# Examiner's report
# F6 (ZAF) Taxation
# June 2017

## 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 consisted of 4 questions worth 10 marks each and 2 longer questions worth 15 marks each. The questions tested the candidates' understanding and application of tax 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. 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.

### Example 1

James sold 15,000 shares in TG Ltd for R100,000 on 15 November 2016. The base cost of these shares was R30,000 when James bought them in February 2010. The disposal of the TG Ltd shares was James's only capital transaction in the 2017 year of assessment. James had an assessed capital loss brought forward of R15,000 from the 2016 year of assessment.

**What is James's taxable capital gain or assessed capital loss for the 2017 year of assessment?**

A James has an assessed capital loss to carry forward of R15,000
B James has a taxable capital gain of R22,000
C James has a taxable capital gain of R15,000
D James has a taxable capital gain of R6,000

This calculative question required candidates to work out the taxable capital gain/assessed capital loss for an individual disposing of shares. The correct answer was D: (R100,000 – R30,000) – R40,000 (annual exclusion) – R15,000 (capital loss) = R15,000 x 40% inclusion rate = R6,000. Candidates must remember that key information is contained in the tables to the examination. A number of candidates forgot to bring in the 40% inclusion rate.

### Example 2

Manu Ltd acquired a new machine for R500,000 on 1 June 2015 to be used for manufacturing purposes. The company has a year end of 31 March each year. On 15 April 2016, Manu Ltd moved its factory from one location to another. The cost of moving the machine to the new location was R60,000.

**What amount of deduction can Manu Ltd claim in respect of the machine for the year of assessment ended 31 March 2017?**

**A** R112,000
**B** R120,000
**C** R160,000
**D** R224,000

This calculative question required candidates to work out the deduction a company could claim in respect of the acquisition and moving costs of a machine. The correct answer was B: (R500,000 x 20%) + (R60,000/3 years) = R120,000. Most candidates did not realise that the moving costs were spread over the remaining useful life of the machine. Candidates either deducted the moving costs in full with the allowance (option C) or added the costs to the cost of the machine and applied the current rate.

<u>Section B</u>

Question One

This 10-mark question examined the candidates' ability to calculate the taxable capital gains / capital losses in terms of the $8^{th}$ Schedule to the Income Tax Act.

In part (a), for 6 marks, candidates were required to calculate the capital gain / capital loss for a natural person operating a small business as a sole proprietor arising from the disposal of a warehouse and a forklift in the 2017 year of assessment.

With reference to the disposal of the warehouse, candidates generally correctly applied the time apportioned base cost formulae (TABC) to calculate the capital gain / capital loss.

Very few candidates, however, correctly calculated the capital gain / capital loss on the disposal of the forklift. In this instance, candidates did not identify all the steps required to calculate the capital gain / capital loss. For example, the majority of the candidates correctly identified that the tax value was 'nil'. However, most candidates did not pick up that they were required to calculate the recoupment (i.e. the selling price – tax value) which was subsequently subtracted from the sale price and amounted to 'nil'. For candidates that did not pick up all the requisite steps in the calculation, they merely applied the selling price (R150,000) less the costs (R600,000) amounting to a capital loss of R500,000.

In part (b) for 4 marks candidates were required to calculate the taxable capital gain / assessed capital loss. In this regard, candidates generally correctly identified the annual exclusion and the assessed capital loss brought forward (given in the question). Some candidates, however, applied the 80% inclusion rate, failing to recognise that the natural person inclusion rate (i.e. 40%) should have applied.

Further, most candidates, did not identify and apply the natural person small business capital gain exclusion limited to a maximum of R1,800,000 in calculating the capital gain. Identifying this exclusion constituted 1 mark out of the 4 mark question (i.e. 25% of this part of the question).

Question Two

This 10 mark question required candidates to calculate input value added tax (VAT) and output VAT arising from a set of transactions undertaken by Furniture Design & Deliver Ltd (FDD).

Part (a) for 8 marks required the candidates to tabulate the 'Input VAT' and 'Output VAT' arising from the transactions, and provide a brief explanation for any transactions which does not result in either 'Input VAT' or 'Output VAT'.

The majority of the candidates performed well on part (a), correctly identifying the 'Input VAT' and 'Output VAT' arising from the transactions, illustrating it in a table format and providing reasons where no 'Input VAT' and 'Output VAT'. Some candidates failed to achieve the maximum marks available because they did not provide a brief explanation when transactions did not result in either 'Input VAT' or 'Output VAT'.

The following common mistakes were noted:

- Identification of the insurance premium as an exempt supply.
- Accounted for 'Input VAT' on the guest reception dinner.
- Treated bank charges as an exempt financial service and accordingly did not account for 'Input VAT'.
- Failed to identify that VAT at the standard rate applied to local delivery.
- Candidates' solutions often did not clearly show whether the amounts were 'Input tax' or 'Output tax' as instructed in the question. We would therefore suggest that candidates refer to the solution published and the format followed in the solution as a future guide.

In part (b) for 2 mark the candidates were required to calculate briefly explain why the invoice from the delivery service provider was incorrect. Candidates failed to identify the issue, namely, the fact that FDD was not a fuel-supplying vendor who consequently does not qualify for zero rating.

## Question Three

This 10 mark question required covered topics relating the calculation of taxable income for micro businesses and small business corporation.

