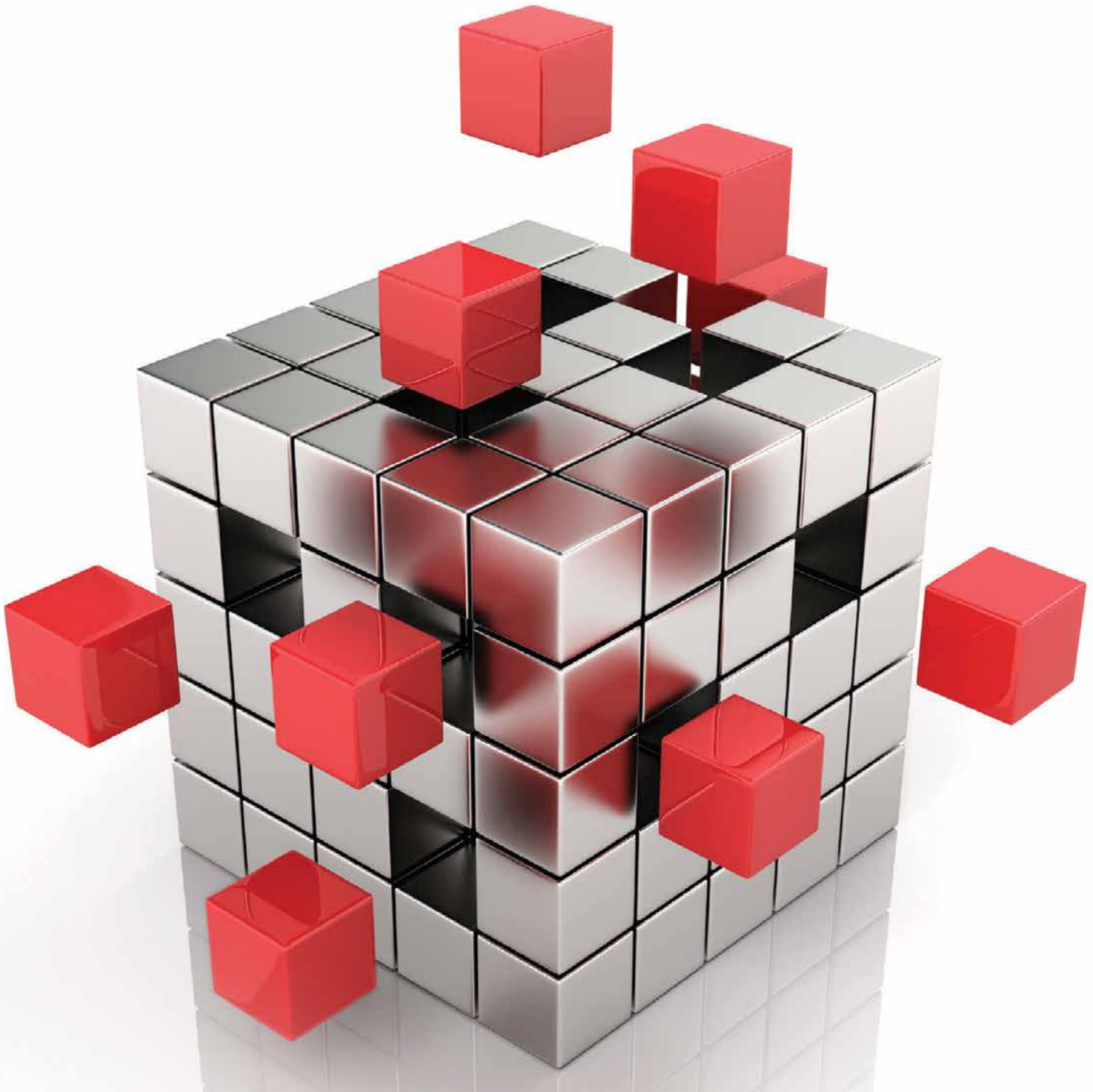


PRINCIPLES OF TAXATION(P6)

CHARTERED ACCOUNTANT (MALAWI)
KNOWLEDGE LEVEL



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Studying Taxation (TC 10)

Paper TC10 Taxation is a paper that is discursive and requires computation. As a result the exam has both narrative and computational questions.

Contents of the Paper

This paper comprises the following main areas:

- a) Principles of taxation and introduction to Malawi taxation;
- b) Income tax on persons;
- c) Taxation of businesses income;
- d) Capital allowances;
- e) Taxation of special trades and cases;
- f) Collection and administration of tax;
- g) Value added tax;
- h) Customs duties; and
- i) Excise tax.

Skills to Demonstrate

You will be required to understand the principles of taxation and apply these principles in computation of tax.

Aim of the Module

To enable candidates understand the general objectives of taxation and to apply this knowledge in practice by calculating income tax for different taxable persons including individuals, partnerships, corporate bodies and taxation principles applicable to special trades.

Outcomes

On completion of this module the candidate should be able to:

- i. Explain the principles of taxation;
- ii. Describe the administration of taxes in Malawi;
- iii. Explain the general objectives of Malawi tax and the different types of tax;
- iv. Calculate tax liabilities for individuals and corporate bodies;
- v. Calculate value added taxes, excise and customs duties owed by taxpayers; and
- vi. Prepare various tax returns.

Format and Standard of the Examination Paper

The examination will be divided into two sections, A and B. Section A will have two compulsory questions. Section B will have five questions and candidates will be required to answer any three. Section A will account for 40% of the examination and section B 60%. There will be a balance between narrative and computational questions.

The table below shows the relative weightings of topics within this module and gives an indication of the exam content for each area.

<i>Syllabus area</i>	<i>Weighting</i>
Introduction to Taxation and Administration of Tax	10%
Income tax on individuals and corporate bodies	40%
Capital allowances	10%
Taxation of special trades and cases	10%
Collection of taxes	10%
Value added tax	10%
Customs duties	5%
Excise	5%
Total	100%

Learning Outcomes

The following are the learning outcomes:

1. Introduction to Taxation and Tax Administration

Candidates should be able to explain the principles and objectives of taxation and how taxes are administered in Malawi.

In the exam candidates may be required to:

- Explain reasons for a government introducing a tax system;
- Describe essential elements of a good tax system;
- Classify taxes and explain characteristics of taxes;
- State the powers of the Commissioner General;
- Explain the significance and application of the rule of secrecy;
- Explain the role of the Public Officer; and
- State appeal procedures.

2. Income Tax on Individuals and Corporate Bodies

Candidates should be able to classify entities as individuals, partnerships, or companies for tax purposes and state how they are taxed.

In the exam candidates may be required to:

- Identify assessable and exempt income, allowable and non-allowable deductions and taxable income;
- Compute fringe benefits tax;
- Compute capital gains or losses;
- Compute foreign exchange gains or losses;
- Compute tax on passive income; and
- Compute taxes for individuals, partnerships and corporate bodies.

3. Capital Allowances

Candidates should be able to explain and compute the different types of capital allowances and identify the scenarios and on which assets capital allowances can be claimed.

In the exam the candidate may be required to:

- Describe initial, investment and annual allowances;
- Identify assets that qualify for capital allowances;
- Compute capital allowances; and
- Describe incentives and restrictions on capital allowances.

4. Taxation of Special Trades and Cases

Candidates should be able to describe how special trades are taxed.

Candidates may be required to explain or compute taxes for:

- Farming;
- Timber trade;
- Charities and trusts;
- Clubs and societies;
- Ecclesiastical bodies;
- Insurance business;
- Hire purchase;
- Double taxation; and
- Turnover tax.

5. Collection of Taxes

Candidates should be able to identify the obligations the Malawi tax system imposes on tax payers and the implications of non-compliance.

In the exam candidates may be required to:

- Explain collection procedures for the following:
 - Pay As You Earn,
 - Withholding tax,
 - Provisional tax, and
 - Non-resident tax.
- Identify the records that must be kept for various taxes; and
- State due dates for various tax returns and penalties for non-compliance.

6. Value Added Tax

Candidates should be able to calculate the amount of VAT owed by or owed to businesses.

In the exam candidates may be required to:

- Classify supplies as exempt, zero-rated, and taxable;
- Explain when a taxpayer could or should register or deregister for VAT;
- Explain the obligations of a registered person;
- Describe the VAT credit system (input and output VAT, and refunds); and
- Compute VAT.

7. Customs Duty

Candidates should be able to explain the principles of customs duty and, where applicable, calculate the amount of customs duty payable by taxpayers.

In the exam candidates may be required to:

- Describe the nature and functions of customs duty ;
- Explain importation and declaration procedures (ports of entry, import documentation, valuation of goods, and purpose of importation);
- Explain the functions of customs tariffs;
- Explain rules of origin and preference of imported goods;
- Compute customs duty;
- Explain storage and post importation procedures (clearing procedures, bonded warehouses, customs record keeping); and
- Compute customs duty.

8. Excise

Candidates should be able to explain the principles of excise duty and, where applicable, calculate the amount of excise duty owed by taxpayers.

In the exam candidates may be required to:

- Explain what is meant by excise as part of the indirect taxes and how it is accounted for in Malawi;
- Identify goods liable for excise tax; and
- Explain registration procedures and conditions applying to all excise traders and their obligations.

References

Customs and Excise Act
ICAM Taxation Manual
Malawi Taxation Act
Value Added Tax (VAT) Act

Chapter 1: Introduction to Taxation

Learning Outcomes

On completion of this chapter you should be able to:

- Define taxation;
 - Explain the functions of taxation;
 - Explain the canons of taxation;
 - State examples of taxes;
 - Classify taxes ; and
 - Describe the Malawi tax system.
-

Introduction

In this chapter, a short outline of the Malawi Taxation is presented, beginning with the definition of tax and taxation followed by a discussion of the various reasons why governing bodies' world over impose taxes on its citizens. In addition, qualities of a good tax system as well as characteristics and classes into which taxes are grouped are explained too. At the end of the chapter, a brief overview of the Malawi taxation system is given.

1.1 Definition of Taxation

Tax is a fee charged or levied by Government on a product, income or activity. Taxation is defined as impositions made by governing bodies on income and wealth of persons under their jurisdiction. Governing bodies include state, local authorities and central government.

1.2 Reasons for Introduction of Taxes

Governing bodies impose taxes for various reasons including the following:

a) Raising revenues

The revenues are used to provide public goods and services such as defence, education, health services, roads etc. which the free market economy does not provide and for running of government.

b) Redistribution of wealth.

More revenue is collected from higher income earners than lower income earners to provide public goods and services.

- c) Protecting local industries from foreign competition.

The government levies duty on imported goods to make the prices high so that people can buy domestically produced products.

- d) Discouraging consumption of certain products considered undesirable such as cigarettes by levying excise duty.
- e) Used as a fiscal tool to make adjustments to the economy.

Taxes can be introduced or removed and tax rates adjusted to deal with certain economic conditions. For example tax rates can be increased in time of inflation to reduce the taxpayer's spending power and can be reduced during the time of recession to increase the spending power.

1.3 Canons of Taxation

1.3.1 Definition of Canons

Canons of taxation refer to the characteristics or qualities which a good tax system must have. Canons refer to the qualities of an isolated tax and not to the tax system as a whole. A good tax system should have a proper combination of all kinds of taxes having different canons.

A popular economist Adam Smith came up with four canons of taxation. These are: equality or equity, certainty, convenience and economy. Other economists including Bastable added a few more canons. Some of them are: elasticity, productivity, simplicity, diversity, flexibility and comprehensibility.

1.3.2 Canons introduced by Adam Smith

a) Equity or Equality

A tax system should be fair in its application to all taxpayers as a result all tax payers should be treated equally. Taxes should be based on an individual's ability to pay.

It is agreed that a progressive element of income tax is fair in the sense that those with more income pay more tax compared to those with less income.

b) Certainty

The taxpayers must be sure of what is expected of them regarding what they are expected to pay, when, where and how the payment is supposed to be made.

c) **Convenience**

The taxpayers should pay taxes in a convenient manner as a result the payment of tax should be related to the time at which the taxpayer has money.

d) **Economy:**

The cost of collecting tax should not outweigh the benefits of doing so.

1.3.3 Canons Introduced by Bastable and others

a) **Elasticity:**

Taxation should be elastic in nature in the sense that more revenue is automatically fetched when income of the people rises. This means that taxation must have built-in flexibility.

b) **Productivity:**

This implies that a tax must yield sufficient revenue and not adversely affect production in the economy.

c) **Simplicity:**

Simplicity implies that the tax system should be fairly simple, plain and intelligible to the tax taxpayer. If it is complicated and difficult to understand it can lead to malpractices such as evasion and avoidance.

d) **Diversity:**

A good tax system should incorporate a broad taxpayer base and sources of income e.g. from employment, from investments etc.

E) Flexibility

It should be easy for tax authorities to revise the tax structure (coverage and rates) to suit the changing requirements of the economy.

f) Comprehensibility

The tax system must be understood by the taxpayer.

1.4 Examples of Taxes

The following are examples of taxes in Malawi:

- a) **Income Tax:** These are taxes levied on income or earnings of individuals and businesses.
- b) **Property Rates:** These are taxes levied on the value of property. They are used by local authorities such as city and town councils to raise revenue which they use to provide services like cleaning and sewage.
- c) **Poll Tax:** This type of tax is collected on the basis of a fixed amount per individual due to pay tax. It is called Poll tax because it is payable by individuals who have a right to vote. This type of tax has been phased out in Malawi.
- d) **Sales Tax:** This is tax levied on the value of goods sold or services provided. In Malawi, it is now known as Value Added Tax (VAT).
- e) **Wealth Tax:** This is tax levied on the wealth of individuals either at the time of their death or on transfer of property e.g. Estate duty and Capital gains tax.
- f) **Customs Duty:** This is levied on the value of imported goods or services.
- g) **Excise Duty:** This is levied on certain specified locally manufactured and imported goods.

1.5 Classification and Characteristics of Taxes

Taxes are classified as direct and indirect taxes. Both direct and indirect taxes can be progressive, regressive and proportional in nature.

1.5.1 Direct and indirect taxes

1.5.1.1 Direct Taxes

These are taxes which are generally levied on a taxpayer's income or wealth.

a) Advantages of direct taxes

- i. Taxes are fair and equitable because they are levied according to the taxpayer's ability to pay so that those with less income pay less tax compared with those with more income.
- ii. Direct taxes tend to stabilize the economy automatically by taking more income from taxpayers during the time of inflation and less during the time of recession.
- iii. Direct taxes are less inflationary compared to indirect taxes because they reduce taxpayers' disposable income and purchasing power.

- iv. The tax payer is certain as to how much he is expected to pay, as the tax rates are decided in advance. The Government can also estimate the tax revenue from direct taxes with a fair accuracy.
- v. The burden of direct taxes is on the taxpayer hence they take keen interest in how public funds are spent. The taxpayers are likely to be more aware about their rights and responsibilities as citizens of the state.

b) Disadvantages

- i. It is argued that direct taxation acts as a disincentive to work effort as high income earners feel they are highly taxed for their efforts.
- ii. High tax rates can cause migration of highly skilled and highly paid workers to countries with favourable tax conditions.
- iii. Taxpayers with more income may find loopholes so that they can avoid paying tax.
- iv. It is easier for the taxpayers, especially businessmen to evade direct taxes. The tax evasion is due to high tax rates, documentation and formalities, poor and corrupt tax administration. Business men may suppress correct information about their incomes by manipulating their accounts and evade tax on it.
- v. The direct taxes can affect savings and investment. Due to taxes, the net income of the people gets reduced. This in turn reduces savings. Reduction in savings results in low investment. The low investment affects capital formation in the country.

1.5.1.2 Indirect Taxes

These are taxes that are levied on goods and services.

a) Advantages of indirect taxes

- i. Taxes are included in the cost of goods and services making them easier to collect.
- ii. Indirect taxes can be used to discourage consumption of certain goods considered undesirable such as taxes on alcohol and cigarettes.
- iii. Indirect taxes are a flexible instrument of economic policy. The rates for indirect taxes can be changed easily and quickly compared with direct taxes.
- iv. Indirect taxes are convenient. Taxes are imposed on production, sale and movements of goods and services. These are imposed on manufacturers, sellers and traders, but their burden may be shifted to consumers of goods and services who are the final taxpayers. Such taxes, in the form of higher prices, are paid only on purchase of a commodity or the enjoyment of a service. They are also convenient because generally they are paid in small amounts and at intervals and are not in one lump sum. They are convenient from the point of view of the government also, since the tax amount is collected generally as a lump sum from manufacturers or traders.

- v. Unlike direct taxes, the indirect taxes have a wide coverage. Majority of the products or services are subject to indirect taxes. The consumers or users of such products and services have to pay them.
- vi. The indirect taxes may not affect the motivation to work and to save. Since, most of the indirect taxes are not progressive in nature, individuals may not mind to pay them.
- vii. Indirect taxes have in built safeguards against tax evasion. The indirect taxes are paid by customers, and the sellers have to collect it and remit it to the Government. In the case of many products, the selling price is inclusive of indirect taxes. Therefore, the customer has no option to evade the indirect taxes.

b) Disadvantages

- i. Indirect taxes are not considered fair and equitable because the amount of tax paid is the for both high and low income earners, hence they are regressive.
- ii. Because the same amount of tax is paid by both high and low income earners, there is no redistribution of wealth.
- iii. Indirect taxes may reduce demand for goods and service because they increase their price.
- iv. Indirect taxes affect consumption of certain products. For instance, a high rate of duty on certain products such as consumer durables may restrict the use of such products. Consumers belonging to the middle class group may delay their purchases, or they may not buy at all. The reduction in consumption affects the investment and production activities, which in turn hampers economic growth.

1.5.2 Progressive, Regressive and Proportional taxes

1.5.2.1 Progressive Taxes

These are taxes whose rates increase as the taxpayer's income increases. Since the rates are high for high levels of income, taxpayers with more income pay more tax as compared to those with less income.

a) Advantages of progressive taxes

- i) Taxes are considered fair and equitable.
- ii) Taxes help the government redistribute wealth.
- iii) Taxes stabilize the economy automatically by taking more income from taxpayers during times of inflation and less during recessions.

b) Disadvantages

- i) High tax rates may act as a disincentive to work effort as high income earners

- feel they are highly taxed for their efforts.
- ii) High tax rates can cause migration of highly skilled and highly paid workers to countries with favourable tax conditions.
- iii) Taxpayers may find loopholes so that they can avoid paying tax resulting in less revenue for the government.

1.5.2.2 Regressive Taxes

These are taxes whose amounts are fixed regardless of the taxpayer's income. These include parking and market fees which are fixed for both high and low income earners. As a result the tax paid for similar transactions is the same but those with less income pay a high proportion of their earnings compared with those with more income.

a) Advantages

- (i) Taxes are relatively easy to collect and administer.
- (ii) These taxes are paid in the shape of price of commodities. People pay these taxes when they buy commodities. (Convenience)

b) Disadvantages

- (i) Taxes are not considered fair and equitable.
- (ii) Because the same amount of tax is paid by both high and low income earners, there is no redistribution of wealth.

1.5.2.3 Proportional taxes

These are taxes that are paid at the same rate by all taxpayers e.g. income tax paid by companies.

a) Advantage

- (i) Taxes are considered to be fair and equitable, especially by taxpayers with more income.

b) Disadvantage

- (i) Taxes do not contribute much in the redistribution of wealth.

1.6. Overview of the Malawi Tax System

1.6.1 Taxes Collected in Malawi

The Malawi tax system is a mixture of direct and indirect taxes.

a) Direct Taxes

Examples of direct taxes are income tax, non-resident tax, and dividend tax and estate duty.

b) Indirect Taxes

Examples of indirect taxes are:

- (i) Value Added Tax
- (ii) Customs duty
- (iii) Excise duties

1.6.2 History of Taxation in Malawi

The practice of taxation in Malawi can be traced back to the time people lived in communities and societies. At that time people were continually threatened by physical conflict from within their communities and societies and people from other area. Due to the threat need arose to have a system that provided security to the people in exchange for loyalty to those providing the security such as kings or chiefs.

Tribute by the people to their rulers was first paid in kind using farm produce or domesticated animals. Later with the introduction of money tribute was paid in cash.

Over the years Malawi has gone through three phases which have had an impact on its tax system; pre-colonial, colonial and post-colonial.

The 1980s and 1990s saw two major economic reforms in the tax system which were undertaken to bring efficiency and effectiveness usually by simplifying the tax system and reducing tax rates to encourage compliance.

Summary

This chapter has introduced the definitions of tax, taxation, reasons governments impose taxes on their citizens, qualities that a good tax system must possess, and examples of taxes in Malawi. The chapter has also discussed the classifications and characteristics of taxes. At the end a brief background of taxation in Malawi has been presented. To test your understanding of this chapter, answer the questions that follow before you proceed to chapter two which is about the administration of taxes.

End of Chapter Questions

1. Adam Smith set out four canons of taxation. List and explain any two of his canons and any two by Bastable.
2. Explain the following:

- a) Progressive taxes
 - b) Regressive taxes
 - c) Proportional taxes.
3. What is the primary purpose of taxation?
4. In almost every economy in the world people complain about making contributions to the government which most of them think it very unfair. Your friend an engineer is currently employed with an engineering firm and has asked you to explain why taxes should be paid.
5. Describe the following terms:
- a) Taxation
 - b) Equity
 - c) Direct and indirect taxes

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Chapter 2: Administration of Taxes

Learning Outcomes

On completion of this chapter, you should be able to:

- Explain tax administration;
- Explain the powers of the Commissioner General;
- Explain who is responsible for the administration of tax;
- Explain the exceptions to the secrecy rule; and
- Explain the ways through which notices are communicated.

Introduction

This chapter looks at the administration of taxes in Malawi.

2.1 Malawi Revenue Authority

The Malawi Revenue Authority (MRA) is an Agency of the Government of Malawi responsible for assessment, collection and accounting for tax revenues. MRA was established by an Act of Parliament in 1998 and was launched in February 2000. It was formed to improve on the functions previously carried out by Departments of Customs and Excise, and Income Tax in the Ministry of Finance.

The MRA is overseen by a **Board of Directors** and headed by a Commissioner General to provide leadership, strategic direction and control. In pursuance of these duties and to accomplish the mandate of MRA, functional departments and divisions are in place.

MRA has three revenue divisions of **Customs Division (Imports)**, **Customs Division (Exports)** and **Domestic Tax Divisions**. It also has supporting divisions and departments namely Finance, Administration, Human Resource and Organisational Development, Legal, Information, Communication and Technology (ICT), Tax Investigations, Policy Planning & Research, Corporate Affairs, Internal Audit, Supply Chain Management, Internal Affairs, and Modernisation.

The Customs Division (Imports) and The Customs Division (Exports) administer and enforce the Customs and Excise Act. The division collects Import and Excise duty, Export duty, Import VAT and trade statistics. In addition, these divisions facilitate trade and protect the community from entry and exit of prohibited goods.

The Domestic Tax Division administers the Taxation and VAT Acts. The Division collects direct Income Taxes from individuals and corporations. These are in form of Pay As You Earn (PAYE), Provisional Tax, Fringe Benefit Tax and Withholding Tax. The division also collects domestic VAT and domestic excise.

MRA has three regional offices in Blantyre Lilongwe and Mzuzu, it has 32 offices spread across the country from Nsanje to Chitipa.

2.2 Tax Legislation

The key taxes that MRA assesses, collects and accounts for include income tax, value added tax, customs and excise duties. The legislation governing these taxes can be found in the following chapters of the laws of Malawi:

- a) Income Tax legislation is set out in the Tax Act. CAP 41:01 of the Laws of Malawi;
- b) Value Added Tax legislation is set out in the Value Added Tax Act CAP 42.02 of the Laws of Malawi; and
- c) Customs and Excise Duty legislation is set out in the Customs and Excise Act CAP 42.01 of the Laws of Malawi.

2.3 The Commissioner General

The Commissioner General, being the head of MRA is accountable to the Minister on all tax issues under MRA jurisdiction.

2.3.1 Delegation of Functions by the Commissioner General

In order to efficiently and effectively fulfil MRA's mandate, The Act, in S 4, empowers the Commissioner General of MRA to delegate his functions in writing to officers appointed to work under his control and direction at MRA.

2.3.2 Reports by the Commissioner General

S 5 of the Act requires that the Commissioner General:

- a) Furnish the Minister annually for presentation to the National Assembly a report on the working of the Act;
- b) The Commissioner General, in the report, draws attention to any breaches or evasions of the Act which came to his attention during the year.

2.3.3 Powers of the Commissioner General

The Commissioner General is responsible for the administration of the tax laws. The Commissioner General is given discretionary powers under the law to make determinations regarding Taxation Act, VAT Act and Customs and Excise Act.

The following are some of the discretionary powers that are expressly given to the Commissioner General in the Taxation Act:

Section Power

- 24 To decide whether timber has been grown as timber for sale or not
- 35 Approval of deduction of bad debts
- 36A Determination of taxable income from which export allowance is deducted
- 38(A) (1) & (2) Determination of allowable deductions against assessable Income arising from sale of timber.
- 43(1) To decide whether a change in shareholding of a company has been effected to take advantage of assessed loss or not.
- 48- proviso acceptable basis of inventory valuation
- 55(1) Accepting accounts prepared to a date other than 30 June for assessment.
- 59 Determination of taxable income of a non exempt producer's cooperative.
- 84E Reduction or waiver of penalty for non payment of provisional tax.
- 105(6) Extension of time to pay tax, payment of penalty.

Schedule

Power

Second par3 (2) c Determination of rates for annual allowances

2.4 SECRECY. (Section 6)

2.4.1 Requirement

Tax information is considered confidential and private to the taxpayer. Any information relating to one taxpayer may be used to the advantage of competitors. If not properly used, tax information can put a taxpayer in bad light with the government and the public.

Any person carrying out duties under the Taxation Act is, therefore, required to observe secrecy i.e. a person is not supposed to reveal any matter that comes to his knowledge in the performance of his duties under the Act.

Before taking up office under the Act every officer (including the Commissioner) is required to take an oath of secrecy before a magistrate or a Commissioner for oaths.

Anyone who takes office before taking an oath of fidelity or secrecy shall be liable to a fine of K20. If a person who has taken an oath of secrecy or fidelity reveals any matter to any person which has come to his knowledge in the course of carrying out duties under the Act, he will be liable to a fine of K1, 000 and to imprisonment for two years.

It is important to note that the requirement to observe secrecy applies to all officers of MRA and all staff from Public service who need to access MRA files. However, in this chapter, examples given and considered are from the Taxation Act

2.4.2 Exceptions to the Rule of Secrecy

The duty to observe secrecy can be waived in the following circumstances:

- (i) Where the information is required by the Auditor General or any officer duly authorized by him in the course of carrying out his duties.
- (ii) Where the information is required by authorized government officials of another country which has a double taxation agreement with Malawi to enable them assess the tax position of a taxpayer.
- (iii) Where the information is required by the taxpayer or duly authorized agent of the Taxpayer.
- (iv) Where the commissioner wishes to compile and publish statistics about the total amount of income received by any class of persons as declared in returns to commissioner.
- (v) Where information is required for the purposes of carrying out the Act into effect for the purpose of any prosecution of offence committed in relation to any tax matter.

2.5 Communication with the Taxpayer

Each company is required to appoint a public officer who is responsible for ensuring - that all taxation matters are dealt with. All notices, assessments, and returns by the Malawi Revenue Authority are delivered to the public officer at his specified office.

Any notice or document is regarded as served upon a person sufficiently and effectively if it is:

- (i) Personally served upon him.
- (ii) Left with adult person who is resident at his last known place of abode, office or place of business.
- (iii) Sent by post addressed to such last known place of abode, whether inside or outside Malawi, office or place of business.
- (iv) Affixed at the last known place of abode, office or place of business and the person will be deemed to have received the notice on the 14th day after affixing.

Note

The above points will not apply if the officer is satisfied that such a person would not understand the meaning of notice due to illiteracy or infirmity. The officer then may direct that such document be communicated to such a person in manner as he deem fit.

Summary

This chapter has considered administrative arrangements that are in place to facilitate tax administration. The chapter considered MRA as the main body in the administration

of taxes, in terms of its set up, leadership, powers of the Commissioner General, the requirement to observe secrecy on the part of officers and communication with taxpayers. The next chapter will consider how income of individuals is taxed.

End of Chapter Questions

Secrecy is required of all officers performing duties under the taxation Act

Required:

- a) What is the preliminary step that officers must take before taking an office under the Act
- b) When is the duty to maintain secrecy waived?
- c) What are the penalties and fines for breaching the duty to observe secrecy?
- d) Why is the commissioner vested with discretionary powers?

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Chapter 3: Taxation of Individuals

Learning Outcomes

On completion of this chapter you should be able to

- Explain gross income, assessable income and taxable income;
- Explain how single and married taxpayers are treated;
- Calculate monthly and annual tax liability using income tax rates;
- Explain who is responsible to pay tax on income of minor children and other beneficiaries; and
- Explain the income which is exempt from tax.

Introduction

This chapter introduces the procedures to be followed when assessing the income of individuals. It will be noted that some incomes are assessable to tax while other are exempt.

