Examiner's report
F6 (BWA) Taxation
December 2016

ACCA

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.

Section A was not very well answered but Section B was well answered and the majority of candidates demonstrated a good understanding of the subject.

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

Specific Comments

Section A

Overall candidates did not perform well on the multiple choice section of the paper. This section is designed to cover the broad syllabus and for each question 4 possible answers are given of which 3 are distractors – answers that are plausible but still incorrect. The majority of questions require calculations in order to arrive at the correct answer but there will also be questions which specifically test the candidates' knowledge and understanding of tax in general.

Below are two questions that we were not well answered

Sample Questions for Discussion

Example 1

Amos received the following amounts of gross interest during the tax year 2015/2016. Withholding tax was correctly applied in all cases.

		P
1.	Interest on a loan made to his brother	16,731
2.	Interest on an account held with a local bank	28,015
3.	Interest on a debenture listed on the BSE	12,283
4.	Interest on an account held with the Botswana Building Society	8,096

What is the amount of interest that Amos is required to declare in his 2015/2016 tax return?

A P65,125
B P37,110
C P16,731
D P29,014

The vast majority answered C – i.e. only the interest on the loan from his brother needs to be declared in his tax return. However, the answer is D – i.e. interest on the loan from his brother plus interest on the debenture listed on the BSE totalling P29,014. In general all interest is chargeable to tax but if withholding tax has been correctly deducted from interest paid by a local bank or building society to an individual then the tax so withheld is a final charge to tax and there is no requirement to declare such interest. However, this concession does not extend to interest on debentures or any other kind of interest. It is suspected that candidates assumed debenture interest to be exempt income but the only exemption that applies to debentures listed on the BSE is in respect of capital gains arising on disposal which is not applicable in this instance.

Example 2

What is the value added tax (VAT) status of services imported from a foreign country by the University of Botswana?

1. Liable to VAT at the standard rate
2. An exempt supply
3. Not liable to VAT
4. Liable to VAT at the zero rate

The majority of candidates answered B and D – i.e. that the imported service is either an exempt supply or a zero-rated supply. Interestingly this view was often given in Question 3 not only in relation to services but also to the importation of goods but this will be discussed later. It is important to understand the VAT laws relating to imports because Botswana imports virtually all of its goods and many services. The basic rule is that there is no VAT on the importation of services (sometimes referred to as "reverse VAT") provided that such services are in the furtherance of making taxable supplies. However, where the services are in the furtherance of making exempt supplies then VAT is payable at the standard rate. All educational institutions, including the University of Botswana, make exempt supplies and so the correct answer is A – the University of Botswana is required to declare the imported service and to pay the VAT.

Section B

The general standard of this section was high with the majority of candidates exhibiting a reasonable understanding of tax computations and scoring good marks. A few candidates appeared to have time constraints and did not fully answer Question 6 but on the whole candidates made an attempt at all questions.

Question One

This 10-mark question covered the topic of withholding tax

Part (a) tested candidates' knowledge on what triggers a liability to withholding tax and what are the consequences if a taxpayer fails to deduct and pay over the tax. There is a belief in some quarters that withholding tax becomes payable upon accrual of certain expenses payable to non-residents – i.e. interest, royalties and management and consultancy fees. However, this is incorrect and the wording of the Act is clear that the liability to withholding tax is triggered on payment of the expense and that the tax is payable by the 15th of the month following deduction. All candidates answered that the consequences of not deducting withholding tax would result in penalties and interest, which is correct, although some of the penalties quoted, such as imprisonment, are a bit exaggerated. But what was looked for here is that if withholding tax is not paid over in respect of interest, royalties and management and consulting fees paid to non-residents then the taxpayer is not entitled to claim the expense as a deduction in that tax year. Most candidates missed this point.

Part (b) required a computation whereby the expense is added back in the computation and the deduction is determined by the amount of withholding tax paid during the year. The majority of candidates handled this well in respect of payments to non-residents but many were uncertain about how the rules apply to payments to residents. The denial of a deduction until the withholding tax is paid only applies to payments to non-residents; it does not apply to payments to residents.

Overall candidates achieved above average marks on this question.

Question Two

This 10 mark question related to capital gains.

Part (a) required candidates to calculate a capital gains tax liability. Included in the assets disposed of by Pearl were certain business assets and it was disappointing how many candidates brought these into the CGT computation. Only the disposals of 3 assets – the property, the shares and the goodwill – fall to be included in a CGT computation. The profits arising on the sale of fixed assets and stock are liable to income tax and that is dealt with in part (b) below. The calculations were fairly straightforward and because negative marks are not imposed many candidates scored full marks on this section.

Part (b) required candidates to quantify the tax, both capital gains tax and income tax, that was payable. In respect of stock it was necessary to calculate the profit on sale and in respect of fixed assets it was necessary to calculate a balancing charge. Most candidates failed to include the recoupment of capital allowances on the disposal of the property and many were not aware of the fact that there are 2 calculations of tax payable – one for items that fall within the ambit of income tax and one for items that fall under capital gains. Many candidates at this stage deducted the capital loss brought forward. This is incorrect and it should have been deducted in part (a) above since a capital loss can only be deducted against a capital gain – it cannot be deducted from an income tax liability.

Generally candidates handled this question adequately.

Question Three

This 10-mark question dealt with a VAT computation.

The question was very straightforward and the majority of candidates did well and scored good marks.

