

Fundamentals Level – Skills Module

Taxation (Lesotho)

Tuesday 3 June 2014



Time allowed

Reading and planning: 15 minutes

Writing: 3 hours

ALL FIVE questions are compulsory and **MUST** be attempted.
Tax rates and allowances are on pages 2–3.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

The Lesotho Institute of Accountants

ACCA



Paper F6 (LSO)

SUPPLEMENTARY INSTRUCTIONS

- 1 Calculations and workings need only be made to the nearest M.
- 2 All apportionments should be made to the nearest month.
- 3 All workings should be shown.

TAX RATES AND ALLOWANCES

The following tax rates and tax allowances are to be used in answering the questions:

Second Schedule

(Section 9(1))

Resident individual income tax rates

Chargeable income	Rate of tax
First M51,670	22%
Over M51,670	35%
Personal tax credit	M6,100

Third Schedule

(Section 10)

Resident company income tax rates

Nature of income	Rate of tax
1. Manufacturing income derived from a manufacturing activity of an industrial, scientific or educational nature which promotes industrial, scientific, educational or other development within Lesotho.	10%
2. Other manufacturing income	10%
3. Other income	25%
4. Commercial farming income	10%

Fourth Schedule

(Sections 109 and 116)

Tax rate for trustees, fringe benefits and electing non-residents

The applicable rate is 35%

Fifth Schedule

Minimum chargeable income

The multiplication factors for the purposes of s.16(2) are:

Air travel	100%
Electricity amount	100%
Principal residence amount	5%
Schooling amount	100%
Secondary home amount	5%
Vehicle amount	25%

The amounts specified for the purposes of s.16(6) are:

Air travel amount	M2,500
Electricity amount	M3,000
Principal residence amount	M150,000
Schooling amount, per child	M1,000
Secondary home amount	M20,000
Vehicle amount	M20,000

Sixth Schedule

(Section 41)

Declining balance depreciation rates:

Group	Depreciation rate	Assets included
1	25%	Automobiles, taxis, light general purpose trucks, tractors for use over-the-road, special tools and devices.
2	20%	Office furniture, fixtures and equipment, computers and peripheral equipment and handling equipment, buses, heavy general purpose trucks, trailers and trailer mounted containers, construction equipment.
3	10%	Any depreciable asset not included in another group.
4	5%	Railroad cars and locomotives and railroad equipment, vessels, barges, tugs, and similar water transportation equipment, industrial buildings, engines and turbines, public utility plant.
5	100%	Mining

Value added tax (VAT)

Standard rate	14%
Supplies of electricity and telephone calls	5%
Basic foods and agricultural inputs	0%
Exports	0%

ALL FIVE questions are compulsory and MUST be attempted

- 1 Baba is a resident individual who is engaged in a business of building construction and civil engineering. The summarised trading results of Baba for the year ended 31 March 2014 are set out below:

	Note	M
Revenue	1	560,000
Operating expenses		
Wages and salaries	2	237,500
Pension contributions	3	29,400
Depreciation	4	180,000
Finance lease instalments	5	75,250
Insurance premium	6	25,000
Miscellaneous expenses (all deductible)		22,000

Notes:

- 60% of Baba's revenue was derived from construction work under contracts with the Government of Lesotho. This revenue is stated net of 5% withholding tax. The remaining 40% related to construction work under contracts with other parties.
- Wages and salaries are made up as follows:
 - Annual payments for wages of M30,000 to casual employees, and salaries of M160,000 to non-casual employees.
 - Cash drawings by Baba, amounting to M3,500 per month.
 - A compensation payment of M3,000 payable annually to a former employee, who was injured and permanently disabled while on duty.
 - A penalty payment of M2,500 for failure to pay income tax withheld from the salaries of taxable employees. Baba does not keep a proper record of salary payments made to his employees.
- Baba contributes to an employer pension fund on behalf of his non-casual employees only. There are two non-casual employees. The first employee is the foreman, who earns M82,000 per annum. The second employee is the assistant to the foreman, who earns M78,000 per annum. The total contributions made to the fund in the year ended 31 March 2014 amounted to M42,000. Baba contributed M29,400, and the two employees each contributed M6,300.
- Depreciation relates to all of Baba's business assets as reflected in the fixed asset register as follows:

