Examiner's report

F6 Taxation (LSO)
June 2010

General Comments
This examination consisted of five compulsory questions. The first two questions carried 25 and 30 marks respectively. The last three questions each carried 15 Marks. Some questions were fully computational while others consisted of both computational and narrative aspects.

In general, candidates' performance for this examination sitting was relatively satisfactory. Most candidates attempted all the questions. However, there was evidence of poor time management in some few cases affecting any last questions attempted. Where not all questions were attempted question four or five were frequently omitted.

Most candidates seemed to have revised for this examination sitting as evidenced by many excellent answers presented. However, answers for some of the candidates were poorly presented as the result of failure to effectively revise for the examination. The poor performance was once again exacerbated by failure to read and understand the contents of the question.

Workings were generally shown for most candidates, but in some cases they were not clear and made it difficult to follow. It is very important for candidates to clearly label their workings as they also carry some marks.

Specific Comments

Question One
This 25-mark question tested candidates' knowledge of the general principles involved in the calculation of tax liability of the expatriate taxpayer. The question was divided into four parts.

The first part which carried most marks required candidates to calculate the tax payable by an expatriate taxpayer. Most candidates achieved most marks in this part of the question. However, common errors identified included the following:

- Only 50% of entertainment allowance was included in the calculation of chargeable income. Seemingly the tax treatment was confused with that of 50% entertainment allowable deduction.
- Failure to include contributions to superannuation fund as allowable expenses. In some cases M4,400 contributed by employer were included as an allowable deduction to the employee.
- Terminal benefits were often omitted, in particular gratuity. Most candidates treated it as part of lump sum payments. Terminal benefits form part of employment income and are not subject to the standard rate, which most candidates did.
- There was too much confusion as to how much should be exempted from severance payments. Most candidates deducted M1,200 instead of M1,500.
- Lack of knowledge in regard to tax treatment of property income of expatriate taxpayers.
- Failure to apply the correct tax rate in the calculation of tax payable. Candidates could have achieved more marks had they recognised that the tax payable of the expatriate taxpayer is calculated by using the same rates as that of the resident individual.

In part (b) of the question, hardly any of the candidates scored good marks. The lump sum payments were correctly identified in most instances. However, most candidates failed to appreciate that the question clearly stated that the taxpayer elected not to include the said payments in the gross income. This implies that the payments were received net of withholding tax at standard rate. This means that to calculate the amount of tax withheld the gross amount should be used instead of the actual payments received as most candidates did.

Part (c) of the question focused on the calculation of fringe benefit tax payable by the employer. There was more confusion as to the calculation of taxable value of the car fringe benefit. Most candidates calculated 15% of the current market value while others deducted car allowances from the taxable value. On the same note, some candidates seemed to calculated taxable values for housing fringe and excessive superannuation funds when in fact such benefits were non-existent.

The last part of the question was well answered with the exception of those candidates who demonstrated a lack of general understanding on this part.

Question Two
This 30 mark question tested candidates understanding of the principles involved in the taxation of corporations. The question was divided in five parts.

Part (a) required candidates to calculate advance corporation tax (ACT) payable. Most candidates performed very well on this part. However, there were some candidates who wrongly assumed that gain from disposal of shares is treated as deemed dividends.

In part (b) of the question candidates were expected to explain alternative ways in which ACT can be utilised. Candidates should note that once this tax is paid, it can be set off against different types of taxes due/payable as opposed to taxes already paid. On the other hand, this tax cannot be set off against withholding tax or pay as you earn (PAYE) as some of the candidates indicated.

Part (c) of the question required candidates to calculate corporation tax payable and state the due date of payment. This was frequently the best answered part of the question. Most candidates however seemed to ignore the due date of payment. Others confused this due date with the one for payment of income tax instalments. Marks could have been higher if candidates had been able to calculate the correct amount for operating expenses. The amount of M530,150 included all the costs appearing in note 2. Candidates were expected to adjust this figure by simply deducting the expenses which are disallowed. More revision is required on the tax treatment of amortisation of intangible assets and start up costs, there appeared to be too much confusion of the two. Approved training expenses imply that the extra 25% is already included. Most candidates assumed the opposite, 25% was often added to M9,600. No further adjustment was required for management fees. This is a business expense and already included in total operating expenses of M530,150. This was meant to calculate the withholding tax in part (d) of the question.

Part (d) tested candidates' understanding in regard to application of correct withholding tax rates on payments to non-residents. Incorrect tax rates such as 15%, 25% were frequently applied, despite the fact that the question clearly stated that the expenses are payable to the head office in South Africa. Candidates could have scored higher marks had they applied the tax rate of 10% in both cases.

The last part of the question focused on branch taxation. Most candidates could not pick up as many marks as expected. The problem was basically on the calculation of repatriated profits. Some answers demonstrated a lot of confusion as to where to apply 20% and 25%. Once again more revision is required on this part.

Question Three
This 15 mark question focused on the value added tax. In general, the performance was satisfactory. However, there were still some common errors identified as follows:

- Failure to allow input tax for a taxable supply which was given away as a gift. In this case the vendor is also expected to account for a relevant output tax, based on the fair market value. This was frequently omitted in the calculation of output tax.
- Lack of understanding the difference between exemption, zero-rated and exclusions. For instances, transport and water were at times zero-rated. Although this will have no effect on the total input tax, the principle is incorrect. Candidates should clearly indicate when supplies are exempt, zero-rated and excluded. Some answers simply showed zero input tax, and in this case it was difficult to assess whether candidates really understand the principle.

- Difference between input and output tax.

Question Four

This 15 mark question focused on long term contracts. The performance on this question was on average. There were candidates who performed extremely well indicating that they did revise. On the other hand, some candidates performed extremely badly. It was clear from their answers that they did not revise this part effectively. Significant answers showed confusion as to the calculation of chargeable income. At times, in calculating the percentage of contract completed, contract costs were divided by contract price instead of total contract costs. Performance on the narrative part was also not satisfactory. Many candidates seemed to realise that a contract loss may be carried back to a preceding year subject to some conditions, but they failed to mention that the loss can also be carried forward to subsequent year(s) of assessment.

Question Five

This 15 mark question focused specifically on taxation of estates of a deceased taxpayer. Overall performance on this question was not satisfactory. The first part of the question was narrative. Most candidates seemed to be very familiar with this topic although it was examined for the first time. However, most of them failed to carefully read and understand the requirement of the question. They provided everything they knew about taxation of trusts. Candidates were expected to explain the tax treatment of a deceased person before and after death. With regard to the calculation of the tax payable in the second part of the question, the performance was good for most candidates. Most of them correctly realised that the tax credit is pro-rated.