Examiner's report

F6 Taxation (LSO)
December 2014

General Comments

The examination consisted of five compulsory questions. Question 1 for 30 marks and question 2 for 25 marks. The three further questions carried 15 marks each.

The vast majority of candidates attempted all five questions, and there was little evidence of time pressure. Where questions were left unanswered by candidates, this appeared to be due to a lack of knowledge coupled with poor exam technique.

As in previous sessions, a small minority of candidates answered question 2 last and their answers were often incomplete. Question 2 represents 30% of the available marks, leaving this question until last can be a risky strategy, as many answers presented were incomplete or appeared rushed.

The overall performance for this sitting was not satisfactory. Majority of candidates performed particularly well on questions 1, 4 and 5. The questions candidates found most challenging were questions 2(a), 2(b), 2(c), 3(a) and 3(b). This was mainly due to lack of technical knowledge and also due to a failure to read question requirements carefully. A number of common issues arose in candidate's answers:

- Failing to read the question requirement carefully and therefore providing irrelevant answers which scored few, if any, marks.
- Poor time management between questions, some candidates wrote far too much for some questions and this put them under time pressure to finish remaining questions.
- Failure to show all relevant workings.
- Failure to effectively revise all parts of the syllabus.

Specific Comments

Question One

This 25-mark question was based on calculation of individual income tax where a taxpayer has a number of sources of income.

Part (a) for 14 marks required candidates to calculate the income tax payable, clearly showing the different sources of income of the taxpayer, and to state the due date for submission of the tax return.

Most candidates performed adequately well on this part of the question. However, there were a number of common errors identified in most answers. The withholding tax already remitted to the Lesotho Revenue Authority (LRA) in respect of employment income was very often added to the annual salary. Some candidates treated taxable fringe benefits as part of chargeable income. Most candidates couldn't correctly calculate the loss on disposal of shares, the adjusted cost base (ACB) and proceeds were frequently confused. In some cases where the loss was correctly calculated, it was used to reduce the chargeable income comprising employment and business income. According to the Income Tax Act, the loss incurred cannot be set-off against any other income rather it is carried forward to the following year of assessment and set-off against the relevant income. The due date for submission of the tax return was often ignored by most candidates. Interest received from a nominated savings account was not treated in accordance with Section 27 of the Income Tax Act. Majority of candidates included it in the calculation of chargeable income, which was contradictory to the explanation they provided in part (c) of the question.

Part (b) for 6 marks required candidates to calculate fringe benefits tax (FBT) payable by the employer in respect of benefits provided for the year to the employee and to state by when employers should file their quarterly fringe benefits returns. Most candidates seemed to have a general knowledge of taxation for fringe benefits. However, most of them could not pick up as many marks as expected due to failure to read the question carefully. The taxable fringe benefits included meals and refreshments, loan and utilities fringe benefits. The total FBT payable was not correct in most answers for the following reasons: Meals and refreshments were incorrectly treated as exempt fringe benefits by most candidates simply because they assumed that if the benefit is provided to all senior officers it should be treated as such. This benefit is exempt only if it is provided on equal terms to all employees regardless of the level. Some candidates couldn't use the two thirds of the average rate when calculating the loan fringe benefit. In addition, where the question required FBT payable, it was not necessary to calculate FBT for each taxable fringe benefit, then adding up the totals. This is time consuming and at times candidates eventually forget to calculate the total FBT. The right approach is to sum up the taxable values, get the taxable amount and then calculate FBT payable. The due date for submission of quarterly fringe benefits returns was correctly stated by most candidates.

Part (c) for 5 marks required candidates to explain the withholding tax obligations of Nedbank Lesotho, in its capacity as the withholding tax agent regarding the interest received from the nominated savings account. The question was well answered by most candidates. But there were still a large number of candidates who couldn't score as good marks as expected. Instead of focusing specifically on the interest from a nominated savings account, some candidates provided general information about the withholding tax agent, which scored few marks, if any. On the other hand, some continued writing about the whole of Section 27 describing the requirements for a taxpayer to qualify for the first M500 exemption with no regard to what the question was actually about.

Question Two

This 30-mark question covered the general principles of corporation tax of a manufacturing company. The performance in general was not satisfactory. There was an apparent evidence of failure of candidates to read the question carefully, coupled with lack of technical knowledge in some parts.

Part (a) for 4 marks required candidates to explain the limitation imposed on the deductibility of interest payable, and to calculate the interest deduction which should be allowed to the company in question. Basically this was about application of Section 36 of the Income Tax Act. Some candidates seemed to confuse Section 27 which is about interest received from the nominated savings account, with Section 36 which is about interest payable. The Act provides that the interest payable by a company which is not principally engaged in money lending transactions on long term debt is limited to a debt to equity ratio of 3:1. Most responses to this part were incomplete and couldn't gain the full marks. This provision is applicable to companies only. Again the limitation is based specifically on the debt to equity ratio, not any other ratio. The question provided the value of equity capital, long term debt and interest on long term debt. It was therefore possible to determine the amount of interest deductible under Section 36.

