Botswana Institute of Chartered Accountants

JUNE 2018 BUSINESS PLANNING TAXATION

MARKING KEY

(SUGGESTED ANSWERS AND MARKING SCHEME)

Question 1

Memo

From: Tax Adviser

To: Kopano Motsisi, Tax Manager

Subject: Response to issues raised in your memo

In response to the tax issues raised in your memos, kindly find appended the five exhibits responding to the tax issues.

Exhibit 1 – Salary restructure for Keitheile

The salary restructure should ensure that the maximum pension contributions are set aside for the pension.

Approved pension contributions would amount to 15% employee contributions and 20% of employer's contributions, resulting in a total reduction of 35% of her taxable income. 1

Employee's contributions are deductible from Keitheile's salary. ½

Employer's contributions are not added to Keitheile's employment income. ½

(Marks should be awarded if the candidate has opted for the gratuity in the salary restructuring)

Salary restructuring:

Tax on cash salary:	**P**	
First P144,000	13,050	
Next P696,000 x 25%	174,000	

Tax liability on P840,000	187,050	1

Proposed restructuring:		
Salary	840,000	
Less: medical aid contributions	(24,000)	1
Professional subscriptions	(8,000)	1
Rent for the house (P15,000 x 12)	(180,000)	1

	628,000	
Less employer's pension contributions 20/120	(104,667)	1

Cash salary	523,333	

Taxable employment income for Keitheile			
Cash salary		523,333	
Housing benefit – P360,000 x 10%		36,000	1

		559,333	
Less: approved pension contributions:			
P523,333 x 15%		(78,500)	1

Taxable employment income		480,833	

Tax liability on Keitheile:			
First P144,000	13,050		
Next P336,833 x 25%	84,208		

		97,258	1
Tax liability on Keitheile's husband:			
On rental income:of P180,000			
First P144,000	13,050		
Next P36,000 x 25%	9,000		
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Total tax liability		119,308	

Tax liability on cash salary		187,050	
Tax liability on restructured salary		119,308	

Tax savings		67,742	1
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Available marks			**12**
Maximum marks			**10**

Exhibit 2 – Advise on transactions between Masunga and its foreign subsidiary

An entity is free to conduct its business as it sees fit, however, where the Commissioner is of the opinion that a transaction, operation or scheme, is fictitious or artificial, or is entered into or carried out otherwise than as a transaction between independent persons dealing at arm's length and that such transaction has the effect of avoiding, reducing or postponing the liability to tax of any person for any tax year, he may disregard such transaction for the purposes of this Act and determine the liability for the tax chargeable under this Act as if the transaction had not been entered into or carried out, or in such manner as in the circumstances he deems appropriate to counteract such avoidance, reduction or postponement. 2

The transactions between Masunga Ltd and its foreign subsidiary may be deemed to be fictitious or artificial because the foreign subsidiary normally charges a mark-up of 40% to unconnected customers but charges Masunga Ltd a mark-up of 150% which resulted in the reduction of the tax liability of Masunga Ltd. 2

The Commissioner would restate the transaction as if it taken place at arm's length to ensure that the tax liability of Masunga Ltd is not reduced, as follows:

	P	
Fair value sales proceeds	900,000	
Cost of sales – arm's length mark-up P1,200,000 x 150/250	(720,000)	

Deemed profit	180,000	2

The Commissioner would disallow the calculated loss of P300,000 and include a profit of P180,000 . 1

The additional tax liability would be = P480,000 x 22% = P105 600 1

Available marks **8**

Maximum marks **8**

Exhibit 3 – Loss relief for Gasenone

Farming losses can only be relieved in one of two ways, either by carried forward and set-off against future farming income or by farmers averaging relief.

Since Gasenone wants to minimise her tax liabilities, it is best to use the relief that minimizes her tax liabilities. 1

Option 1 – Farmer's averaging relief

Farmer's averaging relief for the 3 years to 30 June 2017:

P300,000 + P0 + P240,000 / 3 years = P180,000 2

Farmer's averaging relief would result in the following chargeable farming income:

	2016	2017	2018	
Averaged farming income	180,000	180,000	180,000	
Less s.46 loss relief	-	-	(180,000)	1
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Farming chargeable income	180,000	180,000	0	
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This will result in taxable farming income of P360,000 over the 3 years.

