Examiner's report
F6 Taxation (BWA)
December 2014

General Comments
The examination consisted of five compulsory questions. One question was for 25 marks, one for 30 marks and the other three questions were for 15 marks each.

The majority of candidates attempted all five questions but, noticeably, many candidates did not attempt to answer each part of the question. It is not certain whether this was due to time pressures or lack of knowledge but it is critical that candidates answer ALL parts of the questions in the paper if they are to give themselves a reasonable chance of passing. Candidates should make an attempt to answer a requirement even if it is on an area which they find difficult.

Candidates' performance this sitting was reasonable and well prepared candidates achieved satisfactory marks. Question 5 appeared to be the question which candidates found the most challenging.

Candidates performed well on questions 1(b), 1(c), 2(a), 3(a), and 3(c) – which totalled 52 marks. The questions candidates found most challenging were questions 1(a), 1(e), 2(b), 2(c), 3(b), 5(b) and 5(c) – which totalled 27 marks. The remaining questions for 21 marks produced mixed results. Overall many candidates did not appear to be sufficiently prepared for the exam.

A number of common issues arose in candidates' answers as follows:

- Failing to read the question requirement clearly – particularly question 5.
- Poor time management between questions.
- Not learning lessons from earlier examiner's reports and hence making the same mistakes.
- Too many crossings out of work done putting the candidate under time pressure.
- Not attempting all question parts.
- Poor expression in English.

Specific Comments

Question One
This 25-mark question was based on Andrew Donaldson who is a non-resident but earns various types of income from a Botswana source and the focus of the question is which taxes his income is subjected to.

Many candidates were not able to answer question 1(a) satisfactorily as they were not aware of the differences in the taxation of residents and non-residents. Andrew is a non-resident because he is physically present in Botswana for less than 183 days in the year and this means that certain types of his income are subject to a final withholding tax – i.e. interest income. However, his Botswana rental income and directors fees are subject to normal income tax (at non-resident rates) and any tax withheld can be claimed as a credit.

Question 1(b) required a computation of net rental income and most candidates tackled this question part well. A taxpayer can claim direct costs as a deduction against rental income including capital allowances on fixed assets such as air conditioners.

Question 1(c) required candidates to calculate Andrew's taxable income in Botswana. Any person who earns income from a Botswana source is going to pay tax in Botswana and the question is whether the income is subjected to a final withholding tax or whether it is liable to Botswana normal income tax or a combination of both. Andrew's taxable income included a capital gain on the sale of some shares together with net rental income and directors fees. The interest received has been subjected to a final withholding tax because Andrew is a non-resident and so this should not be included in taxable income. In general, candidates were not able to distinguish between the income that is subject to normal income tax and that which is subject to a final withholding tax charge.

Most candidates did not provide satisfactory answers to question 1(d). The question required a calculation of Andrew's tax charge and his net tax payable after deducting any tax withheld at source. With regard to the calculation of the tax charge there were 2 issues that needed to be taken into consideration – (i) there are 2 different rates involved – one for ordinary income and the other for capital gains and (ii) the non-resident rates apply to Andrew. In addition, many candidates did not apply the tax credits correctly; credits could only be claimed in respect of rentals received and in respect of directors fees; credit cannot be claimed for tax withheld on dividends and interest as these are final charges to tax. If the income is not brought into charge – such as interest received - then the tax withheld cannot be claimed as a credit.

Many candidates struggled with question 1(e) and stated that Andrew should register for VAT as his rental income is in excess of the registration threshold. Residential rent is an exempt supply and is not liable to VAT and equally inputs cannot be claimed. The correct answer is that Andrew cannot and should not register for VAT because he makes exempt supplies.

Question Two

This 30-mark question was based on Modikane Manufacturing and covered the topics of corporate taxation as well as VAT. It is essential that candidates have a good working knowledge of the mechanics of a tax computation at F6 but this knowledge was not evident from all candidates' scripts.

Question 2(a) contained a corporate tax computation and included disallowable expenses and provisions and IFRS accounting items that all required adjustment in the computation. In general, candidates did not score as well as they might have done. Whilst there was an indication that candidates have a reasonable grasp of the mechanics of a tax computation many did not have sufficient knowledge of which items require to be adjusted. Most provisions have to be adjusted since the expense has not been incurred and the same applies to the fair value adjustment. In addition, in Botswana, certain payments to non-residents – interest, royalties and management fees – are only deductible if the relevant withholding tax was paid during the financial year. However, payments of interest and royalties to residents do not need to be adjusted whether the withholding tax, if applicable, was paid or not. In this question, interest was paid to both residents and non-residents but only the interest paid to non-residents needed to be adjusted in the tax computation; payments of interest, rent and royalties to residents are deductible and do not require adjustment.

Normally penalties – i.e. statutory penalties – are not deductible since they are not incurred in the production of assessable income. However, in the case of contractual penalties – i.e. for late delivery of work consequent to a written contract – it is considered that these are a natural concomitant of the company's business and there is a sufficient nexus between the company's income and the penalty and therefore it is deductible.

