

SOLUTION ONE

SECTION A

1) Ethical and professional matters raised

	ETHICAL AND PROFESSIONAL ISSUES
	Approaching chief executive officers
1	Cold calling Until relatively recently, cold calling has been largely prohibited throughout the profession. Where cold calling has been relaxed, it is only permitted with existing business clients. Whilst MDM may be permitted to “cold call”, the fundamental ethical principles must be adhered to. Solicitation which is decent, honest and truthful may be acceptable but cold calling which amounts to harassment is not.
2	Free Consultancy services Offering a service for free is not prohibited provided that the client is not misled about future levels of fees.
	Displaying Cards
3	Medium of advertising Business cards may be considered a form of stationery and should be of an acceptable standard and comply with legal and member body requirements concerning names of directors, partners, principals, professional descriptions, designatory letters, etc. Whilst placing such an advertisement where target audience might reasonably be expected to exist, displaying it alongside “local tradesman” may appear to belittle the status of professional accountants
4	Use of ZICA name and Logo Although ZICA NAME can be used by MDM on letter heads and stationery, it cannot be used in any way which confuses it with the firm’s name.

5	Professional services The emphasis on “professional” may be unsuitable as it could suggest that others provide non- professional services
6	Competitive Rates There is no basis for asserting competitive rates. There are professional guidelines on how fees should be set and these should be referred to, if need be.
7	Money Back Guarantees It is unlikely that any professional would offer “money back”. In the event of a dispute (e.g. over fees), the matter would be taken to ZICA if a satisfactory arrangement could not be reached with the client. A tradesman may guarantee the quality of his work – and that it can made good in the event that the customer is not satisfied. However, a consultant cannot guarantee a particular outcome for the work undertaken.
	Placing an advert in the ZICA magazine
8	Medium of advertising Advertising is generally allowed subject to the observance of the fundamental principles of ethical codes. Placing an advert in a national accountancy magazine is generally permitted
9	Best Tax planning advice Where advertising is permitted, the minimum requirements are that it must be decent, honest, truthful and in good taste. “The best” is likely to be self-laudatory statement and not based on verifiable facts and may also be making an unjustifiable comparison with professional accountants in public practice. It may also suggest unjustifiable claim of expertise or specialism in the field of tax.

10	<p>However your gains might arise, can ensure</p> <p>These claims may not be supported and therefore the advertisement may not be regarded as being honest in this respect. Expectations of favourable results (lower tax liabilities) may be unjustifiable (or created deceptively) .</p>
11	<p>Techniques you can apply</p> <p>There is a fine line between tax avoidance and tax evasion and “techniques you can apply” and “alternative fact presentations” may lean toward tax evasion and so not be in keeping with the integrity of the profession. In addition, this may imply that MDM is able to influence the Zambia Revenue Authority.</p>
12	<p>Minimise amount of tax</p> <p>The assertion of being able to “minimise the amount of tax” may expose MDM to litigation. The engagement risk associated with taking on this work would be high and so should carry compensatory high fees.</p>
13	<p>No tax saving – no fee</p> <p>The “no tax saving – no fee” does not compensate for the risk associated with undertaking the work advertised. Contingency fees, whereby no fee will be charged unless specific results are obtained, are prohibited by many professional bodies</p>

2) Terms of engagement

a) Factors for determining whether Mr. Tembo is an employee or self employed

In order to distinguish between an employee and a self employed person, the following tests are normally taken into consideration:

i. Type of contract

If there is a contract of service, it will indicate the existence of relationship of master and servant. A contract for services will indicate the existence of self-employment

ii. Work performance

Employees must perform the duties assigned to them themselves while the self employed may hire other people to perform the work for them

iii. Control

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

iv. Payment and financial risk

Employees are paid an agreed salary on a monthly or weekly basis and incur no form of financial risk. In order to earn an extra sum, employees will have to work overtime. Self employed persons are normally paid a proportion of the contract price based on the amount of work performed. They will also bear the full financial risk of their business.

v. Place of work

Employees will normally be told where the duties are to be performed from. This is normally at the employer's premises or at the premises of the client. Self-employed persons will perform the duties at a place of their choice.

vi. Equipment

An employer will provide the tools and equipment which the employees are to use. Self-employed persons will provide their own tools and equipment.

vii. Correction of work

Employees will normally rectify any faulty work during the normal working hours and they will still be paid for those hours. Self-employed persons will rectify any faulty work outside the contract time and they will not be paid for that extra work.

viii. Engagement and dismissal

The employer will take on and dismiss employees. A self employed person will normally enter into a contract with a client specifying the beginning and the end.

ix. Insurance

Employers will normally provide insurance cover for the actions of their employees. Self-employed persons will have to provide for their own insurance needs

x. Integration

The courts will also consider whether an individual's activity is fully integrated within the organisation. If this were the case, it would be difficult for an individual to prove that he/she is self-employed

xi. Exclusivity

Employees normally work for one employer. A self-employed person will normally work for a number of clients

b) Matters to show that Mr. Tembo is an employee of LT Ltd

The following matters are likely to show that Mr. Tembo is an employee of LT Ltd:

- i. LT Ltd has not replaced Mr. Tembo with another full time employee but has instead approached Mr. Tembo to be re-hired to continue performing the duties he used to perform for the company**
- ii. Mr. Tembo is expected to use the same office that he had been using when he was employed by Lt Ltd.**
- iii. Mr. Tembo is expected to spend a substantial amount of his time working for LT Ltd. It is stated that he will be expected to spend about half of his time working for LT Ltd.**
- iv. Mr. Tembo will be paid an agreed amount every month.**

c) Matters show that Mr. Tembo is self-employed

The following matters are likely to show that Mr. Tembo is self-employed

- i. Mr. Tembo has been running his business since his resignation from LT ltd**
- ii. When perform duties for LT Ltd, Mr. Tembo will be using his own technologies in performing his duties for LT Ltd**
- iii. Mr. Tembo has several other clients other than LT Ltd**
- iv. There is no indication that Mr. Tembo may be dismissed by LT Ltd without giving him an appropriate notice**