Assets	Acquisition date	Cost M	Depreciation M
Light general purpose truck	1 December 2012	160,000	48,000
Heavy general purpose truck	1 July 2013	250,000	75,000
Construction equipment	1 January 2014	190,000	57,000
		<u>600,000</u>	<u>180,000</u>

Baba disposed of the light general purpose truck for M161,120 on 1 June 2013.

- The finance lease instalments are in respect of a new light general purpose truck which was acquired on 1 August 2013 to replace the one sold on 1 June 2013 (as in note (4) above). Baba will pay lease rentals amounting to M10,750 (including interest) per month in arrears for the period of 24 months. The truck would have cost M198,000 if it had been purchased outright.

No entries have been made in the books of Baba in respect of this lease other than for the seven months of lease instalments paid prior to 31 March 2014.

- Insurance premiums comprise the following:
 - M7,000 payable to a non-resident insurance company.
 - M18,000 (including M5,000 for Baba's private car) payable to a resident insurance company.

Required:

- (a) Calculate the income tax payable by Baba for the year ended 31 March 2014. (18 marks)
- (b) State how the maximum allowable deduction for a self-provided pension fund is determined and calculate the maximum deduction allowable to Baba for the year ended 31 March 2014, if he only has a self-provided pension fund to which he contributes M2,000 per month. (2 marks)
- (c) Advise Baba on the following:

 - (i) the information necessary for the proper recording of withholding taxes; and (4 marks)
 - (ii) by when a year-end withholding tax return should be filed. (1 mark)

(25 marks)

- 2** Roller Milling Lesotho (RML) is a resident company, which was incorporated ten years ago. The core business of RML is to manufacture and distribute wheat and maize meal for the local market. RML's financial year-end is 31 October. RML's statement of comprehensive income for the year ended 31 October 2013 included the following information:

	Note	M
Income		
Trading income	1	1,400,000
Other income	2	163,000
Operating expenses (all attributable to the manufacturing operations)		
Marketing and advertising	3	500,000
Staff costs	4	220,000
Provision for bad and doubtful debts	5	34,000
Sundry expenses	6	210,000
Loss of factory building by fire		310,000

Notes:

1. Trading income includes insurance compensation of M400,000 received during the year for the loss of one of RML's factory buildings, which was destroyed by a fire due to an electrical fault. The adjusted cost base (ACB) of the building when it caught fire was M310,000.

RML reconstructed a similar factory building at a cost of M340,000 and this new building was brought into use with effect from 1 July 2013. The relevant depreciation at the rate of 5% was properly recorded in the books of RML as part of sundry expenses.

2. Other income comprises the following:

	M
(i) Lesotho source dividends	45,000
(ii) Foreign source dividends (gross) (the related withholding tax is M16,000)	60,000
(iii) Lesotho source interest (net)	36,000
(iv) Foreign source interest (net) (the related withholding tax is M4,000)	22,000
	<hr/>
	163,000

3. Marketing and advertising includes large scale advertising amounting to M380,000, which was incurred prior to the commencement of the new product line in an endeavour to enhance public awareness.

4. Staff costs include the following:

(i) Entertainment of staff members	M8,000
(ii) Canteen expenses for general staff members	M12,000

5. Provision for bad and doubtful debts is made up as follows:

	M
(i) Provision for doubtful debts	35,000
(ii) Bad debts written off during the year	7,000
(iii) Bad debt recovered during the year	(8,000)
	<hr/>
	34,000

6. Sundry expenses include distribution expenses of M120,000. RML uses outsourced transport services from resident contractors in order to ensure the timely delivery of its products.

