



Botswana Institute of Chartered Accountants

Business Planning: Taxation

Examination Paper

Date: 05 December 2018

Time: 14:00 pm -16.30 pm

Time allowed: 2 hour 30 minutes

Instructions to Candidates

This paper consists of **THREE** written test questions (100 marks).

1. Ensure your candidate details are on the front of your answer booklet.
2. Answer each question in black ball point pen only.
3. Answers to each written test question must begin on a new page and must be clearly numbered. Use both sides of the paper in your answer booklet.
4. The examiner will take account of the way in which answers are presented.
5. When the assessment is declared closed, you must stop writing immediately. If you continue to write (even completing your candidate details on a continuation booklet), it will be classed as misconduct.

Assume that the Finance Act 2016/17 rates and allowances will continue to apply in future years unless you are specifically instructed otherwise.

IMPORTANT

Question papers contain confidential information and must NOT be removed from the examination hall.

DO NOT TURN OVER UNTIL YOU ARE INSTRUCTED TO BEGIN WORK

You **MUST** enter your candidate number in this box

Tax Tables

Use the following tax tables to answer your questions, where necessary.

Rates of tax from 2017/2018 tax years

Resident companies	On taxable income	
Standard rate		22%
Manufacturing company rate		15%
Non-resident companies		
Standard rate		30%
Resident individuals		
P0 –	P36,000	Nil
P36,001 –	P72,000	Nil + 5% of excess over 36 000
P72,001 –	P108,000	P1,800 + 12.5% of excess over 72 000
P108,001 –	P144,000	P6,300 + 18.75% of excess over 108 000
Over	P144,000	P13,050 + 25% of excess over 144 000
Non-resident individuals, trusts and estates		
P0 –	P72,000	5% of every pula
P72,001 –	P108,000	P3,600 + 12.5% of excess over 72 000
P108,001 –	P144,000	P8,100 + 18.75% of excess over 108 000
Over	P144,000	P14,850 + 25% of excess over 144 000
Capital gains – individuals		
P0 –	P18,000	Nil
P18,001 –	P72,000	P0 + 5% of excess over 18 000
P72,000 –	P108,000	P2,700 + 12.5% of excess over 72 000
P108,000 –	P144,000	P7,200 + 18.75% of excess over 108 000
Over	P144,000	P13,950 + 25% of excess over 120 000
Capital gains – companies		

Net aggregate gains are taxable at the company rates of tax.

Tax on Foreign dividend **15%**

Notes:

- The mileage allowance was wholly paid for business travel when Justice used his own car.
- Justice Kabelo exercised all the share options that were granted to him in February 2018 at an exercise price of P3.50 per share. He was granted 20,000 share options in January 2016 when their market value was P2.75 per share. The market value of each share in February 2018 was P6.25.
- Justice Kabelo was a beneficiary of a family trust that was set up by his father. He was entitled to a share of the trust income until his death (see note 4 in **Exhibit 2**).
- The tax on the foreign dividend deducted at source in the foreign country was P3,100.
- The foreign interest was subject to a withholding tax of P1,650 in the foreign country.
- Justice runs a business in Zambia. During the year ended 30 June 2018, he received a remittance of P120,000. The remittance was not subject to withholding tax. The branch made profits before tax of P980,000 and accounted for tax of P392,000 on the profits.

Exhibit 2 – Distribution of Justice Kabelo's estate and donations

Justice Kabelo's will provided for the following bequests:

- Family home in Gaborone, with a market value of P2.5 million, was bequeathed to the wife, Qaphela.
- A donation of an investment property to a trust for the benefit of his two children. The children would be entitled to the income from the trust property for ten years and thereafter the property would be vested in the grandchildren absolutely. The annual rental income from the property was P180,000.
- Proceeds from two life assurance policies, the first of P1 million to his wife and the second of P600,000 to his two children jointly.
- The income from the trust that Justice was entitled to represented his right to receive income as a life tenant or as a usufructant. The trust was created by his father and Oteng had the bare ownership was vested in Oteng. The trust provided that upon the death of Justice, Oteng would assume full ownership of the property. The value of the property was P480,000 when Justice became a usufructant and P800,000 at the time of his death.
- A bequest of P60,000 to his niece, Lerato, for her education. Lerato is a full time student at a private university.
- Justice's foreign investments valued at P660,000 were all bequeathed to the wife, Qaphela.

