

Examiner's report

F6 (ZAF) Taxation

June 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

It was very pleasing to see that almost all candidates attempted all of the questions although the results were generally poor in this section. Candidates preparing for the next examination of F6-ZAF are advised to work through the specimen exam and sample questions discussed in examiner reports as well as the past examinations. 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.

Sample questions for discussion

Example 1

Plumb Co (Pty) Ltd began trading on 1 March 2015. The company will not register as a micro business nor will it qualify as a small business corporation.

Prior to 1 March 2015, the company incurred the following expenses in anticipation of the commencement of trade:

- Vehicle purchased on 15 January 2015 – R140,000 (depreciable over five years)
- Tools purchased on 1 February 2015 – R250,000 (depreciable over five years)
- Interest on a loan to acquire the above assets – R3,000
- Rental for a space to store supplies and tools – R6,000
- Marketing costs, including signage on the vehicle – R5,000

What is the amount of the pre-production expenditure that Plumb Co (Pty) Ltd can claim as a deduction in the 2016 year of assessment?

- A R92,000
- B R17,500
- C R21,667
- D R18,667

Analysis: The correct answer is **D**, as interest is not a permitted deduction and the depreciation allowances need to be time apportioned. The calculation to achieve this result is therefore: $[(R140,000/60 \text{ mths} \times 1.5 \text{ mths}) + (R250,000/60 \text{ mths}) + R6,000 + R5,000]$

Example 2

During the 2016 year of assessment, Joe disposed of the following assets:

- Investments with a sale price of R500,000 and a base cost of R550,000
- An artwork with a sale price of R1,200,000 and a base cost of R600,000

Joe collects art but is not an art dealer. Joe has an assessed capital loss brought forward of R20,000.

What is the capital gains tax effect for Joe of these disposals?

- A** A taxable capital gain of R500,000
- B** A capital loss carried forward of R40,000
- C** A taxable capital gain of R530,000
- D** A capital loss carried forward of R70,000

Analysis: The correct answer is **B**, because as the artwork is a personal use asset the gain is excluded. The calculation to achieve this result is: $(R50,000 - R30,000) + R20,000$

Example 3

A company sold an old manufacturing machine for R100,000. The original base cost of the machine was R90,000 and it had been fully written off for tax purposes at the date of the sale. A new manufacturing machine was acquired from the proceeds, costing R150,000. The company is neither a small business corporation nor a micro business.

What is the capital gain to be included in the company's aggregation of capital gains and capital losses?

- A** R4,000
- B** R10,000
- C** R0 (the entire gain is deferred)
- D** R2,000

Analysis: The correct answer is **A**. The new asset qualifies for the accelerated allowance and furthermore the disposal of the old asset qualifies for roll over relief. Only 40% of the capital gain falls to be included in the current year with the balance recognised in subsequent years over the tax useful life of the asset.

Section B

Question One

This 10-mark question covered the topics relating to travel allowances and subsistence allowances.

Part (a) for 1 mark required candidates to calculate the amount of the travel allowances that would be included in remuneration for the purposes of calculating employees tax.

Very few candidates correctly applied the 80% to the gross travel allowance received, the principle in terms of the definition of remuneration. Some students instead applied the reduction methods that would be applicable for determining taxable income. It would appear that candidates had limited understanding of what would be included into 'taxable income' versus 'remuneration'.

Part (b) for 2 marks required candidates to determine the amount of subsistence allowance that would have been included in the taxpayer's taxable income. Candidates were required to determine which reduction method (actual or deemed) would have resulted in a lower inclusion into taxable income.

While the question was generally well answered in terms of applying the deemed rate method, many candidates lost marks because they failed to state that the actual expenditure was less than the deemed expenditure and thus the deemed would be used.

Part (c) for 7 marks required candidates to determine the taxable travel allowance that would have been included in the taxpayer's taxable income. Like part (b) this question required candidates to assess the effects of the deemed cost method versus the actual cost method and state which method would result in the lower inclusion into taxable income.

Once again candidate who could apply the principles of s8(1)(b), of the Income Tax Act, generally performed well. However, like part (b), candidates failed to clearly state the method that would be used.

A few technical inaccuracies were however noted. For example:

- Using the incorrect amounts from the deemed travel allowance table.
- Failing to include fuel and/or maintenance costs.
- Using the incorrect number of years to calculate wear and tear for the purpose of calculating actual cost reduction.

Question Two

This 10-mark question required covered topics relating capital gains tax, the 8th Schedule to the Income Tax Act and the taxable capital gain inclusion into taxable income.

Part (a) for 9 marks required candidates to calculate the taxable capital gain for a natural person taxpayer on the sale of a number of assets during the year of assessment. Candidates had to determine whether the assets would be subject to 'CGT' and then determine the capital gain or loss on the disposals. Finally candidates had to apply the annual exclusion to the aggregate capital gain and then use the inclusion rate.

