BOTSWANA INSTITUTE OF CHARTERED ACCOUNTANTS

BUSINESS PLANNING: TAXATION

DECEMBER 2020 EXAMINATIONS SOLUTIONS

Question One

Report

To The Financial Controller

From Tax Advisor

Date 30 September 2020

Subject Recommendations for the disposal of Jalo Ltd

The manner in which a business is disposed of will have different tax implications for the shareholders and eventually the net amount that they will receive from the disposal.
The detailed calculations are provided in the appendices.

Appendix 1 explains the tax implications of disposing Jalo Ltd via the sale of shares under **Option 1**.

Disposal of shares will only be liable to capital gains tax. As the proceeds are directly received by the shareholders, the issue of extraction of profits will not arise. The total net income, after tax, receivable by the shareholders amounts to P20,905,000 as shown in Appendix 1. 1

Sethunya Ltd would receive a net amount of P15,780,000 from the disposal of its shares while Rapela would receive P5,125. 1

Appendix 2 provides the tax implications of selling the assets of Jalo Ltd as a going concern to Setlhare Ltd.

The disposal of the assets will have income tax implications and capital gains tax.

Income tax implications arise due to the balancing adjustments on the disposal of the factory and the equipment and on the differences between the fair market values and the cost of the trading items, being raw materials, finished goods and trade receivables. The additional income from income tax implications amounted to P3,131,000 **(Appendix 2 (i)**. 1

Capital gains tax arose on the disposal of the land and the factory. Additionally, the disposal of a going concern also gave rise goodwill which was the difference between the fair market value of the assets and the sales proceeds of the business as a whole. The gain on the land and factory is computed as P459,000 and P2,654,000, respectively **(Appendix 2 (ii)**. 1

Goodwill is calculated as P3,750,000, giving total chargeable gains of P6,863,000. 1

The additional income and chargeable gains will be realised by Jalo Ltd. Jalo Ltd will be responsible to pay the tax on the additional income and gains. 1

Sethunya Ltd will only be able to extract the profits from Jalo Ltd via a dividend. The return of the nominal value of the share capital will not be subject to withholding tax when the dividends are distributed. 1

The total net amount payable to the shareholders will be P21,291, Sethunya Ltd will receive P15,968 while Rapela will receive P5,323.

Recommendation

It is recommended that Sethunya Ltd should dispose Jalo Ltd via the sale of net assets. This will result in additional net income of P386,000 (P21,291,000 – P20,905,000), refer to the appendices. 2

Brief explanation of the capital gains tax consequences of merging Jalo Ltd and Setlhare Ltd

If Setlhare Ltd issued its shares to Sethunya Ltd as consideration for the acquisition of Jalo Ltd, Sethunya Ltd shall be deemed to have disposed it's shares in Jalo Ltd and will be liable to capital gains tax. 1

However, if the shares are issued in consequence of the merger of two or more resident companies and the shareholding before and after the merger remains the same, then the seller is deemed to dispose of the shares at cost and no capital gains tax will arise. For capital gains tax not to arise, the Income Tax Act further requires that no shareholder should benefit at the expense of another shareholder. 1

In the case of Jalo Ltd and Setlhare Ltd, the merger will result in capital gains tax liability for Jalo Ltd because Rapela wants to sell his 25% shareholding. If the merger included the acquisition of Rapela's shares, capital gains tax liability would not arise. 1

Appendix 1 – Disposal of Jalo Ltd by sale of shares

	Sethunya Ltd	Rapela		
	P'000	P'000	P'000	
Sales proceeds 75%/25%	18,750	6,250		1x2
Allowable cost	(750)	(250)		1x2
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Un-indexed gain	18,000	6,000		
Less: moveable allowance at 25%	(4,500)	(1,500)		1x2
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Chargeable gain	13,500	4,500		
	-----------	-----------		
Tax liability at 22%/25%:				
P13,500,000 x 22%	2,970			1
P4,500,000 x 25%		1,125		1
	-----------	-----------		
Total tax liability			**4,095**	

