

Examiner's report

F6 Taxation (LSO)

June 2011



General Comments

This examination consisted of five compulsory questions. Question one carried 25 marks and question two carried 30 marks. The three further questions were for 15 marks each. Most of the questions consisted of both computational and narrative aspects with more weight on computations.

The overall performance for this sitting was relatively satisfactory. Excellent answers were presented by most candidates and higher marks were achieved to that effect. However there were still some candidates who appeared to be unprepared for this examination.

There was a clear evidence of poor time management which in most cases affected the last questions attempted. Some candidates could not score higher marks as expected because of their failure to read and understand some of the questions. This was evidenced in question three and five.

Candidates must give a more thought to the layout and organisation of their answers. Workings were generally shown but at times were difficult to follow. Workings should always be labeled and shown separately from the body of the answers. Most candidates seemed to mix their workings with the main calculations thus presenting a very untidy layout.

Specific Comments

Question One

This 25-mark question was divided into two parts. The first part tested candidates' ability to calculate tax payable by an individual taxpayer. In general, the performance for this part was not satisfactory. The most challenging part was on the calculation of allowable deductions for finance lease and hire purchase transactions. Most candidates showed a lot of confusion on the calculation of the tax deductible expenses. In both transactions candidates were expected to allow interest and depreciation as opposed to the payments made. In the case of the finance lease the depreciation allowance was correctly calculated. The main problem was with the calculation of relevant interest. Candidates should distinguish between lease payments payable in advance and in arrears.

The calculation for hire purchase interest also posed a problem to most candidates. This is simply the difference between the hire purchase price and the cash price. The tax deductible expense will then depend on the period the asset has been in use in the year of assessment. Surprisingly, the majority of candidates got the depreciation allowance for an asset bought on hire purchase agreement wrong. Only a few candidates recognised that the cash price is used instead of hire purchase price.

The second part of this question required candidates to explain how the tax losses may be utilised. There was a lot of confusion again in this part. The tax losses were confused with advance corporation tax (ACT). Candidates suggested that they can be offset against other taxes. Others correctly suggested that the losses can be carried forward; however failed not provide any further explanation, thus leaving the answer incomplete. Some candidates mentioned that a foreign source loss is lost forever which was wrong. Candidates could have achieved higher marks had they appreciated that the treatment for tax losses is the same, that is, they are carried forward and offset against relevant income (not any other income) in the subsequent year(s) of assessment. In essence, the Act permits the tax losses to be carried forward indefinitely.

Question Two

This 30 mark question focused on the calculation of corporation tax of a manufacturing company. The overall performance was not bad for most candidates. The question was divided into five parts. The first and second parts tested candidates' knowledge regarding application of methods of depreciation. In the first part most candidates provided excellent explanations as to when to apply the pooling method of depreciation. However, when it came to the second part where they were required to calculate the depreciation allowances some of them did the opposite of what was provided in the first part. Some candidates, who correctly indicated that group four assets are not eligible for the pooling method regardless of whether the election has been made by a taxpayer, ironically used this method to calculate the allowance for industrial buildings. In some cases the single asset method was used throughout, ignoring the fact that the taxpayer made an election for pooling method to apply. This is a clear case of failure to read and understand the question.

Part three required candidates to calculate the tax payable. This is where the layout of some of the answers was poorly presented. The detailed calculations for allowable expenses were mixed with the main calculations. Apart from that, the Lesotho source interest seemed to confuse most candidates. A credit for a related withholding tax was granted yet it was clear from the question that no tax had been deducted at source.

The next part required candidates to calculate income tax instalments for the following year of assessment that is, the year ending February 2012. This part of the question was frequently omitted. This was typical of most candidates who couldn't complete the former part.

The last part of the question tested candidates' knowledge in regard to the application of correct withholding tax rates. It was clear from their answers that more revision is required on withholding taxes. Most candidates seemed not to know when to apply 5%, 10% or 25%.

Question Three

This 15 mark question focused on value added tax (VAT). The performance was not satisfactory for most candidates. The narrative aspects carried more marks than the computations. This could presumably be one of the reasons why most candidates did not perform well. This part required candidates to explain why VAT is referred to as indirect tax. Most answers were very vague, very often highlighting the shifting of the tax burden to the consumer, ignoring the most important element of payment of tax to the government by the person who does not bear the cost.

The second part which was about the rules governing the place of supply was frequently confused with the rules for time of supply. Candidates were expected to explain the rules in the case where the supply involves goods and where the supply is a service. The third part required candidates to state reasons why a vendor may apply for cancellation of VAT. This part was frequently confused with reasons the Commissioner may cancel voluntary registration. It is very important for candidates to read and understand the question in order to score higher marks.

The last part of this question involved calculation of input and output VAT. There were a number of candidates who could not differentiate between input and output tax. It is very important to know the difference between input and output VAT. This is the only way that candidates will get the amount of VAT payable or refundable right. On the same note, some candidates aggregated the taxable values of supplies and at times applying the rate on the wrong total. What should be aggregated is the tax calculated on each supply. Most candidates could not recognise that the taxable value of the supply bought at a reduced price is its fair market value. On the other hand, some candidates failed to realise that the vendor is liable to account and pay for output VAT in relation to the taxable supply which was used to entertain the employees.

Question Four

This 15 mark question focused on taxation of a partnership. The overall performance was very good. However, there were still common errors which need some attention. These included the following:

- Failure to include the correct pension contribution in the calculation of notional chargeable income. Some candidates included both partnership contribution and partners' contribution.
- Omission of interest expense in the calculation of notional chargeable income.
- Crediting the total foreign tax credit of the partnership to the resident partner.

Question Five

This 15 mark question focused mainly on fringe benefits tax. The overall performance was poor. Seemingly, this was due to failure to read and understand the requirement of the question coupled with poor time management. Candidates were expected to show their understanding of the tax treatment of exempt and taxable fringe benefits, as well as payments which should form part of employment income. Most candidates failed to establish the difference between exempt and taxable fringe benefits.

More specifically, it was clear from their answers that they did not know the tax treatment of the loan fringe benefit. While the majority suggested that it should be treated as part of taxable income others indicated that it should be a debt waiver. Those who were aware that it is a taxable fringe benefit could not calculate the taxable value correctly.

Only a handful of candidates got the medical fringe benefit correct. Most of them provided that it should be treated as part of employment income. For those who correctly mentioned that it is an exempt fringe benefit most of them continued calculating the fringe benefit tax (FBT) payable by the employer, implying lack of understanding of the correct tax treatment.

The housing allowance in most answers was treated as a housing fringe benefit instead of employment income. On the contrary, higher marks were gained on the tax treatment of cell phone usage bill. The majority realised this is a utility fringe benefit; the employer is liable for FBT, which in turn is an allowable deduction to the employer.

Generally speaking, a good approach for taxation of fringe benefits is to establish whether a fringe benefit is exempt or taxable. If it is exempt candidates should note that no FBT is payable by the employer, and the cost of providing the fringe benefit is fully allowable to the employer. On the other hand, if the fringe benefit is taxable, the employer is liable to pay FBT, and the tax payable (not the cost of providing the fringe benefit as the majority suggested) is fully allowable to the employer. Otherwise there are different formulas used to calculate taxable values for different taxable fringe benefit as provided by the Act.