Examiner's report
F6 (LSO) Taxation
June 2017

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 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 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 specimen questions 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 examination questions and to provide an examination technique on the topic covered by the specific question selected.

Sample Question for Discussion

Kunutu Hypermarket Pty commenced its operations in Lesotho in January 2016. Its financial year ends on 31 December. For the year ended December 2016, the company's advertising costs amounted to M220,000 comprising the following:

			M
-	Large-scale advertising incurred prior to commencement	160,000	
-	Other advertising and promotion costs incurred during the year	40,000	
-	Donations made during the year	20,000	
			220,000

What is the total start-up cost claimable by Kunutu Hypermarket Pty for the year ended 31 December 2016?

A M32,000
B M220,000
C M160,000
D M22,000

The question focuses on the tax treatment of start-up cost. This relates to expenditure which is incurred prior to the derivation of income from business. According to the Act, an amortisation deduction is allowed for start-up cost. This type of expenditure is of two categories. The first category relates to acquisition of intangible assets needed for carrying out business, such as goodwill, intellectual or contractual rights. The second category involves an intangible advantage that does not manifest itself in any particular assets, such as the cost of feasibility study, large scale advertising or initial transactional expenses. Admittedly, the second category covers expenditure which is not deductible under general principles because it is incurred prior to production of income from the business.

Based on the question provided, the only example of start-up cost is large scale advertising. However, this does not mean that the entire expenditure is claimable all at once by the taxpayer. Only 20% or a four-year write off of the cost will be an allowable deduction for the year.

This area of the syllabus is highly examinable, it may also appear within a longer question. Candidates are therefore advised to have a thorough knowledge of how to determine allowable expenses for different types of expenditure.

Option A suggests that the start-up cost claimable is the 20% of the large scale advertising incurred.

Option B suggests that the start-up cost claimable is the entire cost categorised under advertising including donations made during the year.

Option C suggests that the start-up cost claimable is the entire cost of large scale advertising incurred. There is no amortisation in this case.

Option D suggests that start-up cost claimable is 10% of the total cost categorised under advertising.

The correct answer is **option A.**

Question One
This 10-mark question covered the minimum chargeable income provision.

Part (a) for seven marks required candidates to calculate the minimum chargeable income of the taxpayer in question. Candidates' performance was satisfactory on this question. Many candidates were able to correctly identify the amounts which should be included in the calculation of minimum chargeable income. Where candidates did not score full marks, this tended to be because they used incorrect rates. Many candidates confused 5% and 50% to calculate the amounts for both principal and secondary residences. The correct rate in this case is 5%. In addition, some candidates got the amount of secondary residence wrong as they couldn't multiply the market value by eight as provided by the Act.

Part (b) for one mark required candidates to state a chargeable income, and give a reason for the figure stated. This implies that the one mark was to be split. If the minimum chargeable income calculated in (a) above was incorrect, there was a chance to get half a mark by providing the right reason, of which most candidates ignored.

Part (c) for two marks required candidates to explain the circumstances in which the provisions for minimum chargeable income are not applicable. The question was well answered by most candidates. However, a handful of candidates mentioned that this provision is also not applicable where the taxpayer's chargeable income is greater than minimum chargeable income.

Question Two
This 10-mark question focused on fringe benefits tax (FBT).

Part (a) for seven marks required candidates to calculate quarterly FBT payable. Performance on this question was not satisfactory. Candidates were able to identify taxable fringe benefits. However, some of them were seen calculating annual FBT without providing quarterly amounts. This is a clear evidence of failure to read the question. In some cases others provided mixed answers where some figures were presented as either quarterly or annual amounts.

Part (b) for one mark required candidates to state by when quarterly fringe benefits tax return should be filed. Most candidates were able to provide a correct answer for this question.

Part (c) for two marks tested candidates' knowledge regarding the tax treatment for Public International Organisation (PIO). The question was also well answered because most candidates did mention that PIO is exempt from both income tax and FBT. However, as in previous diets, many candidates were unable to clearly explain the effect on the employee for the PIO. There were various answers provided in terms of what will form part of chargeable income of the employee. For instance, some candidates mentioned FBT, fringe benefits, and taxable amounts. Candidates should note that what forms part of chargeable income of the employee is the taxable values all fringe benefits provided by the PIO.

