Botswana Institute of Chartered Accountants

December 2017 Business Planning: Taxation

MARKING KEY

Question 1

Draft report for the Finance Manager for Lengau (Pty) Ltd

(a)(i) This report is prepared in response to the request of the finance manager regarding the tax implications of certain transactions that occurred during the year ended 30 September 2017.

Income from South African investments

Rental income of P2,700,000

Rental income is treated as business income in Botswana.

The rental income was correctly taxed in South Africa.

If the rental income was remitted to Botswana, the rental income would be taxed in Botswana and double tax relief would be given for the South African tax suffered.

However, since the rental income was not remitted to Botswana, it will not be taxed in Botswana. **2**

Foreign dividend from subsidiary Veld Ltd

Foreign dividend earned or received is liable to Botswana tax, whether remitted to Botswana or not.

However, credit is given for the foreign tax suffered at source up to the equivalent of the Botswana tax equivalent.

In this case, there will be additional Botswana tax liability as the foreign tax suffered at source was less than the Botswana tax liability equivalent as shown below:

	P	
Gross foreign dividend P1,440,000/ 90%	1,600,000	
Botswana tax at 15% x P1,600,000	240,000	
Foreign tax suffered at 10% x P1,600,000	160,000	

Additional tax liability	80,000	**3**

Remittance from foreign branch

A remittance from the foreign branch is not a dividend but a transfer of some of the branch profits to the head office. Since the business profits are brought to Botswana, they will be liable to Botswana tax and double tax relief granted for the foreign tax suffered, as follows:

Botswana tax equivalent:	
Remittance	420,000
Underlying tax P272,000 x 420,000/698,000	164,000

Taxable gross remittance	584,000

Botswana tax equivalent at 22% x P584,000	128,480
Foreign tax suffered	164,000

Additional tax liability	0

As the foreign tax suffered is greater than the Botswana tax equivalent, no additional tax will arise on the remittance from the branch in Botswana. **3**

(ii) Tax treatment of transactions listed in Exhibit 2:

Disposal of replacement warehouse in June 2017

Capital gains tax (CGT) implications

The disposal of a replacement property will trigger tax liability on the chargeable gain that was previously rolled-over on its acquisition.

Sales proceeds	1,215,000	
Allowable cost	(500,000)	

Un-indexed gain	715,000	
Less indexation allowance:		
(1802.5 – 842.3) / 842.3 x P715,000	(815,081)	

Loss on disposal	100,081	**2**

The rollover gain that was deferredof P128,000 below now becomes liable to tax on the disposal of the replacement warehouse. **1**

Computation of heldover/rollover relief:

Minimum reinvestment amount:		
Original investment	372,000	
Chargeable gain on disposal	183,000	

Minimum reinvestment amount	555,000	
Less cost of replacement property	(500,000)	

Amount not reinvested & immediately taxed	55,000	**2**

Therefore, the gain rolled-over = P183,000 – 55,000 = P128,000 **1**

Income tax implications on disposal of replacement warehouse:

On the disposal of the warehouse, a balancing adjustment will arise. Since the warehouse was sold for more than its cost, the balancing charge will equal the capital allowances previously granted.

P500,000 x 12 years x 2.5% = 150,000 **2**

Disposal of plant and acquisition of replacement plant

Balancing charge arising on disposal of plant:

Sales proceeds	355,000	
Less TWDV b/f	(108,000)	

Balancing charge	247,000	1

Revised cost for the replacement plant:

Original cost	340,000	
Less balancing charge	(247,000)	

Revised cost for capital allowances	93,000	2

Capital allowances at 25% x 93,000	23,250	1

Tax treatment of accrued gratuities

The method adopted for accounting for accrued gratuities should be consistently applied and cannot be changed.

Since Lengau (Pty) Ltd has been deducting gratuities when they were actually paid, Lengau (Pty) Ltd must continue to an actual basis.

Consequently, the change in the treatment of accrued gratuities must be reversed as follows:

Add back the gratuities provision		1,125,000	
Deduct gratuities actually paid		(688,000)	

Increase in taxable income		437,000	2

Disposal of an expensive car

Sales proceeds		320,000	1
Cost – restricted	175,000		
Less capital allowances granted			
(P175,000x 3 years x 25%)	(131,250)		
	---------------	(43,750)	2

Balancing charge		276,250	

Disposal of a leasehold property

Capital gains tax implications:		
Sales proceeds	970,000	
Cost	(248,000)	

Un-indexed gain	722,000	
Less indexation allowances:		
April 2007 - May 2017:		
(1799 – 957.7) / 957.7 x 248,000	(217,858)	

Chargeable gain	504,142	2

Income tax implications:

Recovery of allowances granted:		
P248,000 x 10/ 25 years =	99,200	2

(iii) Computation of adjusted taxable income for Lengau (Pty) Ltd

Taxable income per question		11,468,000	
Loss on disposal of warehouse	(100,081)		1
Gain on disposal of leasehold	504,142		1
	---------------	404,061	
Roll over gain now chargeable		128,000	1
Balancing charge on disposal of warehouse		150,000	1
Capital allowances on repl. Plant		(23,250)	1
Reversal of provision for gratuities		437,000	1
B/charge on disposal of expensive car		276,250	1
Recovery of leasehold allowances		99,200	1

Adjusted taxable income		12,939,261	

VAT implications – Exhibit 3

(b) i) Importation of legal services

There is no charge of VAT on the importation of services provided that Lengau (Pty) Ltd incurred the legal services for business purposes. **2**

ii) Hire of returnable containers

Deposit paid on hire of returnable containers will be liable to VAT.

Consequently, Lengau (Pty) Ltd should charge output VAT, as follows:

P100,000 x 12%	=	P12,000	2

iii) Purchase of immoveable property

Lengau (Pty) Ltd will be required to pay transfer duty tax as follows:

Purchase price	490,000	
Less exemption	(200,000)	

Chargeable value	290,000	

Transfer duty at 5%	14,500	1

The transfer duty paid will qualify as recoverable input VAT which Lengau (Pty) Ltd can claim. 1

Total marks available: 43

Total maximum marks: 40

Question 2

1.1(a) The report sets out the income tax, capital gains (CGT) and capital transfer tax implications:

Trust for the children

Donation of property to trust

If Letlotlo donates the house to his children as usufructants, the trust will be liable to capital transfer tax.

The property will be valued at the capitalized amount of 6% of the annuity, as follows:

$$\text{Capital value} = \frac{A \times [1 - (1/(1 + r)^N\,]}{R}$$

$= P240,000 \times (1 - (1/(1.06)^{15}) / 0.06$

Capital value = P2,330,940 3

The capital transfer tax payable by the trust:

First	500,000	16,000
Next	1,830,940 x 5%	91,547

	2,330,940	-------------

Transfer duty		107,547

Selling of property to trust

If Letlotlo sells the property to the trust, Letlotlo will be liable to CGT.

The chargeable gain on disposal of the house to the trust:

Sales proceeds		3,800,000	
Cost of land (July 2005)	400,000		
House(March 2008)	1,300,000		
	----------------	(1,700,000)	

Un-indexed gain		2,100,000	
Indexation allowances:			
Land (June 2017-July 2005)			
(1802.5 – 821.2) / 821.2 x 400,000		(477,983)	
House (June 2017-Mar 2008)			
(1802.5 – 1043.1) / 1043.1 x P1,300,000		(946,429)	

Chargeable gain		675,588	3

Income tax payable on the chargeable gain:

First	144,000	13,950	
Next	531,588 x 25%	132,897	

		146,847	1

Trust for the children

If Letlotlo makes a donation of shares to the trust, the transfer will be liable to capital transfer tax which will be payable by the trust.

The trust will be required to pay capital transfer tax of:

First	500,000	16,000	
Next	4,000,000 x 5%	200,000	

		216,000	2

If Letlotlo sells the shares to the trust he will be liable to pay CGT. The gain or loss on disposal is as follows:

Sales proceeds		4,500,000	
Allowable cost P500,000 x 20%		(100,000)	

Un-indexed gain		4,400,000	
Less moveable allowance at 25%		(1,100,000)	

Chargeable gain		3,300,000	2

CGT liability:			
First	144,000	13,950	
Next	3,156,000 x 25%	789,000	

		802,050	1

Recommendation

Based on the capital transfer tax and CGT liabilities calculated above, it is recommended that Letlotlo should donate the assets to the trusts rather than sell the assets.

If Letlotlo donates the assets to the trust, he will not be liable to any tax liabilities. Instead, the trusts will be liable to capital transfer tax which is significantly less than the CGT liabilities that would arise if the properties were sold. 2

b) Income tax implications of creating trusts

Trust for the children

The trust for the children will be required to distribute all the income to the beneficiaries without any restrictions. Accordingly, the income earned by the trust will be charged tax in the name of the trustee and in the same amount that the beneficiaries would have been liable to.

2

Since both Chilisa and Thabang are higher rate taxpayers, they will be liable to tax at 25%. The additional income for each of the beneficiary is P120,000 (i.e. P240,000 / 2 people).

Additional tax liability is P30,000 (P120,000 x 25%) 2

Trust for the grandchildren

The income from the trust for the grandchildren is subject to a stipulation that requires the trustee to accumulate the income for the grandchildren.

This implies that the income accruing to the trust will be charged on the settlor during his lifetime and not on the trust or the beneficiaries.

