

# Examiner's report

## F6 (BWA) Taxation

### June 2016

#### **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 very well answered but this was not the case with Section B where many candidates appeared to have difficulty with the mechanics of tax computations.

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

#### **Specific Comments**

##### **Section A**

Overall candidates performed 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 two questions that we were not well answered are discussed.

#### **Sample Questions for Discussion**

##### **Example 1**

Which of the following are sources of revenue law?

1. BURS Departmental Guidance Notes
2. Case law
3. Double tax treaties
4. Decisions of the Commissioner General

- A 2, 3 and 4  
B 2 and 3 only  
C 1, 2 and 3  
D 1 and 2 only

Answers were evenly spread out between A, C and D but the correct answer is B. Departmental

Guidance Notes are an indication of how BURS interprets the legislation and how BURS will apply it in practice but it is not law. The same applies to decisions made by the Commissioner General. Both the guidance notes and the decisions can be challenged in court and overturned and such decisions of the court then become law. The Income Tax Act specifically empowers the Minister to enter into double taxation agreements with other

countries and once an agreement has been brought into force the provisions of that agreement override domestic law.

### **Example 2**

Which of the following items are zero-rated for the purpose of value added tax (VAT)?

1. Interest charged to a non-resident
2. A credit note issued in respect of goods exported
3. A contribution made to a pension fund
4. Management fees paid to a non-resident

- A 1, 2, 3 and 4
- B 2 only
- C 1 and 3 only
- D 2 and 4 only

Many candidates are confused between exempt supplies and zero-rated supplies because in both cases VAT is not imposed. However the distinction is important because input tax can be claimed against zero-rated supplies and not against exempt supplies. The majority of candidates gave B as their answer but in fact this is only half the answer. Services rendered to non-resident are, with certain exceptions, zero-rated in exactly the same way that exports of goods are zero-rated and so the answer is D.

### **Section B**

Far too many questions were not attempted which reduced candidate's chances of passing. It is critical that candidates attempt to answer every question and this involves managing the amount of time spent on each question carefully. The two questions that carry the most marks in Section B are 5 and 6 at the end of the paper and so it may be better to attempt those whilst there is still time available rather than being time pressured at the end of the exam.

#### **Question One**

This 10-mark question covered the topic of capital gains

Part (a) required candidates to calculate the gain on the sale of immoveable property that had been extended a number of times. Such calculations using a cost of living index to arrive at a deemed tax cost are fairly straightforward and most candidates had no problems with that but the vast majority did not factor in rollover relief into their answers. If a property is sold and another purchased for use in the business then rollover relief can be claimed which effectively defers the capital gain, or a part of it, until such time as the second property is sold.

Part (b) was not well answered and it would appear that the majority of candidates were not aware that the balancing charge on a sale of immoveable property is limited to the capital allowances that have already been granted. The reason for this is that the sale is going to be subjected to capital gains tax and taxing the full balancing charge could result in double taxation.

Part (c) was straightforward but a number of candidates claimed both the initial allowance and the annual allowance. The question states that both properties were commercial properties and therefore only an annual allowance can be claimed in this instance. Initial allowances can only be claimed in respect of industrial properties.

Most candidates did not correctly answer part (d) because they did not factor in rollover relief as noted above in (a). The cost of the new property reduces to P Nil because the capital gain of the old property has been rolled over.

Overall candidates achieved average marks on this question.

## Question Two

This 10 mark question related to withholding taxes

Part (a) required candidates to state when a liability is triggered to withhold tax and what was being tested here is the timing of withholding tax – is it on accrual or is it on physical payment? A withholding tax liability is only triggered when there is a physical payment of the expense.

Part (b) required candidates to quantify the tax that should be withheld and most answered this well. Part (c) looked at how the payment or non-payment of withholding tax impacts on the tax computation and this was not dealt with in the same manner as (b). In any tax computation there should only ever be adjustments where the accounting treatment is different from the tax treatment. Certain payments to non-residents are only tax deductible in the year in which the tax is paid – namely interest, royalties and management and consulting fees (which includes most service-type expenses) and so the practice is to add back the figure that appears in the accounts and then only deduct that amount which can be supported by payment of withholding tax. No adjustment is required in respect of payments to residents and yet many did make such an adjustment. Where tax is withheld from receipts such as interest, rent, commissions then a credit can be claimed against any tax payable.

Generally candidates handled this question adequately.

## Question Three

This 10-mark question dealt with VAT issues.

The question was structured somewhat differently to the normal VAT computation in that it required candidates to state whether an item should or should not be adjusted and then, where applicable, to actually make the adjustment.

