SUGGESTED ANSWERS

MARK PLAN

Question 1.1

REPORT

To: Finance Director

From: Chartered Accountant

Subject: Explanation of the tax implications of Gumare Ltd fye 30 April 2017

In response to your request, this report explains the tax implications of the transactions referred to your Exhibit.

(a) Acquisition of the industrial building

Income tax implications:

The eligible cost of the industrial building for capital allowances is P1,400,000, the cost of land P400,000 is not eligible for capital allowances. The administration office is treated as part of the industrial building because it is within the same premises.1

Capital allowances	P	
Initial allowance – P1,400,000 x 25%	350,000	1
Annual allowance – P1,400,000 x 2.5%	35,000	1
Industrial building allowance	385,000	

No capital allowances are available on the disposed warehouse. 1

The balancing charge of P300,000 on disposal of the warehouse shall be added to the taxable income. 1

Capital gains tax (CGT) implications:

The chargeable gain arising on the disposal of the warehouse is liable to CGT. 1

However, since Gumare Ltd reinvested some of the proceeds from the disposal of the warehouse, Gumare Ltd can and should elect for rollover relief. To obtain full rollover relief, the cost of the new industrial building must be at least equal to the original cost plus the chargeable gain of the warehouse. 1

	P	
Original cost	800,000	1
Plus chargeable gain	1,400,000	1

	2,200,000	
Amount reinvested	1,800,000	

Amount not reinvested and now taxable	400,000	1

Holdover/rollover relief 1,400,000 – 400,000 =	1,000,000	1

VAT implications

VAT incurred on the materials used in the construction of the industrial building is recoverable. 1

(b) Letting of the industrial building

Income tax implications

The rental income for the tax year ended 30 April 2017 will be included in the taxable income. P180,000 x 9/12 = P135,000 1

The deposit received is not taxable because it has not accrued to Gumare Ltd. Income is only taxable if the taxpayer has become unconditionally entitled. 1

VAT implications

Gumare Ltd will be required to charge VAT of P16,200 (P135,000 x 12%) over the 9 months' period on the rental income. 1

VAT will not be charged on the deposit of P45,000. 1

(c) Acquisition of delivery van

Income tax implications

Balancing charge on the disposal of the delivery van

	P	
Cost	520,000	
Less capital allowance granted:		
Y/e 2014, 2015 and 2016		
P520,000 x 25% x 3 years	(390,000)	

Income tax value b/f	130,000	1
Sales proceeds	330,000	

Balancing charge	200,000	1

Gumare Ltd is entitled to claim rollover relief. By claiming rollover relief, the balancing charge will be deducted against the cost of the newly acquired delivery truck. As the balancing charge exceeds to replacement cost, the excess balancing charge of P40,000 (P200,000 – P160,000) will be added to the taxable income. 1

No capital allowances will be available on the acquired delivery van. 1

VAT implications

On the sale of the delivery truck, Gumare Ltd will be required to charge VAT of P39,600 (P330,000 x 12%). 1

On acquisition of the second hand truck, Gumare Ltd will be able to claim notional input VAT of P19,200 i.e. P179,200 x 12/112. 1

(d) Sale of shares in Ngwedi Ltd

Income Tax implications: Not applicable

CGT implications

The disposal of shares in Ngwedi Ltd will be liable to CGT even though they are listed on the Botswana Stock Exchange. 1

Listed shares are only exempted if the shares are actually traded on the Stock Exchange or the entity has released at least 49% of its shares for trading. Only 20% of Ngwedi Ltd shares have been released, the sale shall be subject to CGT. 1

	P	
Sales proceeds (P23 x 100,000 shares)	2,300,000	1
Less cost (P1 x 100,000)	(100,000)	1

Un-indexed gain	2,200,000	
Less moveable allowance at 25%	(550,000)	1

Chargeable gain	1,650,000	

(e) Sale of shares in Loapi Ltd

CGT implications:

The sale of shares in a company whose dominant or main asset is property shall be treated as the disposal of immoveable property. 1

The capital gain or loss shall be computed as follows:

	P	
Sales proceeds	1,700,000	
Less allowable cost	(1,230,000)	

