Solutions for BPT June 2019

Answer 1.1

Identify the VAT, income tax and capital gains tax consequences of incorporation for Kefilwe and Nyimo Ltd taking into account the differing tax effects of adopting either Alternative 1 or Alternative 2 in respect of thesale of property in Commerce Park.

Alternative 1: Transfer the property in Commerce Park and the business to Nyimo Ltd on 1 July 2019:

Tax implications for Kefilwe

VAT on transfer of the property in Commerce Park and the business as a going concern

The transfer of a taxable activity or business as a going concern by a registered person to another registered person is zero rated provided:

- A notice in writing is signed by the transferor and the transferee and furnished to the Commissioner within 21 days after the supply, and
- Such notice includes the details of the supply.

Kefilwe and Nyimo Ltd would be advised to comply with the requirements for zero rating.

Thus the transfer of the property and the business would be zero rated as a transfer of a going concern (TOGC). **3**

Income tax implications

The assets and liabilities subject to income tax shall be deemed to be disposed of at market value as follows:

Plant & machinery

Balancing charge arising on the deemed disposal

TWDV b/f	225,000		
Deemed sales proceeds	(480,000)		

Balancing charge		255,000	**1**

Light truck

Cost – 2017	400,000		
Capital allowances granted:			
2017 – 2019: 25% x P400,000 x 3 years	(300,000)		

TWDV b/f	100,000		
Deemed sales proceeds	(220,000)		

Balancing charge x 80%	120,000	96,000	**2**

Current assets

Cost	315,000		
Market value	250,000		

Loss		(65,000)	**1**

Property in Commerce Park

Since the property was sold for more than its cost, the balancing charge will be equal to the allowances granted as follows:

From 2012 to 2019:			
8 years x 2.5% x P990,000		198,000	**2**

Total additional taxable income		484,000	

Kefilwe would be taxed on the profits up to 30June 2019.

The additional taxable income arising after the transfer of the business to Nyimo Ltd would also be taxed. **1**

Capital gains tax (CGT) implications

Capital gains tax will arise on the assets that are liable to CGT.

Tutorial: The exemption would be available if the transaction was about the merger or reconstruction of two or more companies, subject to satisfying certain conditions.

Goodwill			
Deemed sales proceeds	700,000		
Cost	(150,000)		

Un-indexed gain	550,000		
Less moveable allowance at 25%	(137,500)		

Chargeable gain		412,500	**2**
Property in Commerce Park			
Sales proceeds	2,450,000		
Less allowable cost	(990,000)		

	1,460,000		
Indexation allowance:			
July 2011 – June 2019			
(1893.4 – 1380.6)/ 1380.6 x 990,000	(367,718)		

Chargeable gain		1,092,282	**2**

Total chargeable gain		1,504,782	

Tax implications for Nyimo Ltd following incorporation

VAT implications

Since both NT and Nyimo Ltd would be VAT registered, the transfer of the business and the property acquired from Kefilwe/ NT would be zero rated as a TOGC. **1**

On the subsequent disposal of the property in Commerce Park and any other taxable supplies, Nyimo Ltd will be required to charge output VAT. **1**

On the disposal of the property, output VAT will be P294,000 (.i.e. P2,450,000 x 12%).

There will be no input VAT to recover on this building since NT would have already claimed such input VAT. **2**

The cost of the assets acquired from NT will be based on the market values of those assets at the transfer date, 1 July 2019.

The capital allowances:

Plant and machinery:		
P480,000 x 25%	120,000	1
Light truck		
P220,000 x 25%	55,000	1
Building in Gaborone North:		
P2,400,000 x 2.5%	60,000	1

Total capital allowances for Nyimo Ltd	235,000	

CGT Implications

There will be no chargeable gain arising on the disposal of the property in Commerce Parkbecause the property would be acquired and disposed of in the same month and the cost would be equal to the proceeds. 1

The carrying cost of the goodwill would be revised to the cost to Nyimo Ltd of P700,000.
1

<u>Alternative 2-Keep the building in Commerce Park and transfer the business as a going concern</u>

<u>Implications for Kefilwe</u>

VAT Implications

NT will be required to account for output VAT on the disposal of building in Commerce Park of P294,000 (i.e. P2,450,000 x 12%). 1

The other business assets and trade transferred to Nyimo Ltd would not be subject to VAT on the basis of TOGC. 1

Income Tax Implications;

The income tax implication will be exactly the same under Alternative 1. So the additional taxable income will be P484,000. 1

In addition, Kefilwe will be able to claim capital allowances on the property in Gaborone North of P1,800,000 x 2.5% = P45,000. 1

Capital Gains Tax

As in **Alternative 1**, CGT will arise on the disposal of goodwill and on the building in Commerce Park.

