purchase price of $17,000. Insurance cost in transit to the port of Durban South Africa was $3,500 and Freight charges were $ 10,000. $900 was paid to

a clearing and forwarding agent to transport the vehicle from Chirundu to Lusaka where vehicle registration and insurance costs were K9,000.

He used an exchange rate of K6.00/US$1 which he had agreed in advance with a bank through a forward contract, although the exchange rate provided by the Commissioner General at that time was K6.30/US$ in both cases.

Required:

Compute the total import taxes paid on the importation of the Rosa bus.

(4 marks)
[Total: 20 marks]

QUESTION FIVE

(a) Explain what is meant by pre-registration input VAT and describe the circumstances under which a business may recover pre-registration input VAT. (4 marks)

(b) Nchimunya started running a retail business making standard rated taxable supplies on 1 June 2014. She made sales of K60,000 in the month of June. Her sales increased by K21,000 each month from July 2014 to November 2014. From December 2014, she expects sales to be K170,000 per month. Her standard rated expenses were K35,000 per month and are expected to remain at this level in future. Nchimunya is not sure whether she is required to register her business for Value Added Tax.

Required

(i) Explain the Value Added Tax registration requirements to Nchimunya. (3 marks)

(ii) State, giving reasons, when Nchimunya will be required to register for VAT and explain the consequences of registering for VAT late. (5 marks)

(iii) Explain five (5) obligations Nchimunya will have once she registers her business for VAT. (5 marks)

(iv) State any three (3) conditions that will need to be met for Nchimunya to be able to recover any input VAT she will incur on her expenditure. (3 marks)

[Total: 20 marks]

END OF PAPER

C5 SUGGESTED SOLUTIONS

SOLUTION ONE

(a) A bonded warehouse is a building, an installation or area licensed under the Customs and Excise Act which is used to store goods without payment of duty. A bonded house can only be used to store goods for a period not exceeding:

- Two years for those goods on which duty and import VAT exceeds K180
- One year for those goods on which duty and import VAT does not exceed K180

Goods must be paid for and removed from the bonded warehouse before the period expires.

The advantages of a bonded warehouse include:

(1) Goods can be warehoused in such a building without the payment of duty, thus giving an importer sufficient time to source funds.

(2) The use of a bonded warehouse ensures a consistent supply of raw materials reducing the risk of running out of stock in the manufacturing industry, as it enables importation of goods in bulk with duty payments being made according to production demands.

(3) Similarly, a bonded warehouse is also useful in situations where a business faces fluctuating demand for its products, as duty can be paid as and when the goods are sold.

(b) Currency declaration is required under the Customs and Excise Act when any person imports into or exports from Zambia currency notes exceeding the value of five thousand United States Dollars. A commercial bank, bureau de change or any financial institution licenced under any law relating to the registration of banks and financial institutions is not required to make such a declaration.

Where a person fails to make such a declaration or makes an incorrect or false declaration and is found with currency notes in excess of the specified amount, the currency notes in excess of the specified amount, shall be seized and forfeited to the state.

(c) The duty drawback system is an export support programme by the government whose objective is to enable local manufactures recover back any taxes incurred, either directly or indirectly, on goods produced for export.

The purpose of the duty draw back system is to avoid double taxation. The scheme benefits exporters by reducing the export price thereby increasing the competitiveness of local products on the local market. Duty draw back also improves exporter's cash flows.

(d) To successfully make a claim for duty drawback the following conditions must be met:

- The exporter must be registered under the scheme.
- The claim must be made using an appropriate accurately filled in form (i.e. DD claim form ZRA DD2).
- The claim form must be supported by commercial invoices and certified customs documentation.

(1 mark for each valid point up to a maximum of 3 marks)

(e) (i) COMPUTATION OF CUSTOMS VALUE

Purchase price	$28,000
Freight	$11,100
Insurance	$3,300
Clearing and other incidental costs	$3,500
	45,900
Exchange rate	x K6.20
Customs Value for duty purposes	K284,580

(ii) COMPUTATION OF INCOME TAX PAID

	Value K	Taxes K
VDP	284,580	
Customs duty @ 25%	71,145	71,145
	355,725	
Excise duty @ 0	0	0
	355,725	
Import VAT @ 16%	56,916	56,916
	412,641	
Total import taxes		128,061

SOLUTION TWO

(a) Reverse VAT (Reverse charge) is Value Added Tax that is levied on all imported services provided by a non – resident supplier where a tax agent has not been appointed. A service will be considered imported if it is performed or undertaken in Zambia or utilized (or if the benefit of its supply is for a recipient) in Zambia regardless of where it is performed.

