

Examiner's report

F6 Taxation (ZAF)

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 (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 the South African tax system in more depth. 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

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 specimen questions on the website and 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. Many examples are discussed here to provide candidates with clear guidance following this first examination in the new format.

Sample Questions for Discussion

Example 1

Alice received the use of a company car from her employer company on 1 March 2014. Company policy requires her to pay for all private fuel based on the logbook. The Commissioner for the South African Revenue Service accepts that accurate records are maintained for travel. The company acquired the car for cash of R489,970 (including value added tax) and the car came with a five-year maintenance plan. For the year of assessment ended 28 February 2015, Alice travelled 35,000 km in total, of which 12,000 km were for private travel.

What is the amount of the assessable benefit to be included in Alice's taxable income for the 2015 year of assessment?

- A R52,208
- B R39,722
- C R162,767
- D R47,168

The correct answer is D but many candidates wrongly selected answer C.

This mistake appeared to be as a result of use of out-of-date legislation. One of the fundamental changes to the fringe benefit calculation some years ago was the business use apportionment (reduction). This critical factor seems to be the key aspect that many candidates missed, leading them to the wrong answer.

Example 2

ENG Consulting (Pty) Ltd has one shareholder and one employee, an engineer, Mr Clem Eng, who provides consultancy services for construction projects. Clem is currently engaged in a large consulting project which will last for 13 months. The maximum turnover the company generates is R950,000.

As which entity type will ENG Consulting (Pty) Ltd be taxed?

- A Sole proprietorship
- B Micro business
- C Standard company
- D Partnership

The correct answer is C but many candidates wrongly selected answer B.

Engineering is a professional service for the purposes of the micro business regime and turnover from engineering services is therefore excluded from qualifying turnover for the purposes of the micro business regime. As it is clearly neither a sole proprietorship nor a partnership the final answer must by default be the correct option i.e. a standard company.

Example 3

Jennifer (aged 42) was sent temporarily to an office outside South Africa by her South African resident employer. Jennifer spent eight months working at the overseas office during the year of assessment ended 28 February 2015.

Jennifer earns a salary of R400,000 per annum. During her time away from South Africa, she earned a further monthly allowance of R75,000 (this was not a subsistence allowance). She earned interest from a South African bank of R28,000 during the year of assessment.

What is the amount of Jennifer's taxable income for the 2015 year of assessment?

- A R137,533
- B R1,004,200
- C R337,533
- D R342,667

The correct answer is A, but many candidates selected answer B.

A critical exemption often overlooked by candidates is the exemption applying to foreign work for South African residents and the exemption of the remuneration from such work [section 10(1)(o) of the Income Tax Act]. Failure to identify the application of this exemption to Jennifer led to many candidates incorrectly selecting answer B.

Example 4

Small (Pty) Ltd is a small business corporation. During the year of assessment ended 31 March 2015, it acquired an asset used for manufacturing purposes for R50,000, office furniture for R23,000 and desktop computer software for R5,000. The Commissioner for SARS accepts a write-off period of six years for office furniture and two years for desktop computer software. All figures are stated exclusive of value added tax.

What is the maximum amount of capital allowances which Small (Pty) Ltd may claim in respect of the above acquisitions in the 2015 year of assessment?

- A R78,000
- B R66,500
- C R56,333
- D R64,000

The correct answer is B but many candidates wrongly selected answer C.

This was due a failure to correctly read the scenario and use the capital allowances information as given in the tax rates and allowances at the front of the exam. By selecting answer C, candidates used the write-off periods given in the question. However, the question stated that Small (Pty) Ltd was a small business corporation. Therefore, it was entitled to claim 100% capital allowances on the manufacturing asset and 50% capital allowances (in the first year) against the office furniture. As the cost of the desktop computer software was less than R7,000, it was entitled to a 100% write off in the year of acquisition.

Section B

Question One

This 10-mark question covered the concept of residence in the context of an individual (Joseph), as well as the concept of a change of intention giving rise to a deemed disposal for capital gains tax purposes. Part (a) for 6 marks required candidates to explain whether or not Joseph would be considered a resident for income tax purposes in the 2015 year of assessment. Candidates' performance was satisfactory on this question.

Many candidates were able to confidently apply the relevant case law to determine that the taxpayer was not ordinarily resident in South Africa. Candidates generally also identified that he had failed the physical presence test based on the number of days spent in South Africa as set out in the scenario.

Where candidates' performance was less satisfactory, this tended to be because they only applied the physical presence test and did not consider whether Joseph was ordinarily resident. In addition, some candidates only set out one or two of the three requirements of the physical presence test and therefore missed out on available marks. Candidates should be reminded that all three requirements of the physical presence test should be met, in order for a natural person to be considered a resident [as defined in section 1 of the Income Tax Act No 58 of 1962 ('the Act')].

