

Fundamentals Level – Skills Module

Taxation (Lesotho)

Tuesday 2 June 2015

**Time allowed**

Reading and planning: 15 minutes

Writing: 3 hours

This paper is divided into two sections:

Section A – ALL 15 questions are compulsory and **MUST** be attempted

Section B – ALL SIX 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.

Do NOT record any of your answers on the exam paper.

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 in Section B.

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 | 20% |
| Over M51,670 | 30% |
| Personal tax credit | M6,100 |

Withholding tax rates

| | Rate of tax |
|--|-------------|
| Payments to resident contractors | 5% |
| Payments of interest by a resident to a resident | 10% |
| Payments of services contract to a non-resident | 10% |
| Payments of international transactions | 25% |
| (A lower withholding tax rate may apply under a double tax treaty entered into by the government of Lesotho) | |

**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 30%

**Fifth Schedule
(Section 16(2))
Minimum chargeable income**

The multiplication factors are:

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

The amounts specified 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% |

Section A – ALL 15 questions are compulsory and MUST be attempted

Please use the grid provided on page two of the Candidate Answer Booklet to record your answers to each multiple choice question. Do not write out the answers to the MCQs on the lined pages of the answer booklet.

Each question is worth 2 marks.

- 1** Mokoma, a widower, died in September 2012. He was self-employed. Mokoma's estate was placed in the custody of an administrator until 2018 when its beneficiary would become eligible.

The chargeable income of Mokoma's estate for the year ended 31 March 2015 was M310,000.

What is the tax payable on Mokoma's estate for the year ended 31 March 2015?

- A** M93,000
- B** M77,500
- C** M81,733
- D** M31,000

- 2** Belina, aged 65, received a lump sum amounting to M420,000 from a complying pension fund. The pension fund withheld tax of M105,000.

Which of the following actions could have resulted in avoidance of the tax of M105,000?

- (1) Re-investing the entire M420,000 into another complying pension fund
- (2) Splitting the M420,000 amongst the beneficiaries
- (3) Depositing the proceeds into a fixed deposit account
- (4) Purchasing an annuity within 90 days of payment
- (5) Depositing the proceeds into a nominated savings account

- A** 1, 2 and 3
- B** 2, 3 and 4
- C** 1 and 4
- D** 2, 4 and 5

- 3** As at the year ended 31 March 2015, Mkize partnership's trading loss brought forward from the previous year ended 31 March 2014 was M48,000. The partnership is owned by two partners who are sharing profits and losses equally. The first partner, Mofo, is a resident partner, and the second one, Kize, is a resident non-resident partner. The partnership owns two business branches. One branch operates in Maseru, another one in Ladybrand.

The trading loss arose from the business in Ladybrand.

How much of the trading loss is claimable as a deduction by Mofo and Kize for the year ended 31 March 2015?

- | | |
|----------|---------|
| (1) Mofo | M48,000 |
| (2) Kize | M48,000 |
| (3) Mofo | M24,000 |
| (4) Kize | M24,000 |
| (5) Mofo | Nil |
| (6) Kize | Nil |

- A** 1 and 2
- B** 1 and 4
- C** 3 and 4
- D** 3 and 6

- 4 Mosa's value added tax (VAT) liability was M25,500 for the tax period of April 2015. Mosa submitted a VAT return in relation thereto on 1 June 2015.

How much penalty will Mosa be charged for late submission of the VAT return?

- A M51,000
- B M255
- C M1,275
- D M765

- 5 Makara Pty uses a substituted accounting period ending 31 October as its year of assessment. For the year ended 31 October 2014, Makara's tax liability amounted to M190,000.

When is the due date for payment of the tax liability of M190,000 by Makara?

- A 31 January 2015
- B 30 April 2015
- C 30 June 2015
- D 31 December 2014

- 6 Leupa, a motor vehicle dealer, sold a second-hand motor car for M55,000 in February 2015. The motor car was originally purchased from a non-vendor for M40,000. Leupa incurred M4,500 to repair the motor car before selling it. The sale proceeds were paid to Apalo, a local vendor.

All amounts are inclusive of value added tax (VAT) at the standard rate where appropriate.

What is the VAT payable by Leupa on the sale of the second-hand motor?

