Examiner's report
F6 (MWI) Taxation
December 2015

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 of two marks each which covered a broad range of syllabus topics. Section B had six questions, four worth 10 marks each and two longer questions worth15 marks, each testing the candidates' understanding and application of tax. This is the first examiner's report since the introduction of the new exam format and question types. The following paragraphs report on each section and focus on some of the key learning points.

Specific Comments

Section A

The majority of candidates attempted all the questions in this section. Candidates are advised to answer all the questions in this section as this increases their chances of doing well in this paper. Candidates preparing for future examinations in this paper should ensure that they have sufficient grounding in knowledge of tax by ensuring that they have covered all the aspects of the syllabus as Section A questions aim to provide a broad coverage of the syllabus. Candidates are advised to carefully read the questions and obtain an understanding before attempting to answer questions. 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 a technical debrief on the topics covered by the specific question selected.

Question
Mudzi Limited owns a factory which manufactures liquid petroleum. It has a house on the factory premises, which is occupied by the factory manager rent free. The factory manager earns a salary of K6 million per year. A house of a similar nature on the market would be rented for K150,000 per month. The house is provided fully furnished.

What is the value of the house for fringe benefits tax purposes per quarter?
A K450,000
B K225,000
C K180,000
D K150,000

This question tested the candidate's understanding of the fringe benefits regulations as detailed in the Tax Act and further tests their ability to work out the values that would be subjected to fringe benefits tax.

The key to passing this question was to have sufficient knowledge of fringe benefits tax regulations and how they are applied. In this particular case it applies to housing where an employer has its own housing which it gives out to its staff, and particularly where no rentals are paid for it.

The correct answer was B.
Fringe benefits tax is based on the higher of actual rental or 12.5% of salary in respect of furnished accommodation.
12.5% of the monthly salary of K500,000 is K62,500 per month which is K187,500 per quarter.
As the house which is company owned is rent free, the market value of the property is instead used in the fringe benefits tax computation, however, as the house is on the factory premises the fringe benefits value is reduced by 50%. Therefore the rental of K150,000 per month for three months is the taxable value for the quarter (total K450,000) but this is then halved to K225,000. This is the higher of the two quarterly values and so is the correct answer.

Section B

Question One

This was a 10-mark question which dealt with the principles of Value Added Tax (VAT) with regard to the circumstances in which input VAT is not claimable. It also presented the transactions which were entered into by Geo Limited, a company involved in the buying and selling of general merchandise.

Part (a) for 3 marks required candidates to state in general terms the circumstances in which input VAT is not claimable. Most candidates wrote about the relationship between input and output VAT and some stated that VAT would not be claimed if the tax payer or supplier were not registered; the unregistered are out of the scope of VAT, so it was clear that most candidates did not know the circumstances in which VAT would not be claimed. An example would be in respect of the personal element where the purchase is partly for business and partly for personal or other use.

Part (b) for 7 marks required candidates to calculate the VAT which was payable by Geo Limited to the Malawi Revenue Authority for the month of April 2015. Generally this part was well answered, most candidates correctly dealt with zero rated and exempt supplies. Only very few candidates claimed input tax on a security charge invoice of K85, 000 which was dated July 2013. As this invoice was over 12 months from the time the right to claim accrued, the VAT on this invoice could not be claimed.

Question Two

This was a10-mark question dealing with taxation of special trades particularly as it concerns the taxation of income by clubs.

Part (a) for 2 marks required candidates to state in general terms, how the income of a club is taxed. This part of the question was poorly answered, as most candidates failed to explain that there are two types of clubs, those that are for pleasure and recreation and those that are not. This particular club was for recreation and the income was taxed as opposed to the other clubs which are not. However, most candidates were able to explain how the income would be taxed, the type of income that is taxed and the rates that are applicable.

Part (b) for 1 mark required candidates to state how the interest received by a club would be taxed.
This was not well answered. Most candidates stated it would be not taxed and only the withholding tax would be deducted. Others stated that it would be taxed but the 6.25% taxable fraction would apply to the interest as well. The Act clearly defines the income to which the taxable fraction would apply and interest is not included. In this case interest would be added to the 6.25% income which was subject to tax and the whole amount of interest would be subject to 30% tax. Obviously a tax credit of withholding tax deducted would apply.

Part (c) for 7 marks required candidates to calculate the tax to be paid by Malindi Recreation Club for the year ended 30 June 2015. Generally this part was satisfactorily answered. Those who did not perform well approached the calculation of tax as if it were a company where tax is based on profits, therefore candidates worked out the profits earned by the club.
What was required was to take into account only the taxable income which in this case was the sales from the bar, restaurant and golf course fees. To the total apply 6.25% as the income subject to income tax, and then add the total interest earned (gross) to arrive at taxable income to which 30% tax would be applied. It was noted that most candidates did not take golf fees as income. The golf fees are not exempt as is the case with entrance and subscription fees.
There were some candidates who deducted expenses, which is not the case as expenses are not taken into account since tax is not based on profits.

Question Three

This 10-mark question dealt with the taxation issues relating to a self-employed person, John Sauli, carrying out a construction business.

Part (a) for 1 mark required candidates to state the date by which John Sauli must submit his tax return. Performance on this part of the question was disappointing. Many candidates were unable to state that the tax return must be submitted 180 days from the end of the year; in this case, should have been by 31 December 2014 (in practice the Revenue Authority does not actually apply the exact actual number of days). It will be taken to the last day of the month. Candidates who did not do well mostly took this as a return of VAT and stated the return should be made on the 25 of the following month and some thought it was a return of PAYE, in which case it was to be on the 14th the following month.

