

BICA BPT June 2021 Exam Solutions

Question 1.1

Recommendation of the appropriate tax treatment for the following unresolved matters in **Exhibit 2**.

Debenture and share sale:

MB Ltd originally purchased the 30,000 shares in Tshedi Ltd for P1,480,000 on 1 September 2010.

When Tshedi Ltd was taken over by Moseetso Ltd on 1 April 2015, the taken over qualified as a merger because the original shareholders became beneficial shareholders in Moseetso Ltd and no shareholder seemed to benefit more than the others. 1

In view of merger, the shares of MB Ltd would be deemed to have been acquired at nil value and therefore retained their original or base cost as follows:

New shares and debentures in Moseetso Ltd:

Shares

30,000 x 18 = 540,000 shares valued P5 each = P2,700,000 1

10% Debentures

30,000/5 = 6,000 P100 valued at P120 each = P720,000 1

Total value of consideration received = P3,420,000

Attributable cost of the base cost:

Shares $P1,480,000 \times P2,700,000 / P3,420,000 =$ P1,168,420 1

Debentures $P1,480,000 \times P720,000 / P3,420,000 =$ P311,580 1

Computation of gain or loss on the disposal of the 6,000 debentures in Moseetso Ltd:

	P	
Sales proceeds	1,100,000	
Less: allowable cost	(720,000)	

Un-indexed gain	380,000	
Less: moveable allowance at 25%	(95,000)	

Chargeable gain	285,000	1

Computation of gain or loss on disposal of 210,000 shares in Moseetso Ltd:

	P	
Sales proceeds	1,400,000	
Less: allowable cost $210,000 / 540,000 \times P2,700,000$	(1,050,000)	

Un-indexed gain	350,000	
Less: moveable allowance at 25%	(87,500)	

Chargeable gain	262,500	1

Sale of property in South Africa

Disposal of a property in a foreign country by a Botswana resident company is not taxable in Botswana. 1

Training levy

The training levy of P250,000 is fully tax deductible when it has been paid. 1

Leased office block

Where the tenant is required by the landlord to effect improvements on the property, the cost of the improvements will be assessed as income on the landlord. 1

However, the landlord can make an election to be assessed on the market value of the said improvements when the property reverts to him. The property reverted to MB Ltd on 31 May 2020 and therefore the value of the improvements of P1,300,000 should be included in the taxable income of MB Ltd. 1

Additionally, MB Ltd will be entitled to claim commercial buildings allowance of P35,000 (being $P1,400,000 \times 2.5\%$). 1

Purchase of equipment from South Africa on credit

The exchange gain or loss on the settlement of the invoice will be reflected in the cost of the equipment, as follows:

13 November 2020
 $R264,000 / R1.20 =$ P220,000

3 February 2021
 $R264,000 / R1.32 =$ P200,000

Exchange gain P20,000

Cost of equipment for capital allowances will be P200,000. 1

Therefore, the annual capital allowances will be $P200,000 \times 25\% = P50,000$. 1

Disposal of an office block in October 2020

Held-over gain on disposal of the warehouse now chargeable:

	P	
Original investment	800,000	
Chargeable gain	520,000	

Minimum amount to reinvestment	1,320,000	
Less amount invested	1,200,000	

Amount not reinvested	120,000	

Amount held-over (P520,000 – P120,000)	400,000	2

Computation of capital gain or loss arising on the disposal of the office block:

	P	P	
Sales proceeds		2,224,114	
Less allowable cost		(1,200,000)	

Un-indexed gain		1,024,114	
Less indexation allowance:			
July 2013 – October 2020:			
(1958.5 – 1576.7)/1576.7 x P1,200,000		(29,114)	

Chargeable gain		995,000	2

Calculation of the revised taxable total income for MB Ltd for year ended 31 March 2021:

	P	P
Taxable trading income:		
Trading income b/f	2,258,000	1
Training levy	(250,000)	1
Market value of improvement on reversion	1,300,000	1
Capital allowances on leased office block	(35,000)	1
Capital allowances on plant from SA	(50,000)	1

	3,223,000	
Less trading losses b/f:		
2017	370,000	1
2019	210,000	1
2020	150,000	1

