TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D1: BUSINESS INFORMATION MANAGEMENT

WEDNESDAY 14 DECEMBER 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.

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

Attempt all FOUR (4) questions.

QUESTION ONE

A car engine company has just began manufacturing complete cars and looking forward to sell their cars throughout Africa.

The main office based in Lusaka has decided to computerise the payroll system. The company engages a Systems Analyst to help analyze the current system.

Required:

(a) Describe the key areas outlined below, in relation to feasibility;

(i)	Technical feasibility	(5 marks)
(ii)	Operational feasibility	(5 marks)
(iii)	Economic feasibility	(5 marks)

(b) Describe the five (5) forces of a strategic model for competitive analysis.

(10 marks)

[Total: 25 Marks]

QUESTION TWO

A Motor repair business company bases its business on repairing cars, trucks, and motor bikes. There are at present 30 members of staff where 6 do office work, the rest are workshop staff. To enhance its business operations the company maintains its data using a computerized database system.

Every organization has a pyramid management structure, made of Senior Executives at strategic level followed by Management Executives at management level, and Operational Managers at operational level.

Required:

(a) Explain each of the following types of decisions made by the Motor repair company giving examples and stating the level in the organization management pyramid they occur:

(i)	Unstructured decisions	(4 marks)
(ii)	Semi-structured decisions	(4 marks)
(iii)	Structured decisions	(4 marks)

(b) State any five (5) functions of a Database Management System (DBMS) with respect to the motor repair company. (10 marks)

(c) List the three (3) main models of electronic business (3 marks)

[Total: 25 Marks]

QUESTION THREE

(a) For EACH of the following Knowledge Management Techniques and Technologies, explain its key features and give its advantages and disadvantages:

(i) Knowledge Storage tools (5 marks)
(ii) Collaboration tools (5 marks)
(iii) Communication tools (5 marks)

(b) Describe each of the following tools management may use to enhance their business operations:

(i) Executive Support Systems (ESS). (4 marks)
(ii) Decision Support Systems (DSS). (4 marks)

(c) Describe the term **critical path** as used in Project Evaluation and Monitoring Techniques (PERT). (2 marks)

[Total: 25 Marks]

QUESTION FOUR

(a) Key Performance Indicators (KPI) are metrics which become useful once the quality of the software is established. Explain what KPI are used for and give examples of typical KPI and the industry that they are used in. (5 marks)

(b) Distinguish between

(i) System testing and user acceptance testing (2 marks)
(ii) Direct changeover and parallel running changeover methods (2 marks)
(iii) Corrective maintenance and perfective maintenance (2 marks)

(c) Discuss the roles that the user(s) and the software development team play in software validation. (8 marks)

(d) List any six (6) components that are considered to be important in each activity node when drawing the Activity On Node (AON) network diagram. (6 marks)

[Total: 25 Marks]

END OF PAPER

December 2016 Examinations

D1 Solutions

SOLUTION ONE

(a) Discuss the key areas outlined below, in relation to feasibility;

(i) **Technical feasibility**

The requirements, as defined in the feasibility study, must be technically achievable. This means that any proposed solution must be capable of being implemented using available hardware, software and other technology. Technical feasibility considerations could include the following;

1 Volume of transactions which can be processed within a given time.

2 Capacity to hold files or records of a certain size.

3 Response time (how quickly the computer does what you ask it to).

4 Number of users which can be supported without deterioration in the other criteria.

(ii) **Operational feasibility**

Operational feasibility is a key concern. If a solution makes technical sense but conflicts with the way the organisation does business, the solution is not feasible. Thus an organisation might reject a solution because it forces a change in management responsibilities, status and chains of command, or does not suit regional reporting structures, or because the cost of redundancies, retraining and reorganisation are considered too high.

(iii) **Economic feasibility**

Any project will have economic costs and economic benefits. Economic feasibility has three strands:

1 The benefits must justify the costs.

2 The project must be the 'best' option from those under consideration for its particular purpose.

3 The project must compete with projects in other areas of the business for funds. Even if it is projected to produce a positive return and satisfies all relevant criteria, it may not be chosen because other business needs are perceived as more important.

b) Students briefly describe the five forces of a strategic model for competitive analysis.

Five competitive forces are:

- Potential for new entrants to enter the market
- Rivalry among existing firms
- Pressure of substitutes
- Bargaining power of buyers
- Bargaining power of suppliers

SOLUTION TWO

a) Students should know the pyramidal structure of an organization, types of decisions made at each of the levels, and computer tools managers use to support each level.

Types of decisions

i) Unstructured decisions:

Decisions made at strategic level by senior managers in the motor repair Company:

- Setting up an assembly factory for the vehicles
- Deciding on models of vehicles to assemble
- Forecasting on future demands for type of vehicle
- Planning for engineers for the future

ii) Semi-structured decisions:

- Sales performance for each vehicle
- Determining cost for each model of vehicle repaired
- Deciding on inventory level to be maintained
- Deciding on type of model to maintain

iii) **Structured decisions:**

- Tracking orders for spares
- Tracking accounts payable to customers

- Tracking accounts receivable from customers
- Tracking the inventory
- Processing new orders of spares

b) **Functions of the DBMS**

- On-line queries from customers can be executed
- Ad-hoc queries can be executed from users
- The database can be created and structured using the DBMS
- Making of amendments to the database by the Database administrator
- Ensuring there is security to the access of the database
- Ensuring that the database is shared among the users
- Meeting the user needs of information from the database

c) Types of electronic business

- Business-to-consumer (B2C)
- Business-to-business (B2B)
- Consumer-to-consumer (C2C)

Allow also

- Government-to-Citizen (G2C)
- Business-to-Employee (B2E)

(Any three)

SOLUTION THREE

a)

Knowledge Storage tools

Also known as content databases, allow a firm to electronically collect and store information. Examples of such storage tools include knowledge databases (Lotus Notes) as well as corporate intranets which serve as a repository of project files and other knowledge created by users. The latest knowledge storage tools differ from earlier database or file systems in that these newer tools have more sophisticated organisational structures which allow users to more easily identify and locate desired information. In addition, the internet has allowed for global access to such knowledge databases so that employees can store and retrieve information on a worldwide basis.

Advantages:

Knowledge storage tools enable the firm to store explicit knowledge in multiple formats. Well-designed tools also offer substantial flexibility And ability to integrate functionality with other knowledge management tools.

Disadvantages:

These tools are often expensive and require substantial user training. If the tools are not easy to use, it may also be difficult to encourage employee use and adoption.

Collaboration tools

These tools allow employees to create a virtual, web-based workplace in which they can share files and interact in an electronic environment. Such tools can provide a "collaborate workplace which can enable distributed teams to work together to accelerate and improve development and delivery of products and services, optimise collaborative business processes, and improve innovation, problem solving and decision making. These tools allow dispersed project teams to exchange electronic files, discuss topics online, as well as store, retrieve and organise project work in a centralised location.

Advantages:

Collaboration tools enable distributed learning and workflow. Most collaboration tools are relatively easy to use. These tools are flexible, can be used in a variety of situations and integrate well into a firm's other knowledge management tools.

Disadvantages:

The cost of some collaboration tools can be moderately expensive. Unless the firm is careful to embed collaboration tools into the work process, the firm may have difficulty encouraging employee use.

Communication tools

Various communication tools can also help firms address their knowledge management issues. These communication technologies can be classified into asynchronous and synchronous tools. Asynchronous tools include technologies which allow communication between two or more users on a sequential basis. Examples of such technologies include email, wikis and weblogs. Synchronous tools are those technologies which facilitate communication between users on a real-time basis. Discussion and chat technologies and videoconferencing are examples of synchronous communication tools. Both asynchronous and synchronous tools help to improve the knowledge sharing, interaction and transfer of information between employees in an organisation.

Advantages:

Most communication tools are simple to use and these tools also allow enhanced communication. In general employee adoption is high as employees enjoy the social aspect of these tools. Also, these tools are usually not cost-prohibitive and they complement and integrate well with other knowledge management tools.

Disadvantages:

There are few effective search tools for communication technologies. Thus knowledge storage and retrieval is challenging with these tools.

b) i) **Executive Support Systems (ESS)**

- Used by senior managers to present overall data on sales of vehicles using simple graphics
- Aggregating data internally
- Aggregating data externally
- Used to produce projections for possible future expansion of the company
- Used for investment portfolio for the company

ii) **Decision Support Systems (DSS)**

- An analytical tool for decision makers
- Used to evaluate alternatives and choose the best solution
- For constructing sort term budgets
- Examining budgets using "what if" analysis
- Can be used to evaluate performance of each vehicle in terms of cost
- Can be used to construct operating schedules for the plant

c) **Critical path** is the path that gives the longest period of time a project should take. Activities on the critical path should never be delayed if the project is to be completed on schedule.

SOLUTION FOUR

a) Key Performance Indicators (KPI) are designed by management for understanding performance in a given dimension , common retail KPI are average delivery times, in banking, the time to create an account

b) **Distinguish between**

i) System testing and user acceptance testing

System testing tests completed systems by the developers while user acceptance testing is testing done in the presence of users

ii) Direct changeover and parallel running changeover methods

Direct changeover is changing from the old to the new system in one move. Suitable for completely different systems.

Parallel running involves running both old and new system in parallel while comparing their results. Suitable for similar systems

iii) Corrective maintenance and perfective maintenance

Corrective maintenance involves correction of errors that arise in the usage of the system. Perfective maintenance involves making improvements to the system to make it more efficient and effective.

c) **Discuss the roles that the customer(s) and the software development team play in software validation.**

The users supply the system requirements at the beginning of the software development process. During user acceptance testing the users validate the system against the requirements.

The software development team have to do unit testing, integration testing and system testing to ensure the system errors are corrected. Moreover, team members have to interact with users during prototyping where it is used to ensure their requirements are being met by the system.

It should be stressed the importance of continuous feedback by users as long as prototypes are made available (validation). Verification is carried forward by the software teams. New approaches like the Agile one put an emphasis on users as part of the team.

d) **Components to consider when drawing AON network diagram**

i) Activity ID
ii) Duration
iii) Early Start
iv) Early Finish
v) Late Start
vi) Late Finish
vii) Slack time

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D2: FINANCIAL MANAGMENT

FRIDAY 16 DECEMBER 2016

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10. Formulae, Present Value, and Annuity tables are provided at the end of this question paper.

Attempt all FOUR (4) questions.

QUESTION ONE

Jewry Ltd is considering investing in a machine which would have an expected life of 4 years. The machine will be bought for K50m. This amount excludes installation costs of K5m and delivery expenses of K3m.

Annual cash flows from the machine are expected to be as follows:

	K'000
Sales	10,000
Direct material costs	2,500
Direct labour costs	1,000
Advertising expenses	500

The machine will have a nil residue value at the end of its life. The annual sales and material costs are expected to increase by 20% at the end of year 3 as a result of the continued expenditure on advertising. However no increase in material costs is expected in year 4.

The rate of corporation tax on profits is 35% and tax is paid one year in arrears. Selling price inflation is expected to be 10% per annum and material price inflation is expected to be 5% per annum. The general rate of inflation is 9% per annum.

Capital allowances will be available at 25% per annum on straight line basis. All cash flows are expected to occur at the end of the year. The company's real cost of capital is 10% per annum.

Required:

(a) Calculate the net present value of the proposed investment in the machine. (19 marks)

(b) Explain the main characteristics of a finance lease. (6 marks)

[Total: 25 Marks]

QUESTION TWO

Given below are the draft statements profit or loss of Trove Ltd and its subsidiary company Bird Ltd for the year ended 31 December 2015.

On 1 January 2014 Trove purchased 800,000 ordinary shares in Bird Ltd at a cost of K3million. The issued share capital of Bird is 1000,000 K1 ordinary shares. At that date the profit and loss reserve of Bird showed a credit balance of K500, 000.

Statement of profit or loss account for the year ended 31 December 2015.

	Trove K'm	Bird K'm
Turnover	7	4
Cost of sales	(4.6)	(2.4)
Gross profit	2.4	1.6
Operating costs	(0.1)	(0.5)
Operating profit	2.3	1.1
Interest payable	(0.3)	-
Profit before tax	2.0	1.1
Tax	(0.6)	(0.33)
Profit for the year	1.4	0.77

The following additional information is relevant.

(1) During the year Bird sold goods to Trove Ltd for K500, 000 making a mark-up of one third. Only 20% of these goods were sold before the end of the year, the rest were still in stock.

(2) Goodwill is to be amortised over ten years. The amortisation is to be recognised as an operating cost.

Required:

(i) Prepare for presentation to members the consolidated statement of profit or loss for the year ended 31 December 2015. (12 marks)

(ii) Explain why it is necessary to eliminate unrealised profits when preparing group financial statements. (5 marks)

(iii) Explain why consolidated financial statements are useful to the users of financial statements (as opposed to just the parent company's separate (entity) financial statements). (8 marks)

[Total: 25 Marks]

QUESTION THREE

Kabs Ltd is planning to make a significant investment in a different business sector. The company has in issue two million shares. A dividend of K7.01 per share for 2015 has just been paid. The pattern of recent dividends is as follows:

Year	2012	2013	2014	2015
Dividends per share (ngwee)	585	625	679	701

Kabs Ltd also has in issue 15.3% bonds redeemable in five years' time with a total nominal value of K70 million. The market value of each K1, 000 bonds is K1, 100. Redemption will be at a nominal value of K1, 000. Kabs Ltd has identified a proxy company in the new business sector with a similar business risk. The proxy company has an equity beta of 1.14 and is financed 70% by equity and 30% by debt, on a market value basis. The current risk-free rate of return is 6% and the average equity risk premium is 7%. Kabs Ltd pays profit tax at a rate of 30% per year and an equity beta of 1.10. The investment will be financed by the existing internal resources.

Required:

(a) Calculate the current share price of Kabs Ltd. (8 marks)

(b) Calculate the current weighted average after-tax cost of capital. (12 marks)

(c) Calculate a project-specific cost of equity for Kabs Ltd for the planned investment.

