TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D5: INTERNATIONAL TAXATION

THURSDAY 16 JUNE 2016

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 **FOUR (4)** questions of Twenty Five (25) marks each. You must attempt all the **FOUR (4)** 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. **Cell Phones** are **NOT** allowed in the Examination Room.

6. 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.

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

8. Present legible and tidy work.

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

10. A Taxation table is provided on pages 2, 3 and 4.

Taxation Table

Income Tax

Standard personal income tax rates

Income band	**Taxable amount**	**Rate**
K1 to K36,000	first K36,000	0%
K36,001 to 45,600	next K9,600	25%
K45,601 to K70,800	next K25,200	30%
Over K70,800		35%
Income from farming for individuals		
K1 to K36,000	first K36,000	0%
Over K36,000		10%
Gratuity		
K1 to K36,000	first K36,000	0%
Over K36,000		25%
Terminal benefits		
K1 to K35,000	first K35,000	0%
Over K35,000		10%

Company Income Tax rates

On income from manufacturing and other	35%
On income from farming	10%
On income of Banks and other Financial Institutions	35%
On income from mineral processing	35%
On income from mining operations	30%

(Variable profit tax rate) $y = 30\% + [a - (ab/c)]$

Where:

y = the tax rate to be applied per annum

$a = 15\%$

$b = 8\%$

$c = \frac{\text{Assessable Income}}{\text{Gross sales}} \times 100\%$

Mineral Royalty

Underground Mining operations	6%
Opencast Mining operations	9%
Mining of industrial minerals	6%

Capital Allowances

Implements, plant and machinery and commercial vehicles:

Wear and Tear Allowance –	Plant used normally	25%
	Used in Manufacturing, Farming, Leasing	50%

Non- commercial vehicles

Wear and Tear Allowance	20%

Industrial Buildings:		
Wear and Tear Allowance		5%
Initial Allowance		10%
Investment Allowance		10%
Low Cost Housing	**(Cost up to K20,000)**	
Wear and Tear Allowance		10%
Initial Allowance		10%
Commercial Buildings		
Wear and Tear Allowance		2%
Farming Allowances		
Development Allowance		10%
Farm Works Allowance		100%
Farm Improvement Allowance		100%

Presumptive Taxes

Turnover Tax	3%

Property Transfer Tax

Rate of Tax on Realised Value of property other than mining rights	5%
Rate of Tax on Realised Value on a transfer or sale of a mining right	10%

Value Added Tax

Registration threshold	K800,000
Standard Value Added Tax Rate (on VAT exclusive turnover)	16%

Customs and Excise

Duty rates on:

1. **Motor cars and other motor vehicles (including station wagons) principally designed for the transport of less than ten persons, including the driver:**

   Customs Duty:

Percentage of Value for Duty Purposes	30%
Minimum Specific Customs Duty	K6,000

   Excise Duty:

Percentage of Value for Duty Purposes for Excise Duty Purposes	
Cylinder capacity of 1500 cc and less	20%
Cylinder Capacity of more than 1500 cc	30%

2. **Pick-ups and trucks/lorries with gross weight not exceeding 20 tones:**

   Customs Duty

Percentage of Value for Duty Purposes	15%
Minimum specific Customs Duty	K6,000

   Excise Duty:

Percentage of Value for Duty Purposes for Excise Duty Purposes	10%

3.	**Buses/coaches for the transport of more than ten persons**	
	Customs Duty:	
	Percentage of Value for Duty Purposes	15%
	Minimum Specific Customs Duty	K6,000
	Excise Duty:	
	Percentage of Value for Duty Purposes for Excise Duty Purposes	
	Seating Capacity of 16 persons and less	25%
	Seating Capacity of 16 persons and more	0%
4.	**Trucks/lorries with gross weight exceeding 20 tonnes**	
	Customs Duty:	
	Percentage of Value for Duty Purposes	15%
	Excise Duty:	
	Percentage of Value for Duty Purposes for Excise Duty Purposes	0%
5.	**Surtax**	
	On all motor vehicles aged more than five (5) years from year of manufacture	K2,000

Attempt all FOUR (4) questions

QUESTION ONE

GHI Ltd is a Zambian company that is a 100% subsidiary company of GHK GmbH, a company that is resident overseas. GHI Ltd has a 75% subsidiary company called PQR Pty Co, a company that is resident abroad. GHI Ltd also has a 5% shareholding in RST Ltd, a Zambian resident company.

