Examiner's report
F6 (MWI) Taxation
June 2017

General Comments
There were two sections to the examination 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 candidate's understanding and application of tax. The following paragraphs report on each section and focus on some of the key learning points.

Specific Comments

Section A

Most 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 exam. Candidates preparing for future examinations 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
Which of the following benefits provided by Dengu Limited to its senior managers would be subject to fringe benefits tax?

(1) Car with unlimited use
(2) Housing allowance
(3) Children's school fees paid to the managers
(4) Utility costs paid to providers

A 2 and 3
B 1 and 3
C 3 and 4
D 1 and 4

This question tested the candidate's understanding of the applicability of fringe benefits tax (FBT), where several benefits are applicable. Which of those benefits qualify for FBT and as such, the respective tax on them is payable by the company. Which of those benefits constitute earnings by the employee and hence subject to Pay As You Earn (PAYE). The question requested candidates to identify each transaction whether it qualifies as a fringe benefit for purposes of FBT or an earning.

The key to passing this question was first to recognise which of the benefits provided to the managers would qualify as a fringe benefit. If it qualified as an earning to employee which would be added to salary and be subject to PAYE, then it would not qualify as a fringe benefit for the purpose of FBT. To qualify as a benefit for purposes of FBT, the benefit must not involve the company paying money to the employee.

Option A - 2 and 3: This is a situation where monies are paid to the employee for housing, as housing allowance and also for school fees. In this particular case as the monies are paid to the employee they will be included as part of his earnings and be subject to PAYE, so no FBT will apply.

Option B - 1 and 3: This answer takes into account use of a car where there is no money paid to the manager and children's school fees, which involves the company paying the fees to the employee/manager. When money is paid to the employee there is no guarantee that the money is used for that purpose. If the school fees were paid directly to the school it would be considered a benefit for the purposes of FBT.

Option C - 3 and 4: Again this involves payment of school fees directly to the manager. The money will be included as part of his earnings and be subject to PAYE and not FBT. With regard to 4, which is paying for the managers utility costs directly to the provider, it is regarded as a benefit for FBT, since it does not involve a payment directly to the employee.

Option D is the correct answer: This is 1 and 4. There is no money paid to the employee and hence it is a benefit that qualifies for FBT.

Section B

Question One

This was a 10 mark question which dealt with the principles of Value Added Tax (VAT) with regard to claiming of input and charging of output tax for a property company that deals in both commercial and residential properties.

Part (a) for 3 marks required candidates to state when a supply is deemed to have occurred for VAT purposes. Performance was generally satisfactory, although some candidates focused of the definition of a supply and some candidates just focused on supply of goods and did not mention supply of services.

Part (b) for 7 marks required candidates to calculate the output VAT which was chargeable and the input VAT claimable by Lexo Properties in respect of the transactions for the month of December 2016. This part was generally well answered. Candidates who did not perform well in this part failed to recognise that expenses were supposed to be split between expenditure as a result of business to do with residential property and that on commercial property. VAT was not claimable on expenditure to do with residential property. Similarly there was no output VAT chargeable on income from residential property. Some candidates did not show the split of expenditure between residential and commercial property as was expected.

Question Two

This 10 mark question dealt with the taxation of capital gains for Sani Mega Limited, a company involved in the distribution of cosmetic products.

Part (a) was for 3 marks and required candidates to state the basis on which capital gains or losses are calculated. Generally the performance was of reasonable standard. The majority of candidates correctly stated that capital gain or loss was calculated as the difference between disposal proceeds of an asset and its adjusted cost. However there were some candidates who did not elaborate on what the adjusted basis was. The adjusted basis of an asset depended on whether capital allowances were claimed or not. On assets where capital allowances are claimed the adjusted cost is the tax written down value of the asset. Where no capital allowances are claimed it is the cost of the asset adjusted using consumer price indices at the date of disposal of the asset and that applicable to the year in which the asset was purchased or constructed or completed, or the 1992 index where a 1992 valuation was registered. However, very few candidates mentioned the valuation in 1992.

Part (b) was for 7 marks and required candidates to calculate the gains chargeable to Sani Mega Limited for the year ended 31 December 2016.The performance in this part was mixed. Candidates correctly calculated the gain arising from the sale of the warehouse. However, most candidates did not perform well in the calculation of the gain on the sale of the unlisted shares. As these shares were sold to a related party the price which should have been used was the fair value and not the actual price. Generally the candidates used the right indices with very few candidates using the wrong indices.

With regard to the motor lorry candidates correctly stated that since capital allowances had been claimed on the asset, balancing charges or allowance would be calculated and would affect the capital allowances claimed. There was no need to index the asset as indices do not apply to assets on which capital allowances are claimed, although some candidates did.

Question Three

This 10 mark question was in two parts and was in respect of taxation of mining activities.

Part (a) was for 5 marks and this required candidates to compute the taxable income of DYX Mining Limited for the year ended 31 December 2016, ensuring all claims are made as early as possible. Generally this part was well answered except for capital expenditure where candidates deducted the whole amount at once. Capital expenditure on mining now gets annual allowance equally over the life of the mining project. Some candidates disallowed expenditure on royalties; royalties are now specifically an allowed expenditure item.

