

# Examiner's report

F6 Taxation (LSO)

December 2013



## General Comments

The examination consisted of five compulsory questions. Question 1 for 30 marks and question 2 for 25 marks. The three further questions carried 15 marks each.

The vast majority of candidates did attempt all five questions and there was a little evidence of time pressure. Where questions were left unanswered by candidates,; this appeared to be due to a lack of knowledge or poor exam technique, as opposed to time pressure. The questions which were most frequently left unattempted by candidates were questions 1(d), 2(b) and 2(e).

A small minority of candidates answered question 1 and 2 last and their answers were often incomplete. Both questions carry the highest marks and answering them last can be a risky strategy, as many such answers were incomplete or appeared rushed.

The overall performance for this sitting was not satisfactory. This appeared mainly due to candidates not revising core syllabus areas sufficiently well; a lack of technical knowledge and also a failure to read the question requirements carefully. Whilst most candidates appeared to be conversant with the technical aspects of question 2(a), 2 (d) and the whole of question 4, they often failed to achieve strong marks due to a failure to read the requirements of the question carefully.

A number of common issues arose in candidate's answers:

- Failure to read the question requirement clearly and therefore providing irrelevant answers which scored few if any marks.
- Failure to effectively revise all parts of the syllabus.
- Not learning lessons from earlier examiner's reports and hence making the same mistakes, especially in relation to the calculation of fringe benefits.
- Failure to show all relevant workings clearly.
- Illegible handwriting and poor layout of answers.

## Specific Comments

### Question One

This 30-mark question was based on the taxation of a partnership and included changes in a partnership constitution. Many candidates demonstrated a lack of technical understanding of the key principles where the constitution of a partnership changes.

Part (a) for 2 marks required candidates to describe how the residence of a partnership is determined. This was adequately answered by most candidates.

Part (b) for 6 marks required candidates to calculate notional chargeable income for the year. Most candidates did not perform well on this part. Many candidates struggled with determining the allowable expenses, which mainly focussed on the tax treatment of the severance payment, superannuation fund contributions and losses brought forward. Candidates are expected to be familiar with the treatment of these items because they are so frequently examined. Many candidates confused the deductibility of severance payments as an allowable

expense to an employer, and its exemption in the hands of employee. Candidates also struggled with the allowable contributions and treatment of losses brought forward. In addition, many candidates encountered problems when dealing with gains/losses of the assets arising upon the change in the partnership constitution. Instead of recognising the gain/loss in determining notional income, some candidates referred to the changes as depreciation which they then included as part of the allowable expenses. It was apparent that many candidates had not revised reconstitution of the partnership.

Part (c) for 14 marks required candidates to calculate the tax payable by each of the partners. This part was not dealt with adequately by most candidates. In principle, when there is a change in a partnership constitution, gains arising from a deemed disposal of the business assets are taxed on a partner provided that the interest of the partner in the partnership is less than 50%. Based on the given scenario, the only partner who was not subject to tax on the deemed gain was the partner with 55% continuing ownership; the other two were fully taxable. There was a lot of confusion in this part and all the partners were taxed on the deemed gains in many candidates' answers. In some cases, candidates apportioned the income and expenses of the remaining partners according to the new profit sharing ratio incorrectly. Again, dealing with the severance payment, pension contributions and share of trading loss proved problematic. Candidates could have gained more marks had they realised that the severance payment forms part of taxable income (less the M1500 exemption) to the recipient; only resident partners are entitled to a deduction relating to superannuation contributions; and partners are entitled to a share of a trading loss provided that the activity giving rise to the loss would have given rise to Lesotho source income if a loss had not been incurred.

Part (d) for 3 marks was a brief discursive question. This requirement was often not attempted by candidates. Only a handful of candidates answered this part well. The question was a continuation of part (c) above. Similarly, understanding of the tax treatment of deemed disposal of assets determined the accuracy with which this question was dealt. Candidates were requested to explain whether the partners' decision to continue with the partnership was tax efficient. Instead of focusing on how elimination of salaries would result in low chargeable income under the new partnership, candidates could have considered the partners' interest in the new partnership and whether they are above or below 50%, and the tax effect on the gains arising on deemed disposal of business assets. In principle, a partner with a partnership interest which is below 50% will be taxable on the said gains and logically that cannot be regarded as tax efficient.

## Question Two

This 30-mark question covered the general principles of corporation tax. Candidates' performance, in general, was not satisfactory. This appeared to be due to a lack of knowledge in some parts of the question coupled with a failure to read the question carefully.

Part (a) for 4 marks required candidates to calculate the depreciation allowance claimable by the taxpayer who had elected for the pooling method of depreciation for tax purposes. Many candidates scored well on this part of the requirement. Where marks were lost, this tended to be because of a failure to carefully read and understand the information provided in the scenario. A motor vehicle acquired on hire purchase agreement was often ignored in the calculations. Candidates should be advised that the depreciation charged for assets acquired under this type of agreement is calculated on the adjusted cost base (ACB), which is the actual cost. The closing balance on the furniture and equipment was a credit as result of an excess of disposal proceeds over ACB. Many candidates showed a general lack of knowledge in regard to the tax treatment of the excess, which should be treated as part of business income.

Part (b) for 2 marks tested candidates' knowledge regarding the tax treatment of a redemption of shares by a company. While some candidates showed a lack technical knowledge, there were still a significant number of candidates who presented very good answers.

Part (c) for 4 marks required candidates to calculate advance corporation tax (ACT) payable by the taxpayer. This was basically a continuation of part (b). Candidates who provided calculations rather than narrative in part (b) were stuck and some of them ignored this part. Candidates were expected to recognise the following in their calculations for ACT: deemed dividends; and dividends paid during the year reduced by Lesotho source dividends. The amount off Lesotho source dividends received are excluded because this is qualified income, and ACT is deemed to have been paid first out of qualified income. Many candidates, however, lost marks because they only recognised deemed dividends and dividends paid during the year.