Un-indexed gain	470,000	1
Indexation allowance		
P1,230,000 x (1751.7 – 1655.8)/ 1655.8	(71,239)	1

Chargeable gain	398,761	

VAT implications: Not applicable

(f) Foreign dividend income

Income Tax implications:

Foreign dividend income is liable to Botswana tax but only at 15%. Any foreign tax suffered on the dividend is deductible but cannot exceed the Botswana tax equivalent. Zimbabwe taxed at 20%, foreign dividend tax in Botswana is 15%, hence no additional tax will arise in Botswana. 1

CGT – Not applicable

VAT – Not applicable

(g) Foreign interest income

Income Tax implication :

Foreign interest income is also liable to Botswana tax. The gross foreign interest income is included in the taxable income of the company. Like dividends, double tax relief is available to ensure that the foreign income is not taxed twice. 1

CGT – Not applicable

VAT – Not applicable

Possible mark	32

Maximum mark 30

Question 1.2

Re-computation of the final taxable income for Gumare Ltd fye 30 April 2017:

	P	P	
Draft taxable income		3,414,000	
Industrial building allowance		(385,000)	1
Balancing charge on warehouse		300,000	1
Chargeable gain on disposal of warehouse		400,000	1
Rental income re industrial building		135,000	1
Excess balancing charge re delivery van		40,000	1
Chargeable gain on disposal of shares in Ngwedi Ltd		1,650,000	1
Chargeable gain on disposal of shares in Loapi Ltd		398,761	1
Foreign dividend income		0	1
Foreign interest income		100,000	1

Taxable income		**6,052,761**	

Computation of tax payable:			
P6,052,761 x 22%		1,331,607	
Tax on foreign dividends			
P192,000/80% x 15%		36,000	1
Less			
Double tax relief on foreign dividends		(36,000)	1
Lower of:			
Botswana equivalent	36,000		
Foreign tax suffered			
P192,000/80% x 20%	48,000		

Double tax relief on foreign interest:		(10,000)	1
Lower of:			
Botswana equivalent:			
P100,000 x 1,331,614/6,052,791	22,000		
Foreign tax suffered:			
P100,000 x 10%	10,000		

		----------------	----
Tax payable		**1,321,607**	**12**
		-----------------	----
			(Maximum mark 10)
Total possible marks			**44**
Total maximum marks			**40**

Question 2.1(a)

Response to Justice's email:

Retiring from the business – income tax
If you dispose of your business to Modiri on 31 December 2017, during your lifetime, the disposal will be liable to income tax, among other taxes.

The value of the business exceeds the expected sales proceeds, the Commissioner General will base the computations on the fair market values. 1

Only the disposal of the goodwill will not be subject to income tax as it is a capital item that was not subject to capital allowances. 1

Therefore, the income tax consequences of selling the business will be as follows:

Commercial property	P		
Cost	430,000		
Less allowances granted			
2007 to 2016			
10 years x 2.5% x 430,000 =	(107,500)		

Income tax value b/f	322,500		
Sales proceeds, limited to cost	430,000		

Balancing charge	107,500		2

Plant & machinery (P&M) and inventory:			
	P&M	Inventory	
	P	P	
Tax value	140,000	100,000	½ x 2=1
Deemed sales proceeds	270,000	160,000	
	-------------	-------------	
Balancing charge/income	130,000	60,000	1 x 2=2
	--------------	-------------	

Total addition to taxable income = P107,500 + 130,000 + 60,000
= P297,000

Capital gains tax – Selling the business

Chargeable gain arising on sale of the business:

Commercial building

	P		
Deemed sales proceeds	1,500,000		1
Less allowable cost	(430,000)		1

Un-indexed gain	1,070,000		
Indexation allowance			
(1806.6 – 924.2)/924.2 x P430,000*	(402,177)		1

Chargeable gain	667,823		

Goodwill			
Deemed sales proceeds	400,000		
Less moveable allowance at 25%	(100,000)		

