NOVEMBER 2016 PROFESSIONAL EXAMINATION
TAXATION & FISCAL POLICY (PAPER 3.4)
QUESTIONS & MARKING SCHEME

QUESTION ONE

You have been appointed as the Tax Manager of Samada Insurance Company. The Executive Director has expressed his persistent worry with the Chief Accountant to accurately calculate the company's tax obligations to agree with what is assessed by the Ghana Revenue Authority each year. He has thus, provided you with the Income Statement below for your consideration and advice.

SAMANDA INSURANCE COMPANY LIMITED
Income Statement for the years ended 2013 and 2014

	Note	2014 GH¢000	2013 GH¢000
Gross Premium		21,000	16,800
Less Reinsurances		(1,400)	(1,200)
Net Premium		19,600	15,600
Claims Paid		(12,600)	(9,600)
Salaries(Management Expenses)		(5,880)	(4,750)
Commission to Agents		(980)	(850)
Other Management Expenses	(1)	(2,033)	(1,750)
Underwriting Profit		**(1,893)**	**(1,350)**
Investment Income(Interest on Commercial Papers)		11,200	7,400
Other Income	(2)	6,300	8,400
Reinsurance recoveries		5,600	3,200
Net profit before finance and Tax		**21,207**	**17,650**
Finance Cost		(5,950)	(3,850)
Tax Charged		(3,814)	(3,450)
Net Profit after Tax		**11,443**	**10,350**

Notes to the Income Statements

Note 1 Other Management Expenses:	**GH¢000**	**GH¢000**
Advertising	168	50
Depreciation	1,700	1,450
Painting of New Office	140	0
Vehicle Rental	25	250
	2,033	**1,750**

Note 2 Other Income:

Gross Dividend	4,300	8,400
Premium Received in respect of 2015	2,000	0
	6,300	**8,400**

Note 3

i) Capital allowance agreed for the year 2014 was GH¢2,450,000
ii) Reserve is calculated at 40% of Net premium.

Required:

a) Compute the tax due the GRA for 2014 year of Assessment. **(8 marks)**

b) Support your computations with relevant explanations. **(2 marks)**

c) You have been appointed as a Tax consultant in a firm in Tabora, Accra. A client approached you one month after your appointment, and asked for your advice with their business records and Value Added Tax and National Health Insurance Levy (VAT/NHIL) returns.

i) One of their customers to whom they sold goods on credit worth GH¢12,500 inclusive of VAT has gone officially bankrupt. The company had paid the VAT on the transaction three months ago.
ii) In March 2015, the client in order to boost sales started selling to customers on 12 months equal instalments payment with some small interest .He is confused as to how to determine the amount of the VAT/NHIL and when he should pay the VAT/NHIL.
iii) The company sold good worth GH¢17,000 in March 2015, on a sale-or return basis, but the company is not clear as to when to account for the VAT/NHIL on the sale and what happens to the VAT/NHIL paid if the customer returns the good.
iv) The company sold stationery and office equipment worth GH¢30,000 to a Jude Power Manufacturing Company in Accra. The accountant of Jude Power informed them that their company is relieved from paying VAT/NHIL, so they will not pay.

Required:

Advise your client on issues raised in "i-iv" concerning VAT/NHIL returns. **(10 marks)**

(Total: 20 marks)

QUESTION TWO

a) The current level of government borrowing has become a topical issue for discussion causing observers to wonder whether borrowing is good or bad. In the light of this, you are required to:
   i) Evaluate the effect of government borrowing on the economy of Ghana. **(4 marks)**
   ii) Discuss how taxation can be used as a fiscal tool in fiscal policy. **(6 marks)**

b) Tax, when it becomes due and payable, is a debt due to GRA and is payable to the Commissioner-General.

