

Examiner's report

F6 Taxation (LSO)

June 2012



General Comments

This examination consisted of five compulsory questions. Question one carried 25 marks and question two carried 30 marks. The last three questions were allocated 15 marks each. Question one and two were fully computational, question three combined computations and narrative aspects with more weight on computations, and question four and five were mainly narrative.

The overall performance for this sitting was relatively satisfactory. Excellent answers were presented by most candidates and higher marks were achieved. However, in some instances, a final score was badly affected by not doing well in some of the questions. Most candidates attempted all the five questions. Where some of the questions were not attempted, some parts of question four and an entire question five were often omitted. There were still some candidates who appeared to be unprepared for this examination.

There was clear evidence of poor time management which in most cases affected the last questions attempted. Some candidates could not score higher marks as expected because of their failure to read and understand some of the questions. This was evidenced in part (b) of question one; part (a) of question three and the entire question five, where irrelevant answers were provided. In some cases it was clear that most candidates did not effectively revise some parts of the syllabus. This was evidenced by the quality of the answers which they provided.

There was a slight improvement on some of the candidates regarding layout and presentation of the answers. However, the majority of candidates still need to give more thought to the layout and organisation of their answers. Workings were generally shown but at times were difficult to follow. Candidates should note that without the clear workings it becomes difficult to ascertain how a final answer was derived. Some candidates seemed to mix their workings with the main calculations thus presenting a very untidy layout.

Specific Comments

Question One

This 25-mark question was divided into three parts.

Part (a) tested candidates' ability to calculate tax payable by an individual taxpayer who has both employment and business income. Candidates were also required to indicate items that are either not taxable or not deductible by the use of a zero, giving brief explanations. This last part was frequently omitted in most answers. Most candidates indicated zeros without explanations or at times with wrong explanations. The explanations ought to focus on the tax treatment of fringe benefits which are excluded from taxable employment income because they are either taxable or exempt fringe benefit, not just fringe benefits as most candidates indicated. Candidates should note that, from a tax point of view a fringe benefit can either be taxable or exempt. In the given scenario the business of the taxpayer gave rise to a trading loss. However, some candidates reduced the chargeable income by this loss which was incorrect. Trading loss cannot be set off against employment income; rather it will be carried forward and set off against business income in the following year of assessment. On the same note, failure to calculate allowable pension contribution was a concern. Some candidates allowed both employer and employee contributions. A few candidates recognised that there was allowable fringe benefit tax (FBT) on the motor van provided to the consultancy manager. In this instance, allowing business related FBT as some candidates did was irrelevant because the van is provided for both personal and business purposes; the whole FBT is wholly allowable.

Part (b) basically required candidates to calculate tax withheld by the employer from the salaries of employees (PAYE). The performance for this part was very disappointing due to failure to read and understand the question.

Most candidates demonstrated a lack of understanding of how PAYE is calculated. Some of them calculated tax payable based on the information related to business income. Those who appeared to understand the requirement of the question combined the salaries of the employees. In principle PAYE is calculated on individual employees' salaries. The total tax remitted is, therefore, the sum of individual PAYE calculated on each salary. The due date for monthly withholding tax from salaries was often confused with the submission of the returns for withholding taxes.

Part (c) of the question required candidates to calculate FBT payable by employer in respect of benefits provided to the employee for the 10-month period. Where benefits are not provided throughout the entire year of assessment, a correct apportionment of benefits tends to be the most challenging part for this kind of question. That was particularly so in this case. Furthermore, calculating FBT for each taxable fringe benefit can be time consuming. Candidates are advised to simply add up the taxable values, and calculate the combined taxable amount and then calculate FBT.

Question Two

This 30 mark question focused on the calculation of corporation tax of a non manufacturing company. The overall performance was not bad for the vast majority of candidates. The question was divided into four parts.

Part (a) of the question required candidates to calculate income tax instalments payable for the year of assessment in question which was 31 December 2011. This was incorrectly calculated by most candidates, as advance corporation tax (ACT) and instalments were deducted from the previous year tax payable. The question clearly stated that the tax payable was before deduction of withholding taxes, ACT and instalments paid. Candidates were expected to deduct withholding taxes only.

Part (b) required candidates to explain alternative ways in which ACT can be utilised. This was well done by the majority of candidates, with the exception of some few candidates who mentioned that ACT can be set off against other taxpayer's business liabilities and trading losses.

Part (c) the question required candidates to calculate ACT payable and state the due date of payment. This was also well calculated, however, the majority of candidates hardly recognised that the first and second instalments calculated in part (a) could be used to satisfy the ACT liability and only the remaining balance not covered by ACT was payable on the due date. In addition, candidates should note that where a company has both qualified and other income, the local dividend received should be deducted from total dividend paid when calculating ACT. This is because no ACT is payable to the extent that the dividend is payable out of qualified income. Dividend from another resident company is also part of qualified income.

