Botswana Institute of Chartered Accountants

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DECEMBER 2018 BUSINESS PLANNING TAXATION

MARKING KEY

(SUGGESTED ANSWERS AND MARKING SCHEME)

Question One

a) KagisoTebogo

Briefing Note: Amount of bank loan finance required:

	P	
Proceeds from employment (W1)	956,364	1
Proceeds from sale of shares (W4)	209,000	1
Proceeds from sale of warehouse (W5)	940,000	1
Total cash proceeds receivable	2,105,364	
Income tax payable:		
Income tax (P117,178.50 + P8,062.50) W2/3	125,241.00	1
Capital gains tax (W6)	129,973.50	1
Total expected taxes payable	255,214.50	
Net cash expected	**1,850,149.50**	**1**

W1 – Final employment income

	Gross Amount P		Taxable Amount P	
Gratuity (P40,000 x 18 months)	720,000	x 2/3	480,000	1
Leave days 42/22 x P40,000	76,364		76,364	1
Retrenchment package	120,000	x 2/3	80,000	1
Salary for December 2018	40,000		40,000	1
	956,364		676,364	

W2 – Tax liabilities on final employment income

First	P72,000 (6/12)	6,525.00	
Next	P604,364 at 25%	151,091.00	
	676,364	157,616.00	1
Less PAYE deducted at source		(40,437.50)	1
Additional tax liabilities		117,178.50	

W3 – Balancing charge on disposal of warehouse

P430,000 x 3 years x 2.5%	32,250.00	1
Tax thereon at 25%	8,062.50	1

W4 – Capital gains tax – disposal of shares

Sales proceeds		209,000	
Allowable cost - 100,000 shares	220,000		
• 10,000 x 45,000/25,000	18,000		
		(238,000)	
Allowable loss		(29,000)	2

W5 – Disposal of warehouse

Sales proceeds	940,000	
Allowable cost	(430,000)	
Un-indexed gain	510,000	
Less indexation allowance: (1868.2 – 1698.7) / 1698.7 x P430,000	(42,906)	
Chargeable gain	467,094	2

Held-over gain now chargeable:

The held-over gain becomes liable to tax when of the replacement property that gave rise to the held-over relief is disposed of. Any amount of the minimum reinvestment that was not reinvested is chargeable to tax immediately. 1

Minimum reinvestment amount:

• Original cost	260,000	
• Chargeable gain arising on disposal	300,000	

	560,000	
Amount reinvested	(430,000)	

Amount not reinvested	130,000	
Therefore, amount held-over and now chargeable	170,000	2

Net chargeable gains

Shares	(29,000)	
Warehouse	467,094	
Held-over gain now chargeable	170,000	

Net chargeable gains	608,094	

W6 – Capital gains tax liability

First P144,000	13,950,00	
Next P464,094 at 25%	116,023.50	

	129,973.50	2
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b) Appendix

Whether a business is incorporated or not will have an effect on the taxation of the entity and its directors.

When would the profits be taxed?

As a sole trader, the tax on the profits of the current tax year will be due by the 30th September following the tax year. Depending on the tax year that the sole trader chooses as his/her accounting period, the sole trader may have a significant period between earning the profits and accounting for the tax. For instance, a sole trader who prepares his accounts to 30 September 2017, will only be required to account for tax by 30 September 2018. 2

If the business is incorporated, it is required to account for tax and submit its tax return within 4 months after the end of its accounting year end. Furthermore, if a company estimates that its tax liability for a particular year will be P50,000 or more, it will be required to account for its tax liabilities under the self-assessment system. The self-assessment system requires that tax is accounted for on a quarterly basis within the current tax year. 3

In terms of when the tax is due for payment, being a sole trader gives the taxpayer more time to account for the tax liabilities. 1

On whom would be the tax be charged?

A sole trader is liable to tax on the profits of the business using the tax rates applicable to individuals. The sole trader will not be liable to any additional tax on the profits whether the profits are drawn or not. 1

The profits realised by a company belong to the company itself. Accordingly, a company will be liable to tax on the profits.