   Required:

i) Examine the rules where the Commissioner-General can use Security on Landed Property for unpaid tax **(5 marks**)

ii) Detail out the rules where the Commissioner-General can recover tax from persons owing money to the GRA as tax debtor **(5 marks)**

(Total: 20 marks)

QUESTION THREE

a) Below is the capital structure of Nyameke Ghana Limited for 2014 year of assessment:

	GH¢
Equity	20,000,000
Loans	80,000,000
Total	**100,000,000**

The loans were taken for Nyameke Limited from the parent company based in Nigeria. During the year under review the subsidiary paid GH¢700,000 as interest on the loan and also incurred exchange loss of GH¢500,000 on the repayment of a loan taken earlier from the parent company.

Required:
Determine how the above transaction will be treated for tax purposes. **(6marks)**

b) John Smith, a prospective investor in Ghana is undecided whether to invest in farming or agro processing. He has contacted you on the tax implications of the two businesses he intends to invest in.

Required:
What advice would you give to John Smith to enable him make a firm decision. **(10 marks)**

c) The Commissioner-General of the Ghana Revenue Authority expects persons conducting business with Related Parties to ensure that the transaction is at arm's length.

Required:
Explain the arm's length principle in tax transactions. **(4marks)**

(Total: 20 marks)

QUESTION FOUR

a) Pearl House Ltd is a company incorporated in Ghana and contemplates applying for a licence to operate within the Free Zone environment from the Free Zone Board as opposed to an earlier decision to run a Micro Finance Business. Management has been at a crossroads on the decision to make.

Required:

As a Tax Consultant, the Management of Pearl House Ltd has approached you to join them at a breakfast meeting and convince them on the tax benefits if any that Pearl House Ltd stands to gain from the operations in the Free Zone milieu. **(10 marks)**

b) Bambara Ltd has the following summarized income statement relating to 2015 year of assessment:

	GH¢
Revenue	100,000
Cost of Sales	65,000
Gross Profit	**35,000**
Operating expenses	20,000
Net profit	**15,000**

Upon a closer scrutiny, the following came up:

i) Dividend net of withholding tax received from A Ltd was GH¢10,000. The amount received was added to revenue above. Bambara Ltd has 10% equity interest in A Ltd.

ii) Bad debts of GH¢1,000 was recovered. This was adjusted to the Income Surplus Account.

iii) A penalty of GH¢2,000 was paid and has been added to operating cost to determine the net profit as disclosed.

iv) Capital allowance agreed with Ghana Revenue Authority was GH¢1,000.00 and depreciation of GH¢1,300 was added to operating cost.

v) Taxes paid in previous quarters amounting to GH¢1,200 was added to operating cost to determine the net profit.

vi) It came to light that an amount of GH¢11,400 net of 5% withholding tax relating to supply of goods was not brought into the accounts at all on account of omission. The withholding tax was certified correct.

Required:

Determine the tax payable by Bambara Ltd and comment on any **FOUR** reasons for the inclusion and or non-inclusion of the transactions in the determination of income.

(10 marks)

(Total: 20 marks)

QUESTION FIVE

a) Ghana, having found oil in commercial quantity has joined its counterparts in the world in the production of Oil. Fiscal systems have been put in place to bring in various revenue streams to the Government of Ghana.

Required:

Discuss fully the under listed revenue types from Upstream Petroleum Operations:

i) Carried Interest

ii) Additional Carried Interest

iii) Additional Oil Entitlement

(3 marks each total: 9 marks)

b) Compute the Royalty payable on the operation of Go-Get Mining Company from the second quarter of its operations in 2015 from the following financial data:

	GH¢
Revenue	100,000
Cost of operation	65,000
Capital allowance agreed	15,000
Royalty (first quarter)	60,000

(3 marks)

c) Discuss the social significance for the imposition of taxes **(4 marks)**

d) Discuss Duty Draw Back as Custom Regime **(4 marks)**

(Total: 20 marks)

2015 INDIVIDUAL TAX RATES		
TAX RATES INCOME		**RATES**
First	1,584	Nil
Next	792	5%
Next	1,104	10%
Next	28,200	17.5%
Exceeding	31,680	25%