(5 marks)

[Total: 25 Marks]

QUESTION FOUR

(a) Gap Ltd has in issue 10% convertible debentures with a book value of K100 each. Each debenture is convertible into 40 ordinary shares. The market price of the debenture is K120, while the current ordinary share price is K2.80.

Required:

Calculate the following:

(i) Conversion premium

(ii) Conversion value

(3 marks)

(b) Gap Ltd most recent summarised statement of financial position is as follows:

	K'm
Non- current assets	25
Net current assets	15
Total	40
Ordinary share capital	15
Reserves	10
Non- current liabilities	15
Total	40

Gap Ltd 's current assets were K20m. Gap Ltd had in issue 10% bonds with a book value of K8m. Interest payable on the bonds for the year was K0.8m. The after tax profits for the year was K2m and corporation tax was K0.7m.The closing inventory was K2m. The ordinary shares had a book value of K0.6 each.

Required:

Calculate for Gap Ltd the following ratios:

(i) Return on capital employed
(ii) Current ratio
(iii) Quick ratio
(iv) Gearing ratio (debt/equity)
(v) Interest cover
(vi) Earnings per share (11 marks)

(c) Discuss the limitations of the economic order quantity model. (5 marks)

(d) Discuss the benefits of factoring to a company. (6 marks)

[Total : 25 Marks]

END OF PAPER

Formula Sheet

Economic order quantity

$$= \sqrt{\frac{2C_nD}{C_H}}$$

Miller – Orr Model

$$\text{Return point} = \text{Lower limit} + (\frac{1}{3} \text{ x spread})$$

$$\text{Spread} = 3\left[\frac{\frac{3}{4} \text{ x transaction cost x variance of cash flows}}{\text{interest rate}}\right]^{\frac{1}{3}}$$

The Capital Asset Pricing Model

$$E(r_i)=R_f+\beta_i(E(r_m)-R_f)$$

The asset beta formula

$$\beta_a=\left[\frac{V_e}{(V_e+V_d(1-T))}\beta_e\right]+\left[\frac{V_d(1-T)}{(V_e+V_d(1-T))}\beta_d\right]$$

The Growth Model

$$P_o=\frac{D_0(1+g)}{(r_e-g)}$$

Gordon's growth approximation

$$g=br_e$$

The weighted average cost of capital

$$WACC=\left[\frac{V_e}{V_e+V_d}\right]k_e+\left[\frac{V_d}{V_e+V_d}\right]k_d(1-T)$$

The Fisher formula

$$(1+i)=(1+r)(1+h)$$

Purchasing power parity and interest rate parity

$$s_1=S_0x\frac{(1+h_c)}{(1+h_b)} \qquad f_0=s_0x\frac{(1+i_c)}{(1+i_b)}$$

Present Value Table

Present value of 1 i.e. $(1 + r)^{-n}$

Where r = discount rate
n = number of periods until payment

Discount rate (r)

Periods (n)	1%	2%	3%	4%	5%	6%	7%	8%	9%	10%	
1	0·990	0·980	0·971	0·962	0·952	0·943	0·935	0·926	0·917	0·909	1
2	0·980	0·961	0·943	0·925	0·907	0·890	0·873	0·857	0·842	0·826	2
3	0·971	0·942	0·915	0·889	0·864	0·840	0·816	0·794	0·772	0·751	3
4	0·961	0·924	0·888	0·855	0·823	0·792	0·763	0·735	0·708	0·683	4
5	0·951	0·906	0·863	0·822	0·784	0·747	0·713	0·681	0·650	0·621	5
6	0·942	0·888	0·837	0·790	0·746	0·705	0·666	0·630	0·596	0·564	6
7	0·933	0·871	0·813	0·760	0·711	0·665	0·623	0·583	0·547	0·513	7
8	0·923	0·853	0·789	0·731	0·677	0·627	0·582	0·540	0·502	0·467	8
9	0·914	0·837	0·766	0·703	0·645	0·592	0·544	0·500	0·460	0·424	9
10	0·905	0·820	0·744	0·676	0·614	0·558	0·508	0·463	0·422	0·386	10
11	0·896	0·804	0·722	0·650	0·585	0·527	0·475	0·429	0·388	0·350	11
12	0·887	0·788	0·701	0·625	0·557	0·497	0·444	0·397	0·356	0·319	12
13	0·879	0·773	0·681	0·601	0·530	0·469	0·415	0·368	0·326	0·290	13
14	0·870	0·758	0·661	0·577	0·505	0·442	0·388	0·340	0·299	0·263	14
15	0·861	0·743	0·642	0·555	0·481	0·417	0·362	0·315	0·275	0·239	15

(n)	11%	12%	13%	14%	15%	16%	17%	18%	19%	20%	
1	0·901	0·893	0·885	0·877	0·870	0·862	0·855	0·847	0·840	0·833	1
2	0·812	0·797	0·783	0·769	0·756	0·743	0·731	0·718	0·706	0·694	2
3	0·731	0·712	0·693	0·675	0·658	0·641	0·624	0·609	0·593	0·579	3
4	0·659	0·636	0·613	0·592	0·572	0·552	0·534	0·516	0·499	0·482	4
5	0·593	0·567	0·543	0·519	0·497	0·476	0·456	0·437	0·419	0·402	5
6	0·535	0·507	0·480	0·456	0·432	0·410	0·390	0·370	0·352	0·335	6
7	0·482	0·452	0·425	0·400	0·376	0·354	0·333	0·314	0·296	0·279	7
8	0·434	0·404	0·376	0·351	0·327	0·305	0·285	0·266	0·249	0·233	8
9	0·391	0·361	0·333	0·308	0·284	0·263	0·243	0·225	0·209	0·194	9
10	0·352	0·322	0·295	0·270	0·247	0·227	0·208	0·191	0·176	0·162	10
11	0·317	0·287	0·261	0·237	0·215	0·195	0·178	0·162	0·148	0·135	11
12	0·286	0·257	0·231	0·208	0·187	0·168	0·152	0·137	0·124	0·112	12
13	0·258	0·229	0·204	0·182	0·163	0·145	0·130	0·116	0·104	0·093	13
14	0·232	0·205	0·181	0·160	0·141	0·125	0·111	0·099	0·088	0·078	14
15	0·209	0·183	0·160	0·140	0·123	0·108	0·095	0·084	0·074	0·065	15

December 2016 Examinations
D2 SOLUTIONS

SOLUTION ONE

SALES

Year 1 k10000 x 1.1=K11000
Year 2 k10000x 1.1^2=K12100
Year 3 k10000x1.2=K12100 x 1.1^3=K15972
Year 4 k12000 x 1.1^4 =K17569.2

MATERIALS

Year 1 K2500 x 1.05^=K2625
Year 2 K2500 x 1.05^2=K2756.25
Year 3 k2500x1.2= K3000 x 1.05^3=K3472.9
Year 3 k3000 x 1.05 ^ 4 = K3646.5

TOTAL COST OF ACQUISITION

Purchase price k50m
Installation k5m
Delivery k3m
Total cost k58m

Capital allowances
K58m x 25% =k14.5
Tax saved 35% x k14.5m=k5.075m

Money cost of capital
(1+m) = (1 + r) x (1+i)
r= 10%
i = 9%
1+m = (1+0.1) x (1 + .09)
m = 1.1 x 1.09 =1.199
1-1.199=0.199
19.9% or 20%

NPV COMPUTATION K000's

YEARS	1	2	3	4	5
Sales	11000	12100	15972	17569.2	
Materials	2625	2756.3	3472.9	3646.5	
Labour	1000	1000	1000	1000	
Advertising	500	500	500	500	
Sales less costs	6875	7843.7	10999.1	12422.7	
Taxation @ 35%		(2406.3)	(2745.3)	(3849.7)	(4347.9)
Taxation saved		5075	5075	5075	5075
Net cash flows	6875	10512.4	13328.8	13648	727.1
D.F @ 20%	0.833	0.694	0.579	0.482	0.402
P.V	5727	7296	7717	6578	292

TOTAL N.P.V =K27610-K58000=K (30.39m)

b) Finance Lease
The main characteristics are as follows:

1) The lessee is responsible for the upkeep, servicing and maintenance of the asset.

2) The lease has a primary period covering all or most of the useful economic life of the asset. At the end of this period, the lessor would not be able to lease the asset to someone else, because the asset would be worn out. The lessor must therefore ensure that the lease payments during the primary period pay for the full cost of the asset as well as providing the lessor with a suitable return on his investment.

3) At the end of the primary period the lessee can normally continue to lease the asset for an indefinite secondary period, in return for a very low nominal rent sometimes called a peppercorn rent'. Alternatively the lessee might be allowed to sell the asset on a lessor's behalf (since the lessor is the owner) and perhaps to keep most of the sale proceeds.

SOLUTION TWO

i)

Consolidated profit and loss account for Trove Group

	K'm
Turnover	10.5
Cost of sales	(6.60)
Gross profit	3.9
Operating costs	(0.78)
Operating profit	3.12
Interest payable	(0.3)
Profit before tax	2.82

Tax	0.93
Profit for the year	1.89
Minority interest (W5)	(0.13)
Retained profits	1.76

Consolidation schedule

	T	B	Adj	Total
	K'm	K'm	K'm	K'm
Turnover	7	4	(0.5)	10.5
Cost of sales	(4.6)	(2.4)	0.5	(6.5)
PURP		(0.1)		(0.1)
Operating costs	(0.1)	(0.5)	(0.18) G'will	(0.78)
Interest payable	(0.3)	-		(0.3)
Tax	(0.6)	(0.33)		(0.93)
Profit after tax	1.4	0.67	(0.18)	1.89

W1 Group Structure

800,000/1,000,000 x100% = 80%

W2) Net assets of Bird

	At date of acquisition date
	K'm
K1 shares 1million	1
Profit and loss reserve	0.5
Net assets	1.5

(W3) Goodwill

	K'm
Purchase consideration	3.0
Net assets acquired (80%xK1.5m)	1.2
Goodwill	1.8

Amortisation over 10 years = 1.8/10 = K0.18million

(W4) Unrealised profit

(80% × 500,000) × 33/133 = K99, 248.12

(W5) Minority interest

20% Bird profit after tax from consolidation schedule

(20% × 0.671) =0.13

ii) Unrealised profits

Unrealised profits arise when group companies trade with each other. In their own individual company accounts profits and losses will be claimed on these transactions, and goods bought from a fellow group company will be recorded at their invoiced cost by the purchaser.

However, consolidated accounts are drawn up on the principle that a group is a single economic entity. From a group point of view, no transaction occurs when goods are traded between group companies, and no profits or losses arise. Revenue and profits will only be claimed when the goods are sold onto a third party from outside of the group.

In this example, Bird sold K500, 000 of goods to Trove making a profit of K124, 060.15. The sale by Bird and the purchase by Trove must be eliminated from the group income statement. This adjustment will not affect profits because both the sales and the purchases have been reduced by the same amount.

By the year-end Trove had sold K100, 000 of these items making a profit. From a group point of view, the profit on these items, including their share of the profit claimed by Bird, has now been realised.

However, Trove still has K400, 000 of goods bought from Bird. This valuation includes an element of profit (K99, 248.12) that has not yet been realised and needs to be eliminated. This will reduce the carrying value of the inventory to the amount originally paid for them by Trove. If unrealised profits were not eliminated, then groups could boost their profits and asset values by selling goods to each other at inflated prices.

iii) Usefulness of consolidated financial statements

The main reason for preparing consolidated accounts is that groups operate as a single economic unit, and it is not possible to understand the affairs of the parent company without taking into account the financial position and performance of all the companies that it controls. The directors of the parent company should be held fully accountable for all the money they have invested on their shareholders behalf, whether that has been done directly by the parent or via a subsidiary.

There are also practical reasons why parent company accounts cannot show the full picture. The parent company's own financial statements only show the original cost of the investment and the dividends received from the subsidiary. As explained below, this hides the true value and nature of the investment in the subsidiary, and, without consolidation, could be used to manipulate the reported results of the parent.

- The cost of the investment will include a premium for goodwill, but this is only quantified and reported if consolidated accounts are prepared.

- A controlling interest in a subsidiary can be achieved with a 51% interest. The full value of the assets controlled by the group is only shown through consolidation when the non-controlling interest is taken into account.

- Without consolidation, the assets and liabilities of the subsidiary are disguised.

– A subsidiary could be very highly geared, making its liquidity and profitability volatile.
– A subsidiary's assets might consist of intangible assets, or other assets with highly subjective values.

- The parent company controls the dividend policy of the subsidiary, enabling it to smooth out profit fluctuations with a steady dividend. Consolidation reveals the underlying profits of the group.

- Over time the net assets of the subsidiary should increase, but the cost of the investment will stay fixed and will soon bear no relation to the true value of the subsidiary.