The total gain, as calculated in **Alternative 1:**

Goodwill	412,500	
Property in Commerce Park	1,504,782	
Total Gain	1,917,282	1

However, as Kefilwe will reinvest the proceeds from the disposal of the property of the Commerce Park into the acquisition of the Gaborone North building,she will be entitled to claim holdover relief and thereby defer the payment of tax on the gain attributable to the disposal of the property in Commerce Park.

To obtain full relief, Kefilwe must reinvest a minimum of the sum of the original investment, P990,000 and the chargeable gain of P1,092,282 total minimum reinvestment amount is P2,082,282. As the amount reinvestedisless than the minimum reinvestment amount, Kefilwe will not obtain full holdover relief.

She will be liable to tax on the amount not reinvested of P282,282 (P2,082,282 – P1,800,000).

The chargeable gain entitled to holdover relief will be P810,000 (chargeable gain less the amount immediately chargeable to tax P1,092,282 – P282,282). 3

The reduction in her CGT liabilities will be P202,500 (25% x P810,000).

<u>Tax implications for Nyimo Ltd on incorporation</u>

VAT implications

Same as in Alternative 1 as the transfer of the trade and its assets will still be considered as a TOGC. 1

The only difference is that the property in Commerce Park will not be transferred and therefore, there will be no output VAT arising on it's disposal. 1

Income tax implications

Nyimo Ltd will claim capital allowances on plant & machinery and on the light truck as in Alternative 1. As no capital allowances will be available on the Gaborone North property, Nyimo Ltd will claim only P175,000. 1

Capital gains tax

There are no capital gains tax implications as a result of the incorporation. 1

Sub-total marks	**35**
Maximum marks	**26**

Answer 1.2

Comparison of the different tax costs of alternatives 1 and 2 recommendation of which of the two is the most efficient:

	Alternatives		
Kefilwe	**1**	**2**	
Additional Costs	**P**	**P**	
VAT Implication	-	-	
Income tax implication			
Additional TaxableIncome	484,000	484,000	1
Capital gains	1,917,282	709,912	1
Nyimo Ltd			
Additional Costs:			
VAT	-	-	
Income tax			
Deductible capital allowances	(220,000)	(175,000)	1
CGT	-	-	1
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Total Additional income	2,181,282	1,018,912	4
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Alternative 2, transfer the business and trade but retain the property in Commerce Park would result in the most efficient tax position.

Answer 1.3

Based on the recommendation above, Kefilwe must retain and sell the property in Commerce Park and then buy the property in Gaborone North.

Kefilwe will be required to pay input VAT of P216,000. As an individual, whose only other source of income is rental income and employment income. She will not meet the threshold for VAT registration.

Therefore, the VAT payable on the acquisition of the property would not be reclaimable.

However, Kefilwe can voluntarily register for VAT and would therefore be able to reclaim the input VAT on the acquisition of the Gaborone North Property.

If Kefilwe registers for VAT, the rentals may become expensive for rentals that are not registered for VAT. **5**

Answer 1.4

Consider whether Kefilwe should incorporate the payment of dividends in the package.

If no dividends are included:

The tax on the salary of P50,000 per month (P600,000 per annum) is as follows;

First P144,000	13,050	
Next P456,000 x 25%	114,000	

	127,050	1
Tax saved by the company:		
P600,000 x 22%	(132,000)	2

Tax benefit	4,950	

If dividends are included:

Tax on P144,000 is P13,050 effective tax rate 9%	13,050	1
Tax on dividends		
Tax on P456,000 at 7.5% =	34,200	2

	47,250	
Less Tax saved by Company		
P144,000 x 22%	(31,680)	1
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Tax expense	15,570	**7**
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<u>**Conclusion:**</u>
It is better for Kefilwe to receive her salary entirely instead of including the payment of dividends. 1

Maximum available marks: 5

Total available marks: 51

Total maximum marks: 40

Answer 2.1

Galeboe will be liable to Botswana income tax on income that is derived from or deemed to arise from a source situate in Botswana. Certain income derived from a source outside Botswana may also be deemed to be Botswana income. In such a case, relief may be available on the foreign tax against the Botswana tax liability. **2**

As Galeboe has taxable income and capital gains, she will be liable to income tax and capital gains tax.