Part (a) for 2 marks required candidates to calculate the tax payable for the micro business for the 2016 and 2017 years of assessment. Candidates did not perform particularly well on this part. Candidates were required to identify that in the 2016 year of assessment, no tax was payable as there was no turnover. Further, for the 2017 year of assessment, candidates had to apply the formulae (provided in the question paper) in order to calculate the tax payable.

Based on the result for this question, it appears that candidates did not understand how to calculate the tax liability for a micro-business.

In part (b) for 8 marks the candidates were required to calculate the tax payable where the entity is classified as a small business corporation for the 2016 and 2017 years of assessment. Candidates had to, firstly, identify that the expenses incurred in the 2016 year of assessment constituted 'pre-trade expenses' that may be deducted once trading commences in the 2017 year of assessment.

Majority of the candidates did not identify the 2016 expenses as 'pre-trade expenses' that had to be taken into account in the tax payable for the 2017 year of assessment. Some candidates incorrectly included the interest expense incurred in respect of the bank mortgage as qualifying pre-trade expenditure. In addition, candidates failed to calculate the correct building allowance and wear and tear amounts.

Further, candidates did not calculate the tax payable correctly, by applying the correct rates (provided in the question paper). Rather some candidates applied 28%, being the normal company tax rate.

Lastly, because candidates failed to identify the 'pre-trade expenses', they calculated the 'inventory acquired' and 'closing inventory' amounts incorrectly.

## Question Four

This 10 mark question required candidates to calculate the travel allowance that will be included in taxable income for normal tax purposes.

Part (a) for 6 marks required candidates to calculate the travel allowance amount to be included in Andile's taxable income (part (b) of the question). Majority of the candidates did not perform well on part (a).

The following common mistakes and inaccuracies were noted:

- Candidates' solutions to this question often lacked the understanding of the steps required to calculate a travel allowance; namely; calculating the actual expenses and separately, the deemed expenses.
- Candidates' solutions did not clearly identify that there were no fuel costs in the actual expenses as all business fuel was reimbursed.
- Candidates' solutions did not apply the ratio of the business kilometres to the total kilometres travelled (i.e. 30,000/40,000) to calculate the reduction amount.
- Further, candidates' solutions did not correctly calculate the cents per km for the deemed expenses.

In summary, candidates' solutions illustrated that they did not have a clear understanding on how to calculate a travel allowance.

Part (b) for 4 marks required the candidates to calculate the normal tax payable by Andile. Although most candidates performed well in this part, it was however noted that some of the candidates failed to subtract the rebate amount (i.e. R13,500) and employees tax already paid (provided in the question).

## Question Five

This 15 mark question required candidates to calculate the income tax or assessed tax loss for a company, Compress Health Ltd for the 2017 year of assessment.

The scenario provided that the sale of stockings were made on two bases, stockings sold to the health industry on orders received (after the receipts of a 50% deposit) whereas stockings to the sports industry are invoiced on delivery. Candidates had to apply the principles of the Income Tax Act to determine which amounts would be included in gross income and 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 for closing stock was not answered well. Some candidates failed to include the manufactured stock and deduct the stock sold as well as the closing stock held by disposed into the calculation of closing stock.
- Some candidates failed to take into account the 25% mark-up on costs for calculating the amount of the stock not delivered and for the order cancelled for damaged stock.
- The calculation of the bad debt and 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.
- Some candidates failed to calculate the scrapping allowance on the old machine. Most did not correctly calculate the allowance (i.e. 60% x R500,000) and deduct the proceeds (being R50,000).
- Capital gain / capital loss calculation was generally not well answered. Candidates omitted to take into account the scrapping allowance in the determining the base cost amount.
- Some of the candidates did not use the supplied wear & tear allowance rates in respect office furniture, computer equipment and other machinery.

- Some of the candidates failed to include the sponsorship cash payment and the stock: recoupment amount (R8,000) in the taxpayer's taxable income.

In part (b), for 2 marks, candidates were required to identify when output VAT must be levied by Compress Health Ltd to the health industry. Candidates were directed to point one of the questions i.e. candidates were required to consider the fact that orders from the health industry are received after a receipt of a 50% deposit. The majority of candidates neglected this fact and, as a result, candidates did not answer this part satisfactorily. It was also noted that a few candidates did not draft any response to this part. This could be due to time pressure or the candidate weighing up whether to spend their time on a longer question than the 2 mark question.

### Question Six

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 environmental consultant for Green Design Architects Ltd (GDA) and, in addition, earns income from his business venture of trimming trees on weekends as a trained arborist (tree specialist).

Part (a) for 2 marks required candidates to calculate the total employees tax which Arnold must withhold in respect of his four-person team. A common mistake made by most of the candidates is that they failed to identify that the employees all earned below the tax threshold and that accordingly, no employees' tax should be withheld.

Part (b) for 13 marks required candidates to calculate the normal tax liability of Arnold based on his salaried income and tree trimming trade income.

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

The following common mistakes and inaccuracies were noted:

- Some of candidates failed to include the Employer contribution fringe benefit in Arnold's remuneration.
- Some of the candidates incorrectly calculated wear & tear amounts of the chainsaws, chipper and truck – these rates were however provided in the question.
- Some candidates included the municipal fine (R70,000) in determining the normal tax liability and failed to identify the cost as a genuine business risk of the taxpayer's tree trimming business.
- The majority of the candidates did not fairly address the determination of the contributions to provident and retirements funds.