

Examiner's report

TAXATION (ZAF)

December 2016

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 (two marks each) which covered a broad range of syllabus topics. Section B had four questions worth 10 marks each and two longer questions worth 15 marks, each testing the candidates' understanding and application of audit and assurance in more depth. The following paragraphs report on each section and focus on some of the key learning points.

Specific Comments

Section A

Sample questions

It was very pleasing to see that almost all candidates attempted all of the questions. Candidates preparing for the next examination of F6 ZAF are advised to work through the sample questions discussed here and to carefully review how each of the correct answers were 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 ZAF syllabus, rather than attempting to question spot. The following two questions are 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 questions selected.

MCQ 7 (calculative)

Sally sold her seafront holiday apartment for R4,000,000 on 1 November 2015, incurring selling expenses (estate agents and attorney fees) of R300,000. Sally had bought the apartment on 1 June 2000 for R650,000. She has incurred no further expenses on the property.

What is the time apportioned base cost of the property for capital gains tax purposes?

- A R1,044,118
- B R895,511
- C R1,308,824
- D R1,008,824

This question required candidates to calculate the time apportioned base cost of a property disposed of by an individual taxpayer. The correct answer was D, which required candidates to correctly apply the formula given in the examinable documents. This is a commonly examined area of the syllabus which candidates should be familiar with. Common mistakes included: (a) ignoring the selling costs incurred; (b) adding the selling costs to the pre-2001 costs for the purposes of the formula (in this regard, candidates should revisit the meaning of the symbols in the formula as supplied in the examination paper), or (c) apportioning the proceeds for the pre-2001 expenses and the selling costs subsequently. For (c), candidates are reminded that selling expenses are not treated as ordinary post-2001 expenses for the purpose of the formula, but rather simply reduce the proceeds value to use in the formula.

MCQ 12 (calculative)

Joe's employer sent him on a long-term one-year secondment overseas which started and ended during the 2016 year of assessment. As Joe's family remained in South Africa, Joe was permitted to return to South African once per month (or twice if he did not utilise a return trip in the previous month). During the 2016 year of assessment, Joe skipped a return trip home in August so that he could have two trips home in September for his wife's and daughter's birthdays respectively. In the 2016 year of assessment, Joe spent 190 days outside South Africa and his salary amounted to R701,300.

What is the amount of employees tax which should have been deducted from Joe's salary for the 2016 year of assessment?

- A R93,651
- B R101,679
- C R195,330
- D R208,587

This question required candidates to calculate the amount of employees tax which should have been deducted from a taxpayer's salary for the 2016 year of assessment. This should have been a straightforward question, however most candidates incorrectly selected option D, which did not take into account the primary rebate or the remuneration exemption. Employees tax must be remembered as a value net of rebates. Furthermore, this scenario was complicated by the application of the exemption for foreign earnings as a result of time outside South Africa.

Section B

Question One

This 10-mark question required covered topics relating to recoupments and trading stock.

In part (a) for 7 marks the candidates were required to calculate recoupments or scrapping allowances on the disposal of three machines that were used in a process of manufacture.

The candidates generally correctly distinguished between and applied the correct capital allowance rates in respect of *new and unused* manufacturing plant and equipment and *used* manufacturing plant and equipment in determining the tax values and recoupments.

With regard the income tax consequences relating to the holding and usage of spare parts very few candidates correctly identified that the spare parts were held as trading stock and that the spare parts must be taxed by taking into account the opening balance, closing balance and the spare parts acquired during the year of assessment. The majority of the candidates instead claimed capital allowances on the spare parts used to repair machine C.

In part (b) for 3 marks the candidates were required to determine what the effect would have been on the recoupments calculated in part (a) had the taxpayer been a small business corporation. The candidates generally correctly identified that the capital allowances for small business corporation manufacturing plant and equipment is 100% and that the full cost would have been claimed in the year in which the manufacturing machines were acquired by the taxpayer and the recoupments would have been the full proceeds received or deemed to have been received in respect of the disposal of the manufacturing machines.

The majority of the candidates however failed to recognise that the proceeds on the disposals of assets to connected persons are deemed to be market value. The calculation of the recoupments in parts (a) and (b) relating to Machine D were therefore mostly incorrect.

Question Two

This 10-mark question covered topics relating to the taxation of fringe benefits, the calculation of the medical aid contribution tax rebate and, lastly, the determination of normal tax liability for a natural person.

Part (a) for 6 marks required the candidates to calculate taxable fringe benefits in respect of the right of use of a motor vehicle, a long service award and holiday rental (free services) provided by the taxpayer's employer.