Part (b) for 2 marks required candidates to explain why a capital gains tax event may arise for Joseph in the 2015 year of assessment notwithstanding that no actual sale took place in that year. Candidates' performance on this question was unsatisfactory.

The scenario described a situation in which the taxpayer changed his intention with respect to a plot of land he owned, from holding the land as a capital asset to effectively holding the land as trading inventory (stock). However the majority of candidates were not able to identify that this would give rise to a deemed disposal. Instead, many students ignored the fact that the question stated that no sale had occurred and then assumed that an actual sale would take place. Candidates must answer the question set rather than the one they wish had been asked.

Part (c) for 2 marks required candidates to calculate the taxpayer's aggregate capital gain for the 2015 year of assessment. This question was well answered with almost all candidates applying the market value proceeds reduced by the base cost. However, some candidates failed to reduce the capital gain by the annual exclusion..

Question Two

This 10 mark question covered a variety of tax issues affecting a newly incorporated company, Judy Ltd.

Part (a) for 5 marks required a clear understanding of the practical financial impact of Judy Ltd registering as a value added tax (VAT) vendor. Unfortunately many candidates did not perform satisfactorily in this question, demonstrating a lack of ability to assimilate the foundations of the VAT syllabus and apply them in a practical way to a 'real world' scenario.

Most candidates correctly identified the requirements for compulsory and voluntary VAT registration. However, many candidates did not prepare the output and input VAT calculations in order to demonstrate that it would be beneficial to register (but only in the short term); this is despite the fact that the question specifically asked candidates to support their answers with calculations. For those candidates who did prepare calculations, it was disappointing to see a number of candidates using the fraction 'x 14/114' rather than 'x 14%' in order to calculate the VAT on the machines and running costs, despite these being given as VAT **exclusive** amounts in the scenario. A more careful reading of the facts presented in the question may have prevented this error. Candidates were slightly more successful in identifying that in the long term it may not be beneficial to register since absorbing the output VAT would impact profitability and passing the VAT charge onto customers may impact competitiveness.

Part (b) for 1 mark required candidates to calculate the tax payable by Judy Ltd if it were to register for the turnover tax regime. This question required a simple calculation and was well answered by the majority of candidates.

Part (c) for 3 marks required candidates to calculate the tax payable by Judy Ltd if it did not register for turnover tax. Candidates' performance was unsatisfactory here. Many candidates did not identify that, since the scenario had stated that the company would not register for VAT, the VAT charged on the machines and running expenses would be a deductible cost to the company and should therefore be added to the expenditure in the calculation of taxable income. It also appeared that candidates did not read the question carefully. For example, the running costs were stated as being R2,000 per annum per machine. However, many candidates did not calculate the full cost relating to the 24 machines held but instead just deducted a total cost of R2,000.

Part (d) for 1 mark required candidates to state whether the company should register for turnover tax in its first year of operation. It was pleasing to see that a number of candidates used their answers in (b) and (c) above to support their answer and, as a result, performed well.

Question Three

This 10-mark question covered the calculation of capital gains tax and the specific capital gains tax exclusion for small businesses.

Part (a) for 2 marks required an explanation as to why the exclusion applicable to small business assets would apply to the taxpayer (Lesley) described in the scenario. Candidates' performance was mixed; some candidates were able to identify that Lesley met the requirements [in paragraph 57 of the Eighth Schedule to the Act], while others did not appear to be aware of the exclusion at all.

Part (b) for 6 marks required a calculation of the taxpayer's capital gain or loss. Candidates were specifically asked to provide full workings. Performance on this question was unsatisfactory.

Many candidates failed to reduce the proceeds on the furniture and machines by the recoupment and / or neglected to reduce the base cost by the capital allowances claimed. In many instances, candidates were unable to accurately calculate the recoupment due to errors in the formula applied (selling price limited to cost, less tax value). Only a few candidates attempted the roll-over relief calculation for reinvestment in replacement assets. The impression given by the performance on this question is that capital gains tax is a broad topic which requires further revision by many candidates.

Part (c) for 2 marks required the candidates to state the maximum amount of any future capital gains in respect of which the taxpayer could claim the small business asset exclusion, as well as the timeframe for these future disposals to qualify for the exclusion. The performance on this question was unsatisfactory and my comments provided in respect of part (a) of this question above are equally applicable here. Of those candidates who were aware that the exclusion is limited to R1.8 million, the majority candidates generally did not know how to calculate the limit remaining for future gains and only a minority of candidates were aware of the 24 month time limit.