Part (a) related to the timing of VAT input claims for both local purchases and imports of goods and services. Virtually everyone knew that an input can be claimed as soon as the taxpayer is in possession of a valid tax invoice. Many answered that the timing is the earlier of payment or invoice but this is the timing of an output whereas the question was aimed at inputs. The answer to the timing of imports was not so good and as alluded to earlier a number answered that imports are not liable to VAT; this is totally incorrect and all imported goods are subject to VAT unless they are specifically exempt or zero-rated and they are few.

Part (b) required a VAT computation which included a number of exempt items of expenditure. This was very well answered and most obtained good marks. It should be remembered that payroll expenses such as salaries, pension and medical aid are outside of the scope of VAT and any expenses relating to residential rentals follow the exempt nature of the rents – ie expenses incurred on residential housing cannot be claimed as an input credit.

This question was very well answered and high marks were obtained.

Question Four

This 10-mark question related to the tax planning of employment packages. Kebonye gets offered employment packages from 2 companies and the question is which package gives him the better option. This issue arises often in practice and there has been very recent case law in Botswana that now makes it clear that an employee can structure his/her employment package in such a way so as to minimise the tax payable. Accordingly we are likely to see more and more tax planning in relation to employment packages.

Part (a) requires a tax calculation for both packages and this was generally dealt with quite well except that many did not take into account the pension contributions in arriving at taxable income. It is important to get this figure correct since it will be an important factor in determining Kebonye's take-home pay.

Part (b) requires a cash-flow calculation for both packages. The question gives the current outgoings to which must be added the 50% medical aid contribution, the 25% pension contribution and the tax to arrive at Kebonye's take-home pay. This then has to be compared to the take-home pay that will be achieved with the offer from Digital. Some candidates mixed up the cash-flow calculations with the tax calculations but the question made it clear that these were separate issues.

In general average marks were obtained.

Question Five

This 15 mark question related to corporate tax. As always this question requires candidates to perform an extended tax computation which provides a lot of marks. It is therefore probably the most important part of the whole paper and is central to the whole subject of taxation. Many candidates appear to struggle with the mechanics of a tax computation and are uncertain as to which income and expenditure needs to be adjusted. Generally income and expenditure for accounting purposes is the same as gross income and allowable expenditure for tax purposes but there are certain accounting items – especially with the advent of IFRS requirements – that do not qualify as income or allowable deductions for tax purpose and in addition the tax laws often give certain incentives such as initial capital allowances. So the tax computation starts with the accounting profit or loss and then adjusts for those items where the accounting and tax rules differ. If an item of accounting expenditure is tax deductible then there should be no adjustment for it in the tax computation but many candidates do just that; it is very surprising the number of tax computations which contain an adjustment for interest received because it is taxable and so should not be adjusted. IFRS requirements to account for unrealised gains and losses and expenditures that have not been incurred have to be adjusted in any tax computation.

Part (a) required a tax computation for 13 marks and most candidates obtained above average marks. Difficulty was experienced with the tax rules relating to provisions – provision for bad debts and provision for warranty. An accounting provision for future expenses is not deductible for tax purposes because the expenditure has not been incurred; accordingly a provision for future warranty costs is not deductible but where warranty costs are actually incurred then such costs are deductible. The normal way to deal with this is the tax computation is to add back the closing provision balance and deduct the opening provision balance; alternatively the net movement for the year is added back or deducted as the case may be. A somewhat different approach is required when dealing with a bad debt provision because in Botswana a specific provision is tax deductible whereas a general provision is not. Consequently it is necessary to isolate the general provision and any other amounts that cannot be deducted which in this case was the bad debts in respect of purchased debtors; such bad debts cannot be claimed by this taxpayer since the income to which they relate was never brought to account by this taxpayer. Goods delivered but not invoiced before the year end need to be added back to ensure that income and expenditure is matched in the same tax year.

Part (b) dealt with the requirements for claiming a bad debt for income tax purposes and was not well answered with many candidates getting mixed up with the VAT requirements. For income tax purposes there are 3 requirements which are applicable in all cases.

Generally above average marks were obtained for this question.

Question Six

This 15-mark question was in respect of an individual who was in receipt of both employment income and business income. Some candidates either did not attempt the question at all or only attempted part of the question and this appears to be because of time constraints. It is imperative that candidates manage their time on each question so as to be able to attempt each question and especially one that carries significant marks.

Part (a) required candidates to calculate Isaac's taxable income from employment. This was very straightforward and the vast majority of candidates scored full marks for this part.

Part (b) required a business tax computation. It is not uncommon for the owners of unincorporated businesses to mix up their private income and expenditure with their business affairs and so the challenge is to separate the two and this often has to happen in the tax computation in order to arrive at the chargeable income from the business. In the present case candidates tended to adjust for items that did not need any adjustment; for instance Elijah's salary and overdraft interest are fully deductible and so no adjustment is required.

Part (c) was not very well answered and many candidates made the error of setting-off a business loss against employment income. Business losses are ring-fenced and can only be set-off against future business chargeable income; business losses cannot be set-off against other income. In addition the bank interest did not have to be included because it had suffered withholding tax. Furthermore many did not claim the PAYE credit or alternatively claimed the PAYE credit as well as the withholding tax on interest credit. The interest does not have to be declared and the withholding tax credit therefore cannot be claimed.

Average and below average marks were achieved on this question.