

Fundamentals Level – Skills Module

Taxation (Malawi)

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 Public Accountants Examination Council of Malawi

ACCA



Paper F6 (MWI)

SUPPLEMENTARY INSTRUCTIONS

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

TAX RATES AND ALLOWANCES

The following rates of tax and allowances are to be used when answering the questions.

Income tax rates: Individuals

K		Cumulative K
0 – 240,000	0%	0
240,001 – 300,000	15%	9,000
300,001 +	30%	–

Company rate

Locally incorporated	30%
Externally incorporated	35%

Annual allowance – rates

(Guidelines laid down by the Commissioner of Taxes)

5%	– Industrial buildings
	– Railway lines
	– Farm improvements
10%	– General plant and machinery
	– Trailers
	– Farm fencing
15%	– Mobile cranes
17.5%	– General plant and equipment on double shift
20%	– Motor cycles
	– Cars
	– Pick-ups
	– Light lorries (for light work)
	– Cement mixers
	– Tractors
25%	– Light lorries (for heavy work)
	– Tippers
	– Tracked tractors
	– Tree-dozers
	– Scrapers
	– Graders
	– Bulldozers
	– General plant and equipment working 24 hours a day
	– Tractors (for heavy work)
	– Transport services
40%	– Computers

Value added tax

Standard rate	16·5%
Zero rate	0%

Capital gain indices

Year	CPI	2014 conversion factor
2003	154·20	2·6152
2004	172·00	2·3459
2005	198·50	2·023
2006	226·10	1·7846
2007	244·10	1·6530
2008	265·40	1·5203
2009	287·70	1·4025
2010	309·05	1·3058
2011	332·00	1·2131
2012	403·00	1·1200
2013	415·25	1·0000

ALL FIVE questions are compulsory and MUST be attempted

- 1** Deluxe Engineering Limited (DEL), a company incorporated in Malawi, is a subsidiary of Mango Limited, which is also a company incorporated in Malawi. DEL is involved in the manufacturing of bus bodies and trailers and makes up its financial statements to 31 December each year.

The following are the results of DEL for the year ended 31 December 2013.

	Note	K	K
Sales of bus bodies and trailers			237,650,450
Less manufacturing costs	1		(142,560,200)
Gross profit			95,090,250
Less expenditure:			
Salaries		20,452,800	
Rental paid	2	2,100,000	
Administrative expenses	3	32,500,000	
Finance costs	4	4,500,000	
Management fees	5	25,000,000	(84,552,800)
			10,537,450
Other income:			
Rent receivable	6	600,000	
Profit on the sale of fixed asset	7	32,500	
Bank interest received		175,000	
Dividend received		62,500	870,000
Net profit for the year			11,407,450

Notes:

1. Manufacturing costs include:

	K
Wages of factory employees	33,000,000
Depreciation of plant and factory	7,500,000
Provision for losses of materials	155,000
Pension contributions	6,600,000

The company contributes 20% of each employee's salary to the pension fund.

2. The rental paid is all in respect of the general manager's house.
3. Administrative expenses include:

	K
Depreciation	10,589,000
Pension contributions (20% as in (1) above)	4,090,560
Fringe benefits tax	919,500
Donation to a local church	35,000
Subscription to engineering magazines	65,000
Staff Christmas party	250,000

4. Finance costs are made up of:

	K
Interest on a loan to finance raw materials	2,689,100
Increase in the provision for doubtful debts (1% of debtors)	712,950
Bad debts written off	545,250
Impairment of goodwill	237,500
Penalty for late payment of taxes	315,200
	4,500,000

5. The management fees are as charged by DEL's holding company, Mango Limited.
6. Rent receivable is in respect of surplus office space which has been rented out. The amount is stated gross of 15% withholding tax.
7. A computer was disposed of during the year. Details of the sale are as follows:

	K
Cost	225,000
Fair value adjustment	(35,000)
Depreciation	(145,000)
	<hr/> 45,000
Sale proceeds	77,500
	<hr/> 32,500
Profit on sale	<hr/> 32,500

The tax written down value of the computer as at 1 January 2013 was K28,500.