SOLUTION THREE

a) Cost of equity=6%+1.1(7)
=13.7%

$P_0 = D\ (1+g)/K_e$

$G=\sqrt[3]{\frac{7.01}{5.85} - 1}$ = 0.062 or 6.2%

P_0=7.01(1.062)/0.137
=K54.34 per share

Value of equity = 2m x 54.34 =K108.68million

b)

Cost of debt

Interest cost = (15.3% of 1,000) x (1-0.3) =107.1

Year	Cash flow	Dis@15%	PV	Dis@5%	PV
0	(1,100)	1.000	(1,100)	1.000	(1,100)
1-5	107.1	3.352	359	4.329	463.6
5	1000	0.497	497	0.784	784
			(244)		147.64

Cost of debt = 5%+ 147.64/391.64 (15%-5%)

=8.77%

Market values:

Equity= 2m x 54.34 = K108.68m

Debt = 70 x 1100/1000= K77m

Total = K185.68

WACC = 13.7% x 108.68/185.68 + 8.77% x 77/185.68

=8.02% + 3.64%

=11.66%

c)

Ba= Be X Ve/Ve + Vd (1-t)
= 1.14 X 0.7/0.7 x 0.3(1-0.3)
= 0.88

0.88 = Be x 108.68/108.68 + 77 (1-0.3)
0.88 = Be 0.67
Be= 1.31

Ke= 6% + 1.31 (7%)
= 15.17%

SOLUTION FOUR

a) Conversion ratio K100=40
Terms k2.5 debenture = K1 share
The cost of buying a k2.5 debenture is K2.5 x K120/K100 =K3
Conversion premium= (K3-K2.8)/K2.8 x100 =7.14%
Conversion value = 40 x K2.8=K112

b) Workings
1) Current assets – current liabilities =net current assets
K20m- CL =K15m
CL =K20-K15= k5m

	km
1) Profit after tax =	2
Add: taxation=	0.7
Profit before tax=	2.7
Interest =	0.8
Profit before interest=	3.5

2) Number of shares =K15/k0.6=25m shares

Return on capital employed = [k3.5m/k40m]x100=8.75%

Current ratio = k20/k5=4 times

Quick ratio [k20-k2] /k5=18/5=3.6 times

Gearing ratio= [k15/k25] x 100=60%

Interest cover=k3.5/k0.8=4.375 times
EPS= [k2/25m] =k0.08 per share

c) Limitations of EOQ

The economic order quantity can be used as a method of minimising inventory costs by calculating the optimum order quantity.

However there are certain limitations of this model. These include:

1) The holding costs and ordering costs is assumed to be known with certainty and are assumed not to change
2) It assumes that demand is constant and lead time is constant or zero.
3) It assumes that purchase costs per unit are constant

d) Benefits of factoring

1) The business can pay its suppliers promptly and so be able to take advantage of any early payment discounts that are available

2) Optimum inventory levels can be maintained because the business will have enough cash to pay for the inventory it needs

3) Growth can be financed through sales rather than by injecting fresh external capital

4) The business gets finance linked to its volume of sales. In contrast overdraft limits tends to be determined by historical statements of financial position

5) The managers of the business do not have to spend their time on the problems of slow paying accounts receivables.

6) The business does not incur the costs of running its own sales ledger department and can use the expertise of debtor management that the factor has.

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D3: BUSINESS TAXATION

WEDNESDAY 14 DECEMBER 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.

TAX TABLES

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 processing of purchased mineral ores, concentrates and other semi-processed minerals	30%
On income from Tolling	30%
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 & Electricity	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:	25%
	Excise Duty:	
	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	15%
	Excise Duty	10%
3.	**Buses/coaches for the transport of more than ten persons**	
	Customs Duty:	15%
	Excise Duty:	
	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:	15%
	Excise Duty:	
		0%
5.	**Surcharge on motor vehicles order than five years other than truckcs &busses K2,000.**	

The minimum amount of Customs Duty on Motor Vehicles in categories from 1 up to 3 above is K2,000

Attempt all FOUR (4) Questions

QUESTION ONE

Kalonga Ltd and Mulonga Ltd are 100% owned subsidiaries of Mumana plc. All three companies are Zambian resident and are engaged in manufacturing. Mumana plc's sales are all standard rated, whilst Kalonga Ltd's and Mulonga Ltd's are zero-rated and exempt respectively. Mumana plc and Kalonga Ltd are accordingly registered individually for VAT whilst Mulonga Ltd is not.

Since the three companies are not registered for Value Added Tax as a group, the directors of the companies are interested in knowing whether any savings in Value Added Tax can be made by the three companies if they were to register for VAT as a group.

They have provided you with the following information relating to the sales and purchases of each company for the year ended 31 December 2016:

	Sales	*Purchases*
	K	K
Mumana plc	3,600,000	1,700,000
Kalonga Ltd	2,500,000	1,400,000
Mulonga Ltd	1,200,000	590,000

The purchases for all three companies are standard rated. In addition to the sales and purchases figures shown above, Mumana plc incurred standard rated overhead expenditure of K450, 000 that cannot be directly attributed to any of the three companies' sales. Mumana plc charges both of its subsidiary companies a management fee of K35, 000 per annum each, in respect of the services of its finance and administration department and this figure has not been included in the figures for sales and purchases shown above.

On 31 May 2016, Mulonga Ltd transferred title to a piece of land which was surplus to its requirements to Mumana plc at nil consideration, when its market value was K1,500,000. Mumana plc will use the piece of land to construct a new production factory in order to expand its production capacity to satisfy increased demand for its products.

Apart from the management fees and the transfer of the land, there are no other inter-company trading between the three companies.

All of the above figures are exclusive of Value Added Tax (VAT) where applicable.

Required:

(a) Calculate the VAT position of each company for the year ended 31 December 2016 and show the net VAT position for the group. (8 marks)

(b) Explain the property transfer tax implications of the transfer of piece of land by Mulonga to Mumana plc. (2 marks)

(c) Advise the Mumana plc of the conditions that must be met for itself and its two subsidiaries to register as a group for VAT purposes. (3 marks)

(d) Assuming that the relevant companies were registered for VAT as a group based on your answer to part (a), calculate what the VAT position would have been for the group for the year ended 31 December 2016. (8 marks)

(e) Explain the benefits of group registration for VAT purposes, and make a recommendation whether the relevant companies should register as a group. (4 marks)

[Total: 25 marks]

QUESTION TWO

(a) Explain what is meant by Thin Capitalization, and describe the criteria used to determine whether a mining company is thinly capitalized. Your explanation should include the tax implications of a mining company being held to be thinly capitalized. (5 marks)

(b) Ngalande Ltd is a Zambian company which was incorporated in 2009. The company manufactures chemicals used by mining companies. The company registered for Value Added Tax (VAT) in 2010, when it exceeded the VAT registration threshold.

The company is considering acquiring manufacturing equipment. The VAT inclusive cost of the equipment is expected to be K649,600. The company is considering the following options of acquiring the equipment.

Option One

Obtain a 12% K649,600 Debenture to fund the acquisition of the equipment. This Debenture is expected to be redeemed in five years' time.

Option Two

Use Hire purchase to buy the equipment. Under this option the company will be required to pay monthly installments of K59,547 for twelve months. The installments are expected to end on 31 December 2016.

Option Three

Lease the equipment under finance lease. Under this option, the company will be required to pay a deposit of K249,600 on 1 January 2016, followed by four annual lease rentals of K125,000. The implicit rate of interest will be 12%.

Required:

Explain the income tax and VAT implications of each of the above options of acquiring the manufacturing equipment. Your explanation should include appropriate calculations.

(15 marks)

(c) Chaku was recently retrenched by Cocola mining company where he was working as operations manager. He was paid all his benefits and is now considering investing in:

(i) Ordinary shares of a LuSE listed company, or

(ii) Ordinary shares of an unquoted company.

He is planning to sell the shares after 2 years.

Required:

Explain the tax implications of investing in shares of each of the above two types of companies. (5 marks)

[Total: 25 Marks]

QUESTION THREE

Mosesa Gabriel started a manufacturing business on 1st April, 2015 as a sole proprietor. He also started a farming business on 1st October, 2015. The first accounts were prepared on 31st May, 2016 for both businesses. The two businesses are run independently of each other. The adjusted profit before capital allowances for the manufacturing business was K966, 000. The non-current assets bought during the period for the manufacturing business were:

15th April 2015 plant cost – K24,000

16th May 2015 motor car – K60,000

17th March 2016 fixtures – K18,000

The adjusted final taxable business profit (after capital allowances) for the farming business was K220,000 for the year ended 31st May 2016. Provisional tax paid for the tax year 2016 was K180,000.

Mosesa Gabriel hopes to expand in the near future and so that he can run the manufacturing business as a partnership or as an incorporated business (limited company).

Required:

(a) Advise Mosesa Gabriel of **the taxation implications** of running a business as:

(i) A sole proprietorship

(ii) A partnership and

(iii) An incorporated business (limited company) (7 marks)

(b) In relation to the Mosesa's manufacturing business:

(i) Calculate the capital allowances for each relevant tax year (8 marks)

(ii) Show the final adjusted profits for each relevant tax year (4 marks)

(c) Calculate the total income tax payable by Mosesa Gabriel from his business activities for the tax year 2016. (6 marks)

[Total: 25 Marks]

QUESTION FOUR

Leah and Choolwe have been in business as retail grocers for many years. For the year ended 31st December 2016, their statement of profit or loss (income statement) showed the following:

	K`000	K`000
Turnover		4,480
Cost of sales		(1,620)
Gross profit		2,860
Add-profit on sale of plant		370
Bank interest earned		93
		3,323
Less expenses		
Staff wages	680	
Rent or rates	140	
Postage or stationery	26	
Repairs and renewal	98	
Electricity	330	
Bad debts written off	4	
Loan interest	144	
Depreciation – plant	210	
- Motor cars	82	
General expenses	390	
		(2,104)
Net profit		1,219

The following information is also relevant:

1. The profit on sale of plant arose from the sale of an old plant with a financial net book value of K4,230,000 and sale proceeds of K4, 600,000. The income tax value of the plant was K4,560,000.

2. Repairs and renewals comprise

	K000
Painting shop	8
Plant repairs	30
Construction of stock room	60
	98

3. The bad debt written off account was:

	K`000		K`000
Trade debts written off	340	Balance b/d	
Loan to employee written off	250	- general provision	610
		- Specific provision	470
Balance c/d		Loan to employee previous written off now recovered	180
General provision	460		
Specific provision	560	Trade debts written off previously now recovered	206
		Profit or loss	144
	1,610		1,610

4. The depreciation for the motor cars was for cars owned by the partnership business. Leah owns a private car bought a year ago costing K48,600. It is also used 60% for private and 40% for business. Depreciation has not been included in the statement of profit or loss account for Leah's car.

5. General expenses included:

	K`000
- Donation – Kasisi Orphanage (public benefit Organization)	40
- UTH (Government Institution)	80
- Up and down party (Political party)	50
- Zambia Netball Association	30
- Entertaining customers	25
- Entertaining staff – Christmas party	70
- Legal expenses – trade debt collecting	35

- Staff loan debt collecting	25
- Sundry allowable expenses	35
	390

6. The partners withdrew from the grocery goods from stock costing K12, 000 for domestic use by themselves. The partners estimate that the gross profit percentage on turnover (margin) is 20%. The withdrawals were recorded as part of the turnover at cost price of K12,000.

7. Choolwe's husband assists in preparing accounts and tax returns for the partnership and was paid K16,000 for the year ended 31st December 2016. This figure is included in staff wages in the statement of profit or loss. Considering the work load, he should have only been paid K12,000.

8. The business is conducted as a partnership sharing profits or losses in the ratio of 3 to 2 for Leah and Choolwe respectively after allowing for partnership salaries of K172,000 per annum for each individual.

9. All the business assets had ITVs of zero, excluding the plant mentioned in note (2) above, as at 1 January 2016.

Required:

(i) Compute the partnership's tax adjusted business profits for the tax year 2016. (13 marks)

(ii) Calculate the tax payable by each partner for the tax year 2016. (9 marks)

(iii) If one of the partners defaults in paying the income tax payable to Zambia Revenue Authority (ZRA), explain how ZRA may recover the tax payable from the partnership. (3 marks)

[Total: 25 Marks]

END OF PAPER

December 2016 Examinations

D3 SOLUTIONS

SOLUTION ONE

(a) Calculation of the group's VAT position for the year ended 31 December 2015

	Mumana	*Kalonaga*	*Mulonga*
	K	K	K
Sales	3,600,000	2,500,000	1,200,000
Management charge	70,000	-	-
	3,670,000	2,500,000	1,200,000
Output tax at 16% and 0%	587,200	0	–
Purchases	1,700,000	1,400,000	590,000
Overheads	450,000		
Management charge		35,000	35,000
Total expenses	2,150,000	1,435,000	625,000
Input VAT at 16% and 0%	344,000	229,600	–
VAT payable/(repayable)	243,200	(229,600)	–

Net VAT payable = K243,200 – K229,600

= K13,600 (1 mark)

(b) Property transfer tax will not arise on the transfer of the piece of land, provided that the transfer was made as part of the internal reorganization of the group.

(c) Two or more companies are eligible to be treated as members of a group provided that each of them is either established in the Republic of Zambia or has a fixed establishment in the Republic of Zambia, and,

(i) One of the companies controls all the others
(ii) One person controls all of the companies
(iii) Two or more persons carrying on a business in partnership control all the companies.

(iv)All companies make taxable supplies

(d) The computation of the VAT payable by the companies if they were registered as a group for VAT purposes can be summarised as follows:

	K	K
Output VAT		
Mumana plc's sales		
(K3,600,000 + K35,000@ 16%)		581,600
Kalonga Ltd's Zero rated sales		
(K2,500,000 x 0%)		0
Total output tax for group		581,600
Input tax		
Mumana plc's purchases		
(K1,700,000 x 16%)	272,000	
Kalonga Ltd's purchases		
(K1,400,000 x 16%)	224,000	
Overhead expenditure		
(K450,000 x16%)	72,000	
		(568,000)
VAT payable		13,600

(d) The benefits of group registration for VAT are that:

(1) It results in a reduction of administrative expenses for the group since only one VAT return should be completed instead of several VAT returns being completed.

(2) In addition, VAT on intra group supplies is avoided, except transactions made to company dealing in exempt supplies which is not included in the group VAT registration.

(3) Group registration for VAT is flexible as not all companies in the group must be included.

Recommendation

Based on the above calculations, the three companies can either register as a group or not. The amount of VAT payable is constant regardless of whether they register as a group or not.

SOLUTION TWO

a. Thin capitalization is when a mining company is financed by excessive Debt finance in relation to its arms length borrowing capacity, leading to excessive interest deductions being made.
Currently, a mining company is said to be thinly capitalized if its Debt to Equity ratio exceeds 3:1

The legislation on thin capitalization is an anti-avoidance legislation aimed at preventing companies from reducing their tax liabilities through excessive interest payments.

