Question One

1.1 Briefly discuss any four (4) general principles contained in the Organisation for Economic Cooperation and Development's (OECD's) model double taxation convention which gives guidance on how countries may avoid double taxation of income.

The OECD has developed a model for double taxation which may be used to determine how double taxation of the same income should be avoided. The main taxation principles of the model convention are as follows:

The OECD double taxation model works where there is treaty agreement between two contracting states.

1 The model sets out the method for eliminating double taxation charge where a liability to tax arises in both contracting states. Exemption is given in incomes of certain persons.

2 There is prevention of fiscal evasion by ensuring that income received by a resident of a contracting state is taxed at least once.

3 It assists in the allocation of taxing rights between the contracting states by ensuring that each state has provisions in the domestic legislation which gives their residents tax credits as a relief of tax suffered from the income received in the other state.

4 The model has clauses which ensures that foreign nationals taxed in the other state are charged tax not more than the nationals of the other state.

5 The model provides mutual agreement procedures for Tax Administrations to discuss and resolve the tax matters for their residents.

6 The model gives guidelines of how the residency in a state should be determined. The resident of a state refers to a person who under the laws of that state is liable to tax there by reason of domicile, residence, place of management or criterion of a similar nature.

7 Override the domestic tax law. The withholding rates of tax contained in the treaty agreements override the domestic. The investment income has preferential rates of withholding tax of 15% or less.

8 The model provides guidelines on how the contracting states should exchange information of their residents for tax purposes.

(Any 4 x 1.5 = 6 marks)

1.2 Explain the taxation implications/ consequences for Chobe Ltd and determine whether any anti-avoidance/ transfer pricing legislation applies to:

The loan made to Wakanda plc

The charging of interest by Chobe Ltd at the rate of 5% instead of 15% on the loan of P2,000,000 made to Wakanda plc will reduce Botswana taxable income of Chobe Ltd and attract the anti-avoidance legislation. 1

A commercial market rate of interest will be substituted for the actual interest rate used. The commercial rate will be an arm's length rate that would be charged if the parties to the transaction were independent of each other. The applicable interest rate will therefore be at 15% per annum. 1

Chobe Ltd will be required to make the adjustment in to ensure that tax is not reduced or lost. The adjustment would involve adding back to the profit the difference between the commercial rate of interest on the loan and the actual rate of interest used. The amount of profit to be added back will be;

(15% - 5%) x P2,000,000 = P200,000. **1**

In addition, Chobe Ltd may be liable to a penalty of P10,000 or 200% of the tax that would have be lost for engaging in transfer pricing practices, whichever is greater. In this case, the penalty would be P44,000 (P200,000 x 22%). 1

Export of goods to Wakanda plc at a transfer price equal to the company's full cost of production.

Exporting the goods to Wakanda plc at full production cost will reduce the taxable income for Chobe Ltds. As Chobe Ltd and Wakanda Plc are associated companies, selling goods at the company's full cost , the transaction will be treated as transfer pricing or a fictitious scheme intended to reduce Chobe Ltd s tax liability. The CG has the power to set aside such transactions and determine the correct tax liabilities. 1

The market price will be substituted for the actual transfer price used. The arm's length price will be market price which would be charged if the parties to the transaction were independent of each other. This price will be the market price at which Chobe Ltd normally sells the goods on the open market. 1

By the CG substituting the arm's length price for the supply, the taxable income for Chobe Ltd will be adjusted upwards. The amount of profit to be added back will be P360,000 (i.e. 30% x P1,200,000). **1**

Furthermore, Chobe Ltd may be liable to a penalty of P10,000 or 200% whichever is greater on tax that would have be lost for engaging in transfer pricing practices. In this case, the penalty would be P79,200 (P360,000 x 22%). **1**

Available Marks : 8

Maximum marks: Any 4 x1.5 = 6

1.3 Calculate the final taxable income and company income tax payable for Chobe Ltd for the tax year 2019/20 after taking into account the transactions in **Exhibit 1 and Exhibit 2**.