GHI Ltd sells products that it imports from GHK GmbH on the Zambian market and processes further some of its import for export to the country where PQR Pty is resident.

For the tax year 2016, GHI Ltd produced a profit before taxation figure of K19,200,000. The profit before taxation was arrived at after dealing with the following:

	K
Income credited:	
Dividend from RST Ltd	210,000
Dividend from PQR Pty	760,000
Expenditure charged:	
Depreciation of non-current assets (Fixed assets)	12,760,000
Interest on debt	2,625,000
Gifts of GHI calendars to 9,500 customers	1,250,000
Bad debts written off	975,000

Additional information:

(1) GHI Ltd was provided with debt finance of K10,500,000 by GHK GmbH to increase its capital base and as a result, the debt to equity ratio rose from an initial debt to equity ratio of 3 to 2, to a debt to equity ratio of 7 to 2. GHI Ltd does not have any other debt in its capital structure apart from that obtained from GHK GmbH. It has also been established that the rate of interest charged on the debt is 25% per annum, although GHI Ltd can borrow from the Zambian markets at an interest rate of 12.75% per annum.

(2) During the year ended 31 December 2016, goods whose open market value is K7,500,000 were sold to GHI Ltd by GHK GmbH at a value of K9,400,000 under transfer pricing arrangements that are applied by the group. In the same way, GHI Ltd invoiced PQR Pty an amount of K10,300,000 under transfer pricing arrangements for goods whose open market value was K17,500,000. The invoiced amounts were incorporated in GHI Ltd's statement of profits or losses for the year.

(3) The gross amounts of dividends from the Zambian company and from PQR Pty are shown. The rate of withholding tax on the dividend from RST Ltd was 15% while the rate of withholding tax on the dividend from PQR Pty was 25%.

(4) There is no double taxation convention between Zambia and the countries where the foreign companies are resident. Double taxation relief, where applicable is granted unilaterally in Zambia by full credit of any foreign direct taxes against Zambian income tax.

Required:

(a) Explain the taxation implications of the various transfer pricing issues affecting GHI Ltd in respect of its international transactions. (10 marks)

(b) Explain whether GHI Ltd is affected by the problem of thin capitalisation in respect of its financing structure and describe the adjustments required for company income tax purposes to deal with thin capitalisation. (6 marks)

(c) Explain briefly how thin capitalisation may be avoided when multinational companies finance their foreign owned companies and other entities. (1 mark)

(d) Calculate the Zambian company income tax paid by GHI Ltd for the tax year 2016. (8 marks)

[Total: 25 Marks]

QUESTION TWO

International tax issues revolve around two main concepts that are also fundamental reasons or causes of international juridicial double taxation. These two concepts are known as the "concept of source" and the "concept of residence"; both concepts arise from domestic tax law provisions, which distinguish between two types of taxpayers – non-residents and residents.

Matthews Chitekulu is a qualified ZICA accountant. He was born in a country called Nankengo and lived there until 30th December, 2013. He decided to come to Zambia on 1st January, 2014 and formally renounced his Nankengo domicility on 30th October, 2014 and became Zambian domiciled.

During the entire 2016, Matthews Chitekulu was employed by Ulemu Ltd as the Finance Director. The conditions of employment were as follows:

(1) He was paid a monthly salary of K60,000 and contributed the appropriate amounts to NAPSA.

(2) Matthews Chitekulu was permanent and pensionable and was entitled to a gratuity of five times his final annual salary on retirement.

(3) He was accommodated in a house which the company was renting for him. The rental amount paid by the Ulemu Ltd for 2016 was K72,000. This house previously belonged to the company until 1995, when it was sold to a sitting tenant for K2,000,000.