Additional information

In the year ended 31 October 2012, RML's tax payable amounted to M29,000. This amount is after deducting local withholding taxes of M5,000; a foreign tax credit of M9,000; and advance corporation tax (ACT) of M18,000.

RML is a tax compliant taxpayer. All tax instalments and outstanding taxes were duly paid on the due dates.

Required:

(a) Explain the tax treatment of the following:

- (i) Insurance compensation used to reconstruct/acquire an asset of a similar nature (as in note 1).** (3 marks)
- (ii) Expenses incurred prior to the commencement of trading (as in note 3).** (2 marks)

(b) Calculate the income tax instalments paid by Rolling Milling Lesotho (RML) for the year ended 31 October 2013 and state the due date on which each instalment should have been paid. (3 marks)

(c) Calculate the tax payable by RML for the year ended 31 October 2013, and state the due date of payment.

Note: Indicate any items which are not taxable or not deductible by the use of a zero. (18 marks)

(d) Explain the effect on RML's tax position if the canteen expenses (note 4 (ii)) were incurred in respect of senior staff members only. Support your explanation with relevant calculations of any additional tax(es) payable. (2 marks)

(e) Explain the tax obligation of RML with regard to the distribution expenses of M120,000 (note 6).

(2 marks)

(30 marks)

- 3** Mokonare owns a fleet of buses which are used mainly as public transport in the highlands of Lesotho. At times, Mokonare uses some of his buses to make trips to South Africa. In addition, Mokonare owns building premises which are rented out for both residential and commercial purposes.

Mokonare is registered for value added tax (VAT) and is a tax compliant taxpayer. He would like to use a cash basis method to account for VAT because some of his tenants delay payment of their rent.

Mokonare's trading record for the month of March 2014 is as follows:

- (1) Total transport income of M85,000, comprising M78,000 for local transport and M7,000 for trips to South Africa.
- (2) Total rental income of M60,000. The rental income is all in respect of residential lettings except for M8,500 received in respect of a manufacturing building used by Api Candle Manufactures, a resident company.
- (3) A payment of M42,000 on 15 March 2014 in respect of building materials bought from DAY Hardware in Ficksburg, South Africa. The building materials were delivered by DAY Hardware to Mokonare's premises in Lesotho on 5 April 2014.
- (4) Payments totalling M15,800 for repairs and maintenance for:

	M
– Buses used for the local transport business	11,800
– Buses used for the trips to South Africa	1,200
– The residential building premises	2,800
	<hr/> 15,800 <hr/>

- (5) A payment of M3,600 for meals and refreshments. A similar amount is incurred every month solely for the purpose of entertaining Mokonare's bus drivers.
- (6) The first payment of M23,000 for the purchase of a new bus costing M230,000 on a finance lease agreement from Hansi Bargain Dealers, in South Africa.

All amounts are stated inclusive of VAT where appropriate.

Required:

- (a) **State, giving reasons, whether Mokonare is eligible to use a cash basis method of accounting for value added tax (VAT).** (2 marks)
- (b) (i) **Calculate the VAT payable by or refundable to Mokonare by the Lesotho Revenue Authority (LRA) for the month of March 2014. Your computation should clearly indicate any items which are zero rated, exempt or disallowed.** (8 marks)
(ii) **Explain the treatment of the entertainment expense (note (5)).** (1 mark)
- (c) (i) **State the general rule governing the time of supply with regard to goods.**
Note: You are not required to state any special circumstances not covered by the general rule. (2 marks)
(ii) **State, giving reasons, whether your answer in (b)(i) would differ if the building materials (note (3)) were delivered to Mokonare before 31 March 2014.** (2 marks)

(15 marks)

4 Lekau, aged 55, is a wealthy businessman who owns a network of retail outlets scattered across Lesotho. He declared chargeable income of M150,000 for the year ended 31 March 2013.