Computation of the final taxable income fye 31 March 2020 for Chobe Ltd :

		P	
Tax adjusted trading income		11,500,000	
Add:			
Deemed interest from transfer pricing		200,000	1
Deemed income on intra group trading	480 000		1
Foreign dividend from Wakanda Plc		0	1
Business profits from foreign branch (P235,000/80%)		293,750	1
Foreign interest P93,500 / 85%		110,000	1

Total taxable income		12,583,750	

Tax payable:			
P12,583,750 x 22%		2,768,425	1
Foreign Dividend	600 000		1
Tax on foreign dividend P600,000 x 15%		90,000	1

Tax liability		2,858,425	
Less double tax relief:			
On foreign dividend:		(72,000)	
Botswana tax	90,000		1
Foreign tax P600,000 x 12%	72,000		1
Business profits from foreign branch:		(58,700)	
Botswana tax P293,750 x 22%	64,570		1

Foreign tax P293,750 x 20%	58,700		1
On foreign interest:		(16,500)	
Botswana tax P110,000 x 22%	24,200		1
Foreign tax P110,000 x 15%	16,500		1
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Tax payable		2,711,225	14
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Available marks: 14

Maximum Marks: 10

1.4 **Calculate the total taxable income and tax payable for David Musi for the tax year 2019/20 (Exhibit 3)**.

	P	
Annual basic salary	480,000	
Housing benefit: P340,000 x 10%	34,000	1
Incidental living expenses P3,500 x 12	42,000	1
Car benefit (First P200,000 + P360,000 x 15%)	64,000	1
Fuel allowance P2,500 x 12	30,000	1
Monthly life insurance premium P1,200 x 12	14,400	1
Annual holiday package	60,000	1
Annual professional subscriptions	0	1
Annual golf club subscriptions	11,300	1

	735,700	
Less: contribution to Provident Fund	0	1
Contributions to APF P480,000 x 10%	(48.000)	1
Approved donations	(5,500)	1

Taxable employment income	682,200	1
Foreign interest	30,000	1

Total taxable income	712,200	

Tax payable:		
First P144,000	13,050	

Next P568,200 x 25%		142,050	

Tax liability before tax on dividends		155,100	1
Foreign Dividend 88 000 x100/88		100 000	2
1			
Tax on foreign dividend P100,000 x 15%		15,000	2

		170,100	
Less: Double tax relief:			
On foreign dividend:		(12,000)	2
Botswana tax P100,000 x 15%	15,000		
Foreign tax P100,000 x 12%	12,000		
On foreign interest:			
Botswana tax		(6,533)	2
(P30,000/P712,200 x P155,100)	6,533		
Foreign tax	9,000		
Less PAYE on salary		(97,050)	1

		54,517	
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Available marks: 21
Maximum Marks: 18

(Total available: 49 marks)
(Total maximum: 40 marks)

Question Two

2.1 Prepare brief notes for your tax partner explaining the ethical considerations and actions that the firm would take in order for you to become tax advisers for Bogolo.

Matters to consider before accepting a new client;

1) Determine whether the acceptance will create any threats to compliance with the fundamental ethical principles. 1
2) Determine the identity of the client and the potential threats to integrity or professional behavior. 2
3) Consider whether the client has questionable business dealings or associations. 1
4) If any such threats are identified we should not accept the appointment unless the threats can be reduced to acceptable levels through the implementation of safeguards. 1
5) We should also assure ourselves that Bogolo is not involved in any form of money laundering. 1

Action to take:

1) We should obtain permission from Bogolo to contact her current tax advisors to ensure that there is nothing in her past to hinder us from acting as her advisors. 1
2) If Bogolo refuses to grant us the permission, then we should decline to act for her. 2

(Available: 8 marks)

(Maximum: 6 marks)

2.2 Based on appropriate calculations, advise Bogolo whether she should trade as a sole trader or as a limited liability company. Your answer must clearly show the tax savings resulting from the preferred choice and based on the information in **Exhibit 1.**

Taxes payable if Bogolo trades as a sole trader:

As a sole trader, Bogolo is tax fully on the taxable income of the business. The income after tax is available as her disposal income.

