Examiner's report
F6 (LSO) Taxation
June 2016

General Comments

There
There were two sections to the examination paper and both 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 10 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 tax (VAT) provisions 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 the next examination of F6 (LSO) are advised to work through the pilot paper and a 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 F6 (LSO) 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

Thusanang Garments Pty (TGP) is a resident company engaged in the manufacture of textiles. TGP commenced its operations on 1 April 2015, at which date the fair values of its fixed assets were:

	M
Office equipment	60,000
Office buildings	150,000
Factory buildings	240,000
Motor vehicles	450,000

What is the total amount of the depreciation allowance claimable by Thusanang Garments Pty for the year ended 31 March 2016?

A M144,000
B M136,500
C M114,000
D M151,500

The question tested two principles regarding the calculation of depreciation allowance. Firstly, how to distinguish between depreciable and non-depreciable assets, for tax purposes. Secondly, how to apply the correct depreciation rates as prescribed by the sixth schedule of the Income Tax Act. According to the Act, the office buildings are treated as non-depreciable assets. While many candidates managed to get the correct figure, there was a significant number of candidates who incorrectly recognised office buildings as depreciable assets. Again, some candidates didn't apply the correct depreciation rate on motor vehicles. The relevant schedules are always attached to the question paper including the sixth schedule which shows the depreciation rates. Candidates should note that the calculation for depreciable allowance is one of the highly examinable parts of the syllabus. It may be examined as a stand-alone question or part of the long question. It is therefore vital for candidates to have a thorough understanding and application of this provision of the Act.

Option **A** suggested that the amount for depreciation allowance should include office buildings and motor vehicles be depreciated at 20%.
Option **B** suggested that the office buildings should be excluded and motor vehicles depreciated at 25%
Option **C** excluded office buildings but depreciated motor vehicles at 20%.
Option **D** incorrectly included office buildings though the correct depreciation rates were used.

The correct answer was option **B**

Section B

Question One
This 10-mark question focused on the withholding taxes regarding payments to resident contactors and non-residents. The overall performance for this question was unsatisfactory.

Part (a) for seven marks required candidates to calculate the withholding tax which should be remitted to the Lesotho Revenue Authority (LRA). For each payment given in the question, candidates were expected to calculate the correct withholding tax. This should not have been a problem as the withholding tax rates were given on the second page of the question paper. However, most candidates used incorrect withholding tax rates, possibly because they didn't read carefully the information which was provided in the question. It was disappointing to see candidates unable to use the rates as provided under supplementary instructions. Perhaps some of them did not even notice that they were provided. Many of the candidates seemed to struggle a lot with the last item which dealt with payments relating to management fees and dividends made to a parent company based in China. Withholding tax on management fees was straight forward, to be calculated at 25% as there is no double taxation agreement between Lesotho and China. The tax treatment regarding dividends appeared to be straightforward for most candidates. However, most of them were seen to ignore the question and opted to calculate the advance corporation tax (ACT) which was not part of the question. Candidates could have scored more marks had they calculated withholding tax at the rate of 25% on that part of the dividends paid out non-manufacturing income; and indicate that dividends paid out of manufacturing income is not subject to withholding tax.

Part (b) for two marks required candidates to give the information which should be recorded and kept for inspection by the LRA in respect of withholding taxes. Most candidates scored higher marks on this part of the question. This is the information needed to substantiate the tax withheld, which should include among other things, the name and address of the payee, the amount paid and tax withheld.
Part (c) for one mark required candidates to give the income tax rate for an electing non-resident which is currently 30%. This was also provided. A significant number of candidates used 25%

instead of 30%. A non-resident taxpayer who elects to be taxed by assessment is referred to as an electing non-resident.

Question Two

This 10 mark question focused broadly on fringe benefits tax (FBT) in respect of fringe benefits payable to an expatriate. The overall performance was satisfactory.

Part (a) of the question required candidates to define an expatriate taxpayer. While there were some candidates who provided incomplete definitions, most of them seemed to be very familiar with the term and obtained good marks on this part.

Part (b) for five marks required candidates to calculate annual FBT payable. Again, candidates scored higher marks. However, the taxable value for a loan fringe benefit seemed to be a tricky part for some candidates as they forgot to discount the interest rate.

Part (c) for three marks required candidates to calculate allowable expenses claimable by an employer in respect of the benefits provided to the employee. In essence, this should include the basic salary and reimbursements as provided in the question. Most candidates focused on the FBT alone, when there were other allowable expenses.

Question Three

This 10-mark question covered value added tax (VAT). The scenario was for a vendor who accounts on a cash basis. The overall performance for this question was very good.

Part (a) for two marks required candidates to state the conditions necessary for a vendor to be eligible to use the cash basis method of accounting for VAT. Excellent answers were provided by most candidates. Although some of them couldn't specifically state that 90% should consist of services, it was clear from their answers that they were aware that most of the supplies should be services.