- (a)** The Lesotho Revenue Authority (LRA) was not convinced of the completeness of the income declared by Lekau, given his living standard and the pattern of his spending. An extensive audit of Lekau's businesses was conducted by the LRA and it was discovered that Lekau had under-declared his income for the year ended 31 March 2013 by M160,000.

Required:

- (i) Explain the difference between tax evasion and tax avoidance, and state whether Lekau has evaded or avoided tax.** (4 marks)
- (ii) State how additional tax in relation to false or misleading information is calculated.** (1 mark)
- (iii) Calculate the additional tax which should be payable by Lekau as a result of his under-declaration of income.** (3 marks)

- (b)** The following information relates to Lekau and his lifestyle for the year to 31 March 2013:

Private property owned by Lekau:

- Two Mercedes Benz cars for Lekau and his wife valued at M520,000 and M450,000, respectively.
- A Toyota Corolla car used by Lekau's daughter, aged 25, valued at M250,000.
- A City Golf car used by Lekau's son, aged 16, valued at M205,000.
- An up-market house valued at M1,500,000 where Lekau spends most of the time, together with his entire family. The adjusted cost base of the house is M800,000.

In December 2012, Lekau travelled to Mauritius for a holiday with his wife, daughter and son. He spent a total of M55,000 on the airfares for this trip.

Required:

Assuming that, instead of conducting an audit, the LRA officials opted to determine Lekau's tax liability based on minimum chargeable income:

- (i) Calculate Lekau's minimum chargeable income for the year ended 31 March 2013.** (6 marks)
- (ii) State, giving reasons, the amount to be treated as Lekau's chargeable income for the year ended 31 March 2013, taking into consideration his declared income of M150,000.** (1 mark)

(15 marks)

- 5 Maeba, a resident individual aged 48, is a marketing manager of Koali Breweries. Maeba also owns property in the form of building premises and land inherited from his late father in November 2010. The building premises are rented out to various business ventures.

Details relating to Maeba's different sources of income for the year ended 31 March 2014 are as below:

	Note	M
Employment		
Annual salary		320,000
Bonus		15,000
Leave pay		11,000
Housing allowance		38,400
Conference fee	1	7,300
Passage granted	2	5,000
Birthday gift		1,000
Rented property		
Rent received		120,000
Municipality rates		3,000
Repairs and maintenance	3	212,000
Land		
Disposal proceeds	4	120,000

Notes:

- Maeba attended a one-week conference in South Africa on marketing related issues in October 2013. Maeba was accompanied to South Africa by his wife. The M7,300 is in respect of a subsidy paid by Koali Breweries directly to the hosts of the conference, to cover Maeba's air ticket of M1,000, and the registration fee of M6,300. Maeba spent an additional M10,000 himself, comprising the following:
 - M1,000 for an air ticket for his wife;
 - M6,000 for accommodation and meals for himself and his wife; and
 - M3,000 for shopping done by his wife.
- During the year, Maeba was transferred to one of Koali Breweries branches located in Leribe district. The M5,000 was incurred by Koali Breweries in respect of Maeba's relocation expenses.
- Included in repairs and maintenance is M82,000 spent on the extension of one of the rented properties.
- Maeba sold half of a plot of land inherited by him in November 2010 for M120,000 in September 2013. At the time the land was transferred to Maeba, the market value of the entire plot was M150,000 and its adjusted cost base (ACB) amounted to M110,000. The ACB of the entire plot at the date of the disposal was M160,000.

Required:

(a) List the types of benefits or payments which are not included in employment income. (4 marks)

(b) Calculate the chargeable income of Maeba for the year ended 31 March 2014.

Note: Indicate any items which are not chargeable to tax by the use of zero. (9 marks)

(c) State the circumstances in which a gift is treated as part of chargeable income. (2 marks)

(15 marks)

End of Question Paper