(4) He was required to pay his own ZICA subscription. In the year 2016, the subscription was K1,405.

Matthews Chitekulu also had the following incomes from other sources during the charge year 2016:

- Salary (PAYE K29,400) - K84,000, from part – time employment as a lecturer at Masomo Institute

- Dividends from a company resident in Nankengo – K9,000 net (WHT 10%)
- Bank interest from a Zambian bank – K40,000 (gross)
- Rent from his house in Nankengo – K36,200 net (WHT rate is 25%)
- Rent from his house in Zambia – K54,000 gross (WHT rate is 10%)

Required:

(a) Explain the role of Double Taxation Treaties. (10 marks)

(b) Explain whether Mathews Chitekulu would be regarded as being resident in the tax year 2016. (5 marks)

(c) Calculate the final income tax paid by Mathews Chitekulu in the tax year 2016, and state the due date. Assume double taxation relief, where applicable is granted unilaterally in Zambia by full credit of any foreign direct taxes against Zambian income tax. (10 marks)

[Total: 25 marks]

QUESTION THREE

Bamboo Ltd is resident in a country called Zerrick. The currency in Zerrick is Z$. Bamboo Ltd imports copper from Zambia and processes it into various world class products. On 1st January, 2016, Bamboo Ltd acquired 100% of the ordinary shares of Nyimba Ltd. Nyimba Ltd is resident in Zambia and trades in many mineral products. The board of Bamboo Ltd immediately directed Nyimba Ltd to stop handling other products, including those for competitors, and be the sole distributor of copper cables, produced by Bamboo Ltd.

During the charge year 2016, Bamboo Ltd transferred 120,000 metres of copper cables to Nyimba Ltd. The manufacturing cost per metre for Bamboo Ltd was Z$10 per metre. The variable manufacturing cost was 60% of the manufacturing cost. The market price of the cables was Z$15 per metre. However, the cables were transferred to Nyimba Ltd at variable manufacturing cost plus 200% mark up. The company income tax rate is 1% in Zerrick. Nyimba Ltd sold the cables for K300 per metre. Nyimba Ltd incurred selling, distribution and administration costs of K4 per metre. The Zambian tax rate is 35% and the exchange rate was K11 per Z$1.

The Zambia Revenue Authority (ZRA) is aware that a company can ordinarily buy and sell goods at any price it wishes, but they have queried Bamboo Ltd and Nyimba Ltd arrangement. ZRA would like to revise the company tax assessment for Nyimba Ltd using the anti avoidance legislation which requires profit to be computed as if the transactions had been carried out at arm's length. Assume all expenses are allowable.

Required:

(a) Discuss the importance of transfer pricing rules and regulations. (6 marks)

(b) Suggest two (2) measures which a country can put in place to counter the negative effects of transfer pricing on tax revenue. (4 marks)

(c) Discuss tax avoidance in cross border transactions and explain two fundamental principles to consider when evaluating approaches to the relationship between tax treaties and domestic anti-avoidance rules. (8 marks)

(d) Compute the original and revised income tax payable by Nyimba Ltd for the tax year 2016, and comment on your results. (7 marks)

[Total: 25 Marks]

QUESTION FOUR

Muweme received the following income in the tax year 2016:

	K
Gross emoluments from Zambian employment	90,000
Dividends from Zambian companies	31,875
Profits from a farming business run in Zambia	650,500
Interest from a bank in foreign country	6,000
Dividends from shares in a foreign company	36,180
Rent from letting of property in a foreign country	95,000

Dividends from Zambian companies are the net amounts received. Withholding tax had been deducted at source. Similarly, foreign interest received from a bank in a country called Wonderland and foreign dividends from a company in a country called Northland are also net of withholding tax at the rates of 20% and 33% respectively. Income tax deducted from the Zambian emoluments and already paid under the Pay As You Earn system amounted to K14,828 while provisional income tax paid was K59,641.