A number of candidates correctly identified that the sale of the primary residence would be subject to CGT and calculated the capital gain on the disposal of the family home. Generally then candidates correctly also provided for the primary residence exclusion which reduced the capital gain to R nil.

However it was also noted that some candidates assumed that the primary residence was a 'personal use asset' and therefore not subject to CGT.

On the transfers to the spouse, candidates either identified that these were 'personal use assets' or that on a disposal to a spouse the 'roll over' provisions would apply, both applications were accepted.

Very few candidates picked up on the fact that cash is excluded from the definition of an 'asset' in paragraph 1 of the 8th Schedule and therefore would not be subject to CGT. Instead candidates

tended to discuss the donations tax consequences on the cash. This was not required in terms of the requirement.

The final asset disposed of was the taxpayer's holiday house. Candidates here had to identify that the holiday home was a pre-valuation date asset and thus the valuation date value in terms of paragraph 25 of the 8th schedule needed to be determined. In answering this question a determination of the TABC was required. Generally, candidates who identified that this was a pre-valuation date asset and calculated TABC scored well.

A number of common mistakes were made, these included:

- Very few candidates applied the annual exclusion of R30,000 to the total gains.
- Few candidates applied the taxable inclusion rate of 33.3% to determine the amount that will be included into taxable income.
- Some candidates applied the full primary residence exclusion of R2,000,000 to the capital gain of R1,500,000 on the sale of the family home. The capital loss was then aggregated against the other capital gains. This is incorrect; an exclusion cannot create a capital loss.
- As it relates to the TABC, many candidates spent time calculating 'R' which was not necessary as there were no post valuation date paragraph 20 expenditure on the asset.
- Candidates used the incorrect 'T' and 'N' or failed to count up the number of years correctly. Candidates are reminded that 'N' is the number of years before valuation and 'T' the number of years after valuation date. Also candidates are reminded that a part of year is deemed to be a full year i.e. 1.5 years for TABC is 2 years.

Part (b) for 1 mark required candidates to advise the taxpayer on what possible course of action he could have taken to avoid 'CGT' on the sale.

This question was generally poorly answered or not even answered. In answering this question candidates had to deal with tax planning and consider what rollover or exclusions from 'CGT' the taxpayer could have applied.

Question Three

This 10-mark question related to Value-Added Tax.

Part (a) for 2 marks required candidates to discuss whether the vendor was required to issue a tax invoice on the donation of stationary to a charity.

Very few candidates correctly identified that the donation to the charity resulted in a 'change of use' adjustment in terms of s18(1), thus a taxable supply arose and a tax invoice would be issued.

Most candidates often referenced to the application of s18A of the Income Tax Act. This was not necessary.

Part (b) for 8 marks required candidates to calculate the net VAT payable or refundable for a VAT period for the vendor. Generally, this part was well-answered.

The following common mistakes were noted:

- Candidates solutions to this question often lacked clarity and were difficult to follow.
- Candidates solutions often did not clearly show whether the amounts were 'input tax' or 'output tax'. Candidates are encouraged to follow the format in the published the solution as a future guide.
- Candidates at times confused whether amounts were inclusive or exclusive of VAT. This was despite the fact that the scenario clearly stated that items (1) to (5) were exclusive of VAT and therefore by default (6) to (8) were inclusive of VAT.
- Where amounts are inclusive of VAT the tax fraction (14/114) should be applied.
- Candidates could not clearly articulate the VAT consequences on the motor cars. Candidates are reminded that the Input Tax on the purchase of motor car is denied in terms of s17(2)(c) as result of this on the sale of a motor car no supply arises in terms of s8(14).
- Many candidates used 14% (tax percentage) to determine the Input Tax on bad debts and recovered bad debts instead of the tax fraction (14/114). It should be noted that generally while amounts per the financial statements of a VAT vendor are VAT exclusive, debtors (accounts receivable) and creditors (accounts payable) are VAT inclusive amounts.

Question Four

This 10-mark question covered topics relating assessed losses, the deductibility of amounts, small business corporations and micro businesses.

This was a discussion type question and candidate's solutions to this question, as a whole, often lacked logical argument and clarity of expression. It would also appear that candidates failed to appropriately understand the requirements and this often led to candidates failing to score maximum marks.

Part (a)(i) for 2 marks required candidates to advise a taxpayer whether he could deduct an assessed loss from a prior period in the next year of assessment. In answering this question it was necessary for candidates to deal with whether the assessed loss can be carried forward if a taxpayer will not be conducting a 'trade'.

Many candidates showed limited understanding of the principles of s20 and the requirements that an assessed loss can only be written off if the taxpayer was carrying on a trade.

Part (a)(ii) for 2 marks required candidates to advise a taxpayer on whether expenditure could be claimed as a deduction. In answering this question candidates were required to assess whether the expenditure incurred on investigating a new machine could be deducted under the general deduction formula.

