Fundamentals Level – Skills Module

Taxation (Malawi)

Tuesday 3 December 2013

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.

Paper F6 (MWI)

The Association of Chartered Certified Accountants

The Public Accountants Examination Council of Malawi

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 – 180,000	0%	0
180,001 – 240,000	15%	9,000
240,001+	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	2013 conversion factor
2003	154·20	2·6042
2004	172·00	2·3346
2005	198·50	2·023
2006	226·10	1·776
2007	244·10	1·6450
2008	265·40	1·5130
2009	287·70	1·3957
2010	309·05	1·2993
2011	333·77	1·2031
2012	358·54	1·1200

ALL FIVE questions are compulsory and MUST be attempted

1 Phiri Dengu Limited (PDL) is an agro-processing company incorporated in Malawi, which sells its products both on the local and export markets. PDL prepares its financial statements to 30 June each year.

The following is a statement of PDL's income for the year ended 30 June 2013.

The information is given to the nearest K'000.

	Note	K'000	K'000
Turnover			
– Local sales	1		28,500
– Export sales			42,000
			70,500
Less: Cost of sales			
– Local sales	2	15,600	
– Export sales	3	30,000	(45,600)
Gross profit			24,900
Less:			
Financial expenses	4	8,500	
Operational expenses	5	12,600	(21,100)
			3,800
Add:			
Dividends from local companies		1,200	
Proceeds from sale of a house	6	4,500	
Proceeds from sale of a motor vehicle	7	850	
Net interest	8	650	7,200
Profit before tax			11,000

Notes:

1. Local sales are stated gross of value added tax (VAT) at 16·5%. Withholding tax at 3% was deducted from all local sales.

2. The local cost of sales includes:

	K'000
Wages	2,600
Depreciation	1,500
Transport	785
Advertising	850
Stock of produce	3,550

The stock of produce is the balance of produce which had not been processed by the year end

3. The export cost of sales includes:

	K'000
Depreciation	800
Wages	1,289
International transport	15,000
Packaging materials	8,500

4. Financial expenses include:

	K'000
Audit and accountancy	3,000
Consultancy for advice on a capital restructuring	1,895
Tax penalties	1,205
Payroll costs	895

5. Operational expenses include:

	K'000
Depreciation	3,350
Fringe benefits tax	785
Salaries	4,500
Donations (all disallowable)	985
Export licence	180
Pension contributions (16% of employee salaries)	1,345
Medical aid costs	230

6. The house which was sold had been used as a guest house. It had cost K1,500,000 in 2005. No depreciation was charged on this property. The house was sold in December 2012.

7. The motor vehicle sold was a car, and it was sold to the employee who had use of the car as a company car. PDL had had the vehicle valued by a dealer, who stated that the commercial price on sale was K1 million.

   The tax written down value of the vehicle as at 1 July 2012 was K750,000 and its net book value was K650,000.

8. Interest is made up of:

	K'000
Interest on overdue customer accounts	150
Bank deposit interest (see (i))	1,375
Loan interest (see (ii))	(225)
Bank overdraft interest	(650)
	650

   (i) The bank interest is stated gross of withholding tax of 20%.

   (ii) The loan interest was on a loan taken out to buy shares in OLM Co, as an investment. PDL receives dividends from OLM Co and these dividends are included in income in the financial statements.

Other information:

1. PDL owns assets, which it uses in its business, in each of the following categories: factory buildings, offices, houses, plant and machinery, motor lorries and motor vehicles.
2. Capital allowances before any balancing allowances or charges for the year ended 30 June 2013 have been agreed at K6,250,000.
3. Provisional tax paid for the year was K1,200,000.

Required:

(a) Other than annual allowances, state the capital allowances available to Phiri Dengu Limited as a manufacturer, stating when they may be claimed. (6 marks)

(b) Explain and calculate all the taxes which should have been paid as a result of Phiri Dengu Limited selling the motor vehicle to the employee at less than market value (note 7). (6 marks)

(c) Compute the taxable income of Phiri Dengu Limited for the year ended 30 June 2013. (15 marks)

(d) Calculate the tax still to be paid by or refundable to Phiri Dengu Limited for the year ended 30 June 2013. (3 marks)

(30 marks)

2 On 1 July 2012, Mayeso and Chakudza entered into a partnership to trade in produce under the name Mapeto Produce Trading. The partnership agreement states that they will share profits 60:40. These profit shares have been based on their respective capital contributions to the business and will be computed after charging both salaries and interest on capital.

The income and expenditure statement for Mapeto Produce Trading for the year ended 30 June 2013, its first year of operation, is as follows:

	Note	K	K
Income			
Capital introduced:	1		
by Mayeso			600,000
by Chakudza			400,000
Sales of produce			8,500,000
Bank interest received (gross)			125,000
Sales of used packing materials			65,000
			9,690,000
Less: Expenditure			
Salaries	2	3,500,000	
Purchase of produce		4,500,000	
Purchase of assets:	3		
– a 3-tonner lorry		1,850,000	
– a motor vehicle (pool car)		450,000	
– two laptops		300,000	
School fees for Mayeso's child	4	165,000	
Rental for warehouse		550,000	
Printing and stationery		45,000	
Maintenance of vehicles		235,000	
Fuel		354,000	(11,949,000)
Loss for the year			(2,259,000)

Notes:

1. The partnership agreement states that interest at 10% on the capital introduced is to be paid at the end of each year. This interest has not been included in the income and expenditure statement above.
2. Included in salaries are the salaries paid to the partners as follows:

	K
Mayeso	850,000
Chakudza	700,000

PAYE was deducted from the salaries of the partners and remitted to the Revenue Authorities on the due dates.