There is no double taxation treaty between Zambia and both Wonderland and Northland. Full credit is therefore given against Zambian income tax for any direct taxes suffered in Wonderland and in Northland on income remitted to Zambia.

Required:

(a) Distinguish between territorial taxation and residence taxation as systems of international taxation and explain briefly the inadequacies of each system. (6 marks)

(b) Explain how the inadequacies of territorial taxation and residence taxation you have explained in (a) above are addressed to ensure maximum tax collection. (2 marks)

(c) Explain the circumstances under which double taxation may arise in international taxation and explain how a relief to avoid double taxation may be claimed. (8 marks)

(d) Based on the information provided above, calculate the final income tax payable by Muweme for the tax year 2016. (9 marks)

[Total: 25 marks]

END OF PAPER

JUNE 2016: INTERNATIONAL TAXATION (D5)
SOLUTIONS

SOLUTION ONE

(a) The transfer pricing issues facing GHI Ltd are in respect of the inter company sales of goods and the loan interest payable on the loan from GHK GmbH.

(1) Goods sold to GHI Ltd by GHK GmbH

Goods sold between group companies must be invoiced at their full market value. When goods were sold to GHI Ltd at less than their market value, the taxable profits in Zambia were reduced by the difference between the market value of the goods and their transfer value. The reduction in taxable profits in Zambia was by:

	K
Transfer value of the goods	9,400,000
Market value of the goods	(7,500,000)
Decrease in Zambian taxable profits	1,900,000

When computing the taxable profits in Zambia, the amount of K1,900,000 must be added back to the net profits as per accounts.

(2) Goods sold by GHI Ltd to PQR Pty

When GHI Ltd transferred goods to PQR Pty at less than their full market value, the Zambian taxable profits were reduced by the difference between the full market value and the actual transfer price. The reduction in the Zambian taxable profits was by:

	K
Market value of the goods sold to PQR Pty	17,500,000
Transfer value of the goods	(10,300,000)
Decrease in Zambian taxable profits	7,200,000

When computing the taxable profits in Zambia, the amount of K7,200,000 must be added back to the net profits as per accounts.

(3) Loan interest

When interest is provided by a related party resident abroad, the rate of interest must reflect the local market borrowing rates. When the actual interest rate chargeable exceeds the local market borrowing rate, then the Zambian taxable profits are reduced by the difference between interest payable based upon the local market borrowing rates and the actual interest payable. The reduction in the Zambian taxable profits is by:

	K
Actual interest payable (25% x K10,500,000)	2,625,000
Interest based on market rates (12.75% x K10,500,000)	(1,338,750)
Decrease in Zambian taxable profits	1,286,250

When computing the taxable profits in Zambia, the amount of K1,286,250 must be added back to the net profits as per accounts, subject to any further adjustment for thin capitalisation. Alternatively, the whole of K2,625,000 may be added back and only K1,338,750 may be deducted, subject to any further adjustments for thin capitalisation.

(b) Thin capitalisation arises when a company is financed by debt finance provided by related company that exceeds the arm's length borrowing capacity of that company. In Zambia, a company is thinly capitalised if its debt to equity ratio exceeds the standard ratio of 3 to 1. This means that the proportion of debt in the capital structure should exceed equity by more than 3 times for a company to be thinly capitalised.

GHI Ltd has a debt to equity ratio of 7 to 2, after raising additional debt finance from the holding company overseas. This debt to equity ratio simplifies to a debt to equity ratio of 3.5 to 1, when both sides are divided by 2. GHI Ltd is therefore thinly capitalised.
As a result of thin capitalisation, part of the interest payable on debt must be added back to the net profit as it will be treated as if it were a dividend. The amount of interest to be added back as a result of thin capitalisation is the amount based upon the normal market borrowing rates in Zambia.

(c) To avoid thin capitalisation when multinational companies finance their foreign entities, they may consider providing debt only up to the level of the standard debt to equity ratio. Alternatively, the multinational companies may authorize their foreign entities to raise debt finance from their local financial markets. Thin capitalization may also be avoided by financing using equity finance.

