Examiner's report
F6 (MWI) Taxation
June 2016

ACCA

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. The following paragraphs report on each section and focus on some of the key learning points.

Specific Comments

<u>Section A</u>

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.

Sample Question for Discussion

Example

Abraham is a sole trader involved in the buying and selling of antiques. On 1 May 2014 he sold an antique for K445,000 which he had bought in June 2008 for K125,000. On 1 June 2014 he sold 200,000 ordinary shares held in Maziko Limited, a non-listed company for K14 each. These shares had been bought at K4 each in July 2005.

What is the amount of Abraham's total capital gains for the year ended 30 June 2014?

A K379,835
B K232,813
C K147,022
D K562,813

This question tested the candidate's ability to work out the capital gain chargeable to tax as a result of the transactions entered into by Abraham. Abraham was a sole trader whose business was to sell antiques. In this question candidates were required to work out the capital gain as a result of selling antiques and shares held in an unlisted company.

The key to passing this question was first to recognise that since his business was selling antiques, then any sales of antiques would be his normal business, therefore not subject to capital gains. Only the sale of shares therefore would be subject to capital gains. Further the cost of the shares would need to be adjusted by the inflation factors provided in the question. The inflation factor adjustment would be the factor applicable at the date of sale divided by the factor on the date of purchase of those shares. The result would be multiplied by the cost to arrive at the adjusted cost

for capital gain purposes. The adjusted cost would be deducted from the sales proceeds to arrive at the capital gain.
Answer A for K379,835. This answer takes into account the gain on both the sale of shares and antique after adjusting for the inflation factor. However, as the sale of antiques is the business of Abraham any sale of antiques is not chargeable for capital gains but the sale is included in his taxable income.

Answer B K232,813. This is the capital gain on the shares only and it is worked out as sales proceeds less the adjusted cost after inflation indices. The adjusted cost is the indicia on date of sale divided by the indicia at date of purchase, multiplied by the cost of the shares. The resultant figure is subtracted from the sales proceeds to arrive at the capital gain.

Answer C K147, 022. This is the gain worked out on the sale of the antiques only after adjusting the cost to arrive at the adjusted cost after the indices. This answer assumed that the capital gain on the sale of shares was not taxed. Capital gain is only exempt on sales held in a listed company and also if the shares have been held for more than 12 months.

Answer D K 562,813. This is made up of the capital gain on sale of shares, the cost which has been adjusted by the indices and the capital gain calculated on sale of antique but the cost has not been adjusted. The sale of antiques is not subject to capital gain as Abraham trades by buying and selling antiques.

B is therefore the correct answer.

<u>Section B</u>

Question One
This 10-mark question dealt with the principles of Value Added Tax (VAT) with regard to claiming input tax where the taxpayer has mixed supplies.

Part (a) for 3 marks required candidates to state how input VAT is dealt with when a tax payer has mixed supplies. Performance was not satisfactory for this part; candidates did not state that input tax would be claimed dependent on the proportion of taxable supplies to the total supplies made by a tax payer. Most candidates focussed on the fact that exempt supplies would not be subject to VAT.

Part (b) for 7 marks required candidates to calculate the VAT which was payable by Mazembe for the month of December 2015. Mazembe had mixed supplies. Again performance in this requirement was unsatisfactory, although some candidates, correctly calculated the taxable purchases, which would be subject to input VAT, they did not apportion the other expenses in the proportion of taxable supplies to non-taxable supplies. They claimed input VAT in full for the other expenses. Candidates needed only to claim input tax relating to the taxable proportion of the supplies.

Question Two
This 10-mark question was in two parts and was in respect of computation of taxable profits and the tax payable in respect of Muziko Limited for the year ended 31 December 2015.

Part (a) was for 7 marks and required candidates to compute the taxable income for Muziko Limited, a company involved in mining activities for the year ended 31 December 2015. The performance in this part was satisfactory; and a majority of candidates answered this part very well. Disallowable and allowable items were correctly identified by many. However, there were a few candidates who failed to realise that the mine machinery and expenditure on access to mineral deposits were all allowable and should have been fully claimed against the profits for the year.

Few candidates understood that mining companies do not qualify for export allowance, therefore most calculated export allowance adjustment, which was not correct. But on the whole the performance was satisfactory

Part (b) this was for 3 marks and required candidates to calculate the balance of tax payable for the year ended 31 December 2015. This part generally was well answered and candidates reduced the amount of tax calculated by the provisional tax payable and also by the withholding tax on the interest. However, most candidates did not make an adjustment for the first K10, 000 of interest which was not subject to withholding tax.

As for the due date of the tax most candidates correctly stated this to be on filing of the tax return. This is 180 days from the end of the financial period subject to assessment. There were of course some candidates who stated this to be due in the following month on the 25th or the 14th of January. These due dates do not apply to the payment of balance of income tax.

Question Three

This was a 10-mark question dealing with the treatment of both trading and capital losses in the computation of taxable profits.

Part (a) for 3 marks required candidates to explain the treatment of trading losses for income tax purposes. This part of the question was answered well by the majority of candidates. Most were able to state that trading losses are carried forward to be offset against future profits. Most candidates correctly identified the limitation of carry forward of losses to six years for most companies and indefinitely for persons engaged in manufacturing, agricultural and mining operations. Very few candidates however stated that losses cannot be carried back to previous years of assessment.