Taxable income	P1,800,000	

Tax liability:		
First P144,000	13,050	
Next P1,656,000 x 25%	414,000	

Tax liability	427,050	2

Bogolo's disposable income from the business is:		
P1,800,000 less P427,050 =	1,372,950	1

Taxes payable if Bogolo operated via a limited company

If Bogolo operates via a company the profits will belong to the company and any salary payable to Bogolo will be tax deductible. Furthermore, the dividend payable to Bogolo will be subject to withholding tax of 7.5%. 2

Taxes payable by the company:
On taxable income:

	P	
Taxable income before Bogolo's salary	1,800,000	
Less Bogolo's salary	(900,000)	

Taxable income	900,000	1

Tax liability at 22%	198,000	1

Income after tax	702,000	1

WHT on dividend 7.5% x P702,000	52,650	1

Total taxes payable by company (198,000 + 52,650)	250,650	1

Tax payable by Bogolo:

Bogolo will pay tax on the salary that she earns from the company. Dividends are taxable in the hands of the recipient

	P	
Salary	900,000	

Tax liability:		
First P144,000	13,050	
Next P756,000 x 25%	189,000	

	202,050	1

Disposable income available to Bogolo:

	P	
Salary from company	900,000	
Dividend from company	702,000	

Total gross income	1,602,000	1
Less: withholding tax on dividend	(52,650)	1
PAYE	(202,050)	1

Disposable income	1,347,300	

Conclusion

Bogolo would currently have more disposable income if she operate her business as a sole trader rather than as a limited company. Her disposable income is more by P25,650. 2

Available marks: 15

Maximum Marks: 14

2.3 Illustrate the income tax and capital gains tax implications for Bogolo if she transferred the property and business to a limited company on 1 July 2020 **(Exhibit 2)**. Calculation of tax liabilities is not required. Note that this part of the question is not dependent on your answer in 2.2 above.

Income tax implications

		P	P	
i)	Bogolo's car:			
	Value at 1/10/18 (restricted)	175,000		
	Less capital allowances granted			
	25% x P175,000 x 2 years	(87,500)		1

	ITV b/f	87,500		
	Sales proceeds (deemed)	(198,000)		1

	Balancing charge	(110,500)		

	Restricted to business use @ 60%		(66,300)	1
ii)	Delivery vans			
	Cost P350,000 x 2	700,000		
	Capital allowance at 25%	(175,000)		1

	ITV b/f	525,000		
	Sales proceeds	(610,000)		1

	Balancing charge		(85,000)	
iii)	Fixtures & fittings			
	Cost	60,000		
	Less capital allowances granted:			
	P60,000 x 10% x 2 years	(12,000)		1

	ITV b/f	48 000 42,000		
	Sales proceeds	(12,000)		1

	Balancing allowance		36 000	
iv)	Computers			
	Cost	45,000		
	Less capital allowances at 25%	(11,250)		1

	ITV b/f	33,750		
	Sales proceeds	(21,000)		1

	Balancing allowance		12,750	

v)	Computer accounting packages			
	Cost	80,000		
	Capital allowances at 100%	(80,000)		1

	ITV b/f	0		
	Sales proceeds	(65,000)		1

	Balancing charge		(65,000)	
vi)	Bogolo's property			
	Cost	380,000		
	Less capital allowances granted:			
	11 years x P380,000 x 2.5%	(104,500)		1

	ITV b/f	275,500		
	Sales proceeds (restricted)	(380,000)		1

	Balancing charge		(104,500)	
			---------------	----
	Additional taxable income		272050	
			----------------	----
	Capital gains tax implications			
i)	Goodwill			
	Sales proceeds	230,000		1
	Less moveable allowance at 25%	(82,500)		1

	Chargeable gains		247,500	
ii)	Bogolo's property			
	Sales proceeds	1,400,000		
	Less allowable cost	(380,000)		1

	Unindexed gain	1,020,000		
	Less indexation allowance (May 2010 – July 2020) (1910.2 – 1268.6)/1268.6 x P380,000	(192,187)		1

	Chargeable gain		827,813	

	Total chargeable gains		1 069 313	2

Available marks: 19

Maximum marks: 15

Total marks available: 40

(Total maximum: 35 marks)

Question Three

3.1 Compute the final taxable income for Apex Ltd for the year ended 30 April 2020 after taking into account the transactions in Exhibit 1. Wherever relevant, you must assume that all the beneficial claims wherever relevant were elected and applied appropriately.