(d) GHI Ltd
Company Income Tax computation for the tax year 2016

	K	K
Net profit as per accounts		19,200,000
Add:		
Transfer pricing adjustments:		
Purchases from GHK GmbH	1,900,000	
Sales to PQR Pty	7,200,000	
Loan interest	1,286,250	
Excess interest due to thin capitalisation		
K1,338,750/3.5 x 0.5	191,250	
Depreciation	12,760,000	
Extra cost of gifts		
K1,250,000 – (9,500 x K100)	300,000	
		23,637,500
		42,837,500
Less:		
Dividends from RST Ltd	210,000	
Dividends from PQR Pty	760,000	
		(970,000)
Taxable business profits		41,867,500
Dividend from PQR Pty		760,000
Total taxable income		42,627,500
Company income tax		
35% x K42,627,500		14,919,625
Double Taxation relief (25% x K760,000)		(190,000)
Company income Tax payable		14,729,625

SOLUTION TWO

(a) Double Taxation Treaties are agreements between two states which are designed to:

(1) Protect against the risk of double taxation where the same income is taxed in two states. This could encourage both inward and outward investments. These can have a positive impact on the economy.

(2) Provide certainty of treatment for cross border trade and investment. Certainty can significantly reduce instances of bribery and corruption.

(3) Prevent excessive foreign taxation and other forms of discrimination against business interests abroad. One of the canons of taxation is equity. All countries strive for quality tax regimes.

(4) Protect the government's taxing rights and protect against attempts to avoid or evade tax. Tax evasion is a criminal offence in most countries. It denies countries the much needed funds for development.

(5) They also contain provisions for the exchange of information between national taxation authorities. The tax authorities can use the information to capture more taxpayers and increase the tax revenues.

(6) Seek to encourage and maintain an international consensus on cross-border economic activity and to promote international trade and investment. This is very important since the world is almost a global village.

(b) Matthews Chitekulu came back to Zambia in 2014 and has lived in Zambia since that time. An individual is resident in Zambia if he or she is **physically present** in Zambia for a period of **not less than 183 days** in a **charge year**. Matthews Chitekulu was physically present in Zambia a period of at 183 days (the whole charge year). In addition, individuals who **normally live** in Zambia are resident and ordinarily resident in Zambia. This also **applies to Matthews**.

The Income Tax Act does not define residence or ordinary residence of an individual. What it does in section 4 (1) is to set out rules under which it will be decided that an individual is not resident in Zambia for a charge year. Section 4(1) says that an individual, for the purposes of the Income Tax Act, is not treated as resident in the Republic where that individual is in Zambia for:

- A temporary purpose; and
- Not with the intention of establishing residence in Zambia; and
- For not more than 183 days in the charge year (excluding days of arrival and departure)

If any of the above conditions is not fulfilled, that individual will be considered to be resident in Zambia in that particular charge year.

(c) Matthews Chitekulu

Personal Income Tax computation for the charge year 2016

	K	K
Salary (60,000 x 12)		720,000
Rent		72,000
Salary (Part-time)		84,000
Foreign dividends (9000 x 100/90)		10,000
		886,000
Less:		
ZICA subscriptions	1,405	
NAPSA	3,060	
		(4,465)
Taxable income		881,535
Income Tax		
36,000 x 0%		0
9,600 x 25%		2,400
25,200 x 30%		7,560
810,735 x 35%		283,757
		293,717
Less:		
Double Taxation Relief (DTR) (W1)		(1,000)
		292,717
Less:		
Tax already paid – PAYE		(29,400)
Final income tax payable		263,317

The due date for the payment of the final income tax is 30th June, 2017.

WORKING

1. Double Taxation Relief (DTR)

Lower of:

(i) Foreign tax paid on dividend = K10,000 x 10% = K1,000

(ii) Zambian tax charge on foreign income =

$$\frac{\text{Gross foreign dividend}}{\text{Total assessable income}} \times \text{Zambian tax charge}$$

$$= \frac{10{,}000}{(881{,}535 + 54{,}000)} \times (293{,}717 + 5{,}400) = K3{,}197$$

Therefore the DTR is K1,000, which is the lower amount.