S71 gives authority for the levying of income tax on the total taxable income of any individual received or accrued from a source within or deemed to be within Malawi.

This chapter must be read together with the First Schedule to the Taxation Act.

3.1 Income

Some incomes are assessed to tax others are exempt. Income that qualifies to be assessed for tax purposes is called assessable income. The Taxation Act provides criteria/guidance on what income is assessable. Further to this the Act provides allowances in form of various deductions to assessable income to determine the income that will ultimately be taxed. This is called taxable income.

This can be presented as follows

Income **less** exempt income (income that does not qualify for tax) = assessable income

Assessable income **less** allowable deductions = taxable income

Assessable income is defined in section 11 of the Taxation Act as:

'The total amount in cash or otherwise, including any capital gain received by or accrued to or in favour of a person in any year or period of assessment from a source within or deemed to be within Malawi and the person's assessable income will be that excluding any amount exempt under the Act.'

Income is assessable to tax regardless of whether it has been received or not. For

example, income that has just been accrued to or in favour of a person is still assessable even though the amount is not yet received.

It is important to remember that only income for the period of assessment should be included in assessable income. Where a question includes income relating to more than one period of assessment, a careful split must be made.

3.2 Source

Income is assessable to tax, if it is from a source within Malawi or deemed to be within Malawi regardless of where the payment takes place. For example, an amount received by or accrued to or in favour of a person as remuneration for services rendered in Malawi is from a source within Malawi regardless of where the payment takes place. This is relevant for those individuals employed and working in Malawi who may be receiving their remunerations from outside Malawi E.g. expatriates.

The source of income is determined using a general rule based on matching source with the location of the activity giving rise to the income in question. If the income generating activity takes place within Malawi, the income has a Malawi source. Where the activity is wholly based in Malawi there is not likely to be any serious problem. However, where the activity which yields the income in question is only partly carried out in Malawi, it is essential to reach agreement with the Commissioner General. While general principles can be laid down, the circumstances of each case of income generated partly in Malawi, give rise to the need for the exercise of discretionary powers.

The country of payment of any income is no indicator, per se, of country of source. Since source and settlement are quite separate issues, income paid for outside Malawi and never remitted to Malawi may yet be deemed to have a Malawi source. An arrangement under which Malawi source income is paid for elsewhere and not remitted to Malawi usually requires written approval from the Reserve Bank of Malawi. If approval is not sought or received, the taxpayer's liability for tax on that income still exists, even where the Commissioner is not aware of it. Exchange violations are a matter for the Reserve Bank to handle.

3.4 Exempt Income

Certain incomes are exempt from tax and as a result no tax is supposed to be charged on such incomes. These incomes are specified in the First Schedule to the taxation Act and the exemptions are applicable only to the first recipient of such income.

Exemption from income does not exempt any person from furnishing any return or information as required by the Commissioner General.

The First Schedule to the Taxation Act has a list of incomes which are exempt from tax. See Appendix A for details.

3.5 Rates of Income Tax

The income tax liability is calculated using income tax rates. The rates are subject to annual reviews as part of the budget process. Once the rates have been adjusted, new rates become applicable as directed by the Minister of Finance.

Income tax rates for the year 2015/2016 tax year are as follows.

Annual taxable income	Applicable rate
First K240, 000	0%
Next K60, 000	15%
Excess over K300, 000	30%

When calculating tax liability for a month, the following rates are applicable.

Monthly taxable income	Applicable rate
First K20, 000	0%
Next K5, 000	15%
Excess over K25, 000	30%

Example

Mr Phiri earns K50, 000 per month. Calculate his annual tax liability

Solution

Annual income (K50, 000 x 12)	K <u>600,000</u>
	Tax liability
	K
First K240, 000 @ 0% -	0
Next K60, 000 @ 15% -	9,000
Balance K600,000 – K300,000 @30% -	<u>90,000</u>
Total	<u>99,000</u>

3.5 Aggregation of Income

All the income of a taxpayer is aggregated when determining his/her tax liability for a given year of assessment.

3.6 Income of a Married Woman

Under S12 (1) income other than earned income of a wife shall be deemed to be income of the husband.

The husband is required to include in his return of income the income that is deemed to be his under S 12 (1).

3.6.1 Earned income of the wife

Earned income of a wife is defined under **S73 (4)** as

- a) Income derived from a business carried on by the wife in her own right and in which the husband is neither an employee nor a partner.
- b) Emoluments from employment received by or accrued to or in favour of the wife where the employer is not,
 - i Her husband.
 - ii A partnership in which the husband is a partner,
 - iii A company in which the husband is a director who controls directly or indirectly more than 5% of the voting rights attaching to all classes of shares of the company.
 - iv A company in which the wife is a director who controls directly or indirectly more than 5% of the voting rights attaching to all classes of shares of the company and in which the husband is employed or is also a director.

Any income of a wife which does not meet the definition above is unearned income which will be deemed to income of the husband and should be included in the assessable income of the husband.

3.6.2 Computation of Tax Liability for a Married Couple

A husband is a taxpayer in his own right and so is the wife. Each of them is required to submit his or her return of income. The return of the wife will show tax liability on her earned income and the husband's return will show tax liability on all his income plus the wife's unearned income.

Under S 73(3), a married couple may elect to submit a joint return of income. If this is done, their tax liability is the sum of

- A Tax liability on all income excluding the wife's earned income and
- B Tax liability on the wife's earned income.

Tax payers under the joint return may apart from the normal tax credits claim a **special**

tax credit that arises when you compare the tax computed on all income and the combined sum of taxes computed on individual incomes of the husband and wife.

3.6.3 Format

The following format illustrates how the tax liability is determined where a couple has opted to submit a joint return of income.

	All income	Husbands	Wife's Earned Income	Tax credits
Salary	xx	xx	XX	xx.
Bonus	xx	xx	XX	xx
Taxable profits from business	xx		XX	
Capital gains	xx			
Rent	xx			xx
Assessable income	xx	xx		
Deductible expenses				
Donations	xx			
Professional subscriptions	xx			
Repairs	xx			
Taxable income	<u>xx</u>	<u>xx</u>	<u>xx</u>	

* All other income includes the husband's income and the wife's unearned income.

** Wife's earned income includes the income which meets the definition under section S73 (4)

*** Tax credits are taxes which have already been paid during the accounting period.

**** Deductible expenses –The amount of income in each column will be reduced by the amount of the allowable expenditure that relates to production of such income.

Example:

Bob and **Loveness** are both employed in different companies as Accountant and Sales Consultant respectively. Their monthly salaries are K600,000 and K350,000 respectively. They both get an additional 40% of their salaries as house allowance. Their employers have deducted the necessary PAYE of (K2,943,000 and K1,683,000

respectively) and remitted to Malawi revenue Authority as required.

Other income and information:

1. Bob has a house in Namiwawa which he bought through a mortgage from NBS Bank. The mortgage repayment is K48, 000 per month [of which interest is K42,000].
The house is rented for K160,000 per month to Kabula Pharmacies. Kabula Pharmacies deducts withholding tax on payment of rent and 15% of the rental is paid to the property manager. During the year K80, 000 was spent on painting the roof and K140,000 on the new concrete drive way.
2. Loveness maintains a fixed deposit account with National Bank of Malawi. During the year to 31 December 2015, interest of K60,000 (Gross) was paid on the account.
3. Bob is a director at Lizulu Limited. During the year he was paid directors fees amounting to K120,000 gross from which 10% withholding tax was deducted.
4. Loveness runs a chicken business and for the year ended 31 December, 2015, she realized a taxable profit of K2,000,000.

Required:

Compute the income tax liability by Bob and Loveness respectively for the year ended 31 December 2015 and Total tax payable by the two as at the end of the tax year, assuming the elect to submit a joint return.

Painting of rented house				80,000	80,000														
Taxable Income				19,938,000	12,058,000	7,880,000													
Tax																			
1st K240,000	@	0%		0	-	-													
Next K60,000	@	15%		9,000	9,000	9,000													
Balance (K19,638,000/K11,758,000/K7,580,000)	@	30%		5,891,400	3,527,400	2,274,000													
Total tax				5,900,400	3,536,400	2,283,000													
The couple are eligible to claim a special tax credit which is a comparison of the individual taxes with the total income																			
In this case:																			
Tax on all income				5,900,400															
Less Tax paid (Husband + WEI) =3,536,400+2,283,000				5,819,400															
Special Tax Credit				81,000															
The taxes already paid are treated as advance tax are deductible from total tax liability.																			
Total Tax																			

|

Tax Credits					4,926,000														
Balance of Tax Payable					893,400														

NOT FOR SALE

7. Income of Minor Children and Other Beneficiaries

A person becomes a taxpayer upon birth. A minor child is a taxpayer in his own right.

A minor child is a child who is under 21 years of age and is unmarried.

Under S73(6) every parent is required to include in his return of income any taxable income received by or accrued to or on favour of or deemed to have been received by or accrued to or on favour of his minor child.

7.1 Gifts from Parents.

If a parent makes a gift, donation, settlement, or other disposition on which taxable income accrues to or in favour of his minor child (legitimate or illegitimate) the taxable income shall be deemed to be that of the parent.

For example

Mr Banda opens a savings account in favour of his 5 Year old daughter Mona; the interest accruing on the account should be included in the return of Mr Banda since it is deemed to be his.

7.2 Reciprocal Gifts

If a person makes a gift, donation, settlement, or other disposition on which taxable income accrues to or is paid to a minor child (legitimate or illegitimate), of some other person and the parent or near relative of the parent of the minor child makes a gift, donation, settlement, or other disposition or given some consideration to the person or near relative of the person who makes a disposition to a minor child, the taxable income so accruing shall be deemed to be that of the parent of a minor child.

Example

Mr Banda makes a gift to James, Mr Bowa's minor child and Mr Bowa's sister Mary makes a gift to William, Mr Banda's Son.

The taxable income arising will be treated as follows;

Mr Bowa will include in his return the income on the gift made by Mr Banda to

James and Mr Banda will include in his return the income arising from the gift made by Mary to William.

9. Conditional Settlements

If any person has made in any deed of gift, donation, settlement or other disposition a stipulation to the effect that the beneficiary of the disposition shall not receive the income or part of it until the occurrence of some event whether fixed or contingent such taxable income shall be treated as that of the donor until the occurrence of that event or the death of the donor whichever occurs earlier.

10. Retention of Powers of Revocation

If any gift, donation, settlement or other disposition contains a stipulation that the right to receive income under deed may be revoked under the powers retained by the person by whom the right is conferred, the taxable income arising on the disposition shall be deemed to be that of the person retaining the powers or revocation for as long as the powers are retained.

11. Summary

The determination of tax liability of an individual is a process that starts with identifying the taxpayer's gross income. Income is assessed to tax if it is from a source within Malawi or deemed to be within Malawi. Gross income includes incomes that are taxable and others that are not assessed to tax. To determine assessable income it is important to exclude those incomes that are exempt according to the First Schedule to the Act. From assessable income deductions are allowed following the Section 45 principle.

It has also been noted that there are specific rules governing the taxation of a married woman, minor children, and reciprocal gifts

End of Chapter Questions

- 1 If a single taxpayer received salary, bank interest, and rent, how would his tax liability be determined?
- 2 What type of income of a wife is deemed to be that of her husband?
3. Define wife's earned income.

- 4 A minor child is not a taxpayer. True or false?
- 5 A donor who retains powers of revocation in respect of a disposition he makes is liable to tax on that income. True or false?
- 6 Mr. Banda works for ICAM at a salary of K40, 000 per month. Calculate his monthly tax liability.
- 7 Calculate the tax payable and amounts receivable (after tax) by Mr Phiri for the year to 30 June 2016 given the following.

He gets a salary of K15, 500 per month
 He gets a salary of K22, 500 per month.
 He gets a salary of K70, 000 per month.
 He gets a salary of K650, 000 per annum
 He gets a salary of K1, 200,000 per annum

8. Miss Zambuko's income details for the year ended 30 June 2016 are as follows.

	K	
Salary		560,000
Pension		240,000
Bank Interest		30,000

Required

- a) Compute the income upon which Miss Zambuko's tax liability for the year to 30 June 2016 is to be based.
 - b) Calculate her tax liability for the year ended 30 June 2016.
1. Mr. Phillip Maudzu is employed as an electrical engineer at AB Limited. He is married and has three children, Evans, Ellen and Esther. His wife Ruth is a teacher at Gumbu primary school.

The following are the details of their income for the year ended 30 June 2016.

(i) Phillip Maudzu

	K
Salary	2.400.000
Capital gains realized from sale of personal car	600,000
Bank interest -national Bank	5,000

Standard Bank	12,000
(ii) Ruth Maudzu	
Salary	K 860,000
Bank interest	15,000
Rental income	300,000
(iii) Evans Maudzu (minor)	
Bank interest NBS	K8, 000

NOTES

- (i) The car which has been sold is a Peugeot 405 which he bought 4 years ago for K900, 000.
- (ii) All bank interests have been stated at their gross amounts.
- (iii) Evans interest is from his savings account which his mother opened on his 11th Birthday
- (iv) The rental income has been stated gross but it was received net of withholding tax.
Outgoings on the property which is yielding the rentals during the year were as Follows
- | | |
|--------------------|--------|
| | K |
| City rates | 2,000 |
| Mortgage repayment | 80,000 |
| Insurance | 12,000 |
| Repairs | 30,000 |
- (v) Included in the mortgage repayment is K6,500 mortgage interest
- (iv) Repairing costs include K25,000 which was used to construct a new drive way and K5,000 which was used to repaint the house.
- (v) PAYE was already deducted from salaries.

Required

Prepare a detailed tax computation for Mr. Maudzu for the year ended 30 June 2014 assuming the couple has elected to submit a joint return of income.

Chapter 4: Taxation of Employment Income

Learning Outcomes

On completion of this chapter, you should be able to

- Explain different types of employment income and how they are taxed; and
 - Explain expenses which an employee may be allowed to deduct from assessable income.
-

Introduction

Employed persons form quite a large proportion of taxpayers in Malawi. Employment income includes salaries, wages, leave grants, housing allowances, fees, bonuses, commissions, and fringe benefits. It also includes pension from past employment and terminal benefits, among others. This chapter looks at how employment income is taxed.

4.1 Salaries, Wages, Bonuses, Fees, Housing Allowances

These are taxed in the year in which they are receivable regardless of whether they have been actually received or accrued. They are taxed using applicable income tax rates.

4.2. Leave Passages

Leave passages are travel expenses incurred by an employer on recruitment, leave and repatriation of contract employees from countries of recruitment to Malawi and vice versa as agreed to by the employer.

Leave passages may be taxable in the hands of the employer. However, the following leave passages are not taxable in the hands of the employer:

- (a) Amounts paid by the government to any of its employees in respect of or in connection with leave passages to a country of origin or destination. For example engaging an expatriate from India to work in Malawi, India is the country of origin and sending a Malawian to an embassy in Japan, Japan is country of destination.
- (b) Any comparable amounts paid by any other employer under a contract with an employee which has been approved by the Commissioner will not be treated as assessable in the hands of an employer.

4.3. Fringe Benefits

Fringe benefits are taxable in the hands of the employer and are covered in chapter 5.

4.4. Lump sum Payments

Employees may be given lump sums on cessation of employment. These may be gratuities, pay in lieu of paid leave and terminal benefits. These are assessed to tax as follows:

4.4.1 Contract Gratuity

This is paid to an individual who was employed on a contract basis. Gratuity is included in assessable income.

4.4.2 Pay in Lieu of Paid Leave

On cessation of employment, an employee may have accumulated leave days. The employer may choose to pay a sum of money instead of granting him paid leave.

This payment is assessed to tax as if it relates to the period immediately following cessation of employment.

The whole amount received is taxed using income tax rates. The main requirement is to identify the period in which the income is taxable.

S17 provides that a single terminal benefit in lieu of paid leave shall be assessed to tax as if such leave had been taken by the employee immediately after cessation of employment and he had been paid accordingly.

Example

Mr. Banda's employment ceased on 30 April 2016. What is the tax position if he is paid K30,000 in lieu of paid leave and his accumulated leave was for

- 2 months?
- 3 months?

Solution

In both cases the amount will be assessed to tax as if leave was taken from 1st May 2016.

- (a) The whole K30, 000 will be assessed to tax in the year 2015/2016 because it will be considered to relate to the months of May and June which fall in one tax year
- (b) The amount relating to the months of May and June will be assessed to tax in the year 2015/2016 and the payment relating to the month of July will be assessed to tax in the year 2016/2017.

4.4.3 Terminal Benefits

Terminal benefits are defined in the taxation Act to mean, in relation to a person who was a member of a pension fund or to whom a contributory pension law applies, any amount other than:

- a) Payment in commutation of a pension;
- b) A payment on account of ill-health or disability, which is paid or will be payable to the beneficiary by reason of the cessation of his employment or his withdrawal from or the winding up of a pension fund;
- c) Employee contributions which were taxed at the time of making those contributions.

The 4th schedule to the Taxation Act gives guidance as to what type of terminal benefits should be subject to taxation and how much should be taxed. However, the 4th Schedule was repealed in full in the year 2012 and so too was Section 14 of the Taxation Act. Section 14 is the section that dealt with the taxation of pensions.

Therefore, both pensions and terminal benefits are not subject to taxation as from the tax year 2012/2013. The exemption of pensions from taxation has specifically been provided for in the exemption schedule one, under sub paragraph (v), of paragraph (b).

4.4.4 Redundancy Pay.

If an employee who has been declared redundant receives redundancy pay, an amount of up to K50, 000 is exempt from tax under the first schedule of the taxation Act. The remaining amount is taxed using income tax rates.

4.5 Income of Expatriates

Emoluments from sources in Malawi are taxable on expatriates during their stay in Malawi. This applies except for countries which have double taxation agreements with Malawi that specifically provide an exemption.

Expatriates who have been present in Malawi for less than an aggregate of 183 days in any twelve month period commencing or ending in the year of assessment concerned are taxed as non-residents using an applicable non-resident tax rate.

4.6 Allowable Deductions

A taxpayer is allowed to deduct expenses from his assessable income before calculating his tax liability. In principle, deductions from assessable income are restricted to those costs incurred to generate the assessable income. **Section 28**

sets the conditions which must be satisfied for an expense to be deducted from assessable income.

S28 states that for the purpose of determining the taxable income of a taxpayer, there shall be deducted from the assessable income of such a taxpayer, the amount of any expenditure or expense not being capital in nature, **wholly, exclusively and necessarily** incurred in the production of income or for the purpose of trade.

Necessarily implies that the expenditure was somehow unavoidable without which the trade would have been adversely affected or income reduced. Two tests related with “wholly and exclusively” are “remoteness and duality”.

Remoteness

Expenditure is too remote when it is incurred for purposes peripheral or too loosely connected to the trade i.e. not **exclusively** for trade.

Duality

Duality of purpose relates to the word “wholly”. Expenditure which is partly not related to the business has a dual purpose. Normally if there is duality of purpose and the expenditure cannot be easily allocated to the business and non business purposes the whole expenditure is disallowed.

4.6.1 Specific rules for Certain Expenditures

An expense can be deducted from assessable income if it meets the requirements under S28. However there are specific rules which relate to deductibility of certain expenditure. Such expenditure is as follows:

a) Travel expenses S45

Travel expenses between work locations are considered to be business related expenses and are therefore deductible but the cost of travel between home and the work place is considered private and therefore is not deductible.

b) Professional subscriptions

Subscriptions to a professional body are deductible if membership to such a body is relevant to the employee’s job.

c) Donations to charitable organisations S39 (d)

An individual donation of at least K250 to a charitable organization approved by the minister for tax purposes are deductible. (For the list of approved charitable organizations see appendix III)

d) **Donations to non-profit making organisations S39 (e)**

Individual donations of not less than K500 made during any year of assessment by a taxpayer to a non-profit making organization operated solely or principally for social welfare, civic improvement, educational development or other similar purposes as the minister may approve are deductible.

Summary

This chapter has explained how employment income is taxed.. Some income, such as salaries, is taxed in the hands of the employees, other income, such as fringe benefits is taxed in the hands of the employers, while other income such as pensions and terminal benefits is not taxable at all. It is important to note that employment income, just like other income, is taxed when it has accrued.

End of Chapter Questions

1. Define leave passage
2. State situations when leave passages are not taxable
3. Explain how travel expenses of an employed person can be allowed as a deduction
4. Why and how does Government encourage donations to approved charitable organisations.

NOT FOR SALE

Chapter 5: Fringe Benefits Tax

Learning Outcomes

On completion of this chapter, you should be able to:

- Define a fringe benefit;
 - Explain who is responsible to pay fringe benefit tax;
 - Calculate the taxable values of different fringe benefits;
 - Calculate fringe benefit tax;
 - State when fringe benefit tax is due; and
 - Explain the penalties for non-compliance with fringe benefits tax regulations.
-

Introduction

This chapter discusses the taxation of fringe benefits in Malawi. It is important to note that fringe benefits arise from an employer – employee relationship with the employer providing fringe benefits to the employee. The fringe benefits are provided in kind and do not include cash payments by the employer to the employee.

5.1 Definition of a Fringe Benefit

A fringe benefit is defined under **S2** of the Taxation Act as, ‘any asset, service or other benefit in kind provided to an employee by an employer if such a benefit includes an element of personal benefit to the employee.’

S94A(1) provides that every employer, other than the government who provides fringe benefits to employees shall be liable to fringe benefit tax on the total value of fringe benefits provided to employees earning not less than **K20,000** per month or **K240,000** per annum.

Fringe benefits tax is due in cases where the employer makes payments directly to third parties in respect of goods or services provided and not on payments made directly to employees. The employee is liable to tax on payments made directly to him.

Any amounts paid in cash to an employee by an employer does not constitute fringe benefits.

5.2 Registration

An employer is required to register with the commissioner within 14 days after he begins providing fringe benefits to employees by completing form **FBT 1** (Fringe benefit tax registration form).

5.3 Rate of fringe benefits Tax

Fringe benefits tax is payable at the company rate of **30%** of the total taxable value of fringe benefits provided.

5.4 Determination of Taxable Values

5.4.1 Housing Accommodation

For housing accommodation the taxable value is:

5.4.1.1 For property owned by the employer:

50% of the taxable value determined as the greater of:

- (i) The open market value of use (rental) value of such property or
- (ii) **10%** of the employee's salary where unfurnished housing is provided or
- (iii) **12%** of the employee's salary where furnished housing is provided

5.4.1.1 For property rented by the employer, the greater of :

- (i) The rental paid by the employer for such property or
- (ii) **10%** of the employee's salary where unfurnished housing is provided or
- (iii) **12%** of the employee's salary where furnished housing is provided

Example

An employee is provided with furnished accommodation. The house is rented by the employer at K50, 000 per month. The employee's salary is K960, 000 per annum. What is the annual taxable value for the benefit?

Solution

The taxable value is the greater of

Rent paid K600, 000

12% of salary $12\% \times K960, 000 = K115, 200$

It is therefore K600, 000

5.4.2 Motor Vehicles

The taxable value of motor vehicles is **15%** of the original value per annum. This is applied for each year the motor vehicle is used.

5.4.3 School Fees and other Related Expenses

If an employer pays school fees and related expenses directly to an institution to enable an employee's children or dependants obtain educational qualifications, the taxable value of such a benefit is **50%** of the total cost to the employer.

5.4.4 Loans to Employees

Taxable value on loans provided to employees will be found by taking the difference between the interest charged by the employer and interest chargeable if bank lending rates were used.

However, the following listed loans will not attract fringe benefits tax:

- (i) Education loans
- (ii) Emergency advances
- (iii) Medical loans
- (iv) Funeral expenses loan

5.4.5 Other General Fringe Benefits

The taxable value of such benefits is the total cost to the employer. These include, but are not restricted to:

Cell phones
Utilities such as electricity, water and telephone
Household items of any kind
Vacations, travel and any other provisions
Domestic servants of any kind such as gardeners, maids, security guards and watchmen.

Where the employee is accommodated in a property owned by the employer the cost of a gardener, watchman and security guard does not constitute a fringe benefit.

In addition, where the employer meets the cost of medical care and uniform expenses for its employees this will not constitute taxable benefits.

5.5 Reduction of Taxable Values

The taxable values of fringe benefits as determined using the rules above should be reduced;

- (i) If the employee contributes towards the provision of the benefit. The taxable value is reduced by the amount contributed by the employee.
- (ii) If the benefit is not provided for a whole year, the taxable value should be reduced in proportion to the period the benefit is provided.

5.6 Payment of Fringe Benefit Tax

Fringe benefit tax is payable in quarterly instalments and is due within 14 days from the end of each quarter.

The quarters are

1 July	-	30 September
1 October	-	31 December
1 January	-	31 March
1 April	-	30 June

Fringe benefits tax due must be accompanied with a duly completed form FBT 2 (Fringe benefit tax quarterly return and remittance form)

5.7 Records to be Kept by the Employer

For the purpose of fringe benefits tax, an employer is required to keep records showing

- a) Nature of fringe benefits provided.
- b) Names of employees receiving fringe benefits.
- c) The taxable values of fringe benefits as determined in accordance with the rules discussed above.

The records must be available for inspection at any reasonable time by the commissioner or any officer duly authorized by him.

5.8 Offences

The following are the main offences which may be committed in relation to fringe benefits tax.

- a. Failure to register within the required period
- b. Failure to pay fringe benefit tax by the due date

If these offences are committed, the employer shall be liable to a penalty of **20%** of fringe benefits tax due. The penalty must be paid together with fringe benefits tax due.

Summary

This chapter has discussed the taxation of fringe benefits in Malawi. It has looked at the various aspects of fringe benefits, eligibility for fringe benefit tax and items that attract fringe tax.

End of Chapter Questions

- 1 What is a fringe benefit?
- 2 What is the rate of fringe benefits tax?
- 3 When is fringe benefits tax due?
- 4 If an employer provided benefits to an employee whose annual taxable emoluments amounted to K100, 000 he would not be liable to fringe benefits tax, true or false?
- 5 What is the taxable value of furnished housing accommodation if the property is not owned by the employer?
- 6 An employer's fringe benefits tax liability for a quarter ended 31 March amounting to K34000 was paid on 28 April. Calculate the penalty that the employer is liable to.

NOT FOR SALE

Chapter 6: Taxation of Passive Income

Learning Outcomes

On completion of this chapter, you should be able to:

- Describe different types of passive income; and
 - Explain how the passive income is taxed.
-

Introduction

This chapter defines passive income, explains the basis of assessment to tax and also discusses the rules guiding deductibility of expenses for passive income.

6.1 Definition of Passive Income

Passive income arises from investments that generate future income. These include rent from movable and immovable property, interest, royalties, patents, and dividends. This chapter examines how these incomes are taxed.

6.2. Rent

According to S23 rent includes premiums received from another person for the right to use or occupy land and buildings, or the right to use plant or machinery, patent, trade mark, or other property which in the opinion of the commissioner is of a similar nature.

Rental income is taxable in the year it is receivable and normally received net of withholding tax. The person making the payment withholds a prescribed percentage of the amount due which is payable to MRA.

Rental income must be included in assessable income.

Example

For a taxpayer receiving rent of K240, 000 for a year, the person making the payment is required to withhold K36, 000 (assuming WHT rate is 15%) and the owner of the asset will receive K204,000. In the assessable income, the owner of the asset will include K240 000. The amount withheld will be deducted from the tax liability for the year.

• 6.2.1 Deductible Expenses

If a person incurs any expense on the asset in relation to which he is receiving rent, he is allowed to deduct the expense from the assessable income if it meets the conditions under **S28**. For the expense to be deducted, it must not be capital in nature and must be wholly, exclusively and necessarily incurred in the production of

rental income.

Examples of deductible expenses include:

- Rates
- Insurance
- Rent (if the property is sublet)
- Repairs

6.3 Interest

Interest is taxable in the year in which it is receivable. Taxable interest is received net of withholding tax.

Interest income should form part of assessable income of a taxpayer, however the following types of interest are exempt from tax and should not be included in the assessable income.

- a) Interest up to K10, 000 per annum from a bank or building society from stocks, bonds, and promissory notes issued by or on behalf of the government;
- b) Interest on certain investment accounts with the new building society (subject to certain limits) on savings certificates issued by the government or on tax reserve certificates;
- c) Interest on public loans raised by the government and specified as being exempt;
- d) Interest on government stocks or bonds directed by the minister of finance to be Exempt; and
- e) Interest on 4½% African development fund.

Note:

- I. The interest exemption (up to K10, 000 per annum) only applies to individual tax payers not companies or other organizations and is also per transaction.
- II. There are no deductible expenses in respect of interest income.

6.4 Dividends

Dividend income should not be included in the assessable income. The company paying dividends is required to withhold **10%** as tax and this is a final tax. Although the word “final” has not been defined, it is applied as meaning that dividend withholding tax suffered cannot be offset against an income tax liability.

Summary

This chapter has discussed one important but often overlooked type of income: passive income. Passive income has been defined before giving examples. For each of the examples of passive income, namely, rent, interest and dividends, the chapter has discussed the basis of taxation as well as the treatment of allowable expenses where

applicable.