Chargeable gain	300,000		2

Total chargeable gains	967,823		

Capital transfer tax (CTT) – Selling the business

There are no capital transfer tax implications. 1

Additional tax liabilities for Justice:			
Income tax – 25% x P297,000 =		74,250.00	1
Capital gains tax			
First P144,000	13,950.00		
Next P x 25%	205,955.75		

		219,905.75	1

Total additional tax liabilities for Justice		P294,155.75	1

Leaving the business to Modiri in your will

If you hold on to your business and transfer it via your will upon your death, there will be no income tax or capital gains tax arising on the transfer of the business. 1

However, Modiri will be liable to pay capital transfer tax on the market value of the business at the time of the transfer. 1

The tax rates on capital transfer assets are very low compared to the income tax and CGT rates. The highest rate is only 5%. If the assets were gifted to Modiri on 31 December 2017, the CTT liabilities would be as follows:

First P500,000	P16,000	
Next (P2,330,000 – P500,000) x 5% =	P91,500	

	P107,500	1

It would be more tax efficient to transfer the assets via the will than sale of the business to Modiri at 31 December 2017. 1

Modiri would be responsible for the payment of CTT. 1

However, this could change depend this position could change depending on the market value of your business at the time of your death. 1

Total possible marks **22**
Maximum full marks **15**

Question 2.1(b)

Any gratuitous transfer of property will be liable to CTT which will be payable by the 8uth.

Alternative 1
If you make a gift to your grandchildren during your lifetime, CTT will arise on the transfer. The donees will be liable to pay any CTT arising. 2

However, since the donees are still minors, Justice, the 8uthori, will ultimately be responsible for the payment of CTT. 1

The CTT payable is:

First P500,000	16,000	
Next P2,300,000 x 5%	115,000	

CTT payable	131,000	1

The income that will subsequently accrue to the grandchildren by reason of the office block will be included in the gross income of the settlor during his lifetime. 1

Alternative 2
If you make a gift to a trust, the transfer will be liable to CTT as in **Alternative 1** above. The CTT payable is P131,000. 1

However, the trustees will be responsible for the payment of CTT and not the settlor as in **Alternative 1**. 1

The income that will subsequently be realised from the donation, in this case the office block, will be taxed in the name of trustees in the sum amount that would have been charged on the beneficiaries. 1

Conclusion

The CTT liability under the two alternative methods is the same. However, Justice would be liable to CTT both on the transfer and the subsequent income if the donation is made to minor children. 1

If the donation is made to the trust, the trust will be responsible for any CTT and income tax liabilities. 1

Gifting the office block to the trust is more tax efficient for Justice

Total possible marks **10**
Total maximum marks **8**

Question 2.1(c)

Restraint of trade payment

Any bonus paid to an employee is taxable and subject to PAYE in the normal way. A restraint of trade payment paid by an employer to an employee in return for not competing the employer on termination of employment is generally treated as capital and subject to capital gains tax rules. However, this is not the case here. 2

You are potentially asking an employee to share confidential information with you which is not acceptable. You should consider carefully exactly what the suggested payment is for and assess whether such a payment should be made. 2

In addition you are proposing misclassifying the actual nature of the payment. 1

As a Chartered Accountant I must act with honesty and integrity and urge you to treat the payment as a bonus and disclose to BURS. I am able to do so with your 9uthorized9on (and will review my engagement letter to see if I am already 9uthorized to do so). 2

Total possible marks **7**
Total maximum marks **6**

Question 2.2

Response to Keamogetse
Your status as small farmer depends on the number of cattle that rear for slaughter. If the number of heads of cattle for slaughter is less than 300 during a tax year, you shall be exempted from tax. 1

The exemption to tax is not optional but depends on number of heads of cattle reared. A farmer who rears less than 300 heads of cattle for slaughter is exempted from tax. 1

However, a farmer who engages in dairy farming will be liable to tax even if he or she keeps less than 300 heads of cattle. If you invest in 80 dairy cows, you will become liable to tax. 1

Payments in consideration of sales of livestock are treated as dividends and subject to a withholding tax of 4%. 1

If the recipient is a farmer who is exempt from tax, the the withholding tax deducted shall represent the final tax. 1

If the farmer is liable to tax the withholding tax so deducted shall be provisional and may be deducted from the tax liability. 1