Therefore, if a mining company is thinly capitalized, then interest on the amount of Debt in excess of the Debt: Equity ratio of 3:1 is not deductible for tax purposes. i.e. it is added back.

b. The following are the income tax and Value Added Tax (VAT) implications of the finance options:

Option one

I. The company will be able to claim capital allowances at the rate of 50% per annum on the VAT exclusive cost of the equipment.
I.e. K649, 600 X 25/29 X 50%
= K280, 000

II. The interest on the Debentures will not be an allowable deduction when computing the taxable business profits, as interest on debt obtained for the purposes of acquiring capital assets is not allowable.

III. The company will be able to claim input VAT on equipment.
I.e. K649, 600 X 4/29
= K89, 600

Option Two

If the equipment is acquired under a hire purchase agreement, the implications will be as follows:

I. The company will be able to claim capital allowances at 50% per annum on the VAT exclusive cash price of the equipment. i.e.
K649, 600 X 25/29 X 50%
= K280, 000

II. The interest of K64, 964 (K714, 564 – K649, 600) on the hire purchase agreement will be an allowable deduction when computing the taxable business profits.

III. The company will be able to claim input VAT on the cost of the equipment.
K649, 600 X 4/29
= K89, 600

Option Three

If the equipment is acquired under a finance lease, the following will be the Income tax and VAT implications:

I. The company will be able to claim capital allowances at the rate of 50% on the VAT exclusive cost of the equipment.
I.e. K649, 600 X 50%
=K280, 000

II. The finance charge (interest) will be an allowable deduction when computing the taxable business profits.

III. The company will be able to claim input VAT on the equipment
I.e. K649, 600 X 4/29
=K89, 600

c. Shares in a LuSE listed company:

I. The dividends receivable from shares in a LuSE listed company payable to individuals are exempt from tax. Therefore, Chaku will be receiving dividends (gross) because he will not pay any tax.

II. On disposal of these shares, Chaku will not pay any Property Transfer Tax (PTT), because shares listed on the LuSE are exempted from PTT.

Shares in unquoted company

I. The dividends receivable by Chaku shall be taxed at 15% Withholding Tax. Chaku will, therefore, be receiving dividends net of 15% WHT.
II. On disposal of shares held in an unquoted company, Chaku will be required to pay Property Transfer Tax (PTT) at 5%.

<u>SOLUTION THREE</u>

(a) Advice to Mosesa Gabriel of the tax implications of running the business as a sole trader, a partnership and limited company are as follows:

(i) A sole trader

- An individual's income that arises in a given tax year is aggregated to arrive at the total taxable income while other income is exempt from tax
- Certain income is not subjected to assessment at the end of the tax year as it is taxed at source.
- Personal income tax rates are then applied on the income to arrive at the income tax payable.

- Expenses are only allowed as deduction from the income if incurred strictly for business.
- Turnover tax is paid if a sole trader is making annual sales of less than K800,000.

(ii) A Partnership

- Expenses deductible from income must be wholly and exclusively for the purpose of partnership business and not appropriations or domestic expenses, unlike limited companies where salaries of directors are deductible.
- After arriving at the partnership adjusted profit, an appropriation of profit or loss is made according to the partnership agreement.
- In cases where the partners use their private assets in the partnership business, capital allowances are deducted from the individual partner(s), restricted to business use, appropriated profit to arrive at the final taxable profit.
- Personal income tax rates are then applied on the income to arrive at the income tax payable in the same way as sole traders.
- Turnover tax does not apply to partnership.

(iii) Limited Company

- Director's salaries and personal expenses (if paid by the company) are deductible to arrive at the adjusted taxable profit.
- Dividends paid to directors (if also shareholders) are not deductible to arrive at the adjusted taxable profit.
- The business adjusted profit is aggregated with other income which are not final after withholding tax (e.g. royalties, bank, interest etc) to arrive at the total taxable company income.
- Company income tax rates are then applied on the adjusted profit to arrive at the company income tax payable.
- Unlike individuals, a company does not have emoluments from employment. All of the income arising in cases where a company offers a service to other companies is taxable business income as opposed to being emoluments from employments.
- A limited company or sole trader may be subject to turnover tax if the turnover is less than K800, 000 in the financial year instead of the provisional tax paid quarterly.

(b) Capital allowances Computation

Manufacturing - 1 April 2015 to 31 May 2016 14 months

Farming – 1 October 2015 to 31 May 2016 – 8 months

Tax years

Manufacturing - T/y 2015 1.4.2015 to 31.5.2015 – 2 months
- T/y 2016 1.6.2015 to 31.5.2016 – 12 months
- T/y 2016 1.10.2015 to 31.5.2016 – 8 months

T/y 2015 capital allowances

15 April 2015 – plant K24, 000x25% K6, 000

16 May 2015 – m car K60, 000x20%	K12, 000
	K18, 000
T/y 2016 capital allowances	
15 April 2015 – plant – K24, 000 X 25%	K6, 000
16 May 3015 – M. car – K60, 00 X 20%	K12, 000
17 July 2015 – Fixtures – K18, 000 X 25%	K4, 500
	K22, 500

(c) Manufacturing business – Final adjusted profit

	Period ended 31.5.2015 K	Year Ended 31.5.2016 K
Profit - (Pre. CA - $\frac{2}{14}$ X K966, 00)	138,000	
- (Pre CA - $\frac{2}{14}$ X K966, 000)		828,000
Less capital allowances	(18,000)	(22,500)
	120,000	805,500

	Total K	Non-farming K	Farming K
(d) Tax payable for tax year 2016			
Adjusted profit-manufacturing	805,500	805,500	
Farming	220,000		220,000
Total adjusted profit	1,025,500	805,500	220,000
Tax computation			
Non farming			
1st K36, 000 @ 0%		-	
Next K9, 600 @ 25%		2,400	
Next K25, 200 @ 30%		7,560	
Balance K734,700@35%		257,145	
		267,105	
Farming			
K220, 000 @ 10%		-	22,000
	289,105	267,105	22,000
Less: Provisional tax	(180,000)		
Final tax payable	109,105		

SOLUTION FOUR

(a) Leah and Choolwe tax adjusted business profit

Tax year 2016	K`000	K`000
Net per financial accounts		1,219
Add back:		
Depreciation – plaint	210	
- Motor cars	82	
Repairs and renewals – stock room	60	
Loan to staff written off	250	
Donation - Up and down party	50	
Entertaining customers	25	
Legal expenses – staff loan collecting	25	
Stock withdrawn (partners) profit	3	
Choolwe's husband wages overpaid	4	709
		1,928
Less profit on sale of plant	370	
Bank interest	93	
Loan staff recovered	180	
Capital allowances (Balancing charge)	(40)	
General provision decrease	150	(753)
Partnership tax adjusted profit		1,175

(ii) Partners appropriation account

	Total	Leah	Choolwe
	K	K	K
Salaries	344,000	172,000	172,000
Balance 3:2	831,000	498,600	332,400
	1,175,000	670,600	504,400
Less: CA – Choolwe's car			
(K48, 600 X 20%) X 40%	(3,888)	(3,888)	-
Partners taxable profit	1,171,112	666,712	504,400
Tax computation			
1st K36, 000 @ 0%		-	-

Next K9, 600 @ 25%	2,400	2,400
Next K25, 200 @ 30%	7, 560	7, 560
Balance – Leah K595,912 @ 35%	208,569	-
- Choolwe K433,600 @ 35%	-	151,760
Partners tax payable	218,529	161,720

(iii) Each partner is an agent of the other. Therefore any default in paying by partner(s) partially or in full will be recovered as follows:

i) One of the partner can pay for the defaulting partner
ii) The amount in default can be recovered using the partner's current account to pay ZRA.

WORKING

Income tax value b/f	4,560
Sale proceeds	4,600
Balancing change	(40)
General provision b/f	610
General provision C/F	460
General provision decrease	150
Stock appropriated	
Stock cost	K12, 000
Gross profit % (margin)	20%
Stock (selling price)	K12, 000
	K15, 000
Therefore profit (15,000 X 20%)	K3, 000
(K15, 000 – K12, 000)	K3000
Staff wage: Choolwe's husband	K16, 000
Choolwe's husband normal wage	K12, 000
Overpayment	K4, 000

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D4 – PERSONAL TAXATION

TUESDAY 13 DECEMBER 2016

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

INSTRUCTIONS TO CANDIDATES

1. You have fifteen (15) minutes reading. 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 and 3

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%
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%

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:	25%
	Excise Duty:	
	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	15%
	Excise Duty	10%
3.	**Buses/coaches for the transport of more than ten persons**	
	Customs Duty:	15%
	Excise Duty:	
	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:	15%
	Excise Duty:	0%

The minimum amount of Customs Duty on Motor Vehicles in categories from 1 up to 3 above is K2,000

QUESTION ONE

Diko Zulu was in employment on a three year non-renewable contract that expired on 31st May 2016. His Annual Basic Salary for each year he worked had been as follows:

1st June 2013 to 31st May 2014	K132,000
1st June 2014 to 31st May 2015	K144,000
1st June 2015 to 31st May 2016	K156,000

His conditions of service provided for an end of contract gratuity at the rate of 35% of his cumulative basic pay for the three year period which was paid on 31st May, 2016. He was also paid an accrued leave pay of K24,000.

During the time of employment, he was entitled to the following allowances payable at the same time as the basic salary:

School children allowance (per month)	K1,400
Housing allowance (per month)	K3,000
Transport allowance (per month)	K600

He made the following payments in the tax year 2016:

Pay as you earn (PAYE)	K43,300
Golf club subscription	K1,400
Contribution into employer's Approved pension scheme	K1,900
NAPSA contribution	K3,250
Donations to local approved public benefit organization on 12 March 2016	K400

He receives an annual copyright royalty every 31 August for a book he published six years ago. For the 31 August 2016, he received K6,970 (net)

Required:

(a) Calculate the total cumulative tax payable by Diko Zulu for the period from 1 January to 31st May 2016. (18 Marks)

(b) Assuming, Zulu never worked for any other employer from 1 June 2016 to 31 December, 2016, recalculate the total tax payable and show the tax payable to or refundable from ZRA. (7 marks)

[Total: 25 Marks]

QUESTION TWO

(a) Dorisa Tembo has run a VAT registered retail business for many years preparing accounts to 30 September each year. The turnover from the business has always exceeded K800,000. The performance of the business in the recent past has however, been poor and therefore, after preparing the accounts for the year ended 30 September 2014, Dorisa decided to stop trading on 30 April 2016. She prepared the last accounts for the period commencing 1 October 2014 to 30 April 2016. The tax adjusted profit before capital allowances for this final period of trading was K380,000. Dorisa had overlap profits of K45,000 which arose when she changed the accounting date six years ago.

The income tax values of assets qualifying for capital allowances at 1 October 2014 and their original VAT inclusive costs were as follows:

Assets	*Original Cost (VAT Inclusive)*	*Income Tax Value at 1 September 2014*
	K	K
Toyota Lexus Car	150,000	60,000
Mitsubishi Canter van	139,200	90,000
Fixtures and fittings	53,360	23,000

She had private use in the Toyota Lexus car of 30%.

On 30 April 2016, Dorisa sold all the business assets realising VAT inclusive proceeds of K35,000 for the Toyota Lexus car, K46,400 for the Mitsubishi Canter Van, and K16,240 for the fixtures & fittings. Dorisa had no other income in the tax year 2016.

Required:

Explain the basis of assessment for the profits generated in the final two tax years and compute the income tax payable by Dorisa for each relevant tax year. You should assume that the tax rates for tax year 2016 applies to both tax years.

(14 Marks)

(b) Gerald Milimo has been employed as the Sales Director at Eden plc for many years. His contract of employment provided for the following in the tax year 2016:

(1) An annual salary of K216,000 and a weekend entertainment allowance of K2,000 per month.

(2) Milimo is entitled to a bonus at the end of each year provided the sales targets for that year have been met. On 5 January 2016, he received bonus of K3,000 which was in respect of the year ended 31 December 2015. Milimo became entitled to this bonus on 31 December 2015. On 6 January 2017, he will receive another bonus of K5,000 in respect of the year ended 31 December 2016. Milimo will become entitled to this second bonus on 31 December 2016.

(3) The company pays college fees for his children. In the tax year 2016, the company paid college fees for his children amounting to K25,000.

(4) Milimo took his annual leave in January 2016 and the company paid him leave passage of K3,000.

(5) The company pays his monthly medical insurance premiums of K1,000 and annual golf club subscriptions of K1,500.

(6) In the tax year 2016, the company provided him with airtime vouchers with a value of K3,000 and shopping vouchers of K11,000.

(7) Throughout the tax year 2016, Milimo used his own personal Toyota Prado motor car with a cylinder capacity of 3000cc for the purposes of the employment. He acquired the car on 1 January 2016 at a cost of K180,000. He travelled a total of 25,000 kilometers in the motor car in the tax year 2016, out of which 15,000 kilometers were in the performance of the duties of his employment. He incurred travel expenses of K3,500 per month wholly and exclusively and necessarily in the performance of the duties in the tax year 2016. Milimo obtained a reimbursement of K4,000 per month from the company in relation to the travel expenses.

(8) Milimo is accommodated in a company house, which had a market value of K450,000 in the tax year 2016. Had it been let out on a commercial basis, the company would have received monthly rentals of K5,000. The company pays the utility bills relating to the accommodation which averaged K2,500 per month in the tax year 2016. The company additionally pays the following wages for the following workers employed by Milimo at his residence:

Garden boy's wages	K1,100 per month
Security Guard's wages	K1,300 per month
House Keeper's wages	K1,500 per month

(9) He made NAPSA contributions of 5% of his basic salary throughout the tax year 2016 and Eden plc also contributed 5% of his basic salary as employer's NAPSA contribution on her behalf in the tax year 2016.

(10) He paid life insurance premiums of K1,500 per month and made a one off donation of K15,000 to an approved public benefit organisation in the tax year 2016.

(11) Pay As You Earn of K108,216 was deducted from his emoluments in the tax year 2016.

Required:

Compute the total income tax payable by Gerald Milimo in the tax year 2016.