Part (b) required candidates to calculate the chargeable income of the company, starting with the profit after tax. Candidates were simply expected to adjust the accounting profit. On the basis of their responses to this part, there seemed to be a lot of confusion. Most candidates showed a lack of general knowledge and understanding of adjusting the accounting profit for tax purposes. Candidates were expected to add back disallowed expenses and withholding taxes which were not included in the accounts. In addition, they were to deduct tax deductible expenses such as depreciation allowance and exempt income which were not considered when calculating profit after tax. Some candidates ignored the requirement, wasted a lot of time deducting expenses as they were given in the question from the profit after tax to get the chargeable income. However, some candidates provided excellent answers and attained very good marks.

Part (c) required candidate to calculate tax payable of the company starting with the chargeable income calculated in part (b). This part seemed to be very difficult to most candidates as most of them struggled in the previous part. Some did not provide answers. However, there was a minority of candidates who made an attempt to this part, and managed pick up a few marks, on the deduction of withholding taxes and the due date.

Part (d) required candidates to calculate the tax instalments payable by the company for the forthcoming year of assessment and state the due date for each instalment. There were still more marks available for candidates to pick up regardless of whether the chargeable income and tax payable calculated in the previous parts were incorrect. Most candidates attained good marks by stating the correct due dates for instalments. It is always advisable to provide the correct date, month and year. Most candidates have a tendency of leaving out the year which is even more crucial.

Part (e) required candidates to calculate withholding taxes payable in relation to royalties' payments which comprised the patent rights and trade mark. The two were supposed to be charged different withholding tax rates. Patent rights were charged at 10% while trade mark was 25%. Most candidates combined the two payments and charged a single withholding tax rate of either 10% or 25% which was not right.

Part (f) and part (g) of the question were on the tax treatment of donations and terminal benefits below 25% respectively. The questions tested candidates' knowledge of the recent amendments made on the Income Tax Act relating to these payments. On the basis of their answers most candidates seemed not to be conversant with these changes.

Question Three

This 15-mark question was based on value added tax (VAT). The overall performance was disappointing. The question was basically about the registration of the vendor.

Part (a) tested candidates' understanding regarding compulsory registration. Based on the scenario, candidates were to explain whether the vendor in question had to register compulsorily for VAT. Candidates were expected first to explain what the VAT Act provides as far as compulsory registration is concerned. Secondly, they were to assess from the given information whether the vendor in question has an annual turnover which is in excess of the registration threshold which is currently M850,000. The question was not well answered because most candidates added the sales which were provided for the period which was more that 12 months. On that basis they concluded that the vendor registered compulsorily because the turnover exceeded M850,000. Only a handful of candidates realised that this was voluntary registration because since commencement the vendor's turnover for any 12 months period had never been above the registration threshold.

Part (b) required candidates to explain how additional VAT payable as a result of failure to register for VAT is calculated and to state the additional tax payable by the vendor in question. Candidates had an opportunity to get a pass mark from the explanation regardless of whether there is tax payable or not. The majority of candidates provided incorrect answers such as 3%, others suggested double of the tax payable. The correct answer is 200% of the tax payable for the period during which the vendor should have been registered for VAT. Most candidates attempted to calculate the additional tax payable based on their assessment in part (a) that the vendor had registered compulsorily. Based on the information given, the vendor registered voluntarily, and as such, there was no additional tax payable.

Part (c) required candidates to calculate VAT payable for the month of February. Most candidates did well on this part. For those who did not score good marks, that was due to not reading the question carefully. Others wasted time by calculating VAT for all the months provided in the given information.

Part (d) required candidates to state obligations of the vendor, only three were required. This part was also well answered by most candidates, except for those who provided irrelevant answers because they did not seem to have revised for this part at all.

Question Four

This 15-mark question was based on the calculation of chargeable income arising from the disposal of investment and business assets of the taxpayer in question. The overall performance on this question was extremely good.

In part (a) the majority of candidates seemed to understand the application of the indexation rule. In most answers, amounts for adjusted cost base (ACB) which were indexed for inflation were correctly calculated. The only part which appeared to be tricky for most candidates was how to determine the ACB for business assets. Most candidates wasted a lot of time depreciating the business assets from the period when they were acquired, without realising that the ACB provided represents the depreciated values.

Part (b) also appeared to be a little bit tricky to most candidates. Instead of providing circumstances in which neither a gain nor a loss is recognised as a result of application of indexation rule, they included some other irrelevant cases such as transfer of assets between spouses, which could not score any marks. The question focused on the application of indexation rule only. Some answers appeared to be too vague, such as, 'neither a gain nor a loss is recognised where there is nominal loss or gain'. This was supposed to be explained further to earn full marks.

Question Five

This 15-mark question was divided into two independent scenarios.

Part (a) for 11 marks was based on taxation for trusts. Candidates were required to calculate tax payable by the trustee and beneficiary. Candidates' ability to apply the basic principles such as treatment of the trading loss and different tax rates was tested. The overall performance was very good in this part of the question. However, there were some candidates who seem to confuse the tax rates applicable to the trustee and beneficiary. Some candidates encountered a problem in differentiating between the trust and partnership. The main difference between the two is the tax treatment of the trading loss. The tax treatment of the foreign source income as far as the trustee is concerned was also well answered by most candidates. However, those who did not revise this part effectively were unable to pick up more marks as expected.

Part (b) for 4 marks was based on calculation of chargeable income of the deceased person. Different assets were listed, and candidates were tested on whether they could identify those assets which are exempt, and those which are taxable. The question appeared to be too straight forward to some candidates but that was not the case. There were some who seemed to be confused, including the values of assets such as land and building premises as part of chargeable income.