MARKING SCHEME

QUESTION ONE

SAMADA INSURANCE COMPANY
COMPUTATION OF TAX DUE

Y/A 2014	**GH¢**	**GH¢**	**GH¢**
	000	000	**000**
Gross Premium			21,000.00
Less Reinsurance			1,400.00
Net Insurance Income			19,600.00
Add prov for reserve b/f (40%*19600)	6,240.00		
Ded prov for rese c/f (40%*19,600)	7,040.00		
			(1 600.00)
			18,000.00
Claims paid	12,600		
Deduct Recoveries	5,600		(7,000.00)
			11,000.00
Deduct Operating Expenses:			
Salaries		5,880.00	
Commission to Agents		980.00	
Other Mgt Exp:			
Advertising	168.00		
Vehicle Rental	25.00		
Financial Charges	5,950.00	6,143.00	13,003.00
			(2,003.00)
Ded. Capital Allowance		2,450.00	2,450.00
Chargeable income (Tax Loss)			**(4,453.00)**

Investment Income

Approach A **With Dividend under section 44 of Act 592 Act 2000**

Add other Income:			
Interest on Commercial Papers	11,200.00		

Gross Dividend ****		4,300.00	
Chargeable Income			15,500.00
Tax Charged @ 25%			**3,875.00**
Less withholding Tax on interest		896.00	**896.00**
Net Tax Payable			**2,979.00**

Approach B Without Dividend-Assume dividend subject to final withholding tax

Other Income:		
Ointerest on commercial papers	11200	11,200.00
Chargeable Income		11,200.00
Tax Charged @ 25%		**2,800.00**
Less withholding Tax		**896.00**
Net Tax Payable		**1,904.00**

(8 marks)

b) **Relevant Explanations to Computations**

- Premium received relating to 2015 in the year 2014 has been deducted from the gross premium
- Interest on commercial papers has been assumed to be gross, hence withholding tax deducted in arriving at the net tax payable
- It is assumed that the insurance company has a stake in the company paying dividend of 25% hence
- no withholding tax but dividend added to income in line with section 44 of Act 2000 Act 592
- It could also be assumed that the dividend should suffer a final withholding tax hence should not be added in the determination of assessable income
- Tax charged on investment as business income is negative

(2 marks)

c)

A supply is said to have taken place on the earliest of the occurrence of any one of the following events:

a) The goods are removed from the taxable person's premises;
b) Where the goods are made available to the person to whom they are supplied;
c) Receipt of payment is made;
d) Tax invoice is issued.

i) The firm should write off the sales as bad debts in its books,
Inform the Commissioner-General in writing supporting the report with official liquidation
The firm, on the basis of the above, can put in a claim for the input tax on the bad debt as an adjustment in line with section 46 of the VAT ACT 2013, Act 870

ii) The taxable value according to section 43(4) under this situation would be based on the total amount of the installments. The tax will be calculated on the full value at the time of supply and not when the installment is paid. The price shall exclude the interest or finance charges.

iii) Regulation 17 of the VAT Regulation 1998 states that "where goods are supplied on sale or return, the tax point shall be the earliest of

a. The date when the purchaser chooses to keep the goods; or
b. The issue of a tax invoice by the seller, or
c. The receipt of payment by the seller, other than a deposit; or
d. The expiry of the period within which the customer may return the goods; or
e. Twelve months after the date of dispatch by the seller

iv) The customers should first obtain a copy of their relief letter/documents. Reliefs per section 38 of the VAT Act and the Third Schedule allow Vat registered manufacturers for raw materials at importation. The case however seems to suggest local purchases, and thus the Manufacturing company cannot claim relieve from such purchases. The company would thus have to claim the VAT, from Jude Power.

(2.5 marks for point (i)-(iv) = 10 marks)

(Total: 20 marks)

QUESTION TWO

(a)

(i)

Effects of Public Debt

- **Effects on Production**
  Public debts are raised to finance productive enterprises of various kinds, e.g., steel works, cement, multipurpose projects, construction of ships, railway lines and highways, heavy electrical and engineering works, mining, oil refining,
- **Effects on Consumption**
  When people subscribe to government loans, they generally have to curtail consumption. Since investment of funds raised by borrowing raises the level of employment and as a result raises the level of consumption
- **Effects on Distribution of wealth**
  Public loans transfer money from rich to government. The fiscal operations of the government are to benefit the poor primarily. The incomes of the poor increase directly through increased employment or it benefit them in directly through the enlargement of social services.
- **Effects on the Level of Income and Employment**

In modern times, public borrowing is resorted to in order to raise funds for financing agriculture, industry, mining, transportation, communication, etc. It increases employment opportunities, the level of income and standard of living.