	(730,000)	

Net taxable trading income		2,493,000
Income from Zimbabwean PE:		
P98,800 / 76%		130,000 1
Foreign dividend (gross)		50,000 1
Chargeable capital gains /losses:		
Gain on disposal of debentures	285,000	1
Gain on disposal of shares	262,500	1
Held-over gain on warehouse	400,000	1
Gain on disposal of office block	995,000	1

	1,942,500	
Capital losses b/f	(2,600,000)	1

Capital losses wasted	657,500	

Total taxable income		P2,673,000

Total taxable income before foreign dividends		P2,623,000

Calculation of tax payable fye 31 March 2021:

	P	
P2,591,800 x 22%	577,060	1
Tax on foreign dividend – P50,000 x 15%	7,500	1
Less: Double tax relief		
On foreign dividend, lower of:	(7,500)	1
Foreign tax	10,000	
Botswana tax equivalent P50,000 x 15%	7,500	
On Zimbabwean PE, lower of:	(28,600)	1
Foreign tax suffered – P130,000 x 24%	31,200	
Botswana tax equivalent – P130,000 x 22%	28,600	
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Tax payable	548,460	38
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Maximum marks available		34

Question 1.2**For MB plc**

MB Ltd has failed to respond to correspondence from BURS. The correspondence challenges whether the PE is a separate trade. We are told that the PE has made losses.

The PE carries on a separate trade of recruitment in a foreign country and cannot be treated to be a part of the MB trade. 1

The losses incurred by the PE cannot be relieved against the income of MB Ltd. 1

Therefore, MB Ltd may have submitted incorrect tax returns for those periods. 1

The penalties for submitting incorrect returns depend on the nature of the incorrectness.

If the incorrectness was attributable to neglect or carelessness the penalty shall not exceed 100% of the tax that would have been lost. 1

If it was due to fraud or willful default the penalty shall not exceed 200% of the amount of tax that would have been lost. 1

Since Tebogo was BICA qualified, it is difficult to prove that the incorrectness was attributable to neglect or carelessness. 1

For you (the FD)

Professional Competence: I need to act competently with the situation as it now stands. I have knowledge that the returns may be incorrect.

I do not know if the losses brought forward in MB Ltd include any of the contentious losses and therefore I am in danger of also submitting an incorrect return for 2021. 1

Professional Behaviour & Professional Competence: I also have knowledge that a fellow member may be guilty of tax evasion. 1

Potential Penalties

- Penalties can arise for submitting incorrect tax returns. 1

The ethical issue for me now is that I have knowledge that the returns may be incorrect and that a fellow member may be guilty of tax evasion. 1

Actions

As penalties can be mitigated with prompt disclosure, I should discuss the matter with the board and enter into communication with BURS as soon as possible. ½

I should assess whether I have the required technical expertise to negotiate with BURS and consider appointing an appropriately qualified professional to act on behalf of the company. ½

I should review the tax arrangements of MB Ltd and ensure that there are adequate reporting lines and that tax information and correspondence is provided for scrutiny to the appropriate personnel. ½

I should consider whether there is a need to report Tebogo to BICA. ½

10

Maximum marks available 6

Total maximum marks: 40

Question 2.1

Email to Baeti & Kabo

Date: June 2021

Subject: BK Ltd

An evaluation of whether the BURS would regard you as employees or self-employed is relevant to each of the contracts undertaken by MD Ltd in the year ending 30 June 2021.

To determine the status of the contract, the key factors used to decide whether an individual is employed or self-employed are applied and this is how I will evaluate the information you have provided on the contracts. These factors are sometimes called 'tests of control' and comprise:

- Contract of service or contract for services – A contract of service is normally used in the engagement of employees who are required to provide services as required by the employer. A contract for services is normally the engagement of a contractor to perform a specific task or work. Once the work is completed the contract is over
- Mutuality of obligation or employer-employee relationship – the obligation of the employer to give and work to the employer and pay for it. The requirement or obligation of the employee to do the work and get paid for it.
- Provision of equipment – the obligation of the employer to provide equipment to the employee in the case of employment.
- Right of substitution –in a contract of service, the employee cannot substitute himself or herself with another person to perform the worker. In a contract for services, the self-employed can substitute any worker to do the work.
- Financial risk – in a contract of service, the employer takes the financial risk and also benefits from sound management. A contractor can benefit from the profit or suffer loss from the work undertaken. The cost of correcting work is borne by the employer rather than the employee. A self-employed person would be responsible for correcting faulty work.
- Degree of control – the extent to which the employer exerts control over when, where and how an employee performs his or her work determines whether the person is an employee or a contractor or self-employed. The more the control the more indicative of the employer – employee relationship.
- Client portfolio – the employer has a first call on the employee's time and the employee normally exclusively works for one employer.

2 marks for any 4 points above

(8 marks)

Contract with Elite Ltd

The following requirements in the contract can be used to help determine whether Baeti could be treated as an employee or a self-employed person:

- Mutuality of the obligations – the contract specifies the work that Baeti should and for which she will be paid. This could show that there is an employer and employee relationship.
- Right of substitution – the contract requires that the services should only be done by Baeti and no one else from BK. Since Baeti has no right of substitution the contract seems to suggest that Baeti is an employee.
- Degree of control – Baeti is required to perform her duties at the premises of Elite Ltd for three days in a week. This indicates that Elite Ltd has control over when and where the work should be done again suggesting that Baeti is an employee.
- Baeti has a high level of involvement in Elite Ltd beyond that expected from a self-employed who is only hired to do some work. She is responsible for the supervision of Elite Ltd's members of staff.
- Financial risk – the contract provides that Baeti will be paid a fixed fee of P6,000 per day worked. She does not seem to suffer any financial risk nor benefit from working harder.
- Client portfolio – if Baeti works exclusively for Elite Ltd, this would also be an indication that she is an employee.

In conclusion, it appears that this contract may be treated as a contract of services and BURS may require Elite Ltd to subject Baeti's income to pay as you earn.

(2 marks each for any 3 points above and the right conclusion – 8 marks)

Contract with Montle Health

This contract has more characteristics of self-employment than employment. This contract is for the engagement of Kabo to supply his services in the form of examination and training. The main considerations are as follows:

- Financial risk – it seems that Kabo bears the financial risk of the work and this could be explained why Elite Ltd has taken out the insurance. It is also evident from the contract that Kabo stands to benefit from his hard work and sound management decisions.
- Mutuality of obligations – Kabo is not compelled to do more and seems to be at liberty to accept or not accept work from Montle Health Ltd. This suggests that Kabo is a contractor.
- Degree of control – Kabo uses his own premises and equipment which shows that he has control over when, where and how he performs his duties.

- Right of substitution – Kabo has assistants who help him perform his duties. This shows that he can be substituted and also suggesting that he is a contractor and not an employee.

In view of all the above, we can conclude that Kabo is not an employee and correctly works under Elite Ltd. The income he earns will belong to Elite Ltd.

(2 marks each for any 2 points and the right conclusion – 6 marks)

Question 2.3

Tax implications for BK Ltd

The income earned by Baeti will be excluded from the taxable income of BK Ltd. Baeti will be responsible for the income that she has earned from the Elite Ltd contract.

	P	P	
Profit before tax		1,111,000	1
Less: income from Elite Ltd		936,000	1

		175,000	
Add: Salary – Baeti	180,000		1
Depreciation	74,000		1
Kabo's salary	0		1

		254,000	

BK Ltd's taxable income		429,000	

Company tax liability:			
P429,000 x 22%		P94,380	1

Tax implications for Baeti:			
Salary		936,000	2

Tax liability:			
First P144,000		13,050	
Next 25% x (P936,000 – P144,000)		198,000	

Tax liability		211,050	1

			9

Question 2.4 – Annual VAT payable or refundable

Output VAT		P	
Contract with Montle Health Ltd – P484,000 x 12%		58,080	1
Training – exempted		0	1

		58,080	
Input VAT			
Business costs – P30,000 x 12%	3,600		1
Medical insurance – P20,000 x 12%	2,400		1
General overhead expenses:			
P45,000 x 12% = P5,400			
P5,400 x 484,000 / (484,000 + 280,000)	3,421		2