The recipient of an imported service simply raises a tax invoice based on the value of the service received from a non - resident supplier.

The value of the service is the taxable value on which VAT at 16% is to be added and declared as output VAT on the return. The reverse charge cannot be claimed back as input tax.

(1 mark for each valid point up to a maximum of 3 marks)

(b) (i) Tax point for operating lease

The tax point for operating lease rentals is the earlier of:

- The time when the lease rental payment is received from the lessee
- The time the lessee issues a tax invoice; or
- The time the leasing services are rendered which is at the expiry of the lease.

(1½ marks)

(ii) Tax point for goods under hire purchase

The tax point is determined as the earlier of the following time periods:

- goods are collected, delivered or made available to the customer,
- payment is made or
- The tax invoice is issued. (1½ marks)

(c) The following conditions must met for a business to claim bad debt relief:

(1) A supply of goods and services must have been made for consideration in money or by barter

(2) Output VAT must have been accounted for and paid by the supplier,

(3) The whole or part of the debt must have been written off as bad in the records of the supplier,

(4) At least eighteen months must have elapsed since the time when the payment was due.

(5) The debtor must have been declared insolvent by the courts of law.

(1 mark for each valid point up to a maximum of 4 marks)

(d) The following procedure must be followed in order to claim bad debt relief:

(1) The supplier must make a claim from the administrator,receiver or liquidator for the VAT inclusive amount that is owed by the insolvent debtor.

(2) The supplier must obtain a written statement from the administrator, receiver or liquidator to the effect that the debtor is insolvent and that he cannot pay the debt.

(3) The supplier must claim a credit for the amount of VAT remitted in respect of the debt by adding the bad debt to the input tax incurred on domestic purchases in the appropriate box of the VAT return.

(4) The ZRA has to be satisfied that claims for bad debt relief are correct. The supplier should therefore retain a copy of the tax invoice issued to the debtor in connection with the supply that later became a bad debt.

(5) The supplier must provide evidence that the VAT being claimed was remitted to the ZRA

(6) The trader is required to keep copies of the correspondence referred to above.

(e) This a scheme under which VAT is accounted for on the basis of the receipts and payments of cash and therefore, the tax point for cash accounting scheme is the time when payment is made.

VAT payments and recoveries are dealt with in the return for the tax period in which cash is paid and receivedVAT is only payable if the customers have made payments.
(Only members of the Association of the Building and Civil Engineering Association are eligible to use the cash accounting system.)

Advantages of the cash accounting scheme

(1) VAT is only payable if the customers have madepayments.

(2) It is easy to prepare the VAT return as the cash book can be used to do so.

(3) Irrecoverable debt relief occurs automatically sinceno VAT is payable if the customers have not madepayments.

SOLUTION THREE

(a) The doctrine of promissory estoppel prevents one party from withdrawing a promise made to a second party if the latter has reasonably relied on that promise. It is a bar or impediment preventing a party from asserting a certain factor claim inconsistent with a position that party previously took, either by conduct or words especially where a representation has been relied or acted upon by others.

In the context of Value Added Tax, estoppel can be applied in situations where thereare disputes about the amount of VAT payable by a tax payer to the Zambia Revenue

Authority. If in such a case the two parties were to agree to a particular sum as the amount of tax to be paidby the tax payer, but then it is later discovered the amount of tax paid is less than what the tax payer actually owed, the ZRA cannot claim the amount of tax underpaid.

Similarly,the principle can also be applied in situations where there are disputes about the amount of VAT refundable by the ZRA to a tax payer. If in such a case, a tax payer were to submit a claim for a VAT refund of a stated amount and the ZRA agrees to refund the tax payer the stated amount, but it is later discovered that the actual amount of the refund to the tax payer should have been higher than that agreed, the tax payer will be stopped from claiming the higher amount, because he agreed to a smaller refund.