Net amount payable to shareholder:				
Sales proceeds	18,750	6,250		
Less: tax payable	(2,970)	(1,125)		
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Net income payable to shareholders	**15,780**	**5,125**	**20,905**	1x2
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Appendix 2 – Disposal of Jalo Ltd's assets

(i) *Income tax implications of the disposal of assets:*

	*TWDV b/f /Cost	Sales proceeds/ Cost	Additional taxable income	
	P'000	**P'000**	**P'000**	
Land	600	600	-	1
Factory	*637.5	1,500	863	1
Equipment	*320	400	80	1
Raw materials	1,612	2,685	1,073	1
Finished goods	5,800	7,400	1,600	1
Trade receivables	3,800	3,400	(400)	1
Bank loan	(900)	(985)	(85)	1
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Total additional income			3,131	

(ii) *Capital gains implications*

Disposal of the land:	**P'000**	**P'000**	
Sales proceeds (deemed)	1,700		
Less: allowable cost	(600)		

Un-indexed gain	1,100		
Indexation allowance:			
(1814.8- 877.4)/877.4 x P600,000	(641)		

Chargeable gain		459	2
Disposal of factory:	**P'000**		
Deemed sales proceeds	5,400		
Less: allowable cost	(1,500)		

Un-indexed gain	3,900		
Indexation allowance:			
(1814.8 - 991.2)/991.2 x P1,500,000	(1,246)		

Chargeable gain		2,654	2
Goodwill			
Total consideration for the assets	25,000		
Less fair value of the assets acquired	(20,000)		
(P21,385 – P1,385)	-----------		
Goodwill	5,000		2
Less: moveable allowance at 25%	(1,250)		

Chargeable gain		3,750	2

Total chargeable gains		6,863	

(iii) *Additional tax liability arising from the disposal of assets:*

	P'000	
Additional trading income (as (i) above)	3,131	1
Additional chargeable gains	6,863	1

Total additional taxable income	9,994	

Tax liability payable at 22%	2,199	

(iv) *Distribution of cash to the shareholders*

	P'000	
Proceeds from disposal of assets	25,000	2
Less tax payable on disposal	(2,199)	1

	22,001	
Less return of nominal value to shareholders	(1,000)	1

Available for distribution	21,001	
Less withholding tax at 7.5%	(1,710)	1

Net dividend payable to shareholders	20,291	

Payable to Sethunya Ltd – (75% x P20,291) + 750	15,968	1
Payable to Rapela – (25% x P20,291) + 250	5,323	1
Total payable to the shareholders	**21,291**	
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Available marks		46

Maximum marks		40

Question Two

a) Calculation of the final taxable income fye 30 September 2020 for Masunga Ltd:

			P	
Draft taxable income (given)			6,780,000	
Compensation for loss of cash			300,000	2
Software package			128,000	1
IT consultants labour			(52,000)	1
Allowance on leasehold property (P300,000 / 20 years)			(15,000)	1
Balancing adjustment on leasehold:				
Cost of leasehold		300,000		
Less allowances granted:				
P300,000/20 years x 8 years		(120,000)		

		180,000		
		(220,000)		

Clawed back of allowance			40,000	2
Gain or loss on disposal of leasehold:				
Sales proceeds		220,000		
Cost	300,000			
Less net allowance granted:				
(300,000 – 220,000)	(80,000)			
	-------------	(220,000)		2

		0		
Less indexation allowance:				
(1814.8 – 1515.4)/1515.4 x P300,000		(59,271)		1

Allowable loss		(59,271)		

Exchange difference arising on purchase of goods from RSA:				
14 June 2020 R156,960 / 1.20		130,800		
1 Sept 2020 R156,960 / 1.25		(125,568)		

Realised exchange gain			5,232	2
Outstanding invoice is unrealized			0	1
Market value on reversion of leasehold property			600,000	2
Gain on disposal of debentures:				
Sales proceeds		230,000		
Allowable cost		(110,000)		

Un-indexed gain		120,000		
Less movable allowance at 25%		(30,000)		

