Examiner's report
F6 (BWA) Taxation
December 2015

General Comments
There were two sections to the examination paper and all of the questions were compulsory. Section A consisted of 15 multiple choice questions (two marks each) which covered a broad range of syllabus topics. Section B had four questions worth 10 marks each and two longer questions worth 15 marks, each testing the candidates' understanding and application of tax in more depth. This is the second examiner's report since the introduction of the new exam format and question types. This was not considered to be a difficult paper but it did appear that some candidates were not well prepared and some appeared to be time pressured in Section B. An overall observation is that many candidates struggled with the principles and mechanics of tax computations which are so important to this paper.

The following paragraphs report on each section and focus on some of the key learning points.

Specific Comments

<u>Section A</u>

It was very pleasing to see that almost all candidates attempted all of the questions however it is important that this section should not take up time that should be allocated to Section B. Section A questions aim to provide a broad coverage of the syllabus, and future candidates should aim to revise all areas of the F6 BWA syllabus, rather than attempting to question spot. The majority of the questions require calculations and the choice of answers from which the candidate must select will contain one correct answer and then 3 distracters – i.e. answers that are plausible but incorrect. The following two questions are reviewed with the aim of giving future candidates an indication of the types of questions asked, guidance on dealing with exam questions and to provide a technical debrief on the topics covered by the specific questions selected.

Sample Questions for Discussion

Example 1
Golden Designs (Pty) Ltd imported goods from a South African supplier and paid Value Added Tax (VAT) at the time of importation. The VAT paid on the import was recovered as input tax in the VAT return for the month ended 31 October 2015. In November 2015, the South African supplier gave Golden Designs (Pty) Ltd a discount of P500,000 and issued a credit note for this amount against the purchase.

What is the correct action which Golden Designs (Pty) Ltd should take in relation to the discount for VAT purposes?

A Resubmit its VAT return for the month of October 2015 reflecting the discount received
B Report an input VAT adjustment in its VAT return for the month ended 30 November 2015
C Report a change in the inventory value to the Botswana Unified Revenue Service (BURS)
D No action required to be taken

This question tested the VAT reporting on cross border transactions. When goods are imported into Botswana VAT is paid and the importer can claim an input tax credit. The question is what then happens if there is a subsequent adjustment such as a discount or a credit note for a short supply of goods issued by the non-resident supplier? This question was not well answered with the vast majority of candidates choosing B – report an input VAT adjustment in its VAT return for the month of November 2015.

VAT is meant to be tax neutral to the business; so if VAT is paid upon importation and an input credit is given then the importer is in a tax neutral position. In fact there are no further VAT reporting requirements after this point and there is no VAT impact on any further book entries such as debit or credit notes issued by the non-resident supplier. The correct answer then was D – no further action to be taken. Such kinds of price and volume adjustments are common in practice but there is only a VAT impact and reporting requirement on debit and credit notes issued to resident persons – not to non-resident persons.

Example 2

Richard declared taxable income of P200,000 but failed to declare certain taxable income of P120,000 in his tax return for the tax year 2014/2015. The Botswana Unified Revenue Service (BURS) considers that Richard's actions constitute carelessness.

What is the maximum penalty which can be imposed on Richard?

A P30,000
B P120,000
C P60,000
D P240,000

This question tested candidates' knowledge of penalties that can be imposed for failure to declare the correct amounts in tax returns.

The absolute maximum penalty that can be imposed is *"twice the amount of tax which would have been lost…"* and this is in respect of fraud or wilful default. The next lesser penalty is *"not exceeding the amount of tax that would have been lost…"* which is in respect of neglect or carelessness. The tax on P120,000 is 25% being the maximum marginal tax rate which is equal to P30,000 and so the correct answer was A. The majority of candidates selected B – P120,000 - but this is 100% of the income that was not declared instead of 100% of the tax that would have been lost.

Section B

A large number of candidates did not answer all of the questions and it is assumed that this was due to time pressures rather than the difficulty of the paper. It is critical that candidates attempt to answer every question in order to give themselves a reasonable chance of passing and this involves managing the amount of time spent on each question properly . The two questions that carry the most marks in Section B are at the end of the paper and so it may be better to attempt those whilst there is still time available.

Question One

This 10-mark question covered the topic of VAT.