In calculating the fringe benefit in respect of the right of use of the motor vehicle, the following common mistakes and inaccuracies were noted:

- Some of the candidates failed to reduce the 'determined value' of the motor vehicle by 15%. Where a motor vehicle was acquired not less than 12 months before the date on which the employee was granted right of use, the 'determined value', must be reduced by 15% for each 12 month period completed from the date of acquisition by the employer.
- Although the candidates generally applied the correct benefit percentage to determine the monthly fringe benefit (i.e. 3.25%), a number of the candidates failed to multiply the monthly fringe benefit by 12 to calculate the fringe benefit for the whole year of assessment (i.e. 12 months).
- A significant number of the candidates incorrectly calculated the amount relating the private fuel expense which may be deducted from the value of the fringe benefit. Very few candidates calculated the amount to be deducted by multiplying the private kilometres by the deemed fuel cost per kilometre as per the ruling travel allowance table (provided).

The calculation of the long service award and holiday rental fringe benefit was generally well answered.

In part (b) for 1 mark the candidates were required to calculate the taxpayer's medical aid contribution rebate. Although the required was generally well answered, it was noted that some of the candidates incorrectly multiplied the rebate rates for the individual persons by four.

Part (c) for 3 marks required the candidates to calculate the taxpayer's normal tax liability. It was noted that some of the candidates deducted the primary rebate, medical aid contribution rebate and employees tax from 'income'. This is a principle mistake that shows lack of understanding of what would be taken into account in determining 'taxable income'.

Question Three

This 10-mark question required covered topics relating to capital gains tax in terms of the 8th Schedule to the Income Tax Act.

Part (a) for 7 marks required candidates to calculate the capital gain or capital loss for a natural person arising from four discrete asset disposals. Candidates also had to determine whether any specific exclusion would apply to the capital gains and/or capital losses realised on the disposals.

The assets disposed of were an equity interest in a small business corporation, a 12-metre yacht, an art collection and the taxpayer's primary residence.

The following common mistakes in accuracies were noted:

- Disposal of the equity shares in the small business corporation: The majority of the candidates failed to apply the small business entity exclusion in determining the capital gain.
- Capital loss on the disposal of the yacht: A significant number of the candidates failed to identify that the yacht, while outside the scope of the 'personal use asset' exclusion, requires the capital loss to still be disregarded. The capital loss was therefore often incorrectly included in the determination of the aggregate capital gain/loss (i.e. not disregarded).
- Donation of art collection: The majority of the candidates failed to identify that any capital gain or loss determined in respect of donations to a public benefit organisation must be disregarded. Some of the candidates however determined the art collection to be 'personal use assets' and disregarded the capital loss suffered on this basis.
- Primary residence: The candidates generally correctly identified that the sale of the taxpayer's primary residence would be subject to CGT and calculated the capital gain on the disposal of the family home. The candidates generally applied the primary residence exclusion. It was however noted that some of the

candidates failed to correctly calculate the portion of the capital gain that does not qualify of the primary residence exclusion. Instead of reducing the portion of the capital gain that qualifies for the primary residence exclusion, some of the candidates reduced the primary residence exclusion by 5%.

In part (b) for 3 marks the candidates were required to calculate the taxable capital gain or assessed capital loss to be carried forward for the 2016 year of assessment. Candidates had to apply the annual exclusion to the aggregate capital gain and then use the correct CGT inclusion rate.

In their determination of the aggregate capital gain some of the candidates failed to deduct the annual exclusion. Only a few of the candidates correctly deducted the non-connected person assessed capital losses (i.e. non-clogged losses) brought forward in the determination of the net capital gains.

Lastly, it was noted that only a few candidates calculated the taxable capital gain for inclusion in taxable income by applying the 33.3% inclusion rate. This inclusion rate is supplied in the information tables at the start of the paper.

Question Four

This 10-mark question required covered topics relating to Value-Added Tax.

Part (a) for 8 marks required candidates to calculate the input and output VAT arising from a list of transactions. Part (a) was well-answered.

The following common mistakes and inaccuracies were however noted:

- The candidates' solutions to this question often lacked clarity and were difficult to follow. For example in some instances the suggested table format was not followed.
- The candidates' solutions often did not clearly show whether the amounts were 'input tax' or 'output tax'. It is suggested that candidates refer to the solution published and the format followed in the solution as a future guide.
- A few candidates confused whether amounts were inclusive or exclusive of VAT. This was despite the fact that the scenario clearly stated that all items (1) to (13) were inclusive of VAT. Where amounts are inclusive of VAT the tax fraction (14/114) should be applied.

