Examiner's report
F6 (BWA) Taxation
June 2017

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.

Neither Section A or B was well answered although the performance of candidates was better in Section B.

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 four possible answers are given of which three 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 were not well answered are discussed.

Sample Questions

Example 1
Canvas Products (Pty) Ltd (CPL) supplied goods to Warner Stores (Pty) Ltd (WSL) on 13 January 2016 and paid the VAT due on the tax invoice on 25 February 2016. WSL never paid the tax invoice and was placed in liquidation on 8 November 2016.

In which tax period can CPL claim an input tax credit for the bad debt?

A November 2016
B January 2017
C February 2017
D January 2016

The majority of candidates selected option A – November 2016 when WSL was placed in liquidation and the debt became definitely bad. This would be the logical answer but in fact in terms of Section 21(11) of the VAT Act an input credit for a bad debt can only be claimed one year after the output VAT has been paid – i.e. February 2017. Therefore the correct answer was C.

Example 2
When does income accrue to a business?

A When payment is received
B When goods or services are received
C When the taxpayer becomes entitled to the income

D When an invoice is issued

The majority answered D – i.e. when an invoice is issued. It would appear that candidates are getting income tax and VAT mixed up but the two do not necessarily follow each other. VAT is invoice driven and all supplies of goods and services must be supported by a tax invoice (except in a few cases as noted in Question 4 below). However, income tax is not necessarily invoice driven and income does not necessarily accrue when an invoice is issued. The correct answer is C – i.e. when the taxpayer becomes entitled to that income. So if a taxpayer supplies goods to Mr A but does not issue an invoice for 2 months the income still accrues on the date of delivery or the date on which the taxpayer became entitled to the income. The concept of accrual is central to income tax and is dealt with more extensively in Question 2 below.

Section B

The general standard of this section was below average with many candidates struggling with the mechanics and logic of tax computations. A good understanding of income tax computations is critical to success in this paper. The number of no responses to questions was greater than normal which is disappointing. Candidates are urged to attempt an answer to all questions so as to give themselves a chance to score some marks.

Question One

This 10 mark question covered the topic of capital gains.

Part (a) consisted of a capital gain calculation arising from the disposal of immoveable property, shares and a business division. The capital gains tax regime in Botswana is not difficult and candidates should always look to score maximum marks on such questions. There is a difference in the method of calculating a capital gain arising on the disposal of immoveable property and that arising on the disposal of moveable property; in the case of immoveable property the cost of the property is indexed upwards by the cost of living so as to take account of the effect of inflation and in the case of moveable property a flat 25% allowance is given. In the case of the sale of a business division it is only that part of the sales price that is applied to goodwill that is liable to capital gains tax. The sale of goodwill is treated in exactly the same manner as the sale of moveable property. In this question the 25% moveable property allowance only applied to the sale of goodwill and not to the sale of shares because the latter was a loss.

Part (b) was badly answered by the vast majority of candidates possibly because they did not understand the question. Candidates were advised that the company had an option to acquire a new plot of land but the option was not exercised. The question was what would be the disposal gain or loss if the option had been exercised which brings rollover relief into play. The sale of Plot 14825 Gaborone had resulted in a capital gain of P214,381 but if rollover relief is applied the gain is reduced to PNil.

Part (c) related to the preconditions for claiming rollover relief and better than average marks were achieved on this question.

Question Two

This 10 mark question related to tax administration. It is not uncommon for the taxing authority to conduct audits and to issue assessments that are different to the amounts returned by the taxpayer. The taxpayer must be in a position to defend its position and this is done, in the first instance, by lodging a formal objection within 60 days of receiving the objection.

In Botswana income comes into charge when it has “accrued” and this is different to certain neighbouring countries where income comes into charge when it has been “received by or accrued to”. There is no

definition of accrual and so reference is made to case law which states that income accrues to a taxpayer when there is an inalienable right to that income. An advance payment does not necessarily constitute an accrual of income especially if the advance can be repaid in the event of non-performance. In the question the taxpayer must deliver goods and it is only when the taxpayer has done that does the taxpayer have an inalienable right to claim the income.

Capital versus revenue issues often lead to disputes between taxpayers and the taxing authority. In the question, kits are purchased for marketing and demonstration purposes and normally such expenditure is of a revenue nature. Another argument is that the expenditure on the kits has been incurred for the purpose of earning profits in the current year since their life only lasts to 6 months rather than in future years.

Below average marks were achieved here.

Question Three
This 10 mark question dealt with withholding tax.

