

SOLUTIONS FOR BICA BPT DECEMBER 2019 EXAMS

- 1.1 Explain the income tax, capital gains tax and VAT implications for Topo, Tebogo and Gauff Ltd of the two options for selling the Gauff business to Thebe Ltd.
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Option 1: sale of trade and assets

The sale of the trade and assets will be made by Gauff Ltd. So any tax liabilities arising will be recognised by Gauff Ltd. Topo and Tebogo will then be required to withdraw the profits from Gauff Ltd.

Income Tax implications for Gauff Ltd

- Goodwill

Disposal of goodwill does not give rise to any income tax implications. 2

- Inventory

The gain on the disposal of the inventory is P1,200,000 (i.e. P6,800,000 – P5,600,000) 2

- Receivables

There is a loss of P300,000 (P6,100,000 – P6,400,000) being the difference between the income tax value and the market value. 2

- Plant & machinery

The balancing charge is computed as follows:

	P'000	
Income tax value	6,700	
Less market value	7,800	

Balancing charge	1,100	2

In summary, the total taxable income for the year ended 31 December 2019 is as follows:

	P'000	
Taxable income b/f	5,650	
Goodwill	0	
Inventory	1,200	
Receivables	(300)	
Plant & machinery	1,100	

Taxable income	7,650	½ x 4=2

Capital gains tax implications for Gauff Ltd

- Goodwill

	P'000	
Market value	5,300	1
Less: allowable cost	(2,000)	1

Un-indexed gain	3,300	
Moveable allowance at 25%	(825)	1

Chargeable gain	2,475	

Total taxable income for the year ended 31 December 2019:

	P'000	
Taxable income	7,650	
Chargeable capital gain	2,475	

Total taxable income	10,125	2

Company tax liabilities = P10,125,000 x 22% = P2,227,500. 1

VAT implications for Gauff Ltd

Gauff Ltd and Thebe Ltd can make an election to treat the transfer as zero rated. And it is recommended for the two to make an election. 2

Tax implications for Topo and Tebogo arising on the sale of the trade and assets

The profits for the year and those realised from the disposal of assets are realised by Gauff Ltd. Topo and Tebogo will only suffer tax on the extraction of the profits from the company. 1

	P'000	
Gross proceeds	26,000.0	
Less tax liabilities	(2,227.5)	

Available for distribution	23,772.5	2

Withholding tax on dividends 7.5/107.5	<u>1,658.5</u>	
Net dividend	<u>22,114.0</u>	
Dividend received by each shareholder /2	<u>11,057.0</u>	2

Therefore, Topo and Tebogo will each receive a net amount of P11,057,000 on the sale of the trade and assets of Gauff Ltd. 1

Option 2: Sale of all the shares by Topo and Tebogo

Income tax implications for Gauff Ltd

There will be no income tax implications as there is no deemed disposal of the assets. 2

Capital gains tax (CGT) implications for Gauff Ltd

There are no CGT implications. 1

VAT implications for Gauff Ltd

There are no VAT implications 1

Tax implications for Topo and Tebogo

Topo and Tebogo will only be liable to CGT as follows:

	Topo P'000	Tebogo P'000	
Sales proceeds	13,000	13,000	
Less allowable cost	(500)	(500)	
	-----	-----	
Un-indexed gain	12,500	12,500	
Less moveable allowance at 25%	(3,125)	(3,125)	
	-----	-----	
Chargeable gain	9,375	9,375	2x2=4
	-----	-----	
Tax thereon:	P	P	
P9,375,000 x 25%	2,343,750	2,343,750	
	-----	-----	
Tax payable	2,343,750	2,343,750	1
	-----	-----	

Net cash receivable:

Gross proceeds	13,000,000	13,000,000	
Less tax payable	(2,343,750)	(2,343,750)	
	-----	-----	
Net cash	10,650,250	10,650,250	2
	-----	-----	

Total available: 35

Maximum marks: 26

1.2 Advise, based on tax savings, Topo and Tebogo which is the best option for selling the Gauff business.

Based on tax savings, the best option for selling the Gauff business is option 1, sale of the trade and assets. If Topo and Tebogo choose Option 1, they will increase their net cash proceeds by P378,700 (i.e. P11,057,000 – 10,678,300) each.

3

1.3 Explain the tax implications for Topo if the property is donated or sold on an interest free loan (Exhibit 2). Also explain the tax implications for Topo in respect of the income earned by the trust.