Question Three

You work as a tax advisor in the tax department of a firm of BICA Chartered Accountants.

Your tax manager informs you that one of the clients, Mrs Qaphela Kabelo needs some tax advice on the tax implications of husband's death, Justice Kabelo. Justice died on 25 July 2018 after a short illness. His personal tax return has not yet been completed. Details of his income are provided in **Exhibit 1**.

Qaphela has been appointed the administrator of Justice's estate and his will and other donations are given in **Exhibit 2**.

Both Qaphela and Justice Kabelo are citizens of Botswana and they have two adult children, Oteng and Boitumelo. Both Oteng and Boitumelo have two children each.

Requirement

- a) Calculate the taxable income and the tax payable for Justice Kabelo for the year ended 30 June 2018 based on the information provided in **Exhibit 1**.
- b) Calculate the chargeable/taxable transfer arising as a result of the death of Justice Kabelo based on the information provided in **Exhibit 2**.

Exhibit 1 – Justice Kabelo's income relating to the year ended 30 June 2018:

Justice worked as a director in Leading (Pty) Ltd in which he also held shares. He had acquired the shares through an employee share scheme operated by his employer. In addition, Justice also had local and foreign investments.

	Gross Income P	Tax deducted at source P
Salary	264,000	43,050
Director's fees	12,000	-
Mileage allowance (note 1) <i>deduct</i>	9,500	-
Share options (note 2)	-	-
Income from trustees (note 3)	65,000	-
Local dividends	40,000	3,750
Foreign dividends (note 4)	62,000	3,100
Foreign interest (note 5)	33,000	1,650
Remittance from a foreign branch (refer to note 6)		

*At the end
Tax credit
PAYE 43050*

Basis of valuation of benefits

Individuals' vehicle benefit

Vehicle cost	Employee benefit	Fuel cost adjustment
P1 - P50 000	P2 500	P1 000
P50 001 - P100 000	P5 000	P2 000
P100 001 - P150 000	P7 500	P3 000
P150 000 - P200 000	P10 000	P4 000

Benefit on the excess of P200 000 is 15% thereof with a maximum fuel cost adjustment of P5 000.

Individual's housing benefit:

If rated:

10% of the property's rateable value prorated by occupation and reduced by any contribution made by the employee.

If not rated:

Gross floor area x P250 per sqmetre x 8% for a standard building

The benefit is prorated by period of use and reduced by any contribution made by the employee.

Individual's furniture benefit

10% of furniture cost in excess of P15, 000 pro - rated by usage.

CAPITAL TRANSFER TAX RATES

	Aggregate Taxable Value	Rate of Tax per cent
1. Person (other company)	First P100 000	2 per cent
	Next P200 000	3 per cent
	Next P200 000	4 per cent
	Balance	5 per cent
2. Resident company		12.5 per cent
3. Non-resident company		12.5 per cent

Capital value of an annuity

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

Where - A is the annuity payable
r = rate of return

N = number of years over which the annuity is payable.