End of Chapter Questions

- (i) What is the basis of assessment for rental income?
- (ii) A taxpayer's bank account was credited with K18, 000 (net). How much is he supposed to include in his return of income as interest assuming withholding tax rate is 20%? How much is taxable.

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Chapter 7: Taxation of Gains and Losses

Learning Outcomes

On completion of this chapter, you should be able to:

- Define foreign exchange gain or loss;
- Define capital gain or loss;
- Calculate foreign exchange and capital gains and losses;
- Determine the gain which is assessable and the loss which is deductible; and
- Identify gains which are exempt.

Introduction

This chapter discusses taxation of gains and losses as provided in Section 26 of the Taxation Act. These include gains and losses incurred on foreign currency transactions, and on disposal of fixed assets.

7.1 Foreign Exchange Gains and Losses

Foreign exchange gains and losses arise in transactions which are denominated in foreign currency if there is a difference in the rate of exchange for foreign currency on the date the transaction was initiated and on the date the transaction is satisfied.

S26 requires that foreign exchange gains and losses that arise from a source within Malawi be included in the computation of taxable income.

Foreign exchange gains and losses are determined using the formula **ar1 - ar2**

Where

a is the amount of foreign currency received, paid, or otherwise computed with respect to a foreign currency asset or liability in the transaction in which the foreign currency asset or liability is disposed off, converted, repaid or otherwise eliminated

r1 is the official rate of exchange for foreign currency with respect to Malawi currency at the date on which the foreign currency asset or liability was obtained or established by the taxpayer.

r2 is the official rate of exchange for foreign currency with respect to Malawi currency at the date of satisfying the transaction.

Foreign exchange asset or liability means an asset or liability denominated in or whose amount is otherwise determined by reference to the foreign currency.

Example

A Malawian trader imported goods whose value was \$2,000 in January when the rate of exchange was \$1 to K350. Payment was made in June when the rate of exchange was \$1 to K400. Calculate the foreign exchange gain or loss realized by the trader.

Solution

$$\begin{aligned}\text{Gain or loss} &= ar1 - ar2 \\ &= \$2,000 \times 350 - \$2,000 \times 400 \\ \text{Loss} &= K700,000 - K800,000 \\ &= K100,000\end{aligned}$$

7.1.1 Treatment of Foreign Exchange Gains and Losses in the Computation of Taxable Income.

A foreign exchange gain which has been realized is included in the assessable income for the period in which it is realized.

A foreign exchange loss which has been realized is deducted from the assessable income for the period in which it is realized.

However, **S28(6)** limits the amount of a foreign exchange loss which can be deducted from assessable income if in the same period the taxpayer has an unrealized foreign exchange gain. The deductible loss is the excess of realized foreign exchange loss over the unrealized foreign exchange gain.

Where the taxpayer has an unrealized foreign exchange gain, an unrealized foreign exchange loss and a realized foreign exchange loss in the same period, the deductible loss is the excess of the realized loss over the net of the unrealized gain and unrealized loss.

Example

The following table shows tax treatment of foreign exchange transactions over a few years of assessment.

<i>Tax Year</i>	<i>Details</i>	<i>Transaction</i>	<i>Computation</i>
2012/2013	Realised foreign exchange gain	200000	
	Realised foreign exchange loss	<u>Zero</u>	
	net realised gain for year	<u>200000</u>	
	Amount assessable per computation		<u>200000</u>
	Unabsorbed loss carried forward		Zero
2013/2014	Realised foreign exchange gain	Zero	

	Realised foreign exchange loss	800000	
	Unabsorbed loss brought forward	<u>Zero</u>	
	<u>net realised loss for year</u>	800000	
	Unrealised foreign exchange gain	500000	
	Amount deductible per computation		<u>300000</u>
	Unabsorbed loss carried forward		500000
2014/2015	Realised foreign exchange gain	100000	
	Realised foreign exchange loss	Zero	
	Unabsorbed loss brought forward	<u>500000</u>	
	<u>net realised loss for the year</u>	400000	
	Unrealised foreign exchange gain	250000	
	Amount deductible per computation		<u>150000</u>
	Unabsorbed loss carried forward		250000
2015/2016	Realised foreign exchange loss	450000	
	Unabsorbed loss brought forward	<u>250000</u>	
	<u>net realised loss for year</u>	<u>700,000</u>	
	Amount deductible per computation		700,000

7.2 Capital Gains and Losses

Capital gains and losses realized for a Malawian source must be included in the computation of tax liability.

Capital gains and losses accrue from a Malawi source if they are realized in respect of tangible property located in Malawi or property representing an interest in a company incorporated in Malawi.

7.2.1 Definitions

- a) **Capital gain** – Excess of the amount realized on the disposal of an asset over its basis or adjusted basis.
- b) **Capital loss** - Excess of the basis or adjusted basis of an asset over the amount realized on its disposal.
- c) **Capital asset** – All property held by a taxpayer whether connected with any trade or not but excluding stocks in trade and accounts receivable,
- d) **Disposal** - The transfer of ownership of an asset by whatever means, including but not restricted to sale, gift, bequest, distribution or exchange.
- e) **Amount realized** - Disposal proceeds of a capital asset which may be cash received or contracted to be received if the asset is sold, the market value of the other asset if

it is exchanged for another, or its open market value if it is disposed off without consideration

f) Basis of an asset.

- i. For assets on which capital allowances were being claimed, the basis is the **tax written down value**. The tax written down value is the difference between the **cost of an asset and total capital allowances** claimed on the asset.
- ii. For assets on which no capital allowances were being claimed, the basis is the **cost** of the asset adjusted by **consumer price index (CPI)** published by the **National Statistical Office (NSO)** at the time of disposal of an asset and applicable to the year in which the asset was purchased or constructed.

7.2.2 CPIs or Conversion Factors Adjusting Basis of an Asset for Disposals Occurring from Jan 2015- Dec 2015

CPIs to be updated after a consensus on workings

Year	Original CPI	Rebased CPI 1970 = 100	Conversion Factor
1970	100.000	100.000	900.316981
1971	108.300	108.300	831.317619
1972	112.500	112.500	800.281761
1973	118.900	118.900	757.205199
1974	140.000	140.000	643.083558
1975	167.500	167.500	537.502676
1976	187.700	187.700	479.657422
1977	212.000	212.000	424.677821
1978	240.800	240.800	373.885790
1979	278.300	278.300	323.505922
1980	352.200	352.200	255.626627
1981	110.400	388.829	231.545858
1982	120.100	422.992	212.844819
1983	136.200	479.696	187.684748
1984	151.200	532.526	169.065230
1985	173.800	612.124	147.080913
1986	199.500	702.639	128.133648
1987	252.900	890.714	101.078144
1988	332.200	1,170.008	76.949617

1989	384.400	1,353.857	66.500163
1990	429.100	1,511.290	59.572740
1991	108.200	1,635.216	55.057985
1992	133.400	2,016.061	44.657226
1993	163.800	2,475.493	36.369194
1994	220.500	3,332.395	27.017116
1995	404.200	6,108.635	14.738431
1996	556.200	8,405.796	10.710669
1997	607.100	9,175.043	9.812673
1998	788.000	11,908.967	7.559992
1999	1140.700	17,239.287	5.222472
2000	1476.400	22,312.689	7.750912
2001	122.700	27,377.669	6.316962
2002	140.800	31,416.265	5.504909
2003	154.300	34,428.478	5.023274
2004	172.000	38,377.824	4.506344
2005	198.500	44,290.687	3.904741
2006	226.100	50,448.989	3.428090
2007	244.100	54,465.273	3.175302
2008	265.400	59,217.875	2.920464
2009	287.700	64,193.605	2.694095
2010	309.000	68,946.208	2.508385
2011	332.600	74,212.002	2.330400
2012	403.500	90,031.698	1.9209 20
2013	513.790	114,640.37	1.508575
2014	636.031	141,915.68	1.218637
2015	775.091	172,943.70	1.000000

Base Years are highlighted.

a) How to calculate Capital Gains Using Conversion Factors

1. Multiply the cost price of the asset by the conversion factor for the year in which the asset was acquired in order to obtain the adjusted basis of the asset.
2. Get the difference between the selling price and the adjusted basis to get either the capital gain or capital loss.

3. The total amount (100%) of the capital gain is taxable.
4. Calculate 30% provisional tax on the Capital Gain and pay to MRA.

Examples

1. A house was bought in 1971 at K50, 000 and is being sold at K44 million.
 - Multiply K50,000 x 831.317619 (conversion factor for 1971)
=K41,565,880.95

Capital Gain = K44, 000,000- K41,565,880.95
= **Mk 2,434,119.05**

 - **Provisional Tax payable = K2,434,119.05 x 30% = K730, 235.715**
2. A house cost MK10, 000 to construct in 1980 is being disposed for MK3.5 million.
 - Multiply K10,000.00 x 255.626627(conversion factor for 1980)
=K2,556,266.27
 - Capital Gain= K3, 500,000- MK2,556,266.27
 - = **K947, 733.73**
 - **Provisional tax payable = K947,733.73 x 30%= K284, 320.12**

The above conversion factors are applicable for disposals taking place from January 2013 up to December 2013.

7.2.3 Exempt Gains and Losses

Gains and losses realized from the following transfers are not recognized

- (a) Between spouses and former spouses
- (b) To a spouse from an estate of a deceased spouse
- (c) To a child from an estate of a deceased parent.
- (d) On disposal of an individual's principal residence
- (e) On disposal of personal or domestic assets not used in connection with any trade

7.2.4 Treatment of Capital Gains and Losses in the Computation of Tax Liability

Realized capital gains are included in the assessable income for the period in which it is realized.

replacement asset. In this case, the gain to be recognized is the excess of the amount realized over the cost of the replacement asset.

7.3.1 Qualifying Replacement Asset - an asset similar to or related in use to the asset converted.

7.3.2 Valid Election – An election made in a timely filed return of income for the tax year in which the conversion takes place which

- Briefly describes the type of the conversion
- Identifies the asset converted
- Indicates the adjusted basis of the asset converted
- States the intention to acquire a qualifying replacement asset.

If the taxpayer does not acquire a qualifying replacement asset in the year in which the conversion takes place but makes a valid election to acquire the asset, it must be acquired within 2 years from the end of the year in which the conversion takes place.

Provisions relating to involuntary conversion do not apply in respect of motor vehicles except those used in the business of transporting goods and passengers.

7.4 Capital Gains on Disposal of Business Assets (Roll Over Relief)

Rollover relief is given where the taxpayer has disposed an asset to acquire a qualifying replacement asset. This means that the taxpayer does not pay tax on the gain immediately. Instead, the cost of the replacement asset is reduced by the amount of the gain. The taxpayer must declare this in the tax return.

Under **S15B (1)**, subject to subsection 2, no capital gain shall be recognized on the disposal of an asset if the gain has been used to acquire a qualifying replacement asset.

Example-2

Assuming in the example the company received an insurance compensation of K200,000 and used K170,000 to purchase another machine similar in use to the first one within the qualifying period. Calculate the basis of the replacement machine.

Solution

The amount of gain realised on the conversion:

Amount realised	200,000
Adjusted Basis	<u>100,000</u>
Gain realised	<u>100,000</u>

Only K30, 000 of this gain will be recognised (the excess of the amount realised over the cost of the qualifying replacement asset i.e. K200, 000 less K170,000)

Gain not recognised:

Gain realised	100,000
Gain recognised	<u>(30,000)</u>
Gain not recognised (deferred)	<u>70,000</u>

The basis of the new machine

Cost of the machine	170,000
Gain not recognised	<u>(70,000)</u>
	<u>100,000</u>

Subsection 2 provides a condition for the roll over relief to be available. Under this subsection, the qualifying replacement asset should be acquired within 18 months from the date the disposal occurred and should be declared on the income tax return.

7.5 No Gain No Loss on Certain Contribution to Capital

No gain or loss is recognized upon the contribution of assets to capital of a company where the person making the contribution own at least 80% of shares in the company.

In such a case, the basis of the asset contributed in the hands of the company shall be the adjusted basis in the hands of the person immediately prior to the contribution.

7.6 Distribution of Property with Respect to Shares

According to S70B if a company distributes property to a shareholder in respect of his shares, there will be either a gain or a loss recognized in the same manner as if the property was sold to the shareholder at its open market value.

7.7 Bonus Shares

These are free shares issued to shareholders in proportion to their existing number of shares held. A company may decide to distribute further shares as an alternative to increasing the dividend payout. A company's reserves are used to issue out such shares.

Under S70C, when the shares are issued,

- i. The distribution shall not be included in the income of a taxpayer and shall not be treated as a dividend.
- ii. The shareholding following such an issue shall remain unchanged

- iii. The basis of the old shares shall be allocated between the old and new shares in proportion to their respective values.

7.8 Distribution in Complete Liquidation of the Company

Under S70d, if a company makes a distribution of assets when it is being liquidated, the shareholders will be treated as if they have sold their shares in exchange for the property or cash received and gains or losses will be recognized.

7.9 Reorganisation

According to the taxation Act reorganization means

- i. a mere change in the form of the company.
- ii. a recapitalization of a company
- iii. a combination of two or more companies into a single company
- iv. a division of a company into two or more companies
- v. The acquisition of at least 80% of the equity interests in a company in exchange solely for equity interest in the acquiring company.
- vi. The acquisition of at least 80% by value, of the assets of a company in exchange solely for equity interests in the acquiring company.

7.9.1 Qualified Reorganization

A qualified reorganization means reorganization pursuant to written plan undertaken for valid business purposes and not for avoidance by any person involved in the reorganization.

If the reorganization is qualified no capital gain or loss is recognized. The basis of asset acquired shall be determined with reference to the adjusted basis of the asset immediately before reorganization. The acquiring company shall take into account the tax attributes of the acquired company unless otherwise provided.

Distribution of equity shares between parties to reorganization shall not be taxable but any other distributions of cash or other property shall be taxable in the hands of the recipient as consideration received in a sale or exchange.

Any reorganization which is not qualified shall be treated as a sale of the company and

all its assets.

7.10 Tax Clearance Certificate on Transfer of Capital Assets

Any person transferring land and buildings is required to obtain a tax clearance certificate. Any person concluding the transfer of land before obtaining the certificate shall be liable to a penalty of K50, 000.

The certificate can be issued upon application to the commissioner .For the certificate to be issued, the commissioner must be satisfied that

- i. The applicant is a registered tax payer and is not exempt from income tax.
- ii. He has filed all income tax returns due.
- iii. He has no outstanding tax liability

7.10.1 Other Transactions Which Require a Tax Clearance Certificate

- Renewal of business resident permit
- Renewal of certificate of fitness for commercial vehicles.
- Renewal of certificate of registration under the national construction industry Act
- Renewal of professional business licenses and permits of medical practitioners, or dentists, legal practitioners engineers and architects who are engaged in private practice on his or her own or in partnership with another private practitioner.

Summary

This chapter has covered foreign exchange gains and losses, capital gains and losses, involuntary conversions, company reorganizations and tax clearing certificates.

End of Chapter Questions

- 1 For the purposes of the Taxation Act, define the term **amount realized** for an asset that has been:
 - (i) Sold for cash
 - (ii) Exchanged for another
 - (iii) Disposed off without consideration

- 2 **Calculate the amount of realized capital loss which is deductible** from assessable income in the following circumstances. Assume no capital allowances were claimed:
- (i) Where a taxpayer has a realized loss of K20, 000 and there is no capital gain realized.
 - (ii) Where a taxpayer has a realized loss of K40, 000 and there is a unrealized capital gain of K10,000.
- 3 How would your answer to part (2) above, differ if the capital losses and gains related to asset on which capital allowances were claimed.
- 4 A Malawian business person imported trade goods whose value was ZAR600, 000 in March 2015 when the exchange rate was ZAR1 to K40. Payment for the goods was made in December 2015 when the rate of exchange was ZAR1 to K42.

Required

Calculate the foreign exchange gain or loss realized on the day the payment was made. Using the formula $ar_1 - ar_2$ where

A = Amount of foreign currency involved

r_1 = Official rate of exchange of the Rand with respect to Malawi Kwacha in March 2013

r_2 = Official rate of exchange of the Rand with respect to Malawi Kwacha in December 2013.

- 5 A taxpayer's records for the year to 30 June 2014 had the following information

Realized foreign exchange losses	K20, 000
Realized foreign exchange gains	K40, 000
Unrealized foreign exchange gains	K15, 000

Advise the taxpayer whether or not

- (i) A deduction from the assessable income can be made in respect of the whole of the realized loss
- (ii) Both the realized and the unrealized foreign exchange gains can be included in the assessable income

Chapter 8: Capital Allowances

Learning Outcomes

On completion of this chapter you should be able to:

- Explain types of capital allowances;
- Identify assets qualifying for the different types of capital allowances;
- Apply appropriate restrictions on investment, initial and annual allowances; and
- Compute capital allowances.

Introduction

Accountants provide for depreciation in accounts to apportion the value of an asset used in a period against the revenue it has created (matching concept). Depreciation is not an allowable deduction for tax purposes. This does not mean that the tax law does not recognise the matching concept but that it seeks to iron out differences that could be brought about as a result of using different depreciation methods. Capital allowances are therefore given instead of depreciation. This chapter outlines how capital allowances are computed.

8.1 Capital Allowances Provision

Under **S33** and Part 1 of the Second Schedule to the Act the taxpayer is allowed to **deduct capital allowances**.

8.2 Types of Capital Allowances

There are three types of capital allowances namely: **investment, initial and annual**. Investment and initial allowances are first year allowances, mutually exclusive (Meaning that where an investment allowances has been given initial allowances are not allowed on the same asset). Both initial and investment allowance are claimed in the year in which the asset is acquired and brought into use.

Annual allowances are given to a taxpayer in respect of all assets that are used by a taxpayer on the last day of a year of assessment.

8.2.1 Investment Allowances

These are available to a taxpayer who is also a manufacturer. **A manufacturer** is the owner of business carried on in industrial buildings or the owner of a plantation producing tea, coffee, tobacco, sugar, cocoa, or such other crop as the minister may approve.

Investment allowances are claimable on industrial buildings, plant and machinery which are in use by a taxpayer during the year of assessment and used by taxpayer in the process of manufacture for purpose of manufacturing.

The rates are as follows:

- i. 100% of the cost of new and unused industrial buildings and plant and machinery; and
- ii. 40% of used industrial buildings, plant and machinery.

For the purposes of investment allowances Plant & Machinery does not include motor vehicles intended or adapted for use or capable of being used on roads.

A taxpayer who is eligible for investment allowance shall **in addition** be given a **15% allowance** if he invests in an area designated for purposes of the additional allowance by the Minister and published in the Gazette.

a) Meaning of an Industrial Building

An industrial building is a building which is used for:

- The making of a part or a full article.
- The subjecting of goods to any process including breaking up, or demolition.
- The adaption for sale of any article.
- The generation of power.
- Transport, dock, inland navigation, water refrigeration, electricity hydraulic power tunnel, bridge undertaking.
- An hotel.
- The processing and distribution of fish, including shell fish.
- Any activity which the Minister declares in writing to be making an important contribution to national development.

b) Exclusions from the Definition of an Industrial Building

The following are not industrial buildings:

- Dwelling houses;
- Retail shops;
- Show rooms;
- Storehouses; and
- Offices.

c) Meaning of Staff Housing

These are houses elected for occupation by an employee engaged in the business or farming operations of a manufacturer or farmer respectively.

Staff houses do not qualify for investment allowances but for initial and annual

allowances.

Where staff housing is occupied by an employee described below, the capital allowances shall be restricted to one third of such allowances, an employee:

- Whose time is not wholly occupied in the service of the company.
- Who is able directly or indirectly to control more than 5% voting rights attaching to all classes of shares of the company.

d) Building with both Industrial and non Industrial Elements

Where a building has both industrial and non industrial elements and the capital expenditure which has been incurred on the construction of the non industrial element is not more than one-fifth (20%) of the total capital expenditure which has been incurred on the construction of the whole building, the whole building and every part thereof shall be treated as an industrial building.

If the non industrial element is more than one-fifth of the total capital expenditure, the non industrial part of the building shall not be treated as an industrial building.

Example

An industrial building with offices cost K100, 000 to construct. How much of the cost qualifies for capital allowances if the cost of constructing the part which is used as an office is

- i. K18, 000
- ii. K25, 000

Solution

- i. K18, 000 is only 18% of K100, 000 which means allowances are available on K100, 000.
- ii. K25, 000 is 25% of K100, 000; only K75,000 will qualify for allowances.

8.2.2 Initial Allowances

Where a taxpayer so elects, an initial allowance shall be made in respect of capital expenditure incurred by a taxpayer during the year of assessment on the construction of new;

- Farm Improvements
- Farm Fencing
- Industrial Buildings
- Railway Lines

Or additions or alterations to existing;

- Farm Improvements

- Farm Fencing
- Industrial Buildings
- Railway Lines
and in respect of;
- Articles
- Implements
- Machinery e.g. motor vehicles, office equipment
- Utensils e.g. furniture & fittings, computers etc

Purchased and used by the taxpayer for the purpose of his trade or for farming purposes.

No initial allowances shall be made in respect of private passenger motor vehicles and assets on which investment allowances have been claimed.

Private passenger motor vehicles include:

- Saloon
- Sedan
- Station wagon
- Double cabin pick-up
- Land cruiser
- Pajero
- Prado
- Other makes of a similar nature
- Excluding those used for hiring purposes

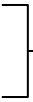
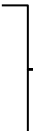
a) Farm Improvement

This is any building or structure or work of a permanent nature including any water furrow used in the carrying on of farming operations excluding any building or structure or work of a permanent nature to which S58 applies. (e.g. drilling of boreholes and any building used as a dwelling house by the taxpayer)

b) Farm Fencing

This is fencing used for carrying on of farming operations e.g. fencing for Paddock farming.

c) Rates of Initial Allowances

- | | | |
|--|---|-------------|
| <ul style="list-style-type: none"> • Farm improvements • Industrial buildings • Railway lines |  | 10% of cost |
| <ul style="list-style-type: none"> • Articles • Implements • Machinery • Utensils |  | 20% of cost |

- Farm fencing 33 1/3 % of cost

8.2.3 Annual Allowances

Annual allowances are given to a taxpayer provided an asset is in use for the purposes of a taxpayer's trade at the end of the period of assessment regardless of when an asset was purchased if it was purchased during that year of assessment. The allowances are given on the reducing balance basis.

The annual allowances are on cost less investment / initial and annual allowances previously claimed. Assets qualifying for the 100% investment allowance are not eligible for the annual allowance.

Where 100% investment allowance has been given on an asset, no annual allowances will be claimed.

a) Rates of Annual Allowances

Farm improvements	
Industrial buildings	5% of cost
Railway lines	
Farm fencing	
Plant, Machinery and equipment	10 % of cost
Newly constructed commercial building whose cost is K100 million or above	2½% of cost

Commercial buildings are those buildings used for trading purposes such as selling and buying of merchandise. Wholesalers and retailers are examples of business operating in commercial buildings.

For other assets the rates of annual allowances to be used are those determined by the Commissioner General as being appropriate in relation to the class of assets in question. Once the rates have been determined they apply to subsequent years unless superseded by any other determination by the Commissioner General.

If an asset is subject to extensive use such as machinery working in double shifts, so that its expected economic life is reduced, the Commissioner General may agree to increase the rates of annual allowances e.g. Mapeto David Whitehead, Blantyre Print, and Carlsberg

Note: These rates will be given in the exam paper.

8.3 Disposal of Assets

a) Capital Gain on Disposal

If the disposal proceeds of an asset on which capital allowances have been claimed exceed the tax written down value (i.e. the cost of the asset less capital allowances) - the "adjusted basis" there will be a **capital gain** which must be included in assessable income.

b) Capital Loss on Disposal

A capital loss occurs where the written down value (adjusted basis) is greater than the disposal proceeds. Capital losses are deductible in full from assessable income (there are no restrictions on the deductibility of capital losses realised on the assets on which capital allowances have been claimed).

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8.4 FORMAT FOR THE COMPUTATION OF CAPITAL ALLOWANCES

Asset	Tax Written down value B/F	Additions	Disposals	Total	Investment	Capital Allowances			Total	Tax written value C/F
						initial	Annual Rate %	Annual		
Pool 1	K	K	K	K	K	K		K	K	
Pool 2										
Pool 3										
Pool 4										

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Example

Mr Chirwa has a manufacturing business and had the following balances in his claim for capital allowances for the year ended 31 March, 2016:-

Asset	Annual Allowance	TWDDV at 1/04/15
Industrial building	5%	107,000
Plant and machinery	10%	97,500
Saloon Cars	20%	24,000
Lorries	20%	14,000
Office equipment	10%	10,000

During the year the following transactions took place:

- He purchased plant for K30, 000 of which K10, 000 was second hand.
- Sold the industrial building for K250, 000, original cost of the building was K200, 000.
- He purchased a new industrial building for K300, 000.
- A lorry purchased on 31 March 2014 for K20, 000 was involved in a road accident and totally written off. The insurance company has settled the company's claim for the loss of K10, 000.
- He purchased two new saloon cars for K8, 000 and K10, 000. He trades in a car in part exchange which cost K6, 000 new on 6 February 2014. The trade in value was K3, 000.

Required

Prepare Mr Chirwa's claim for capital allowances for 2015/2016 assuming he claims all allowances to which he is entitled. (*R E Mdeza's Tax Manual Modified*)

Solution

MR CHIRWA
COMPUTATION OF CAPITAL ALLOWANCES FOR THE YEAR ENDED 31.03.2016

Asset	Tax written down value b/f	Additions	Disposals	Total	Investment	Capital Allowances			Total	Tax written value c/f
						Initial	Annual Rate	Annual		
Indust. Build	107,000	300,000	107,000	300,000	300,000	K	0	0	300,000	0
P&M	97,500	30,000	0	127,500	24,000		0	10,350	34,350	93,150
Saloon cars	24,000	18,000	3,840	38,160				7,632	7,632	30,528
lorries	14,000	0	9,600	4,400	0			880	880	3,520
Office Equip.	10,000	0	0	10,000	0			1,000	1,000	9,000
	252,500	348,000	119,480	480,060	324,000		0	19,862	343,862	136,198

8.5 Mining Allowances

A person carrying on mining operations who incurs mining expenditure is entitled to an allowance of **100%** of the mining expenditure in the year the expenditure is incurred.

8.5.1 Meaning of Mining Expenditure

Paragraph 11 of the Second Schedule - Mining expenditure is capital expenditure incurred in Malawi by a person carrying on or about to carry on mining operations in Malawi. Such capital expenditure includes:

- a. Searching for or discovering and testing or winning access to deposits of minerals.
- b. The acquisition of or of rights in or over such deposits other than from a person who has incurred mining expenditure in relation to such deposits.
- c. The provision of machinery which would have little or no use at all if the mine ceased to be worked.
- d. The construction of buildings or works which would have little or no value if the mine ceased to be worked.
- e. The development, general administration and management prior to the commencement of mining operations.

A proviso to paragraph 11 specifically excludes from the definition of 'mining expenditure' the acquisition of the site of deposits or of the site of buildings or works connected with mining operations. Mining expenditure incurred after 1 November 1969 before commencement of mining operations is deemed to have been incurred on the day mining operations commence. No mining allowances can be claimed in respect of expenditure incurred prior to 1 November 1969.

A person engaged in mining operations shall not be eligible to claim any export allowance or any transport allowance for goods, materials or products exported from Malawi.

Companies engaged in mining operations will **be liable to an additional resource rent tax of 10% on profits after tax, if the company's rate of return exceeds 20 percent.** This is in addition to the normal income tax charged on profits.

Example

Company A makes an investment in the mining industry amounting to K1 million. Profit for the year come to K800,000.

Corporate tax is	K240,000.
Profit after tax is	K560,000
Resource rent is	K 56,000

Summary

This chapter has described the capital allowances that are claimed on specific assets in accordance with S 33 of the Taxation Act. The allowances are; investment, initial, and annual. There are specific rules relating to how assets qualify for each type of allowance. The chapter has also explained the allowances available on mining operations.

End of Chapter Questions

1. Who is a manufacturer?
2. When do dwelling houses qualify as industrial buildings? What types of allowances are available in respect of such dwelling houses?
3. What type of machinery is excluded from the term 'machinery' under investment allowances?
4. Define 'Mining Expenditure.'
5. Explain the tax implications of the disposal by a person carrying on mining operations of his interest in the mine.
6. What is the difference between Initial allowance and Annual Allowance?
7. During the first year of trading to 30 September 2015, Mr Phiri who is engaged in a manufacturing business, purchased and used the following assets:

Type of Asset	Purchase Price in K
Industrial Building (second hand)	1,000,000
Plant and Machinery (new)	800,000
Motor Vehicles (second hand)	250,000

Required

- i. State whether investment allowance is due on the three types of assets. If it is, calculate the amount of the allowance.
 - ii. If Mr Phiri was using one of the motor vehicles for private purposes, what effect would such private motoring have on the amount of capital allowance claimable on the motor vehicle?
 - iii. What other expenses would be affected by the use of the vehicle by Mr Phiri in (ii) above and state in what way they would be affected.
- d. In relation to capital allowances, comment on the validity of each of the

statements listed below:-

- i. In respect of the same asset, a taxpayer can claim investment allowance in addition to initial allowance.
- ii. No capital allowances can be claimed or given in respect of motor vehicles intended or adapted for use or capable of being used on roads.
- iii. Capital allowances are given to taxpayers because of the use of assets in the business of such taxpayer.