Part (b) for 1 mark required the candidates to list the VAT return due date for category C VAT vendors that file their VAT returns electronically (i.e. the month last business day of month following the relevant VAT period). It was noted that some of the candidates failed to distinguish between the due dates for VAT returns filed electronically and manually. In the case of the latter the VAT return due date is the 25th of the month following the VAT period.

Part (c) for 1 mark required the candidates to firstly identify that a 10% late penalty applies in respect of the late filling of VAT returns and secondly that interest will be levied on in respect of late payments of VAT. It was however noted that in the a few instances candidates listed the incorrect penalty rate. Another common mistake was that the candidate did not identify that interest will be levied on late payment of VAT.

Question Five

This 15-mark question required covered topics relating to the calculation of the normal tax liability of a natural person, who is a full-time salaried employee and earns income from his rental and plumbing trades.

Part (a) for 3 marks required candidates to calculate the taxpayer's qualifying pre-trade expenditure in respect of this plumbing trade. A common mistake made by most of the candidates is that the wear & tear allowances

claimed in respect of a motor vehicle and plumbing tools were not correctly calculated. The majority of the candidate failed to apportion the wear & tear allowances claim in respect of these assets.

Another common mistake is that the candidates incorrectly included the interest expense incurred in respect of the plumbing equipment as qualifying pre-trade expenditure.

Part (b) for 2 marks required candidates to discuss why the taxpayer's rental income for the 2016 year of assessment must be ring fenced or whether it is available to be set off against income from other trades. This question was poorly answered as only a few candidates identified that the rental trade loss for the 2016 year of assessment must be ring-fenced based on the fact that the taxpayer has incurred tax losses in respect of the rental trade in three of the last five year.

Part (c) for 10 marks required candidates to calculate the normal tax liability of the taxpayer based on his salaried income, rental income and plumbing trade income.

Although this part was generally well answered, some of the candidates' solutions were incoherent and lacked structure. Please refer to the suggested solution for appropriate layout and format.

The following common mistakes and inaccuracies were noted:

- The majority of the candidates failed to identify that the rental trade loss for the 2016 year of assessment was ring-fenced and therefore the rental loss was included in the determination of the taxable income.
- Some of candidates failed to apply the 100% wear & tear write-off rate to small items (i.e. items less with a value of less and R7,000).
- Some of the candidates incorrectly deducted either the primary rebate or employees' tax withheld or both from the taxpayer's 'income' and not the normal tax liability.
- The majority of the candidates did not address the second part of the part (c) which required a brief explanation of the treatment of the losses, i.e. the ring-fenced pre-trade expenses relating the taxpayer's plumbing trade and the ring-fenced loss from his rental trade. Both losses are carried forward.

Question Six

This 15-mark question required candidates to calculate the income tax and dividends tax liabilities of a company.

The scenario provided various amounts received by a company taxpayer and expenditure incurred. The candidates had to apply the principles of the Income Tax Act to determine which amounts would be subject to normal tax, amounts which are be deductible and lastly the income tax liability.

Some of the candidates' workings were not clearly laid out, it was then difficult to follow the candidates thought process and award principle marks.

The following common mistakes and inaccuracies were noted:

- The calculation of the allowances for doubtful debts was answered fairly. A few candidates however failed to determine what deductions were in the current year and what the deduction was in the previous year.
- Capital allowances, the relating recoupments and capital gains tax was generally not well answered. Some candidates failed to calculate and deduct capital allowances on either Machines A or B or both (two shunting machines). The majority of the candidates failed to defer the taxable recoupment realised on the shunting machine (Machine A) which was replaced by a new shunting machine (Machine B).
- Some of the candidates did not use the CSARS wear & tear allowance rates in respect office furniture, computer equipment and other machinery, as set out in the required.

- In calculating the recoupment on an office desk distributed as *in specie* dividend to a director/shareholder of the taxpayer the majority of the candidates failed to apportion the wear & tear allowances claimed in respect of the office desk during the year of assessment.
- Some of the candidates failed to calculate and include the taxable capital gain realised on the disposal of Machine A and the office desk (distributed to a director/shareholder) in the taxpayer's taxable income.
- Some of the candidates made a principle mistake by incorrectly including the dividends tax in the taxable income of the taxpayer.
- Some of the candidates incorrectly deducted the taxpayer's provisional tax payments from 'income' and not from the normal tax liability.