You will be liable to withholding tax whether you are exempt to tax or not. However, if you are exempt from tax, the withholding tax deducted shall represent a final tax liability. If you are liable to tax, the withholding tax shall be provisional and recoverable from your tax liability. 2

Total possible marks **8**
Total maximum marks **6**

Grand total possible mark 47
Total maximum mark 35

Question 3.1

Response to CEO's request

VAT input tax implications

1. Purchase of motor car

   Input Vat is denied on the purchase of a motor car subject to exceptions. 1

2. Purchase of a television set to give an employee as a long service award.

   Option 1 – the television set was not acquired for the purpose of business and therefore the input VAT should not be claimed.

   Option 2 – claim the input VAT on the basis that the television set was acquired for the purpose of business. (for either option) 2

3. Purchase of a small pick-up truck

   Input VAT of P15,600 (P145,600 x 12/112) was claimable. 1

4. Purchase of a plot of land

   No VAT was chargeable by the seller because he was not VAT registered. 1

   However, Sekhukhu Ltd will be required to pay transfer duty of P7,500 (5% x (P350,000 – P200,000). 1

   The transfer duty payable will treated as claimable input tax. 1

5. Weekend planning retreat

   The VAT incurred on accommodation and meals is not recoverable because it falls under entertainment. 1

   No Vat would arise on the services provided by the South African consultant as it constitutes importation of service that are consumed for a business purpose within Botswana. 1

Possible mark 9
Maximum mark 8

Question 3.2

Implications for output VAT

1. Provision of motor car to employee

   No output VAT implications. 1

2. Long service award

   Option 1 – if input VAT was not claimed, then no output VAT would be charged.

   Option 2 – If input VAT was claimed, then out VAT should be charged because the asset has been applied to a non-business use or different use. 1

   The output VAT should be charged on the lesser of:
   - The input VAT claimed on acquisition, and
   - The fair market value of the supply.

   In this case, the output VAT will be based on the fair market value i.e. P9,428.57 (P88,000 x 12/112). 1

3. Sale of a small pick-up to an executive director

   The sale was made at below fair market value, therefore the output VAT will be based on the fair market value.

   The output tax = P9,428.57 (P88,000 x 12/112) 1

4. No output VAT implications. 1

5. No output VAT implications. 1

(6)

Question 3.3

Income tax and CGT implications

1. Provision of motor car to employee

   Income tax implications
   For the company
   Capital allowances – P175,000 x 25% = P43,250 1

   For the employee
   Benefit in kind (B-I-K) assessable on the employee

First P200,000	10,000	
Next P50,880 x 15%	7,632	

Benefit included in employment income	17,632	1
	-----------	

2. Long service award

   Income tax implications
   For the company
   The cost of the television set, either P8,064 per option 1 or P7,200 per option 2, is deductible as part of the employment cost. 1

   For the employee
   No income tax implications. 1

3. Purchase and sale of a small pick-up to an executive director

   CGT
   The small pick truck was acquired and sold in the same tax year, therefore, the disposal will be liable to CGT as follows:

	P	
Deemed sales proceeds (fair market value)	78,571.43	
Allowable cost P145,600 x 100/112	130,000.00	

Capital loss	51,428.57	1

Income tax
For the company

No capital allowances as the truck was sold in the same tax year.

For the executive director
The executive director will be liable to tax on the benefit in kind arising on difference between the fair market value and the amount paid by the director. 1

	P	
Fair market value	78,571.43	
Less amount paid by the executive director	36,000.00	

Assessable benefit	42,571.43	1
	----------------	

4. Purchase of plot of land

No income tax implications.

CGT
The allowable cost for CGT purposes will be P342,500 (P350,000 – P7,500).1

5. Weekend planning retreat

Income tax implications
Amount of P76,160 (VAT inclusive) incurred on the accommodation and meals was wholly tax deductible. 1

The amount paid to the South African consultant is tax deductible 1

On condition that the WHT of P3,600, 10% of P36,000 had been deducted and paid over to BURS. 1
(11)

Total possible marks **26**
Total maximum marks **25**