		(9,421)	

Annual output VAT		48,659	6

Total possible marks: 37

Maximum marks: 30 marks

Question 3.1

Question 3.1

A calculation of the tax implications of the disposal of the business

Option 1: Sale of shares

Income tax implications:

1. Car transferred to David Morapedi

	P	
Cost restricted	175,000	
Allowances granted:		
P175,000 × 25% × 4 years	175,000	

	0	
Sales proceeds	328,000	

Balancing charge	328,000	1

2. There are no capital gains implications on the transfer of the car to Morapedi. 1

3. The taxable income fye 30.06.2021 will be :

	P	
Taxable income	1,420,000	1
Balancing charge-Car	328,000	1

	1,748,000	
Less: termination payment	(320,710)	1

Taxable income	1,427,290	

Tax payable:		
Tax liability @ 25%	314,004	
Less: quarterly instalments		
P2,570,000 × 22% × 75%	424,050	

Tax refundable	110,046	1

6

Option 2-Sale of net assets

Income tax implications

1	Balancing charge on transfer of car to David Same as in option 1	328,000	1
2	Termination package Same as in option 1	320,710	1
3	Conference hall: Balancing charge on disposal: Tax years 2005 - 2020 $P1,500,000 \times 2.5\% \times 11$ years	600,000	1
	Extension Tax years 2010-2020 $P1,050,000 \times 2.5\% \times 11$ years	288,750	1
4	Tents Balancing charge: $P1,800,000 - P1,240,000$	560,000	1
5	Delivery vans: balancing charge $P1,260,000 - P470,000$	790,000	1
6	Chairs and tables Balancing allowance: $P174,000 - P150,000$	(24,000)	1
7	Net assets $P730,000 - P550,000$	180,000	1
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	Additional taxable income	2,863,640	8
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Capital gains tax
Conference hall

Sales proceeds	6,500,000	
Allowable cost	(2,900,000)	

Un-indexed gain	3,600,000	1
Indexation allowance:		
Land (Feb 2002 - June 2021)		
(1,981.0 - 613.9)/ 613.9 × 350,000	779,418	1
Conference hall: (Sept 2004 - June 2021)		
(1,981.0 - 765.7)/ 765.7 × 1,500,000	2,380,762	1
Extension: (March 2010 - June 2021)		
(1,981.0-1,234.6)/1,234.6 × 1,050,000	634,797	1

	(3,794,977)	

Capital loss	(194,977)	

Goodwill		
SP	3,560,000	
Less:25% movable allowance	(890,000)	

Chargeable gain	2,670,000	1

Net chargeable gain	2,475,023	1

Taxable income:		
Additional taxable income	2,863,640	1
Net chargeable gains	2,475,023	1
Taxable income for the year	1,420,000	1

	6,758,663	

Tax liability @ 22%	1,486,906	1
Less SA instalments P2,570,000 × 22% × 75%	(424,050)	1
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Tax payable	1,062,856	11
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Tax implications for Ronaldo and Katlego:

Option 1 – Sale of shares

	60%	40%	
	Ronaldo	Katlego	
Sale proceeds	8,400,000	5,600,000	
Less allowable cost	(150,000)	(100,000)	
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Un-indexed gain	8,250,000	5,500,000	
Movable allowances @25%	(2,062,500)	(1,375,000)	
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Chargeable gain	6,187,500	4,125,000	2 x 2 = 4
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Tax payable:			
First P144,000	13,950	13,950	
Next P6,187,500 - 144,000) × 25%	1,510.875	-	
(4,125,000 - 144,000) × 25%	-	99,525	
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	1,524,825	1,134,750	1 x 2 = 2
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Net income	6,875,175	4,465,250	1 x 2 = 2
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			8

Option 2 – Sale of net assets

Proceeds	14,000,000	
Less: tax payable	(1,062,856)	

Net proceeds	12,937,144	2
less WHT @7.5%	(970,286)	2

Distributable dividend	11,966,858	

Ronaldo @60%	7,180,115	1

Katlego @40%	4,786,743	1

Conclusion		
Option 2 is the better option for both shareholders / directors.		2

		6

Total possible marks: 39**Total maximum marks: 30**