Additional information:

- (i) The tax written down values of DEL's assets as at 1 January 2013 were:

	K
Factory building	130,500,000
Plant and machinery	65,750,000
Motor vehicles:	
– Pickups	12,850,000
– Passenger carrying cars	22,465,500
Computers	5,425,000
Furniture and equipment	6,375,000

- (ii) The following additions were made to fixed assets during the year:
 - A Toyota Fortuner was bought for a new manager at cost of K8,500,000.
 - Three new desk top computers were bought for K275,000 each.
 - A new laptop computer was bought for K325,000.
 - An extension was made to the factory at a cost of K650,000. The extension to the factory building included a supervisor's office at a cost of K85,000. At the request of the contractor, the extension to the factory building was all paid for in cash.
- (iii) Provisional tax of K3,000,000 was paid during the year.
- (iv) DEL has a valid withholding tax exemption certificate, but Mango Limited does not.

Required:

- (a) On the basis that all expenses and purchases are stated gross of any applicable withholding tax, calculate the withholding tax deducted and remitted by Deluxe Engineering Limited for the year ended 31 December 2013. (3 marks)
- (b) Prepare Deluxe Engineering Limited's capital allowances computation for the year ended 31 December 2013. Clearly identify the total capital allowances for the year and the tax written down values (TWDVs) carried forward as at 31 December 2013. (11 marks)
- (c) Compute the taxable income of Deluxe Engineering Limited for the year ended 31 December 2013. (8 marks)
- (d) Calculate the tax payable by Deluxe Engineering Limited for the year ended 31 December 2013. (3 marks)
- (e) Identify and calculate the additional taxes which would be payable by Deluxe Engineering Limited for the year ended 31 December 2013, if Mango Limited were a foreign company. (5 marks)

(30 marks)

2 Mabvuto Soko runs a wholesale shop. His wife, Esmie, works in the shop.

The results of the business for the year ended 30 June 2013 are as follows:

	K	K
Turnover		25,000,500
Less cost of sales		
Opening stock	345,890	
Purchases	16,500,400	
Closing stock	(765,400)	(16,080,890)
Gross profit		8,919,610
Less expenses:		
Salaries and wages	3,456,000	
Depreciation	455,000	
School fees	445,000	
Traffic fines	65,000	
Selling expenses	895,000	
Interest paid	188,000	
Electricity and water	122,500	
Rent of shop	1,200,000	(6,826,500)
Profit for the year		2,093,110

Additional information:

- Salaries include a salary for Esmie of K1,560,000, on which PAYE has been duly deducted; and drawings of K575,500 taken by Mabvuto.
- The school fees were paid for the couple's children, who attend the Bwaila School.
- A pick-up vehicle is used in the business and the capital allowances for the year ended 30 June 2013 have been agreed at K460,000.

Mabvuto is also employed as an engineering manager at the electricity board. His earnings from employment for the year ended 30 June 2013 were:

	K
Earnings from employment:	
Salary	6,000,000
Bonus	450,000
Benefits from employment:	
Housing allowance	600,000
Telephone allowance	65,000
Water allowance	75,000
Free electricity	95,000
Free use of a company car, which had cost K8,000,000 two years ago.	

Mabvuto and Esmie's other earnings for the year ended 30 June 2013 were:

	Mabvuto K	Esmie K
Dividend received (net)	75,000	
Director's fees	125,000	
Interest received	110,000	22,000
Rental income		345,000

The rental income relates to a property owned by Esmie in Chirimba. The rentals were paid without deduction of withholding tax. All remaining items are stated gross of withholding tax.

Expenses relating to the property for the year were:

	K
City rates	32,000
Plumbing maintenance	22,000
Building of a new driveway	125,000

Required:

(a) Explain how the benefits provided to Mabvuto Soko will be taxed.

Note: Calculations are not required for this part. (4 marks)

(b) Compute the taxable profits of Mabvuto Soko's wholesale business for the year ended 30 June 2013.

(4 marks)

(c) Calculate the tax payable on Mabvuto Soko's employment earnings for the year ended 30 June 2013.

(3 marks)

(d) Calculate the total tax payable by Mabvuto and Esmie Soko for the year ended 30 June 2013.

Note: Indicate any items which are not taxable or not deductible by the use of a zero. (14 marks)

(25 marks)

- 3 Bwanoni Limited is a trading company (buying and selling assorted items) which makes taxable supplies for the purposes of value added tax (VAT).