- A M6,754
- B M7,700
- C M1,289
- D M1,842

- 7 Seeta sold his investment property for M2,800,000 in September 2014. The property comprised a guest house which cost Seeta M550,000 to construct in May 1998 and land which cost M35,000 when he acquired it in September 1995.

The relevant indexation numbers are given as follows:

| Period | September 1995 | May 1998 | September 2014 |
|--------------------|----------------|----------|----------------|
| Indexation numbers | 140 | 210 | 325 |

What is the chargeable gain payable by Seeta on the sale of his investment asset in September 2014?

- A M2,250,000
- B M2,215,000
- C M1,867,560
- D M1,948,810

- 8 Thato, aged 28, works as a laboratory technician at one of the public hospitals. His basic annual salary amounted to M180,000 for the year ended 31 March 2015. He incurred the following expenses during the year:
- M500 for purchase of a dust coat which he wears while on duty. The cost was reimbursed by his employer at the end of the year.
 - M4,500 for attending a two-week workshop on issues pertaining to his work. He was accompanied by his spouse. Included in the M4,500 was M1,500 for the workshop registration fee. The remaining M3,000 was paid for accommodation for himself and his spouse.

What is the allowable deduction against Thato's employment income for the year ended 31 March 2015?

- A M5,000
 - B M3,000
 - C M4,500
 - D M2,000
- 9 One of the motor vehicles of Kim Consultants was declared a write-off due to an accident in June 2014. The adjusted cost base of the motor vehicle when the accident happened was M220,000. Kim received insurance compensation of M290,000 to replace the damaged motor vehicle. The cost of the replacement motor vehicle amounted to M240,000.

If Kim were to sell the replacement motor vehicle in 2019, how much tax would have been deferred?

- A M12,500
 - B M17,500
 - C M72,500
 - D Nil
- 10 Kaloli received her taxable terminal benefits in February 2015 from her employer, which included severance payment of M30,900.

How much severance payment to Kamoli is exempt from income tax?

- A M1,200
 - B M1,300
 - C M1,400
 - D M1,500
- 11 Nthabi Tiles Manufacturers, a resident company, incurred a total cost of M140,000 for research and development expenditure for the year ended 31 March 2015. The break-down of this expenditure is given as follows:

| | M |
|------------------------------------|---------|
| – Market research | 14,000 |
| – Production equipment | 78,200 |
| – Engineering design | 40,800 |
| – Quality control (pre-production) | 7,000 |
| | 140,000 |

What is the total cost incurred by Nthabi Tiles Manufacturers which qualifies to be treated as research and development expenditure for tax purposes?

- A M140,000
- B M92,200
- C M47,800
- D M40,800

- 12** Tsotang, a Lesotho diplomat in the country of Lybia, received a foreign service allowance of M420,000 for the year ended 31 March 2015. In addition, she is entitled to a monthly M1,500 for child support from her former husband. Tsotang also owns buildings in Leribe which are rented out for residential purposes. Rental income of M252,000 was deposited into her Standard Lesotho Bank nominated savings account during the year ended 31 March 2015.

How much is the gross income of Tsotang for the year ended 31 March 2015?

- A** M690,000
- B** M671,500
- C** M269,500
- D** M252,000

- 13** Palesa is a finance manager of Lesotho Institute of Higher Learning (LIHL). On 1 April 2014, Palesa obtained a loan of M25,000 from LIHL to pay for her part-time studies, which are directly related to her current job. The loan was interest free and payable over a period of 12 months. The Central Bank of Lesotho average rate was 18% throughout the year to 31 March 2015. It is the policy of LIHL to waive 50% of the funds advanced to its employees provided that the training will improve the current knowledge and skills of the employees. LIHL is a tax exempt employer.

Which of the following is the correct tax treatment of the above transaction?

- A** No tax payable by LIHL as it is a tax exempt employer
- B** LIHL is liable for fringe benefits tax of M5,358
- C** LIHL is liable for fringe benefits tax of M1,286
- D** LIHL is liable for fringe benefits tax of M6,643

- 14** Monte is a resident individual engaged in the provision of public transport services. In his self-assessment tax return form for the year ended 31 March 2015, he reported tax payable of M65,000. His tax return was selected for tax audit. Following the tax audit, it was discovered that Monte had included some false statements to minimise his tax liability. The correct tax liability turned out to be M102,000.

What is the additional tax payable by Monte as a result of providing false statements?