Computation of taxable income for Galeboe for tax year ended 2019:

		Gross Income P	**Tax deducted at source P**	
Salary		480,000	97,050	**1**
Director's fees		60,000		**1**
Dividends from Bina Ltd		0		**1**
Local consultancy fees		120,000		**2**
Foreign consultancy fees (P89,600/80%)		112,000	22,400	**2**

Taxable income before foreign dividends		772,000		

Tax liability				
First P144,000		13,050		
Next P628,000 x 25%		157,000		

		170,050		**1**
Tax on foreign dividends: P45,000 x 15%		6,750		**2**

Tax liability		**176,800**		
Less: double tax relief:				
On foreign dividends – lower of:		(4,500)		**2**
Foreign tax – P45,000 x 10%	4,500			
Botswana tax	6,750			

On foreign consultancy fees:		(22,400)	**2**
Foreign tax at 20%	22,400		
Botswana tax			
P176,800 x 112,000/772,000	25,533		

PAYE on salary		(97,050)	**1**
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Tax payable		**52,850**	**17**
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Capital gains tax (CGT liability) for Galeboe

The capital gain on the disposal of the property in South Africa is not liable to tax in Botswana, as the source of the income is South African. **1**

There will be no relief for the tax suffered in South Africa. **1**

The chargeable gain realised from the disposal of a property in Gaborone is liable to Botswana tax because it was income derived from a source situate in Botswana.

The transfer duty paid by the buyer does not give relief to Galeboe in any way. **1**

Tax liability of the disposal of the property:

	P	
First P144,000	13,950	
Next P36,000 x 25%	9,000	

Capital gains tax liability	22,950	**1**

Galeboe's total tax liability:		
Income tax payable	52,850	
Capital gains tax payable	22,950	

Total tax liability	75,800	**1**
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		5

Answer 2.2

Briefing notes for Bina Ltd on the income tax and VAT implications of the transactions.

1. *Intra-group transactions*

   Bina Ltd and Hoek Ltd are related companies because Hoek Ltd controls Bina Ltd by virtue of it's investment of 80%. The two companies are free to trade with one another. However, if they enter into transactions that independent companies are unlikely to enter into or are fictitious or artificial and the Commissioner is of the opinion that those transactions have the effect of reducing or postponing the tax liabilities of Bina Ltd, then the Commissioner will invoke the provisions of S.35 and determine the tax liabilities by disregarding the effects of the fictitious or artificial transactions. **2**

   In a case where Hoek Ltd's mark-up is generally 25% but charges 50% on sales to Bina Ltd, the Commissioner is likely to invoke the provisions of S.35 to ensure that Bina Ltd does not reduce or postpone its tax liabilities. **2**

   Without invoking S.35, Bina Ltd's gross profit on the goods purchased for Hoek Ltd will be as follows:

	P
Sales – P1,350,000 x 1.1	1,485,000
Less cost of sales	1,350,000

Gross profit	135,000

   If S.35 is invoked, the cost of the goods will be revised to a mark-up of 25% instead of the 50% that was charged originally.

		P
Sales -		1,485,000
Cost of sales – P1,350,000 x 100/150	900,000	
Add: mark-up of 25%	225,000	
	----------------	1,125,000

Gross profit		360,000

   The additional profit if S.35 is invoked is P225,000 (P360,000 – P135,000) **2**

   (NB: Additional profit – P1,350,000 x 25/150 = P225,000).

2. Disposal of equipment

Income tax

On disposal of the equipment, Bina Ltd will be required to compute the balancing adjustment as follows:

	P	
Cost: 1 January 2016	650,000	
Capital allowances granted:		
Tax years 2016 – 2018:		
3 years x P650,000 x 25%	(487,500)	

Income tax value b/f	162,500	
Sales proceeds	(420,000)	

Balancing charge	257,500	2

VAT implications

Bina Ltd will charge output VAT of P50,400 (P420,000 x 12%). 1

3. Import of goods and equipment

Importation of goods

Income tax implications

The tax allowable cost for the imported goods will be P288,321 measured at the acquisition date. However, the gain arising on the settlement of the payable of P14,015 will be included in the taxable income of Bina Ltd. 2

Working for Pula amounts:

1/12/2018	R395,000 / 1.37	P288,321	Acquisition date
30/12/2018	R395,000/ 1.40	P282,143	Arrival date
28/2/2019	R395,000 / 1.44	P274,306	Settlement date

Exchange gain = P288,321 – P274,306 = P14,015

VAT implications

For the purposes of VAT, the tax point for imported goods is the date when the goods are arrived in Botswana. 1

Bina Ltd will be required to pay input VAT based on the exchange rate at the date that the goods arrived in to Botswana. The input VAT will be recoverable. 1

P282,143 x 12% = P33,857.16 i

Importation of equipment

Income tax implications

The cost of the equipment will be P476,140, the initial cost of P563,610 and the exchange loss of P12,530. 2

Bina Ltd will be advised to apply the rollover relief since it had sold and realised a chargeable gain. The chargeable gain will be deducted from the cost of the replacement equipment, as follows: 1

	P	
Cost of replacement equipment	476,140	
Less balancing charge	(257,500)	

Cost for capital allowances	**218,640**	1

Annual capital allowance at **25% x P218,640** = P54,660 1

VAT implications

VAT will be charged at the point when the equipment arrives in to Botswana. 1

The input VAT paid on importation is recoverable.

