

UNIVERSITY OF ESWATINI
DEPARTMENT OF BUSINESS ADMINISTRATION
MAIN EXAMINATION PAPER MAY 2019

DEGREE AND
YEAR OF STUDY : MASTER OF BUSINESS ADMINISTRATION

TITLE OF PAPER : TAXES AND BUSINESS DECISIONS

COURSE CODE : ACF636

TOTAL MARKS : 100 MARKS

TIME ALLOWED : THREE (3) HOURS

- INSTRUCTIONS :
1. This paper consists of **FIVE (5)** numbered pages, including this page.
 2. There are **FOUR (4)** questions, answer **ALL FOUR (4)** questions.
 3. Begin solution to each question on a new page.
 4. Show all the necessary workings.
 5. Round off as you deem appropriate.

Note: You are reminded that in assessing your work, account will be taken of accuracy of the language and general quality of expression, together with layout and presentation of your answer.

THIS PAPER MUST NOT BE OPENED UNTIL PERMISSION HAS BEEN GRANTED BY THE INVIGILATOR OR SUPERVISOR.

QUESTION 1 (25 marks)**ANSWER ALL TWO UNRELATED PARTS OF THIS QUESTION****PART A [10 marks]**

ABC (Pty) Ltd is a large multinational company that has facilities (both manufacturing and distribution) located in many large towns in Eswatini and in the SADC region. The firm's long-serving Chief Financial Officer (CFO) just retired and his replacement is reviewing the firm's economic balance sheet. She discovers that the firm leases many of its distribution facilities and relies heavily on long-term debt for financing. She vaguely recalls having heard about implicit taxes and tax clienteles and would like these concepts explained and then applied to her observations to determine if the firm is bearing implicit taxes and whether it is in the right clientele.

Required

- i) Briefly explain the term 'Implicit Taxes' to the new CFO (2 marks)
- ii) Briefly explain the term 'Tax Clienteles' to the new CFO (2 marks)
- iii) Use your answers in (i) and (ii) above to explain to the new CFO whether the company is bearing implicit taxes and is in the right clientele. (6 marks)

PART B [15 marks]

You have just been appointed by a firm of accountants based in Manzini as a tax consultant. The firm publishes a monthly newsletter called, *Tax Matters*, for its existing and potential clients. The May 2019 edition of *Tax Matters* contained an article on '**Personal tax planning**' that had been authored by yourself. You ended the article by inviting readers to email you queries that they may have. Soon after the publication of your article, you received an email from two potential clients requesting you to assist them answer the following questions:

- Potential Client 1:** What tax planning activities would a taxpayer undertake in the current period to minimise his tax liabilities if his marginal tax rate will decline in the next period?
- Potential Client 2:** What is the difference between **Tax avoidance** and **Tax evasion**?

You are required to

- (i) Respond to potential client 1's request by setting out clearly the tax planning activities that he would undertake in the current period to minimise his tax liabilities. (9 marks)
- (ii) Respond to Potential Client 2's request by setting out clearly the meanings of the terms: tax avoidance and tax evasion. (6 marks)

QUESTION 2 [25 Marks]**ANSWER ALL TWO UNRELATED PARTS TO THIS QUESTION****PART A [14 marks]**

Amber (Pty) Ltd is considering a joint venture with another company to start an Internet-based business. The new business will tap into the expertise Amber (Pty) Ltd has developed in writing the complex software algorithms the firm uses to schedule and manage its complex manufacturing and distribution processes. Each entity is required to initially contribute E20 million for a 50% share in the joint venture. As with most Internet-based businesses, the joint-venture partners do not expect to earn positive profits for the foreseeable future.

Required

- (i) Discuss the strengths and weaknesses of the alternative organisational forms that the joint venture might take. In your discussion, consider both the tax and nontax costs and benefits of the alternatives and recommend the most appropriate form organisational form for the joint venture.

(8 marks)

- (ii) In contributing the E20 million, Amber (Pty) Ltd is considering two options:

Option 1 - the entire amount contributed as equity,

Option 2 - E10 million treated as equity with the remaining E10 million being treated as a short-term debt payable with annual interest rate of 10%.

Evaluate the two alternatives and recommend which option should be selected.

(6 marks)**PART B [11 marks]**

Briefly explain why it is important for the tax planner to know the tax consequences of a particular transaction not only to the entity employing the tax planner but also to the other party (or parties) to the transaction. Use examples of negotiating the purchase price of another business and the buying of goods and services in a competitive market to illustrate your answer.

(11 marks)

QUESTION 3 [25 marks]

You are the accountant of XYZ (Pty) Ltd. The Chief Financial Officer informs you that:

- the Government has passed a new tax law where the top corporate statutory tax rate will decrease from 35% to 30% next year. The Chief Financial Officer of XYZ (Pty) Ltd wants to defer as much income as possible.
- Suppose XYZ (Pty) Ltd.'s tax rate is 30% if taxable income is positive and 0% if taxable income is negative.

Required

- (i) Prepare a detailed list of actions which XYZ (Pty) Ltd will apply to shift income (that is, ways in which the firm can shift income). For each action, outline any nontax costs associated with the action.

(12 marks)

- (ii) For each of the following four projects, calculate the expected pre-tax payoff, expected taxes, and expected average tax rate (expected total taxes divided by expected taxable income). Note that for each project the expected taxable income is E50,000. Briefly comment on your results.

Project 1: Certain payoff E50,000

Project 2: 50% chance of E100,000 and a 50% chance of E nil

Project 3: 50% chance of E200,000 and a 50% chance of a loss of E100,000

Project 4: 50% chance of E500,000 and a 50% chance of loss of E400,000

(13 marks)

QUESTION 4 [25 marks]

Suppose you operate a very profitable sole proprietorship. Your current year marginal tax rate is 40%, but you expect it to increase to 50% next year due to legislative changes. Your business includes exclusive rights to distribute microcomputer software packages in specified geographical areas throughout Eswatini. Your typical gross margin on software sales for the programs distributed is an impressive 50%. The end of the year is approaching, and you wonder whether a special price reduction to promote sales in the current tax year would be desirable.

You assess that a 10% across the-board price reduction for the remainder of the year will generate E400,000 of new sales, but E800,000 of normal sales for the rest of the year will be made at a 10% discount. Moreover, E1,000,000 of next year's sales will be cannibalised. That is, a 10% price cut will result in E1,000,000 of next year's product line being sold this year for E900,000, and E800,000 of normal sales for the rest of this year will yield only E720,000 in revenues, but you will also pick up E400,000 in new sales this year.

Required

Determine how much better or worse off you would be **before** and **after** tax if you employ the year-end sales strategy and it goes according to plan.

(25 marks)

END OF QUESTION PAPER