Question Three

This 10-mark question covered value added tax (VAT). The performance for most candidates was satisfactory. The question in general tested candidates' knowledge regarding vendors' registration and treatment for opening stock prior to registration.

Part (a) for two marks required the conditions necessary for a person to register for VAT compulsorily. This part of the question was answered well by the majority of candidates. Where candidates couldn't score well this was due to a failure to provide a complete answer. To provide only the threshold was not enough to attain the full marks. There were some candidates who could not even provide a correct threshold.

Part (b) for eight marks required candidates to calculate VAT payable by or repayable to the vendor for the month of April and to state the due date to file the return for the very same month. Most candidates were able to determine the correct input VAT for opening stock. The treatment for finance leases appeared to be a very tricky part for the majority of candidates. Most of them incorrectly claimed input VAT based on the monthly lease instalment instead of the fair market value.

Question Four

This 10-mark question covered chargeable gains.

Part (a) for six marks required candidates to calculate the chargeable gain arising on sale of assets by an individual taxpayer. The performance in this question was extremely good for the vast majority of candidates. As indicated in previous diets, this part of the syllabus used to pose some problems for many candidates, especially with regard to application of the indexation rule. However, the majority of candidates seemed to be very conversant with this part. Again, most candidates were able to identify a chargeable gain where there is an involuntary conversion of an asset and insurance proceeds were not wholly utilised in a similar asset.

Part (b) for four marks was a follow-up on part (a) above in regard to the principle of involuntary conversion of an asset. Candidates were expected to provide a detailed explanation in relation to the tax treatment of insurance proceeds which were not wholly reinvested a similar asset. In general, the question was not satisfactorily answered. Many candidates couldn't score higher marks as they were not able to explicitly describe the whole principle. Some of them provided calculations showing what is taxable and what is not taxable which was not answering the question at all.

Question Five

This 15-mark question was based on a taxpayer with employment income and other sources of income. The performance in general was very satisfactory.

Part (a) for 13 marks required candidates to calculate income tax payable for the year ended 31 March 2017. Candidates were expected to determine the employment income of the taxpayer which consisted of annual salary, housing allowance, bonus and education allowance. This was well done by most candidates. However, some candidates got employment income wrong because firstly, they added PAYE to the annual salary. Secondly, they treated reimbursements by employer to employee as part of employment income. These were reimbursements for expenditure which would otherwise have been a deduction had the expenditure been directly incurred by the employer. Thirdly, there were some candidates who treated education allowance as an allowable deduction. The PAYE and withholding tax on sitting were correctly deducted to determine the net tax payable.

Part (b) for two marks required candidates to explain the tax treatment of the reimbursed car expenses. This part was also well done. Candidates who couldn't provide the correct explanation tended to be those who included reimbursements in part (a) as part of employment income.

Question Six

This 15-mark question was based on the principles of corporation tax. The performance in general was unsatisfactory.

Part (a) for two marks required candidates to calculate income tax instalments for the tax year ended 31 March 2017. Most candidates performed very well in this part.

Part (b) for three marks required candidates to calculate advance corporation tax (ACT), and to state by when it is payable. Since all the dividends were paid out of unqualified income, there was no need to adjust the figure for dividends when calculating ACT. Only a small number of candidates were able to identify that the first instalment as calculated in (a) above would be used to meet the ACT liability. And again, since the instalment paid was in excess of the ACT liability, the end result was no ACT liability. But in any case, candidates were still expected to provide the due date for payment.

Part (c) for 10 marks required candidates to calculate corporation tax payable, starting with the operating profit as given. The performance was disappointing in this part of the question, not because candidates were unable to calculate the chargeable income, but due to an inability to correctly adjust the operating profit for tax purposes. Seemingly, there was a lot of confusion as to what should be added to or subtracted from the operating profit. Some candidates even preferred to skip this part and went straight to the calculations for tax payable. It is worth noting that future candidates should learn to adjust the operating profit.