Part (b) for eight marks required candidates to calculate the VAT payable or refundable. Many candidates were able to correctly calculate the input and output VAT. However, treatment of the negotiated receipt with regard to a taxable supply was notably a problem for a significant number of candidates. Candidates should note that the fair market value is always used to determine the taxable value in this case. There were some expenses incurred by the vendor which were partly settled. Most candidates couldn't appreciate the fact that the input VAT claimable relates to what has been paid for, instead of the total expense incurred. Most candidates incorrectly recognised the whole amount of input VAT. Moreover, candidates claimed input VAT for private expenses. This was the case with the rent and electricity in the given scenario. Candidates were expected to apportion the input VAT incurred in respect of the rent and electricity paid for a building used for both business and private purposes. Lastly, for items which are zero-rated, exempt or disallowed candidates are always required to use zero (0). But in addition to that, they should note they are expected to indicate clearly whether an item is zero rated, exempt or disallowed, otherwise a (0) without any explanation will not score any marks.

Question Four

This 10 mark question focused on chargeable gains. The performance on this question was generally good. This part of the syllabus used to pose some problems for many candidates, especially with regard to application of the indexation rule. Many of the candidates seemed to be very conversant with this part. In the scenario given, candidates were expected to apply their knowledge of distinguishing between capital and revenue expenditure. Unfortunately, there were some candidates who couldn't attain higher marks because of their failure to differentiate between the two concepts. The typical example was the expenditure incurred in replacing the electric wiring. Many candidates didn't index it as they treated it as revenue expenditure.

Candidates were generally able to identify the circumstances in which neither a gain nor a loss is recognised for tax purposes on the disposal of an investment asset.

Question Five

This 15-mark question was based on taxation of a partnership. This question also tested the area of reconstitution of a partnership. The overall performance was not satisfactory.

Part (a) for eight marks required candidates to calculate the notional chargeable income of the partnership. Candidates were able to confidently identify two sources of income, which were business income and property income. All the expenses incurred by the partnership were correctly set off against business income. However, many candidates seemed to have a problem with adjusting the pension contribution and sundry expenses. From the question, the amount for pension contributions incurred by the partnership was clearly indicated as M54,000 (27,0000 x 2). Some candidates allowed the same amount without checking whether it was within the 20% ceiling. Sundry expenses included an annuity of M8,000 and trading loss of M23,200. Most candidates seemed to know the tax treatment of these two items included in sundry expenses, but they were unable to adjust the amount which should be allowable. Instead of reducing the total amount by disallowed amounts, candidates provided different figures, for instance, deducting M1,200 or M6,800 for annuity; and M23,200 for trading loss. This demonstrated lack of understanding in dealing with adjustments of either expenses or income for tax purposes.
With regard to deemed disposal of partnership assets on dissolution, most candidates likewise demonstrated lack of technical knowledge. Most of them attempted to depreciate the assets, and allow depreciation, yet the adjusted cost base (ACB) at the end of the year were given. Candidates were unable to recognise that the difference between the ACB and market value may constitute either a chargeable gain or allowable loss. Future candidates should ensure that they fully understand this part of the syllabus.

Part (b) for six marks required candidates to calculate the chargeable income of each partner. A number of candidates did not read this question carefully and wasted some time determining the tax payable by each partner, which was not part of the question. Where the partnership has both Lesotho source and foreign source income, it is always advisable to split the notional chargeable income into two different sources of income, in particular when one of the partners is a resident non-resident or non-resident, and therefore not subject to tax on the foreign source income. Some candidates simply divided the total notional chargeable income by the profit sharing ratio to determine the distributive share of partnership, which was incorrect.

Question Six

This 15-mark question was generally based on principles of corporation tax. The overall performance was satisfactory.

Part (a) for one mark required candidates to state the condition to be met for a company to use a substituted accounting period. The question was well answered by most candidates.

Part (b) for three marks required candidates to state the conditions which needed to be met for the donation to be deductible. Yet again, many of the candidates were familiar with the conditions required, even though there were some who provided incomplete answers.

Part (c) for 11 marks required candidates to calculate corporation tax payable. From the scenario, the business income included the insurance proceeds, and was to be adjusted accordingly. It was impressive to see most candidates confidently determining the chargeable gain arising from the insurance proceeds. With regard to business expenses, the most challenging part was yet again the adjustment of allowable amounts. For instance, candidates were expected to adjust training expenditure by further allowing 25% to have 125% in total where appropriate. However, most candidates incorrectly granted 25% for training delivered overseas. The Act provides that the training should be offered by a local institution to qualify for 125% in total. Again, the FBT which related to dinners provided to senior management was very often omitted by most candidates. Lastly, only a few candidates noticed that there was depreciation allowance regarding a delivery van which was purchased to replace the one involved in an accident. Candidates could have scored higher marks had they read the information provided carefully.