

# Examiner's report

## F6 (LSO) Taxation

December 2015

### General Comments

There were two sections to the examination paper and were compulsory. Section A consisted of 15 multiple choice questions (two marks each) which covered a broad range of the syllabus topics. Section B had six questions. Four shorter questions worth ten marks each, and two longer questions worth 15 marks each. The questions were testing the candidates' understanding and application of income tax and value added in more depth. The following paragraphs report on each section and focus on some of the key learning points.

### Specific Comments

#### Section A

It was very pleasing to see that almost all candidates attempted all of the questions. Candidates preparing for future F6 (LSO) examinations are advised to work through the specimen exam questions and the sample question discussed here and to carefully review how the correct answer was derived. Section A questions aim to provide a broad coverage of the syllabus, and future candidates should aim to revise all areas of the F6LSO syllabus, rather than attempting to question spot. The following question is 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 an examination technique on the topic covered by the specific question selected.

#### Sample Question for Discussion

Morena, an individual taxpayer, bought 4,000 shares at M8.10 per share in Transcom Limited in December 2010. In June 2015, Morena encountered severe cash flow problems and decided to sell half of the 4,000 shares held in Transcom Limited for M12.50 per share. The market value of the shares at the date of disposal was M14.00 per share.

**What is the chargeable gain regarding the disposal of Morena's shares?**

- A M8,800
- B M17,600
- C M11,800
- D M23,600

The question tests two principles pertaining to the calculation of chargeable gain. Firstly, how to determine the adjusted cost base (ACB) where there is part disposal of the shares. Secondly, how to determine the consideration on the date of disposal where the proceeds/sale price differs from the fair market value of the asset. The correct tax treatment in this case is to determine the ACB on the basis of the part of the asset disposed of. The consideration is the market value of the asset instead of the proceeds received. The topic about chargeable gains is highly examinable; therefore candidates are expected to have a thorough understanding and application of the relevant provisions.

Option A suggests that chargeable gain is the proceeds received for the 2,000 shares less the ACB of the shares. This would be correct if the consideration was the same as the market value of the shares.

Option B suggests that all the shares were disposed of and the proceeds were used instead of the market value.

Option C suggests that chargeable gain is the market value of the 2,000 shares disposed of, less the ACB.

Option D suggests that all the shares were disposed of, though the market value of the shares was rightly used to determine the chargeable gain.

Options B and D are incorrect as it was clearly stated that the taxpayer sold half of the 4,000 shares. Therefore the ACB was to be determined on the basis of 4,000 instead of 2,000. Candidates who couldn't read the question very carefully suggested these options.

The correct answer was option C.

## **Section B**

### **Question One**

This ten-mark question covered the allowable deductions against employment income as stipulated in the Income Tax Act Regulations.

Part (a) for seven marks required candidates to calculate chargeable income for the year ended 31 March 2015 on the basis of the given information. Candidates' performance was satisfactory on this part of the question. Many candidates were able to confidently identify the allowable expenses to get to the chargeable employment income.

Where candidates did not score enough marks to pass, this appeared to be due to lack of knowledge regarding tax treatment of expenses allowable against employment income.

Part (b) for five marks required candidates to describe how education expenses incurred by an employee (Maria) would be treated had they been incurred by employer (LEC). Candidates were expected to recognise the education expenses as approved training expenses to the employer. Many candidates did not achieve higher marks on this part.

This was due to some of them recognised the expenses as fringe benefits, indicating that the employer will be subject to fringe benefit tax (FBT). On the other hand, there were some who correctly identified that the expenses should be treated as approved training expenses, but their answers could not reflect all the required elements. The response which simply provides that the expenses will be allowable to the employer is incomplete.

### **Question Two**

This ten mark question focused on fringe benefits tax (FBT). Performance on this question was unsatisfactory, although candidates seemed to have a general knowledge on this part of the syllabus

Part (a) for eight marks required candidates to calculate quarterly FBT. The scenario provided monthly values. A quarter in a year is three months. However, candidates multiplied the values by four, others were providing annual values, thus providing incorrect answers. As in previous diets, a significant number of candidates tended to waste more time calculating the FBT for each taxable fringe benefit, instead of simply determining the sum of taxable values and then calculate FBT. There are no marks for each FBT calculation. Again, more time was wasted in calculating excess superannuation contributions FBT for each of the four employees. This was not necessary because the employer was a taxable employer. Again, in a number of cases, the taxable value for car fringe benefit was incorrect. There seemed to be some confusion as to whether the rent payable is deducted from the market value before multiplying by 15% or vice-versa. Most candidates were not certain about the formula for car fringe benefit.

Part (b) for two marks tested candidates' knowledge regarding the tax treatment of the superannuation contributions in the case of the tax exempt employer. Notably, majority of candidates couldn't differentiate between the tax exempt employer and the Public International Organisation (PIO). The scenario was about a taxable employer. Candidates were required to explain the tax implications of the superannuation contributions if the employer was tax exempt. Most candidates indicated that the excess superannuation contributions will form part of the employees' chargeable income as the employer would be a PIO. This part of the syllabus needs to be

revised effectively as more often than not candidates tend to consider the exempt employer to be the same as PIO.

### **Question Three**

This ten-mark question covered calculations of the value added tax (VAT) in relation to MTT, a vendor who supplies both taxable and exempt supplies.