Capital gain	90,000		1
Less allowable loss on lease	(59,271)		1
Net chargeable gain		30,729	
Fair value gain on investment property		(140,000)	1
Bank deposit interest		48,000	1
Training levy contributions		(240,000)	1
Final taxable income		7,484,961	
Tax payable:			
Tax liability P7,484,9461 x 22%		1,646,691.42	1
Less withholding tax on bank deposit interest:			
P48,000 x 10%		(4,800.00)	1
Tax payable		1,641,891.42	22

b) Tax implications of the proposed staff working arrangements

Engagement of staff outside of Botswana

Option One

Where Masunga Ltd enters into a contract with a South African to second its employees to work in South Africa, the income from the secondment will be deemed to be Botswana income if the employees are still regarded as residents of Botswana. 2

This will be the case if the employees physically present in Botswana for at least 183 days. 1

If the employees stay more than 183 days in South Africa, then they will cease to be treated as residents of Botswana and any income earned while in South Africa shall not be liable to Botswana tax. 1

Option Two

Where the employees are engaged directly by the South African company, the income earned will not be subject to Botswana tax whether the employees are regarded as Botswana residents or not. 2

Introduction of Employee Share Ownership Scheme

Granting of shares to employees will not be liable to tax at the time of the grant. 1

However, when the employees exercise their right to purchase the shares, a benefit in kind will arise on the difference between the fair value of the share and the exercise price at the date of the purchase of the shares. 2

Question Three

a) *Calculation of the taxable employment income fye 30 June 2020:*

	P	
Annual salary	600,000	1
Employee contribution to ASF at 10%	(60,000)	1
Employer’s contribution to ASF at 10%	0	1
Contribution to provident fund	0	1
Car benefit (480,000 – 200,000) x 15% + 10000	52,000	1
Employer’s medical aid contribution	0	1
Employee’s medical aid contribution	0	1
Capital allowances on the laptop:		
P28,000 x 25% x 60%	(4,200)	2
Family holiday package	120,000	1
Leave commutation pay:		
38/ (22 x 12) x P600,000	86,364	2
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Taxable employment income	794,164	12
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b) *Calculation of taxable income fye 30 June 2020:*

		P	
Employment income		794,164	1
Foreign rental income		0	2
Foreign dividends (P52,800 / 88%)	60,000	0	1
Foreign interest income (P22,500 / 90%)		25,000	1
		-------------	-----
Total taxable income		819,164	5
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Tax payable:			
First P144,000		13,050	
Next P675,164 x 25%		168,791	

Tax liability before tax on foreign dividend		181,841	
Tax on foreign dividend P60,000 x 15%		9,000	1

		190,841	
Less Double tax relief:			
On foreign dividend: lower of:		(7,200)	2
Botswana equivalent (as above)	9,000		
Foreign tax suffered P60,000 x 12%	7,200		
On foreign interest: lower of:		(2,500)	2
Botswana equivalent			
P181,841 x 25,000/819,164	5,550		
Foreign tax P25,000 x 10%	2,500		
Less PAYE on salary		(127,050)	1
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Tax payable	54,091	6
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c) *Tax consequences of the proposed bequests for Mr & Mrs Tsheko's children:*

(i) If David Tsheko donates the property to the trust set up for the benefit of the children, the trust will be liable to pay capital transfer tax (CTT) on the value of the property donated. The CTT payable is P116,000. David Tsheko would not be liable to pay any tax. 1

If David Tsheko sells the property to the trust, he will be required to pay capital gains tax as follows:

	P	
Sales proceeds	2,500,000	
Allowable cost	(1,100,000)	

	1,400,000	
Indexation allowance:		
P1,100,000 x 0.782	(860,200)	

Chargeable gain	539,800	1

Tax liability:		
First P144,000	13,950	
Next P395,800 x 25%	98,950	

	112,900	1

The tax liability is lower if David Tsheko sells the property to the trust. From an overall position of David Tsheko and the trust, the sale will result in a tax saving of P3,100. 1

(ii) The income earned by the trust for distribution to the beneficiaries shall be included in the income of the trust and shall be charged 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

However, the income distributable to the minor children will be included in the gross income of the settlor, in this case, David Tsheko. The P60,000 due to each of the two minor children will be taxed on David Tsheko. 1

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Total: 30 marks