Part (b) was for 1mark and required candidates to state the penalty for late filing. Again this performance was disappointing; candidates seemed not to know the penalties applicable for late filing of income tax returns. Those who knew gave the penalties applicable to companies, which is K200,000. The penalty for late filing for an individual is K50,000. Candidates should familiarise themselves with the various penalties applicable to various taxes.

Part (c) was for 7 marks and required candidates to calculate the tax payable by John Sauli for the year ended 30 June 2014. This part of the question was well answered by the majority of candidates. However some candidates failed to appreciate that first they needed to work out the adjusted business profits for tax. To this they would add other income such as the consultancy fee and allow the tax free interest portion. Some candidates treated the consultancy fee as if it was included in the business income statement.
Presentation of the answers is very important to enable candidates to demonstrate that they have a grasp of the issues being examined.

Part (d) was for1 mark and required candidates to calculate penalty that would be suffered by John Sauli if the final tax was paid 30 days after the due date . It was very clear candidates were not aware of the rules regarding penalties. There would be interest payable for the late payment of the balance of tax. The balance due was K544, 290. The penalty suffered would be interest for the late payment of tax which is at ¾% for the first month or part thereof and increasing by ¼% for each subsequent month. As this is only one month late the ¾% shall apply. The total interest in this case was K4,082.

Question Four

This 10 mark question was in two parts and was in respect of capital gains tax arising from the sale of both unlisted and listed shares and also a property which caught fire and insurance compensated for the loss.

Part (a) was for 4 marks and was divided into two parts; part (i) and part (ii).
Part 4 (a) (i) was for 3 marks and required candidates to calculate the capital gain which would be payable by Masauko Mbedza for the year ended 30 June 2014. The performance in this part was satisfactory, candidates correctly applied indices that were given in the question paper. Those who failed to earn marks did not apply any indices and just compared cost price versus selling price.
Part 4 (a) (ii) was for 1 mark and required candidates to explain how the sale would have been treated for tax purposes if Miyambo Limited was a listed company. This part on the whole was well answered. Those who did not perform well failed to realise that in part (a) (i), Miyambo Limited was unlisted company. Therefore these candidates treated the two parts the same. The shares in part a (i) were held for more than 1 year, therefore if it was a listed company the sale would not be subject to capital gains.

Part (b) was for 6 marks and was divided into three parts; part (i), part (ii) and part (iii).

Part 4 (b) (i) was for 4 marks and required candidates to calculate Majuba's chargeable gain for the year ended 30 June 2014. This part which dealt with sale of property was well answered and performance was satisfactory. Candidates correctly adjusted for the cost of the adjoining plot and appropriately applied indices.
Part 4 (b) (ii) was for 1 mark and required candidates to calculate the gain if the house was not sold but destroyed by fire. The performance was satisfactory. Candidates correctly treated this in the same way if it was a sale. The cost used to deduct from the insurance proceeds was the same as in b (i) above.
Part 4 (b) (iii) was for 1 mark and required the candidates to state what the tax position would be if Majuba was buying a replacement house. The performance was mixed. Those who did not do well failed to state there would be no gain for involuntary conversion to the extent that the proceeds are used to acquire a replacement asset. However if the proceeds are not fully invested in the new asset then the gain would be restricted to the excess of the proceeds over the cost of the replacement asset.

Question Five

This question was for 15 marks and involved the taxation of an individual Peter Chisale who is in partnership with John Zowe. The question was divided in two parts, part (a) dealt with the calculation of taxable income of Peter Chisale and part (b) the responsibilities of filling the partnership return.

Part (a) for 13 marks required the candidates to calculate the taxable income of Peter Chisale for the tax year 2014/15. This part of the question was generally well answered. Those that did not score more marks did not carefully read the question which in certain cases resulted in them not making correct adjustment or omitting income.
The common mistakes were:

- Not annualising the salary paid to John Zowe, which was disallowable;
- No initial allowance being claimed on motor lorry;
- Not showing the sharing of profits amongst the partners;
- Not adjusting rental income by adding back replacement of roof (which is capital expenditure) to net rental.

Some candidates worked out the tax payable which was not requested for as and a result that work did not earn any marks. Candidates need to ensure that they follow the instructions given in the question paper.

Part (b) was for 2 marks and required candidates to state who is responsible for filling the partnership's income tax return and whether it is the partnership or the partners individually who will be assessed to income tax. This part of the question was well answered. However, some candidates stated that the partnership would be responsible for the payment of the tax and not the individual partners which was not correct. Tax is the responsibility of the partners and not the partnership.

Question Six

This question was for 15 marks and it involved the computation of tax liability for a company which was involved in the manufacturing of truck bodies and trailers. The company is a branch of an externally incorporated company. The question was divided into two parts.
Part (a) was for 11 marks and required candidates to calculate the taxable income for Brando Malawi for the year ended 31 December 2014.
This part was well answered by a majority of the candidates.
For those who did not do well the following mistakes were made:

- Not properly considering items which should be allowed or disallowed;
- Not making the adjustment to profit as a result of accrued interest. Interest accrued in the previous year should have been deducted from taxable income and interest for the current year should include accrued interest for the year;
- Not considering that two motor vehicles (not one) should have been included in the capital allowance calculation.

It is important that candidates read the questions very carefully to obtain an understanding of what is required.

Part (b) was for 4 marks and required candidates to calculate the net tax payable or refundable to Brando Malawi for the year ended 31 December 2014. The performance in this part was satisfactory. However, those who did not earn marks did not treat this as an external company whose applicable tax rate was 35% and not 30%. There were candidates that did not deduct withholding tax on interest and rent receivable from the tax calculated. Withholding tax on interest should have been calculated on interest received and not taking into account accrued interest.