The input VAT is P56,492.40, i.e. P470,770 x 12%. 1

Working for Pula amounts

1/2/2019	£35,800 x P12.95	P463,610	Acquisition date
22/2/2019	£35,800 x P13.15	P470,770	Arrival of equipment
30/3/2019	£35,800 x P13.30	P476,140	Settlement date

Exchange loss: P476,140 – P463,610 = P12,530

Available Marks: 21

Total Marks available: 38

Total Maximum marks: 35

Answer 3.1

Where a VAT trader purchases property from a non-registered person, the buyer will be required to pay transfer duty tax. **1**

Adima Ltd will be required to pay transfer duty tax on the purchase of the warehouse as follows:

	P	
Sales price	690,000	
Less exemption	(200,000)	

Chargeable transfer	490,000	

Transfer duty tax at 5% of P490,000	P24,500	**2**

The transfer duty tax payable of P24,500 by Adima Ltd is claimable as input VAT for Adima Ltd. **2**

Sub-total: 5 marks

Answer 3.2

Nnete Ltd should first consider whether the transaction or scheme that has been proposed is lawful and if the details can be disclosed to BURS. **2**

Generally, tax saving schemes fall into tax evasion or tax avoidance. Tax evasion is illegal and punishable by the provisions of the Income Tax Act. However, tax avoidance is legal as it uses the provisions of the Act to minimize its tax liabilities. **2**

The Income Tax Act under S.35 empowers the Commissioner to disregard transactions or schemes which are fictitious or artificial which are entered into with the effect of reducing or postponing the tax liabilities of the taxpayer. **2**

The tax specialists require Nnete Ltd to enter into a confidentiality agreement that would prevent Nnete Ltd from making disclosures of how the tax was reduced. This appears suspicious as it may be an unlawful transaction because entities are required to disclose how they have arrived at their tax liabilities. **2**

An application of tax planning need not be covered in a confidentiality agreement. This could be misconstrued as a tax evasion scheme or a fictitious or artificial tax avoidance transaction that could be disregarded under S.35 of the Income Tax Act. **2**

In view of the above considerations, it is advisable that Nnete Ltd should not enter in to an agreement with the tax specialists. **2**

Available: 12 marks

Maximum:10 marks

Answer 3.3

The taxation of income from trusts largely depend on two things, firstly whether the trusts were created inter vivos or during the lifetime of the settlor and secondly whether the beneficiaries are minors or they have attained the age of majority.

Inter vivos or lifetime settlements or trusts

If the beneficiaries are minors

The income accruing from the trust for the benefit of a minor child shall be included in the gross income of the settlor and taxed on the settlor during his life time. **2**

If beneficiaries have attained the age of majority

If the beneficiaries have attained the age of majority, then the income from the trust shall be taxed on the trust in the amount that the beneficiaries would have been taxed. **2**

Trusts containing a stipulation that is fixed or contingent

Where any deed of donation, settlement or other disposition made by the settlorcontains a stipulation of the effect that the beneficiaries therein, or one or more of them shall not receive any amount accrued under the settlement until the happening of an event, whether fixed or contingent, any such amount as would, but stipulation have accrued to the beneficiaries, shall until the happening of the event, or the prior death of the settlor, be deemed to have accrued to the settlor and shall be included in his income. **3**

Revocable trusts

Where any deed of donation, settlement or other disposition made by the settlor contains a stipulation that the right of any person to receive any amount accrued under the settlement may be revoked by the settlor or conferred upon some other person, such amount as is subject to the stipulation shall be deemed to have accrued to the settlor and shall be included in his gross income. **3**

Testamentary trusts or wills created by will

Trusts without any stipulation

Any amount accrued to a trust for the benefit of any person shall be included in the gross income of the trust and the taxable income ascertained therefrom shall be charged to tax in the name of the trustee in the same sum as would have been charged if such amount had been included in the gross income of such person. **2**

Trusts with a stipulation in relation to the receipt of income

Where any person has made, in a will or other testamentary disposition, a stipulation to the effect that the beneficiaries therein, or one or more of them, shall not receive any amount accrued under such will or disposition until the happening of any event, whether fixed or contingent, any such amount as would, but for the stipulation, have accrued to the beneficiaries shall, until the happening of that event , be deemed to have accrued to the trust and shall be included in the gross income of the trust and the taxable income ascertained therefrom shall be charged to tax in the name of the trustee. **3**

Sub-total: 15 marks

Grand-Total:25 marks