

Fundamentals Level – Skills Module

Taxation (Lesotho)

Thursday 7 June 2018



F6 LSO LIA

Time allowed: 3 hours 15 minutes

This question 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 question paper until instructed by the supervisor.

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

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

Paper F6 (LSO)

Think Ahead



The Association of Chartered
Certified Accountants

The Lesotho Institute of
Accountants

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 M58,680 | 20% |
| Over M58,680 | 30% |
| Personal tax credit | M6,960 |

Withholding tax rates

| | |
|--|-----|
| Payments to resident contractors | 5% |
| Payments of interest by a resident to a resident | 10% |
| Payments of Lesotho 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, minors, fringe benefits and electing non-residents | 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 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)** Lipetu Designers and Construction Pty, trading as Lipetu, is a resident company. In May 2016, the company was contracted by Mountain Scenery Hotel to refurbish the interior and exterior parts of the hotel. The work was scheduled to take two years starting from June 2016 to May 2018. The contract price was set at M1,800,000. The total contract cost was projected as M1,200,000, comprising M800,000 and M400,000 estimated to be in the first year and second year of the contract respectively.

Lipetu had received a total payment of M1,520,000 (net of withholding tax) from Mountain Scenery Hotel by the end of September 2017. The agreement was that the remaining balance would be paid once the contract work had been completed and confirmed to be in accordance with the agreed specifications.

Required:

- (i) Calculate the chargeable contract income of Lipetu for the years ended 31 March 2017 and 31 March 2018.** (2 marks)

- (ii) In relation to payments made by Mountain Scenery Hotel to Lipetu by the end of September 2017, explain why Mountain Scenery Hotel is justified in withholding tax on payments; and calculate the total amount of tax withheld on the payments.** (3 marks)

- (b)** Gumby Ltd, a South African based company, was contracted by the government of Lesotho to reconstruct Seaka bridge in Quthing district. The contract was for three years and commenced on 1 April 2016. The chargeable income of Gumby Ltd calculated on the basis of percentage of completion over the three-year period is given as follows:

| Year | 1 | 2 | 3 |
|-------------------|--------|--------|--------|
| Chargeable income | 86,400 | 57,600 | 48,000 |

During the course of year three, the actual contract costs escalated due to unanticipated expenses to the extent that an overall contract loss of M60,000 was realised at the end of the contract.

Required:

- (i) Explain the tax relief which is available to Gumby Ltd in respect of the overall contract loss of M60,000.** (2 marks)
- (ii) Assuming Gumby Ltd claims the maximum relief available for any losses, calculate Gumby Ltd's taxable profits for each year over the three-year contract period.** (3 marks)

(10 marks)

- 2 Toka, an entrepreneur aged 65 years, retired from his business on 1 October 2017 due to ill health. On that date, he disposed of some investment assets in order to have access to cash for medical bills. The assets were disposed of at their market values as follows:

| | Note | Original cost M | Market value October 2017 M |
|-------------------|------|-----------------------|-----------------------------------|
| Unimproved land | (1) | 24,000 | 64,800 |
| Shares | (2) | 98,500 | 118,300 |
| Building premises | (3) | 550,400 | 2,100,000 |

Notes:

- (1) The land was acquired at a negotiated price from Toka's uncle in December 2006. The market value of the land on the date of acquisition was M36,000. Toka had planned to use the land for business purposes but never did.
- (2) Toka purchased the shares in June 2000 from his business partner at a reduced price. The market value of the shares on the date of purchase was M120,500.
- (3) The building premises were rented out to various business people. The rental income of the premises amounted to M26,000 per month. Toka realised a loss of M179,000 from his rental business in the previous year of assessment ended 31 March 2017.

The premises had been constructed on land purchased by Toka at a cost M46,700 in September 2005. The construction was completed at a total cost of M550,400 and the premises were readily available for use in November 2007.