Part (b) was for 5 marks and required candidates to calculate the taxes payable by DYX Mining Limited for the year ended 31 December 2016. Candidates correctly identified income tax as tax to be paid on the profits of the mining project. However the majority of candidates failed to identify the resource rent tax payable as another tax payable. The resource rent would be paid in addition to the income tax on profits. The resource rent is calculated by taking taxable profits and adding to that figure taxation paid (other than resource rent tax) and subtracting expenditure on financing. The resulting figure was then taxed at 15% as the resource rent.

Question Four

This was a two part 10 mark question dealing with the taxation of a company, Mafuleka Trading Limited.

Part (a) was 8 mark question which required candidates to calculate the tax payable by Mafuleka Trading Limited for the three years ending 30 September 2015, 2016 and 2017. The performance in this part was less than satisfactory primarily due to the fact that the presentation was not good. Most candidates did not present their answers logically which would easily allow them to arrive at assessable profits or losses easily.

What was required was the answer to be presented in columnar form as was the question itself. First trading profits would have capital allowances deducted from them and then losses offset, then capital gain from the sale of shares added and the capital loss deducted. Pre-operating losses would not be offset as Mafuleka Limited is not a manufacturing company. The capital gain should have only been only from sale of shares as the capital gain on the house would be rolled over.

Most candidates wrongly included dividends as taxable amounts and also included provisional tax and withholding tax in arriving at taxable income or losses. Withholding tax and provisional tax should have been deducted from income tax calculated.

Part (b) for 2 marks required candidates to state how trading losses, capital losses and pre-operating expenditure are dealt with for the purposes of computing taxable income.

This part was well answered and most candidates correctly stated on how losses are dealt with, including capital losses. However most candidates did not correctly state how pre-operating losses are dealt with, that is they will not be offset as they are not made by a manufacturing company.

Question Five

This was a 15 mark question dealing with the taxation of an individual's income from a business as well as from employment, including income earned by his wife.

Part (a) for 12 marks required candidates to compute the taxable income for Simon and Jennifer Phiri for the year ended 30 June 2016.

Most candidates correctly answered this part of the question, first by working out the taxable business income for Simon. This involved adjusting the net profit by adding items that were not allowed for taxation and then subtracting capital allowances. They then correctly isolated income which would be taxable on Simon and that which would be taxed on Jennifer. Most candidates correctly treated income for the property owned by Jennifer as unearned income and therefore taxed on Simon and not Jennifer. The rental income was added to the income of Simon minus the expenses on the property but excluding mortgage capital payments. Interest received by an individual is now taxed in full .The exemption of K10,000 per person was removed, and there were some candidates who still deducted the exemption from the interest.

The candidates who did not perform well failed to treat the unearned income of Jennifer as the income of Simon. It is also important that instructions given in the question are followed. The question stated that in the answer all items should be listed and any items that do not give rise to an adjustment in the tax computation should be indicated with a zero ('0') in the amount column. Some candidates did not follow the instruction, thereby missing vital marks.

Overall it was a well answered question.

Part (b) for 3 marks required candidates to state what would be the tax implications of the amounts paid to or for Simon if the business were a limited company. Again this part of the question was well answered with a majority of candidates stating that fringe benefits tax would apply for any amounts paid on his behalf like school fees and utilities. They also stated that if the amounts were paid directly to him then they would be added to his earnings and be subject to PAYE.

Salary paid to Simon if it was a limited company would be required to deduct PAYE

Question Six

This question was for 15 marks and it involved the computation of tax liability for a company which was involved in the manufacture of plastic ware. This question was in three parts.

Part (a) for 5 marks required candidates to calculate capital allowances to be claimed by Sawelenga Limited for the year ended 31 December 2016. This part was generally well answered with candidates giving the investment allowance for the second hand plant and no initial allowances for the addition to motor cars. Annual allowances were given for all items, except that in some cases the candidates used the wrong rates. The candidates that did not perform well were those that did not present their answer in columnar form such that it became difficult for them to see if all the appropriate allowances had been claimed.

Part (b) for was for 7 marks and required candidates to calculate the tax to be paid by Sawelenga Limited December 2016. The performance in this question was fairly good. 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 the capital allowances which had been calculated in part (a).

The candidates that did not do well were those that did not specifically follow the instructions and they made the following mistakes:

- Not properly considering items which should be allowed or disallowed;
- Calculating tax based on rates applicable to individuals;
- Not giving tax credits for withholding taxes on interest received;
- Not giving tax credit for the provisional tax that had been paid during the year.

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

Part (c) for 3 marks required candidates to state when the company should pay the balance of any tax due and penalties which would be paid for non- compliance. On the whole the majority of candidates explained that tax would be due and payable on the submission of the tax return, which is 180 days from the end of the financial year. Some candidates stated this as 180 days from when the assessment is done or end of the tax year.

Most candidates did not mention that late payment would attract interest at the prevailing bank rate plus 5% per annum. The penalties stated by most of the candidates related to those applicable to payment of insufficient provisional tax. There would also be a penalty for late filing, which for a company is K200, 000.