(PAEC Dec 1994, Modified)

NOT FOR SALE

Chapter 9: Business Taxation

Learning Outcomes

On completion of this chapter you should be able to:

- Explain how sole proprietorships are assessed to tax;
- Calculate taxable income of a sole proprietorship business;
- Compute tax liability of a sole proprietorship business; and
- Outline the records that have to be kept by a sole proprietor.

Introduction

This chapter introduces regulations governing assessment of sole proprietorships to tax, computation of taxable income, tax liability and records to be kept.

9.1 Definition of a Sole Trader

A sole proprietorship is a business owned by one person. In this business, there is no divorce of ownership between the owner and the business.

9.2 Determination of Taxable Income of a Sole Proprietorship

In determining the taxable income of a sole proprietorship, the following are taken into consideration:

1. Total assessable income of the sole proprietorship
2. Total allowable deductions of the sole proprietorship

The taxable profits of the sole proprietorship business will therefore be the difference between assessable income and allowable deductions i.e. $\text{assessable income} - \text{allowable deductions} = \text{taxable income}$

9.2.1 Assessable Income

S11 –This is the total amount in cash or otherwise including capital gains received by, accrued to or in favour of a person in any year or period of assessment from a source within or deemed to be within Malawi excluding amounts exempt from tax.

a) **Assessable income** will include:

- Operating revenue
- Passive income
- Capital gains
- Realised Foreign exchange gains – s26(1)
- Bad debts recovered – s36(2)

b) Assessable income will exclude:

- Dividends because they are subject to a final withholding tax of 10%
- Profit on disposal of non current assets because they are calculated based on depreciation which is not an allowable deduction for tax purposes
- Exempt income as given by the first schedule to the Taxation Act
- Unrealized Foreign exchange gains

9.2.2 Allowable Deductions

Not all expenses are tax allowable expenses. There are other expenses that may be incurred by a business which will not be allowable for deduction.

9.3 Determining Allowable Deductions

9.3.1 General Rule

The **general rule** to apply for those expenses **not specifically** mentioned in the Taxation Act is given by **S28**;

‘In determining taxable income of a taxpayer, there shall be deducted from the assessable income of such tax payer the amounts of any expenditure and losses wholly, exclusively and necessarily incurred by the taxpayer for the purpose of his trade or in the production of the income.’

9.3.2 Specific Rules

a) S32 – Repairs

Repairs of a revenue nature are allowable; those of a capital nature are not. It is needful to know the difference between capital and revenue expenditure.

- Capital expenditure is one that results into acquisition or improvement of the earning capacity of a capital asset (non current asset).

- Revenue expenditure, on the other hand is incurred when carrying on day to day operations.

b) S33 – Capital Allowances

As provided in the second schedule to the Act.

c) S34 – Premiums Paid

The tax deductible amount of the premium paid for the right of use or occupation of land or buildings, plant or machinery, patent design, trade mark, copy right or any other property of a similar nature is:

- a) The amount of premium or consideration divided by the number of years for which the right of occupation or use is granted; or
- b) Where the period for which the right of occupation or use is granted exceeds 25 years, the deduction is one-twenty fifths of the premium or consideration.

Example

A retailer paid K2.5million for the right to use a building as a retail shop for 30 years. How much is the retailer allowed to deduct from his assessable income when computing taxable income?

Solution

The premium paid is spread over the lower of:

- i. 30 years
- ii. 25 years.

Therefore, the premium allowable for deduction in each year of assessment up 25 years will be $K2.5m/25 \text{ years} = K100,000.00$

The premium is tax deductible where the asset or right in respect of which the premium or consideration is paid is used for the generation of income.

If a taxpayer acquires the ownership of the asset or right, no further deduction of the premium or consideration is allowed from the date ownership is acquired.

Premiums or consideration paid for the right to use somebody's property (tangible or intangible) are allowable for deduction. Some premiums may relate to a period of more than 25 years, in such a case, 25 years must be the maximum period for spreading of the premium.

c) S35 – Bad Debts

Debts proved bad to the satisfaction of the Commissioner General during the year of assessment and are included in either current or previous year of assessment are allowable for deduction.

d) S36(1) - Doubtful Debts

They are allowable **only if** they are specific provisions. General provisions are not allowed.

e) S36A, 41B - Export Allowances

Exporters, including those manufacturing in bond, are entitled to claim additional tax allowances for the export of non traditional goods as follows:

- i. 15% export allowance calculated as 15% of the taxable income derived from the export of non traditional products
- ii. Additional 25% tax allowance on international transport costs for non traditional exports

Traditional exports are tea, coffee, cane sugar and unmanufactured tobacco and tobacco refuse

Export allowances may not be claimed in respect of exports from mining operations.

Other additional benefits include:

- No duties on import of capital equipment used mainly in the manufacture of exports
- No VAT
- No excise taxes on purchase of raw materials and packaging materials made in Mw.
- No duties of capital equipment and raw materials.

f) S37 - Pension Contribution by Employer

An employer is allowed to deduct an amount contributed on an employee's behalf to an approved pension fund subject to the provisions of the 5th schedule.

Allowable deduction under the 5th schedule is the lesser of:

- Total contribution by employer for the year or
- 15% of annual salary of employee

Amounts contributed by employees to their pension funds are no longer allowable for deduction.

g) S39 - Research Expenditure

Revenue expenditure pertaining to **research and experimental work** of taxpayer in a field **relating to his trade** is **allowable**.

Sums contributed by taxpayer, towards **research and experimental work** connected to **taxpayer's job**, to **scientific/educational society approved by minister** is **allowable**.

h) S39 - Donations to Approved Charitable Organisations

Allowable provided it is not less than **K250**

i) S39 - Donations to Not for Profit Organisations

Allowable if:

- The donations are at least **K500**
- Made to not for profit organisations operated solely or principally for:
 - social welfare;
 - Civic improvement;
 - Educational development; or
 - Similar purposes as approved by minister.

j) S 39A Social Contributions

There is allowed as a deduction 50% of any amount paid as a social contribution directly into the building of a public hospital or school, or sponsoring of youth sporting development activities.

k) S40 - Annuity Payment

There shall be allowed any amount paid by way of annuity, allowance or pension during the year of assessment by any taxpayer:

- a) to a former employee who has retired on grounds of ill health, infirmity or old age, or
- b) to any person who is dependent for his maintenance upon a former employee or was dependent immediately prior to his death.

The allowable deduction is restricted to **K1,200 per former employee per annum** if amounts are paid to **dependants of employee**.

l) S41 - Initial Business Expenditure

Allowed as deduction provided it

- is **incurred 18 months prior** to commencement of a manufacturing business.
- should be one which would have been allowable as a deduction if incurred after commencement of business.

m) 42 - Trading Losses

- a. They are allowable for deduction from taxable income of future years of assessment
- b. They can be carried forward for a **maximum period of 6 years**.
- c. The right to carry forward trading losses is lost by a person who:
 - i. Has been adjudged or declared bankrupt
 - ii. Has made a conveyance of his property or estate for benefit of his creditors releasing him wholly or partially from the scheme
- d. Where creditors of taxpayer agree to have liabilities incurred in ordinary course of business reduced, the amount allowable in respect of trading losses is also reduced by this reduction.

n) S45 - Specifically Disallowable Expenses

- The cost of maintaining the taxpayer and family;
- Domestic/private expenses;
- Losses/expense recoverable under an insurance contract or indemnity;
- Income tax and penalties thereon;
- Fringe benefits tax and penalties thereon;
- Expenses relating to income not included in assessment; and
- Employer pension contributions to unapproved pension funds.

9.4. Determination of Taxable Profits when an Income Statement is Available

To arrive at the taxable profits the Income Statement has to be adjusted to take account of the provisions of the Act. The format for adjustment of profits (losses) is as follows:-

Net Profit (Loss) per accounts	xxx
Add back: all expenses which have been deducted in the	

Income Statement but are not allowable-			
e.g. - depreciation		xxx	
- Capital expenditure		xxx	
Private expenses		<u>xxx</u>	
			xxx
Add: Taxable income which has not been added to profit			xxx
			<u>xxx</u>
Less: Allowable expenses which has not been deducted in the Income Statement-			
e.g. - capital allowance -		xxx	
Income which has been included in profit but is not taxable -			
e.g.- Profit on disposal of Non Current Assets		xxx	
			<u>(xxx)</u>
Adjusted (Taxable) Profits			(xxx)

Example

John who owns a manufacturing business drew up the following Income Statement for the year ended 30 June 2015:-

Gross Profit for trading			100,000
Add : Profit on sale of car		1,000	
Discounts received		<u>900</u>	
			<u>1,900</u>
			101,900
Less Rent and rates		2,400	
Light and heating	1	1,560	
Travel Expenses		2,460	
Wages and Salaries	2	60,000	
Depreciation		15,000	
Repairs	3	5,100	
Bad and doubtful debts	4	1,080	
Amortisation of lease	5	1,000	
Legal expenses	6	150	
Pension fund contributions	7	6,000	
General expenses		8,800	
Income Tax		3,000	
			<u>98,550</u>
Net Profit for the year			<u>3,350</u>

Notes to the Income Statement:-

1. One third of rent, rates, light and heating relates to the flat in which John and his family live above his workshop premises.
2. Salaries include K10,000 that John draws for himself.

- | | | | | |
|----|---------------------------------|--------------|---------------------|--------------|
| 3. | Repairs account: | K | | |
| | Extension to workshop | 4,000 | | |
| | General maintenance | 500 | | |
| | Repainting flat | <u>600</u> | | |
| | | <u>5,100</u> | | |
| 4. | Bad and doubtful debts account: | | | |
| | | K | | K |
| | Trade debts | 1,000 | General provision | 800 |
| | Non-trade debts | 100 | at 1.7.14 | |
| | General provision | | Specific provision | 400 |
| | at 30.6.15 | 980 | at 1.7.14 | |
| | Specific provision | | Bad debts w/off | |
| | at 30.6.15 | 600 | Profit and loss A/c | <u>1,480</u> |
| | | | | <u>2,680</u> |
5. In 1990, John paid a premium of K30, 000 to acquire a 30 year lease on his workshop. This is being written off in equal amounts over the 30 year lease period.
6. Legal expenses comprise of K100 for debt collection and K50 re extension to workshop.
7. Pension fund contributions relate to four employees for whom an approved pension scheme is operated. Each employee earns a salary of K8, 000 per annum and contributes 8% of this by way of his own contribution.
8. General expenses comprise K450 college fees for Malawian employees, donations of K120 to MACOHA K100 to MALAWI CONGRESS PARTY and K15 to MAP; and K115 of other allowable items.
9. Capital allowance for the year has been agreed at K20, 000.

Required

Calculate John's taxable income for the year ended 30 June 2015?
(R E Mdeza's Manual with modifications)

Solution

JOHN TAXABLE BUSINESS INCOME FOR THE YEAR ENDED 30 JUNE 2015

	Notes	K	K
Net Profit per account			3,350
Add back:			
Rent and rates	1	800	
Light and wages	1	520	
Wages and salaries	2	10,000	

	Depreciation	3	15,000	
	Repairs	4	4,600	
	Bad debts	5	280	
	Lease amortisation	6	1,000	
	Legal expenses	7	50	
	Income Tax	8	3,000	
	General expenses	9	235	<u>35,485</u>
				38,835
Less: Capital Allowances		10	20,000	
Training costs allowance		11	225	
Profit on sale of car		12	1,000	
Lease Amortisation		6	1,200	<u>(22,425)</u>
Taxable Profits				<u>16,410</u>

NOTES

1. Expenditure of a private nature is specifically disallowed under s45.
2. Salaries to owner are drawings which are not deductible.
3. Depreciation is expenditure of a capital nature.
4. Extension of the workshop is expenditure of a capital nature and repainting flat is domestic expenditure
5. Non-trade debts written off are not incurred for trade purposes and general provisions are specifically disallowed under S36.
6. The premium should be written off over a period of 25 years and not 30 years – S34.
7. The legal expenses in respect of extension to workshop are of a capital nature.
8. Income Tax is specifically disallowed under s45
9. General expenses:
 - The donation to MACOHA and MAP are disallowed because each is less than K250 despite that both are approved charitable organisation.
 - Malawi Congress Party is not a charitable organisation.
10. Capital allowances are allowable deductions - s33.
11. Under s41A there is an additional 50% allowable deduction in respect of training costs that have been paid to enable an employee who is a Malawian to attain a qualification. The assumption is that the said college is an approved institution.
12. Profit on sale of car - this is an accounting capital gain. The assumption made here is that the capital gain/loss in tax terms has been included in capital allowances.
The net profit before tax has to be adjusted to take account of the provisions of the Act.

Computation of Tax Liability for the Sole Trader

As pointed out earlier, sole proprietorship is not a separate legal entity from its owner

and as such, the sole trader has to pay tax on taxable income of The Sole Proprietorship as well as his other taxable income..

Taxable Income

Taxable income of the sole proprietorship	xxx
Add: Sole traders other taxable income	<u>xxx</u>
Total taxable income of a sole trader.	<u>xxx</u>

Tax Liability of the Sole Trader

This is found by multiplying the aggregate taxable income of the sole trader by the income tax rates given in the appendix to the eleventh schedule of the Taxation Act.

Currently the rates are(2015/2016):

	Rate(%)		Cumulative
1 st K240, 000	0		
Next K60, 000	15	1 st K300, 000	15%
Excess over K300, 000	30	Excess over K300, 000	30%

8.6 S 55(1) Period of Assessment

- Accounts should be prepared for a **period of 12 months**.
- Where the period exceeds 12 months, prepare accounts for 12 months and those for the remaining period.
- Under section 55 of the Taxation Act, the Commissioner General may, in his discretion accept the accounts whose year end is other than 30 June for assessment in respect of the assessment year ending 30 June prior or subsequent to the closing date of such accounts. While the Commissioner's discretion is under lock and key, the normal practice is to designate 30 June prior for all accounts made up to 31 July, 31 August and 30 September. Accounts prepared after September 30 June subsequent.

Example

Where a taxpayer's accounts are prepared to 31 August, 2015, will be assessed to tax in the tax year ending 30 June 2015 while Where a taxpayer's accounts are prepared to 31 December, 2015, will be assessed in the tax year ending 30 June 2016

9.5 Information to be kept for Tax Purposes

- Every person carrying on business is required to keep sufficient records of income and expenditure to enable ascertainment of assessable income and allowable deductions These records should be kept for a minimum of **7 years**.

However preservation of records will not be required where:

- The Commissioner General has notified the taxpayer that the preservation of records is not required.
- A company has gone into liquidation and finally been dissolved

9.6 Tax Relief for Taxable Income Assessed to Tax in more than one Accounting Period (Section 55)

- Tax relief is available if taxpayer ceases to trade
- It is available in last year of assessment
- Takes the form of a reduction in taxable income for that year of assessment
- If taxable income for final year is not enough, reduce taxable income for penultimate year

Summary:

The deduction of allowable expenditure enables determination of taxable income from businesses. Some deductible expenditure is incurred in the process of generating income while others are deducted in order to encourage participation by the public in the provision of social service, attract investment and foster economic development.

End of Chapter Questions

1. What is the year of assessment for accounts which have been prepared to 30 September 2015?
2. What type of repairs are deductible under the Act
3. What conditions must be met for a debt declared bad to be allowed as a deduction?
4. What method of stock valuation is acceptable by the tax law?
 1. List any four types of expenditure which are specifically disallowed under s45.
 - 2.

- 6 Boyizi Leze, a sole trader, trading as Mchiza Enterprises, has two major divisions: a general farming division and a wholesale and retail division. The Income Statement for the year ended 30 June, 2015 is as follows:-

	Notes	K	K
Gross profit	1		130,140
Investment income			<u>4,000</u>
			<u>134,140</u>
Less: Rent and insurance		16,200	
Salaries		12,220	
Light and heat		4,000	
General expenses	3	1,800	
Travel expenses		3,300	
Depreciation		27,000	
Loss on sale of motor vehicle		1,030	
Bad debts	4	6,000	
Subscriptions and donations	5	8,000	
Legal and accountancy fees	6	20,500	
Bank loan interest		4,000	<u>104,050</u>
Profit/(Loss) for the year			<u>30,090</u>

NOTES

The following information relating to the accounting period above is also available.

1. Depreciation on the Plant and machinery is charged to the trading account. The charge for the year ended 30 June 2015 was K14, 950.
2. Investment income is in respect of dividend received from a local company.
3. General expenses were made of:

Calendars sent to customers	1,000
Bank overdraft interest	400
Medical aid contributions (for proprietor)	<u>400</u>
	<u>1,800</u>
4. Bad debts is a general provision and is provided as 5% of total debtors.
5. Subscriptions and donations:

Malawi Congress Party	6,000
Malawi Red Cross	10

Chamber of Commerce	200
Save the Children fund	<u>1,790</u>
	<u>8,000</u>

6 Legal and Accountancy fees include:

Proposed sale of farming division	2,000
Accountancy fees	6,000
Cost of action for failing to get spirit licence	5,000
Debt Collection	6,000
Renewal of short lease	<u>1,500</u>
	<u>20,500</u>

7. Capital allowances for the year were agreed at K20, 500.

REQUIRED

Calculate the adjusted profits for the year ended 30 June 2015.

QUESTION TWO

- a) AB is an individual taxpayer whose business includes letting property. A summary of the Profit and Loss Account of the business for the year ended 31st December 2015 is given below:

TAXPAYER AB

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31ST DECEMBER 2015

	NOTE	K'000	K'000
Turnover			2,000
Less: Salaries		800	
Depreciation		45	
Gratuities	(1)	150	
Legal Costs	(2)	40	
Motor Vehicle Expenses		110	
General Expenses	(3)	50	
Fringe Benefits Tax		20	
Pension Contributions		50	
Repairs and Maintenance	(4)	100	
Auditors Fees		25	
Bad debts	(5)	105	
Rent Payable		145	
Local Business Travel		<u>60</u>	<u>1,700</u>
Profit before taxation			<u>300</u>

Notes

(1) Gratuities K150,000

The amount is made up of the following:	K
Gratuity on completed contracts	125,000
Gratuity on uncompleted contracts	<u>25,000</u>
	<u>150,000</u>

All contracts were approved for purposes of the Taxation Act.

(2) Legal Costs K40,000

These have been incurred in respect of the following:	K
Debt collection	15,000
Lease agreements	15,000
Loan agreement	<u>10,000</u>
	<u>40,000</u>

(3) General Expenses K50,000

	K
Office teas and other consumables	20,000
Church donation	6,000
Postage	10,000
Donation to street beggars	<u>14,000</u>
	<u>50,000</u>

(4) Repairs and Maintenance K100,000

	K
Completed repairs	25,000
Uncompleted repairs	25,000
New steel door protectors	<u>50,000</u>
	<u>100,000</u>

(5) Bad debts K105,000

	K
General provision	50,000
Specific provision	<u>55,000</u>
	<u>105,000</u>

(6) Capital allowances

These have been computed and agreed to amount to K75,000

Required

Compute the taxable income of the taxpayer for the year ended 31st December 2015. (5 ½ marks)

- b) Explain how you have dealt with the following expenditures under notes (1) and (4) in (a) above:
- i) Gratuities; (2 marks)
 - ii) Repairs and maintenance (3 marks)
- c) i) What tax advantages are enjoyed by:
- 1) an employee on contract providing gratuity;
 - 2) an employer who sets up a pension scheme for employees(5 marks)
- ii) What precondition is necessary for the enjoyment of these tax advantages?
(1 mark)

NOT FOR SALE

Chapter 10: Taxation of Partnerships

Learning Outcomes

On completion of this chapter you should be able to:

- Compute taxable income of a partnership;
 - Distribute the taxable income of the partnership to the partners; and
 - Calculate tax liability for each partner.
-

Introduction

This chapter discusses the taxation of partnerships. It considers who is liable to pay tax on taxable profit of a partnership, determination of taxable income, and distribution of profits in a partnership.

10.1 Definition of a Partnership

A partnership is a relationship that subsists between two or more persons carrying on Business in common with a view to profit.

A partnership, just like a sole proprietorship, is not a separate legal entity from its owners and as such it is not a taxpayer.

10.2 Liability to Tax on Taxable Income of a Partnership

The partners are liable to tax on the partnership income in their individual capacities.

S74 of the Act requires persons carrying on trade in partnership to submit a joint return of income in respect of such trade and other particulars as may be required from time to time and each partner is separately and individually liable for the submission of the joint return. The partners are liable to tax in their separate individual capacities so that separate assessments will be made on the partners.

10.3 Determination of Taxable Income

Taxable income is determined in the hands of the partner taking into accounts various items and their tax treatment. For example, adding back all expenses that have been deducted from profit but are not deductible paying particular attention to items like partner's salaries, interest on capital and drawings, private expenses of the partners paid for by the partnership, deducting allowable expenses which have not been deducted such as capital allowances.

10.4 Distribution of Taxable Income

Since each partner is separately and individually liable to tax the partnership's taxable income should be shared among the partners. This is done using the profit and loss sharing arrangements in the partnership agreement.

The first step is to allocate interest on capital and salaries (if any) to each partner.

Then allocate the private expenses which have been enjoyed by the partner(s) from the partnership.

Lastly, the balance is shared according to the profit and loss sharing ratios; then each partner's amounts are added up to get the total share of the profits for him/her.

Example

D, E, and M who are in partnership trading as DEM & Co share profits equally. The following is the partnership' profit and loss for the year ended 30 June 2015:

Gross Profit					50,000
Less: expenses					
General expenses				10,000	
Advertising				5,000	
Depreciation				5,800	
Salaries	D	4,000			
	E	3,200			
	M	2,400		9,600	
Interest on capital:	D	1,500			
	E	2,100			
	M	2,300		5,900	(36,300)
					<u>13,700</u>

Required

Compute the taxable profit for each partner using the information above.

Solution

DEM & CO
TAX COMPUTATION FOR THE YEAR ENDED 3 JUNE 2015

Accounting profits

			13,700
Add: Depreciation	5,800		

Salaries	9,600	
Interest on capital	5,900	<u>21,300</u>
		<u>35,000</u>

DISTRIBUTION OF TAXABLE INCOME

	Total	D	E	M
Salary	9,600	4,000	3,200	2,400
Interest on capital	5,900	1,500	2,100	2,300
Balance 1:1:1	<u>19,500</u>	<u>6,500</u>	<u>6,500</u>	<u>6,500</u>
	<u>35,000</u>	<u>12,000</u>	<u>11,800</u>	<u>11,200</u>

Note:

You may be required to calculate the tax liability of one of the partners. In this case you should include the share of the partnership taxable income in the partner's total income if he/she has other incomes. For example if you were asked to compute E's tax liability you would include K11, 800 as business profits in his taxable income.

Trading losses - if the partnership has an assessed loss, the loss is shared among the partners. Each partner can relieve the loss by offsetting it against his other income of either the year of the loss or the following year.

Key Issues

- A partnership is not a separate legal entity from its owners; therefore, the partners are liable to tax on the profits in their individual capacities.
- The Profit and Loss a/c is adjusted in the same way as that of the sole trader and then the profit/loss is shared in accordance with the profit and loss sharing arrangements.

Summary

This chapter has discussed the taxation of partnerships by looking at who is liable to pay tax on taxable income of a partnership, determination of taxable income and distribution of profits in a partnership.

End of Chapter Questions

1. What are provisions regarding partnership taxation as contained in Section 74 of the Taxation Act?

2. If a partnership had an assessed loss how much tax would each of the partners be liable to? And how would the loss be treated?
- 8 Messrs Jere, Muhiwa and Miss Mkwanda have for the past six years jointly operated a successful garment manufacturing concern in Lilongwe sharing profits in the ratio 2:3:5.

The following are details of the concerns financial affairs for the year ended 31 March 2016 as presented by their bookkeeper.

	NOTE	K'000	K'000
Sales			2,800
Cost of Sales			
-Raw Materials		1,120	
-Labour		224	
-Factory overheads	1	205	<u>1,549</u>
Gross Profit			1,251
Less Expenses			
-Salaries and wages		280	
-Depreciation	2	35	
-Salary - Mr Jere		22.8	
-Finance charges		85	
-Other expenses	3	195	
-Interest on Capital	4	<u>80</u>	<u>697.8</u>
NET PROFIT			<u>553.2</u>

NOTES

1. Factory overhead includes depreciation on factory plant and machinery of K120,000.
2. Included in the depreciation charge is the sum of K10,000 being depreciation of a car belonging to the partnership but used by Mr Jere who manages the concern on a full-time basis.
3. Other expenses comprise all sundry expenses including:-
 - a. Donations and gifts

- Malawi Red Cross	380
- Malawi Against Polio	250
- Commonwealth Ex- Services League	4,000
- Local Church	7,200
 - b. Provision made against specific

- | | | |
|----|---|---------|
| | Doubtful debts | 6,000 |
| | Bad debt written off - No provision was made
in respect of these debts before | 3,500 |
| c. | Drawings | |
| | - Miss Mkwanda | 29,000 |
| | - Mr Muhiwa | 15,000 |
| 4. | The interest on capital is levied at the rate 10% p.a. and the partners capital
accounts throughout the year stood at: | |
| | -Mr Jere | 150,000 |
| | -Mr Muhiwa | 250,000 |
| | -Miss Mkwanda | 400,000 |
| 5. | Capital allowance for the year are K83, 000. | |

REQUIRED

Calculate the taxable income of each partner and state who is responsible for payment of the tax.

NOT FOR SALE

Chapter 11: Taxation of Companies

Learning Outcomes

On completion of this chapter you should be able to:

- Explain how companies are assessed to tax;
 - Calculate taxable income of companies;
 - Compute tax liability of companies;
 - Explain the treatment of assessed losses of a company; and
 - Explain the tax implications of dividend declaration and distribution.
-

Introduction

Chapters three, nine and ten introduced the procedures to be followed when assessing income of employed individuals, businesses run by either individuals or partnerships. This chapter presents the guidelines to be followed when assessing income of companies to tax.

11.1 Definition of a Company

A company is a separate legal entity from its owners; it is a person incorporated by law and liable to tax in its own right.

Every company that carries on trade or that has an office in Malawi is required to appoint an individual resident in Malawi who will be its public officer responsible for handling tax matters on its behalf. This individual must be approved by the Commissioner General.

11.2 Rates of Tax

Currently, the rates of tax are as follows:

- a) 30% for companies incorporated in Malawi,
- b) 35% for companies incorporated outside Malawi.

11.3 Determination of taxable income of companies

11.3.1 Procedure

The procedure for determining taxable income is as follows:

- a) All income of the company earned in an assessment year are summed up;
- b) From the total income arrived at in (a), all exempt income is deducted;
- c) The balance is referred to as assessable income;
- d) From assessable income (in c), are deducted all allowable expenses and allowances;
and
- e) The balance (in d) is the taxable income for the company.

11.3.2 Special Considerations

The following issues must be taken into account when computing taxable income of a company:

- a) No adjustments must be made in respect of private expenses (in the profit and loss account of the company.). There may be fringe benefit tax implications.
- b) No adjustments must be made for private use of assets when computing capital allowances.

11.3.3 Computation of Taxable Income from a Income Statement

When computing taxable income of a company from a prepared profit and loss account, the procedure is as follows:

- a) The profit or loss from the income statement is the starting point.
- b) To the profit or loss (in a) are added all expenses that have been deducted in the profit and loss account but not allowable for tax purposes and also all income which is taxable but was not included in the profit and loss account;
- c) To the profit or loss in (in a) are deducted tax allowable expenses which have not been deducted.

Example

Sterling Holdings Limited is a company incorporated in Malawi and is engaged in property letting and provision of services. The following is the summary of the company's financial activities for the year ended 30 June 2015:

Sterling Holdings Limited

Operating Profit and Loss Account for the year ended 30 June, 2015

	Note	K	K
Operating profit	1		820,000
Less: Salaries and Wages		165,000	
Depreciation-furniture		8,500	
General expenses	2	45,000	
Hire charges	3	16,000	

Vehicle running expenses		48,500	
Legal expenses	4	10,500	<u>293,500</u>
Profit before taxation			<u>531,500</u>

NOTES:

- The following was taken into account in arriving at the figure of K820, 000 operating profit.
 - K3, 200 - Depreciation on equipment
 - K25, 000 - Fencing of two properties
 - K15, 000 - Alterations - one property has a room subdivided to provide the tenant with a lockable garage.
- General expenses included K4,500 being the cost of building plans which were submitted to the City Authorities for approval.
- Hire charges were a prepayment in respect of a vehicle which, for some reason, was not delivered for use by 30 June, 2015.
- Legal expenses were incurred due to an increase in share capital except for an amount of K1,500 which was incurred in respect of tenancy agreements.
- Agreed capital allowances on all eligible items amounted to K27, 000.

Required

- Prepare an income tax computation for Sterling Holdings Ltd for the year ended 30 June, 2015.
- Assuming that the figure of operating profit included rental income from which withholding tax was deducted, what effect would such withholding tax have on the company's overall tax liability?