Part (d) for 18 marks required candidates to calculate corporation tax payable starting with the turnover figure as given in the question. The main problem encountered was that many candidates attempted to adjust the turnover for expenses disallowed and exempt income which was irrelevant in this case. The income was still gross. The approach candidates should have taken was to adjust the expenses and deduct them from income to arrive at chargeable income. With regard to the adjustment of expenses, many candidates demonstrated confusion largely as a result of a failure to read the contents of the question. A typical example was the motor vehicle running costs which were given inclusive of the down payment of a delivery van acquired under a hire purchase agreement. Many candidates allowed the down payment and monthly instalments as deductible expenses which was incorrect. In principle, the allowable deduction is interest payable and candidates were expected to calculate the correct amount of interest to deduct.

Part (e) for 2 marks was the last part of the question and required candidates to explain the tax treatment of donation to local sports associations. The question was often omitted by candidates. For those candidates who were able to attempt this part, most of them just stated that donations are disallowed for tax purposes. Only a significant minority of candidates recognised the conditions imposed on the deductibility of this type of donation. Candidates should note that a deduction is available if it is of M1,000 or more and is paid to the Lesotho Sports and Recreation commission, who will then distribute it to the organisation /individual specified by the donor. This was not the case with the taxpayer in question.

### Question Three

This 15 -mark question was on Value Added Tax (VAT). Candidates' performance on this question, in general, was relatively satisfactory.

Part (a) for 8 marks required candidates to calculate VAT payable by the vendor. A number of common mistakes in candidates' answers were noted as follows:

- Failure to distinguish between input VAT and output VAT. As noted before, the difference between the two is crucial.
- Failure to carefully read the information provided in the question. This was evidenced by many candidates charging VAT as if the amounts were exclusive of VAT, yet it was clearly stated that all amounts were inclusive of VAT.
- Failure to determine the taxable value of second-hand goods. Instead of charging output VAT on the difference between the sales price and cost of acquiring the second hand goods, many candidates charged VAT on the whole amount of the sales price
- Failure to determine the value of supply for the hire purchase sale. Many candidates charged output VAT on the deposit paid which was not correct. In this case, the Act provides that the value of supply is the fair market value of the supply, as the time of supply is when the hire purchase contract commences. Candidates were expected to charge output VAT on the full cash value.

- A general lack of knowledge with regards to input VAT for sales returns. No input VAT can be claimed without necessary documentation (credit notes). Candidates should note that it is the obligation of taxpayers to keep proper records of their transactions.
- Charging VAT on items which are not taxable supplies such as wages and salaries.
- Charging VAT on exempt supply such as insurance.

Most candidates scored good marks on the calculation of input VAT on opening stock.

Part (b) for 5 marks required candidates to explain the VAT treatment of the second hand computer, hire purchase sale and sales returns. Only a few candidates, who had got the calculations for these items right in part (a), answered this part well.

Part (c) for 2 marks required candidates to state the due date for submission of a VAT return, and to calculate the penalty due because of late submission. This part was adequately dealt with by most candidates.

#### **Question Four**

This 15-mark question was based on the calculation of fringe benefits tax (FBT). The overall performance in this question was not satisfactory. Whilst most candidates appeared to have a general knowledge of the calculation of FBT, they failed to pick up as many marks as expected. The main contributing factor was, again, a failure to carefully read and understand the question.

Part (a) for 7 marks required candidates to first calculate the annual amount of FBT that would be payable in respect of the fringe benefits provided to the employee, and to describe the procedure by which FBT is paid. Many candidates calculated FBT for the two months period because the employee in question assumed his duties two months before the end of the year of assessment in question. This was a clear example of a failure to carefully read the question.

The second requirement of part (a) asked candidates to describe the procedure for the payment of FBT. This was generally not well answered. Whilst some candidates described how FBT is calculated, others provided the tax treatment in terms of what is allowable and what is disallowable. The question clearly asked about how the tax is remitted to the Lesotho Revenue Authority. It was sufficient for candidates to think of quarterly returns, when are they filed, and the due date for payment of tax. Only a few candidates scored good marks on this part of the requirement.

Part (b) for 8 marks tested candidates' ability to identify fringe benefits which are treated as part of chargeable income, by comparing the net disposable income under two different offers which were available to the taxpayer, and advise the taxpayer accordingly. Instead of identifying the relevant information for each offer, many candidates showed a lot of confusion as to what to include or exclude. Candidates could have scored higher marks had they focused on the scenario given to calculate the chargeable income, the tax payable and the net income. The advice provided by most candidates was based on incorrect calculations.

#### **Question Five**

This 15-mark question focused on both principles of taxation for corporations, and the obligations of the taxpayer regarding procedures relating to objections and disputes. The overall performance in this question was very satisfactory.

Part (a) for 5 marks required candidates to list the factors used to determine whether a company is a tax resident of Lesotho. This part was strongly answered by the majority of candidates.

Part (b) for 4 marks tested candidates' knowledge of the tax treatment of a branch of a non-resident company in relation to repatriated income. Many candidates demonstrated a general knowledge here, but struggled with the calculation of the tax payable on repatriated income.

Part (c) for 6 marks required candidates to describe a procedure to be followed when there is an objection against an amended assessment, and to indicate whether or not the tax in dispute must be paid. This was generally well-answered, although the time limits were frequently ignored. However, in some cases the responses included procedure for appeals, which did not score any marks because it was irrelevant to the requirement.