ACCA

Examiner's report

F6 Taxation (MWI)

June 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 worth 15 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 did not attempt all the questions. 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.

Example 1

ABC Limited has a taxable income of K3,000,000 for the year to 31 December 2014.

During the year K250,000 of withholding tax was deducted from payments made by the company and K650,000 deducted from receipts. Total fringe benefits tax paid was K175,000. No provisional tax payments had been made.

What is the balance of total income tax to be paid by ABC Limited for the year to 31 December 2014?

A K475,000
B K75,000
C K650,000
D K250,000

This question tested the utilisation of tax credits and the nature of tax payments that reduce the overall tax liability at the end of the year when the returns are submitted to the Malawi Revenue Authority. During the year tax payers make payments of tax, some of these taxes are final whilst others are taken as advance payments and can be used to offset the final tax liability. The key to passing this question was to identify which of the taxes paid by ABC Limited could be offset against the final liability and hence work out the final tax that needed to be paid.

The correct answer was D - K250,000. This is made up of the tax on profits at K900,000 less the withholding tax deducted on payments received of K650,000.

Incorrect answer A takes the tax on the profit for the year of K900,000 less the tax withheld on payments made of K250,000 and fringe benefits tax of K175,000. The tax credits given are not appropriate. The withholding taxes on payments made by the company are made on behalf of a third party to whom the payments are made.

It is, therefore, the recipient party who can obtain a credit of that withholding tax against his total tax liability. With regard to fringe benefits tax, it is a final tax and no credit is given for this.

Incorrect answer B takes the tax on profit for the year of K900,000 less the withholding tax deducted on payments received of K650,000 and fringe benefits tax of K175,000. The withholding tax on receipts qualifies as a deduction as it is tax that was deducted and paid over by a third party on the company's behalf. The fringe benefits tax does not qualify as explained above.

Incorrect answer C takes the tax on profit for the year of K900,000 less the tax withheld on payments made of K250,000.

Section B

Question One

This was a 10-mark question which dealt with the principles of value added tax (VAT)It presented the transactions which were entered into by AJ Bunda who was a property developer.

Part (a) for 3 marks required candidates to state the circumstances under which VAT must be imposed. Performance was satisfactory for this part; however some candidates mistakenly stated the conditions for claiming VAT or the conditions for VAT registration which was not what the question was asking.

Part (b) for 7 marks required candidates to calculate the VAT which was payable by AJ Bunda for the year to 30 June 2014. The majority of candidates' performance was satisfactory. The question stated that AJ Bunda was involved in the construction of an office complex as well as some residential properties. Some candidates wrongly treated all the costs as claimable despite the fact that some of the costs related to residential property. The renting and selling of residential property is exempt from value added tax, as such no input VAT can be claimed on expenditure related to such property. Candidates should have reduced the claimable portion by the proportion related to residential property.

Question Two

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 in respect of which insurance compensation was received for the loss.

Part (a) was for 7 marks and required candidates to calculate the capital gains tax liability for Abraham Bengo for the year ended 30 June 2014. The performance in this part was less than satisfactory. This was because many candidates did not apply indices to the cost of the asset concerned to bring the cost to the present value. Of those who did apply indices, many applied the indices for the wrong year (2014) rather than using the indices for the year of purchase of the respective asset.

With regard to shares sold to the taxpayer's son, many candidates failed to realise that this was not an arm's length transaction, therefore the selling price should have been adjusted to market value.

The receipt of proceeds from insurance for the house that caught fire was dealt with properly by the majority of candidates and the capital gain correctly calculated. However, some candidates dealt with this as an involuntary conversion irrespective of the use of the proceeds and recorded no gain.

Most candidates correctly dealt with the sale of shares in a listed company that were held for less than a year. As the shares were held for less than one year, the capital gain was taxable and calculated as sales proceeds less purchase cost and selling expenses to arrive at the gain. However, some candidates did not adjust for selling expenses and stated the gain was exempt. Other candidates felt the shares which were sold after 12 months were taxable and proceeded to work out the capital gain. Candidates are reminded that shares listed on the Stock Exchange and held for more than 12 months are exempt from capital gains. Therefore, there was no need for candidates to calculate the capital gain.

Part (b) was for 3 marks and required candidates to explain the effect on the capital gains tax liability if Abraham Bengo sold all the shares in BAC Limited on 1 March 2014 and decided to buy another property with the insurance proceeds. This part was generally well answered; most candidates correctly stated there would be no gain on the shares. This was because of the fact that they would have been held for more than 12 months. However, there were candidates who felt there would be an increase in the capital gain.

Question Three

This was a 10-mark question dealing with the taxation of special trades, particularly the taxation of income from the growing of timber.

Part (a) for 4 marks required candidates to explain how the income of a farmer growing timber is determined. This part of the question was answered well by the majority of candidates.
Most were able to identify that costs to be offset from income would be those that would be carried forward until the timber reaches maturity and that a fixed percentage would be added annually until the timber reaches maturity. The total costs would be apportioned to the proportion of the timber sold and deducted from the revenues of the timber sold to arrive at taxable income.

Candidates who performed less well tended to focus on general relief for costs available to farming activities and not those specific to timber growing. Some candidates merely stated that the taxable income would be arrived at by taking revenues less costs without stating how the costs were arrived at.