Part (d) of the question required candidates to calculate the corporation tax payable and state the due date. While stating the due date was frequently ignored by most candidates, it was surprising to note that there were some who got it wrong. Nevertheless, the majority of candidates seemed to be conversant with the basic principles for corporation taxation. This was with the exception of some candidates who seemed to have the tendency to memorise past examination answers. That is, they just provide answers without due regard to the requirement of the question. The typical example relates to treating a taxpayer in this question as a manufacturing company charging tax at the rate of 10%, apportioning administrative expenses between manufacturing and non-manufacturing income, yet all these were not mentioned anywhere in the question. The calculation of taxable business income was found to be challenging by the majority of candidates. Most candidates were confusing accounting and tax profits. Calculation of allowable administrative expenses also posed a problem to some candidates. What was needed from candidates was to carefully read and understand the information given in the question. It is worth mentioning that most candidates were aware of the tax

credits available to the taxpayer, though in some cases were not correctly calculated. These were foreign and local withholding taxes and instalments.

Question Three

This 15 mark question focused on value added tax (VAT). The question was divided into two parts.

Part (a) was narrative and the performance was not satisfactory for most candidates. The question tested candidates' understanding of the treatment of bad debts written off. Coupled with a failure to read the question, it was clear that candidates lack a general understanding of VAT relating to bad debts. Candidates could have gained more marks had they recognised that credit arising from bad debts is claimable only on the later of the date on which the debt was written off in the books of the vendor; or 12 months after the end of the tax period in which the related VAT was paid to the LRA. In this case the tax period was March 2012. According to the VAT Act, the tax period refers to a period of one month ending on the last day of the 12 months of the calendar year. A number of guessed tax periods were suggested including a year of assessment. Some were confusing tax period with a due date of payment of VAT payable.

Part (b) of the question required candidates to calculate VAT payable to or refundable from the LRA. There were a few candidates who still confuse input and output VAT. While most candidates managed to score higher marks on this part, most of them treated revenue from training offered by a vendor as an exempt supply. Input VAT for rent payable in relation to training was virtually excluded. Candidates should note that according to the Act, this kind of exemption is granted provided that an institution was established for the promotion of education and training and it is registered with the Ministry of Education. This was not the case with the vendor in question. In addition to that, input VAT relating to bad debts was often omitted by most candidates who got the first part of the question wrong. If candidates charged water at 5% assuming that it was combined with sewerage, rather than exempt, equal credit was awarded.

Question Four

This 15 mark question was divided into three different parts most of which focused on tax avoidance. Performance in general for this question was satisfactory.

Part (a) of the question tested candidates' ability to differentiate between tax evasion and tax avoidance. While most candidates gained good marks on this part, some were frequently confusing the two concepts. Interestingly, the examples which were given were the same. These were either income splitting, or taxable fringe benefits and fringe benefits which are treated as part of employment income. Income splitting appeared interchangeably as tax evasion or tax avoidance. The main difference between tax evasion and avoidance is a legal aspect; tax evasion is illegal while tax avoidance is legal.

Part (b) of the question tested candidates' understanding of the tax treatment of the lumpsum pension payments. Most candidates failed to attain higher marks as expected due to not reading and understanding the question properly. The question was often misinterpreted as a fixed deposit which qualified for exemption of the first M500 on interest receivable, without realising that once the proceeds are paid out by a pension provider, they should be taxed before they can be deposited, and there should be no tax avoidance. The whole focus was shifted from identifying savings available through reinvesting the proceeds into a complying superannuation fund or purchasing an annuity. By so doing the taxpayer would be deferring the tax until a subsequent payout and thus avoiding tax.

Part (c) of the question tested candidates' understanding of insurance compensation used to reconstruct similar premises. The performance was generally satisfactory. Although the majority of candidates could not explain



explicitly that this is an involuntary conversion which is treated as a disposal for tax purposes, they did differentiate the chargeable gain from the notional gain.

Question Five

This 15 mark question focused mainly on allowable deductions against employment income as provided by Income Tax Regulations 1994 (as amended). Performance was very poor for most candidates. This question appeared to be something new to most candidates. Most candidates confidently mentioned examples of general expenses incurred in the production of income subject to tax, with superannuation fund contribution frequently appearing as one of the examples in most answers. Some provided wealth indicators used to determine minimum chargeable income. Candidates could have attained better marks had they revised all parts of the syllabus.

Part (b) of this question which required the minimum threshold for the expenses to be tax deductible was often omitted. Only a handful of candidates who got the first part right, attained good marks in this part.