

Examiner's report

F6 Taxation (BWA)

December 2013

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General Comments

The paper consisted of 5 compulsory questions. One question was for 25 marks, another for 30 marks and the remaining three for 15 marks each. Questions 1 and 2 count for 55 marks and so therefore should be given priority by candidates since it is performance in these two questions which will ultimately determine the difference between passing and failing.

The overall standard of the answers was average but there were many candidates who did not demonstrate sufficient understanding of the mechanics of a tax computation. In practice a tax computation has to be prepared at least once a year for every business and if it is wrong the implications can be significant. Therefore, an understanding of the mechanics of the tax computation is essential to any businessman and is central to this paper. It cannot be stressed enough that in order to pass this paper candidates must have a reasonable ability to perform a tax computation and this comment has been made on virtually every past paper.

Candidates tended to find questions 1 and 2 difficult whereas questions 3, 4 and 5 were more straightforward. Even if considered difficult, candidates must give priority to answering the first two questions as they carry the most marks. Whilst most candidates scored well on questions 3 – 5 this is generally not sufficient to pass the exam. Exam technique in general could be improved. Some common issues found were -:

- Significant crossings out. Obviously no marks are given to answers that have been crossed out but it is the time factor that is most important. Most crossings out are at the beginning of the exam indicating that the candidate is suffering from exam nerves. It is recommended that candidates chose one of the smaller questions which they are comfortable with to start with and then tackle the first two questions;
- Some candidates left questions 1 and 2 to the end and then found themselves under pressure to finish. This is not recommended;
- In a few cases candidates started a question from the end – ie first answered 4(d) before answering 4(a). Again this is not recommended because the last part of a question often involves answers to earlier parts. It is better to start at (a) and then work through to (d).
- General time management – it was evident that some candidates were under time pressure at the end. Candidates must give themselves every opportunity to pass and this means tackling every question during the time allotted and managing the time taken on each question is crucial.

Specific Comments

Question One

The first question is always for 25 marks and relates to an individual (or partnership) who carries on business on their own account as well as having income from a number of different sources such as interest, rent etc. Very often with individuals their personal tax affairs get mixed up with their business tax affairs and so it is necessary to identify which transactions are for the business and which are personal. Personal transactions must be separated as they do not form part of the individual's business income although they might be taxable in their own right.

Section 1(a) related to disposal gains and should have been straightforward but full marks were rarely obtained. There were two disposals – property and shares. The shares, although listed on the Botswana Stock Exchange, are liable to capital gains tax because they had not been owned for a minimum period of 1 year. Most candidates did not claim the legal fees or the moveable property allowance as a deduction.

Section 1(b) was not well answered. Candidates were required to calculate chargeable income from rents and therefore income and expenses relating to the property needed to be separated from other amounts. However many candidates failed to do this. It is necessary with individuals to determine what constitutes gross income and what does not – for instance a bank loan received does not constitute income. Other points for candidates to note were that the rental income was net of withholding tax and therefore needed to be grossed-up for tax purposes and that a security deposit is not gross income until such time as it is forfeited.

Very few candidates were aware that there were 2 calculations required in 1 (d) to determine the tax payable – one for income tax and the other for capital gains tax which are taxed according to different rates.

Many candidates in 1(e) were not aware that if interest paid by a bank or building society is paid to an individual and 10% withholding tax is deducted then that is a final charge to tax and there is no further requirement to declare the interest in the tax return.

Question Two

The second question is always for 30 marks and relates to a corporate tax situation. Again this was not well answered.

Candidates appear to be confused over the difference between rollover-relief and holdover-relief although it should be mentioned that both expressions are colloquial and are not mentioned in the Act. Rollover-relief is where a balancing charge arises on the disposal of a moveable asset and the balancing charge is used to reduce the cost of the new replacement asset. Holdover relief, on the other hand, is where a capital gain arises on the sale of immovable property and the gain is used to reduce the cost of the new property. Therefore, one relates to income tax and the other relates to capital gains tax but note that there is no rollover relief in respect of immovable property. (It is appreciated that the word “rollover relief”, which is not used in the Income Tax Act, tends to be used for both situations and this is possibly what leads to confusion. The word “holdover relief” is also not used in the Income Tax Act, but better suits the capital gains situation).