Botswana levies withholding tax on both payments of certain expenses to residents and non-residents and this can result in compliance issues for taxpayers. However, a deduction for income tax purposes can only be claimed in respect of payments of interest, royalties and, management and consultancy fees to non-residents if the withholding tax applicable to them is physically paid during the tax year. This does not apply to payments to residents. Exam questions relating to withholding tax will invariably focus on the deductibility of the expense.

Part (a) contained a number of payments to both residents and non-residents and required candidates to state which payments should be adjusted for in a tax computation and to quantify the deduction. The normal method to approach this is to add back the full expense charge in respect of payments of interest, royalties and management and consultancy fees and then to calculate that deduction based on the amount of withholding tax paid during the tax year – i.e. withholding tax divided by 15%. In addition the question required candidates to indicate in the answer those expenses which had no tax effect.

Answers to this question on the whole were rather disappointing.

Question Four
This 10 mark question related to VAT.

In part (a) candidates were requested to discuss the VAT implications of certain transactions. The majority of candidates stated that discount allowed should not be allowed as an input credit because invoices were missing but in practice invoices are not raised for discounts and BURS allows the deduction by concession. The golden rule for the timing of a VAT liability is the earlier of invoice or cash received and since both took place in the next tax period there is no liability in the current tax period.

Most candidates were alert to the fact that entertainment and hotel costs are prohibited inputs. Insurance receipts should always include VAT in addition to the claim and so needs to be isolated and reported as an output. VAT applies to all kinds of supplies, however insignificant, and therefore includes the sale of scrap.

The majority of candidates struggled with part (b) which required them to restate net outputs in the light of the incorrect treatment of certain transactions. Since all the expenses and the insurance receipt

included VAT it was necessary to remove the VAT in the restatement and very few did this. In practice this is a common type of situation.

This question was not well answered.

Question Five

This 15 mark question related to corporate tax. As always this question requires candidates to perform an extended tax computation which is fundamental to an understanding of tax. Unfortunately far too many candidates do not fully comprehend the mechanics and logic of a tax computation and which items of income and expenditure need to be adjusted. The adjustments that are required in a tax computation are because the income and expenditure that are acceptable in today's accounting conventions are not acceptable in tax law. A tendency was noted that many candidates adjusted everything in a gunshot type of approach but this is to be discouraged since marks are given for showing those items for which no adjustment is required.

Part (a) required candidates to calculate the net balancing charge on the sale of assets and this was very straight forward with most candidates scoring maximum marks. Part (b) was the calculation of the capital allowance claim which should also be fairly straightforward but some candidates made heavy weather of this. Where there is a balancing charge then the option for claiming roll-over relief presents itself which was the case here.

Part (c) was the tax computation where candidates should look to score good marks. On the income side the items that need to be adjusted are dividends received since they do not constitute income and are therefore not taxable and the fair value adjustment which is a book adjustment which also does not constitute income. Interest received by a company (as opposed to an individual) is fully taxable and does not require adjustment.

The type of expenditure which is invariably adjusted in any tax computation is depreciation, impairments, fair value adjustments, profit and losses on disposal of assets and provisions and this question was no different. In addition the tax deduction in respect of payments to non-residents is determined by the withholding tax that was actually paid in the tax year. A difficult factor was introduced with the rental cost since part was made up of a security deposit and part by rental-smoothing, neither of which is considered a deduction for tax purposes since the cost has not yet been incurred. A similar difficult factor was also introduced with provisions, with only the provision for future expenses being disallowable; a specific provision (as opposed to a general provision) for bad debts and a specific provision for obsolete stock are allowable deductions.

Generally below 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. Where individuals also carry on a business it is not uncommon to see their personal expenditure being mixed up with their business expenditure and it is necessary to separate out personal expenditure in the business tax computation.

Part (a) required candidates to calculate the individual's chargeable income from employment and most did this quite well. The motor vehicle benefit is calculated according to a formula and medical aid paid by the employer is not a taxable benefit. The housing allowance and school fees paid by the employer are fully taxable. Whilst the majority of candidates were alert to the fact that the severance pay receipt came into charge not many deducted the one-third allowance.

Part (b) calculated the chargeable income from the business and again was reasonably well handled although very few calculated the capital allowance correctly which is calculated on the brought forward cost plus the cost of the addition of the van.

Part (c) wraps up an individual's income from all sources and part (d) required a tax loss to be calculated. A business loss is ring-fenced and cannot be set-off against other income – it can only be set-off against future business income. Interest from a building society that has been subjected to withholding tax does not come into charge but interest from the uncle does.

Average marks were achieved on this question.