The following VAT return was submitted by the company for the period ended 31 March 2014:

	Notes	Value K	VAT K
Sales and other outputs	1 and 2	26,550,000	4,380,750
Underpayment from previous period	3	–	32,500
Value of zero rated supplies		825,000	0
Total value and VAT due on outputs		<u>27,375,000</u>	<u>4,413,250</u>
Value of exempt supplies		345,200	0
Purchases and other expenses	4	22,500,000	3,712,500
Capital goods	5	6,500,000	1,072,500
Excess VAT brought forward from the previous period less application for refund		–	0
Other adjustments		–	0
Zero rated purchases and other expenses		650,000	0
Total value and VAT on inputs		<u>29,995,200</u>	<u>4,785,000</u>
VAT payable/credit			<u>(371,750)</u>

The following information was discovered when the return was reviewed:

- The company had sold a motor vehicle to a member of staff for K350,000. No VAT was charged on this sale and it had not been included in the sales figure.
- A deposit of K120,000 had been paid by a customer in March 2014 for goods to be delivered in April. This amount had not been included in the sales figure.
- The underpayment from the previous period relates to a discount granted to a customer of K96,970 and a debit note issued to a customer who was undercharged by K100,000.
- The following items are included in purchases and other expenses:

	K
Hotel expenses	145,900
Purchase of a stock of motor vehicle spare parts	75,500
Rental of residential property	600,000
Repairs to warehouse	345,500
Purchase of goods for resale from a supplier who is not registered for VAT	5,500,000

- Capital goods are made up of:

	K
Purchase of a saloon car	4,000,000
Purchase of office furniture	2,500,000
	<u>6,500,000</u>

- Bad debts amounting to K650,000 were recorded in the books during the period but these were not recorded on the VAT return.

Required:

- (a) Explain the correct value added tax (VAT) treatment of each of the items referred to in (1) to (6) above.
(8 marks)
- (b) Prepare an adjusted VAT return for the period ended 31 March 2014, showing the correct VAT amount payable or to be carried forward.

Note: You should include all of the headings listed in the original return, together with their value and any related VAT amount, even if this is zero.
(7 marks)

(15 marks)

- 4 (a) List the types of expenditure incurred by persons involved in mining operations which are specifically allowable in determining taxable income and state the basis on which they are deductible. (6 marks)

- (b) JNJ Mining Limited (JNJM) mines coal. The company's income statement for the year ended 31 December 2013 is as follows:

	Notes	K
Turnover		60,300,000
Operating costs	1	(24,216,000)
Gross profit		36,084,000
Administration expenses	2	(27,155,000)
Profit before taxation		8,929,000

Notes:

1. Included in operating costs are:

	K
Premium paid to the government to acquire the right to use the land for mining for a period of 20 years	3,600,000
Depreciation	2,961,000
Royalties	2,716,000

2. Included in administration expenses is K1,200,000 paid towards the cost of putting up a clinic for the community around the mine. This is part of the social responsibility programme adopted by JNJM.

Additional information:

- (i) During the year, JNJM acquired some specialised equipment at a cost of K6,000,000. This cost was capitalised.
- (ii) JNJM has tax losses brought forward from the previous period of K5,000,000.

Required:

Calculate the income tax payable by JNJ Mining Limited for the year ended 31 December 2013.

(6 marks)

- (c) State by when a company is required to submit its self-assessment return and pay the balance of any tax due to the Commissioner General. State the penalty payable by a company which fails to file its return on time. (3 marks)

(15 marks)

- 5 Millennium Limited, a highly profitable company, is considering employing an additional sales manager. Two alternatives have been proposed for the sales manager's remuneration package, as follows:

	Option 1 K	Option 2 K
Salary	3,511,600	2,450,000
Bonus	600,000	n/a
Commission on sales	–	2% of sales
Pension – employer's contribution	10% of salary	10% of salary
Pension – employee's contribution	5% of salary	5% of salary
Housing allowance	n/a	800,000
School fees	750,000	n/a
Use of a company car which will cost the company K6,500,000 to purchase (option 2 only)	n/a	Free use

Additional information:

1. Sales are expected to be K70 million per annum.
2. The school fees will be paid directly to the school.

Required:

- (a) Prepare calculations to determine which of the options (1 or 2) will result in:

- (i) the lower annual expenditure by Millenium Limited; and (6 marks)
- (ii) the higher after tax annual take home pay for the sales manager. (6 marks)

- (b) Briefly comment on the results of your calculations in part (a)(i) and explain why as financial controller of Millenium Limited you might advise against the adoption of the apparently 'lower cost' option. (3 marks)

(15 marks)

End of Question Paper