COST OF LIVING INDEX – JULY 1982 to SEPTEMBER 2016

YEAR	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1982	-	-	-	-	-	-	100.0	101.2	101.2	102.1	103.3	103.8
1983	104.1	104.8	105.5	106.6	108.3	108.4	109.0	110.2	110.2	110.7	111.7	112.3
1984	113.5	114.5	115.2	116.0	116.9	118.3	119.1	120.1	119.8	120.7	119.7	119.5
1985	119.9	120.7	122.0	124.1	126.6	128.6	130.1	129.8	131.1	131.5	131.8	132.0
1986	133.9	135.5	135.5	136.8	138.0	140.9	141.2	141.8	142.7	143.4	144.7	146.3
1987	147.4	148.5	148.9	151.9	153.6	154.1	154.9	156.6	156.7	157.1	157.5	158.1
1988	157.8	158.7	160.8	163.4	164.1	165.5	168.0	169.3	171.0	172.6	173.9	174.4
1989	176.9	178.0	180.1	182.7	184.1	186.2	187.3	188.7	190.2	191.1	191.5	194.2
1990	196.6	199.0	200.5	204.1	205.1	206.0	207.2	209.2	210.7	212.6	216.0	217.6
1991	220.5	221.4	223.5	225.8	227.3	229.0	232.0	234.2	237.2	239.5	242.5	244.9
1992	248.3	251.7	256.3	262.1	265.5	269.4	272.3	275.0	277.6	280.1	283.0	285.4
1993	291.0	293.1	295.8	301.1	303.1	306.0	311.6	313.5	315.0	317.6	320.1	321.5
1994	324.2	326.8	328.5	332.7	337.3	340.2	343.1	345.3	347.0	348.4	351.3	353.0
1995	357.9	361.0	364.9	368.6	370.5	374.9	377.8	381.6	384.3	386.0	387.9	391.3
1996	395.5	398.1	402.2	405.6	408.8	413.9	417.0	419.5	421.6	423.8	426.0	428.7
1997	431.6	435.5	439.7	443.6	448.7	451.2	454.1	454.9	457.5	459.7	460.9	461.9
1998	464.8	466.0	469.9	476.0	477.9	478.9	481.0	484.0	484.4	486.9	489.5	491.2
1999	495.1	499.7	504.3	507.5	509.2	513.3	514.3	517.7	521.1	523.5	524.0	525.2
2000	530.8	536.3	538.8	545.5	548.9	552.0	568.6	569.8	571.4	576	577.5	578.7
2001	581.4	582.1	587.2	598.9	596.9	598.6	601.3	603.0	605.4	608.5	610.2	611.0
2002	613.1	613.9	622.1	629.6	631.3	634.0	654.4	662.4	666.7	670.8	677.6	679.3
2003	683.2	689.0	692.2	701.4	705.8	715.0	714.5	698.0	707.0	715.9	717.9	718.9
2004	721.3	728.6	735.8	743.6	754.0	721.3	758.9	761.3	765.7	770.7	772.4	774.9
2005	779.2	781.7	783.8	789.4	801.5	813.2	821.2	834.8	842.3	857.1	859.7	863.1
2006	877.4	884.0	891.5	901.4	909.6	915.0	918.6	924.2	930.8	936.4	935.4	936.4
2007	942.9	948.5	949.5	957.7	968.1	974.5	988.5	991.2	994.1	1004.3	1007.2	1012.8
2008	1022.2	1034.4	1043.1	1064.7	1085.0	1115.1	1136.7	1140.6	1133.8	1135.5	1159.0	1151.2
2009	1152.7	1155.1	1165.0	1172.8	1176.0	1193.4	1204.8	1209.7	1213	1213.3	1217.2	1218.4
2010	1223.2	1225.4	1234.6	1256.2	1268.6	1285.3	1289.7	1290.6	1297.9	1300.6	1304.2	1309.1
2011	1320.0	1330.2	1338.9	1359.0	1373.6	1386.4	1380.6	1403.4	1409.0	1415.0	1424.0	1428.8
2012	1436.1	1440.0	1446.5	1460.4	1480.0	1487.3	1492.1	1496.7	1508.9	1515.4	1530.2	1534.8
2013	1544.3	1546.9	1555.4	1565.6	1570.2	1573.8	1576.7	1580.4	1584.3	1587.9	1593.5	1598.1
2014	1611.1	1618.6	1624.2	1637.2	1641.8	1646.5	1648.4	1653.0	1655.8	1662.4	1667.0	1663.3
2015	1670.7	1664.2	1669.8	1687.5	1690.3	1696.8	1698.7	1701.5	1704.2	1708.9	1709.8	1708.9
2016	1715.4	1714.5	1721.0	1735.9	1737.8	1741.5	1744.3	1747.1	1751.7	1755.2	1758.7	1760.5
2017	1769.2	1772.7	1781.5	1795.5	1799.0	1802.5	1804.3	1806.0	1807.8	1807.8	1811.3	1816.5
2018	1823.5	1828.8	1832.3	1856.8								

Exhibit 1

Purchase of the Lengau IT Ltd

The purchase is expected to take place on 31 January 2019.