Toka made the following renovations to the premises:

| | |
|--------------|--|
| August 2016 | M54,300 for sealing the leaking roof and minor repairs (this was properly accounted for in the relevant year). |
| | M40,500 for construction of a car park for customers. |
| October 2017 | M45,300 for a security wall around the entire compound. |

Required:

Calculate Toka's chargeable income for the year ended 31 March 2018.

Note: Relevant price indices are as follows:

| | |
|----------------|-----|
| June 2000 | 125 |
| September 2005 | 180 |
| December 2006 | 183 |
| November 2007 | 190 |
| August 2016 | 235 |
| October 2017 | 238 |

(10 marks)

- 3 Shiny Beauty, a vendor, specialises in the provision of hairdressing services. Shiny Beauty also sells hair and beauty products. The following are the value added tax (VAT) related transactions of Shiny Beauty for February 2018:

| | Note | M |
|---|------|--------|
| Revenue | | |
| Services (exclusive of VAT) | (1) | 55,300 |
| Sales of hair and beauty products (inclusive of VAT) | | 18,500 |
| Expenses (all inclusive of VAT where applicable) | | |
| Electricity | | 6,200 |
| Water consumption | | 2,100 |
| Hair and beauty products purchased | | 21,700 |
| Rent paid to a vendor | | 4,500 |
| Bad debt | (2) | 450 |

Notes:

- (1) M6,800 included in services revenue represents services rendered on credit during the month of February 2018, which are not yet paid up.
- (2) The M450 bad debt expense relates to services provided to a customer on credit during the past six months. It has been proved beyond reasonable doubt that the debt is irrecoverable, and it was written off during the month of February 2018.

Required:

- (a) Explain the general rule for determining the time of supply for goods or services.

Note: You are not required to provide any special circumstances which are not covered by the general rule.

(2 marks)

- (b) Explain whether Shiny Beauty qualifies for any bad debt relief in the tax period ended February 2018.

(3 marks)

- (c) Calculate the VAT payable by Shiny Beauty for the month of February 2018.

Note: Your answer should clearly indicate items on which input VAT is exempt, zero rated or not claimable.

(5 marks)

(10 marks)

- 4 Namane, a resident individual, is the manager of Lesotho Children Charity (LCC), a tax exempt employer, earning an annual basic salary of M590,000. Withholding tax on employment income (PAYE) of M155,000 was deducted from Namane's basic salary for the year ended 31 March 2018.

In addition to his basic salary, Namane received the following benefits and payments from LCC for the year ended 31 March 2018:

- (1) Use of a motor car which cost LCC M430,000 when it was purchased in July 2015. The market value of the motor car was M380,000 when it was provided to Namane in September 2016. The current market value of the motor car is now M320,000. Namane pays M1,500 per month to LCC for provision of this benefit.
- (2) A medical aid scheme into which LCC contributes M800 per month for every employee, including Namane.
- (3) An approved employer superannuation fund into which LCC contributes M10,000 per month for Namane.
- (4) A provision of free meals and refreshments at any luxurious suite at an annual cost of M4,500 per person. This benefit is provided to Namane and other senior officers of LCC only.
- (5) Reimbursements of water and electricity utility payments which are substantiated by supporting documents to the maximum of M10,500 in total per annum. Namane submitted supporting documents to the value of M14,200.

Required:

- (a) **State the four types of payments or benefits from an employer as provided by the Income Tax Act, which are excluded from employment income.** (2 marks)
- (b) **Calculate the fringe benefits tax (FBT) payable by LCC in respect of the fringe benefits provided to Namane for the year ended 31 March 2018.**

Note: Indicate any items not giving rise to an FBT liability by the use of a zero (0). (8 marks)

(10 marks)

- 5 Thato, aged 55 years, was employed on a three-year written contract from January 2015 until December 2017, as the marketing manager by Telecoms Pty. Thato also runs his own catering business and has rental income. The following information relates to Thato's different sources of income for the year ended 31 March 2018:

Employment income

- (1) Thato received a basic monthly employment income of M34,800 evenly throughout the life of the contract.
- (2) During the year Thato received a total reimbursement of M14,700 from Telecoms Pty in respect of motor car expenses. Thato used his motor car for both private and business assignments, travelling a total distance of 1,400 km, of which 600 km were business related. Telecoms Pty reimbursed Thato for both his private and business travel at a rate of M10.50 per km.
- (3) Thato incurred the following expenses:
 - (i) Interest of M5,700 per annum on a bank loan used to purchase the motor car referred to in (2) above.
 - (ii) Total annual subscriptions of M5,700. M3,200 represented a professional subscription relevant to Thato's employment. The remaining M1,800 was paid to a golf club for Thato to mingle and network with prospective clients.
 - (iii) Travel expenses totalling M1,900 to attend an annual conference relevant to his employment. Thato travelled with his spouse who happened to have the same career interest as Thato's but Thato paid for all their travel expenses.
- (4) Thato's contract included a terminal benefit of M350,784, payable upon expiry of tenure of office. The gratuity was calculated based on 28% of basic salary.

Other sources of income

Catering business income

Thato owns a catering business. During the year, he received total revenue of M54,700. 65% of this amount was received net of 5% withholding tax from one of the government hospitals which contracted Thato to provide food and refreshments to the in-patients at the hospital. The remaining 35% was received gross from various different clients. Thato's tax deductible expenses amounted to M10,500.

Rental income

Thato receives rental income amounting to M30,000 per annum from his five-roomed house which has been rented out for the past five years. Thato has never declared this income to the Lesotho Revenue Authority (LRA) on the basis that he considers it as exempt income because it is derived from property of a personal nature.

Required:

- (a) **Advise Thato of his tax obligations in relation to the rental income derived from his rented house and explain, in general terms, whether he is liable for any penalties.** (2 marks)
- (b) **Calculate the income tax payable by Thato for the year ended 31 March 2018 and state the due date of payment.** (11 marks)
- (c) **Explain the circumstances under which the terminal benefits are exempt from income tax.** (2 marks)

(15 marks)

6 Tau Shoes Manufacturer ('Tau Shoes') is a resident company which specialises in the manufacture of a variety of training shoes. The company owns a number of retail outlets across the country where its products are sold. The following information relates to the company's trading results for the year ended 31 March 2018:

1. The company had total turnover of M870,420, comprising the following:
 - (i) Manufacturing income of M550,120, inclusive of value added tax (VAT) at a rate of 14%.
 - (ii) Retail trade income of M320,300, net of all the tax deductible expenses.
2. Net interest of M38,160 was received from local financial institutions.
3. An accounting profit of M65,800 was realised from the sale of one of the company's light general purpose trucks. Tau Shoes had purchased the truck for M180,500 on 1 August 2015. The company received proceeds of M117,781 from its sale on 31 October 2017.
4. Operating expenses of M206,000 (all attributable to manufacturing income) comprised the following:
 - (i) Depreciation expense of M148,600. This relates to annual accounting depreciation of M45,125 for the company's truck disposed of on 31 October 2017 as stated in (3) above, and M103,475 for other assets of the company which were depreciated in accordance with the relevant tax provisions.
 - (ii) Entertainment costs of M35,400 relating to the employee Christmas party.
 - (iii) Other operating expenses (all tax deductible) of M22,000.
5. Finance costs of M54,200 comprised the following:
 - (i) Overdraft interest of M5,600.
 - (ii) Interest of M43,800 on a long-term loan.
 - (iii) Municipality taxes of M4,800.

Additional information:

- (i) The capital of the company is made up of equity capital of M52,700 and long-term debt of M310,500.
- (ii) All the income tax instalments for the year ended 31 March 2018 were paid on their due dates. Each instalment amounted to M22,300.

Required:

- (a) Calculate the corporation tax payable by Tau Shoes Manufacturer for the year ended 31 March 2018.**
(13 marks)
- (b) State the due dates for each income tax instalment and the due date for tax payable by Tau Shoes Manufacturer for the year ended 31 March 2018.**
(2 marks)

(15 marks)

End of Question Paper