Transfer of property (office block) to the trust

1. By donation

A donation is a gratuitous transfer of property and will be liable to capital transfer tax. 1

However, since the income from the property will be used for the education, training and maintenance of the children, the donation will be exempt from capital transfer tax. 1

From an income tax perspective, the income from the trust which is for the benefit of minor children will be taxed on the settlor during the period of their minority. The income from the trust will be included in the gross income of Topo. Since Topo is a high earner, the income will be taxed at 25%. 2

Tax liability on trust income charged on Topo:

$$P276,000 \times 25\% = P69,000$$

2. By sale of property

If the property was sold to the trust, it would be a sale at full market value for the purposes for capital gains tax. 1

Topo would be liable to tax on the following chargeable gain:

	P'000	
Market value	2,400.0	
Less allowable cost	(800.0)	

Un-indexed gain	1,600.0	
Indexation allowance (Aug 2013 – Dec 2019): (1939.16 – 1580.4)/1580.4 x P800,000	(181.6)	

Chargeable gain	1,418.4	2

Since the property was sold to the trust, it cannot be treated as a settlement or donation of the donor. Therefore, the income from the trust will be taxed in the

name of the trustees and charged tax in the same amount as if it was taxed on the beneficiaries.

The tax payable by the trustees on the trust income of P276,000 will be as follows:

	Tshepo P	Thabo P	
Taxable income P276,000/2	138,000	138,000	
	-----	-----	
First P108,000	6,300	6,300	
Next P30,000 x 18.75%	5,625	5,625	
	-----	-----	
Tax liability	11,925	11,925	2
	-----	-----	
Total tax payable by the trustees = P11,925 + P11,925 = P23,850.			1

		Total available	10
		Maximum marks	6

1.4 Identify and explain the tax and ethical implications for Topo and Tebogo arising from the suggestion from their friend that they should not declare the income from the online business.

Income derived from a source in Botswana is liable to tax in Botswana regardless of where payment comes from. 1

The suggestion from the friend that BURS would not be able to determine the income from the online business because the proceeds go into an offshore account is tantamount to tax evasion. 1

A taxpayer has the obligation to disclose any income that s/he has earned from Botswana sources, whether actual or deemed. 1

Since Topo and Tebogo have been our clients from inception, we should make it very clear to them that not declaring income is incorrect and that they should be honest and transparent in their actions. 1

Because of the long standing relationship between the client and ourselves, there could a familiarity threat. 1

In addition, we are compelled by professional integrity to explain to our clients that concealing income which is liable to Botswana is not appropriate. Should the client refuse to comply with our advice we would remain with no option but to resign. 1

We should also ensure that we observe the principle of confidentiality in our communications with Topo and Tebogo. 1

Available Marks	7
Maximum marks:	5
Grand total:	40

2.1 Determine the taxable employment income for Mr Moagi for the tax year ended 30 June 2019

Computation of taxable income for Mr Moagi for the year ended 30 June 2019:

	P	P	
Basic salary		1,080,000	1
Gratuity entitlement ($P1,080,000 \times 3 \times 35\%$)	1,134,000		1
Less exemption ($P1,080,000 \times 3 \times 27.5\%$) $\times 1/3$	(297,000)		2
	-----	837,000	
Holiday package		120,000	2
Purchase of shares ($100,000 \times (P17 - P5)$)		1,200,000	2
Security services		96,000	1
Cook		72,000	1
Gardening services		60,000	1
Mrs Moagi's salary		72,000	1
Suits for Mr Moagi		108,000	1
		-----	-----
Employment income		3,621,000	13
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2.2 Calculate the total taxable income and the tax payable for Mr Moagi for the tax year ended 30 June 2019.

Computation of the total taxable income for Mr Moagi fye 30 June 2019:

	P	P	
Employment income		3,621,000	1
Rental income from businesses	696,000		1
- Less repairs	<u>(108,000)</u>		1
		588,000	
Rental income from individuals	432,000		1
- Less repairs	<u>(112,000)</u>		1
		320,000	
Income from foreign consultancies P129,600/80%		162,000	1
Income from local consultancies		70,000	1
Honorarium		0	1
Gain on disposal of foreign property		0	2
Foreign dividend		0	1
		-----	----
Taxable income excluding foreign dividends		4,761,000	11
		-----	----

Computation of the tax payable fye 30 June 2019:

	P	
First P144,000	13,050	
Next P4,617,000 x 25%	1,154,250	

Tax liability	1,167,300	1
Tax on foreign dividend (P40,500/90%) x 15%	6,750	1

	1,174,050	
Less PAYE deducted at source	(247,050)	1
Less Double tax relief:		
On business rental income: P696,000 x 5%	(34,800)	2
On foreign consultancy income: lower of:		
Botswana equivalent		
- P1,167,300/4,761,000 x P162,000	39,719	1

Foreign tax suffered P162,000 x 20%	32,400	(32,400)	2
DTR on foreign dividend, lower of:			
- Botswana equivalent	6,750		1
- Foreign tax P45,000 x 10%	4,500	(4,500)	2
		-----	-----
Tax payable		855,300	11
		-----	-----
		Total marks:	35

3.1 Calculate the revised taxable total income and tax payable for Mogwana Ltd for the year ended 30 November 2019, providing supporting calculations or explanations for any adjustments you make.