(b) COMPUTATION OF VAT PAYABLE FOM THE MONTH OF OCTOBER 2014

	K	K
Output VAT		
Sales		
- Standard rated sales (K2,600,000 x 16%)		416,000
- Zero rated Sales (K1,900,000 x 0)		0
Sale of fixtures (K34,000 x 16%)		5,440
		421,440
Input VAT		
Purchases from registered customers		
((K1,300,000 x 70%) x 16%)	118,400	
Purchases from unregistered vendors (no VAT)		
Zero rated purchases (K300,000 x 0%)	0	
Exempt purchases (no VAT charged)	-	
Motor car (Input VAT irrecoverable)	-	
Motor van (K174,000 x 4/29)	24,000	
Motor car expenses (K69,600 x 4/29)	9,600	
Entertainment for customers(VAT irrecoverable)	-	
Entertainment for suppliers (VAT irrecoverable)	-	
Staff refreshments(Input VAT irrecoverable)	-	
Diesel for motor vans (K41,760 x 4/29)	5,760	
Petrol for motor cars (K47,560 x4/29) x 20%	1,312	
Director's accommodation (VAT irrecoverable)	-	
		(186,272)
VAT payable		235,168

(c) A trader can be de-registered if any of the following occur, while that trader is registered for VAT:

(1) If the business is sold or ceases to trade permanently.

(2) If ZRA is satisfied that the trader is no longer making taxable supplies nor intending to maketaxable supplies, then he would be de-registered.

(3) If there is a change in the legal status of the trader. This may be a situation where a sole traderincorporates his business.

(4) If a trader had applied for registration before commencing to trade and that trader fails tocommence to trade on the expected date.

(5) If a trader submits nil returns for twelve consecutive standard periods.

(6) When a trader voluntarily applies for deregistration as a result of the VAT exclusive turnover of taxable supplies falls below the registration threshold. The three months threshold is K200,000 while the twelve months threshold is K800,000.

SOLUTION FOUR

(a) (i) A tourist will be eligible to claim VAT on purchased goods under the VAT Refund Scheme for Tourists if that person:

(1) is not a resident of Zambia, that is, has not been in Zambia for more than 12 months out of the previous 24 months or;

(2) Does not hold a Zambian passport

(ii) An eligible tourist must present to the following supporting evidence in order obtain a refund of the VAT incurred:

- The goods purchased
- An export tax invoice
- His or her passport
- An airline ticket, where the tourist uses an airline to exit Zambia

(iii) The following types of retailers will be permitted to participate under the scheme:

- Only retailers registered for the scheme are permitted to participate. The retailer must therefore apply for registration under the scheme using an appropriate form (i.e. form VAT 262)

- Only Retailers having a satisfactory standard tax compliance are permitted to register under the scheme. These are retailers who file VAT returns and pay the tax due on time.

- Only retailers making regular sales to tourists are permitted to participate under the scheme

(b) Duty Concessions available to businesses operating in manufacturing:

(1) Import Duty on PVC lining and eyelets used in the manufacture of shoes has been reduced to 5%.

(2) Import Duty on semi refined wax and cerechlor used in the manufacture of paint, and on tapioca starch with dextrose powder which is used in the manufacture of biscuits has been reduced to 15%.

(3) Suspension of Import Duty on machinery, equipment and capital goods for assembling of motor vehicles, trailers, motorcycles and import of bicycles.

(4) Duty on various textile machinery has been reduced to 0% and all woven fabrics of polyester imported for further processing, all imported sewing threads and gray fabrics has duty reduced to 0%.

(4) Reduced Import Duty to 5% on the following inputs used in manufacturing:

- Crude Coconut(copra) oil
- Plates Sheets, film, foil and strip of unsaturated polyesters

(c) Differences between import tariffs and Trade quotas

Import tariffs are a form of indirect tax imposed on imported goods designed to reduce foreign competition in the local market in order to protect the local industry.
They have the effect of making imported goods more expensive than similar locally produced goods, thereby stimulating demand for locally produced goods.
Trade quotas on the other hand are an imposition of a limit to the quantity of the types of goods which can be imported into the country.