SOLUTION THREE

(a) **Transfer pricing** is the general term used to refer to the problem of allocating profits among the parts of a corporate group. Companies which have subsidiaries resident in countries with **lower corporate tax rates** may attempt to **divert profits** by inter-company pricing arrangements. This would result in reduced tax liabilities for the whole group and normally **loss of significant tax revenue** to the country. Transfer pricing rules therefore **act as anti-avoidance rules** meant to protect government tax revenues.

Countries are enacting general provisions in their tax laws directed against tax avoidance, which give **powers to reconstruct transactions**. It seems to be increasingly **accepted by the OECD** that such rules are not in conflict with tax treaty obligations and can be applied to international transactions. In general, rules prevent a company to transfer goods from one country to another at a price that is lower than the market price of those goods.

In **most countries**, including Zambia, when transfer prices are lower than the actual market values of the goods being transferred, then the profit element must be added when calculating the taxable profits. Similarly, when loan interest is charged at less than the commercial lending rate, the company receiving the said loan interest is deemed to have received interest at the commercial rate.

It is important, however, to note that the increasing of the activities of corporate groups, the growing importance of unique intra group intangibles and services, and the sophistication of their financing operations mean, however, that application of the arm's length standard is **becoming more difficult**, both conceptually and practically. The problems have been addressed in part by the OECD, which has expanded its guidance on this issue.

(b) The measures which can be used to counter the negative impact of transfer pricing include:

(1) Advance Pricing Arrangement – this is a procedure whereby a company can agree in advance that its transfer pricing policy is acceptable to the tax authorities.

(2) Enacting laws which reflect international norms. The OECD standards represent internationally accepted norms. Countries must take these into account when enacting national laws.

(3) Capacity building of the tax authorities – most tax authorities are poorly funded, and as such are therefore unable to embark on comprehensive capacity building strategies.

(4) Networking with other tax authorities – developing relationships outside the traditional organization boundaries can also assist. It could be easy to obtain intelligence and expert information on tax matters.

(c) **Tax avoidance** in cross-border transactions is a **growing problem** for countries worldwide. With business becoming **increasingly international**, there is a greater need for coherent structures that facilitate cross-border transactions and help protect economies that are **increasingly fragile** and reliant on one another. An example of such a structure is the double tax treaty networks which are designed to prevent international double taxation.

However, **double taxation agreements** pose a particular problem. This is because they provide opportunities for taxpayers to avoid domestic tax obligations and receive undue benefits under the treaty. This would be the case where someone acts through a company created in another country to obtain benefits that would not be available directly to the individual alone. International tax avoidance poses a threat to the **integrity of domestic tax systems** and the flow of revenue governments receive from them.

To counter-act undesirable avoidance, countries enact general and specific anti-avoidance rules to protect their domestic interests. There are **two fundamental principles** to consider when evaluating approaches to the relationship between tax treaties and domestic anti-avoidance rules, namely:

(1) The **application** of anti-avoidance rules may undermine the certainty of law and the inviolability of agreements struck between nations. This is balanced against the domestic interests of a state in maintaining the integrity of their tax system and not having their tax revenue exploited by abusive taxpayers.

(2) The **compatibility** of tax treaties and the domestic anti-avoidance rules. The OECD model outlines two approaches to help evaluate the compatibility of domestic anti-avoidance rules, that is, the factual approach and the interpretative approach.

(d) Nyimba Ltd

Computation of original company income tax payable - 2016

	K
Sales (120,000 x 300)	36,000,000
Cost of sales (120,000 x 10 x 60% x 3 x 11)	(23,760,000)
Gross profit	12,240,000
Selling, distribution and administration costs	(480,000)
Taxable profits	11,760,000
Company income tax	
11,760,000 x 35%	K4,116,000

Nyimba Ltd

Computation of revised company income tax payable - 2016

	K
Sales (120,000 x 300)	36,000,000
Cost of sales (120,000 x 15 x 11)	(19,800,000)
Gross profit	16,200,000
Selling, distribution and administration costs	(480,000)
Taxable profits	15,720,000
Company income tax	
15,720,000 x 35%	K5,502,000

The income tax has increased by K1,386,000 (5,502,000 – 4,116,000). This is substantial and ZRA will insist on revising assessment.