An owner-managed company can choose how profits are paid out to its owners and seek to minimise the tax cost of withdrawing profits by choosing the most tax-efficient method of profit extraction. 1

Profits of a company could then be drawn as a salary or dividend. 1

A salary will be liable to tax on the director but deductible as an expense for the company. 1

A shareholder may be entitled to a dividend. However, the dividend is subject withholding tax at source and the tax is borne by the shareholder as a final tax. 1

The dividend is not deductible for tax purposes. 1

Rates of taxation

A sole trader is liable to tax at the rates applicable to individuals ranging from 0 to 25%. 1

A resident company is liable to a flat tax rate of 22%. In addition, if the directors/ shareholders withdraw the profits whether in the form of salaries or dividends, additional income tax will arise on them as individuals. 1

Computation of tax implications

	Sole trader	Company	
	P	P	
Taxable profit	720,000	720,000	
Less director's salary		(360,000)	
Net taxable profit		360,000	
Tax liability: @22%		79,200	
First P144,000	13,050	13,050	
Next P576,000/P216,000 @25%	144,000	54,000	
Total tax liability	157,050	146,250	2 x 2

Conclusion

It would be more tax advantageous for Kagiso to operate his business as a limited company.

The resulting annual tax savings based on the information provided is P10,800 (i.e. P157,050 – P146,250). 1

Future investment by your cousin Tumelo

If you set up in business as a sole trader business and your cousin Tumelo wished to invest in your business he would have two options. Firstly he could lend the money to your business, and be paid interest on his investment, which would be taxed on him as interest income and deductible for your business as an expense.

Alternatively, the two of you could enter into a partnership and share the profits in accordance to the partnership agreement. The shared profits would be taxed on each of you. 2

If you incorporate your business, your cousin could lend money to the company, the company would then pay him interest on his loan. The company would deduct the interest payable in calculating taxable total profits. 2

Alternatively you could issue shares to your cousin in exchange for his investment in the company. The dividends payable to him would not be deductible for tax purposes. 2

The most tax efficient form of investment will depend upon several factors including whether there is any intention for Tumelo to play an active part in the business, his proposed level of investment and his personal circumstances. 1

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Total marks **46**

Maximum available **40**

Question Two

a) Tax implication for the shareholders of Lengau IT Ltd on the sale or merger of its business to Tsala Care Ltd. There are three options available for consideration.

Option 1 – Sale of the trade and assets of Lengau IT Ltd as a going concern:

The sale of the trade and assets by Lengau IT Ltd implies that the proceeds will first be realised by Lengau IT Ltd and then a dividend shall be paid to the shareholders.

Income tax implications

The sale would represent a disposal of assets at their fair market value and balancing adjustments will arise on the disposal of assets on which capital allowances were claimed.

i) Balancing adjustments:

	Office Building P	Plant & machinery P	
Tax value b/f	320,000	120,000	
Sales proceeds (restricted to cost)	800,000	380,000	
Balancing charge	480,000	260,000	2 x 2

ii) Loss on inventory P200,000 – P120,000 = P80,000 2

VAT implications

There are no VAT implications as both the seller and the buyer are registered for VAT and the business shall continue to be carried on for a taxable activity. The transfer shall be deemed to be zero-rated for VAT purposes. The seller and buyer should give appropriate written notice within 21 days of the transfer to the Commissioner General. 2

Capital gains tax

Only the office building and the goodwill will be liable to capital gains tax as follows:

	Office Building	Goodwill	
	P	**P**	
Sales proceeds	1,800,000	700,000	
Less indexed cost	(1,440,000)	-	
Less moveable allowance at 25%		(175,000)	
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Chargeable gain	360,000	525,000	2 x 2
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Total chargeable gain P360,000 + P525,000 =		P885,000	

Total taxable income arising from the disposal of Lengau IT Ltd:

		P	
Balancing charge:	Office buildings	480,000	1
	Plant & machinery	260,000	1
Loss on inventory		(80,000)	1
Total chargeable gains		885,000	1

Total taxable income		1,545,000	

Tax thereon at 22%		339,900	1
Distributable profit			
Proceeds		3,000,000	1
Less tax liability		(339,900)	1

Available for distribution		2,660,100.00	
Withholding tax on dividend at 7.5%		(199,507.50)	1
Net dividend		2,460,592,50	1
Payable to each shareholder P2,460,592.50 / 3 =		**P820,197.50**	**1**

Option 2 – Purchase of all the share capital of Lengau IT Ltd

This will be a transaction between Tsala Care Ltd and the shareholders of Lengau IT Ltd. Consequently, it is merely a disposal of shares and the proceeds are received directly by the shareholders.