(PAEC Dec 1992 Modified)

Solution

- STERLING HOLDINGS LIMITED**

INCOME TAX COMPUTATION FOR THE YEAR ENDED 30/06/15

	Notes	K	K
Net Profit per accounts			531,500
Add back:			
Depreciation	1	11,700	
Fencing	2	25,000	
Alterations	2	15,000	
General expenses	2	4,500	
Hire charges	3	16,000	
Legal expenses	4	9,000	<u>81,200</u>
			612,700
Less:			<u>27,000</u>
TAXABLE PROFITS			<u>585,700</u>

TAX LIABILITY	5	<u>175,710</u>
---------------	---	----------------

NOTES

1. Depreciation is capital expenditure hence not deductible instead capital allowances are deducted.
 2. Fencing, alterations and building plans are capital expenses.
 3. The expense, though paid for, has not been incurred.
 4. Cost of raising share capital is expenditure of a capital nature.
 - 5, The tax liability is 30% of taxable profits (K585, 700).
- b) The withholding tax would be deducted from the company's overall liability to arrive at the amount of tax remaining to be paid.

11.4 Priority Industries

Companies operating in sectors designated as priority industries, are taxed differently from the procedures outlined above.

The Taxation Act has, with effect from the 2013/2014 tax year, designated as priority industries for the purposes of assessment of income tax, the following industries:

- a) Agro-processing industries; and
- b) Electricity generation, transmission and distribution.

Agro-processing means the process of converting primary or raw agricultural products into consumable commodities.

Generation refers to the production of electricity for sale and the term "generate" and "generating" shall have corresponding meanings, and

Transmission means the conveyance of electricity at 66, 000 volts or more, from generators or an import point to distributors or large customers or an export point through a transmission power system. The terms "transmit" and "transmitting" shall have corresponding meanings.

11.4.1 Objectives of designation of priority Industries

The designation of certain sectors of the economy as priority industries is meant to achieve the following objectives, amongst other:

- a) promote investments in the designated industries
- b) increase employment
- c) encourage exports so that the country is able to increase its foreign currency earnings;

11.4.2 Registration

A taxpayer who intends to be granted a priority industry status may file a written application with the Commissioner General for consideration. The applicant must, on application, have met the following minimum requirements:

- a) Be a natural or any legal entity;
- b) Has obtained a tax identification personal number;
- c) Has either commenced trading or obtained an investment certificate in accordance with the Investment and Export Promotion Act 2012;
- d) Has invested:
 - i. in agro-processing industry with a minimum capital of:
 - US\$500, 000 or its Kwacha equivalent in plant and machinery with 100 percent shareholding by Malawian citizens and subject to verification, there is value addition of 35% to the final product.
 - US\$5 million or its Kwacha equivalent in plant and machinery in any other case and subject to verification, there is value addition of 35% to the final product. or
 - ii. US\$30 million or its Kwacha equivalent in plant and machinery for electricity generation, distribution and transmission industry.

The priority industry certificate is granted to such taxpayer after a committee has assessed the application and is satisfied. The certificate is issued as evidence of registration and is valid for ten years.

11.4.3 Income tax benefits of priority industry status

A taxpayer, who has obtained a certificate and is complying with conditions prescribed in the certificate, shall hold the priority industry status for ten years.

The rate of tax applicable to priority industries in agro-processing and electricity generation, distribution and transmission shall be zero for the whole period granted.

A taxpayer who is operating in the priority industry shall not be exempted from complying with the requirements of any other written law.

11.4.4 Revocation of the priority Industry Status

The Commissioner General may revoke the status to operate in a designated priority industry where the tax payer:

- a) acts in breach of any terms and conditions of his status;
- b) acts in contravention of these regulations;
- c) acts in breach of any other law;
- d) has extended the application of his status to other non designated industries;

- e) has invested less than a required minimum capital;
- f) has contravened any other written law under which a relevant permit of its respective industry was issued; or
- g) has failed to disclose any material fact which if disclosed would prevent the granting of such status.

11.4.5 Grounds for Appeal by a taxpayer

A taxpayer can appeal against the decision of the Commissioner General on the following grounds:

- a) has been refused the priority industry status, or
- b) is aggrieved with the decision of the Commissioner general in the Commissioner general's application of the regulations governing priority industries status.

The appeal procedure is discussed in chapter sixteen.

11.5. Allowance of Losses

11.5.1 Allowable losses

Under **S42** a company can carry forward its assessed losses to offset them against the assessable income of future periods of assessment. Losses that are allowable to be deducted from assessable income of such a taxpayer are only those that:

- a) arise solely out of operations in Malawi;
- b) are incurred by the taxpayer in any previous year of assessment;
- c) have not been allowed as deduction from his income of a previous year of assessment.

11.5.2 Limitations to carry forward assessed losses.

The Act imposes the following limitations regarding the carrying forward of assessed losses:

- a) The assessed losses can be carried forward and deducted from future assessable income up to six years, thereafter the losses, if still not used are not available for deduction;
- b) A person who has been declared bankrupt or insolvent; or has made an assignment of his properties or estate for the benefit of his creditors or an arrangement with his creditors to release him wholly or partially from his debts shall not be entitled to carry forward his assessed loss incurred before the date he was declared bankrupt or made the assignment;

- c) Assessed losses will be reduced by an amount or value of benefit received by, or accrued to, a person resulting from a concession or reduction or extinguishment of liabilities in the ordinary course of operations; and
- d) The ability to utilise assessed losses brought forward is lost if there has been a change in the share holding of the company with assessed losses or the company that controls the one with an assessed loss, if the Commissioner General is satisfied that the change has been effected to take advantage of the losses.

11.6 Dividends

Under S70A (1) Every company incorporated in Malawi shall, upon distribution of any dividend, withhold 10 per cent of such dividend and remit the amount to the Commissioner within fourteen days from the date of distribution.

Where a dividend is distributed by a subsidiary or a holding company to a holding or related company and the income being distributed is derived from a dividend which was subject to withholding tax in the first instance, no withholding tax shall be deducted.

The amount of tax withheld from a dividend under subsection (1) shall be a final tax and the recipient of the dividend shall not be required to include the dividend received in his taxable income.

11.6.1 Penalty for non Compliance

Any company which fails to withhold tax at the time of distribution of any dividend as required by Section 70 A (3) shall be liable to pay the tax due and an additional sum equal to 20 per cent of the tax due.

Summary

This chapter has explained the regulations governing assessment of companies to tax.

End of Chapter Questions

Question One

ADAMSON MANUFACTURING LIMITED, a Malawi registered company and a 'manufacturer' within the meaning of paragraph 4 of the Second Schedule commenced business on 1 July, 2015. The company's statement of comprehensive income for the year ended 30 June, 2016 is as follows:

	K	K
Gross Profit		97,195
Discount receivable		1,042

Less: Overheads		
Salaries and wages	21, 572	
Lease premium	5,243	
Rates and insurance	10,692	
Motor expenses	26,185	
Depreciation	16,427	
bad debts	4,391	
General expenses	10,683	
	<u>98,237</u>	<u>98,237</u>
Net Profit for year		<u>3,044</u>

The following points should be noted in connection with the profit and loss account:-

1. Salaries and wages include K900 in respect of wages paid to domestic servants of the managing director.
2. Lease premium - on 1 July 2015, the company paid the sum of K40,000 as a single payment to secure a thirty-year lease for certain premises from which the company intended to operate. The finance director has calculated that this payment is equivalent to the present value of K5,243 (the amount charged to the profit and loss account) paid at the end of each of the thirty years of the lease, using a discount rate of 12,75%, the company's estimated cost of capital.
3. In addition to depreciation shown above, depreciation of K25, 231 has been charged in the manufacturing account.
4. Bad debts include the amount of K4, 000 set aside to establish a provision for doubtful debts.
5. General expenses include K5,200 in total in respect of donations (each over K250) paid to charities approved in terms of section 39 (d).
6. The following is the cost of fixed assets brought into use by the company during the year ended 30 June, 2014:-

Factory buildings K50,000 including K9,000 in respect of office accommodation within that building erected by the company in time to begin operations.

Plant and machinery K80, 000 of which K25, 000 was in respect of plant bought over from a company winding up. The remainder was for new items.

Land on which factory was built K10, 000.

Staff housing (all occupied by full-time non-director employees) total cost amounting to K60, 000.

Motor vehicles (new) K60, 000.

(One of the motor vehicles which cost K10, 000 is exclusively used by the GM. Private use has been agreed at 30%)

Rates of annual allowance

Plant and machinery	10%
Motor vehicles	20%

- 7 In the profit and loss account, the company has shown the amount of K4,000 deducted from net profit after taxation being the first year's share of write-off over ten years of the costs, incurred during the year before starting the business, of establishing the company. Of the total 'development' costs amounting to K40, 000, the amount of K7,500 was paid to a plant hire company for the use of earth moving equipment to clear the factory building site to enable building to start. The remaining K32, 500 was for normal business expenses (e.g. wages, salaries, etc) including labour costs of K1, 500 for the above site clearing. All 'development' costs are in addition to fixed assets noted in 6 above.
8. The company's turnover for the year was K1, 550,000.

REQUIRED: To draft:

a detailed income tax computation in respect of ADAMSON MANUFACTURING LIMITED for 2015/2016 giving brief notes and explanation of significant points.

Chapter 12: Special Trades and Cases

Learning Outcomes

On completion of this chapter you should be able to:

- Compute tax liability of a farmer;
 - Compute tax liability of timber businesses;
 - Compute tax liability of clubs and societies;
 - Explain tax implications of ecclesiastical bodies, charitable organisations and trusts;
 - Compute tax liability of insurance businesses;
 - Explain tax implications of hire purchase;
 - Explain double taxation; and
 - Compute turnover tax.
-

Introduction

The Taxation Act provides for special treatment for the taxation of special activities considered special trades. Special trades include; farming, cooperative agricultural societies, consumer cooperative societies, clubs etc. This chapter discusses the tax provisions for such trades.

12.1 Farming

A farmer derives income from pastoral, agricultural, or other farming operations. Apart from the deductible expenses looked at so far, under S58 (2) any person deriving income from pastoral, agricultural or other farming operations is allowed to deduct expenditure listed below although capital in nature:

- a) The stumping, levelling and clearing of lands;
- b) Works for the prevention of soil erosion;
- c) Boreholes;
- d) Wells;
- e) Aerial and geophysical survey;
- f) Any water control work in connection with the cultivation of rice, sugar or such other crop as the Minister may approve. ("water control work" includes any canal, dyke, channel, furrow and any flood control structure whether of a permanent nature or not); and
- g) Water conservation work. ("Water conservation work" means any reservoir, weir, dam or embankment constructed for the impounding of water).

If a farmer pays another person who carries out any work relating to the above, the expression "expenditure incurred" means the amount paid by the farmer during a year of assessment.

12.2 Timber Trade

Income from timber grown for sale is assessable income. As a growing crop, care must be taken on the part of the farmer in determining the income from timber in any year of assessment.

12.2.1 Sale of Timber

Under ordinary circumstances the generation of income from timber can only be deemed to have commenced when the actual selling of timber has commenced. Once sales of timber are made, the costs up to that point are capitalised as development expenditure. Even after timber sales have commenced, only expenses which related to specific timber sales income are deductible, with expenses of growing timber being carried forward as part of the cost of the timber.

On sale of timber, the appropriate proportion of cost carried forward is deductible [Section 38 (b)] from the income of that year of assessment.

12.2.2 Purchase of Land with Growing Timber

When the purchase price of land [Section 38(a)] acquired includes an element of cost of growing timber, it is necessary to reach an agreement with the Commissioner General as to how much of the purchase price attributable to standing timber [Section 38(a)(i)].

In the event that the taxpayer acquires the land at no purchase price, for example through inheritance, an agreement has to be reached with the Commissioner General as to the fair amount of an allowance [Section 38(a)(ii)] representing the value of the standing timber, if relevant, at the date of acquisition (inheritance) of the land. On the sale of timber, the portion of cost or allowance attributable to standing timber at the date of acquisition is deductible [Section 38(a)(iii)] against income derived from that sale.

12.2.3 Sale of both land and timber growing on land

a) Tax implications to the seller

Under section 24 where land with growing timber is disposed of, the seller is deemed to have assessable income from that sale of an amount equal to the market selling value of that timber at the date of disposal if:

1. the disposal is for valuable consideration, that is, a purchase price is payable or value is exchangeable in some form other than cash; and
2. the Commissioner General is of the opinion that the timber has been grown for sale.

Market selling value is the price which the timber would fetch [Section 50] if sold in its normal market in the normal course of business or the average prevailing market price of the timber.

Example

Joyce planted timber 5 years ago with the intention of felling and selling the timber. This year Joyce has decided to sell the land together with the timber at K5, 000, 000. The market selling value of the timber at the time of disposal is K3, 000, 000. The market selling value (K3, 000, 000) should be included in Joyce's assessable income; and K2, 000, 000 is the 'amount realised' for capital gain/loss purposes.

b) Tax implications to the buyer

Under S38 the allowable deductions will be:

- i. the value of the consideration that relates to the cost of the standing timber at the time of acquisition, if land was acquired for valuable consideration,
- ii. the amount fixed by the Commissioner General to represent the value of standing timber at the time of acquisition, if no valuable consideration was given by the taxpayer,

12.2.4 Sale of the right to fell trees only

a) Tax implications to the seller

If a taxpayer derives income from the sale of right to fell timber which was growing on land at the time the seller acquired the land, the taxable income will be the market value of the timber sold.

The allowable deduction will be:-

- i. If only a portion of the timber is sold, the allowable deduction will be that relating to timber sold during the year.
- ii. If taxpayer acquired timber and the right to fell and dispose of the timber was not acquired together with the land, the allowable deduction would be the amount of the consideration paid by the taxpayer in respect of the timber that relates to the timber sold or the value of the timber sold at the time of acquisition if no consideration was paid.

b) Alternative Tax Treatment of a Timber Farmer

Section 58(4) indicates that a farmer who derives taxable income from timber can opt

for an alternative tax treatment by making an irrevocable election for income from timber to be determined according to certain rules requiring that the cost of planting be carried forward from year to year, with an annual addition of five percent of that cost, the fixed percentage, representing the increase in value of the growing crop. The fixed percentage is deemed assessable income for each year of assessable. When timber is sold, a deduction is allowed against income for that part of the brought forward planting cost plus fixed percentage as represents the proportion of total timber sold in the year of assessment to total timber for which planting cost was incurred.

Maintenance and upkeep of timber are deductible expenses in the normal way.

The rules below are listed under section 58 (4):

- i. The cost of planting timber shall be carried forward until the timber reaches maturity.
- ii. 5% shall be added to the cost of the timber each year until the timber reaches maturity
- iii. To determine taxable income from sale of the timber, a proportion of the cost and 5% annual addition shall be deducted from the proceeds.
- iv. The 5% addition on cost shall be added to the taxable income or assessed loss of the farmer in each year of assessment.
- v. Any expenditure including capital allowances and premiums (S33 and S34) incurred by such farmer in the maintenance and upkeep of such timber shall be deducted from taxable income or assessed loss of that farmer.

Example

A farmer spends K20,000 in planting timber. After 5 years he sells the timber at K200,000. How much will be his assessable income?

Solution

Proceeds	K200, 000
Less; cost of planting	(20, 000)
Additional 5% of K20, 000 *5years	<u>(5, 000)</u>
Assessable income	K175, 000

12.3 Cooperatives Societies

12.3.1 Cooperative Agricultural Societies

S59 - the income of any producers' cooperative agricultural society registered under any law in Malawi is exempt from tax if the income is derived from transaction or dealing carried out in fulfilling all or any of the following objectives (**SIXTH Schedule**):-

- a) To dispose of the agricultural products or livestock of its members in the most profitable manner;
- b) To manufacture or treat the agricultural or livestock products of all its members and to dispose of such products in the most profitable manner;
- c) To purchase agricultural implements & machinery, livestock feeding stuffs, seeds manure or other farming requisites on behalf of its members;
- d) To manufacture or treat feeding stuffs, manure or other farming requisites;
- e) To engage competent persons to carry out any of its objects and to give instruction and advice to its members on farming operations;
- f) To acquire and distribute information on the markets of the world and cooperation in general, and information as to the best manner of carrying out farming operations profitably;
- g) To recruit and supply labourers for its members; and
- h) To purchase or otherwise acquire shares in any other cooperative agricultural limited company or society formed under any Malawi Law.etc.

Any producer's cooperative agricultural society which has income which has not been derived from the furtherance of any of the objects listed in the Sixth Schedule should submit proposals to the Commissioner General for the determination of its taxable income.

The Commissioner General may or may not accept the proposals. If he does not accept the proposals he will determine the taxable income of such cooperative societies in a manner he deems fit.

12.3.2. Other Cooperative Societies

The income of all cooperative societies (other than those discussed above) is liable to tax regardless of the fact that the income arises from transactions of the cooperative society with its members.

- Taxable income is found by taking 6.25% of the Gross Turnover; and
- Tax liability is found by taking 30% of such taxable income.

The word 'Turnover' means the total amount in cash or otherwise received by or accrued to the cooperative society in question from the sale of goods or services rendered.

REBATES or **BONUSES** based on purchases made by a member are not included in assessable income of a member except where the price of the purchases is allowable as a deduction in determining the member's taxable income.

12.4 Clubs, Societies or Associations

These fall into two categories, those that are exempt from tax and those that are liable to tax.

a) Exempt clubs, societies or associations include:

- i. Clubs, societies or associations **not formed for pleasure or recreation but formed, organised or operating solely or principally for social welfare, civic improvement** or other similar purposes if their receipts or accruals are not divided among the members.
- ii. **Ecclesiastical, charitable and educational institutions and trusts of a public character.**

These organisations would be liable to tax if they derive income from the carrying on of business.

b) Non exempt clubs, societies or other associations

The income of any club, society or association **formed, organised or operated solely or principally for pleasure or recreation is liable to income tax.**

The taxable income of any club, society or association is **6.25% of its gross receipts and accruals from sales of goods, cinematograph performances, stage plays and gambling machines.** This income is taxable at the rate applicable to companies (30%). The income is still taxable even where it is received by or accrued to or in favour of a trustee for such a club society of association.

The expression "STAGE PLAY" includes any tragedy, comedy, play, opera, farce, revue, variety, burlesque, interlude, melodrama, pantomime, dialogue, prologue, epilogue or other dramatic entertainment.

Example

PVC Club presented the following income and expenditure account to its members for the year ended 30 June 2016.

INCOME	K
Subscriptions	250,000
Profits from bar	15,000
Surplus from gambling machine	16,000
Donations from ex-members	500
Fees from sporting activities	<u>21,000</u>
	<u>302,500</u>
EXPENDITURE	
Staff wages	150,000

Loss on theatre shows	35,000
Maintenance of equipment	60,000
Affiliation fees	45,000
General expenses	<u>15,000</u>
	<u>305,000</u>
NET DEFICIT	<u>(2,500)</u>

NOTES

1. Turnover from bar was K125,000
2. The gambling machine operated on the basis of 80% pay out.
3. Revenue from theatre show amounted to K95,000

Required

Computed the tax liability for the club for the year ended 30 June 2016?

Solution

PVC CLUB

INCOME TAX LIABILITY FOR THE YEAR ENDED 30 JUNE 2016

	K
Turnover from bar	125,000
Gambling machine (W1)	80,000
Theatre shows	<u>95,000</u>
TOTAL RECEIPTS AND ACCRUALS	<u>300,000</u>
TAXABLE INCOME (W2)	<u>18,750</u>
TAX LIABILITY (W3)	<u>5,625</u>

Workings

W1 Gambling machine receipts - 80% pay out; K16,000 represents 20% of total takings.

$$\text{Total takings} = 16,000 \times \frac{100}{20} = \text{K}80,000$$

W2 Taxable income is 6.25% of total receipts and accruals i.e. 6.25% of K300,000. = 18750

W3 Tax liability = $30\% \times 18,750$
K5,625

12.5 Insurance Companies

Insurance business can be classified into two - Life Assurance and General insurance.

12.5.1 General Insurance Business

The tax provisions are contained in the SEVENTH Schedule and these are:

- i. The gross income of such insurance business is the sum of:
 - premiums received in Malawi;
 - amounts, other than premiums, received in respect of short term insurance business; and
 - the amount of a reserve allowed as a deduction in the previous year of assessment for unexpired risks at the percentage adopted by the insurer for such risks in relation to the general insurance business as a whole (as with bad debts recovered).

- ii. The allowable deductions include:
 - Premiums paid on re-insurance
 - Actual losses in Malawi less losses recoverable on re-insurance;
 - Management expenses, other than those of a capital nature;
 - Net commission after deduction of commission received on reinsurance.
 - Other expenditure (not being of a capital nature) incurred in the production of income;
 - an allowance as approved by the Commissioner in respect of expenses incurred outside Malawi in connection with premiums and other amounts received in respect of the short term insurance business; and- an amount of a reserve for unexpired risks at the percentage adopted by the insurer for such risks in relation to his insurance operations which is set aside by the insurer at the end of the year of assessment (as with provisions for doubtful debts).

Where a person in general insurance business derived income from a source other than insurance, the taxable income or assessed loss relating to such a source is to be determined in accordance with the general provisions of the Act.

12.5.2 Life Assurance Businesses

The receipts and accruals of Life assurance business are exempt from tax under the First Schedule. Under Section **S63 (2)** investment income (excluding investment income attributable to pension, provident and annuity funds) arising from the business of life assurance is liable to tax and it is determined using the following formula-

$$\text{Taxable income} = T1 \text{ less } E$$

Where T1 = Gross taxable income

E = the lesser of E1 and E2; where

E1= Expenses relating to taxable investment income.

E2=Expenses relating to taxable investments income restricted to 70% of gross taxable investment income.

Expenses relating to investment income include commissions, contractual bonuses, and management expenses.

12.6 Hire Purchase

S64 - Hire purchase is a legal term for a contract in which a purchaser agrees to pay for goods in parts or a percentage over a number of months. This usually occurs where the buyer cannot afford to pay the asked price for an item of property as a lump sum but can afford to pay a percentage as deposit and resultant monthly instalments.

When a sum equal to the original full price plus interest is paid the buyer may exercise to buy them or return them to the owner. If the buyer defaults on payment of instalments the owner may repossess the goods.

Taxpayers may get goods on higher purchase or enter into various agreements whose resultant effect is to delay change of ownership of both movable and immovable property. The whole amount involved in the transaction shall be deemed to have passed on, on the date of agreement.

The Commissioner General may take into consideration various aspects including capital allowances enjoyed, or to be enjoyed, on the items involved.

12.7 Double Taxation Relief

A taxpayer's income may be liable to tax in two countries. For example, the UK income tax system is based on residence i.e. the source of income does not matter; generally an individual is liable to income tax on 'worldwide' income if he/she is resident or ordinarily resident in the UK. The Malawi tax system is based on source. Say, an individual who is resident in UK has a bank account in Malawi; Non resident tax will be withheld on the interest arising on the account by the bank and he will be liable to tax in the UK on the same income. This could result in very high rates of tax.

To avoid such situations the Act provides for a relief which takes the form of a tax credit against the taxpayer's total liability. This is after subject of Double Taxation Agreements between countries and Malawi has entered into such agreements with several countries including (see Appendix C).

S123 states that the amount of reduction in tax under the double taxation agreements cannot exceed the amount derived using the formula below-

A x B where

C

- A is the amount of income which is taxable in two countries.
- B is the taxpayer's Malawi income tax liability before any reduction;
- C is the taxpayer's total income taxable in Malawi.

Example

Z has in 2013/2014, taxable income of K650, 000 (income tax liability is K153, 600). The income includes K130, 000 which is also taxable in the UK. Calculate tax liability assuming full reduction is given under the Double Tax Agreements.

Solution

$$\begin{aligned} & \text{Maximum tax credit (full reduction)} \\ & = \frac{130,000 \times 153,600}{650,000} \\ & = \text{K30,720.00} \\ \text{Tax liability after full reduction} & = \text{K153,600} - \text{K30,720} \\ & = \text{K122,880} \end{aligned}$$

Where the other country has no double tax agreement with Malawi, and the taxpayer proves to the Commissioner that he has paid tax in the country, the taxpayer's liability is reduced using the above formula or the amount of foreign tax paid; whichever is the lesser.

12.8 Turnover Tax

This is tax that was introduced in the 2013/2014 budget. This type of tax is **payable by small taxpayers with turnover of up to K10 million per annum**

Tax is payable monthly on the Turnover realised.

Turnover tax is charged at **2% of total turnover**. This is a final tax. Withholding tax deducted on any such taxpayer will be credited on assessment.

Turnover tax is not payable by registered companies even though their turnover in a year is less than MK10,000,000.

Partnerships are part of this arrangement if individual partner's turnover is less than MK10,000,000. If, however, one partner in a partnership is also a partner in another partnership where his total aggregate turnover is more than MK10,000,000, then the whole partnership is not subject to turnover tax instead they should submit the normal

returns to the Commissioner General.

This tax is optional. Business entrepreneurs whose turnover falls within the above range may choose not to register for turnover tax. In this case, they will be required to pay tax using the normal rates and their tax liability will be calculated on the taxable profit

Turnover tax is not applicable to taxpayers who fall within Section 58(2)

Turnover tax is not applicable to the following categories of income

- (i) Rental income, management or professional or training fees
- (ii) Income of incorporated companies
- (iii) Any income which is subject to final withholding tax

Advantages of turnover tax

- i. Operation of this tax is simple. Taxpayers are expected to maintain simple records of sales on which they will be applying the 2%
- ii. The rate of tax is very low
- iii. The cost of compliance is very low.

Records to be maintained

- i. Tax Payer is supposed to keep records of daily turnover.
- ii. These records subject to inspection by MRA

Penalties and Sanctions

- i. Failure to submit return attracts penalty of K5000 per return not submitted plus K250 each day a return is not submitted; and
- ii. Failure to pay tax shall render taxpayer liable to additional 20% of the unpaid tax plus additional 5% per month or part thereof.

SUMMARY

This chapter discussed the way the other businesses that have not been covered are supposed to be taxed and these include farming, timber, cooperative societies, life insurance businesses, hire purchase arrangements and turnover tax. They have given the basis of coming up with the taxable income and the relevant tax rates to be used. The chapter also discussed the issue of double taxation that would occur where a taxpayer may suffer tax twice in Malawi and another country, relief is available for such taxes but need to follow the guidelines is vital.

EXAM STYLE QUESTION

Section 58 to 65 of the Malawi Taxation Act, set out the provisions for the taxation of “special trades and cases”.

Required:

- a) In terms of the Malawi Taxation rules, why are farming, cooperatives, clubs and societies included under special trades? **[2 Marks]**
- b) List the type of expenditure incurred by the taxpayers who are engaged in pastoral, agricultural or other farming operations which are specifically allowable in determining their taxable incomes. **[5 Marks]**
- c) Explain the special basis that tax payers who are engaged in timber growing operations may use to determine their taxable income. **[5 Marks]**
- d) State how the income of a club or society which is organized solely for the pleasure or recreation of its members is assessed to tax. **[4 Marks]**
- e) It is possible that a Malawian taxpayer may have their income taxed twice due to circumstances at the time.

Required:

- i. How does double taxation arise **[2 Marks]**
- ii. List two strategies that the Taxation Act has put in place in order mitigate double taxation of tax payers income. **[2 Marks]**

[Total : 20 Marks]

Chapter 13: Tax Collection Methods

Learning Outcomes

On completion of this chapter you should be able to:

- Explain the PAYE tax ;
 - Compute PAYE;
 - Explain the Withholding tax;
 - Compute WHT;
 - Explain the Non Resident Tax;
 - Compute Non Resident Tax; and
 - Explain penalties for non compliance with withholding tax requirements.
-

Introduction

Income tax is collected in various ways. This chapter discusses the collection of income tax through withholding at source.

13.1 Withholding Taxes

13.1.1 Definition of Withholding Taxes

Withholding of taxes applies where any person due to make a payment to another person retains part of that payment and remits it to MRA. Withholding tax is not a system of taxation but only a method of tax collection. Taxes are collected through Pay As You Earn (PAYE), withholding tax, and non resident tax.

taxes collected using withholding tax methods are advance taxes (tax credits) except for non resident tax.

13.1.2 The Pay As You Earn (PAYE)

Every employer is required to operate the PAYE system in respect of all employees earning more than the zero percent threshold. The employer must deduct tax from the emoluments of such employees at the time the emoluments are paid (this could be weekly, fortnightly or monthly). PAYE is calculated based on the gross salary.

13.1.3 Payment of Tax

Tax deducted under the PAYE system is due within 14 days of the end of the month in which the deduction was made. e.g. tax deducted in the month of April is due by 14 May.

The employer should remit the PAYE due together with form P12 on a monthly basis and submit form P16 at the end of the year.

13.1.4 Penalty for Non Compliance

- a) An employer is personally liable to a penalty of 20% of the tax due if he does not pay the tax in time.
- b) An additional surcharge at 5% of the accrued amount is also imposed monthly until the amount due is paid.

The Commissioner General may reduce or waive the penalty if a satisfactory explanation for the delay is given.