Option 2 – S.46 loss relief

A farmer can use s.46 and set-off the farming loss against future farming income for 5 years only.

Farming income s.42	300,000	-	240,000	
Less s.46 loss relief	-	-	(240,000)	
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Farming chargeable income	300,000	-	-	1
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Option 2 will result in taxable income of P300,000 over the 3 year period to 30 June 2018. 1

Option 2 relief would result in a reduction in the taxable income of P60,000 (P360,000 – P300,000) over the 3 year period to 30 June 2018. 1

Trading and rental income are aggregated as business income and if a net loss arises, the business loss can be carried forward and relieved against future business income for 5 years. 1

Year ended 30 June	2016	2017	2018	
	P	P	P	
Employment income	240,000	264,000	290,400	1
Farming income s.42	300,000	-	240,000	
Less s.46 loss relief	-	-	(240,000)	
	540,000	264,000	290,400	
Trading income / (loss)	(450,000)	140,000	80,000	
Rental income	80,000	80,000	80,000	
Net business income/loss	(370,000)	220,000	160,000	½ x 3
S.46 loss relief	-	(220,000)	(150,000)	1 x 2
Business income	0	0	10,000	½ x 3
Total taxable income	**540,000**	**264,000**	**300,400**	
Available marks				**14**
Maximum marks				**10**

Exhibit 4 – Computation of tax payable by Lesego for tax year 2018:

		P	
Botswana taxable income		418,000	
Foreign business income (P225,000 / 72%) x 50%		156,250	1
Foreign dividends		0	½
Foreign capital gains		0	½

Total taxable income		574,250	

Tax liability / tax payable:			
First P144,000		13,050.00	
Next P430,250 x 25%		107,562.50	

		120,612.50	1
Botswana tax on foreign dividends		4,500.00	1

Tax liability		125,112.50	
Less double tax relief:			
On foreign business income, lower of:		(34,375.00)	1
• Botswana equivalent –			
○ P156,250 x 22%	34,375		
• South African equivalent –			
○ P156,250 x 28%	43,750		

On foreign dividend, lower of:		(3,000.00)	1
• Botswana equivalent –			
○ (P27,000 / 90%) x 15%	4,500		
• South African equivalent-			
○ (P27,000 / 90%) x 10%	3,000		
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Tax payable		87,737.50	6
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Exhibit 5 – Draft notes concerning the ethical implications

Ethical implications of providing advice to both Mokaila and Mokobi and how they may be overcome.

There is a clear conflict of interest arising for the firm working for both Mokaila and Mokobi which the firm must address.

The firm must check that they have engagement letters for both parties and that these do not exclude working for the other party. 1

The must notify both Mokaila and Mokobi that the firm acts for them both and ensure that this is reflected in the respective engagement letters and if necessary that the engagement letters are revised. 2

Appropriate safeguards should be set up to ensure that client's confidentiality is maintained and the independence of the firm's advice is preserved. 1

These safeguards should include informing the clients of the potential conflict of interest; using separate teams within the firm; or indeed deciding that working for both clients is not possible if the quality of advice and confidentiality is to be assured.

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Maximum marks	**6**

Total available marks	**46**
Total maximum marks	**40**

Question 2

Brief notes for the Directors of Maun Ltd relating to the year ended 31 May 2018:

i) Disposal of a branch as a going concern to a VAT registered sole trader

The disposal will occur after the tax year 2018 and consequently this transaction will not affect the draft taxable income. However, the tax implications are considered below.