(1 mark for each point = 4 marks)

(ii) **Fiscal Policy and Taxation**

There are two main types of taxes: direct taxes and indirect taxes. A tax cut increases disposable income, and leads to added consumption spending. Income will increase by a multiple of the decrease in taxes.

Taxation has been an important policy field throughout history and will stay a crucial aspect in future politics since it creates the basis for the state to work.

The following are some goals of taxation;

- The primary function of a tax system is to raise revenue for the government for its public expenditure. So the first goal in the development strategy as regards taxation policy is to ensure that this function is discharged adequately
- Taxes are used to reduce inequalities through a policy of redistribution of income and wealth. Higher rates of income taxes, capital transfer taxes and wealth taxes are some means adopted for achieving these ends.
- For social proposes such as discouraging certain activities which are considered undesirable. The excise taxes on liquor and tobacco, the special excise duties on luxury goods, betting and Gaming Levy are examples of such taxes, which apart from being lucrative revenue sources have also goals.
- Tax factors that affect development and growth
- Taxes affect growth in two ways. First, by influencing the aggregate supply of the main factors of production by raising or lowering their net (after tax) returns; and Second, by influencing the efficiency of resource utilisation factor (total productivity).

(1 mark for each relevant point for a maximum of 6 points = 6 marks)

(b)

(i)

Security on Landed Property for Unpaid Tax

- Where a person who is the owner of land or buildings situated in Ghana fails to pay tax when it is due and payable, the Commissioner-General may, by notice in writing, notify that person of the intention to apply to the Chief Registrar of Lands, for the land or buildings to be the subject of security for tax as specified in the notice.
- If a person on whom a notice has been served as above fails to make payment of the whole of the amount of the tax specified in the notice within thirty days of the date of service of the notice, the Commissioner-General may, by notice in writing, referred to as a “notice of direction”, direct the Chief Registrar that the land or buildings of that person, to the extent of the interest of that person in the land or buildings, be the subject of security for unpaid tax in the amount specified in the notice.
- Where a notice of direction is served on the Chief Registrar, the Chief Registrar shall, without fee, register the direction as if it were an instrument or mortgage

over, or charge on, the land or buildings and the registration shall, subject to any prior mortgage or charge, operate in all respects as a legal mortgage over or charge on the land or building to secure the amount of the unpaid tax.

- Upon receipt of the whole of the amount of tax secured under the landed property for tax unpaid, the Commissioner-General shall serve notice on the Chief Registrar cancelling the notice of direction and the Chief Registrar shall, without fee, record the cancellation at which time the direction shall cease to have effect.

(1 mark for 5 relevant points mentioned = 5 marks)

(b)
(ii)

Recovery of Tax from Person Owing Money to Tax Debtor

Where a person, referred to as the "tax debtor", has not paid tax which is due, the Commissioner-General may, by notice in writing, require any other person:

- Owing or who may owe money to the tax debtor,
- Holding or who may subsequently hold money for, or on account of, the tax debtor,
- Holding or who may subsequently hold money on account of a third person for payment to the tax debtor, or
- Having authority from a third person to pay money to the tax debtor, to pay the money to the Commissioner-General on the date set out in the notice, up to the amount of tax due.
- The Commissioner-General may only issue a notice as indicated above with respect to tax which is due but not currently payable where the Commissioner-General reasonably believes that the tax debtor will not pay the tax by the date on which it becomes payable.
- The date specified in the notice given above shall not be a date before the money becomes due to the tax debtor, or is held on behalf of the tax debtor.
- At the same time that notice is served as above, the Commissioner-General shall also serve a copy of the notice on the tax debtor.
- Where a person served with a notice as above is unable to comply with the notice by reason of lack of moneys owing to or held for the tax debtor, that person shall, as soon as is practicable and in any event not later than the payment date specified in the notice, notify the Commissioner-General accordingly in writing setting out the reasons for the inability to comply.
- Where a notice is served on the Commissioner-General from the person owing the tax payer, the Commissioner-General may, by notice in writing,
- Accept the notification and cancel or amend the notice issued or
- Reject the notification.
- A person dissatisfied with a decision above may only challenge the decision under the objection and appeal procedure.
- A person making a payment pursuant to a notice from the Commissioner is deemed to have been acting under the authority of the tax debtor and of all other persons concerned and is hereby indemnified in respect of the payment against all proceedings, civil or criminal, and all processes, judicial or extra-judicial,