- A** M1,850
- B** M74,000
- C** M37,000
- D** M3,060

- 15** The financial records of Clement Milling Ltd for the year ended 31 December 2014 showed the values of taxable fringe benefits as M360,000 in total. 20% of this amount represents the cost of exempt fringe benefits.

What is the tax deductible expense in respect of the fringe benefits provided by Clement for the year ended 31 December 2014?

- A** M123,429
- B** M72,000
- C** M195,429
- D** M360,000

(30 marks)

Section B – ALL SIX questions are compulsory and MUST be attempted

Please write your answers to all parts of these questions on the lined pages within the Candidate Answer Booklet.

- 1 (a) Niki Manufactures, a branch of a Chinese company, commenced its operations in Lesotho in October 2013. At its inception, Ling, the assistant manager who was not yet conversant with Lesotho tax laws at the time, could not understand why Niki Manufactures should be treated as a resident company.

Required:

- (i) **Based on the test(s) of residence, explain why Niki Manufactures qualifies to be treated as a resident company.** (2 marks)
- (ii) **Indicate the extent to which income of Niki Manufactures, as a branch of a non-resident company, is taxable in Lesotho.** (2 marks)

- (b) For the year ended 31 March 2015, Niki Manufacturers filed a self-assessment income tax return, reporting a chargeable income of M1,200,000. This amount is after deducting other tax deductible expenses, including the following:

- (i) Management fees of M12,500 payable to the headquarters in China.
- (ii) Hire of equipment of M18,000, used in the manufacturing process, payable to a sister branch in South Africa.

In addition, the following were revealed from the financial records of Niki Manufacturers:

- (i) Niki Manufacturers repatriates 15% of its after tax profit on annual basis to its headquarters in China.
- (ii) The interest from a fixed deposit account of M28,900 (gross) from the First National Bank in South Africa was not included in the chargeable income of M1,200,000.

Required:

- (i) **Calculate the tax on the repatriated profits of Niki Manufacturers for the year ended 31 March 2015.** (4 marks)
- (ii) **Calculate the total amount of tax which should have been withheld by Niki Manufacturers in respect of management and hire of equipment fees.** (2 marks)

(10 marks)

- 2 Mr Phuthi, aged 65, has been engaged in commercial pastoral and crop farming in Mokhotlong district for the past 15 years. In February 2014, Mr Phuthi was diagnosed with diabetes and his condition deteriorated severely since then. He decided to retire from the farming business and emigrate to Durban in South Africa to stay with his elder son.

The information below relates to the assets of Mr Phuthi which were professionally revalued and disposed of as follows:

- (1) 8 hectares of land sold for a total of M430,000 in July 2014. These 8 hectares of land included 2 hectares which were acquired by Mr Phuthi in a non-arm's length transaction from a friend in August 1999. Mr Phuthi paid M55,000 to acquire this land whose market value amounted to M62,000 on the date of acquisition. The remaining 6 hectares were acquired in December 2005 at a cost of M180,000.
- (2) A warehouse for harvested crops and some equipment sold for M70,000 in September 2014. The warehouse was constructed in May 2007 at a cost of M27,000. Due to an increase in crops harvest, Mr Phuthi had to extend the warehouse in November 2013 at a cost of M14,600.
- (3) Boreholes and windmills were sold for M80,900 in November 2014. These two assets had originally cost M38,800 when they were constructed in January 2008. Mr Phuthi spent M1,500 on an annual basis as maintenance and service costs for these assets.
- (4) Tractors and equipment were sold for M510,000 in December 2014. Their adjusted cost base amounted to M240,000 on 1 April 2014.
- (5) Livestock comprising dairy cows and sheep was sold for M240,000 in February 2015. Mr Phuthi incurred a total of M110,000 in breeding and taking care of the entire livestock.
- (6) A residential house built in 1999 at a cost of M150,000. The house was sold for M220,000 in February 2015.

Additional information

The relevant indexation numbers are given as follows:

| | |
|----------------|-----|
| August 1999 | 101 |
| December 2005 | 135 |
| May 2007 | 140 |
| January 2008 | 142 |
| November 2013 | 145 |
| July 2014 | 146 |
| April 2014 | 146 |
| September 2014 | 147 |
| November 2014 | 148 |
| December 2014 | 149 |
| February 2015 | 152 |

Required:

Calculate the chargeable gains arising on the disposal of Mr Phuthi's assets for the year ended 31 March 2015, and provide explanation(s) for any items excluded from your calculations.