Computation of the final taxable income for Apex Ltd fye 30 April 2020:

	P	
Draft taxable income	14,556,000	.5
Returned faulty goods	(220,000)	.5
Scrap value for faulty goods	35,000	.5
Decrease in allowance for receivables (650-580)	70,000	1
Provision for gratuities	0	1
Interest expense	0	1
Chargeable gains (W1)	625,835	2
Held-over gain now chargeable (W2)	100,000	2
Lease premium P300,000/20 years x 9/12	(11,250)	1
Rent (9 months x P10,000)	(90,000)	1
Balancing allowance on equipment (294,000 – 240,000)	(54,000)	1
Capital allowance on plant (W3)	(107,500)	3
Capital allowance on Tipper Truck (rollover relief)	0	.5
Net chargeable gain on disposal of shares (W4)	80,000	3
Less local dividends	(74,000)	.5
Final taxable income	14,910,085	2

Available Marks: 21
Maximum marks: 17

Working 1 – Disposal of replacement property

	P	
Sales proceeds	1,400,000	
Less: allowable cost	(600,000)	.5

Un-indexed gain	800,000	
Less indexation allowance:		
(1909.6 – 1480.0)/1480.0 x P600,000	(174,162)	.5

Chargeable gain	625,835	1

Working 2 – Held-over chargeable gain now chargeable:

	P	
Minimum reinvestment on original investment		
(P500,000 + P220,000)	720,000	
Replacement cost	(600,000)	.5

Amount not reinvested	120,000	
Therefore, amount held-over	100,000	.5

Gain on disposal of original investment	220,000	1

On disposal of the replacement property, the gain held of P100,000 over becomes chargeable.

Working 3 – Capital allowances on replacement plant:

	P	
Balancing charge on disposal of original plant:		
ITV b/f	130,000	
Sales proceeds	(350,000)	.5

Balancing charge	220,000	

Cost of replacement plant	650,000	
Less rollover relief	(220,000)	1

Cost for capital allowances	430,000	.5

Capital allowances P430,000 x 25% =	107,500	1

Working 4 – CGT on disposal of shares

Gain on disposal of shares in Ocean Ltd:

	P	
Sales proceeds	360,000	
Cost	(200,000)	.5

Un-indexed gain	160,000	
Less moveable allowance at 25%	(40,000)	.5

Chargeable gain	120,000	

Allowable loss in Sea Ltd:		
Sales proceeds	180,000	
Allowable cost	(220,000)	.5

Allowable loss	(40,000)	.5

Net chargeable gains	80,000	1

3.2 Based on your final taxable income in 3.1 above, compute the final tax payable for Apex Ltd fye 31 March 2020.

Tax payable:		
P14,910,085 x 22%	3,280,218.70	1
Less WHT on:		
Rent P250,800 x 5/95	(13,200.00)	1
Bank deposit interest P30,600 x 10/90	(3,400.00)	1

Tax payable	3,263,618.70	

Available marks: 3
Maximum marks 3

3.3 Briefly explain to the financial controller of Apex Ltd, with illustrations, how the items noted in **Exhibit 2** will be accounted for under VAT.

Purchase of land from a non-VAT registered seller

Apex Ltd will be required to pay transfer duty of:

	P	
Purchase price	1,500,000	
Less exemption	(200,000)	

Chargeable transfer	1,300,000	1

Transfer duty payable at 5%	P65,000	1

The transfer duty of P65,000 payable by Apex Ltd will be treated as input VAT for Apex Ltd. 1

Importation of management services

The importation of services for business purposes is not subject to VAT. Therefore, Apex Ltd will not be required to pay any VAT on the management consultancy. 1

Deposit for a returnable container

A deposit for a returnable container is subject to VAT. 1

The input VAT = P12,000 x 12% P1,440 1

Deposit on purchase of a truck on credit

VAT will arise on the payment of a deposit on the purchase of a truck on credit because the credit is applied to the sale. 1

The input VAT will be based on the cash value of the supply.

P620,000 x 12% = P74,400 1

Available marks: 8

Maximum marks: 6

Total available marks: 30

Total Maximum Marks: 25