Therefore in 2(a) there was rollover relief in respect of the equipment sold and there was holdover relief for the sale of Xanaka Safari Lodge. Care was necessary here as the cost of the new equipment is reduced for the purposes of calculating capital allowances but not for the new lodge – the capital allowances relating to the disposal of Xanaka Safari Lodge should be included in taxable income as a balancing charge.

However, the base cost of the new lodge is reduced by the “holdover relief”– ie the capital gain arising on the disposal of Xanaka. Here candidates should note that the answer does refer to “rollover relief” and no marks were lost whichever expression was used. This is admittedly a complex technical area for candidates.

Part 2(d) related to the calculation of capital allowances. Although this is a regularly tested area, it was not dealt with satisfactorily by many candidates. Most candidates did build up the cost and accumulated allowances of the assets in the correct manner but in this case many did not get the correct cost of the new lodge because they had deducted the capital gains despite the fact, as stated above, that rollover relief does not apply to immovable property. In the case of the equipment, many candidates failed to deduct the balancing charge. This then resulted in incorrect calculations for capital allowances. Additionally, not all candidates were aware that a hotel (and a safari lodge falls within the definition of a hotel) is an industrial building and therefore an initial allowance of 25% of the cost can be claimed.

Part 2(e) was reasonably answered but very few candidates correctly calculated the deduction that could be claimed for management fees paid to non-residents; a taxpayer can only claim a deduction for management and consultancy fees paid to a non-resident if the withholding tax has been paid in that tax year.

Part 2(f) relating to the VAT requirement for zero-rating a going concern sale was generally well answered.

Question Three

This was a VAT question and most candidates scored reasonable marks.

Many had trouble in explaining the nature and scope of VAT but were fully aware of the various types of supply. Most candidates scored well on the VAT computation. However, a lot of candidates made the error of stating that the profit or loss on the sale of an asset is a supply; the sale of the asset is the supply.

Question Four

This question related to when withholding tax needs to be deducted. It is not enough to simply say “withholding tax should be deducted”; reasons must be given as required in the question and the bulk of the marks were allocated to the reasons.

Withholding tax is liable to be deducted from both payments to residents and non-residents and the rates are given within the tax rates and allowances information provided at the beginning of the paper. This information should have assisted candidates when answering the question.

Tax needs to be deducted from the following payments to residents – interest, rents, commissions and construction. Tax needs to be deducted from the following payments to non-residents – interest, royalties, management and consultancy fees, rents, commissions and construction.

There are various exceptions but rent paid to an individual is not one of them.

Part 4(b) was generally not well answered. It required a quantification of the withholding tax payable and it was surprising how many candidates got the rate wrong despite it being provided in the tax rates and allowances information at the beginning of the paper.

Question Five

The question looked at the taxation of an employee and the various requirements applicable to PAYE and was generally well answered.

It is common nowadays for employees to receive “employment packages” and their remuneration can take several different forms – i.e. provision of a company car, pension, medical aid etc. Thus structuring of packages becomes important so that the individual can minimise the impact of taxation.

Most candidates tackled the part of the requirement relating to the computation of taxable income well and were aware of the fact that leave encashment and the labour dispute award fall within gross income. Equally any allowance – in this case a cell phone allowance – is taxable as additional salary.

Part (b) could have been answered better by many candidates. It related to PAYE and what should be deducted, in respect of which kinds of receipts. It also tested the document – ITW8 – which is provided to the employee and serves as the basis of that person’s tax return. PAYE affects almost every working person’s life and so a reasonable understanding is required. The basis of any PAYE deduction is the tables that are provided by the Botswana Unified Revenue Service.