If the employer does not deduct tax from any of his employees' emoluments or deducts less tax than that which should have been deducted, he will personally be liable to pay the tax he has failed to deduct or the difference between the tax due and the tax deducted. (Rule 3)

Under the same rule (3), the employer is allowed to recover such taxes from the employee. The employer cannot recover any penalties he is liable to due to failure to deduct or under-deductions from the employee's emoluments.

13.1.5 Varying of Tax Deductions

Under rule 4 the Commissioner General is authorised to permit an employer to vary the amount of tax deductions under PAYE regulations if the employer is of the opinion that the deductions may cause exceptional hardships on the employee.

13.1.6 Records to be Kept by the Employer

Every employer is required to keep records showing

- a. The emoluments paid to each employee; and
- b. The amount of income tax deducted from the emoluments of each employee.

These records must be available for inspection by the Commissioner or any public officer duly authorised by him.

13.1.7 Offences

Any person who

- a. Makes any false declaration in any form, record or return completed, kept or made under the PAYE regulations;

- b. fails to operate the PAYE system;
- c. fails to remit tax by the due date;
- d. fails to provide form P9 to employees;
- e. fails to maintain records required under the PAYE rules.

Shall be liable to a fine of K100 in addition to the penalties already mentioned.

13.2 Non Resident Tax

S76A - Any income payable to a person not being a person resident in Malawi arising from a source within Malawi shall be liable to a final tax (Non Resident Tax) at the rate 15% of the gross amount of such income.

Who is a person not resident in Malawi?

The Act defines a person resident in Malawi as:

- a. any individual present in Malawi for an aggregate of 183 days or more in any 12 months period commencing or ending in the year of assessment concerned.
- b. any trust, estate or partnership established or otherwise organised under any written law of Malawi; and
- c. any company incorporated in Malawi.

Any person other than the above is said to be a person not resident in Malawi.

13.2.1 Payment of Tax

Non resident tax payable should be deducted from the amount of income payable on:

- a. Accrual of the amount to a non-resident;
- b. Payment of the amount to a non-resident whether directly to him or to his account in or outside Malawi.
- c. Remittance of the amount to a non-resident;
- d. Crediting of the amount or value thereof in favour of a non-resident.

13.2.2 Exemptions

Non- Resident tax is not payable in respect of:-

- a. Income and other amounts exempt under the First Schedule.
- b. Dividends because they are subject to a final tax of 10%.
- c. Any pension or annuity payment.

Example

MINCOM (Malawi) Ltd is a wholly owned subsidiary of SPARCUS inc. an American company. During the year to 30.6.16, the company remitted the following to its parent

company:-

Dividends	130,000
Loan repayment (part)	100,000
Interest on loan	65,000

Required

Calculate the Non-Resident tax due on the above amounts and state who is liable to pay.

Solution

- Dividends Taxable at a final 10% rate by the issuing company and not to be included in the computation, therefore non-resident tax will not be deducted;
- Loan repayment is not an income to the non-resident company;
- Non-resident tax is due on the interest as follows
 $15\% \times 65\,000 = 9,750$
MINCOM should pay this tax to the Tax Department
SPARCUS Inc. will get the net amount i.e. K55, 250

13.3 Withholding tax

The withholding Tax legislation was introduced in 1985 with the aim of accelerating tax collection and bringing into the tax net certain incomes which were not being declared by recipients.

13.3.1 Operation of withholding Tax

Under S102A, any person who makes any payment specified in the Fourteenth Schedule is required to withhold tax in accordance with the rates specified in the Schedule. For example a person making payment in respect of rent during the year 2015/16 must withhold 15% of such payment as tax.

When tax has been withheld, the person withholding is required to prepare a Withholding Tax Certificate (WTF 1) in triplicate. The copies are distributed as follows:

- The original is remitted together with the tax deducted to the Inspector of Taxes;
- The duplicate is issued to the person from whose payment Withholding Tax has been deducted;
- The third copy is retained by the person making payment.

The tax withheld is due within 14 days of the end of the month in which the withholding was done.

Failure to withhold renders a person personally liable to pay the amount which he fails to withhold plus a penalty of 20%.

Failure to remit the amount withheld renders a person personally liable to pay the amount which he fails to remit plus a penalty of 20%.

Late payment of amount withheld renders a person personally liable to a penalty of 20%.

13.3.2 Withholding Tax Exemption Certificate

Withholding tax is not applicable to any payment to any person who is a holder of a valid withholding tax exemption certificate.

A person is granted a withholding tax exemption certificate, on application, if the following conditions are satisfied:-

- a. The applicant is a registered taxpayer;
- b. The applicant's returns of income that are due have been submitted to the Commissioner and have been accepted;
- c. The applicant has complied with Provisional tax, Fringe Benefits tax, and Pay As You Earn law requirements; and.
- d. The applicant has settled all outstanding tax.
- e. The applicant has made all necessary arrangements to satisfactorily settle any tax liability that is still outstanding at the time of application

A withholding tax exemption certificate is issued for a particular year of assessment or such period as determined by the Commissioner. The Commissioner may, by notice in writing, withdraw or cancel or order the taxpayer to surrender the certificate within the period specified in the notice.

The regulations require that a withholding exemption certificate **does not** exempt its holder from paying income tax.

A proviso to S102 A (1) states that **no withholding tax exemption certificate shall be granted in respect of bank interest, rent, royalties, fees, commissions, payment of casual labour, payment to contractors and subcontractors.**

Bank interest includes:

- Interest payable by an institution registered under the Building Societies Act or the Banking Act on deposits held on accounts with such institutions; and
- Interest on treasury bills, stock, bonds or promissory notes raised by or on behalf of the Government under S24 and S26 of the Finance and Audit Act of Malawi.

Bank interest does not include:

- Interest payable by any person to institutions registered under the Building Societies Act or the Banking Act;
- Interest payable to a person exempt from income tax under the first schedule;
- Interest payable to a person who is not resident in Malawi and whose income is liable to Non-Resident tax.

13.3.3 Offences and Penalties

Any person who

- a. fails to operate Withholding tax i.e. who makes any payment specified in the Fourteenth Schedule without deducting tax;
- b. fails to pay amounts withheld;
- c. fails to remit withheld amount within 14 days of the end of the month in which the amount was withheld;
- d. does not surrender a withholding tax exemption certificate when the Commissioner has ordered him to do so;

Shall be guilty of an offence punishable by a fine of K200 in addition to any other penalties mentioned above.

Summary

Income taxes are collected in advance when some payments are made. Taxes are collected through PAYE, withholding tax, and non-resident tax. Under PAYE the employer deducts tax from the emoluments of employees at the time the emoluments are paid. Non-resident tax is collected from a person not being a person resident in Malawi arising from a source within Malawi. Under withholding tax any person who makes any payment specified in the Fourteenth Schedule is required to withhold tax in accordance with the rates specified in the Schedule. The Act stipulates offences and the relevant penalties under withholding taxes.

End of Chapter Questions

Question One

- a. What is withholding tax in general?
- b. Describe two common types of withholding tax currently in use in Malawi stating both differences and similarities between the two.
- c. List any four types of payments which are subject to Withholding Tax

under the Fourteenth Schedule of the Taxation Act.

- d. Explain the procedure as regards payment of Withholding Tax in respect of payments specified in the Fourteenth Schedule.
- e. List any three items that are not subject to Withholding Tax Exemption Certificate.
- f. What are the consequences of one's failure to deduct Withholding Tax from a qualifying payment?

Question Two

- a. What is Non-Resident Tax? Explain why it should be paid.
- b. What is the rate of Non- Resident tax? What expenses are deductible before the rate of Non-Resident tax is applied?

Question Three

Tony's Haulage Limited has 31 March as its year end. It operates strictly on a cash basis and achieves a gross profit percentage of 25%. Its profit before tax is 10% of turnover. You should assume that adjustments for tax purposes have no net impact, so that its taxable income is also 10% of turnover.

Required

- a. Calculate the tax charge on Tony's Haulage Limited for the year ended 31 March 2016 when its turnover was K10 million.
- b. Tony's Haulage Limited held a Withholding Tax Exemption Certificate for the year ended 31 March, 2016. Briefly describe the benefit to the company of having this certificate.

Chapter 14: Provisional Tax System

Learning Outcomes

On completion of this chapter you should be able to:

- Explain the Provisional Tax System;
 - Compute Provisional Tax; and
 - Explain penalties for non compliance with provisional tax requirements.
-

Introduction

Provisional Tax system was introduced in 1988. This was done to enable the Government collect income tax in advance from taxpayers. This chapter introduces the regulations governing provisional tax payment system.

14.1 Meaning of Provisional Tax

Provisional tax is an advance payment of income tax in quarterly instalments.

14.2 Eligibility to Provisional Tax

All persons chargeable to income tax are subject to provisional tax except those taxpayers whose taxable income for the year of assessment is estimated:

- a) not to exceed the tax free threshold currently at K240,000; or
- b) to exceed the tax free threshold but is all from employment or pension or both in relation to which PAYE is being deducted; or
- c) to exceed the tax free threshold (K240,000)and to include non-employment and/or non-pension income of not more than the tax free threshold(K240,000).

14.3 Payment of Provisional Tax

Provisional tax is based on an estimate of the total taxable income. A taxpayer must make the estimate at the beginning of every year of assessment based on the previous year.

Provisional tax is payable in quarterly instalments and is due within 25 days of the end of each quarter except for taxpayers with seasonal income.

14.4 Taxpayer with Seasonal Income - S84A (2)

A taxpayer whose income for the year of assessment in question is estimated to include

75% or more income which meets the definition of seasonal income must notify the Commissioner General in writing of the time or times within that year of assessment when he shall pay the provisional tax in whole or in part. This notification must be done before the end of the first quarter of that year of assessment.

The Commissioner General may accept the dates proposed by the taxpayer or he may issue a notice to the taxpayer specifying dates on which a substantial part of the provisional tax must be paid. If the Commissioner General issues such a notice, the taxpayer shall pay within 14 days of the specified dates.

S84A (4) defines **seasonal income** as income that is ordinarily received from a given source during any period of six consecutive months of the year of assessment of the person receiving such income.

14.5 Determination of Provisional Tax - S84A (3)

The taxpayer shall determine the provisional tax payable during the year of assessment by estimating the current year's tax liability. The estimate must not be less than 90% of the actual tax liability for the year of assessment and is payable in quarterly instalments.

Example

PAM Ltd, a Malawian Company, has a financial year ending 30 June. In July 2015 the company estimated taxable income for 2015/2016 to be K2, 000,000. Show how provisional tax would be calculated indicating when each instalment would be due assuming the taxpayer decides to pay evenly for the first three quarters and the actual taxable profits are K3, 200,000 and the rate of tax is 30%.

Solution

QUARTER	AMOUNT DUE	DUE DATE
1.07.15 - 30.09.15	150, 000 (W1)	25.10.15
1.10.15 - 30.12.15	150, 000 (W1)	25 01.16
1.01.16 - 30.03.16	150, 000 (W1)	25.04.16
1.04.16 - 30.06.16	<u>414, 000 (W2)</u>	25.07.16
	<u>864,000</u>	
Balance	<u>96,000</u>	27.12. 16
	<u>960,000</u>	

Workings

W1	Amount due in first quarter	
	Estimated liability for the year	$30\% \times 2,000,000$
		$= K600, 000$

Initial instalment	<u>600,000</u>
	4
	= <u>K150,000</u>
W2 Amount due fourth quarter The company must pay an amount so that total paid after the fourth instalment is at least 90% of actual liability	90% x 3,200,000 x 30% =864,000
Amount paid so far	450,000
Balance	864,000 - 450,000 = <u>414,000</u>

14.6 Provisional Tax Penalties

A person who fails to pay any amount of provisional tax shall be liable to a penalty as follows:

If the amount of tax unpaid as a percentage of total tax liability	Penalty
Does not exceed 10%	Nil
Exceeds 10% but does not exceed 50%	25% of the unpaid amount of tax
Exceeds 50%	30% of the unpaid amount of tax.

The Commissioner General may reduce or waive the amount of penalty chargeable if in his opinion a satisfactory explanation for failure to pay is given.

Example

Justus Limited whose taxable profits for 2015/2016 amounted to K 2,500,000 had never paid provisional tax during this period. Calculate the penalty that the company is liable to.

Solution

Provisional Tax liability for 2015/2016

$$= 90\% \times 30\% \times K2, 500,000$$

$$= K 675,000$$

as a percentage of total liability =90%

The amount of tax unpaid as a percentage of total tax liability exceeds 50% therefore the company is liable to a penalty of 30% of the unpaid tax.

$$\text{i.e. } 30\% \times \text{K } 675,000 = \text{K } 202,500$$

Summary

Provisional tax is a system of collecting income tax in advance. The tax is payable in quarterly instalments within 25 days after the end of each quarter. There are penalty provisions for failure to pay the tax and certain categories of taxpayers are exempt from paying this tax.

End of Chapter Questions

- a. Write brief notes on provisional tax stating:-
 - (i) What it is;
 - (ii) Who is liable to pay;
 - (iii) When it is payable;
- b. Briefly discuss how a taxpayer determines the amount of provisional tax payable for any year of assessment in respect of which provisional tax is payable. Illustrate your answer with figures.
- c. Comment on the advantages and disadvantages of the provisional tax system:-
 - (i) to the tax system
 - (ii) to the tax payer

Define "Seasonal Income" and state the conditions that must be satisfied in order for a taxpayer to qualify for special consideration under the provisional tax system. What special consideration does the tax payer get? (PAEC)

Chapter 15: Returns and Assessments

Learning Outcomes

On completion of this chapter you should be able to:

- Explain the various types of returns;
- Explain the due dates for submission of returns;
- Explain the additional assessments that may be done on a taxpayer;
- Explain circumstances that may give rise to additional assessments; and
- Explain non compliance penalties relating to returns.

Introduction

This chapter discusses the various types of returns that are required to be submitted for tax purposes, eligibility for submission, the due dates for submission, additional assessments that may be done on a taxpayer and the circumstances giving rise to the additional assessments and penalties for non-compliance with return submission requirements.

The expectation from the collection of taxes discussed earlier on is that these methods should have collected all the taxes due. However, due to other circumstances the methods do not collect all the taxes the taxpayer should have paid requiring submission of returns of income to collect the balance.

15.1 Income Tax Returns

S84 (1) states that every taxpayer is required to submit a return of income **within 180 days** after the end of the year of assessment. The Commissioner General may, by notice in writing, require a taxpayer to submit a return of income at any time during the year; in this case the taxpayer must submit the return within 30 days of the issue of such notice.

A married couple may make an election to submit a joint return of income (a married woman is a taxpayer in her own right in respect of her earned income).

It is not compulsory for an employed person or a person receiving pension income whose income does not exceed K240, 000 p.a. on which PAYE has been deducted to submit a return of income unless he chooses to do so.

15.2 Other Returns Which may be Required by the Commissioner General

S85 (1) states that the Commissioner General may require an employer to submit returns of all or any particular class of persons employed by him.

S85 (2) states that any person carrying on trade in Malawi may be required to submit to the Commissioner returns showing

- a. Payments made to any person in respect of any share or interest in such trade;
- b. Moneys received by him from any person on deposit for any fixed time or period with or without interest.
- c. Any other information which is in his possession in respect of income received by himself or any other person.

15.3 Access to Records in Public Offices

S86 (1) The Commissioner General has access to public records such as registers, books of account, returns kept by an officer in the public service in Malawi without fee or charge, the inspection of which may tend to secure tax or give proof or lead to the discovery of any fraud or offence or omission in relation to tax.

These records include those in custody of the following public institutions:

- The Anti Corruption Bureau
- The Courts
- Financial Intelligence Unit
- Registrar General
- Registrar of Companies
- And others

15.4 Supporting Documents to a Return

Under **S87**, every return required from a taxpayer shall be accompanied by supporting documents such as a statement of financial position, statement of comprehensive income and other accounts necessary to support information contained in the return.

15.5 Payment of Taxes

S84C - A taxpayer should pay the difference if any between his/her total liability as disclosed in the return and the taxes paid during the year (tax credits e.g. PAYE, Provisional Tax, etc) when submitting his/her return of income.

15.6 Penalties

Under S112 (3), a taxpayer who

- i. Fails to furnish the Commissioner General with a return of income for any year of assessment;
- ii. Omits income from his return;

- iii. Makes a deduction which is not allowed or claims an allowance to which he is not entitled.

is liable to penalty not exceeding K200,000.00 for companies and K50,000 for individuals plus the difference between the amount of tax he ought to have been charged and the amount he has been charged.

Under subsection 4, if the taxpayer commits the offences above with the intention to defraud he shall be liable to a penalty of K10,000 or twice the difference between the tax he ought to have been charged and that which he has been charged; whichever is the greater.

Also a taxpayer who with intent to defraud:-

- a. Makes any false statement or gives any false information when complying with any notice served on him under the Act; or
- b. Prepares or maintains or authorises or causes the preparation or maintenance of any false books or accounts or other records, or falsifies or causes the falsification of any books, accounts or other records; or
- c. Make any false claim for repayment of tax for any year of assessment, shall be liable to the penalty stated above.

15.7 Estimation of Income

Under S89 (1) the Commissioner General may estimate a taxpayer's income in the following circumstances:

- a. A taxpayer defaults in furnishing any return or information; or
- b. The Commissioner General is not satisfied with the return or information furnished by the taxpayer; or
- c. The Commissioner General has reason to believe that the taxpayer is about to leave Malawi without furnishing a return or satisfactory return.

Under S89 (2) if the Commissioner General is of the opinion that the taxpayer is unable from any cause to submit an accurate return of income, he may accept the taxpayer's estimate of his taxable income.

15.8 Assessments

Under S90 the Commissioner General will proceed to assess a taxpayer to tax basing on the information provided by the taxpayer in his return of income if the taxpayer has submitted a satisfactory return or on estimated income where S89 applies.

15.8.1 Additional Assessments - S91

If the Commissioner General discovers or is of the opinion that a taxpayer has not been assessed or has been assessed to a lower amount of tax, he may within **six** years of the end of the year of assessment in question issue an assessment or an additional assessment.

Where any fraud or wilful default has been committed by or on behalf of a taxpayer which has led to him (taxpayer) not being assessed or assessed to a less amount, the Commissioner General can still raise an assessment even where the six year limit has been exceeded.

In the event that the taxpayer who commits fraud or wilful default or on whose behalf fraud or wilful default has been committed is deceased, an assessment on his personal representatives in respect of any of the six years preceding the tax year death takes place must be raised not later than the end of the third year following the end of the year in which the taxpayer died.

For example, if a taxpayer died during 2005/6, an additional assessment in respect of any of the years from 1999/2000 to 2005/2006 must be issued not later than 30 June, 2009.

15.8.2 Notice of Assessment

The Commissioner General must give a notice of assessment to the taxpayer which must contain a note that any appeal against the assessment can be made within 30 days of the issue of the notice of assessment.

15.9 Representative Taxpayers

A representative taxpayer is a person who acts as a taxpayer on behalf of another person as regards matters concerning tax; for example paying tax on behalf of another person. The other person might not be able to act on his own - e.g. a company cannot fill returns although it is a legal person and a taxpayer in its own right.

This may also apply in the case of absent taxpayers. The representative taxpayer takes personal responsibility on taxes due and payable on incomes under his custody. A representative taxpayer is not the same as a taxpayer representative. A taxpayer representative acts on behalf of a taxpayer on tax matters and does not take personal responsibility on such matters in terms of liability. Audit firms are examples of taxpayer representatives.

The Act lists representative taxpayers in S77. These are:

- a. Public officer of a company;
- b. Trustee of a trust;
- c. An agent who is controlling or managing another person's assessable or taxable income;
- d. Person remitting or paying assessable or taxable income to a person who is temporarily or permanently absent from Malawi;
- e. Receiver if income is paid under a decree or court order;
- f. A company as an agent of a shareholder who is absent from Malawi in respect of income accruing to the shareholder from the company.

15.9.1 Public Officer

S67 - A public officer is an individual representing a company.

Every company that carries on trade or that has an office in Malawi is required to appoint an individual resident in Malawi who will be its public officer. This individual must be approved by the commissioner.

The public officer must be appointed within one month of establishment of an office or place of business by a company in Malawi. If the public officer is not appointed within one month of establishment, the Commissioner may appoint the Managing director, director, secretary or other officer of the company to act as a public officer.

Such companies must also appoint a place where notices will be served or sent within one month of establishment.

Every notice or proceeding which may be given or taken against any company should be given to the public officer.

Acts done by the public officer in his representative capacity shall be deemed to have been done by the company.

15.9.2 Declaration of Dividend

The public officer of a company incorporated in Malawi must, within 30 days of declaration of dividend, submit to the Commissioner:-

- a. A copy of the resolution declaring the dividend; and
- b. A statement containing, in respect of each person to whom dividend has accrued -
 - (i) name and address of the person;
 - (ii) amount of dividend accrued;
 - (iii) the date on which dividend was declared.

15.9.3 Agent

The Commissioner General may declare any person to be an agent of another person if he deems it necessary to do so. The agent will act on behalf of the other person for the purposes of tax e.g. paying tax on behalf of the other person.

The Commissioner General may appoint an agent in the United Kingdom for the purpose of facilitating assessment of income of any person residing in the United Kingdom.

15.9.3 Duties of the Representative Taxpayer

S78 - The representative taxpayer is liable to tax in respect of taxable income to which he is entitled in his representative capacity and such tax is recoverable from him except for tax in respect of an assessment made upon the public officer which is recoverable from the company. An assessment is raised in the representative's name. He is responsible for the submission of returns required by the Commissioner General from the person he is representing.

The representative taxpayer has the right to recover any amounts of tax he pays in his representative capacity from the person on whose behalf he pays tax.

If a representative taxpayer has not paid tax that is due and while it is still unpaid he:

- a. Alienates, charges or disposes of taxable income in respect of which tax is chargeable.
- b. Disposes of or parts with any funds or money which is in his possession or comes to his after the tax is payable when tax could have been lawfully paid out of such funds or money;
- c. he shall personally be liable for the payment of tax which is due in his representative capacity.

Summary

This chapter has discussed the various types of returns that should be submitted for tax purposes, eligibility for submission, due dates for submission of returns, additional assessments that may be done on a taxpayer and circumstances giving rise to the additional assessments and penalties for non compliance with tax requirements.

End of Chapter Questions

1.
 - a. Who is liable to submit a return of income?
 - b. When is a return of income to be submitted to the tax authorities?
 - c. When is submission of a return of income made optional?

2. Under s91 of the Act the Commissioner is empowered to make an additional assessment on any taxpayer.
 - a. State the circumstances under which an additional assessment may be issued to the taxpayer.
 - b. What is the time limit for issuing such an additional assessment?
 - c. When is such time limit disregarded?
3. Under which circumstances would the Commissioner estimate a taxpayer's income? Can he issue an assessment on the basis of estimated income?
4.
 - a. Explain in your own words as far as possible what you understand by the term "Representative Taxpayer". Give four examples of representatives taxpayers.
 - b. Under what circumstances would a representative taxpayer be personally liable for tax assessed by the Commissioner?
5. What is the name given in the Taxation Act to the representative taxpayer of a company?
6. In the event that a tax assessment cannot be personally served on the representative taxpayer of a company, what are the three options available to the Commissioner General of Taxes so that the assessment is "sufficiently and effectively served"? In each case, how is the date of such delivery determined?
7. How may an assessment be sufficiently and effectively served on a tax pay who is unable, through illiteracy or infirmity, to read the assessment?
8. What is the name given in the Taxation Act to the person who administers the payment of remuneration for a business and who accounts to the Commissioner of Taxes for the PAYE deducted?

Chapter 16: Tax Appeals Procedure

Learning Outcomes:

On completion of this chapter you should be able to:

- Explain circumstances that may result in a taxpayer being aggrieved; and
 - Explain the tax appeals procedure.
-

Introduction

This chapter discusses the tax appeals procedure and the grounds which can necessitate the taxpayer to appeal to the Commissioner General when aggrieved.

16.1 Valid Grounds of Appeal

Under the Taxation Act, a taxpayer may appeal if he:

- a) is dissatisfied or aggrieved by any assessment made by the Commissioner General;
- b) is dissatisfied or aggrieved by any decision of the Commissioner General to an assessment; or
- c) is dissatisfied or aggrieved by the determination of the reduction of tax;

The taxpayer may appeal to the Commissioner General against such assessment within 30 days in writing. The opportunity to appeal is given to taxpayers under the Act for purposes of fairness.

16.2 Validity of an Appeal

Every appeal must have valid grounds. A taxpayer has no valid grounds of appeal if:

- an appeal is made simply because the taxpayer does not want to pay tax; or
- has cash flow problems.

Valid grounds of appeal would be where the taxpayer does not agree with the Commissioner General's interpretation of the tax law.

In any appeal process the burden of proof that any amount is exempt from income tax; not liable to income tax; and is subject to any deduction or allowance shall be upon the person claiming.

16.3 Appeals Procedures

16.3.1 Appeals to the Commissioner General

1. The taxpayer is required to make a written submission to the Commissioner General within 30 days from the date the notice of assessment or decision was despatched to him and should specify the grounds of appeal.

The 30 day period may be extended if the Commissioner General is satisfied with any reason given by the taxpayer for the delay.

2. The Commissioner General may require the personal attendance of the appellant but if the appellant fails to do so the appeal may be dealt with in his absence and the Commissioner General will send a written notice of his decision to appellant.

16.3.2 Appeals to Special Arbitrator

The taxpayer who is not satisfied with the Commissioner General's decision may appeal to the special arbitrator (Chief Resident Magistrate) through the Commissioner General and the procedures for appeal are as follows:-

- a. The taxpayer is supposed to notify the Commissioner General in writing within 21 days of the issue by the Commissioner General of the notice of his decision, of his intention to appeal.
- b. The taxpayer should within 42 days of the issue by the Commissioner General of the 'notice of his decision' lodge with the Commissioner General a written statement (in duplicate) on his grounds of appeal. This statement should contain facts and points of law on which the appellant shall rely upon in the appeal case.
- c. Within 42 days of receiving appellant's grounds of appeal, the Commissioner General shall lodge with the special arbitrator the appellants' grounds of appeal and Commissioner General's reply.
- d. Then an arbitrator will notify the taxpayer and the Commissioner General the date and place of hearing the appeal.

Notes:

- i. If any party is not present at the date of hearing the special arbitrator may decide the appeal in his absence.
- ii. The ruling by special arbitrator is final as regards to matters of fact.
- iii. Anyone publishing proceedings without the authority of special arbitrator is fined K1,000.

16.3.3 Appeals to High Court

1. Any party aggrieved by special arbitrator's decision shall lodge with the high court his intention to appeal within 21 days of the special arbitrator's decision.
2. The appellant should within 42 days from the date he received special arbitrators decision lodge with the high court (four copies) a written statement specifying his ground of appeal.
3. Upon receipt of written statement of appeal the high court shall send a copy to the respondent who is also supposed to write a statement of reply (four copies) specifying the grounds upon which he will rely on the hearing of appeal.

Summary:

This chapter has discussed the appeals procedures that an aggrieved tax payer must follow when appealing on tax matters.. the appeals can be made to the Commissioner General, Special arbitrator and the high court.

End of chapter questions

- a. If a taxpayer is aggrieved by an assessment raised on him he first appeals to the Commissioner General. What steps will the Commissioner General take?
- b. If the taxpayer remains aggrieved he next appeals to the Special Arbitrator.
What powers does the Special Arbitrator have in order that he may fulfil his role in the appeal process?
- c. If the taxpayer remains aggrieved, he may, for one reason only appeal to the High Court.
With what reason may a taxpayer finally appeal to the High Court?
- d. Why is the appeal process heard in private? What restrictions therefore arise if publication of the results of the appeal are deemed appropriate?
- e. What is the statutory penalty for publicising the appeal proceedings without the authority of the Special Arbitrator or the High Court as the case may be?

Chapter 17: Value Added Tax

Learning Outcomes

On completion of this chapter you should be able to:

- Explain when a taxpayer is legally required to register for VAT purposes;
 - Explain voluntary registration ;
 - Explain how the VAT credit system operates.;
 - Explain obligations of a registered person;
 - Compute the value for VAT purposes;
 - Explain when a VAT return is due and the types of returns that may be submitted;
 - Compute VAT payable or refundable;
 - Explain the types of visits Tax Authorities may make; and
 - .Explain penalties for failure to comply with VAT Act provisions.
-

Introduction

Value added tax is a tax on the amount by which the value of an article has been increased at each stage of its production or distribution or on the service provided. The buyer or provider of a service will normally pay this tax to the seller or service provider and he in turn passes on to the next customer. The taxpayer will normally pay or claim the net amount between the amount he paid on the purchase and the amount he collected on the sale.

VAT was first introduced into the Malawi tax system in 1971 as Surtax.

In 2001, Parliament passed an Act known as Surtax Act 2001 which among other things had the following effects on Surtax:

- a. The Act increased the application of Surtax to a wide range of commodities covering both manufactured as well as other goods and services. As such, service providers, retailers e.g. Grocery and shop owners, and manufacturers were all liable to register for Surtax on supplies of taxable goods and services.
- b. This Act also introduced heavy penalties to enforce compliance to the legislation.
- c. In 2005, Surtax was renamed to Value Added Tax (VAT) following the passing of VAT Act 2005. This Act consolidated provisions of the previous legislations, i.e. the Surtax Act 2001 and others.