Part (a) contained a number of scenarios some of which had been correctly treated and some of which had not been correctly treated in a VAT computation. Candidates were required to state whether each scenario should be adjusted and to give reasons. When it comes to debit and credit notes for post-sale adjustments it should be remembered that they must mirror the original tax invoice. So if a credit note is issued in respect of a zero-rated tax invoice then the credit note must also be zero-rated. The majority of candidates seemed not

aware of the fact that it is not the profit on a sale which is subjected to VAT but the total proceeds of the sale. By concession there is no documentary requirement for claiming an input tax credit on discounts allowed.

Part (b) required a revised VAT computation but with the net outputs of the old computation as a starting point. Many did not do well on this part even though they had correctly stated what adjustment was required in part (a). All the scenarios required an adjustment except for the goods only received after the year end and the discounts allowed where the input tax deduction had been correctly claimed.

For the most part this question was adequately answered.

#### **Question Four**

This 10-mark question covered the topic of tax administration.

Part (a) for 4 marks covered a taxpayer's rights to object and appeal against an assessment and most candidates adequately answered this question. Part (b) related to the time-barring of an amended assessment or "prescription" to give it the correct technical term. Many candidates brought up the fact that a taxpayer was only required to keep books and records for a period of 8 years but this had nothing to do with the validity of an amended assessment issued after 4 years but before 8 years from the tax year to which it relates. Assessments can be issued any time up to 4 years and only in certain circumstances up to 8 years; one of the circumstances in which an assessment can be amended after 4 years is if the taxpayer has misrepresented material facts or has failed to disclose such facts. What is given in the question was that the facts had been fully disclosed in the taxpayer's return and so the assessment is prescribed after 4 years. This is necessary to bring finality to an assessment.

Part (b) related to the basis upon which interest is charged if a company underpays or late pays its quarterly SAT instalment. The late submission penalty in part (d) is calculated at P100 per day.

In general average marks were obtained.

#### **Question Five**

This 15 mark question related to corporate tax. As always this question contains a tax computation which could have been answered better than it generally was.

Part (a) required a calculation of capital allowances but only after rollover relief had been claimed on the disposal of equipment and the purchase of replacement equipment. This should have been a straightforward exercise but many candidates missed the rollover claim whereby the balancing charge is deducted from the cost of the new plant. Part (b) was the tax computation itself and the answers were generally disappointing. As stated above the only adjustments that are required in a tax computation are those where the accounting treatment is different to the tax treatment but candidates continue to adjust for income and expenses where the accounting and tax treatment are the same – a common example is interest received which is fully taxable and requires no adjustment. The majority of candidates missed the adjustments for contributions to provident funds which are not

deductible because they do not fall within the definition of an “approved superannuation fund” and the allowance for leasehold improvements which is calculated evenly over the period of the lease. Most candidates were also not aware that no adjustment was required for stock obsolescence and unrecovered VAT both of which were deductible costs.

Part (d) related to stock obsolescence which is an allowable deduction if the value of the stock has been diminished because of damage, deterioration, obsolescence or other cause.

Generally less than average marks were obtained for this question.

### Question Six

This 15-mark question was in respect of an individual who received both normal employment income as well as abnormal and non-employment income.

Part (a) required candidates to calculate Kabelo’s taxable income from all sources. Most candidates brought his salary and commission earnings into charge but thereafter the answers were very varied. A prize given by an employer is gross income as is the car allowance and the court award for unfair dismissal. Medical expenses paid by an employer on behalf of an employee are specifically exempted from gross income and bank interest received by an individual where withholding tax has been deducted does not have to be declared as gross income. Many candidates were uncertain how to treat abnormal and non-employment income but the general rule is that such income is liable to tax unless it is specifically exempted and there are not many exemptions.

The vast majority of candidates completely ignored the vehicle costs and how these impacted on Kabelo’s taxable income. Kabelo receives a car allowance and *“any travelling, entertainment or other allowance to the extent to which it does not represent moneys wholly, exclusively and necessarily expended for the purposes of employment”* is liable to tax. Therefore Kabelo can deduct those expenses incurred in the production of his employment from the allowance received and it is given in the question that the car is used 70% for business purposes so 70% of the vehicle costs incurred can be deducted. In addition to the fuel and repair costs to the vehicle Kabelo can also claim capital allowances on the car which virtually all candidates missed.

Part (b) was not well answered. An alternative arrangement to Kabelo owning his own car and being paid a car allowance is for the company to own the car and to give him use of the company car so that he can fulfil his duties. The tax consequences of the two options are different and the purpose of the question was to see which option gives the lowest tax cost. This is a typical planning question which comes up often in practice.

Candidates did not score very good marks on this question partly because there appeared to be time pressures but also because there was uncertainty on how to treat certain income and failure to claim all allowable costs. Candidates must always ensure that they are claiming the maximum reliefs and allowances in calculating the taxable income of taxpayers.