Part (b) for 7 marks required candidates to calculate the chargeable income for Ngozi Limited for three years 2013, 2014 and 2015, claiming losses as early as possible. This part was not well answered.

The format used to claim losses used by many candidates was incorrect and candidates failed to demonstrate understanding that capital losses cannot be claimed against trading losses, whilst trading losses can be offset against capital gain resulting in the year of assessment. As a result the correct treatment was that trading profits/ losses for each year should have been listed and then capital allowances deducted. From the result each year trading losses should have been offset. In this particular instance there were trading losses in 2014 which then would be offset against trading profits in 2015.

After this capital gain should have been listed for each year and then capital losses offset. The offset for capital losses would happen in 2015 when there were capital gains. It should be noted that dividend income is exempt and cannot be used in offsetting any losses. These should have been listed each year but with zero value placed against them.

Question Four
This 10-mark question dealt with the taxation of capital gains for Medieval Limited.

Part (a) was for 3 marks and required candidates to state how the sale of a factory building would be dealt with for tax purposes. Generally the majority of the candidates did not perform well in this part. Almost all the candidates did not mention how the accounting profit would be dealt with, that is it would be removed from the profits for tax purposes. Further as the asset qualified for capital allowances, then a balancing charge would be worked out and this would in its entirety be included in assessable income. The replacement asset qualifies for capital allowances in the form of an investment allowance and would reduce the profits for the year.

Part (b) was for 7 marks and required candidates to calculate the capital gain that would be subject to income tax for the year ended 31 December 2015, as result of the transactions entered into by Medieval Limited. The items subject to capital gain calculation were sale of shares in Moldovia Limited and the sale of the general manager's house. The performance in this part was less than satisfactory, in the main because candidates did not apply indices to the cost of asset concerned to bring the cost to the present value; In fact very few did. The candidates needed to work out the conversion factor. This would be deteremined as follows; divide the indice applicable on the date of sale of the asset by the indice applicable on the date the asset was sold. The result was then multiplied by the cost of the asset. The result was the present value of the asset which then needed to be subtracted from the sales proceeds' to arrive at the gain of the asset.

Question Five

This question was for 15 marks and involved the taxation of an individual in this case John Banda, who runs two businesses. Part (a) dealt with the calculation of tax payable resulting from John Banda's businesses and part (b) required an explanation of the impact on the tax payable by John, if one of the businesses was turned into a limited company and paid a dividend to John.

Part (a) for 10 marks required candidates to calculate the tax payable by John Banda for the year ended 30 June 2015. This part was generally well answered. There was evidence that some candidates had not read the question carefully which in certain cases resulted in them not making appropriate adjustments.

The common mistakes were:
- Combining the two business which resulted in wrong adjustments being made;

  For the office building not carrying out the following;
- Not disallowing Banda's salary:
- Not deducting deposits from tenants
- Not deducting rates not accrued to arrive at taxable income

  For Style Clothing shop not carrying out the following:
- Depreciation not being disallowed
- Penalty for late payment of tax not being disallowed

- Not deducting capital allowances

For Total income:
- Not aggregating all income for income from all sources; a
- Not making allowance for the first K10,000 interest which is tax free;
- Tax calculation based on corporate rate or
- Taxes being calculated for each source using rates applicable to individuals resulting in overstatement of taxes payable;

Part (b) was for 5 marks, this required candidates to explain how the answer in (a) would change if Style was a limited company in which John Banda owned 100% of the shares. The performance for most candidates was satisfactory. Most candidates stated that John's income would be reduced by the taxable income of Style which would be the same as in (a) and his tax reduced by the tax of the taxable income at the higher rate of 30%. The dividend payable would be subject to 10% final tax rate which would be income for John. John would receive net dividend but this would not be taxable in his hands.

Question Six

This question was for 15 marks and involved the computation of tax liability for a company which was involved in the provision of internet services. This question was in two parts;

Part (a) for 3 marks required candidates to state how the pre-operating expenditure by ICT Limited would be dealt with for tax purposes. The performance was satisfactory by a majority of the candidates who correctly stated that these would not be claimable as ICT Limited was not a manufacturer. Further for pre-operating expenses to be claimed by a manufacturing business, the expenditure needed to have been incurred not more than 18 months before commencement of trading.

Part (b) was for 12 marks and required candidates to work out the taxable income for ICT Limited for the year ended 31 December 2015. The performance in this question was mixed. Generally most candidates prepared the tax computation to arrive at taxable profits. This involved adding back to profits items which were not allowable for taxation and subtracting items which were included in income but are not taxable.

Candidates correctly followed the instruction in the question that all items should be listed, and where there was no adjustment required then this be indicated with a zero.

Some candidates failed to make adjustment to the pension which was limited to 15% of salary. There were some common mistakes including:
- Not properly considering items which should be allowed or disallowed;
- Not calculation capital allowances
- Not listing all items of expenditure as per question and indicating against the value with a “0” those items that did not require adjustment

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