Part (a) (i) required candidates to explain whether goods that had been invoiced but not delivered should be included in taxable outputs. Candidates' performance was satisfactory on this question and most was aware that a VAT liability is triggered by the earlier of issue of a tax invoice and cash received and that the time of delivery is not important. Part (a) (ii) also related to outputs but in respect of a the sale of a saloon car

Questions such as these are looking for a reason and not just a statement. It is not enough to simply say that the sale should be included in outputs - what is more important is the reason why it should be included in outputs. In the case of (a) (i) the reason is as above and in (a) (ii) it is because the purchase of a saloon car is a prohibited input and therefore there is no VAT upon its subsequent sale. Many candidates stated that the reason was because it was exempt supply but this is not correct.

Part (a) (iii) required a calculation of the VAT outputs that should be declared and this was not answered so well. Sales returns must be reduced from outputs (or treated as an input adjustment) but the VAT impact is only in respect of standard rated outputs and not in respect of zero-rated outputs. Candidates were required to take out the VAT element in undelivered goods and bad debts recovered but many failed to do this and not many recognised the fact that where a bad debt is recovered and an input credit has been given in a previous period then VAT must be accounted for on the amount recovered.

Part (b) related to penalties in respect of late submission of VAT returns and payment and the majority of candidates gave the penalties relating to late income tax returns. VAT penalties are a lot more severe than income tax penalties.

Overall candidates achieved less than average marks on this question.

Question Two

This 10 mark question related to the taxation of an individual and was generally well answered.

Part (a) for 5 marks required a calculation of Josephine's income from employment and the PAYE that her employer should have deducted and this was fairly straightforward with the majority of candidates scoring good marks. For the purposes of calculating PAYE only the individuals' contribution to a pension fund can be deducted and not contributions to a retirement annuity fund although this made no difference to the overall tax payable because they are both deductible costs.

Part (b) also for 5 marks required a calculation of Josephine's non-employment income that is subject to tax. In this case she has rental income from which she is allowed to deduct various expenses that have been incurred in the production of income such as insurance, mortgage interest and repairs. The construction or extension of the house cannot be claimed as a deduction as this is considered to be an expense of a capital nature; a few candidates however claimed capital allowances on the construction of the garage but there are no capital allowances on residential houses. Josephine had 4 sources of income – namely employment, rents, interest and dividends. Dividends do not fall into gross income and interest that has been subjected to 10% withholding tax does not have to be declared.

Generally candidates handled this question well and scored good marks.

Question Three

This 10-mark question covered the topic of capital gains.

Part (a) for 4 marks required an explanation of whether various capital transactions entered into by Anand were subject to capital gains tax. As in Question 1 above a simple statement "the sale is subject to capital gains tax", and many candidates made such statements, is not going to be sufficient to score full marks even if the statement is correct – questions are very rarely that simple. Questions such as these require an explanation as to why the sale is subject to capital gains tax. Whilst most candidates were aware that the sale of shares that are listed on the BSE are exempt but most failed to state that the exemption only applies if the shares have been held for at least 1 year. Unlisted shares are liable to capital gains tax but where the sale is shares and loan account then the value of the loan account must be deducted to arrive at the sale price of the shares. Principal private residences are only exempt from capital gains tax if they have been held for at least 5 years. Where shares are sold in a property company where the dominant assets are immoveable property then the sale is subject to capital gains tax but is calculated as if it is a sale of the underlying property and not of the shares.

Part (b) was for 6 marks and required the calculation of the capital gains less any deductions and reliefs. What was surprising was that quite a few candidates having stated that the sale of shares listed on the BSE are exempt then proceeded to calculate a capital gains tax liability. The vast majority of candidates correctly calculated the liability of the sale of unlisted shares and goodwill but failed to treat the sale of shares as a sale of immoveable property as discussed in (a) above. In this case the cost of the property to Anand – i.e. 50% - must be indexed instead of applying the 25% moveable property allowance.

For the most part this question was well answered and good marks obtained.

Question Four
This 10-mark question covered withholding taxes.

Part (a) for 4 marks required candidates to state the rate and amount of tax to be withheld from certain transactions and was an easy question and everybody should have scored full marks. The rates are supplied at the beginning of the paper and there are no excuses for getting anything wrong on this part.

Part (b), on the other hand, was not well answered and many candidates exhibited very muddled thinking on the calculation of the company's taxable income and the calculation of the tax payable, both of which were very straightforward. The only adjustments that take place in a tax computation are those where the accounting treatment and tax treatment are different. Thus the only adjustments required in this part were in respect of royalties paid to non-residents and dividends received. In all other cases of income and expenses the accounting and tax treatment are the same and accordingly no adjustment is required. Many candidates adjusted for work certified and sub-contractor costs possibly because contractors are subject to a 3% withholding tax but the payment of this withholding tax does not affect the deductibility of the expense; it is only where tax should be withheld from payments to non-residents that the deduction of the expense is denied if payment of the withholding tax is not made during that financial year. Payments to residents are not affected by this rule.