(11 marks)

[Total: 25 Marks]

QUESTION THREE

(a) In order to determine whether an individual is in employment or self-employed, there are a number of factors taken into account. These may include the following:

(i) Type of contract
(ii) Financial Risk
(iii) Control
(iv) Opportunity to profit from sound management
(v) Length of engagement
(vi) Holiday pay, sick pay and pension rights
(vii) Engagement and Dismissal

Required:

Explain what is meant by each of the above factors. (14 marks)

(b) Individuals in employment and self-employed individuals are assessed differently for tax purposes.

Required:

(i) Explain how employees and self-employed persons are assessed to income tax. You should state the tax rates applicable in each case and the due dates for the payment of the applicable taxes. (7 marks)

(ii) Explain the consequences of paying the taxes applicable to employees and self-employed late. (4 marks)

[Total: 25 Marks]

QUESTION FOUR

Assume today`s date is 31 December, 2016.

Mr Jack Momba and Jill Momba were married in Zambia in 1990. They had their first child Blackson in 1993 and the three immediately left Zambia for employment in United States of Ascovia (USA). The couple had two other children in U.S.A.

During the period of absence from Zambia, Jack was earning a salary of U.S.A $60,000 per annum from the foreign duties, while Jill Momba`s salary from the foreign duties was U.S.A $52,000. Using the savings and their earnings, they bought a house in the U.S.A that has been let out on a long term basis in that country. They received rent of K52,800 from their house situated in the U.S.A. This amount is net of USA withholding tax at the rate of 12% of the gross amount. The rental income is shared equally by the couple.

Jack and Jill Momba returned to Zambia together with their two children on 1 February, 2016, where Jack had secured a new employment but, Blackson remained in the U.S.A because he had secured permanent employment there and does not intend to come back to Zambia but will visit Zambia occasionally. His annual salary in the U.S.A is $36,000.

The following information relates to Jack's and Jill's affairs for the tax year 2016.

(i) The annual salary for Jack was K228,000.
(ii) He is entitled to a servant allowance of K18,000 per annum and a housing allowance of K36,000 per annum.
(iii) He was also given a new personal to holder 2000 CC Honda car costing K74,000
(iv) A 5% pension scheme contribution was deducted from Mr. Jack Momba's basic salary.
(v) Mr. Jack Momba was offered shares (in an employee share option scheme which is approved for tax purposes) during the course of the tax year 2016.
(vi) Mrs Jill Momba secured employment on 1 April, 2016 and is entitled to an annual salary of K84,000. She received K8,800 bank interest from her foreign fixed deposit bank account she holds in the USA in the tax year 2016. This amount is net of 20% U.S.A withholding tax on the gross amount.

Required:

(a) Explain the residence of each of the members of the family from the date of departure from Zambia to 31st December, 2016 on their return to Zambia. (6 marks)

(b) Calculate the income tax payable by Mr. Jack Momba and Mrs. Jill Momba for the tax year 2016 assuming unilateral credit relief is available. (12 marks)

(c) Explain what you understand by an 'employee share option scheme' and the tax benefits for an employee and the employer. (You are not required to explain the requirements to be met for the approval of the employee share option scheme) (7 Marks)

[Total: 25 Marks]

END OF PAPER

December 2016 Examinations

D4 SOLUTIONS

SOLUTION ONE

(a) Diko Zulu Tax Payable on normal PAYE to 31 May 2016

	K	K
Basic Salary (K156, 000 x $^{5}/_{12}$)		65, 000
School children allowance (K1, 400 x 5)		7, 000
Housing allowance (K3, 000 x 5)		15, 000
Transport allowance (K600 x 5)		3, 000
Accrued leave pay		24, 000
Non- Qualifying Gratuity		43, 200
		157,200
Less: Allowable deductions		
Pension (255 X 5)	(1275)	
Donation	400	
		(1,675)
		155,525
Less: exempt (K36, 000 x $^{5}/_{12}$)		15, 000
Taxable Income		140,525
Tax computation		
1st K9, 600 x $^{5}/_{12}$ @ 25%		1, 000
Next K25, 200 x $^{5}/_{12}$ @ 30%		3150
Balance K126,025 @ 35%		44,109
Tax liability		48,259
Less: Tax credits		
PAYE		(43, 300)
Tax payable on normal PAYE		4,959

Gratuity

Total earned basic salary (K132, 000 + K144, 000 + K156, 000)	K432, 000
Qualifying gratuity K432, 000 x 25%	K108, 000
Non- Qualifying Gratuity K432, 000 @ 10%	K43, 200
Total gratuity K432, 000 x 35%	K151, 200

Tax on Qualifying Gratuity

Total Qualifying gratuity	108, 000	
Less: Exempt	(36, 000)	
	72, 000	
Tax on K72, 000 @ 25%	18, 000	

Summary

Tax on normal PAYE	4,959
Tax on Qualifying Gratuity	18, 000
Total tax payable	22,959

(b) Diko Zulu

Tax Payable to 31 December 2016

	K
Taxable income (up to 31.5.2016)	157, 200
Less: Pension	(3,060)
Donation	(400)
Add: other income	
Royalty (6970/0.85)	8, 200
	161,940
Less: exempt	(36, 000)
Total taxable income	125,940
Tax computation	
1st K9, 600 @ 25%	2, 400
Next K25, 200 @ 30%	7560
Balance K91,140 @ 35%	31,899
	41,859
Less Tax credits	
- PAYE	(43, 300)
- WHT – Royalty (K8, 200 x 15%)	(1,230)

Tax repayable (or refund)	(2,671)
On normal PAYE	
Summary	K
Tax on normal PAYE to 13.12.2016	(2,671)
Tax on Qualifying gratuity	18, 000
Total tax payable to 31.12.2016	15,329
Total tax paid to 31.5.2016	22,959
Total tax repayable 31.12.2016	(7,630)

SOLUTION TWO

(a) The basis of assessment for the final two tax years will be determined as follows:

Since the final period of account is made up of nineteen months from 1 October 2014 to 30 April 2016, the period will be split into two notional accounting periods -for tax purposes. This will result in a twelve months period ending on 30 September 2015 and a seven months period, starting on 1 October 2015 and ending on 30 April 2016.

Profits, as adjusted for taxation purposes but before capital allowances will then be apportioned on a time basis to these two periods.

The year ended 30 September 2015 will be the basis period for the tax year 2015.

The seven month period to 30 April 2016 is the basis period for the tax year 2016.

COMPUTATION OF TAXABLE PROFITS FOR THE TAX YEAR 2015

	K
Tax adjusted profits before capital allowances (380,000 × 12/19)	240,000
Capital allowances (W1)	(62,500)
	177,500
Income Tax	
On first K70,800	9,960
On Excess K106,700x 35%	37,345
	47,305

COMPUTATION OF TAXABLE PROFITS FOR THE TAX YEAR 2016

	K
Tax adjusted profits before capital allowances (K380,000 × 7/19)	140,000
Capital allowances (W2)	(14,000)
	126,000
Less overlap profits	(45,000)
	81,000
Income tax	
On first K70,800	9,960
On Excess K10,200 x 35%	3,570
	13,530

Workings

1 COMPUTATION OF CAPITAL ALLAWANCES FOR THE TAX YEAR 2015

Assets	*Value* K
Toyota Lexus	
Wear and Tear allowance (K150,000 × 20%) x 70%	21,000
Mitsubishi Canter Van	
Wear and Tear allowance(K139,200x25/29) × 25%	30,000
Fixture & fittings	
Wear and Tear allowance K53,360 x 25/29) × 25%	11,500
	62,500

2 COMPUTATION OF CAPITAL ALLOWANCES FOR THE TAX YEAR 2016

Assets	*Value* K	*Allowance* K
Toyota Lexus		
ITV b/f (K60,000 – K30,000)	30,000	
Proceeds	(35,000)	
Balancing charge	(5,000) x 70%	(3,500)
Mitsubish Canter Van		
ITV b/f (90,000 – K30,000)	60,000	
Proceeds (K46,400 x 25/29)	(40,000)	
Balancing allowance	20,000	20,000
Fixtures and fittings		
ITV b/f (K23,000 – K11,500)	11,500	
Proceeds (K16,240 x 25/29)	(14,000)	
Balancing charge	(2,500)	(2,500)
		14,000

(b) GERALD MILIMO

PERSONAL INCOME TAX COMPUTATION FOR THE TAX YEAR 2016

	K	K
Salary		216,000
Entertainment allowance (K2,000 x 12)		24,000
Bonus		5,000
College fees		25,000
Leave passage		3,000
Medical insurance (K1,000 x 12)		12,000
Golf club subscriptions		1,500
Airtime vouchers		3,000
Shopping vouchers		11,000
Reimbursement of travel expenses (K4,000- K3,500) x 12		6,000
Utility bills (K2,500 x 12)		30,000
Garden boy's wages (K1,100 x 12)		13,200
Security guard's wages (K1,300 x 12)		15,600
House keeper's wages (K1,500 x 12)		18,000
Total emoluments		383,300
Less allowable deductions:		
NAPSA contribution (restricted to maximum)	3,060	
Donation to approved public benefit organisation	15,000	
Capital allowances (K180,000 x 20%) x 15,000/25,000)	21,600	
Taxable emoluments		(39,660)
		343,640
Income Tax		
On first K70,800		9,960
Excess K272,840 x 35%		95,494
		105,454
Less PAYE		(108,216)
Income Tax refundable		(2,762)

SOLUTION THREE

(a) The following are the factors:

(i) Type of contract

Where there is a contract, the terms of that contract would have to be studied while in case where there is no contract, other tests or factors have to be applied. If the contract is a contract of service that indicates that the individual is an employee while if the contract is a contract for services, it means the individual is self-employed.

In order to determine whether an individual is employed or self-employed, it is important to establish the legal relationship of master and servant.

(ii) Financial risk/payment

Employees are paid an agreed salary on a monthly or weekly basis and incur no form of financial risk. Self-employed persons are normally paid a proportion of the contract price based on the amount of work performed. They also bear the full financial risk of the business.

(iii) Control

The work of an employee is controlled by the employer who normally stipulates working hours and other conditions. A self-employed decides when to perform the duties and how to perform them.

(iv) Opportunity to profit from sound management

In the case of the self-employed, sound management will result in more profit and better working relationship with other workers or helpers. For individuals who are employed, sound management will also result in better working relationship and a guaranteed salary at the end of the month or week. Any extra profit is not further distributed to employees.

(v) Length of engagement

The employer takes on and dismisses employees. A self-employed person normally enters into a contract with a client specifying the beginning and the end of the contract.

(vi) Holiday pay, sick pay and pension rights

If an employee goes on leave he may be paid holiday pay. Likewise, if an employee fall's sick he may still be paid his salary depending on the duration of his sickness. A self-employed person however, does not get a holiday pay or sick pay. An employee pension rights are specified by law unlike a self-employed person who can only set-up his pension pay if he/she wishes but there is no legal obligation to set up a pension.

(vi) Engagement and Dismissal

An employer can take on employees or dismiss them after giving them an appropriate period of notice.

Self-employed persons enter a contract to perform a task of a limited duration such that once the task is completed the contract comes to an end.

(b) The employees and self-employed are taxed as follows:

(i) Employees are taxed under the Pay As You Earn (PAYE) system through their employer who deducts from their earnings. The employer then remits the PAYE for all employees in total to ZRA
Self-employed make a self-assessment on yearly basis and pay either turnover tax (where the turnover of his business is less than K800, 000) or pay quarterly provisional tax (if turnover is more than K800, 000 per annum)

(ii) In both cases however, individual personal tax rates are used as set out in the table. (if turnover tax does not apply)

(iii) PAYE is normally accounted for on monthly basis and remitted to ZRA on or before the 14th of the subsequent month.

(iv) Turnover tax for self-employment is also assessed on monthly basis and paid on the 14th of the subsequent month.

(v) Provisional tax for self-employed is due at the end of the quarters for the tax year.

(c) The following are the consequences of paying the tax late:

(i) Penalties of 5% of the amount outstanding for each month or part thereof.

(ii) Interest is also chargeable on the amount outstanding at the Bank of Zambia discount rate per annum plus 2%.

SOLUTION FOUR

(a) An individual is held to be 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.

The residence status is lost or split if an individual:

i) Is a new permanent resident
ii) Leaving Zambia for permanent residence abroad
iii) Going abroad to take up employment

Therefore Jack and Jill Momba ceased to be residents from the date of departure in 1993 and regained their residence on coming back to Zambia in February 2016.

The first born child, Blackson also ceased to be a resident from the date of departure with the parents and did not however regain his residence as he remained in the USA.

The other two children born in the USA became Zambian residents on their coming to Zambia with their parents in February 2016.

(b) Jack Momba tax payable for tax year 2016

	K
Basic salary (K288, 000 x $^{11}/_{12}$)	209, 000
Servant allowance (K18, 000 x $^{11}/_{12}$)	16, 500
Housing allowance (K36, 000 x $^{11}/_{12}$)	33, 000
	258, 500
Less: Pension	(3,060)
	255, 440
Less: Tax exempt	(36, 000)
Taxable Income	219, 440
Tax computation	
1st K9, 600 @ 25%	2, 400
Next K25, 200 @ 30%	7, 560
Balance K184, 640 @ 35%	64, 624
Tax liability	74, 584

Jill Momba tax payable for the tax year 2016

Basic Salary (K84, 000 x $^{9}/_{12}$)	63, 000
Foreign bank interest (K8, 800 x $^{100}/_{80}$)	11, 000
	74, 000
Less Tax exempt	36, 000
Taxable Income	38, 000
Tax payable	

1st K9, 600 @ 25%	2, 400
Next K25, 200 @ 30%	7, 560
Bal K3, 200 @ 35%	1, 120
Tax liability	11,080
Less: Double Taxation Relief on Foreign bank interest	(1,647)
Tax payable	9, 433

Workings

D.T.R is the lower of:

i) Foreign tax K11, 000 x 20% = K2, 200

ii) Zambian Tax

$\frac{K11,000}{K74,000} \times 11,080$ = K1, 647

(c) An employee share option scheme is an option available to employees of a company to own shares in the same company they work for. The employees have the right, not the obligation, to buy shares in their employer company at a future date at a pre-determined fixed price.