17.1 VAT Credit System

This is a system that ensures that vat does not become a business expense by

transferring it to the final consumer. this system is a mechanism under which registered trader deducts vat paid in his raw materials (input vat from the vat charged on his customers (output vat).

17.1.1 VAT Credit System Operation

A registered person will be charged VAT when he imports or locally acquires materials for his business. This VAT is called "**INPUT VAT**".

The registered person will charge VAT on the selling price of the goods that he has sold to customers. This VAT is called "**OUTPUT VAT**".

At the end of **each month or tax period**, the registered person will net off . . Input VAT and Output VAT. . .

. A registered person may fall in one of the following three situations;

- a. Input VAT being greater than Output VAT – "**EXCESS VAT**". There will be a refund if it occurs in three consecutive months.
- b. Input VAT balances with Output VAT or where the registered person neither purchases nor supplies taxable goods – **Nil**.
- c. Output VAT being greater than Input VAT – **balance to pay to the MRA**.

Where the registered person neither purchases raw materials nor sells goods in a particular month or where the Input VAT balances the Output VAT. In this situation, the registered person will still be required to submit a **Nil Return**.

17.2 Liability for Registration for VAT

A person is liable for compulsory registration if he makes **taxable supplies** of goods or services and, his business turnover is, or exceeds, K10,000,000 per annum.

A person who expects his turnover to exceed K10,000,000 in the year ahead must apply for voluntary. VAT registration.

Registration must be made on VAT form 1 within 30 days from the date he. qualified as a taxable person.

However, any manufacturer whose sales turnover does not exceed the prescribed limit may apply for voluntary registration if he can satisfy the Commissioner General that his business may suffer if he was not registered for VAT. .

17.3 Obligations of Registered Person

The following are the obligations of a registered person for VAT purposes:

17.3.1 Issuance of VAT invoice

The registered person must issue a VAT Invoice for every taxable supply made . except for retailers in special retail schemes, for example when selling small value items such as a box of matches. Special retail scheme is granted on application to the Commissioner General.

An invoice provides a means for verifying VAT payable or refundable.

The invoice must be issued not later than 7 days after the delivery of goods. It must be marked “**VAT Invoice**” and must contain:

- i. VAT registration Number – Taxpayer’s Identification Number (TPIN)
- ii. Serial number,
- iii. Date of issue;
- iv. Name and address of purchaser
- v. Date of supply of goods (if different from the date of issue)
- vi. Description and quantity of goods;
- vii. Total value of goods
- viii. Rate of VAT
- ix. Total VAT payable.
- x. Registered person’s name and address.

17.3.2 Maintenance of VAT account

The registered person must keep a VAT Account where Input VAT and Output VAT shall be posted. At the end of each month or tax period the VAT account must be balanced.

17.3.3 Production of monthly returns

The registered person must submit **VAT form 2 which is a monthly return**. The return for any month is due on the **25th day of the month following the month or the taxable period on which it relates**. .for example, a VAT return for the month of March is due on 25th April.

17.3.4 Maintenance of records and accounts

Every registered person must keep sufficient records to show how monthly returns have been compiled to the satisfaction of the Commissioner General. These records must follow acceptable business practice and shall be made available to MRA on demand for verification. Examples of records include the following;

Sales Records

Sales invoices must be recorded in the Sales Day Book or similar records. The amounts of VAT shown on the invoice must be entered into a VAT account. The invoices must be

filed in numerical order.

Purchases Records

All purchases invoices must be recorded in the Purchases Day Book or similar records. Any VAT shown on the invoices must be posted into the VAT Account. The invoices must be filed in chronological order.

Bill of Entry

Bills of Entry should be filed in chronological order after the invoices relating to these have been posted to the books of accounts e.g. purchases or sales (Exports).

Other Records

A full and true written record in the English language of every transaction should be kept.

17.3.5 Retention of Records

All VAT records and documents must be kept for at least 7 years from the date of the last transactions to which they related.

17.4 Types of Supplies

A supply of goods means any arrangement under which the owner of the goods parts with or will part with possession of the goods including provision of goods by sale, barter, lease, transfer, exchange, gift or similar disposition, and appropriation to own use. There are different categories of supplies including the following;

17.4.1 Taxable Supplies

These are supplies of goods or services made by a taxable person for consideration in the course of, or as part of his or her business activities. These are taxable at the standard rate (i.e. they are called standard rated supplies) of 16.5% and include:

- a. The processing of data or supply of information or similar service,
- b. The supply of staff
- c. The acceptance of a wager or stake in form of betting or gaming, including lotteries and gaming machines,
- d. The making of gifts or loans of goods,
- e. The leasing or letting of goods on hire,
- f. The appropriation of goods for personal use or consumption by the taxable person or by any other person.
- g. The sale, transfer, assignment, or licensing of patents, copyrights, trademarks, computer software, and other proprietary information

17.4.2 Zero Rated Supplies

A zero rate may be applied for a limited range of goods and services, in particular, **all goods and services which are exported** from Malawi or goods or services closely related to export activities.

VAT is charged at **zero** percent for zero rated supplies. Where a person supplying such goods is charged Input VAT paid . . he will apply for refunds of his Input VAT.

Refer to appendix G for list of zero rated goods and services.

17.4.3 Exempt Supplies

Persons who wholly manufacture exempt goods cannot register for VAT because they are not entitled to Input VAT refunds. Refer Appendix H for the list of exempt goods and services.

17.4.4 Mixed Supplies / Partial Exemption

This refers to supply of both taxable and exempt goods.

Where a registered person incurs input VAT which relates to an exempt supply he is partly exempt and cannot take credit for all input VAT. The person must work out how much input VAT is deductible using the **standard method**.

17.5 Relief Supplies

Relief supplies are goods and services that are delivered without payment of VAT to certain persons or organisations that are exempted by law from the payment of VAT.

Relief supplies include the following:

- a. Goods and services for official use of the President and the Vice President of the Republic of Malawi,
- b. Goods and services for use of a retired President and Vice President of the Republic of Malawi,
- c. Goods for use by the National Council of Sports
- d. Goods for the exclusive use of the Government of any other country, at foreign embassies, missions and Consulates in Malawi,
- e. Goods for use of diplomatic staff in terms of the Immunities and Privileges Act,
- f. Goods for use of International agencies or Technical Assistance Schemes where the terms of the agreement made with the Malawi Government includes exemption from taxes, and
- g. Specified goods for use of Government including donations of whatever description

17.6 Time of Supply

VAT is due and payable:

- i. on the date on which the goods or services are first applied to own use where goods or services are appropriated to own use,
- ii. on the date on which ownership in the goods passes or the performance of the services is completed, as the case may be where goods or services are supplied by way of gift,
- iii. In any other case, the earliest of the date on which
 1. The goods are removed from the premises, or from other premises of the taxable person where the goods are under the control of the taxable person, or
 2. The goods are made available the person to whom they are supplied; or
 3. The services are supplied or rendered; or.
 4. A tax invoice is issued
 5. Payment is received for all or part of the supply
- iv. Where supplies are made on a continuous basis or by metered supplies, when a meter reading is taken or at the time of the determination of the supply.
- v. Where goods are supplied under hire purchase or finance lease agreements, on the date the goods are made available
- vi. Where goods are supplied under a rental agreement or where goods are supplied under an agreement or written law which provides for periodic payment, the goods or services shall be treated as successively supplied for successive parts of the period of the agreement or as determined by the law, and each successive supply occurs on the earlier of the date on which payment is due or receivable
- vii. Where goods are imported, at the time when goods are entered for consumption

17.7 Value for VAT Purposes

The determination of value for VAT purposes follows the following standard practice:

17.7.1 Imported goods

The sum of:

- i. the value determined for Customs purposes under Customs Act -(CIF)
- ii. import duties, if any, paid or payable at the time or importation, and
- iii. any other duty or levy payable at the time of importation

17.7.2 Taxable Locally Manufactured Goods

- i. the actual selling price at which the goods are supplied by a taxable person to any other independent person of himself: or
- ii where there is association between the seller and the buyer the

normal selling price at which the goods would have been supplied in the ordinary course of business;

iii the Commissioner General may determine the value when the selling price does not represent the true value.

17.8 Deductible Input VAT

In addition to deducting input VAT on raw materials the registered person is also entitled to deduct Input VAT on capital goods such as;

- i. machinery and spares
- ii. furniture
- iii. goods carrying vehicles
- iv. other goods related to the manufacture of taxable goods.

However, there is a limitation to the provision in that some goods although used in the manufacturing of taxable goods are not allowed as deductible input . These are

- i. motor vehicle and motor vehicle spare parts
- ii. Entertainment including restaurant, meals and hotel charges

Note: a registered person can claim input VAT on motor vehicle and motor vehicle spare parts if they are used wholly, exclusively and necessarily in the business or if the taxpayer is in the business of dealing in or hiring of motor vehicles or selling them.

Example

Transactions in respect of the procurement of goods and services were recorded in the business of a registered taxpayer during the tax period to 31 December 2015, as follows:

	Cost K
Raw materials	300,000
Electricity for factory	55,000
Water for factory	36,000
Fuel	70,000
Security for residence	25,000
Security for factory	45,000
Machinery spares	90,000

Note: VAT is payable at 16.5% on all materials and services except on fuel which is exempted and water which is zero rated

During the same period, manufactured goods were dealt with as follows:

Value of taxable goods sold locally	1,700,000
Value of goods exported	<u>300,000</u>
	<u>2,000,000</u>

Note: VAT on sales is chargeable at 16.5%

Required:

Calculate:

- The deductible input VAT; and
- The gross output VAT

(PAEC 2007 Modified)

Solution

- Deductible Input VAT

	K
Raw materials (300,000 x 16.5%)	49,500
Electricity for factory (55,000 x 16.5%)	9,075
Security for factory (45,000 x 16.5%)	7,425
Machinery spares (90,000 x 16.5%)	<u>14,850</u>
Total deductible input VAT	<u>80,850</u>

Note: water attracts VAT of K0
 Fuel attracts no VAT
 VAT on security for residence has not been included because this expenditure is private

- Gross output VAT

	K
Value of taxable goods sold locally	<u>1,700,000</u>
VAT @16.5%	<u>280,500</u>

Note: All exports are zero rates hence no VAT

17.9 Deductible Input VAT for a Partially Exempt Person

If a registered person cannot be treated as fully taxable he cannot take credit for all . input VAT. The person is required to work out how much can be claimed using the **standard method**.

Standard method-steps involved

- Identify all supplies and imports received and work out the extent to which they are directly related to taxable supplies. This amount will be

used to determine allowable Input VAT.

2. Identify all supplies which are directly attributable to the exempt supplies. This amount will be used to determine disallowable or exempt Input VAT.
3. Identify all supplies which cannot be directly attributed to either taxable or exempt supplies. This amount is subject to the adjustment below.

The following formula shall apply in determining deductible Input VAT under 3:

$$\frac{A \times B}{C}$$

Where

A is the total amount of input tax identified at step 3 above for the period:

B is the total amount of taxable supplies made by the taxable person during the period: and

C is the total amount of all supplies made by the taxable person during the period.

Note

- a. The registered person cannot claim input VAT when after applying the above formula, the fraction of the taxable supplies to the total supplies is less than 5%
- b. the registered person can claim all input tax when after applying the above formula, the fraction of taxable supplies to the total supplies is more than 95%.

Input VAT paid on the following should be disregarded:

- i. Motor vehicle and motor vehicle spare parts unless the registered person is in the business of hiring, selling and dealing in motor vehicles and motor vehicle spare parts.
- ii. Motor vehicle and motor vehicle spare parts unless they are used wholly, exclusively and necessarily for the purpose of business.
- iii. Entertainment, including restaurant, meals and hotel expenses, unless the registered person is in the business of providing entertainment.

V Terms of the agreement made with the Malawi Government includes exemption from taxes, and

Vi. Specified goods for use of Government including donations of whatever description.

17.10 VAT Special Schemes

There are a number of special schemes operated to deal with different categories of businesses and transactions. Some of the special schemes include the following;

17.10.1 VAT on Property Transactions

This scheme has the following features;

- I. There is no VAT on rent or sale of residential properties.
- II. Construction as a service is liable to VAT and the contractor must therefore charge VAT on cost of constructing property.
- III. Rent and sale of commercial property is subject to VAT at the standard rate.
- IV. Materials used for construction are subject to VAT at the standard rate.

17.10.2 Margin scheme for second hand car dealers

Under this scheme, a seller of a second hand vehicle will be required to calculate VAT on the **difference between the buying price and the selling price of the vehicle**. This is contrary to normal required practice where VAT is charged on the selling price of a product.

This scheme is of importance to second hand vehicle dealers who purchase vehicles from individuals and other sources who are not VAT registered and therefore, under normal circumstances, the taxpayer would not be able to recover any input VAT on such vehicle purchases.

17.10.3 VAT Retail Schemes

This scheme applies to a retailer in any business which makes supplies of goods and services of small value . directly to private consumers.

Under this scheme, the trader need not issue a VAT invoice for each and every sale which the business makes, as normally required.

The trader will be required to keep the following records:

- a. A copy of Daily Gross Takings(DGTs)
- b. A copy of receipt given to customers
- c. A copy of full tax invoice where a customer requests one
- d. All purchases invoices, and

- e. Cash register, cashbook or other suitable records.

Daily Gross Takings should include the following;

- a. Cash received
- b. Cheques received
- c. Credit card sales
- d. Full value of credit sales
- e. Value of goods appropriated or donated

17.10.1 Types of Retail Schemes

a. Basic Scheme

This is a scheme applicable to retailers supplying taxable goods only. VAT will be calculated by taking the VAT rate and applying it on the total Daily Gross Takings for the tax period.

b. Point of Sale Scheme

This is a scheme for retailers supplying both taxable and non-taxable goods. Cash register will be used to separate taxable and non-taxable supplies and VAT will be applied on taxable supplies only.

c. Apportionment scheme

This scheme is used where the retailer cannot at the point of sale distinguish between taxable and non-taxable goods. The scheme is based on calculating or estimating the proportion of sales which are taxable. The method used in estimating taxable supplies must firstly be approved by the Commissioner General of Taxes.

17.11 Visits by MRA Officers to Registered Persons' Business Premises

17.11.1 Purpose of Visits

MRA officers visit taxpayer premises for the following purpose;

- i. to verify returns on hand and confirm that correct VAT has been paid or claimed.
- ii. to carry out checks and observations to detect error or fraud:
- iii. to examine the accounting system, production and sales methods of the registered person;
- iv. to ensure that registered persons understand liability and basis of value and are applying them correctly.

17.11.2 Types of Visits

a. **Routine visits**

These are random visits conducted on quarterly basis.

b. **Special Purpose visits**

- i. These are visits carried out for particular reasons e.g. where fraud is suspected, or to check correctness of a final return in case of deregistration, etc.

17.11.3 Frequency of Visits

VAT control visits are normally made once each quarter . to each registered person. This may be varied at the discretion of the . Commissioner General.

17.12 Refunds of VAT

If in any month a registered person's input VAT exceeds his output VAT, the excess is carried forward to the next month. If the excess continues **for three months** the Commissioner General may refund the excess on application by the registered person on Form ST 11 such refunds may be made after verification by an officer.

17.13 VAT Penalties

VAT penalties are charged for various offences as stipulated in the VAT Act as follows;

a) **False invoicing**

Any person who issues an invoice which falsely purports to be a VAT invoice . is required . to **pay any amount of VAT shown on the invoice** to the Commissioner General **within 7 days** of issuing it and may be prosecuted.

b) **Failure to issue a VAT Tax Invoice**

Section 46 states that a person who fails to issue VAT tax invoice as required under section 21 for goods supplied or services rendered commits an offence and is liable on conviction to a fine of **ten times** the value of VAT involved in the transaction.

c) **Failure to submit vat returns**

Section 34(8) of VAT Act 2005 imposes a heavy penalty for failure to submit VAT returns. The penalty is **K20, 000.00 and a further penalty of K1, 000.00 for each day that the return is not submitted.**

d) **Failure to pay vat due**

Interest will be charged at the ruling bank rate **plus a quarter of the rate for the period (days or months) VAT remains unpaid** if a person fails to pay VAT

on the due date. If payment of VAT is done by way of cheque and this cheque is later referred to as refer to drawer cheque, the taxpayer will pay a penalty of **30% on the amount of that cheque.**

17.15 Other Offences and Penalties

Section 45(1) states that a person who fails:

- i. **to apply for registration** as required under section 11,
- ii. **or notify the Commissioner General of change in his business** as required under section 13,
- iii. **to apply for cancellation of registration** as required under section 14, commits an offence.

Subsection (2), states that where the failure under subsection (1)

- a. is **deliberate or reckless**, the person shall be liable on conviction to a fine of **K100,000.00 and imprisonment for five years**; and
- b. for any other reason, the person shall be liable to a fine of **K20,000.00** and to imprisonment for **12 months**

Section 47(1) states that a person who in any matter relating to VAT:

- i. makes a statement to an officer of the Authority which is false or misleading in any material particular, or
- ii. omits from statement made to the officer of the Authority any matter or thing without which the statement is misleading in any material particular, commits an offence.

Subsection (2) of the same section 47 states that where a statement or omission under subsection (1):

- a. **was made knowingly or recklessly**, the person shall be liable on conviction to a fine of **K100,000.00 and to imprisonment for five years**; and
- b. in any other case, the person shall be liable on conviction to a fine of **K20,000.00 and to imprisonment for 12 months.**

Section 50 (1) states that a person who fails to maintain proper records as required under the VAT Act 2005 commits an offence and is liable on conviction to:

- i. where the failure was deliberate or reckless, a fine of **K100,000.00 and to imprisonment for 5 years**, and
- ii. in any other case, to fine of **K20,000.00 and to imprisonment for 12 months.**

17.16 Advantages and Disadvantages of VAT Credit Method

Advantages

- I. Advance payment of VAT enables Government to receive revenue earlier than under ring/suspension system previously used.
- II. VAT invoice or Import Bill of Entry evidence required for deductible input tax has created an "Audit trail" within the system. It is self-policing.
- III. Fractional payment is less erroneous or less burdensome than under ring/suspension system (ring/free system). Less prone to fraud by payment through stages.
- IV. Associated business will be registered and transfer pricing is countervailed.
- V. Tax point of manufacturing retailers is at retail stage.

Disadvantages

- I. False invoicing
- II. Inflation or deflating of credit and debit notes
- III. Value manipulation for appropriation, gifts, and goods on hire or loan.

Summary

This chapter has discussed operation of the VAT system, types of VAT, documentation requirements, claim periods and penalties resulting from non compliance with the law and regulations.

End of Chapter Questions

1. a) when is a taxpayer registrable for purposes of Value Added Tax (VAT)
3.5 marks
b) In relation to VAT, the time of supply of goods and services for normal VAT purposes is when the earliest of the five events occurs
Mention the five events which may define the tax point **2.5 marks**
(PAEC 2013 extracts)
2. a) For purposes of VAT Act 2005, what does VAT stand for? **1 mark**
b) Describe how the VAT system works **3 marks**
c) State whether the deductible input VAT is restricted to VAT on raw materials only. If not, on what other items does VAT qualify as deductible input VAT?
3.5 marks
(PAEC 2007 extract)

Chapter 18: Customs Duty

Learning Outcomes

On completion of this chapter you should be able to:

- Define customs duty;
 - Describe functions of customs duty;
 - Identify approved ports of entry;
 - Explain methods used to declare goods;
 - State documents to be produced for imported goods;
 - Explain purposes for which goods may be entered;
 - State the time limit for entry of goods;
 - Explain the origin and preference of imported goods;
 - Explain the valuation of goods for customs purposes;
 - Describe customs tariff classification of imported goods;
 - Explain how goods are stored before clearing;
 - Calculate customs duty; and
 - Mention clearing agents that may be used.
-

Introduction

This chapter describes what Customs Duty is, how it is administered and how Customs Duty is computed.

18.1 Definition of Customs Duty

This is an **advalorem** duty levied on either imported or exported goods. write something on export taxes. It is called advalorem (Latin for “according to value”) because it is based on the value of the article taxed.

18.2 Functions of Customs Duty

18.2.1 Revenue Generation

The Customs and Excise Department is a revenue - collecting organisation. It collects import duties, VAT and excise duties on goods and services imposed by law as promulgated by Parliament. Revenue of this nature is known as “indirect taxation” as opposed to Income Tax which ‘direct taxation. All monies which are collected are paid

into the consolidated fund. Parliament, in budget session, decides on how the income of the country is to be obtained and how it shall be spent (e.g. on Education, health, Defence, Agriculture etc). At present at least sixty percent of the total annual government revenue of Malawi is derived from Customs and Excise collections. It also to be noted that the Department of Customs and Excise is charged with control over the importation and exportation of goods.

18.2.2 Protection of domestic industry from foreign completion

This is achieved because:

- a) **Customs duty has the effect of raising the prices of imported goods hence making them expensive relative to domestic goods.**
- b) **Importation of goods is heavily regulated;** Many goods and classes of goods may not be imported or exported except under certain conditions (e.g. import licence is required for firearms) or in some cases entirely prohibited (e.g. drugs such as marijuana).

18.3 Functions of Customs Tariff

The functions of the Malawi Customs Tariff are, in brief, to provide for;

- a. the collection of government revenues
- b. the protection of and assistance of infant industries
- c. the collection of trade statistics
- d. the implementation of the provisions of Trade Agreements with other countries in so far as they relate to Malawi duties.

18.4 Approved Ports of Entry and Exit of Goods

The Minister of Finance is empowered by Section 8 of the Customs and Excise Act (Cap.42.01) to prescribe ports at or through which goods shall be imported or exported (e.g. Mwanza, Mchinji, Muloza, Songwe and Dedza).

He also prescribed ports known as Customs airports at which aircrafts from foreign ports shall land, from which aircrafts leaving for foreign ports shall depart and through which goods shall be imported or exported . (e.g. Lilongwe International Airport and Chileka Airport).

Under Section 8 (d) the Minister of Finance may prescribe customs offices for the collection of revenue and general administration of the Customs Laws e.g. Blantyre, Balaka, Nsanje and Karonga.

18.5 Importation of Goods

Importation of goods means to bring or to cause it to be brought into Malawi.

18.5.1 Goods Imported by Road

Immediately after entering Malawi all vehicles must be driven to the nearest customs offices and the driver or person in-charge of such vehicles must report his arrival to the customs officer to declare all goods that are carried on the vehicle.

18.5.2 Goods Imported by Train

In terms of Section 27 of the Customs and Excise Act the person in charge of any train shall upon arrival in a port before unloading or in any way disposing of any goods subject to customs control, report his arrival to the proper officer at such port and produce:-

- a. copies of all invoices, waybills or other documents relating to the goods,
- b. copies of delivery and advice notes
- c. advice of all goods delivered to licensed private sidings.

The following ports have been approved for trains:- Blantyre, Balaka, Nsanje, Lilongwe and Mchinji.

Any person arriving from a foreign port, whether or not he has goods in his possession should proceed immediately to the nearest port to report his arrival to the proper officer and make declaration of the goods carried.

18.6 Declaration of Goods

The law requires that all imported goods be declared. A declaration can be either verbal or written depending on circumstances such as type of goods, mode of importation, etc.

18.6.1 Arriving Aircrafts

Within 3 hours after the arrival of any aircraft from a foreign port before the unloading of any goods from such aircraft the person in-charge shall make a declaration to the proper officer of all cargo carried on such aircraft by producing the relevant cargo manifest and any other documents relating to the goods.

18.6.2 Postal Importations

All postal parcels from foreign countries must be declared to customs by the postal authorities. There are three approved Post Offices for the clearance of

postal importation namely: Limbe Post Office for the Southern Region, Lilongwe Post Office for the Central Region and Mzuzu Post Office for the Northern Region.

18.7 Documentation for Imported Goods

Documentation in import and export trade is a very important part of trade. To the honest importer/exporter a written record is a safeguard of his own rights as it shows what facts were brought to the notice of the appropriate customs officials and what action they took at each stage.

The Commercial documents get properly scrutinized to see whether any third person, (intermediary/shipper) has been mentioned.

If a third person is mentioned, a call for a document that may have been issued is made and attached to the bill of entry. Where no document was issued or used the importer is called upon to explain to the satisfaction of the officers or the documents are referred to the Valuation and Origin Branch for further inquiry.

The following are some of the documents commonly used in the Customs clearance which must be submitted to customs wherever appropriate in support of the Bill of Entry.

- a. Commercial Invoices
- b. Freight Invoices (Sea/Air)
- c. Rail, Road, Advice Notes
- d. Port Charges Invoices
- e. Shippers Invoices
- f. Bill of Lading (Inward or Ordinary)
- g. Insurances
- h. Packing List
- i. Certificate of Origin (Form 18)
- j. Declaration of Value (Form 19)
- k. Work-sheet
- l. Clean Record of Findings (CRF)
- m. Import Licence.

Bills of Entry are of great significance because the Government uses them in many ways including audit of Customs documents, accounting purposes and compilation of national trade statistics.

18.8 Purposes for Which Imported Goods may be entered

Imported goods may be entered for any of the following purposes:-

- a. Consumption
- b. Temporary Importation

- c. Warehousing in a bonded warehouse
- d. Transit

18.9 Onward Carriage of Goods

The Commissioner General is empowered by the Act to allow on carriage of imported goods from the port of importation to another port for clearance there subject to such conditions as he may impose. The movement of such goods is covered by a Report Order/Authority to proceed.

18.9.1 Report Order System / Authority to Proceed (ATP) System

A report Order/Authority to proceed is a Customs Document which is issued at the Port of Entry to cover the goods which are allowed to be on-carried from the border port to an inland port for clearance there. The procedure for Report/order/ATP is as follows:

- (I) Three copies of the ATP are printed at the Border Post and signed/stamped by a Customs Officer. The ATP details are sent electronically to the Customs House.

An Advance copy of the ATP is sent to the Port of Clearance by fax or any other quickest means.

- (ii) The vehicle driver brings all three copies to Temporary Store Operators to the Collector for Temporary Stores at the Custom House.
- (iii) All three copies of the ATP are taken by the Temporary Store Operators to the Collector for Temporary Stores at the Custom House.
- (iv) The computer at the Custom House makes a list of all imports awaiting off-loading authorisation. All ATPS are listed in order of need to be witnessed.

All carriers or agents who wish to use the ATP facility must furnish the Department with a bond to cover 50% of the value of the goods. If no security is provided the vehicle will not be allowed to enter the country but the goods will have to be cleared at the border.

18.9.2 Reasons for Onward Clearance.

1. Finance institutions not available at border e.g. banks
2. Need to facilitate trade.
3. Carriers are not the owners of goods and many not possess all necessary documents for clearance at border.

4. No customs Clearing Agents at the border.
5. Security reasons.

18.9.3 Time Limit for Entry of Goods

- a. Goods delivered to Temporary Stores (e.g. MANICA) must be cleared within 30 days.
- b. Goods delivered to Private Sidings must be cleared within ten days.

If goods are not cleared within the prescribed time they are removed to the Customs Warehouse.

18.10 Bonded Warehouses

A bonded warehouse is a place licensed by the Commissioner General for the storage of dutiable goods. The purpose is to allow goods to be stored under official supervision without the payment of duty until when they are cleared out for consumption. They can be exported from bond without payment of duty.

18.10.1 Types of Bonded Warehouses

Bonded Warehouses are of the following types:

- a. **Private Bonded Warehouses**

These are for the deposit of dutiable goods belonging to the licensee only.

- b. **General Bonded Warehouses**

These are for the deposit of dutiable goods belonging to several other importers.

- c. **Bonded factories for processing of goods/EPZ**

The bonded warehouse will be approved by the Commissioner General if its area is not less than 186 square meters.

18.10.2 Bond

When an approval for a warehouse is made by the Commissioner General, the applicant is required to enter into bond with the Commissioner General on Form 123 for the due observance of the customs laws relating to bonded warehouse.

The penalty of the bond will be a maximum amount of duty which is anticipated on the goods warehoused at any one time. The amount must be agreed upon before completing form 123 (the bond). The surety to the bond must be a bank or an insurance company established and registered in Malawi. The original copy of the bond is kept by the MRA. If the Principal and/or the surety to the bond wishes to have copies for their own purposes they should be submitted for endorsement.

18.10.3 Obligations of the Warehouse Licensee

1. The licensee is responsible for the care and custody of all goods in the bonded warehouse.
2. He is not allowed to keep naked lights unless on emergency.
3. Inflammable goods likely to cause danger to other goods are not allowed unless segregated from other goods to the satisfaction of a proper officer.
4. Public sales may not be held in a bonded warehouse except with the authority and presence of an officer.
5. The licence must provide such facilities for the examination and taking account of goods as the Customs Officer may require.
6. Each consignment of goods must be stacked separately and with sufficient space between stacks.
7. Each consignment must be marked with the warehousing date.
8. Stock cards must be attached to each consignment of goods showing the number and date of the Customs entry by which they were warehoused on Form 24.
9. No goods may remain in a bonded warehouse for more than six months.