notwithstanding any provisions to the contrary in any written law, contract, or agreement.

(1 mark for 5 relevant points mentioned = 5 mark)

(Total: 20 marks)

QUESTION THREE

(a) This is a case of the interest and foreign exchange loss being subjected to Thin Capitalisation. Ratio of Debt Equity ie 2:1

Twice Equity = 2* 20,000,000		
Allowable Debt = 40,000,000.00		
Debt Acquired = 80,000,000.00		
Interest Allowed = 40,000,000*700,000/80,000,000		
40,000,000 X 700,000		
80,000,000		
350,000.00		
	GH¢	
Total Interest	700,000	
Interest Allowed based on Thin Capitalisation	350,000	
Interest to be Disallowed	**350,000**	
Withholding tax @ 8% * 700,000	56,000.00	
Foreign exchange loss	500,000	
Foreign exchange loss = 40,000,000 * 500,000		
80,000,000		
250,000.00		
		GH¢
Total foreign exchange loss		500,000
Allowable for Thin Capitalisation		250,000
Exchange loss not allowable		**250,000**

b) Farming or Agro Processing businesses in Ghana enjoy tax holidays or exemption periods. During the period of exemption the incomes are not taxable until the period is over. The exemption periods vary and depend mainly on the type of businesses. These are granted to serve as incentives for taxpayers

Farming	**Agro processing**
Tax Holidays	**Tax Holidays**
i) Tree Crops 10 years holidays starting from first harvest	Agro Processing Business before 2004 3 years holidays
ii) Cattle- 10 years starting from when business operation commences	Agro Processing Business established after 2004 5 years tax holidays starting from commencement 5 years tax holidays starting from commencement
iii) Livestock, Fish and Cash crop 5 years holidays starting from commencement of business operation	Companies producing cocoa by products from cocoa waste with 5 Holiday starting from commencement of business operation
The income from a cocoa farmer - Indefinite	
	Incentives relating to tax rates after exemption
	Agro companies located in Accra, Tema -rate of tax 20%
	Regional Capitals except Upper East, Upper West and Northern Region 10% rate of Tax
	Upper East, Upper West, and Northern Regional Capitals 0% tax rate
Other Incentives: Carryover of loss -5 years following the year in which the loss was incurred	**Other Incentives** Carryover of loss -5 years following the Year in which the loss was incurred
Employees residing on farm, their rent element is excluded from the determination of their income for tax purpose	

- "Tree Crops" includes coconut, coffee, oil palm, rubber and sheanut.

- "Cash Crop" includes cassava, maize, pineapple, rice and yam.
- "Processing Business" means business of converting crops, fish or livestock produced in Ghana into edible canned or other packaged products other than their raw state.
- "Farming Business" means the business of producing crops, fish or livestock.

(10 marks)

c) The arm's length principle states that "If **conditions made or imposed** between **associated enterprises** in their **commercial or financial relations** differ from those which would have been made between **independent enterprises**, then profits that, but for those conditions, would have accrued to one of the enterprises may be included in the profits of that enterprise and taxed"
That is taxable profit is to be computed on the basis that transactions between related parties take place on the same terms as those between unrelated parties/independent person.