The benefits of operating an approved share option scheme for the employer are as follows:

1. Costs incurred by the employer to set up an administer the scheme will be allowed as a deduction in computing the company`s profits for tax purposes.
2. The income of an approved share option scheme will be exempt from tax
3. The employer will be exempt from paying property transfer tax on shares transferred under the terms of an approved share option scheme.
4. The employees benefit is that the benefit which arises to him or her on allotment or acquisition of shares under an approved share option is exempt from tax.

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D5: INTERNATIONAL TAXATION

THURSDAY 15 DECEMBER 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

Mundia, who was married and had two children, died on 8th January, 2016 leaving an estate valued at K2,340,000. 30% of the estate is located in a European country. Mundia was born in Zambia and left a will, which clearly stated the distribution of the estate as follows:-

1. Wife - 30% of the estate

2. Children - 50% of the estate in equal proportions

3. Dependants - 10% of the estate in equal proportions

4. Parents - 10% of the estate.

The Executor, Nambi, has just received a tax bill of $20,000 from the tax authorities in the European country. In addition, the Zambia Revenue Authority (ZRA) has also made an assessment of K819,000. He would like to appeal against this double assessment. Nambi has been informed by a friend, who is pursuing the ZICA Taxation programme (Diploma level), that, the provisions of the OECD Model Double Taxation Convention on Estates and Inheritance could be used to consolidate his appeal.

Prior to his death, Mundia worked for Gunja International Plc, a Zambian resident company which trades in a country called the Democratic Republic of Pambezia through an investment in a local company, Ngunja Ltd. The Democratic Republic of Pambezia has no exchange control problems and cash flow requirements do not call the repatriation of all profits to Zambia. The effective tax rate for the company in the Democratic Republic of Pambezia is lower than that of the Zambian company. ZRA suspects that the company in the Democratic Republic of Pambezia is being used to facilitate undue tax avoidance and would like to apply the special rules for "controlled foreign companies (CFCs)". The Directors of Gunja International Plc have sought your advice on the matter. Ngunja Ltd has not distributed any dividends.

Required:

(a) Discuss the provisions contained in the OECD Model Double Taxation Convention on Estates and Inheritances. (8 marks)

(b) Identify and explain five (5) key issues relating to Estates and Inheritances arising in the Scenario, which could present challenges to the executor, when computing the relevant taxes. (5 marks)

(c) Explain the operation of and rationale for controlled foreign corporations (CFC). (8 marks)

(d) Advise the Directors of Gunja International Plc, whether, Ngunja Ltd could be considered to be a CFC. (4 marks)

[Total: 25 Marks]

QUESTION TWO

(a) ABD Plc is a public company incorporated in the state of Utopia. The company is listed on the stock exchange in the state of Eastland and one individual resident in Eastland owns a substantial minority of the shares. He is also chairman of the board of directors, three of whom reside in Eastland. The company maintains an office in Eastland.

It operates a manufacturing plant in Utopia. Decisions regarding the management of the operations at the plant are made by two directors resident in Utopia who meet weekly (but consult the three directors resident in Eastland on matters of exceptional importance). Quarterly board meetings of the company are held in Eastland at the company's office there. The Chairman and two directors attend the meetings in person and one director remains at the plant in Utopia and participates by telephone.

Utopia treats a company as a resident if it is incorporated under the laws of Utopia. Eastland treats a company as a resident if its central management and control is exercised in Eastland. Under Eastland law ABD Plc is regarded as resident in Eastland. The tax treaty between Utopia and Eastland is identical to the OECD Model Tax Convention.

Required:

Advise ABD Plc in which state it is a resident for the purposes of the tax treaty between Utopia and Eastland. (15 marks)

(b) Some countries subject their residents and non- residents to very low or no taxes at all. Such countries are normally referred to as Tax Havens.

Required:

(i) Describe four (4) factors for the identification of tax havens. (8 marks)

(ii) Explain how a double taxation treaty can be used to discourage bad tax haven policies from being adopted by certain countries. (2 marks)

[Total: 25 marks]

QUESTION THREE

AHJ Inc is a company resident in the state of Southland. DKH Ltd is a wholly owned subsidiary of AHJ Inc and is resident in the state of Westland. The business of AHJ Inc is the manufacture and distribution of expensive medical diagnostic equipment. The business in Westland is undertaken as follows:

AHJ Inc maintains a warehouse in Westland. AHJ Inc purchases components for the equipment and stores them in its warehouse. It sells the components to DKH Ltd which is licensed by AHJ Inc to manufacture the equipment and sell the whole of its production to AHJ Inc. The completed equipment is stored in the warehouse by AHJ Inc for sale to customers. AHJ Inc sells the equipment to customers in Westland via a website on a server situated in Southland. The website collects payment and arranges delivery of the equipment by sending a message to DKH Ltd which arranges delivery of the equipment from the warehouse to the customers on behalf of AHJ Inc. Marketing representatives employed by DKH Ltd make visits to potential customers in Southland and demonstrate the operation of the equipment, but instead of taking orders,

refer the potential customer to the website. Customers who enter the representative's details on the website qualify for a discount and the representative in question receives an incentive payment for each such sale. In view of the low risks to DKH Ltd, it charges a modest, but arm's length, mark up on the cost of manufacturing and services provided to AHJ Inc.

The tax treaty between Southland and Westland is identical to the OECD Model Tax Convention.

Required:

Advise the tax administration authorities in Westland whether AHJ Inc has a permanent establishment in Westland. **[Total: 25 Marks]**

QUESTION FOUR

The widening gap between rich and poor is becoming serious. It is clear that taxation has significantly failed to perform one of its function of wealth redistribution. Most countries, unfortunately, are failing to reduce poverty, and their poverty reduction strategy papers, which were prepared at great cost, have been rendered useless.

It is widely reported that the widening of the poverty gap is a dangerous global phenomenon, but in Africa it is particularly evident as a phenomenon caused by the absence of effective resource allocation, which in turn is affected by poor tax collection, and weak government regulation and enforcement.

Today, a few richest Africans own over 75% of the continent's wealth, at the same time, some of poorest people continue to exist in sub-Saharan Africa alongside the richest. It is believed that a wealth tax of less than 2% could eliminate extreme poverty.

Money laundering has become a big problem, especially in developing countries. Tax evasion and corruption is making a number of rich organizations and people richer. A multinational organization involved in manufacturing and selling clothes declared a profit before tax of K4,540,600 for the charge year 2016 and paid company income tax of only K493,200. The profit was arrived at after charging the following:

	K
1. Directors' fees	600,000
2. Staff entertainment	200,000
3. Depreciation	570,000
4. General provision for bad debts	80,000
5. Donation to Mulungushi University for agricultural research	40,000
6. Motor vehicle expenses (30% private use)	35,000

Required:

(a) Describe further legislation and regulation which developing countries, like Zambia, could put in place to combat tax evasion. (12 marks)

(b) Explain the meaning of money laundering and explain its impact on tax revenue. (8 marks)

(c) Compute the difference in the income tax declared and the actual income tax, and comment on your results. (5 marks)

[Total: 25 marks]

END OF PAPER

DECEMBER 2016 Examinations

D5 SOLUTIONS

SOLUTION ONE

(a) The OECD Model text does not give a definition of estates, inheritance or gifts. This is a **serious omission** and could result in varied interpretations. The key phrases in the description of the taxes covered are taxes imposed on:

(1) transfers of property by reason of death;

(2) transfers for no, or less than full, consideration.

The most **straightforward common feature** of taxes on estates, inheritances and gifts is that they are levied upon the transfer of property: the terminology employed throughout the Model refers to unilateral transfers to heirs, donees, legatees or other beneficiaries.

Article 1 of the OECD Model lays out the estates, inheritances, and gifts covered, providing that "the treaty only applies to those estates and inheritances where the deceased was domiciled in one of the states, or in the case of gifts, where the donor was so domiciled". The treaty thus focuses on property rather than persons, namely property which forms part of the estate of, or a gift made by, the resident of a contracting state.

Estate, inheritance and gift taxes in various countries are levied on the basis of nationality of the deceased/donor. Some countries use the concept of residence of the donor/deceased to determine the jurisdictional basis of inheritance and gift taxes. Yet other countries see the residence of the recipient as the basis on which to levy inheritance or gift taxes. Conversely, **tax burdens** in several countries tie into the location of immovable property transferred upon death or by way of gift.

Pursuant to the text of **Article 1(2)** ("taxes on the corpus of the estate"), estate taxes are such taxes that are levied on the estate itself. This approach is taken in countries such as the USA, UK, Korea and New Zealand, and is rooted in the frequent use of testamentary trusts in these countries, where determining the value of each beneficiary's interest may be difficult.

While estate, inheritance and gift taxes share the features of transfer taxes, estate taxes distinguish themselves in that the **estate tax** is levied on the entire taxable estate, which will usually include the money used to pay the tax, while gift taxes and inheritance taxes apply only to the value that is being transferred. The estate is often treated as a legal person under domestic law and the tax is based on value transferred, with graduated rates depending on the value. The deceased's property is thus not taxed at the beneficiary level but rather before transfer of the property is complete. Estate

taxes as levied on the transferor are seen to be based upon the power to transmit in that their basis is the net value of the transferor's estate.

Inheritance taxes tie in with the transfer event as well, but may be levied either at the transferor or at the beneficiary level. They are calculated based on **the decrease in value** at the transferor level, or the family or marital relationship between transferor and beneficiary and/or value received by the beneficiary.

Provided that the taxes are imposed by **reason of death,** it is immaterial whether they are imposed on property bequeathed by the deceased or on property transferred during the transferor's lifetime where under the law of one or both of the contracting states; the property transferred is subject to estate tax at the moment of death of the transferor. Such transfers are thus not classified as gifts under the Model treaty, as the treaty ties in with the point in time at which the tax arises.

It is therefore important to note that the assessments are based on the **individual tax laws for each country** in question. The OECD model may only provide general guidance. Specific guidance could be found in the Double Taxation Agreement (DTA) between two countries that aim to eliminate the double taxation. Unilateral double taxation relief may apply where there is no agreement between two countries or the DTA has no provision on the issue at hand.

(b) The five key issues are:

(i) Date of death – the scenario mentions the issue of death which is relevant in estates and inheritances. The date of death is important since it could affect valuation of assets, especially listed securities. Inaccurate valuations will result in wrong assessments.

(ii) Estate – the composition of the estate and the allowable expenses may be incorrect. Incomes earned prior to the date of death should not be part of the estate, and not all expenses are allowable.

(iii) Transfers (inheritance) – the will specifies the various inheritances. It is possible that the assessments could easily be confused with lifetime transfers.

(iv) Different states – the provisions of the Double Taxation Agreement (DTA) may be ignored and the resulting tax bill could be wrong.

(v) Double taxation – the computation for double taxation relief may be wrong.

(vi) Tax rates – wrong tax rates may be used.

(c) In **general terms**, a controlled foreign company (CFC) is a company:

(1) resident outside a particular country e.g. outside Zambia,
(2) controlled by residents of a particular country e.g. Zambia,

(3) resident in a territory in which it is subject to low level of taxation and

(4) the company in the particular country is entitled to substantial profits of the CFC on an apportionment e.g. at least 25% of the profits of the CFC.

Most tax authorities, including the Zambia Revenue Authority (ZRA) are concerned that CFC's provide a fertile ground for **tax avoidance**. It is necessary to distinguish between tax avoidance and tax evasion. Tax avoidance is the reduction of tax liabilities within the framework of the law, while tax evasion is the reduction of tax liabilities by not informing the tax authorities of all relevant facts. Tax avoidance may not always succeed, but is legal; **tax evasion** is never legal.

If the **conditions** for a CFC are satisfied for an accounting period of a CFC, then, subject to a range of exclusions, the CFC's chargeable profits and creditable tax for that period are **apportioned** between the persons who hold an interest in the company during that period. The tax payable in the particular country will then be **computed at the full rate, on the apportioned profit.**

Generally, the **provisions will not apply** if the CFC:

(1) pursues an acceptable distribution (dividend) policy e.g. at least 90% of taxable profits less capital gains and foreign tax being distributed;

(2) engages in exempt activities (mainly arm's length trading with third parties);

(3) is quoted on a recognized stock exchange in the overseas country of residence with substantial voting power held by the public e.g. at least 35%;

(4) has profits not exceeding a defined limit;

(5) satisfies the motive test i.e. does not exist wholly or mainly to reduce the tax for the particular country by diverting profits from the particular country.

Most countries also have a statutory list of **excluded countries** (i.e. those that are not classed as 'low tax' areas).

(d) Gunja may be classified as a CFC because of the following:

1. It does not pursue a an acceptable distribution policy;

2. It is not quoted on a recognized stock exchange;

3. It is resident in a low tax area;

4. It is resident outside Zambia.

5. It is controlled by a Zambian resident company

SOLUTION TWO

(a) In this case many signs show that ABD plc has a dual residence, it is a resident of both Contracting States. ABD plc will be deemed to be a resident in the country in which its place of effective management is situated.

The situation in respect of Utopia is clear. Utopia uses the incorporation concept and regards companies as residents if they are incorporated in Utopia. This concept is quite common and used by many states, examples of which include Zambia, the UK, Canada and so on.

The incorporation test is certain and leaves no room for discussion. The facts which show that ABD plc has a residence in Eastland do not matter in this case. ADB plc will be treated as a resident in Utopia by the tax authorities in Utopia.

The UK primarily treats companies as resident in the UK if they are incorporated there. Companies that are not incorporated in the UK are resident only if they satisfy the secondary test. Such companies must be centrally managed and controlled in the UK. The same law applies in Zambia as well. Accordingly, in Calcutta Jate Mills, the UK considered a company which was attached to India by many ties to be a UK resident company because the company was incorporated in the UK.