SOLUTION FOUR

(a) Territorial taxation is a system of taxation whereby only income that arises from sources that are within the country or deemed to be from within the country is taxable on all types of taxable persons.

The key problem argued for of territorial system of taxation is the ability to avoid taxation on portable income by moving it offshore. This results in loss of tax revenue by governments.

On the other hand, residency taxation is a system of taxation whereby all the income of persons who are resident in the country is taxable, irrespective of whether that income arise from within or from outside the country where the taxable persons are resident. In this way, residents are taxable on their worldwide income while non-residents are taxable on certain income that arise from within the country.

(b) The inadequacy of residency taxation is that persons may avoid taxation by not becoming resident in any state. This reduces tax revenue for the governments.

To ensure the inadequacies of territorial and residence taxation are addressed, governments use hybrid taxation systems. These are systems that contain features of several systems of international taxation such as some features of territorial taxation blended with features of residency taxation to ensure maximum collection of tax revenue occurs.

(c) Double taxation arises where income that has suffered taxation abroad must be subjected to taxation locally as well. The taxable income both abroad and locally is the income before deduction of taxes.

Double taxation relief may be eliminated by claiming a relief known as double taxation relief. This relief may be available in three main ways as follows:

(i) By treaty relief where a double taxation convention has been signed between two countries. The double taxation convention specifies how double taxation relief must be granted.

(ii) Unilateral credit relief which applies where there is no double taxation convention between the two states. Under this relief, double taxation relief is granted in one unilaterally in one country by the tax authorities in that country allowing a credit against the local tax of the lower of the foreign tax paid and the local tax payable on the foreign income.

(iii) Unilateral expense relief where the amount of foreign tax paid is treated as an allowable expense. This also applies where there is no double taxation convention between the two states.

(d) Muweme

Personal Income Tax computation for the tax year 2016

	Total	Non – farming income	Farming Income
	K	K	K
Emoluments from employment	90,000	90,000	
Farming profits	650,500		650,500
Foreign Bank interest (100/80 x K6,000)	7,500	7,500	
Foreign dividends (100/67 x K36,180)	54,000	54,000	
Total income	802,000	151,500	650,500
Income Tax on non – farming income:			
On the first K70,800			9,960
On the balance: 35% x (K151,500 – K70,800)			28,245
Income Tax on farming income			
10% x K650,500			65,050
			103,255
Double Taxation relief:			
Foreign interest (W3)		973	
Foreign dividends (W4)		7,004	
Total double taxation relief			(7,977)
			95,278
Less taxes already paid:			
Provisional Income Tax		59,641	
Income Tax paid under the PAYE system		14,828	
			(74,469)
Income Tax payable			20,809

Workings:

(1) Total assessable income:

	K
Income chargeable to income tax	802,000
Gross Zambian dividends (100/85 x K31,875)	37,500
Total assessable income	839,500

(2) Total amount of Zambian tax charge:

	K
Income tax	103,255
Withholding Tax on Zambian Dividends (15% x K37,500)	5,625
Total Zambian tax charge	108,880

(3) Double Taxation relief on foreign interest is the lower of:

(a) Foreign Tax paid = 20% x K7,500
= K1,500

(b) Zambian tax charge = K7,500/ K839,500 x K108,880
= K973

The amount of double taxation relief is K973.

(4) Double Taxation relief on foreign dividends is the lower of:

(a) Foreign Tax paid = 33% x K54,000
= K17,820

(b) Zambian tax charge = K54,000/ K839,500 x K108,880
= K7,004

The amount of double taxation relief is K7,004.

END OF SOLUTIONS