(10 marks)

3 Little Flower Wholesalers (LFW), a registered value added tax (VAT) vendor, is a supplier of children's clothing. The following information is in respect of the tax period ended April 2015:

- (1) Sales amounting to M55,900.
- (2) Part-payment of M5,500 received from one customer whose debt amounting to M12,500 had been written off in September 2014. VAT had been accounted for on the relevant sale in July 2013. LFW was allowed a credit with respect to the bad debt as all the necessary conditions were met. The M5,500 is not included in the sales revenue stated above.
- (3) Quarterly rent amounting to M4,500 payable to Kamohelo Properties, a local vendor. The rent relates to a five-year operating lease agreement of M22,500 for building premises used by LFW, signed in October 2014.
- (4) A credit note was received for defective stock which was returned to a supplier on 15 April 2015. The stock for which M6,200 consideration was paid was purchased in March 2015.
- (5) Sundry expenses of M25,400.

All amounts are inclusive of VAT at the standard rate where appropriate.

Required:

- (a) **Calculate the amount of value added tax (VAT) payable by Little Flower Wholesalers (LFW) for the VAT period of April 2015.** (6 marks)
- (b) **Calculate the amount of the input VAT which LFW claimed as a credit in respect of the bad debt written off in Note (1); and state the tax period in which LFW was entitled to make the claim.** (2 marks)
- (c) **Explain the tax treatment of the operating lease agreement as in Note (3).** (2 marks)

(10 marks)

- 4 Basotholand College of Education (BCE) is one of the renowned education institutions in Lesotho. The college is in the process of restructuring its management and operating systems. The entire process is led by an expatriate, Eric, from Ireland. Eric was offered a two-year contract with effect from 1 July 2014 until 30 June 2016.

BCE offered the following remuneration package to Eric:

- (1) Monthly basic salary of M65,500.
- (2) A fully furnished house. A fair market rent for the house was M4,000 per month. Eric paid a monthly rent of M1,500 to BCE for this benefit. The amount was deducted from Eric's monthly salary.
- (3) The use of a motor car which had cost BCE M240,000 when it was purchased in February 2014. The market value of the car on 1 July 2014 was M225,000.
- (4) A non-contributory medical aid scheme. BCE pays M450 per month per person for all non-casual employees regardless of the level of seniority.
- (5) A telephone allowance of M2,000 per month payable to a resident utility company.
- (6) An approved employer superannuation fund into which BCE contributes M9,400 per month for each non-casual employee. Eric contributed M4,600 per month.
- (7) Gratuity of M350,000 on termination of the employment contract in 30 June 2016.

Required:

- (a) **Calculate the fringe benefits tax (FBT) payable by Basotholand College of Education (BCE) in respect of the benefits provided to Eric for the year of assessment ended 31 March 2015.**

Note: You should state any exempt items by the use of zero ('0').

(7 marks)

- (b) **State, in general terms, by when BCE is expected to file a tax return of fringe benefits.**

(1 mark)

- (c) **Explain how the tax position of Eric and BCE would change if BCE was a public international organisation (PIO); and support your answer with relevant tax calculations.**

(2 marks)

(10 marks)

- 5** Kumdah, a South African citizen, won a tender in December 2012 from Lesotho Road Fund (LRF) to refurbish Senqu Bridge. The construction work was scheduled for two years, starting from April 2013 to March 2015. The contract price for the entire work amounted to M1,600,000 payable by LRF in instalments over the construction period. The total contract costs were estimated by Kumdah at M800,000, split between years ended 31 March 2014 and 2015 at M590,000 and M210,000, respectively.

LRF paid the first instalment of the contract price amounting to M855,000 in October 2013. The second instalment of M585, 000 was paid in December 2014. The two instalments were paid net of the withholding tax.

Kumdah elected to be taxed by assessment irrespective of the fact that this was a one-off deal for him in Lesotho.