3. No depreciation has been charged in the income and expenditure statement.
4. The school fees for Mayeso's child had been paid to Mayeso.

Other information:

(i) The partnership paid provisional tax of K500,000 during the year.

(ii) Mayeso has no other sources of income. However, Chakudza had other income in the year ended 30 June 2013 as follows:

	K
Interest from a savings account in a local bank (net amount received)	45,000
Dividends from a local company	6,500
Wife's salary (from an employment independent of the partnership)	465,000
Sale of his personal car (not a partnership asset) which had been bought for K400,000 in 2011	650,000

Required:

(a) State how the income of a partnership is taxed, including who is responsible for submitting the tax return(s). (3 marks)

(b) Compute the taxable profit of the partnership for the year ended 30 June 2013. (8 marks)

(c) Show the allocation of the partnership profit between the partners. (6 marks)

(d) Calculate the tax to be paid by or refunded to Chakudza for the year ended 30 June 2013.

Note: Indicate items which are not taxable or not allowable by the use of a zero. (7 marks)

(e) State when provisional tax is paid. (1 mark)

(25 marks)

3 **(a)** John Mwasi is a retailer who is registered for value added tax (VAT) and operates under the retailer's special scheme as approved by the Commissioner.

John had the following transactions in the month of June 2013:

	K
Total gross takings	5,545,600
Exempt supplies	2,580,000
Total purchases for resale bought in the month	3,650,000
Total purchases of taxable goods in the month	2,256,800

Required:

(i) **Explain how output tax is calculated under the retailer's special scheme when a retailer makes both taxable and exempt supplies, including how any subsequent adjustments will be made to the output tax payable.**

Note: No computations are required in this part. (4 marks)

(ii) **Calculate John Mwasi's output tax for the month of June 2013, using each of the options available.** (3 marks)

(b) Piringu Properties Limited (PPL) is a company involved in the development of both commercial and residential properties, for both sale and rental. All rentals are billed and received three months in advance.

In June 2013 the following transactions took place:

– residential property rents of K1,300,000 were billed and received;
– a residential property was sold for K6,500,000;
– commercial property rents of K2,400,000 were billed and received; and
– a commercial property was sold for K8,500,000.

PPL incurred the following expenditure during the month of June 2013:

	K
Salaries and wages	3,580,000
Telephones for administration offices	125,000
Security charges (see note)	435,000
Water and sewerage charges	115,000
Electricity charges for administration offices	95,000
Rental of office building	435,000
Maintenance costs for pick-up vehicle	215,000
Fuel	175,000
Purchase of a photocopying machine	600,000

Note: The security charges are shared as to: 50% for the commercial properties, 30% for the residential properties and 20% for the administrative offices.

The above figures are all stated excluding value added tax (VAT).

Required:

Calculate the net value added tax (VAT) payable or carried forward by Piringu Properties Limited for the month of June 2013.

Note: Indicate any transactions which do not result in output tax or to a claim for input tax by the use of a zero. (8 marks)

(15 marks)

4 Munali Sports Club is a club formed for recreational purposes, whose takings come solely from dealings with members of the club.

The Club prepares its financial statements to 31 December each year and the following figures have been extracted from the Club's income and expenditure statement for the year ended 31 December 2012.

	K
Subscriptions received	1,350,000
Entrance fees received	106,000
Bar sales	4,850,000
Restaurant sales	2,758,500
Drama shows	450,000
Video shows	175,000
Bank interest received	185,000
	9,874,500
Bar expenses	3,505,860
Depreciation	985,000
Restaurant expenses	1,258,000
Salaries and wages	3,156,600
	8,905,460
Surplus of income over expenditure	969,040

Additional information:

1. The bank interest is stated gross before the deduction of withholding tax.
2. The Club paid provisional tax of K45,000 during the year.

Required:

(a) **Explain how the taxable income of a club formed solely for recreational purposes is determined.** (4 marks)

(b) **Calculate the tax to be paid by the Munali Sports Club for the year ended 31 December 2012.**

Note: Indicate any items which are not taxable or expenses not deductible by the use of a zero. (5 marks)

(c) Certain transactions require the taxpayer to obtain a tax clearance certificate before they can be finalised.

Required:

List any SIX transactions which require a tax clearance certificate. (6 marks)

(15 marks)

5 Bestheza Company Limited is a company which manufactures consumer goods. The company has always sold its products through wholesalers who are not related to it, but is now considering establishing its own wholesale unit.

The wholesale unit will be called Mwatipeza and its trading results for the next three years are expected to be as follows:

Year ended 31 December	**2013**	**2014**	**2015**
	K'000	**K'000**	**K'000**
Turnover	44,000	65,000	80,000
Gross profit	17,600	35,750	48,000
Selling expenses	(8,800)	(21,450)	(20,000)
Administration expenses	(15,400)	(9,750)	(24,000)
Profit before taxation	(6,600)	4,550	4,000
Included in administration expenses is a depreciation charge of:	855	785	800
Capital allowances are estimated to be:	1,255	890	755

The estimated taxable profits of Bestheza Company Limited excluding any profit or loss of the wholesale unit (Mwatipeza) are:

	2013	**2014**	**2015**
	K'000	**K'000**	**K'000**
	8,500	4,500	(3,500)

Required:

(a) Prepare calculations of the tax payable for each of the three years 2013, 2014 and 2015:

(i) By Bestheza Company Limited if Mwatipeza is operated as a division; and (5 marks)

(ii) By Bestheza Company Limited and Mwatipeza if Mwatipeza is operated as a subsidiary. (5 marks)

(b) Based on your calculations in (a) above, advise Bestheza Company Limited which operating strategy (division or subsidiary) is likely to be better from a tax viewpoint. (5 marks)

(15 marks)

End of Question Paper