As the expenditure related to capital assets, the expenditure fails to meet the requirements of s11(a). Furthermore the expenditure would also not be allowed as a deduction under any capital allowances section.

The following common mistakes and technical inaccuracies were noted:

- Candidates often asserted that amounts would be allowed as a deduction under s11(a). This showed a clear lack of understanding of the principles of the general deduction formula.
- Candidates who correctly identified that no s11(a) deduction could be claimed, incorrectly went on to address that the deduction would be allowed under s11D as the expenditure

was a research and development. This was incorrect as s11D could not apply as the expenditure was not 'research and development'.

Part (b)(i) for 3 marks required candidates to advise a taxpayer on whether the formation of a new business as either a partnership or a company would impact on the registration of another existing company as a 'small business corporation'.

In answering this question candidates had to address the requirements for registration of a small business corporation in terms of s12E(4) and in particular had to address what is considered permissible shareholding by a shareholder in small business corporation.

In answering this question candidates had to address the fact that the formation of a partnership would have no impact on the registration of the existing company, as this is permissible shareholding. On the other hand the registration of a company would not be permissible shareholding

The following was noted:

- Candidates did not address both components of the requirement i.e. the discussion on the company and discussion on the partnership. Candidates solutions generally only addressed one of the two or combined the two discussions as one. Marks could then not be appropriately awarded.
- Candidates displayed limited understanding of s12E(4) and the registration requirements.

Part (b)(ii) for 3 marks required candidates to advise a taxpayer on whether the formation of a new business could be registered as a microbusiness or a small business corporation if it is either formed as a partnership or a company.

In answering this question, candidates had to compare the registration requirements of a microbusiness and a small business corporation. Then had to address what is considered permissible shareholding by a shareholder in both types of businesses.

As above candidates here also did not address both components of the requirement i.e. the discussion on the company and discussion on the partnership. Additionally candidates displayed limited understanding of technical registration requirements relating to microbusinesses.

Question Five

This 15-mark question covered topics relating to the calculation of the normal tax liability of a natural person, who was both a salaried employee and earned income from rentals, and brief discussion on gross income.

Part (a) for 2 marks required candidates to discuss whether certain deposits would be gross income.

In answering part (a) candidates had to consider whether the security deposits met the requirements of the gross income definition and were considered to have been 'received or accrued' to the taxpayer.

Like all discussion questions in this examination, the solutions lacked a logical flow and argument. Solutions were often incoherent and difficult to follow.

Very few candidates correctly addressed whether the amounts were 'received or accrued'. Candidates also did not substantiate their statements that amounts were 'received or accrued' with reference to the scenario.

Part (b) for 13 marks required candidates to calculate the normal tax liability of a natural person.

The scenario provided various amounts received by a taxpayer and expenditure incurred. Candidates had to apply the principles of the Income Tax Act to determine which amounts would be subject to normal tax and which amounts would be deductible.

While this part was generally well answered, some candidates solutions were incoherent and lacked structure. Please refer to the suggested solution for appropriate layout and format. 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 technical issues arose:

- As it relates to the pension fund deduction, instead of using the s11(k) deduction many candidates applied the RAF deduction.
- Where a candidate used the pension fund deduction at times some applied the 7.5% requirement to taxable income instead of remuneration.
- Local dividends received were included into taxable income at the amount net of the dividends tax. This is incorrect and the gross amount is included into taxable income.
- Dividends from REITs were often exempted.
- The local interest exemption was applied to both local and foreign interest. It should be noted that no exemption is available for foreign interest.
- Some candidates claimed the s6B rebate as a deduction from taxable income instead of a rebate after normal tax. It would appear that candidates were still applying the provisions of s18, which has since been deleted.
- Foreign tax rebates was generally not claimed.

Question Six

This 15-mark question required candidates to calculate the taxable income of a company.

Many candidates calculated the normal tax of the company, which was not necessary. This showed a lack of understanding of the requirement.

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

The following common mistakes arose:

- The calculation of the allowances for doubtful debts was very poorly answered. Very few candidates could determine what the deduction was 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 on the boiler.

- Often the capital allowance on the old boiler was not claimed or was claimed at 40%, instead of 20%.
- Where amounts are received on the disposal of a capital asset, a determination of recoupment or scrapping allowance must be made. Thereafter capital gains tax must be considered.
- As the old boiler was replaced the recoupment had to (could) be deferred. This was not always the case in candidates' solutions.
- On the capital gain candidates did not reduce proceeds by the recoupment nor was the base cost reduced by the capital allowances claimed. Instead proceeds were based on the R105 000 and base cost on R100,000.
- The damages awarded to the boiler maker was often not clearly dealt with.
- Finally candidates generally struggled with the application of s18A and the donations deduction. The deduction under s18A is limited to 10% of taxable income.