Question Four

This 10-mark question covered a wide range of VAT-related issues.

Part (a) for 6 marks required a calculation of the net VAT payable by the VAT vendor in respect of a particular VAT period, based on various transactions set out in the question. Performance on this question was satisfactory.

The majority of candidates set out their answers well, with columns provided for output and input VAT. Candidates were generally able to correctly calculate the VAT input on the costs relating to the export sale and the delivery truck, and were generally able to identify that no input VAT was claimable in respect of the salaries and wages; they were also able to correctly calculate the output VAT on the sales, sales for scrap and the progress payments.

However, some candidates appeared to be confused on the whether an amount of VAT represented input VAT (reclaimable) or output VAT (payable). Candidates should ensure that they are aware of the distinction between output and input VAT. Other common errors included:

- the calculation of output VAT on the export sales (which should be zero-rated);
- the treatment of bank charges as an exempt supply;
- incorrectly claiming input VAT on the interest payment (which is an exempt supply); and
- incorrectly claiming input VAT on the double cab vehicle purchased (input denied).

Part (b) for 1 mark required candidates to state the date by which the VAT vendor's VAT return should be filed based on the facts of the scenario. The performance on this question was satisfactory with most candidates either identifying 25 July for submission and payment for manual returns, or 31 July for submission and payment for returns filed through eFiling. Both answers were accepted as correct.

Part (c) for 3 marks required the candidates to list 6 items which should be included on a valid tax invoice. Candidates generally demonstrated good knowledge here. Where candidates did not score well, this was because they had listed items which are not actually required for a valid tax invoice (e.g. an income tax reference number).

Question Five

This 15 mark question was based on an individual, Charles, who operated a business in a partnership. Candidates were required to calculate Charles' normal tax liability. This question tested the determination of the taxable income of the partnership starting with the net profit before tax and making appropriate adjustments to arrive at taxable income; as well as testing the determination of the tax liability of an individual, taking into account his share of partnership profits, interest income and exemptions, retirement annuity contribution deductions, and the various rebates applicable to individuals, among other adjustments. Performance on this question was unsatisfactory.

The recommended approach for answering such a question (and indeed the approach followed by the South African Revenue Service) is to first calculate the taxable income of the partnership and then calculate the taxable income of the individual partner, bringing in his or her proportional share of the partnership's taxable income. Candidates generally did not set out their answers in this way and created confusion for themselves by preparing one calculation for the individual, but bringing in partnership income and expenditure here and there in a rather haphazard manner. These inclusions were often made without adjusting for the Charles' proportional share or without making the correct tax adjustment from the partnership's perspective. Some items relating to the partnership were often ignored entirely, presumably because the candidates knew that it would not be appropriate to include such an item in the individual's tax computation (e.g. depreciation), but were unsure how else to deal with it. Candidates are encouraged to revise the taxation of partnerships and to work through some example questions.

A number of candidates also attempted to calculate a medical expenses deduction, rather than a rebate. Candidates are encouraged to pay special attention to changes in the legislation. For example, the rebate [in section 6B of the Act] for additional medical expenses was introduced for years of assessment commencing on or after 1 March 2014 and is therefore applicable to the year of assessment ending 28 February 2015 in this scenario. Furthermore, the specimen questions for the June 2015 exam published on the ACCA website included an example of such a calculation to help prepare candidates for this new examinable legislation.

Question Six

This 15 mark question was based on a list of various transactions recorded by a manufacturing company (Sun Energy Ltd) during its 2015 year of assessment. Candidates were required to calculate the taxable income of Sun Energy Ltd. The question tested capital / revenue principles in relation to legal fees, whether certain costs qualified for the R&D accelerated allowances, the special deductions relating to lease premiums and leasehold improvements, capital allowances and recoupments, and capital gains on disposal of allowance assets. Performance on this question was generally unsatisfactory.

Some of the common errors encountered were as follows:

- Candidates generally claimed a deduction for the legal costs in respect of the filing of patents, however no deduction should be claimed due to the capital nature of these costs;
- Candidates generally did not identify that the salaries qualified for the 150% R&D allowance, the prototype qualified for a 50% allowance, and the related interest did not qualify for the R&D allowance. Candidates should revise this area of the syllabus [section 11D of the Act] and also pay attention to the information on R&D expenditure provided in the tax rates and allowances at the front of the exam paper;
- Candidates spread the leasehold improvements over 120 months (and in some cases over just 12 months) rather than over 119 months. Candidate are reminded to calculate the spread from the date the improvements are completed and not the date that the agreement is signed;
- Candidates struggled with the calculation of the recoupment and the capital gains. My comments provided above for Question Three part (b) are equally relevant here.