The trade and assets of Lengau IT Ltd have been valued at P3 million, as follows:

	Cost/ NRV* P	Indexed cost/ Tax value P	Market value P
Office building	800,000		1,800,000
- indexed cost		1,440,000	
- income tax value		320,000	
Plant & equipment	600,000	120,000	380,000
Inventory	120,000*	200,000	120,000
Goodwill	-	-	700,000
Total			3,000,000

*NRV is net realizable value and only applicable to inventory.

Tsala Care Service Ltd have three, different, mutually exclusive options for carrying out the purchase of the trade and assets of Ltd, as detailed in the table below.

Option	Structure of the deal	Description of the purchase
1	Tsala Care Service Ltd pays P3 million for the trade and assets of Lengau IT Ltd as a going concern.	The payment for the trade and assets is paid to Lengau IT Ltd. The shareholders will liquidate Lengau IT Ltd subsequently.
2	Tsala Care Services Ltd pays P3 million to the shareholders of Lengau IT Ltd	Tsala Care Services Ltd acquires 100% of the share capital of Lengau IT Ltd. Lengau IT Ltd will become a 100% subsidiary of Tsala Care Services Ltd.
3	A new company, CFB Ltd, is formed and it issues shares to the shareholders of Tsala Care Services Ltd and Lengau IT Ltd in exchange for the shares of the two companies.	CFB Ltd will be the holding company of Tsala Care Services Ltd and Lengau IT Ltd. It will own 100% of the share capitals of the two companies. The shareholders of Tsala Care Services Ltd and Lengau IT Ltd will own 60% and 40%, respectively, of the shares of CFB Ltd. CFB would be registered for VAT immediately.

Question Two

You are a tax adviser, working for a firm of BICA Chartered Accountants, Khama and Co. Your firm has been engaged by Lengau IT Ltd, to act on their behalf providing tax advice concerning a proposed acquisition or merger offered by Tsala Care Services Ltd. Tsala Care Services Ltd is a private clinic with a large customer base. The company commenced in 2008 and has rapidly grown. The directors have decided to acquire or merge with an IT company so that it can help with the computerization of the clinic. They identified Lengau IT Ltd as an appropriate IT company to acquire or merge. Lengau IT Ltd was started by three brothers with an initial share capital of P300,000 of P1 each in August 2012. The shareholders also acted as the directors of the company and they were all higher tax payers.

Both Lengau IT Ltd and Tsala Care Services Ltd are VAT registered.

Negotiations for the acquisition are underway and the directors of Lengau IT Ltd would like advice on the tax implications of the proposal made by Tsala Care Services Ltd under the following options:

- the purchase of net assets of Lengau IT Ltd, or
- the purchase of the share capital of Lengau IT Ltd, or
- the creation of a new entity where both the businesses of Tsala Care Services Ltd and Lengau IT Ltd would be transferred to. *sale of business as going concern*

The details for the different options are provided in **Exhibit 1**.

Requirements

Your manager has asked you to prepare a briefing note in preparation for a meeting with the Lengau IT Ltd in which you should:

- (a) Explain and illustrate with figures the income tax, capital gains tax and VAT implications, for the shareholders of Lengau IT Ltd, for each of the three different options suggested in **Exhibit 1**. Assume that the shareholders did not make any other capital disposals during the tax year.
- (b) Recommend which purchase option Lengau IT Ltd should adopt if the directors wished to divest from Lengau IT Ltd.

Total: 35 marks

Question One

You work as a tax adviser for a firm of BICA Chartered Accountants. Your manager, Tshumba, has left a memo on your desk concerning a new client, KagisoTebogo (**Exhibit 1**).

Kagiso has approached your firm for tax advice, because he is about to be made redundant from his employment with BBC Ltd. He intends to start his own business, but is unsure of the taxation implications.

Kagiso has already had a meeting with Tshumba and she has made two notes on Kagiso's file:

Exhibit 2 a file note concerning the financing needs of the new business.

Exhibit 3 a file note concerning the choice of trading entity for the new business.

Requirements

Prepare the two items listed in Tshumba's memo (**Exhibit 1**).