18.10.4 Approval at the Discretion of the Commissioner General

The Commissioner General takes into consideration the following factors when granting approval for a bonded warehouse:

- a. the financial standing of the applicant;
- b. the amount of revenue involved in the goods proposed to be warehoused;
- c. the situation of the proposed warehouse;
- d. the security arrangements at the proposed warehouse and;
- e. the bonded warehouse facilities already available to the public in the area.

18.11 Rules of Origin

The country of origin of any goods is defined to be the country in which such goods were grown or wholly produced. In the case of manufactured goods, the country in which the last process of manufacture was performed.

18.11.1 Goods Grown

These are agricultural products e.g. vegetables, maize etc.

18.11.2 Goods Produced

These are mineral products such as coal, gold and copper, and live animals such as cattle, goats and poultry.

18.11.3 Manufactured Goods

These are goods that have undergone a manufacturing process

18.11.4 Preference of goods

Preference in customs context is explained as an act of choosing or liking one above another, thus a lower rate of duty applying to goods of certain origins as stipulated in the Malawi Customs and Excise Act.

There are, however, specified countries whose goods are given preference if they meet Malawi customs requirements.

- (i) Members states of the Africa Caribbean and Pacific (ACP) as stipulated in the convention signed in Lome, Togo on 28 February, 1975.
- (ii) Independent countries of the Commonwealth and any dependent territory, protectorate or protected states of such independent states of such independent country under the trusteeship system of the United Nations (e.g. Namibia but now independent).
- (iii) A contracting party to the General Agreement of Tariff and Trade-(GATT).
- (iv) Goods imported into Malawi from Common Market for East Southern Africa (COMESA) / Southern African Development Community (SADC) members states being goods described in the common list.

Preference is given where the percentage content of manufacture for the said country is at least 25% as stipulated in Part II of the Malawi Customs Tariff as read with Section 118 (b) (ii) of the Act. In case of goods originating from Preferential Trade area (PTA) states the percentage content of manufacture must be at least 45%.

As stated above, for goods grown or produced, they must be grown / wholly produced in the specified countries mentioned above to qualify for preference in Malawi Customs Tariff.

18.11.5 Importance of Correct Declaration of the Country of Origin

The significance of correct completion of Certificate of origin (Form 18) is that it enables MRA to:

1. establish the correct rate of duty in accordance with preferential provisions of the Customs Tariff.
2. establish whether goods are subject to Open General Licence (OGL) importation that does not require Specific Import Licence.
3. collect trade statistics for the national Statistical Office.

18.12 Valuation of Goods for Customs Purposes

Customs valuation systems in Malawi are based on the General Agreement on Tariffs and Trade (GATT) Code which uses cost Insurance and Freight (CIF) value up to Malawi port of entry.

Discounts and commissions are taken into consideration in arriving at value for customs purposes.

18.12.1 Discounts

There are two types of discounts, namely: non allowable and allowable.

If the discount is given because of the commercial relationship between the parties, the discount is non allowable. For example agent discount or distributor discounts.

On the other hand where the discount arises as a result of a normal business transaction, for example, settlement discount or quantity discount, it is allowed.

18.12.2 Commissions

Commissions are amounts charged by an intermediary to an importer for rendering certain services. There are three types of commissions.:

1. **Buying Commission:** paid for arranging purchase of goods on behalf of the importer.
2. **Selling Commission:** paid for arranging sell of goods on behalf of supplier, and

- 3 **Financing Commission:** paid for arranging goods to be financed on behalf of an importer.

Financing and selling commission are included in the Value for Duty Purposes (VDP) whereas buying commission is not. The reason being that Financing and selling commissions are incidental (Connected with) to the sale and delivery of the goods.

18.12.3 Calculations of Customs Duty

VDP includes all the costs and charges incidental to the delivery of goods to Malawi port of entry – (CIF Value) = Cost, Insurance and Freight. However, allowable discounts (cash, quantity) must be deducted while non-allowable must be included. Non- includible commissions must be ignored.

Example

What is the customs duty and total revenue on the following importation?

79 Christmas tree candles made in UK (70%) and the value of duty purposes is UK Sterling 2.00 pounds per candle.

GIVEN

Rate of Exchange:

UK Sterling 1.00 pound = MK 900

Rate of customs duty = 30%

Rate for import VAT is 16.5%.

Tariff Heading: 34.06.00/00

Solution:

TH : = 34.06.00.00

VDP: = 79 X £2 X K900
= K142, 200

Duty : = K142, 200 at 30%
K42, 660

Value for VAT calculation = (VDP + Duty)
= K142, 200 + K42, 660

=K184, 860
VAT (16.5%) = K30, 501.90

Total Revenue	=	K42, 660+K30, 501.90
	=	<u>MK73, 161.90</u>

18.12.4 International Commercial Terms (INCOTERMS)

INCOTERMS are international rules for the interpretation of trade terms. The International Chamber of Commerce (ICC) first issued its incoterms in 1936 and published them in 1953. These are regularly up-dated.

The following are some of the incoterms commonly used.

EX-WORKS or EX FACTORY: where the seller makes the goods available to the buyer at the sellers own premises. Ex Factory Price cost of goods and packing only,

FOB: (Free on Board Rail, road, Truck-Price) cost of goods, packing and loading on the train, truck and lorry.

FAS: (Free alongside Ship) cost of goods, packing, delivery to ship and freight to Port of destination.

C & F (Cost and Freight): Cost of goods, packing, and delivery to ship and freight to Port of destination.

CIF: (Cost of Insurance and Freight):Cost of goods, packing deliver to ship, insurance and freight to Port of destination.

FRANCO DOMICILE: Cost of goods and all other charges incidental to the delivery of goods to the buyer's premises.

18.12.5 GATT Valuation System

Malawi uses the GATT valuation system. Other countries use the Brussels Definition of Value (BDV) system. GATT valuation system is based on six methods as explained. below. The primary basis for valuation is the transaction value method. Where the transaction value method cannot be applied, other methods are used

1. Transaction Value Method

This transaction value is the price actually paid or payable for export to the country of importation adjusted in accordance with the provisions of article 8 of the GATT CODE.

2. Transaction Value of Identical goods method

The transaction value of identical goods sold for export. The transaction value of these identical goods has to be a customs value previously examined and accepted in accordance with article 1.

3. Transaction Value of Similar Goods

The transaction value of goods alike in nature

4. Deductive Method

5. Computed Method

5. Fall-back Method

Based on the reasonable and flexible interpretation of all other methods above.

18.12.6 Basic Requirements and Conditions for Obtaining Duty Drawback

Where a taxpayer imports raw materials to make a product that is re-exported, they are eligible to claim back the duty that was paid on the imported raw materials as part of the incentives to spur production and exports in the country.

18.12.6.1 Eligibility for Duty Drawback

Any exporter, person or company who is registered as a "Registered Exporter" under the Export Incentives Act (6/1988) is eligible to claim a drawback.

How to become a registered Exporter?

Any exporter, person or company can approach the Malawi Export Promotion Council and register. An application form for registration can be obtained from the following address either by person or by mail.

Postal address: Chief Executive Officer
Malawi Investment and Trade Centre

Street Address: Lilongwe

An application fee has to be included.

18.12.6.2 Imported Goods and Materials Eligible

Imported goods and materials, including packaging material, incorporated in, attached to, or directly consumed in the manufacture or production of goods which subsequently exported are eligible for the drawback.

What kind of Imported Goods and Materials are **NOT** Eligible for duty drawback?

The following imported goods and materials are not eligible for duty drawback.

- a. Fuel, lubricants or any other goods or materials that are not incorporated into, attached to, or directly consumed in the manufacturing or production process.

For example, duty paid on imported machinery used in the production of exports is not allowed under this drawback program

- b. Any by-product or waste, derived from a production process, which Has commercial value and has not been exported.
- c. Any imported goods that are not re-exported.
- d. Any imported goods for which a drawback, refund or remission of duty is claimed under any other law.

For example, if a refund on duty on an imported goods has been claimed by the exporter under the industrial drawback program, this goods will not be eligible for drawback under this program.

18.12.6.3 By-Product and Waste

If the manufacturing or production process produces by of any drawback shall be reduced by the same proportion that the by-products or waster bear to the total value of the total value of the goods produced, unless they are exported.

For example, if the by-product represents 5% of the total value of goods produced. If the total claim is MK100,000 the claim would be reduced by MK5000.00

If any amount of waster which could have been sold in the market but was nevertheless destroyed under Customs' supervision, this amount of waste should not be included in the waste ratio calculation.

18.12.6.4 Conditions for Granting Drawback

Whilst the Government will be pleased to assist any exporter to obtain its duty drawback, there are certain conditions that have to be fulfilled before a drawback claim can be paid.

The following conditions must be fulfilled with in order to obtain a drawback.

- a. The imported goods or materials must have been exported.

Prior to the exportation of the goods, the exported must give Customs a "Notice to Pack" at least 48 hours in advance so that customs may inspect the packing if it wishes.

When making a duty drawback claim, the exporter must attach a copy of Form 34 in support of all shipments claimed. It is important to note that the form 34 should prominently marked "SUBJECT TO DUTY DRAWBACK". Form 34 for duty drawback must also bear a 'Certificate of Exportation' (Illustrated Below) which must be signed and stamped by a Customs Officer at the boarder or the post office. Note that if the Certificate of Exportation is not printed on Form 34, the exporter must have the Form 34 stamped by customs.

CERTIFICATE OF EXPORTATION

Examined _____ packages externally

1. Seals intact
2. Opened and examined _____

Satisfied _____ packages exported

(Date stamp _____
Customs Officer or Postal Official

- b. The goods must not have been used in Malawi for any purpose, other than for incorporation into, attachment to, or packaging of the goods to be exported.
- c. If the claimant is not the importer for the goods, for any imported goods the claimant purchased from another importer, Form No.45 should be obtained from the importer, or producer who used the imported goods in its production. Form 45 should be filled in by the importer who waives his right to the drawback on the imported goods sold to the exporter. This form must be attached to the claim.
- d. A claim, in Form No. 44 (Form 44-A and Form 44-B), for drawback shall be submitted to proper officer in six (6) copies within two (2) year from the date of payment of the duty on the imported goods. Duty paid on imported goods more than two years from the date will not be eligible for drawback.

Summary

This chapter has covered functions of customs duty, approved ports of entry for imported goods, declaration and documentation for imported goods and conditions for onward carriage of goods for clearing. The chapter has also described types of bonded warehouses and obligations of a warehouse licensee.

End of Chapter Questions

- a) For purposes of Customs duty, the law demands that all goods must be cleared at the border port except in some circumstances where the importer is allowed to clear at an inland port.

Required:

Name any four reasons/circumstances that may necessitate the Commissioner General of the Malawi Revenue Authority to allow an importer to clear their goods at the inland port.

- b) In readiness for Easter, a church in Chilobwe had obtained a quotation to imported 500 Easter cards from Israel. The prospective supplier has just emailed a quotation which indicates that the cost of each candle is 2 United states dollars C.I.F Blantyre.

An enquiry from Malawi Revenue Authority reveal that, upon arrival at the border port of the imported candles, the church will be required to pay 10% customs duty, 20% excise tax and 16.5% Value added Tax.

Required:

- i. Explain the term C.I.F normally used in international trade.
 - ii. Advise how much the church will pay to Malawi Revenue Authority, should they go ahead to import the cards. [Assume the exchange rate at the time of the arrival of the candles will be MK450 to 1 United States dollar].
 - iii. List five methods of Customs Valuation under the new GATT valuation system.
- c) According to the Customs and Excise Act, goods may be imported for a number of **reasons**.

Required:

- i. State any three reasons that the Act allows that goods should be imported for.
- ii. State any four documents that are commonly used in customs clearance which must be submitted to Customs.

NOT FOR SALE

Chapter 19: Excise Tax

Learning Outcomes

On completion of this chapter you should be able to:

- Explain what is meant by Excise as part of the indirect taxes and how it is accounted for in Malawi;
 - Explain legal provisions as read in the Customs and Excise Act and Regulations;
 - Identify goods liable for excise tax; and
 - Explain registration procedures and conditions applying to all excise traders and their obligations.
-

Introduction

This chapter discusses provisions relating to administration of Excise tax.

19.1 Excise Tax

Excise tax is an indirect tax charged on the sale or use specific goods and services. There are two components of excise tax; import excise, and domestic excise tax. Import excise is levied on certain importations and is administered by the Customs Division while domestic excise tax is levied on certain locally manufactured products and services and is administered by the Domestic Taxes Division.

Domestic Taxes Division handles excise tax relating to locally manufactured products including spirits, beer, air time (voice and data) and cigarettes.

19.2 Legal Provisions

The laws relating to the administration, charging and collection of Excise duty are found in sections 63-82 (d), 83 and the rates applicable are in the Second Schedule of the Customs and Excise (Tariffs) order, as read together with Regulations 93-112 of the Customs and Excise Act (Cap.42.01) of the Laws of Malawi.

19.3 Goods Liable to Excise Duty

Excise as an indirect tax is collected on the following locally approved and manufactured goods:

- a. Cigarettes
- b. Snuff (pipe tobacco, cigarette tobacco)
- c. Beer produced by factory methods e.g. Carlsberg Special Brew
- d. Opaque beer e.g. Chibuku
- e. Ethanol
- f. Potable spirits e.g. Malawi Gin

- g. Manufactured tobacco
- h. Vessels for pleasure
- i. Motor cars

19.4 General Requirements Before Manufacture

19.4.1 Licence to Manufacture

No goods liable to excise duty may be manufactured in Malawi except under licence issued by the Commissioner General.

Exceptions

Excisable goods manufactured by private person for own use and goods manufactured for experimental purposes.

19.4.2 Application for Licence

The manufacturer is required to apply to the Commissioner General in writing stating

- i.** Full name and trading style of the applicant;
- ii.** The goods to be manufactured;
- iii.** The anticipated annual output;
- iv.** The size and location of premises;

MRA inspects the premises to assess suitability for manufacturing of excisable goods.

19.4.3 Entry of Premises

The applicant is required by law to complete an Entry of Premises in Triplicate of Official form (Ex 37) accompanied by the plans of the premises and plant.

The entry of Premises must describe accurately:

- a. All rooms, stores for the storage of raw materials and finished goods.
- b. All plant, equipment and apparatus used in the manufacture
- c. All marks and numbers of rooms and plant.
- d. Manufactures and storage of goods other than as stated on the approved Entry of Premises is illegal.

The object of an Entry of Premises is to have an official cognisance of places, plant and apparatus which the applicant proposes to use in the manufacture of excisable goods.

19.4.4 Bond

Before an Excise Licence can be issued the applicant must enter into a bond with the Commissioner General for the observance of the law relating to Excise manufacture

A bond is issued in Form 123 and is an agreement between a manufacturer and the Commissioner General for the full observance of the law relating to the goods under bond.

The surety must be a bank or insurance company established in Malawi. The penalty of the bond must not be less than the anticipated duty arising from any consecutive two months.

19.4.5 Licence fees

The applicant is required to pay an Excise Licence fee prior to the issue of the first licence which will be renewable every year on or before December each year.

19.5 Maintenance of Records

The Excise Trader is required by law to keep;

- i. Stock records of receipts or disposal of raw materials.
- ii. Stock records or receipt or disposal of finished goods sufficient to satisfy the officer that all excisable goods manufactured goods are duly accounted for.

19.6 General Conditions Applying to all Excise Traders

- a. No other business should be conducted on the entered premises except with the permission of the Commissioner General
- b. No other excisable goods may be kept on the entered premises except those manufactured on the premises
- c. All rooms, stores, plants, equipment and warehouses must be given distinguishing marks and numbers.
- d. The licensee must provide office, sanitary or living accommodation for an officer or facilities for proper exercise of the officers functions as the Commissioner General may require.
- e. The name of the licensee must be exhibited on a conspicuous place outside the entered premises

19.7 Duty Point

The point at which duty becomes payable on excisable goods is normally upon delivery, from the manufacturing premises.

- i. In case of goods consumed on the entered premises, duty point is upon removal from the bonded Excise Warehouse.
- ii. In case of goods consumed on the entered premises is upon the time of such use.

19.8 Rate of Excise Duty

The rate of duty on excisable goods is that in force when they pass the duty point.

In case of a change in any rate of duty the manufacturer is required to distinguish between goods that passed the duty point before and after the effective date.

Where the goods were delivered duty free because they were for export or for removal into bond or rebate store but for one reason or another were not so exported or received in Bonded Warehouse or used for rebate, the rate of duty is that in force at that given point in time.

19.9 Payment of Excise Duty

- a) Excise duty is payable immediately after excisable goods have been delivered for consumption in Malawi, normally on delivery from excise warehouse or used for rebate, the rate of duty is that in force.
- b) Licencees in Malawi are however, allowed to total their deliveries at the end of the month and to pay the duty by the 20th day of the following month- (deferred payment).

19.10 Excise Returns

- a) Each registered licencee is required to submit Excise Duty Returns monthly by the 20th of every month showing disposals of all excisable goods during the previous month from the entered premises.
- b) The Excise Return must show disposal details of all excisable goods. These will include:
 - a. Sales to diplomats and exempted organisations
 - b. Exports
 - c. Goods removed to industrial use
 - d. Goods removed to industrial rebate
 - e. Donated or given away as gifts
 - f. Appropriations to the licencee himself
 - g. Sold on duty paid basis

19.11 Losses or Destruction of Excisable Goods

When goods are accidentally lost or destroyed on the entered premises prior to being delivered for consumption, the Commissioner General may allow refund of Excise duty.

If the goods are found to be defective after delivery and are returned to the entered premises, the Commissioner General may allow them to be destroyed or to be further manufactured to remedy the defect and refund the amount of Excise duty paid.

Refunds are affected by allowing the licensee to deduct the appropriate amount of duty from the payment for the month in which the destruction or further manufacture took place.

19.12 Functions of MRA Officers

These include the following:

- i. receipt and monthly processing of returns and excise remittances.
- ii. sending of reminders to excise traders in arrears of payments
- iii. visiting excise traders and verifying the correctness of excise returns.
- iv. advising the Commissioner General of any irregularities or omissions by excise traders.

Summary

This chapter has explained the provisions of the Customs and Excise Act relating to the application of excise tax. Specifically it has explained a number of issues including; goods liable to excise, the general requirements of a manufacturer dealing in excisable goods, records keeping requirements, and; the determination and payment of duty.

End of Chapter Questions

- a) List any five general conditions that all traders dealing with goods and services that attract Excise tax must comply with according to the customs and excise tax law.
- b) Mention any 5 products that may attract excise tax.
- c) When is Excise Duty payable?
- d) When is the excise return due and what must it contain ?

References

Chapter 41:01 of the Laws of Malawi – The **Taxation Act**
Chapter 42:01 of the Laws of Malawi – Customs and Excise Act
The Value Added Tax Act
PAEC TC10 (B) - Taxation Syllabus
Malawi College of Accountancy Taxation Manual
<http://kalyan-city.blogspot.com>

NOT FOR SALE

Appendices

Appendix A: General Exemptions – ‘First Schedule to the Taxation ACT

The following incomes are exempt from income tax:-

1. The revenues of local authorities:-
2. The receipts and accruals of-
 - i. Land and agricultural banks specifically established by any law of Malawi to foster or control primary production, manufacture, or marketing of any commodity or stabilizing of any price of any commodity;
 - ii. A registered trade union;
 - iii. Clubs societies and association formed or operated solely or principally for social welfare, civic improvement or other similar purposes, if the receipts or accruals are not divided amongst the members;
 - iv. Statutory corporations, bodies and associations as may be specified by the Minister (Statutory corporations that are liable to tax are those in the Commercial Category e.g. ESCOM, BWB, ADMARC, LWB)
3. Any amount received as a war disability pension paid out of public funds;
4. Interest received by or accrued to or in favour of any person from any stock or bonds issued by the Government which the Minister has directed shall be exempt from tax.
5. Interest up to K10000 received by or accrued to or in favour of an individual.
 - i. on any sums deposited with an institution registered under the Building Societies Act or the Banking Act;
 - ii. From stock, bonds or promissory notes raised by or on behalf of the Government;
6. Capital gains on shares traded on the stock exchanged if the shares have been held by the taxpayer for at least one year;
7. Capital gains realised by an individual on the disposal of personal and domestic assets not used in connection with any trade;
8. The gratuity, pension and other benefits granted by the Government to a former president or a former vice president;

9. The salary and emoluments of the president and vice president received from the Government in respect of their offices as president and vice president respectively; the former and vice president's gratuities, pensions and other benefits;
10. Any scholarship, bursary or similar educational endowment paid to a person receiving full time instruction at a university, college, school or other educational establishment approved by the Minister;
11. Amount up to K50, 000 of any amount paid by an employer to an employee who has been declared redundant, not being notice pay or commutation of leave; and
12. Allowances given to members of national assembly.

NOT FOR SALE

Appendix B: Rates of Income Tax - Eleventh Schedule

PART I - TABLE OF RATES OF INCOME TAX ON TAXABLE INCOME 2015/2016

INDIVIDUALS

TAXABLE INCOME		RATE
First	K 240,000	0%
Next	K 60,000	15 %
Excess over	K300, 000	30 %

SIMPLIFIED TABLE

Taxable Income	Rate	Tax	Cumulative Income	Cumulative tax
First K 240,000	0	0	First K 300,000	9,000
Next K 60,000	15%	9,000	Excess over K 300,000	30%
Excess over K300, 000	30%			

RATES OF INCOME TAX FOR CORPORATE BODIES

Companies incorporated in Malawi 30%

Except for:

- i. Companies in priority industries which are liable to tax at 0% for a period not exceeding 10 years;
- ii. Companies not incorporated in Malawi an additional 5% in each case

LIFE ASSURANCE BUSINESS 21%

FRINGE BENEFITS 30%

RELIGIOUS CHARITABLE ORGANISATIONS INCLUDING TRUSTS 25%

PENSION FUNDS (INVESTMENT INCOME) 15 %

Appendix C: Countries with which Malawi has Entered into Tax Agreements

United Kingdom and Ireland

Switzerland

France

Netherlands

South Africa

Norway

Sweden

NOT FOR SALE

Appendix D: Annual Allowances

5%	-	industrial buildings railway lines farm improvements
10%	-	general plant and equipment trailers farm fencing
15%	-	mobile cranes
17.5%	-	general plant and equipment on double shift
20%	-	Motor cycles cars pickups tractors cement mixers
25%	-	light lorries (for heavy work) tippers tracked tractors tree-dozers scrapers bulldozers general plant and equipment working 24 hours a day
33.3%	-	tractors (for heavy work) transport services
40%		Computers

Appendix E: List of Approved Charitable Organisations

Approved Non Profit Making Organizations for Tax Purposes over K500							
Albarakah Charity Trust							
Antiquities and Museums Building Fund							
Bakili Muluzi Foundation for the poor							
Chatinkha Maternal Care Support (CHAMACA)							
Chombo Mission							
Gift of Givers Foundation							
Habitat for Humanity organisation							
Islamic Zakat Fund							
Justerini & Brooks (J&B) Circle of Malawi							
Mai Aisha Trust							
Malawi Against Polio							
Malawi Council for the Handicapped							
Mzuzu University Trust							
National Disaster Relief Fund							
President Bakili Muluzi's International Appeal Fund for Clean Water							
Royal Commonwealth Society for the Blind							
Scottish International Relief Malawi							
The British Leprosy Relief Association							
The Cheshire Homes							
The Children Fund							
The Commonwealth Ex-Service League of Malawi							
The Kamuzu Foundation Fund							
The Malawi Red Cross							
The National Commission for Children (Malawi) Fund							
The President's Appeal for Rehabilitation of the Handicapped in Malawi							
The Private Hospital Association of Malawi (Christian Health Association of Malawi)							
The Samaritan Trust							
The Save the Children Fund of Malawi							
The University of Malawi Appeal Fund							
The Wildlife Society of Malawi							
World Vision Malawi							

Approved Charitable Organizations for Donations of over K250			
1. The Malawi Red Cross Society			
2. The President's Appeal for the Rehabilitation of the Handicapped in Malawi			
3. The University Appeal Fund			
4. The Save the Children Fund of Malawi			
5. British Leprosy Relief Association for the Leprosy Control Project in Malawi			
6. Royal Commonwealth Society for the Blind			
7. Christian Service Committee of the Churches in Malawi			
8. Malawi Council for the Handicapped			
9. The Commonwealth Ex-Service League of Malawi			
10. The Private Hospitals Association of Malawi			
11. Antiquities and Museums Building Fund			
12. Malawi Against Physical Disabilities			
13. The Kamuzu Foundation Fund			
14. The National Commission for Children (Malawi) Fund			
15. The Designated Schools Board			
16. The Cheshire Homes			
17. National Disaster Relief Fund			
18. Habitat for Humanity Organisation			
19. The Samaritan			
20. The Wildlife Society of Malawi			
21. The Children's Fund			
22. President Bakili Muluzi's International Appeal Fund for Clean Water			
23. Bakili Muluzi Foundation for the Poor			
24. Freedom Foundation Trust			
25. Mai Aisha Trust			

Appendix F: Withholding Tax Rate of Deduction

Nature of payment	Notes	Rates of Withholding Tax on gross payment
1. Royalties	-	20%
2. Rents	1	15%
3. Payment for any supplies to traders and institutions:		
i. foodstuffs-		7%
ii. other		10%
4. Fees	2	10%
5. Commission		20%
6. Payment for carriage and haulage		10%
7. Payment for tobacco and other farm products		3%
8. Payment to contractors in building and construction industries		4%
9. Payment for public entertainment	3	20%
10. Payment of over K20, 000 for casual labour or services		20%
11. Bank interest of over K10, 000		20%

Notes:

- Includes rent for moveable and immovable property, whether paid under a lease or otherwise, but excludes rent payable by an individual whose source of income is only from employment and the rent is payable in respect of property used as a dwelling house and at a rate not exceeding K6,000 per annum.
- Excludes fees and commission on which PAYE is being operated includes technical fees and management fees to the extent they do not relate to reimbursement of expenses - who will collect the tax.
- Includes payment to musicians, radio and television artists, athletes and theatres, but excludes payments to radio and television artists which are subject to PAYE.

Appendix G: Zero Rated Goods and Services for VAT Purposes

1. Export of taxable goods and services;
2. Goods shipped as stores on aircraft and vessels leaving the territory of Malawi;
3. Fertilizers;
4. Salt;
5. Laundry soap;
6. Exercise books;
7. Agricultural, horticultural, forestry machinery e.g. ploughs, harrows, manure spreaders and parts;
8. Harvesting machinery e.g. lawn mowers, egg grading machinery, combine harvesters, haymaking machinery;
9. Buses with seating capacity of forty-five or more persons including the driver;
10. Building materials used for construction of factories and adjoining warehouses;
11. Goods for use in tourism industry such as building materials, industrial catering equipment, motor boats, scuba diving, jet skis, knives, forks, spoons and similar articles for cutlery;
12. Motor vehicles for transport of goods;
13. Miscellaneous Chemical Products – Insecticides, fungicides and herbicides;
14. Ambulances;
15. Motor cycle ambulances;
16. Industrial and construction material;
17. Goods for use in Dairy Farming Industry;
18. Goods for use in Fish Farming Industry;
19. Goods for use in Mining Industry;
20. Goods used in water supply – machinery, equipment, water meters and water treatment chemicals imported or purchased from bonded warehouses by water boards approved by the Minister responsible for water management;
21. Goods for electricity generation and distribution - machinery, equipment, electricity supply meters imported or purchased from bonded warehouses by an organisation approved by the Minister responsible for electricity management;
22. Goods used in Telecommunication – transmission apparatus and accessories, generators, including solar power system, transmission towers, transmission equipment, shelters, steel palisade fence, cabins and switching apparatus;
23. Goods for use by Malawi National Council of Sports;
24. Goods for the use of a retired President of the Republic of Malawi; and
25. Goods for use of the retired Vice President of the republic of Malawi.

Appendix H: Exempt Goods and Services for VAT Purposes

1. Live animals;
2. Animal products such as meat, edible meat offals, fish, natural honey, eggs;
3. Vegetable produce in raw state;
4. Water;
5. Residues and waste from the food Industries;
6. Medical services;
7. Fuel wood;
8. Petroleum products;
9. Printed books and newspapers;
10. Other furnishing articles;
11. Coin;
12. Vehicles other than railway, train way, rolling stock;
13. Mosquito and sand-fly nets;
14. Ambulances, tractors and other goods carrying vehicles;
15. Medical equipment;
16. Educational services;
17. Banking and insurance services;
18. Postal services;
19. Funeral services such as provision of vehicles, coffins, wreaths and tombstones;
20. Transport of exports;
21. Rentals and sale of properties used for residential purposes;
22. Ordinary bread;
23. Hessian Cloth;
24. Betting and gaming including lotteries and casinos;
25. Rail locomotives and parts;
26. Medical, surgical or laboratory sterilizers; and
27. Aircraft and aircraft parts.

PRINCIPLES OF TAXATION (P6) KNOWLEDGE LEVEL



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