Letlotlo will be required to pay additional annual tax of P45,000 (i.e. (P180,000 x 25%). 3

2.2 **Explanation of the CTT implications relating to the bequests in the will:**

i) A bequest of a house in South Africa to any person who is domiciled outside Botswana is exempted from CTT. Tirelo will not be liable to CTT. 2

ii) Cash to his children jointly will be liable to CTT. Each child or donee will be liable to CTT on their share. 2

iii) Plot of farming land to Chilisa and Thabang as full owners after the cessation of a usufructuary interest.
Upon Letlotlo's death, the usufructuary interest would cease and the property would be passed to Chilisa and Thabang.

Chilisa and Thabang would be deemed to have received a chargeable transfer of the difference between the value of full ownership when the usufructuary interest commenced and when it ceased.

The chargeable value of the transfer is P424,000 (P692,000 – P268,000) 3

iv) Cash of P1,000,000 to letlotlo's grandchildren for their education

The transfer will be liable to CTT. The exemption for education and maintenance is only available if the donees are the donor's children who are either less than 21 years of age or are in full time school or training. 2

Total available marks: 35

Total maximum marks: 30

Question 3

3.1 Tax implications for Tshenolo of drawing P200,000 either as a bonus or as a dividend

Income tax implications of drawing a bonus

A bonus is fully taxable in the hands of Tshenolo. 1

The additional tax on the withdrawal of P200,000, net of tax, is:

P200,000 x 25/75 = P66,667 2

Yarona Ltd will be required to pay a gross dividend of P266,667 (i.e. P200,000 + P66,667).

Income tax implications of paying a dividend

Dividends are not taxable in the hands of Tshenolo. 1

However, for Tshenolo to receive a net dividend of P200,000, Yarona Ltd will need to gross up the dividend and pay P216,216 (P200,000 / 92.5%). 1

Tax implications for Yarona Ltd of paying Tshenolo P200,000 net of tax, as a bonus or as a dividend

Income tax implications of drawing a bonus

A bonus payable to Tshenolo is a tax deductible expense for Yarona Ltd. Therefore, the bonus will save tax as follows:

P266,667 x 22% = P58,667 1

The net cost of paying a bonus to Tshenolo by Yarona Ltd is P208,000 (i.e. P266,667 – 58,667) 2

Income tax implications of paying a dividend

Dividends are an appropriation paid out of post-tax profits and are therefore not tax deductible for Yarona Ltd.

However, they are subject to withholding tax of 7.5%. The withholding tax is P16,216 (P216,216 x 7.5%) 1

The net cost of paying a dividend is P216,216, i.e. the dividend paid to Tshenolo of P200,000 and withholding tax to Burs of P16,216. 2

Advise to Tshenolo

It has been determined that Tshenolo will receive a net amount of P200,000 whether as a bonus or as a dividend. 1

To determine the most tax efficient manner of Tshenolo withdrawing P200,000 net of tax, a comparison is made between the payment as a bonus or as a dividend from the perspective of the company.

The net cost to Yarona Ltd is as follows:

Payment of a bonus	208,000	
Payment of a dividend	216,216	

Savings if bonus is paid	8,219	2

It is therefore recommended that Yarona Ltd should pay a bonus instead of a dividend and thereby save P8,219. 1

3.2 Restructure of Tshenolo's salary

The objective of salary restructuring is to organize the remuneration package in the most efficient manner without increasing the cost to the employer.

Tax liabilities on the unrestructured salary of P660,000:

First	144,000	13,050		
Next	516,000 x 25%	129,000		

Tax liability		142,050		2

Restructuring of remuneration:

Annual cash salary	660,000		
School fees	-		1
Annual subscriptions	(2,800)		1
Purchase of computer (P36,000/3 years)	(12,000)	2	
Medical aid contributions	(48,000)		1
House rentals	(72,000)		1

Restructured salary before gratuity	525,200		
Gratuity at 25/125	(105,040)		2

Restructured salary	420,160		

Taxable employment income:			
Salary		420,160	1
Computer		-	1
Medical aid contributions		-	1
Housing benefit (10% x P240,000)		24,000	1

		444,160	
Add: annual taxable gratuity			
P105,040 x 2/3		70,027	2

Total taxable employment income		514,187	

Tax liability:			
First	144,000	13,050	
Next	370,187 x 25%	92,547	

Tax liability		105,597	1

Tax savings from restructuring:

Tax liabilities from un-restructured salary	142,050	
Tax liabilities from structured salary	105,597	

Tax savings	36,453	1

Conclusion

It is recommended that Tshenolo should restructure her employment income so that
she can save P36,453. 2

Total marks available: 35

Total maximum marks : 30