SECTION B

3) Mr. Tembo being re-engaged as an employee

a) Taxation implications and relevant calculations

The tax implications of Mr. Tembo's proposed terms of employment are as follows:

- i. The implication of being employed on a fixed term contract is that Mr. Tembo will not be able to benefit from the exemption from income tax of the first K25 million of his terminal benefits. This exemption only applies to pensionable employees**

ii. The starting salary will be taxable under the PAYE system. The settling allowance of 10% of his starting basic salary will be taxable as additional emoluments since all allowances receivable by employees in the course of employment are taxable emoluments. The amount of settling allowance will be $10\% \times \text{K240 million} = \text{K24 million}$

The annual increments will be spread throughout the relevant tax years when they will be available and will result in a higher salary from one year to another. The expected increments will be

Tax year	Expected annual Salary
2011/2012	K240 million
2012/2013	K252 million
2013/2014	K264 million

iii. The gratuity payable at end of the contract will be a qualifying gratuity as it will not exceed 25% of the cumulative basic pay and the contract term will exceed the minimum period of two years. This will only apply provided that Mr. Tembo does not resign from this employment before serving a minimum of two years. In case he resigns after working for less than two years, the gratuity will not be a qualifying gratuity and will be taxable as an additional emolument.

The qualifying gratuity will be taxable at the tax rate of 25% after deducting the tax free pay, assuming that the current tax rate will be in force at the time of receiving the gratuity.

The actual gratuity that he will receive, assuming he serves the three years, will be

$$\begin{aligned}\text{Gratuity receivable} &= 20\% \times (\text{K240m} + \text{K252m} + \text{K264m}) \\ &= 20\% \times \text{K756 million} \\ &= \text{K151.2 million}\end{aligned}$$

The amount of income tax on this gratuity will depend upon the taxation rules and rates applicable in the tax year 2013/2014, when the gratuity will be received.

iv. In respect of accommodation that will be provided by the employer, Mr. Tembo will be assessed on the maintenance costs, cost of electricity, water and general cleaning that LT Ltd will incur on his behalf

v. No assessment will arise in respect of the reimbursement of medical expenses that Mr. Tembo will incur. This is because the amount actually incurred by Mr. Tembo will be set off in full against the amount that LT Ltd will re-imburse

vi. The payment of Mr. Tembo's recreation club subscription will be treated as an emolument and chargeable to income tax on Mr. Tembo So, the K500,000 payable by LT Ltd will be subjected to tax under PAYE system in the month when paid.

vii. The subscription of K1.2 million payable to EIZ will be deductible from Mr. Tembo's emoluments as it appears that membership to EIZ is relevant to his employment. He is being employed to undertake engineering related duties.

viii. The National Pension Scheme Authority (NAPSA) contributions are also deductible from emoluments. The maximum amount deductible is limited to the lower of 15% of the emoluments and K1,860,00 for the tax year 2010/2011

4) Deferred taxation

a) Relevance of the note supporting the deferred taxation

Accounting for taxation has created numerous problems in the past, largely because of the subjectivity associated with the estimates for current and deferred tax. The reconciliation highlights the effects of the subjective decisions and estimates made by management in arriving at the tax expense. This makes it easier to see what effect such adjustments as:

- Changes in rates,
- Actual versus expected tax charges
- Etc

have had on the tax charge in the income statement.

It also provides users with some comfort about figures in the income statement. Many analysts calculate the profit figure used in the tax computation by dividing the estimated tax charge by the tax rate. The resulting figure is the profit as determined according to the tax regulations, which is regarded as a slightly more uniform and reliable basis for comparing enterprises' results.

b) Computation of deferred taxation balance for the year

Current taxation – income statement

Tax on profit on ordinary activities:	K'Billion	K'Billion
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Current tax: Tax on profits for the period		0.40
Deferred tax: Reversal of timing differences Effect of decreased tax rate on opening liability	0.11 0.10 -----	(0.21)

Total charge in the income statement		0.19
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Deferred taxation – Statement of financial position extract and associated note

	K'Billion
Temporary differences on non-current assets	0.60
Provision at the start of the period Deferred tax credit in income statement for the period	0.81 (0.21)

	0.60
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Workings

	K'Billion
Temporary difference at start of year Opening deferred tax balance (2.3*35%)	2.30 0.81
Closing deferred tax balance (2*30%)	0.60
Decrease in provision (0.81-0.61) The decrease arises because of the a reversal (2.3-2.0 * 35% = 0.11, and decrease in the tax rate (2.0*5%) = 0.10	0.21

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c) Why it is necessary to computer deferred tax in relation to the revaluation of the land and buildings

The creation of a provision on a timing difference which is highly unlikely to reverse might seem to be slightly at odds with the recognition criteria for a liability. If the assets are unlikely to be sold there is no real possibility of an outflow of economic resources arising from the revaluation.

The logic behind creating a provision in respect of each and every timing difference has more to do with reducing the scope for accounting choice in accounting for deferred tax.

If a company can exclude potential payment on the grounds of management's beliefs concerning the future transactions then it will be possible to manipulate the provision by making an optimistic set of assumptions. Management can always claim to have acted in good faith if the gain is subsequently recognised and the tax becomes payable.