Eastland, the other country, uses the seat test to determine whether a company is resident in Eastland. This means if Eastland will treat ABD plc as a resident company in Eastland if ABD plc's central management and control is exercised in Eastland. In the UK, this is a secondary test and would only apply where a company is not incorporated in the UK. In De Beers, a South African incorporated company was held to be a UK resident company because the central management and control over it was exercised by the directors in the UK. In a case called Bullock, the UK court declared that the real, effective, ultimate power matters, even if it is exercised by the directors of the parent company illegally or unconstitutionally in the UK.

There are many facts that show that the central management and control is exercised in Eastland. Most of the directors (two directors plus the chairman) are resident in Eastland. Quarterly board meetings are held in Eastland. ABD plc has an office in Eastland, it is listed on the stock exchange of Eastland and the substantial minority of the shares are owned by an Eastland resident individual.

Eastland will definitely argue that the strategic decisions are made in the quarterly board meetings. We do not know anything about the advisors of the company. Had there been

such information, the decision in the case of Wood v Holden case would be considered to help decide the question.

If Eastland heard about the Swedish Railway case it can argue that a part of the central management is exercised in Eastland and it is enough for the residence for tax purposes. Furthermore it can argue that the substantial degree of the controlling power matters and it is exercised in Eastland.
In this case when two countries consider a company to be resident in their territories, Act 4(3) of the MTC applies.

In order to arrive at the residence of ABD plc, it would be necessary to establish the place of effective management. This should be the place of "effective" and "positive" management. [Smallwood case]. Argument for the residence in Utopia is on the basis that the daily decisions are made there by the two directors there. Eastland would argue that the quarterly board meetings are held in its territory and the two directors cannot decide in matters of exceptional importance.

We do not have information on what "exceptional importance" means but it seems that this concept covers cases which are outside the course of business.

One could argue based on New Datacom that in exceptional cases an executive brand is established in Eastland but it is not enough to have the place of effective management there.

Still it could be argued that key management and commercial decisions that are necessary for the conduct of the entity's business as a whole are made in Eastland during the quarterly board meetings or during the exceptional board meetings.

Thus, it is most likely that ABD plc will be treated as a resident in Eastland for the purposes of the tax treaty between Utopia and Eastland. This is because ABD plc's place of effective management is most likely in Eastland.

(b) (i) Factors for identification of Tax Havens:

(1) Strict secrecy rules and other protectionist measures against scrutiny by tax authorities, thereby preventing the effective exchange of information on tax payers benefiting from the low tax jurisdiction.

(2) Lack of transparency by some countries or inadequate regulatory supervision or financial disclosure. Lack of transparency may be attractive for those who want to hide the origins of their income or keep them undeclared in their home countries.

(3) No substantial economic activities in some countries. This is what makes it doubtful as to how small islands can host billions of dollars in foreign direct investment, if they apparently do not have the necessary resources to yield production.

(4) There is no or nominal tax on relevant income and usually capital, although this may be due to competing fairly or adopting a preferential regime.

(ii) A double taxation treaty can be used as way of combating tax haven policies by some countries by agreeing on disclosure and exchange of information between countries regarding the income of residents of the countries agreeing to the treaty.

SOLUTION THREE

There are many provisions of Article 5 of the OECD MTC which have to be examined in this case.
The structure of business in the case may trigger application of more than one provision of Art 5.

Thus it could be argued that AHJ Inc has a permanent establishment (PE) in Westland because of the warehouse or because of the delivery of equipment and the business activity which is carried on through a website. Furthermore the application of Act 5 para 5 maybe invoked when marketing representatives visit the customers in Westland.

There can also be a debate over the application of the "two taxpayer" concept of OECD in respect of the remuneration and activity of the dependent agents. AHJ Inc can argue if someone takes a closer look at the case then it becomes clear that Act 5 para 7 excludes the possibility to look at DKH Ltd as a PE of AHJ Inc. DKH Ltd is a subsidiary of AHJ Inc in Westland. AHJ Inc will argue that the fact that it has a warehouse in Westland falls within the scope of para 4 of Act 5. It would mean that AHJ Inc does not have a PE in Westland. Equipment is stored in the warehouse before the manufacturing and also after the manufacturing for delivery.

AHJ Inc will also suggest that the operations through a website do not constitute a PE because the server is situated in Southland.

Although, as mentioned above, AHJ Inc will argue that Act 5 para 7 will exclude DKH Ltd as a PE, the fact that the website sends messages to DKH Ltd which arranges delivery of the equipment from the warehouse to the customers on the behalf of AHJ Inc suggests DKH carries on business activity to AHJ Inc. If this activity is substantial and requires DKH Ltd to maintain staff (employees), technical equipment, premises to work for AHJ Inc, then it may argued that this activity falls outside the scope of para 7 and constitutes a PE for AHJ Inc, either in respect of para 1 or para 5. The activities carried on by DKH Ltd on the behalf of AHJ Inc may be examined in the light of the alternative service provisions if the DTC contains those.

The next circumstance which must be examined is the activity of the marketing representatives of AHJ Inc. The fact that they are employed by DKH Ltd does not exclude the application of Para 5. The employees visit the customers and demonstrate the equipment to them. Para 5 requires them to act on behalf of AHJ Inc and habitually exercise the authority to conclude contracts. From the facts of the case it seems to that they do not have the authority to negotiate the terms, conditions of the contracts, or to arrange the pricing. As a result, they would be regarded as independent agents (para 6) if they act in the ordinary course of their business. On the other hand if they are instructed by AHJ Inc (directly or indirectly through DKH

Ltd) and do not have legal and economic freedom and devote all their time and energy to AHJ Inc and its equipment, then it would be argued that they constitute a PE for AHJ Inc.

On the whole, more facts point toward that AHJ Inc has a PE in Westland. The representatives, the warehouse, the arrangements through the website, the delivery evaluated together suggest that AHJ Inc has a PE. Still one must be using caution to declare a PE.

If AHJ Inc has a PE, then Art. 7 can be applied and profits can be attributed to the PE under the arm's length principle based on the separate accounts of the PE.

SOLUTION FOUR

(a) The further legislation and regulation, which developing countries like Zambia, could put in place to combat tax evasion include:

(1) Demand full transparency from financial institutions to provide all information concerning their activities in offshore supervisory authorities. In this respect, financial institutions must be discouraged or, if necessary, prohibited from operating in territories that feature on the black lists of the Financial Action Task Force (FATF), Organisation for Economic Co-operation and Development (OECD) and the World Bank's Stolen Asset Recovery Initiative (StAR).

(2) Establish an interconnected and well integrated system of legal shareholder registries encompassing economic blocs and their member states, which will feature all necessary information concerning the shareholders of corporations operating within the economic blocs. This registry may be complemented with a risk-based index that will factor in some of the most suspicious aspects of a corporation's operations. This information on this registry should be available to authorities on demand and all corporations should be expected to provide information concerning their beneficial owner, at the moment they are asked or within a prescribed timeframe.

(3) Create a regularly-updated beneficial owner registry. Information of this kind should be either exchanged or coordinated across member states without any obstacle, so that instances of fiscal dumping would be avoided and variances in national legislation would not offer a window of opportunity to criminals and to those who make use of legal loopholes in a manner that is sophisticated, structured and systematic, suggesting that their intention is clearly malevolent, to abuse the system rather than conduct normal operations.

(4) Strengthen the requirements on the function of corporate directors. Directors should be held accountable for failing to take reasonable steps to prevent money-laundering, this should apply regardless of whether they are nominees or not. Information of this sort should, for issues of transparency and democratic legitimacy be made publicly available to the citizens, journalists and NGOs

among all others, so that an additional layer of social scrutiny may be placed over corporations.

(5) Reconsider and reinforce the rules regarding the due diligence that corporate registries and financial institutions should perform, always on an accurate risk based approach, in an attempt to verify that all information pertaining to the beneficial ownership is correct and that no margin for fraudulent or corrupt activity is allowed.

(6) Introduce requirements for enhanced due diligence in cases where politically exposed people are identified, with the option of rendering void or otherwise limiting the transaction in question.

(7) Formation of a financial Intelligence Unit (FIU) whose role shall be to monitor, assess and analyse suspicious transaction reports and contracts. This entity could operate within the context of the Single Supervisory Mechanism that would be incorporated within the range of responsibilities of the Central Bank.

(b) **Money laundering** is the **generic term** used to describe the process by which criminals disguise the original ownership and control of the proceeds of criminal conduct by making such proceeds appear to have derived from a legitimate source.

Illegal arms sales, smuggling, and the activities of organized crime; including for example drug trafficking can generate huge amounts of proceeds. Embezzlement, insider trading, bribery and computer fraud schemes can also produce large profits and **create the incentive** to 'legitimise' the ill-gotten gains through money laundering.

Money laundering has a **negative impact** on tax revenue. When a criminal activity generates substantial profits, the individual or group involved must find a way to control the funds **without attracting attention** to the underlying activity or the persons involved. Criminals do this by disguising the sources, changing the form, or moving the funds to a place where they are less likely to attract attention. This generally makes it difficult for tax authorities to make **accurate tax assessment** and **collect the correct taxes.** Money launderers may also bribe the various enforcement officers.

(c) Computation of actual company income tax – 2016

	K	K
Profit before tax		4,540,600
Add:		
Depreciation	570,000	
General provision	80,000	
		650,000
Taxable income		5,190,600
Company income tax payable		
5,190,600 x 35%		K1,816,710

The difference in the tax is K1,323,510 (1,816,710 – 493,200). This is material and should not be tolerated by the tax authorities. Such under declarations are one of the major contributors to increasing levels of poverty, especially in developing nations. Countries must also be "preaching" good moral behavior to multinationals and strengthen corporate governance codes. Tax evasion or even aggressive tax planning could be deemed as morally wrong.

END OF SOLUTIONS

TAXATION PROGRAMME EXAMINATIONS

DIPLOMA LEVEL

D6: TAX AUDIT AND INVESTIGATIONS

MONDAY 12 DECEMBER 2016

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

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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

(a) Explain the differences between Tax Avoidance and Tax Evasion. (7 marks)

(b) **Assume today's date is 15th December 2015**.

You are a senior Tax Consultant in a firm of Chartered Accountants. A potential client, who intends to commence business, has left the following request, which your Tax Manager has asked you to respond to:

Gray Mata intends to commence business on 1 January 2016 as a supplier of goods. His monthly orders are expected to be in the range of K75,000 for the foreseeable future. Out of this turnover, he envisages to meet the following expenses:

(i) Employees' emoluments of K8,000, with PAYE and NAPSA contributions of K2,000 and K600 respectively;

(ii) A monthly salary to self of K2,000 which he intends to use primarily for domestic expenditure, personal entertainment and pleasure;

(iii) He intends to import a 2800cc motor van at an estimated cost of K70,000, intended to be used for both business and private purposes;

(iv) House rentals of K1,500 per month. He will also draw K5,000 monthly for the first six (6) months to enable him acquire building materials for completion of construction of his own house. He then will take occupancy and all residential expenses which he expects to average K1,200 per month (rates, electricity, servants, security, etc.) will be met by his business; and

(v) The business will also pay the bills on his post-paid mobile phone of about K800 per month, which he will primarily use for business internet access, but also privately to communicate with his friends and relatives.

Required:

Write a letter to Mr. Gray Mata advising him of the Value Added Tax, Income Tax and Customs implications of the above issues in respect of the Tax Year 2016. (15 marks)

(c) Explain how industries can be Benchmarked with the help of ratio analysis. (3 marks)

[Total: 25 Marks]

QUESTION TWO

(a) Explain four (4) differences between a tax audit and a tax investigation. (8 marks)

(b) Explain the circumstances under which a tax investigation may be initiated. (3 marks)

(c) Describe the risk assessment process in a tax audit. (5 marks)

(d) You are carrying out a tax audit of **XYZ Bank Ltd** for the charge year 2016. The following information has come to your attention:

(i) Statement of Profit or loss

	K'000
Revenue	
Interest income	10,500
Interest expense	(2,000)
Net interest income	8,500
Non-interest income	3,100
Total Revenue	11,600
Provision for loan losses	(2,800)
Non-interest expense	(4,900)
Total expenses	(7,700)
Income before taxation	3,900
Income tax expense	(400)
Net income	3,500

(ii) The accounts, tax computation and return submitted to the Zambia Revenue Authority showed a returned taxable profit of K4,100,000. A review of the tax computation showed that no adjustments have been made with regard to provisions for loan losses and exchange losses/gains.

(iii) The Provision for Loan Losses in the Statement of profit or loss is broken down as follows:

	K'000
Specific loan loss provision	2,700
General loan loss provision	100
Total provision for loan losses	2,800

(iv) Under the Banking and Financial Services Act, the allowed Loan Loss Provision is restricted to a maximum of K3,000,000.

(v) The analysis for the Exchange Loss is as follows:

	K'000
Realized exchange losses	450
Unrealized exchange losses	550
	1,000

A further analysis of the K450,000 for Realised Exchange Losses revealed that only K250,000 was revenue in nature.

Required:

Compute the adjusted taxable profit/loss for XYZ Bank Ltd giving reasons for the adjustments you intend to make to the declared profit. (9 Marks)

[Total: 25 marks]

QUESTION THREE

(a) Discuss the Functional Model and Taxpayer segment Model of organising a Revenue Authority. (8 marks)

(b) Explain "bottom-up" and "top-down" approaches of managing a tax audit function. (8 marks)

(c) Explain the criteria that the Zambia Revenue Authority would use to determine whether a company is resident in Zambia for income tax purposes. (3 marks)

(d) Determine what the residence status of each of the following companies would be, using the criteria you have explained in part (c) above;

(i) Jaymla Tea Estate was incorporated in the country called Cayman. The board of directors holds its meetings in Zambia in most cases. (2 marks)

(ii) K'wide Limited was incorporated in Zambia, while its business operations are carried out in a country called Kambole. (2 marks)

(iii) Waga Limited is incorporated in the country known as Mbazibwe. The company's directors hold monthly meetings in Cayman. The company's major business operations are in Zambia. (2 marks)

[Total: 25 marks]

QUESTION FOUR

(a) A lease is an agreement in which one party, the lessor, transfers an asset and the rights to use the asset to another party, the lessee, in return for lease rentals over a period of time. This involves an agreement between the lessee and the lessor which could be in form of an operating lease or a finance lease.