Income tax implications

There are no income tax implications. 2

VAT implications

There are no VAT implications. 2

Capital gains tax implications

The sale of shares will result in capital gains tax implications as follows:

	P	
Sales proceeds	3,000,000	
Allowable cost	(300,000)	

Un-indexed gain	2,700,000	2
Less moveable allowance at 25%	(675,000)	1

Chargeable gain	2,025,000	

Chargeable gain per shareholder:		
P2,025,000/ 3	675,000	1
Income tax liability on each chargeable gain:		
First P144,000	13,950	
Next P531,000 at 25%	132,750	

Income tax liability	146,700	1

Net amount receivable by each shareholder:		
Proceeds	1,000,000	
Less tax liability	(146,700)	

Net receivable	**853,300**	**2**

Option 3 – Transfer of the shares of Tsala Care Ltd and Lengau IT Ltd to a new holding company, CFB Ltd

This will not be treated as a disposal of the assets of Tsala Care Ltd and Lengau IT Ltd.

Income tax implications

There are no income tax implications as there is no disposal of assets by Lengau IT Ltd. 2

VAT implications

There are no VAT implications. 2

Capital gains tax implications

There are no capital gains tax implications as there was no disposal of the assets.

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b) **Recommendation**

If the shareholders wish to divest from Lengau IT Ltd, it should consider the better option b

From the workings in a) above, the shareholders would receive more cash if they sold shar

Each shareholder would be better off by:

Net proceeds if shares were sold:	**853,300.00**
Net proceeds if trade and assets were sold:	**820,197.50**
	33,102.50

Option 2 of selling the shares is recommended. 2

Available Marks	**40**
Maximum Marks	**35**

Question Three

a) Computation of Justice Kabelo's taxable income fye 30 June 2018:

		P	
Salary		264,000	
Director's fees		12,000	1
Mileage allowance		-	1
Share options 20,000 x (P6.25 – P3.50)		55,000	1
Income from trustees		-	2
Local dividends		-	1
Foreign dividends		-	1
Foreign interest:			
• Remittance	120,000		1
• Tax – P120,000 x 40/60	80,000		1
	--------------	200,000	
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Taxable income		**531,000**	9
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Computation of tax payable:

First P144,000			13,050	
Next P387,000 at 25%			96,750	
			109,800	1
Less PAYE deducted at source			(43,050)	1
			66,750	
Tax on foreign dividends: 15% x P62,000			9,300	1
Less DTR lower of:			(3,100)	1
• Botswana tax		9,300		
• Foreign tax		3,100		
DTR on foreign interest: lower of:			(1,650)	1
• Botswana tax P118,050 x 33,000 / 564,0000		6,907		
• Foreign tax	1,650			
DTR on remittance: lower of:			(41,862)	2
• Botswana tax P118,050 x 200,000/564,000		41,862		
• Foreign tax	80,000			
Tax payable			29,438	7

b) Computation of the chargeable /taxable transfer arising on the death of Justice Kabelo:

		Wife P	Boitumelo P	Oteng P	Lerato P	Trust P
	Family home	2,500,000				
2	Investment property (W1)					1,324,916
2	Assurance policy	1,000,000	300,000	300,000		
2	Property (800 – 480)			320,000		
1	Education bequest				60,000	
1	Foreign investment	660,000				
		4,160,000	300,000	620,000	60,000	1,324,816
1	Exemption	(4,160,000)				
2	Allowable deduction		(13,016)	(26,900)	(2,604)	(57,480)
	Chargeable transfer	0	286,984	593,100	57,396	1,267,336

Working 1 – Computation of the capital value of an annuity:

Capital value of an annuity

$$\text{Capital value} = A \times \frac{[1 - (1/(1 + r)^N]}{r}$$

$$P180{,}000 \times \frac{1 - (1/1.06^{10})}{0.06} = P1{,}324{,}816$$

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Available Marks: 27

Maximum Marks: 25