Part (a) for eight marks required candidates to calculate VAT payable by or refundable to MTT. The overall performance was unsatisfactory. MTT operated a motel services which constitutes a supply taxable at 14%. The majority of candidates were able to get output VAT correct. MTT also provided transport services within and outside Lesotho. According to the VAT Act transport services within Lesotho are exempt supplies, whereas transport services outside Lesotho are zero-rated. A zero-rated supply is also classified as a taxable supply. It was disappointing that many candidates did not know the tax treatment of transport services. Most of the candidates exempted the total revenue for transport. Others confused the two types of transport services. The confusion continued when determining input VAT. Input VAT was claimed for expenses in respect of transport services within Lesotho, while expenses for transport services outside Lesotho were denied input VAT. Many candidates couldn't tailor their knowledge regarding the difference between exempt and zero rated supplies to the given scenario. The correct tax treatment is that input VAT for exempt supplies is disallowed, while input VAT for zero-rated supplies is claimable.

On the same note, most candidates claimed the entire input VAT in relation to acquisition of a computer to be used for all the operations of the company. The operations of the company in this case were provision of both exempt and taxable supplies. Candidates were expected to apportion input VAT on the basis of the revenue, between exempt and taxable supplies, as input VAT in relation to exempt supplies is not claimable. It was clear from most of their answers that candidates were not aware of this treatment.

Part (b) for two marks was well done by most candidates. The question required candidates to state requirements of a valid VAT invoice. Only a minority of candidates misunderstood the requirement, and instead of stating the requirements, they described the obligations of a vendor.

### **Question Four**

This ten mark question focused on chargeable gains. In each scenario given, candidates were required to calculate the chargeable gain and income (if any). The performance on this question was generally satisfactory. This part of the syllabus used to pose some problems to most candidates, especially with regard to application of the indexation rule. Here, the majority of candidates applied the rule correctly. There was, however a minority of candidates who couldn't score higher marks. This was due to provision of incomplete answers. For instance in scenario (2) where there was an involuntary conversion, an answer which simply states that there is neither a gain nor a loss, without any further explanation cannot score full marks.

### **Question five**

This 15-mark question was based on a manufacturer of textile, Gloria Textile Manufacturer. The question tested candidates' knowledge on corporation tax principles.

Part (a) for 12 marks required candidates to calculate corporation tax payable. The performance for most candidates was moderate. Though candidates were able to identify two different sources of income for the taxpayer, in most instances the gross income was incorrectly stated. Most candidates did not exclude the VAT which was inclusive in the local sales. The withholding taxes for export sales and interest were often excluded, thus resulting in an incorrect gross income.

Most of the allowable expenses were also calculated incorrectly when determining the chargeable income. The majority of candidates wasted a lot of time calculating depreciation allowance, when it was clearly indicated that

the depreciation figure which was given was calculated in accordance with the relevant tax provisions and relates to all assets held by the taxpayer by the year end. This implies that it was not necessary to calculate the depreciation of assets acquired during the year. A number of candidates also appeared to struggle to determine the allowable expense for large-scale advertising. This is a start-up cost which is amortised. Again, candidates could not determine allowable interest pertaining to an asset acquired through a finance lease.

When calculating the corporation tax payable, a number of candidates incorrectly deducted the VAT included in the value of local sales to get net tax payable.

Part (b) for three marks required candidates to state the conditions which must be met for a company to be considered a resident company in Lesotho. The performance was generally good in this part of the question. The majority of candidates were able to identify the three conditions. However, some candidates tended to confuse the conditions for a resident individual with the conditions for a resident company.

### Question Six

This 15 mark question focused generally on individual income tax. The overall performance in this question was unsatisfactory, notably due to the following two reasons:

- Poor time management as this was the last question; and
- Failure for most candidates to read and understand the question before providing answers.

Part (a) for eight marks required candidates to calculate chargeable income of the taxpayer, Dr Phakoe. In most instances the entire question was omitted.

Where candidates attempted this part of the question, the following common mistakes were noted:

- The revenue from the taxpayer's surgery was incorrectly stated. Most candidates overstated the revenue by M150,000, yet it was clearly indicated that this amount was already included in the consultation fees of M750,000.
- Most candidates apportioned the rental income receivable by the taxpayer, excluding from the gross income that part of the rent attributable to the portion occupied by the taxpayer.
- Interest from the nominated saving account recognised as part of gross income yet the relevant withholding tax had been withheld at source.
- Most candidates were not able to identify the relevant allowable expenses such as:
  - o A trading loss of M55,001, brought forward from the previous year of assessment;
  - o Superannuation contributions allowable;
  - o Interest on loan, and repairs apportioned proportionately between revenue from the surgery and rental income.

Some candidates continued to waste more time calculating the tax payable which was not part of the question.

Part (b) for four marks required candidates to calculate the tax payable by Dr Phakoe's employees. The performance was unsatisfactory on this part, as most candidates did not carefully read the entire question carefully from the beginning. Instead of calculating employees' tax payable, some candidates calculated employer's tax payable, using the information from part (a). To gain higher marks on this part, candidates were expected to know the tax treatment of superannuation fund contributions on both residents and non-residents.

Part (c) for one mark required candidates to state a due date for filing a record of payments and tax withheld for employees to the Lesotho Revenue Authority (LRA). While some candidates seemed to confuse this date (28



April) with the date for monthly remittances for withholding taxes (15 of the following month), the majority of candidates were able to identify that the correct date was 28 April 2015.

Part (d) for two marks required candidates to explain the tax treatment of interest on the savings account which is nominated for tax purposes. The majority of candidates scored full marks on this part of the question.