(4 marks)

(Total: 20 marks)

QUESTION FOUR

a) Tax benefits of the free zone
The following are benefits the Free Zone persons stand to gain and would accrue to Pearl House Ltd if it operates as a free zone company:

- Both foreigners and nationals can own 100% shares without restrictions. Pearl House Ltd shareholders alone can own the shares as they are no restrictions on the shareholding structures.
- Pearl House Limited would be exempt from value added tax and import duties on imports of raw materials and equipment for the use by Pearl House Ltd in its business operations.
- Exempt from payment of corporate tax for the first 10 years of its operation
- Exports of goods and services shall be taxed @ 15% as opposed to 25% to Domestic market.
- Dividend paid to shareholders of Pearl House Limited shall be exempt from withholding tax.
- Can obtain inputs for its operation from national custom controlled territory which are relief from Value Added Tax
- Can obtain permission to sell up to 30% to the Domestic Market
- Faulty goods which fall short of meeting international market standards shall form part of the up to 30% for the domestic market
- Custom Division of Ghana Revenue Authority does not control the Free Zone Enterprise but monitors it to ensure it operates within the rule

- The Free Zone board facilitates the acquisition of other permits for the operation of the Free Zone Enterprise which may be essential for the operation of the Free Zone Enterprise

(2 marks each for any five points=10 marks)

b)

BAMBARA LTD COMPUTATION OF TAX PAYABLE		
Y/A 2015	**GH¢**	**GH¢**
Net Profit as disclosed		15,000.00
Deduct Dividend		10,000.00
		5,000.00
Add back the following:		
Bad Debts	1,000.00	
Penalty	2,000.00	
Depreciation	1,300.00	
Taxes	1,200.00	
Revenue (100/95*11400)	12,000.00	
		17,500.00
		22,500.00
Capital Allowance		1,000.00
Chargeable Income		21,500.00
Tax Charged @ 25%		5,375.00
Less withholding Tax (12,000-11400) +tax of 1200		1,800.00
Net Tax Payable		**3,575.00**
		(7 Marks)

Comments on inclusion and or non-inclusion

- Dividend is subject to a final withholding tax at the rate of 8% where the receiving entity does not have the at least 25% equity in the paying entity and should not be added to income
- Bad debts recovered should be added to income and taxed but not added to income surplus as income surplus is a recipient of residual income
- Penalty is not an allowable deduction hence added back to income
- Capital allowance granted instead of depreciation but depreciation disallowed
- Taxes are non-deductible allowance
- The revenue was not added to income because of omission but now added as it is part of assessable income

QUESTION FIVE

a)

i) Carried Interest

Carried interest entitles the State to a share of the oil produced without making financial contribution towards exploration and development costs. The State should contribute towards production cost being its proportionate representation. The carried interest ranges between 7.5% and 15% in most oil producing countries.

(3 marks)

ii) Additional Carried Interest

Additional carried interest is a paying interest that allows the State to pay the proportionate share of only the development and production cost. The state does not pay towards exploration and appraisal cost.

The State can acquire up to 5% in any commercial discovery subject to petroleum agreement.

(3 marks)

iii) Additional Oil Entitlement

Additional oil entitlement which is also called super normal profit tax. It is levied in case the windfall profit, where the venture's rate of return exceeds the target rate of return used to evaluate the profitability of the venture during negotiation.

It is computed on the basis of the after-tax inflation adjusted rate of return that the contractor achieves with respect to each field.

(3 marks)

b) **Royalty payable:**

Act 2010 Act 794

Royalty Rate 5%

Revenue		GH¢100,000
Royalty Computation	5/100* 100,000	GH¢5,000
Royalty payable		GH¢5,000.00

(3 marks)

c) The social significance for the imposition of tax by the government is to achieve the following reasons:

- To protect the consumption of harmful goods
- To check lifestyle by imposing taxes on goods consumed by the rich
- To provide social amenities to the citizenry
- Redistribution of income by taking more from the rich and subsidizing good consumed by the poor

(1 tick for each answer Maximum of 4 Marks)

d) Duty Draw Back as Custom Regime

It is the refund or reimbursement of duty paid by an importer when goods which are initially imported are re-exported at later date. The duty is refunded save the payment of small administrative charges. The object of a drawback is to allow commodities which are subject tax be exported and sold in a foreign country on the same terms as goods from countries where they are untaxed.

(4 Marks)

(Total: 20 marks)