Computation of the revised taxable income for Mogwana Ltd for the year ended 30 November 2019:

	P	
Taxable income b/f	10,800,000	1
Exchange gain on purchase of goods (W1)	9,396	2
Exchange gain on purchase of equipment (W2)	0	1
Capital allowance on equipment (W2)	(68,360)	1
Chargeable gain disposal of shares (W3)	2,840,653	1
Capital allowances on replacement equipment (W4)	(51,250)	1
Foreign interest	250,000	1

Taxable income	13,780,439	

Computation of tax payable:	P	
Tax liability P13,780,439 x 22% =	3,031,696	1
Less Double tax relief on foreign interest:	(37,500)	1
Lower of:		
Botswana equivalent		
250,000/13,780,439 x P3,031,696 =	55,000	
Foreign tax suffered P250,000 x 15% =	37,500	-----
Tax payable	2,994,196	-----

W1 – Exchange gain on the purchase of goods

			Gains
15/10/19	R220,000/1.20	P183,333	
15/11/19	R220,000/1.25	P176,000	7,333
15/11/19	R110,000/1.25	P88,000	
30/11/19	R110,000/1.28	P85,337	2,063

			9,396

W2 – Purchase of equipment

1/10/19	R350,000/1.12	P312,500	
30/11/19	R350,000/1.28	P273,438	39,062

The exchange gain of P39,062 is adjusted against the cost of the equipment for the purpose of calculating capital allowances. Accordingly, the capital allowances on the equipment is:

$$P273,438 \times 25\% = P68,360$$

W3: Disposal of 100% of the shares in Monato Ltd

The disposal of the shares will be treated as a disposal of an immovable property. This is because the immovable property is the dominant asset of the company. 1

Accordingly, the capital gains tax computation was as follows:

	P	P	
Sales proceeds		6,000,000	
Allowable cost:			
- Architectural drawings	100,000		
-Purchase of land	500,000		
-Site preparation	80,000		
-Construction	2,000,000		
-Landscaping	300,000		
	-----	(2,920,000)	2
Un-indexed gain		-----	
		3,080,000	

Indexation allowance:

Drawings/land (Jan 2016 – Jan 2019) (1940.9 – 1715.4)/1715.4 x P600,000	78,874	1
Site preparation (Mar 2016 – Jan 2019) (1940.9 – 1721.0)/1721.0 x P80,000	10,222	1
Construction (Dec 2017 – Jan 2019) (1940.9 – 1816.5)/1816.5 x P2,000,000	136,967	1
Landscaping (Jun 2018 – Jan 2019) (1940.9 – 1858.6)/1858.6 x P300,000	13,284	1

----- (239,347)

Chargeable gain -----
2,840,653

W4: Balancing adjustment on disposal of equipment:

	P	
ITV b/f	85,000	
Sales proceeds	300,000	

Balancing charge	215,000	1

Rollover relief:

	P	
Cost of replacement equipment	420,000	
Less balancing charge	(215,000)	

Revised cost	205,000	1

Capital allowances on replacement equipment:

P205,000 x 25% = P51,250

Available marks: 19

Maximum marks: 15

3.2 (a) Explain the value added tax (VAT) implications for Logistics Extra Ltd of the proposed distribution operations taking place in Botswana.

The customers import goods and Logistics Extra Ltd is intending to help the customers with the clearance of goods. In this case, the customers who are also the importers are the principal and Logistics Extra Ltd is the agent.

As an agent, Logistics Extra Ltd will not be required to register for VAT merely on account of acting as an agent. However, it may be responsible for paying VAT which it would in turn collect from its customers. **4**

3.2 (b) Explain whether or not the proposed distribution operations are likely to create a permanent establishment for Logistics Extra Ltd and the associated income tax implications. Explain whether or not this would change if Logistics Extra Ltd were set up or registered in Botswana as a subsidiary.

A “permanent establishment” means a fixed place of business through which the business of an enterprise is wholly or partly carried on. However, the definition excludes, among others,

- (a) the use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;
- (b) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display.

Therefore, if Logistics Extra Ltd only receives and couriers goods to its customers via its warehouse, its operations will not be considered to be a permanent establishment. As a non-resident company, it would be liable to tax on the profits earned within Botswana. Those profits would be liable to tax at 30%. **3**

If Logistics Extra Ltd incorporated a subsidiary in Botswana, the subsidiary would be regarded as a resident company. A resident company would be liable to tax at 22%.

Furthermore, even if Logistics Extra Ltd does not incorporate in Botswana, increasing its presence by employing more staff to undertake operational and administrative duties could indicate that the management control is exercised in Botswana and may qualify to be treated as a resident company. **3**

Available marks: 13

Maximum marks: 10

Total: 25 marks