The requirement of question 2(a) (ii) was to calculate the withholding tax on the declaration of a dividend which was equivalent to 45% of the company's after tax profits. This required a calculation of the tax charge on the taxable income calculated in question 2(a) (i) and this figure then to be deducted from the given net profit per the accounts. Many candidates calculated the tax on 45% of the net profit rather than on the taxable income as calculated in part (a) (i).

Candidates were required in question 2(a) (ii) to calculate the VAT payable assuming the results given in the question were in respect of a tax period. Most candidates were aware of the fact that provisions, impairments and fair value adjustments have no VAT impact. However, many candidates calculated output VAT on the profit on the sale of the fixed assets – VAT is levied on the gross sale proceeds.

The answers to question 2(b) demonstrated that many candidates do not know that a VAT liability is triggered on the earlier of the issue of a tax invoice and receipt of cash. This is fundamental VAT concept.

In part (c), many candidates appeared to have little knowledge of Departmental Guidance Notes (DGNs) and their purpose and, in fact, some candidates did not even attempt to answer question 2(c). From an investor's point of view, and Botswana is trying to attract investment, such documents are extremely important because they spell out how the Revenue Authority interprets various sections of the legislation and they provide some degree of certainty as to how transactions will be taxed.

Question Three

This 15-mark question was a mixed capital gains and VAT question. Question 3(a) required a CGT calculation of the sale of a property, shares and goodwill. Many candidates performed very well on this part of the question. The sale of goodwill is treated in the same manner as a sale of shares. Capital gains arising on the sale of immoveable property can be rolled over against the cost of a new property which is used in the business. However, many candidates missed this aspect.

Question 3(b) required candidates to state the base cost of the new property once rollover relief had been applied and the answer was P0. The cost of the new property was P1, 750,000 and against this a capital gain of P2, 046,386 was applied but this was limited to the cost of the new property. Many candidates struggled with this part of the question

Candidates were tested in question 3(c) on their knowledge of the VAT on the capital transactions that had taken place in question 3(a). Many candidates demonstrated a good knowledge of the principles tested here and correctly classified the outputs and inputs between taxable and non-taxable supplies.

Question Four

This 15-mark question tested candidates' knowledge of tax administrative issues and performance was mixed. Some candidates demonstrated a lack of knowledge relating to tax administration. The subject is of significant importance, both to the F6 exam and in the real world, since failure to comply with the revenue laws can result in penalties and interest.

The question required written answers and there was evidence of some poor expression in English in scripts. In addition, some of the written answers were extremely vague and ambiguous. In order to maximise their marks, candidates must give a reasoned explanation and the number of marks that the question carries will indicate the level of depth required in the answer. Question 4(a) was for 4 marks and thus a one line answer will not be sufficient but, on the other hand, a full page answer is too long.

Many candidates stated that a direct tax is tax that is charged directly on salaries such as PAYE. PAYE is not a tax but instead is a means of collection. A direct tax is a tax charged on income or property or wealth whereas an indirect tax is imposed on transactions – eg VAT.

Administrative issues tend to be ignored by many candidates in the course of their revision. Such candidates are cautioned against disregarding this important area of the F6 (BWA) syllabus. As well as being important for the exam, this is also an area of importance to accountants in practice who face these types of issues on a daily basis.

Question Five

This 15-mark question related to a tax efficient employment package. This question proved to be challenging for candidates. However, more marks could have been scored had candidates read the question with more care.

Pentagon Paints has 3 senior employees who are all currently earning a cash salary. However, each of the employees wants to structure their employment package in a different way and this is agreed to on the condition that the cost to the company remains the same as before. This is not an uncommon situation in practice with many employers adopting the total employment package concept.

Part (a) of the question required a calculation of the tax suffered by the senior employees on their current package and most candidates tackled this fairly well. However, many candidates struggled with part (b) due to a failure to read the question correctly. The purpose of this part was to calculate the new cash salary (which in turn resulted in a new pension deduction) so as to accommodate the fringe benefits that each employee wanted to include in their package. This involved a consideration of the cash flow impact to the company of the desired fringe benefits. For example, candidates were told in the scenario that the annual cost to the company of providing a company car would be 25% of the relevant car's cost. However, rather than using this figure, many candidates used the tax value of the car benefit, which was not addressing the requirement for this part of the question. There is a tendency with such questions for candidates to fail to distinguish between the requirement for cash flows and tax values in the calculation. Careful reading of the requirement should help here.

The final part 5(c) was the calculation of the tax on the new packages and then a comparison of the tax suffered under the two packages. In this part of the question, the tax values of the fringe benefits needed to be applied.

Comparisons of employment packages are something which happen regularly in practice and F6 (BWA) candidates should be prepared to encounter similar simple tax planning scenarios in future questions.