Required:

Explain the following terms:

(i) Operating lease (3 marks)

(ii) Finance lease (3 marks)

(b) In order to minimize tax payments, the tax payer may hide certain information through transfers to members of the same family or group as well as to the names and addresses of these close relatives. The tax payers identification number (TPIN) can be used in tracing movements of income between the related parties. However the tax investigators can peruse specific information from many sources and this would involve a review of such specific information.

Required:

List eight (8) specific information that the tax investigators can review to verify and review of the movement of income of the tax payers. (4 marks)

(c) Explain four (4) factors that the tax auditor can use to determine the tax payer's compliance with statutory requirements regarding tax compliance. (4 marks)

(d) Explain the difference between self-assessment and administrative assessment. (5 marks)

(e) Describe the different types of tax audits in terms of scope and intensity. (6 marks)

[Total: 25 marks]

END OF PAPER

December 2016 Examinations

D6 SOLUTIONS

SOLUTION ONE

(a) Tax Avoidance - this is the application of the Tax Laws to the best advantage of the tax payer. As the tax payer is within the legislation, tax avoidance also called Tax Planning is Legal. Tax Avoidance may also be defined as the reduction of tax liabilities within the framework of the law. From a moral point of view, tax avoidance may not always succeed, though it is perfectly legal.

Though it is not an offence, to discourage its practice, tax legislation aims at sealing the loopholes so as to prevent tax payers from taking advantage of them.

Tax Evasion - refers to the use of illegal means to avoid tax. Such means include failing to disclose the relevant amounts of income and other forms of fraud. This is the illegal circumventing of the existing tax laws in order to obtain advantage. As such it is punishable by fines or imprisonment, or both. Tax evasion is a problem that affects everyone. Those who evade tax contribute less than their fair share to the government revenue that funds essential services such as education, health care and national security. But they still make use of those services. At the same time, honest taxpayers have to pay more to cover the shortfall left by those who are dishonest.

The aim of the tax payer practicing Tax Evasion is to defraud the Government off the revenue. Tax Evasion is an offence and may be punishable by fine /or imprisonment. Any person guilty of an offence against the Tax Income Act shall, be liable on conviction to a fine not exceeding ten thousand penalty units or to imprisonment for a term not exceeding twelve months or both.

Unlike tax avoidance, tax evasion is always against the law.

Tax avoidance, sometimes referred to as tax planning, is a legitimate arrangement of one's tax affairs in such a way as to save or minimise tax, while tax evasion is a criminal way of avoiding or dodging tax. Back duty is a term used when referring to the tax uncollected because of tax evasion.

(b) Letter to Mr. Gray Mata

CKL Chartered Accountants
Sable Road, Plot 375
P.O. Box 50198
LUSAKA

15th Dec 2015,

Mr. Gray Mata
Gumbo Road
P.O. Box 30028
CHINGOLA

Dear Sir,

RE: TAXATION IMPLICATIONS OF THE INTENDED BUSINESS TRANSACTIONS

The purpose of this letter is to explain the tax implications of your various proposed transactions.

(i) VAT Implications

Registration Threshold – examination of the projected monthly turnover figures (K75,000) results into an annual turnover that will be in excess of the VAT registration threshold of K800,000. As a result, you will be required to register for VAT as you meet the ZRA VAT registration requirements.

Tax Invoices - when you become registered, you will be required to issue tax invoices for all the supplies you make. You will also be required to maintain proper accounting records (receipts, expense invoices, etc.), which you must retain as required by the VAT legislation for a minimum period of six (6) years. No input VAT will be claimable on the talk time vouchers, building materials and other non-business expenses.

Import VAT – this will be available for reclaim on the imported motor vehicle. When this asset is disposed of, VAT should be charged and declared to the ZRA as an output tax.

Income Tax Implications

Business Taxation - capital allowances on the landed cost and taxes (excluding VAT) of the motor van will be available and tax deductible at an annual wear and tear rate of 25% of the VAT exclusive cost of the motor vehicle, being commercial. In computing your taxable business profits, the employees' monthly salaries will be deductible. The adjusted business profits will be taxable at individual graduated tax rates.

PAYE - will be due on the employees' salaries, which you be required to remit to ZRA on their behalf. NAPSA also will be charged at 5% of employees' gross emoluments and remitted to the pension institution.

Domestic Expenses - the rent for the house which you are occupying, the cost of building materials for your house and your nominal salary will not be claimed as business deductions from your profits for taxation purposes.

Import Tax (Customs) Implications

The imported vehicle will be subject to import VAT, Excise and Import Duties based on its make (i.e. vehicle capacity 2800cc, Type, etc.). Except for the import VAT, which would be recoverable upon registration for this purpose, the other costs will be available for capitalization.

We hope the above will address your concerns. We shall be available to handle any further queries that may arise.

Yours Truly,

Godwin Mapala

Senior Tax Consultant

(c) The underlying principle is that businesses of comparable sizes, working in the same industry should perform similarly. An analysis of ratios can be used to compare with expected performance indicators within an industry sector. This can then be used to identify taxpayers who fall outside the industry norms. It can also be used to test the declared incomes of businesses, and to make estimations of income for taxpayers with incomplete books & records. In practice, different ratios are computed for this purpose.

SOLUTION TWO

(a) The differences are as follows:

Tax Audit	**Tax Investigation**
Normally covers current year of assessment	May extend to previous years of assessment
Random sample examination by tax body	In-depth examination by tax body
Conducted with no prima facie fraud/evasion case	Conducted for prima facie fraud/evasion scenario

May be routine or instigated by external factors	Rarely routine, normally triggered by outside forces
Audit outcome normally a civil case	Investigation outcome normally a criminal case

(b) The circumstances are:

(i) Can be commenced because the tax agency has reason to believe a tax return or business could be incorrect in some aspect (evasion)

(ii) It May also begin when there is a tax dispute.

(iii) Other cases instigated by tip-offs/whistle blower alarms, or even a late return.

(c) This is a part of the audit planning stage where the auditor determines the likelihood or possibility of recording an inappropriate opinion as a result of a mistatement in the financial documents examined.

Audit risk has several components:

- Likelihood that material mistatement will be made in the financial statements;
- Mistatement will not be detected by internal controls;
- Mistatement will not be detected by the auditor.

These components are assigned numerical scores for decision making in audit process (e.g. more frequent audits for high risk to improve detection probability, or change factor to lower risk).

(d) **XYZ Bank Ltd**

	K'000	K'000
Returned taxable profit		4,100
Add Back:		
General loan loss provision	100	
Capital exchange loss	200	
		300
Taxable profit		4,400

Reasoning:

General Provision for Bad Debts -

- General Provisions are not allowable and Banks are not an exception; only specific bad debt provisions are allowable;
- Both the Loan Principal and Interest are tax deductible;
- Section 43A (2) states that the maximum allowable shall not exceed minimum provision under the Banking and Financial Services Act, less the value of Security or Collateral pledged against the Debt. We are not obliged to give a further allowance of K3,000,000 where the Bank has made provision under IFRS.

Exchange Losses -

- For Banks , Exchange Losses are deductible, whether Realized or Unrealized;
- Like any other, Capital Exchange Losses are not tax deductible.

SOLUTION THREE

(a) Functional Model – staff are organised by functional groupings (registration, accounting, information processing, audit, enforcement, appeals, …) and work across tax types. This approach was introduced to:

- enable greater standardisation of work processes across taxes:
- Simplify computerisation and other arrangements for taxpayers;
- Generally improve operational efficiency.

Compared to the 'tax type' model from which many revenue bodies have evolved, this model was perceived to offer many advantages (as above). Its adoption has facilitated many developments aimed at improving tax administration performance (tax payment & accounting approaches, more effective management of tax audits & debt collection functions, …) This has seen many revenue bodies (ZRA inclusive) integrate the management of direct & indirect taxes, where audit work for Income Tax & VAT is conducted jointly, creating synergies across these tax types. Other support functions (Finance, Legal, IT, Admin, etc) are managed separately.

Taxpayer Segment Model – more recent development in first world, organises service & enforcement principally around segments of taxpayers (LTO, SMTO, high net worth individuals, …) rationale being that each segment has its own peculiar characteristics and tax compliance behaviour and therefore presents different revenue risks which needs to be managed appropriately and effectively by implementing suitable strategies.

(b) As tax audits are key to delivering a revenue body's goal of optimising revenue collection, they require a high degree of planning, monitoring & evaluation.

'Bottom-Up' Approach – has been trending (and tested) till recent times, where most audit cases are identified by manual/computerised case selection criteria, or ad hoc industry-based compliance campaigns. While effective in identifying and treating individual cases of non-compliance:

- It does not provide strategic assurance to management that major risks are being addressed optimally;
- It has been recognised that the behaviours underpinning tax compliance in many risk areas are quite complex &broad ranging;

- Rather than rely wholly or substantially on audit activity a more tailored and comprehensive approach was required.

  'Top-Down' Approach – recent (and yet to be tested) trend which takes a more strategic view of all compliance risks (not just understated tax dues). More systematic and structured process to:
- identify, assess and prioritise compliance risks;
- determine appropriate treatment actions for the major risks identified.

(c) The following are the criteria:

(i) A company is resident in Zambia, if it is formed or incorporated in Zambia;

(ii) If not incorporated in Zambia, a company is still Zambian resident if it is centrally managed and controlled in Zambia;

(iii) A company is centrally managed and controlled in Zambia if its board of directors holds its meeting in Zambia.

Primarily, a company's residence status for taxation purposes is determined using the incorporation test. If a company is not incorporated in Zambia, then the place of central management and control of that company is considered.

(d) The residence status of the various companies are as follows:

(i) Jaymla Tea Estate is resident in Zambia where the board of directors holds its meeting in, in most cases. despite the fact that it was incorporated in Cayman

(ii) K'wide Limited is resident in Zambia where it was incorporated. This is despite the fact that its business operations are carried out in a country called Kambole.

(iii) Waga Limited is resident in the Mbazibwe as that is where it is incorporated. This is despite the fact that the company's director hold monthly meeting in Cayman and that the company's major business operations are in Zambia**.**

SOLUTION FOUR

(a) The following are the explanations:

(i) **Operating Lease**;

An operating lease is an agreement similar to a typical rental agreement on a real property where the lessee has the right to use the asset in return for lease rentals over the lease term. However, the legal ownership of the leased asset remains with the lessor, and therefore, the lessor is entitled to claim capital allowances on the same leased asset. The lessor is also responsible for maintenance and insurance of the asset and those expenses are generally tax allowable/deductible. Lease rentals are fully tax deductible and VAT is claimable for the lessee.

(ii) **Finance Lease**.

Finance lease is an arrangement where all the risks and rewards of ownership are substantially transferred to the lessee. The lessee is responsible for maintenance and insurance of the leased asset. The costs incurred by the lessee on the leased asset are all allowable for tax purposes. In addition the lessee claims capital allowances. The lessee claims the input VAT on the cost of the leased asset. The interest income is taxable on the lessor

(b) The following is the source of information:

i. Savings account
ii. Checking account statements
iii. Lifestyle analysis
iv. Cash flow procedures in a business
v. Credit card receipts for purchases
vi. Bank statements to analyses deposit of cash and cheque
vii. Offshore accounts
viii Loan application and personal net worth statements at bank

(c) The following are the factors:

(i) The financial statements have been prepared using acceptable accounting policies which have been consistently applied and are appropriate to the tax payer's operations.

(ii) The result of the operations, state of affairs, and all other information included in the financial statements are compatible with each other and with the auditor's knowledge of the enterprise.

(iii) There is adequate discussions drawn from the other tests which he has carried out together with those drawn from all over all review of the financial statements enable him/her to form an opinion on the financial statement.

(iv) The conclusions drawn from the other tests which he/she has carried out, together with those drawn from his/her overall of the financial statements enables.

(d)The following are the differences:

There are two generally accepted systems of tax assessments applied by OECD countries, self-assessment & administrative assessment. The former system is used to varying degrees in the administration of personal and corporate income/profits tax. All countries administer VAT under self-assessment principles.

Administrative assessment systems operate on the understanding that all tax returns should be subjected to a degree of technical scrutiny before a formal assessment is sent to the taxpayer. In practice, this is done based on taxpayer risk profiles by automated screening techniques to identify returns requiring further scrutiny before a revised formal assessment can be issued. The depth of examination depends on the risk profile attached to the return.

Self-assessment system operates on the principle that returns are typically accepted as filed in the first instance, save for mathematical errors. Revised assessments advising the tax liability is sent to the taxpayer before any inquiry.

Audits can vary in scope and intensity. Various terminologies have evolved to describe different types of audits:

(i) Full Audits – the scope is all encompassing, typically entails a comprehensive examination of all information relevant to the calculation of a taxpayer's correct tax liability for a specific period.

(ii) Limited Scope (Issue Based) Audits – confined to specific issues on a tax return and/or a particular tax scheme arrangement employed by the taxpayer, with the objective of identifying key potential areas of non-compliance. Such audit consume relatively fewer resources and allow increased coverage of taxpayer population.

(iii) Single Issue Audits – confined to one item of potential non-compliance apparent from examination of a return. Given their narrow scope, they take less time to perform and can cover more taxpayers involved in similar schemes of non-compliance.

(iv) Deregistration Audits – for a business pending deregistration from VAT with the aim of establishing tax liability/refund.

(v) Education Audits – when there is a major change in the tax law that is complex, sensitisation type.

(vi) Credibity Checks – for instance under VAT to assess the correctness of a claim for a VAT refund.

Therefore the scope and nature of any audit will depend on the available evidence pointing to the likely risks of non-compliance and taxpayer history and transaction complexity.

END OF SOLUTIONS