Income tax implications

Only the inventories will be liable to income tax on the disposal of the branch. The taxable income will be computed as the difference between the sales proceeds and the cost of the inventories. 2

Capital gains tax implications

The brand and the goodwill will be liable to capital gains. Both would be treated as moveable properties and taxed as follows:

	Brand	Goodwill	
	P	P	
Deemed sales proceeds	200,000	150,000	
Cost	(0)	(0)	
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Un-indexed gain	200,000	150,000	
Less moveable allowance at 25%	(50,000)	(37,500)	
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Chargeable gain	150,000	112,500	2 x 2
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VAT implications

A disposal of a business as a going concern is chargeable to VAT at the standard rate. 1

However, the transfer of a going concern is exempted if the following conditions are met:

- The transferor and the transferee should be both registered for VAT. ½
- All the goods and services necessary for the continued operation of the taxable activity are supplied to the transferee. ½
- The transferor carried on the operation up to the time that the business was transferred to the transferee. ½
- The transferor and the transferee provide a notice in writing to the Commissioner General within 21 days of the transfer. ½

9

ii) Disposal of delivery truck and acquisition of a second hand light truck

The disposal and replacement of a second hand light truck within the same tax year may be entitled rollover relief as follows:

Balancing adjustment arising on the disposal of the delivery van:

	P	
Cost – August 2014	420,000	
Capital allowances		
Y/e 2015 – 2017		
P420,000 x 3 years x 25%	(315,000)	

Tax written value b/f	105,000	
Sales proceeds	(280,000)	

Balancing charge	175,000	2

Acquisition of the second hand light truck

	P	
Cost	168,000	1
Less notional input tax		
12/112 x P168,000	(18,000)	2

Cost for capital allowances	150,000	
Less rollover relief	(175,000)	<u>1</u>

Balancing charge liable to tax	25,000	
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iii) Disposal of a factory

The disposal of a factory has a number of tax implications.

Income tax implications

The disposal will generate a balancing charge equal to the industrial building allowances (IBA) granted as the factory was sold for more than its original cost.

IBAs	P	
Tax year 2012:		
Initial allowance – 25% x P1,130,000 =	282,500	
Annual allowances – tax year 2012 – 2017		
6 years x 2.5% x P1,130,000 =	169,500	

Balancing charge	452,000	2

Capital gains tax implications

There are two capital gains tax implications on the disposal of the factory, the crystallisation of the rollover gain and the computation of the chargeable gain or allowable capital loss.

Computation of the capital gain or capital loss on disposal of the factory:

	P	
Sales proceeds	1,744,241	
Less allowable cost	(1,130,000)	

Un-indexed gain	614,241	1
Indexation allowance:(1/2012 – 9/2017):		
P1,130,000 x (1807.8 – 1436.1) / 1436.1	(292,473)	1

Capital gain	321,768	

Crystallisation of rollover/heldover gain on disposal of warehouse;

Maximum amount rolled-over:	P	
Original investment	680,000	
Add chargeable gain	520,000	

	1,200,000	
Amount re-invested	(1,130,000)	

Amount not re-invested	70,000	1
Maximum amount **rolled-over**	450,000	1

Chargeable gain	520,000	

Therefore, on the disposal of the factory, the gain that was rolled-over of P450,000 on the first disposal of the warehouse will crystallise and be liable to tax in the current year. 2

VAT implications

Output VAT on the disposal of the factory will arise as follows:

P1,940,000 x 12% = P232,800 1

9

iv) Termination of contract

The damages were paid as compensation for the loss of income that would Maun Ltd would suffer as a result of the termination of the contract. The compensation will therefore be treated as income in the hands of Maun Ltd and should be added to the taxable income. 2

P612,000 should be added to the taxable income of Maun Ltd.

v) Interest free loan of P200,000 to Tibe

Tibe is a participator in Maun Ltd because she is the beneficial owner of 30% of the share capital of Maun Ltd. Therefore, the tax treatment for the interest free loan of P200,000 made to her will be subject to the rules for close company legislation. 2

Income Tax implications for Maun Ltd

The interest free loan will not be tax deductible and has no tax consequences for Maun Ltd. 1

Income tax implications for Tibe

The interest free loan of P200,000 shall be deemed to be a dividend and included in the taxable income of Tibe. 1

It will be charged to tax at the prevailing rate for dividends, that is, at 7.5%
P200,000 x 7.5% = P15,000 1

Re-computation of the taxable income for Maun Ltd for the year ended 31 May 2017:

	Note	**P**	
Draft taxable income – given		2,188,000	
Chargeable gains on disposal of the branch:	i		
• Brand		150,000	2
• Goodwill		112,500	1
Balancing charge – disposal of delivery van	ii	25,000	2
Balancing charge – disposal of factory	iii	452,000	1
Chargeable gain – disposal of factory	iii	321,768	1
Heldover gain now chargeable	iii	450,000	2
Compensation for termination of contract	v	612,000	1

Taxable income		**4,311,268**	

Total available marks			**41**
Maximum marks			**35**

Question 3

3.1 Draft notes for Mr Rantao

Capital transfer tax (CTT) payable on lifetime transfers:

Gift of shares to Mrs Rantao.

The gift of shares to Mrs Rantao is exempt from CTT under inter-spousal exemption. 2

Gift of cash to Mogagi on the occasion of his marriage:

	P	
Cash gift	100,000	
Less: marriage exemption	(5,000)	

Chargeable transfer value	95,000	1

Mogagi will be required to pay CTT of:

P95,000 x 2% =	P1,900	1

Gift of cash to all, i.e. 3, grandchildren in consideration for their education.

The exemption applicable to gifts made to the donor's children in consideration for their education or maintenance is not applicable because Mr Rantao made the gift to his grandchildren. Consequently, the gifts will be wholly taxed. 2

CTT payable by each grandchild on the P50,000:

P50,000 x 2% =	P1,000	1

CTT payable assuming that Mr Rantao died on 30 June 2018:

Any transfers, gifts or bequests etc to Mrs Rantao are exempted from CTT. 1

Transfers/gifts to Mr Rantao's children and friend will be liable to CTT as follows:

	Monyatsi	Mogagi	Koontse	
	P	**P**	**P**	
Family car – M/Benz	300,000	-	-	1
Family home – 50% share	-	1,250,000	-	1
Less share of mortgage	-	(200,000)	-	1
Lodge in Mochudi (W1)	3,303,337	-	-	2
House in South Africa	-	-	1,100,000	1
Shares in Gemstone	280,000	280,000	-	1
	3,883,337	1,330,000	1,100,000	
Less exemption	-	-	(1,100,000)	
	3,883,337	1,330,000	0	
Allowable deduction (W2)	(74,488)	(25,512)	-	2
Chargeable transfers	3,808,849	1,304,488	0	
CTT payable:				
First P500,000	16,000	16,000		
Next P3,308,849 x 5%	165,442	-		
Next P804,488 x 5%	-	40,224		
	181,442	56,224		2
				19

Workings:

1. Capital value of lodge in Mochudi held by a usufructant

$$= \frac{A \times [1 - (1/(1 + r)^{N}]}{r}$$

$$\frac{P288{,}000 \times [1 - (1/(1.06)^{20}]}{0.06}$$

= P3,303,337

2. Allowable deductions:

Monyatsi	3,883,337	74,488
Mogagi	1,330,000	25,512
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	5,213,337	100,000
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3.2 Recommendations of how Mr Rantao could minimise capital transfer tax for his beneficiaries:

Make a will

If an individual dies intestate, his or her assets are distributed in accordance with the statutory provisions which may be result in higher CTT liabilities eventually. Making a will ensures that the most efficient manner of passing on the property is provided. 2

Leave the property to the surviving spouse

Property passed on to the surviving spouse is exempt from CTT. 2

Taking advantage of exempt transfers

The donor can make transfers that are exempt from CTT such as casual gifts etc. 2

Skipping a generation

The donor can donate to his grandchildren instead of donating to his or her children. By so doing it means that the same property is unlikely to suffer double taxation within a short period of time. Double taxation would arise if the donor passed on his property to his children who would later also pass on the same property to his children (i.e. the donor's grandchildren). 2

Passing the property to a trust

Selling or donating property to a trust for selected beneficiaries will attract capital gains tax or CTT. The advantage of passing property to a trust is that the increase in the value of the property will not be liable to additional tax when the property is ultimately passed on to the beneficiaries. 2

Available marks	**10**
Maximum marks	**6**

Total Available = 29

Total Max Mark = 25