Import Tariffs have the following advantages over Trade quotas:

- Tariffs generate revenue for the government whereas trade quotas do not.
- Imposing trade quotas tend to result in administrative corruption.
- Import trade quotas tend to encourage smuggling of goods into the country.

(d) CUSTOMS VALUE FOR ROSA BUS

	Rosa bus
Purchase	$17,000
Insurance	$3,500
Freight	$10,000
	$30,500

Translated @	x K6.30
Value for customs duty purposes	K192,150

COMPUTATION OF TOTAL IMPORT TAXES ON IMPORTATION OF BUS

	Value K	Taxes K
Customs value	192,150	
Customs duty (K192,150 x 15%)	28,823	28,823
	220,973	
Excise duty (K220,973 x 0%)	0	0
	220,973	
Import VAT(K220,973 x 16%)	35,355	35,356
	146,073	
Total import taxes		64,179

SOLUTION FIVE

(a) PRE-REGISTRATION OF INPUT VAT

This is the VAT that is incurred on supplies acquired prior to the time of obtaining registration for VAT. It relates to both the supplies of goods and supplies of services received by a trader.

Conditions for recovery of pre-registration of input VAT

For pre-registration tax to be recoverable:

- The goods and services should have been acquired within a period of up to three months prior to the effective date of registration may be allowed,

- the goods are in stock on the effective date of registration.

In other words, input tax incurred prior to registration cannot be recovered with regard to goods that have already been supplied out or consumed regardless of the three-month period.

(b) (i) VAT REGISTRATION REQUIREMENTS

VAT registration is required when a business makes taxable supplies in the following circumstances:

VAT registration is compulsory once the VAT exclusive taxable supplies of a business exceed K800,000 for any period of twelve months, or K200,000 for any period of three months. Once this happens, a business has an obligation to inform ZRA within 30 days of the end of the month in which the registration limit

is exceeded. Registration will become effective on the first day of the following month.

A business which expects the turnover of taxable supplies, excluding VAT, for the following twelve months to exceed K800,000 or for the following three months to exceed K200,000 must register for VAT immediately under this same rule. In such cases, notification is required by the end of that 30 day period with registration being effective from the start of that period.

A trader who makes taxable supplies whose VAT exclusive taxable turnover is below the registration threshold can also register for VAT voluntarily.

(ii) The sales will exceed the annual VAT registration limit of K800,000 in December 2014, when the cumulative sales from June 2014 will be K845,000 (K60,000 + K81,000 + K102,000 + K123,000 + K144,000 + K165,000 +170,000)

She will therefore have to inform ZRA by the end of January 2015 and her VAT registration will be effective as of 1 February 2015, or from an earlier agreed date.

Alternatively, the quarterly registration threshold of K200,000 will be exceeded in August 2014, when cumulative sales for a period of 3 months will be K247,000 (K60,000 + K81,000 + K102,000). In this case the ZRA will have to be informed by the end of September 2014.

Late registration for VAT attracts automatic penalties consisting of 10,000 fee units for each standard tax period the supplier remains unregistered after meeting the registration threshold.

(iii) Nchimunya will have the following obligations in relation to VAT once registered:

- She will be required to display the VAT registration certificates at its her business premises.
- She will be required to issue tax invoices in respect of the supplies she makes.
- she will be required to complete and submit VAT returns, and pay VAT on the due dates.
- Nchimunya must maintain VAT records for a minimum period of at least five years and allow VAT inspectors access to the VAT records at any time.
- Nchimunya will have inform the Zambia Revenue Authority of any change in the legal circumstances of her business that will warrant a cancellation of the VAT registration.

(1 mark for each valid point up to a maximum of 5 marks)

(iv) Input VAT is recoverable if the following conditions are met:

- At the time the supply was made, the trader was a registered trader for VAT purposes.
- The supply must have been made to the taxable person making the claim.
- The supply must be supported by evidence. The evidence is normally in the form of the tax invoice.
- The person making the claim must use the goods or services for business. Personal expenses do not qualify for relief.
- The amount available for recovery is that which is accurately calculated. The tax must be the amount that accurately relates to the supply.
- The VAT should not be that which is irrecoverable.

END OF SUGGESTED SOLUTIONS