Where tax is withheld from the income of the company then the taxpayer can claim a credit for that tax and this was what was looked for in Part (c). Tax had been withheld from contractor work certified and from interest and accordingly credit can be claimed for this. Majority of candidates did not claim the tax withheld on interest received but it should be noted that interest exemption where tax is withheld only applies to individuals and not to companies. Tax withheld from dividends cannot be claimed as a credit since the dividend income does not for part of gross income.

In general average marks were obtained.

Question Five
This 15 mark question dealt with an individual who had a business and was in a farming partnership and could have been better attempted by many candidates..

Part (a) for 3 marks simply required an adjustment for opening and closing farming stock at standard values; it did not require a full computation. A partnership farming loss was reported but before adjusting for the stock of cattle and as is allowed in Botswana tax the stock of cattle can be valued at advantageous values known as standard values.

Part (b) for 10 marks required a tax computation of Malebogo's beautician business. The question typically included personal income and expenditure in the business records which need to be isolated in order to arrive at the correct chargeable income from the business. It is often the case with individuals that operate businesses that their personal affairs get mixed up with their business affairs and it is necessary to split each out and most candidates did this successfully in this question by adjusting in the computation for those items of income and expenditure that were of a personal nature or of a capital nature. Very few candidates picked up that the interest element of the repayment of the bank loan is a deductible expense and although P36,000 was repaid to the bank only P28,716 needed to be adjusted in the tax computation.

Where candidates did badly was on the deduction of Malebogo's share of the farming loss against the chargeable income on the beautician business. Business losses are normally ring-fenced but a farming loss incurred in the current year can be set-off against 50% of the chargeable income from other sources (including employment income). Very few candidates got this part correct.
Part (c) for 2 marks on Malebogo's farming loss to be carried forward was not at all well answered with the majority of candidates getting very mixed up largely because they had incorrectly calculated the loss that could be deducted from chargeable income in (b) above. Note that farming tax losses can be carried forward indefinitely and only current year losses can be set-off against other income. In this case Malebogo's loss brought forward was given, the current loss was calculated in (a) above and the loss utilised was calculated in (b) above.

Overall less than average marks were obtained on this question.

Question Six
This 15-mark question was in respect of corporate tax and there will always be such a question and it will invariably involve a tax computation and so understanding the mechanics of a tax computation is essential. A simpler company tax computation was included in Question Four above and was not very well attempted and that was also the case with this question.

It was noted that quite a number of candidates did not attempt all the sections of this question presumably due to time pressures and as a result forfeited valuable marks. The average candidate simply cannot afford to forgo any marks and so time management is essential and every question should be attempted.

Part (a) for 9 marks dealt with a company tax computation but first calculations were required for rollover relief on the disposal of a machine and the purchase of a replacement machine and for the sale of goodwill. The majority of candidates handled these calculations satisfactorily but then failed to carry them forward into the tax computation itself indicating a fundamental lack of understanding of the mechanics of a tax computation. In this question the company had estimated its taxable income but had not included certain transactions and so the requirement was to revise the estimated taxable income to include the tax effect of the given transactions. Many candidates again exhibited muddled thinking on the adjustments that go into a tax computation – for instance having calculated the adjusted cost on the new machine after applying rollover relief more than a few candidates then went and claimed the full adjusted cost in the tax computation instead of calculating the capital allowance and claiming that.

Part (b) for 4 marks was a follow on from Part (a) above. The purpose of revising the company's taxable income was so to determine the minimum amount of Self Assessment Tax (SAT) that needed to be paid every quarter. SAT must be paid in advance thereby requiring estimates to be made and must be 80% paid up by the year end failing which interest is applied. A final payment of 20% is payable no later than 4 months after the year end. Because many candidates got an incorrect answer in Part (a) this flowed through to this part but marks were given if the correct logic and dates were used.

Part (c) dealt with the date a company must file its annual tax return which is 4 months after the year end – in this case 30 April 2016 – and the penalty of P100 per day for late returns.

Candidates did not score very good marks on this question partly because there were many no responses and partly because of poor handling of the tax computation. The tax computation is central to this paper and to the whole subject of taxation and so candidates must ensure that they have a good grasp of the principles of a computation if they are to achieve a pass mark.

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