Total: 40 Marks

Exhibit 1

Memo from Tshumba

From: Tshumba, Tax Manager

To: A Tax Adviser

Date: 3 December 2018

Subject: New Client – Kagiso Tebogo

Kagiso Tebogo is a new client. He is 56 years old and will be made redundant from his job at BBC Ltd on 31 December 2018. Kagiso intends to set up his own business, dealing in motor vehicle spares, with effect from 1 March 2019.

He is negotiating a contract under which the new business will supply motor vehicle spares to Phatismo Mines Ltd with effect from 1 March 2019. Phatismo Mines Ltd will be the major client of the new business.

I am meeting with Kagiso next week and need the following items prepared in advance of that meeting:

- (a) a briefing note estimating the amount of the business bank loan required to start the new business. Use the information Kagiso has given us concerning his financing needs (**Exhibit 2**), explain any calculations you make.
- (b) an appendix, capable of being added to a letter to Kagiso, explaining the differences, for tax purposes, between operating as a sole trader or as a company, specifically addressing the areas Kagiso has identified (**Exhibit 3**).

Kagiso has estimated that he will need P2,000,000 as working capital for his new business.

Kagiso intends to finance his business using the redundancy package and other terminal employment benefits from his employer. Additionally, he will also dispose of some of his investments in shares and property. If the income from these sources are insufficient to amount to the required P1,000,000, then he will obtain a bank loan to cover the shortfall. These were the only disposals that Kagiso would make during the tax year.

Kagiso is aware that the disposals of shares and property may attract taxes which will reduce the proceeds. He wants us to prepare calculations, which will allow him to estimate the shortfall which would be required to be financed by a bank loan.

Kagiso has no other sources income.

Final employment income

Kagiso's employment will cease on 31 December 2018 due to redundancy. Kagiso was employed on a three year contract which had commenced on 1 January 2017. This was his third contract with BBC Ltd and was accordingly entitled to a gratuity of 30%. BBC Ltd will pay the gratuity on a pro rata basis.

His gross monthly salary was P40,000 and pay as you earn of P40,437.50 had been deducted by 30 November 2018. The December salary will be paid together with the other final payments.

In addition to the gratuity entitlement above, Kagiso will also be receiving the following as a final payment:

Retrenchment pay P120,000
Accrued leave days (one month is 22 day working days) of 42 days.

Disposal of assets

Kagiso has no intention of making any other disposals apart from the ones detailed below during the tax year.

Disposal of shares in Tau (Pty) Ltd

Kagiso purchased 100,000 shares for P220,000 on 1 August 2000. In March 2010, he acquired an additional 25,000 for P45,000 via a rights issue. He will sell 110,000 shares for P209,000 on 23 January 2019.

Disposal of property

Kagiso has an warehouse which he has always rented out. He will sell the warehouse for P940,000 in January 2019. He had purchased the warehouse for P430,000 in July 2015. Assume that the NCOLI in January 2019 will be 1868.2. This acquisition was financed out of the proceeds of a warehouse that was sold in January 2015 for P880,000 and realised a chargeable gain of P300,000. The warehouse had cost P260,000. Kagiso had made appropriate reinvestment elections to reduce his tax liabilities.

Exhibit 3

File Note - Choice of trading entity

Kagiso is unsure of whether to trade as a sole trader or as a limited company. He would like further information to assist him choose between these two options.

Kagiso will be actively involved in the running of the business and expects to draw a gross annual salary that will be equal to 50% of the net taxable profit. The expected net taxable profit in the first two years will be approximately P720,000.

He would like to understand, for each type of trading entity:

- when and on whom the profits would be taxed and at what rates of taxation; and
- a calculation of the tax implications if the business was incorporated or not, based on the expected tax profit of P720,000, and
- a determination of the option which would be tax advantageous. Your calculation should show the tax saving that would result if the tax advantageous option was chosen.

Additionally, Kagiso's cousin Tumelo is interested in investing in Kagiso's business in the near future. Kagiso would like to know the difference, for tax purposes, of investing in a sole trader's business or in a limited company. Tumelo does not intend to participate in the running of the business.