Required:

- (a) Calculate the tax payable by Kumdah for the years ended 31 March 2014 and 2015 respectively.**

Note: You should compute chargeable income on the basis of the percentage of completion method. All the expenses incurred by Kumdah were tax deductible. (6 marks)

- (b) (i) Explain to Kumdah the advantage of being an electing non-resident.** (1 mark)

(ii) Based on your calculations, indicate from the tax perspective whether it was advantageous for Kumdah to be an electing non-resident. (3 marks)

- (c) Mojalefa is a South African citizen and has elected to be taxed by assessment in Lesotho. He has undertaken a two-year one-off project in Lesotho, which shows a profit in the first year of assessment and a loss in the second year of assessment.**

Required:

Explain whether or not Mojalefa's loss may be set off against his Lesotho profits in the first year of the project. (5 marks)

(15 marks)

**This is a blank page.
Question 6 begins on page 14.**

- 6 JJ Motor Spares Pty Ltd, trading as JJ, is engaged in the selling of motor spare parts and accessories. In addition, JJ owns buildings which are sublet to other business merchants.

The following is JJ's summarised income statement for the year ended 30 November 2014.

| | Note | M | M |
|-----------------------------|------|---------|----------------|
| Trading income | 1 | | 450,000 |
| Less: expenses: | | | |
| Legal and professional fees | 2 | 35,000 | |
| Sundry expenses | | 145,000 | (180,000) |
| | | | <u>270,000</u> |
| Other income: | | | |
| Rental income (net) | 3 | | 50,400 |
| Investment income | 4 | | 22,600 |
| | | | <u>343,000</u> |
| Profit before tax | | | |

Notes:

- Trading income includes accounting profit of M30,000 realised from the disposal of the company's motor vehicle. The adjusted cost base (ACB) and market value at the date of disposal were M120,000 and M165,000, respectively. The motor vehicle was disposed of at its market value. The depreciation allowance calculated in accordance with the tax code was correctly included in the operating expenses.
- Legal and professional fees comprise the following:
 - M800 for renewal of trader's licence
 - M450 for penalty charge for late renewal of trader's licence
 - M500 for legal costs in respect of transfer of title deeds for new buildings acquired by JJ in September 2014.
 - M33,250 for audit fees paid to Morsels Consultants, a resident audit practice.
- Rental income is made up of the following receipts and payments:

(i) Receipts

| Date | Details | Amount M |
|------------------|---|----------------|
| 18 December 2013 | Security deposit for first quarter – 2014 | 4,050 |
| 5 January 2014 | January to March quarter | 22,950 |
| 2 April 2014 | April to June quarter | 27,000 |
| 6 July 2014 | July to September quarter | 27,000 |
| 4 October 2014 | October to December quarter | 27,000 |
| 30 Nov 2014 | Security deposit for first quarter – 2015 | 4,050 |
| | | <u>112,050</u> |

(ii) Payments

| | M | |
|--|----------|---------------|
| Insurance premium payable to: | | |
| Star-Lion insurers – Lesotho company | (10,850) | |
| Old Mutual insurers – South African company | (4,200) | |
| Extension (including M1,500 for minor repairs) costs | (45,500) | |
| Municipality rates (including M85 for December 2014) | (1,100) | (61,650) |
| | | <u>50,400</u> |
| Net income | | |

- Investment income relates to dividends received from a resident company of M14,300. The remaining M8,300 (after grossing up for M2,075 of foreign withholding tax paid) was received from a non-resident company.

Additional information:

- JJ paid dividends of M54,600 on 30 June 2014. The dividends were paid entirely out of unqualified income.
- The tax payable by JJ for the previous year ended 30 November 2013 amounted to M96,700. This amount is before deduction of the following:

| | |
|-------------------|----------|
| | M |
| Withholding taxes | 3,100 |
| ACT | 14,600 |

Required:

- (a) Calculate the total instalments payable by JJ Motor Spares Pty Ltd (JJ) for the year ended 30 November 2013. Clearly indicate your treatment of withholding taxes and ACT.**

Note: You should assume that the individual instalments were all paid on their respective due dates.

(2 marks)

- (b) Calculate the advance corporation tax (ACT) liability of JJ in respect of the dividends paid on 30 June 2014; and indicate as far as possible how the instalments paid in (a) could be utilised to settle the ACT liability.**

(2 marks)

- (c) Calculate the tax payable by JJ for the year ended 30 November 2014.**

Note: Your calculations should start with the figure of profit before tax. Indicate by the use of a zero ('0') any items of expenditure which do not require adjustment.

(11 marks)

(15 marks)

End of Question Paper