Part (b) for 6 marks required candidates to calculate the income for Peter Bazele from the sale of timber which would be subject to income tax for the year ended 30 June 2014. Many candidates performed well here as they were able to itemise the costs for each year and also added the 5% fixed costs for each year and multiplied this by the number of years from the date the costs were incurred to the year of sale. The fixed percentage was added to the costs and the total apportioned to the portion of the timber sold to arrive at the proportion of the costs to be deducted from the proceeds of sale of the timber. The candidates who did not perform did not add the portion of the fixed percentage to the costs of growing timber. Other candidates incorrectly did a straight calculation of the 5% without calculating this for the number of years from the date of growing to the date the timber reached maturity. It was apparent that some candidates were aware of the principles but were not able to apply the principles to answer the question.

Question Four

This 10-mark question dealt with the taxes payable by a sole trader on the activities carried out by the business.

Part (a) for 3 marks required candidates to calculate the provisional tax payments that should have been paid by the sole trader, James Ndala, by the year end 31 March 2015 and to state the dates when such payments should have been paid and the amounts. Performance on this part of the question was unsatisfactory.

Many candidates were unable to correctly calculate the provisional tax that should have been paid; some calculated the provisional tax payments by dividing the taxable income by 4 and then taking the figure arrived at as the provisional tax. Others correctly calculated the tax payable as 30% of the taxable income, however, instead of dividing this figure by 4 to arrive at the provisional tax, they instead took 90% of the tax arrived at and divided that figure by 4. The rule of 90% is that, by the fourth quarter, a total of 90% of the tax should have been paid in provisional taxes. Very few candidates actually correctly understood the principles of the provisional tax payments. As far as the dates were concerned, the results were mixed. Some candidates correctly recognised that it was the 25^{th} day after the end of the quarter and so, for the first quarter, it was 25 July. However, the majority of candidates thought it was 14th day after the end of the quarter and also got the wrong quarter periods.

Part (b) was for 4 marks and required candidates to calculate the final amount of tax payable in respect of the year ended 31 March 2015 and to state the due date for payment. Again, performance was unsatisfactory in this part. The majority of candidates failed to calculate the tax correctly. The tax should have been calculated by taking the adjusted profits for the business and calculating the tax as 30% of the profits. The lower rate of tax would have applied to James' salary; but the profits should have been taxed at the higher rate of 30%. From the tax calculated, a total of 90% would have to be paid by the fourth quarter. From this figure, provisional tax paid up to third quarter should be deducted to arrive at the provisional tax to be paid by the fourth quarter. Therefore, the final tax would be calculated as the tax being 30% of taxable profits less total provisional tax paid by fourth quarter and withholding tax on sales.

Most candidates did not calculate the 90% and neither did they take the 90% as the total of provisional tax that would have been paid by the fourth quarter and, as such, should have been taken as a credit to arrive at the balance due on filing.

Some candidates also failed to mention the due date for payment of the tax. This could have been due to a lack of knowledge or because candidates did not read the question properly.

Part(c) was for 2 marks and required candidates to calculate penalties if the final balance of tax was not paid by 31 October 2015. The performance on this part was very unsatisfactory as it was clear that 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 K34,515. It should be noted that James complied with the rules regarding the payment of provisional tax. Therefore the penalties payable would be interest for the late payment of tax which is at 3/4 % for the first month or part thereof and increasing by ¼% for each subsequent month. As the tax was only one month late, the ¾% should have been applied.

Part (d) was for 1 mark and required candidates to state the frequency and due dates for payment of PAYE, withholding tax and FBT. Performance was mixed on this part. Some candidates mixed up the different taxes when answering this part. PAYE and Withholding taxes are paid monthly on the 14th for the transactions of the previous month, whilst for FBT it is quarterly and on 14th the month following the end of the quarter.

Question Five

This question was for 15 marks and involved the taxation of an individual,George Manganya. The question was divided in two parts, part (a) dealt with the taxation of interest income earned by an individual and part (b) the calculation of income tax payable by George Manganya.

Part (a) for 2 marks required candidates to state how interest receivable by an individual is treated for both income tax and withholding tax. This part was generally well answered with many candidates able to state that K10,000 of bank interest received by an individual is exempt from income tax and that any interest received in excess of K10,000 is subject to withholding tax. Those who performed less well did not know how interest was dealt with for withholding tax and, as such, they either did not comment on this or stated that all interest was subject to withholding tax.

Part (b) was for 13 marks and required candidates to calculate the tax payable by George Manganya for the year ended 30 June 2015. This part of the question was generally well answered. Those that did not perform as well tended to do so because they did not carefully read the question which, in certain cases, resulted in them not making correct adjustment or omitting income.

The most common mistakes noted were:

- Including all the three years' salary in income for the year;
- Housing allowance being based on the total of the three years' salary;
- Including the wife's salary as the income of George:
- Not grossing up net interest received;
- Not making any allowance for the first K10,000 of interest which is tax free;
- Basing the tax calculation on the corporate tax rate; and

Not deducting withholding tax on the director's fee and rental and also not deducting PAYE from the tax calculated.

Question Six
This question was for 15 marks and it involved the computation of tax liability for a company which was involved in the growing and processing of tea and coffee .The performance in this question was mixed.. Candidates were required to prepare a tax computation to arrive at taxable profits. This involved adding back to profits expense items which were not allowable for taxation and deducting items which were included in income but were not taxable. In this particular case, the exempt income involved dividends and capital gains on sale of shares in a listed company which were held for more than 12 months. In addition, candidates should have deducted allowable tax deduction which, in this particular case, involved capital allowances and stock adjustments as a result of differences in valuation policy for accounting and tax purposes. Trading losses brought forward should then have been deducted to arrive at the taxable profits to which a tax rate of 30 % would apply.
The following common mistakes were note:

- Not properly considering items which should be allowed or disallowed;
- Not making the adjustment to profit as a result of the stock valuation policy;
- Not deducting losses brought forward from the adjusted profit for tax to arrive at taxable profits for the year

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