

Examiner's report

F6 Taxation (LSO)

June 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 not attempt all five questions. Where questions were left unanswered by candidates, questions 2, 4 and 5 were frequently omitted; this appeared to be due to a lack of knowledge or poor exam technique, as opposed to time pressure.

As in previous sessions, a small minority of candidates answered question 2 last and their answers were often incomplete. Question 2 carries the highest marks and answering it last can be a risky strategy, as many answers presented were incomplete or appeared rushed.

The overall performance for this sitting was not satisfactory. This is mainly due to candidates not revising core syllabus areas well enough; a lack of technical knowledge and failing to read question requirements carefully. A majority of candidates seemed to be conversant with the technical aspects of question 2 (b) and (c) but again failed 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 marks.
- Poor time management between questions, resulting in time pressure to finish remaining questions.
- Not learning lessons from earlier examiner's reports and hence making the same mistakes, especially in relation calculation of fringe benefits and failure to distinguish between input and output VAT.
- Illegible handwriting and poor layout of answers.

Specific Comments

Question One

This 30-mark question was based on taxation of an expatriate with different sources of income. That is, employment income, business income and property. With regard to employment income, the question in general tested candidates' ability to differentiate between payments and benefits which should be treated as part of employment income and those which should be subject to fringe benefit tax (FBT).

Part (a) for 8 marks required candidates to calculate annual tax payable by an employee. Some candidates performed adequately well on this part. But a large number of candidates who could not score higher marks as expected. The main problems encountered were that candidates did not read the information provided in the scenario carefully. Some figures were given on a monthly while others were stated on annual basis, and as such most candidates struggled to provide the correct figures to be included in the calculations. For instance, for the year of assessment in question, taxpayer was to be taxed for 8 months period, this is up until when the employment contract expired. Most candidates included the 12 months salary, allowances and deduction for superannuation fund. The terminal benefits were not treated as part of employment income, rather, frequently confused with pension payments. The exemption for severance payment was wrong in most answers. Instead of deducting M1, 500 some candidates deducted M1, 200, others deducted M1,500 from the gratuity.

Business income was exempted in some answers. Property income which included fixed deposit interest from a local bank and foreign source gain were incorrectly treated. Majority of candidates confused this interest with interest from a nominated savings account (section 27), and as such, the first M500 was very often provided in most answers.

Calculation of the chargeable income was well done by most candidates. Marginal rates were used although some apportioned personal tax credit for 8 months. A large number of candidates incorrectly used 25% standard rate.

Candidates should have firstly identified from the scenario that the taxpayer is an expatriate. The tax treatment of the expatriate is similar to that of a resident taxpayer, that is worldwide income is included in a gross income, with the exemption of foreign source chargeable gains.

Part (b) for 10 marks required candidates to calculate the FBT payable by employer for benefits provided to the expatriate, and also to state when employers should file FBT returns. Majority of candidates did well on this part. However, a common mistake was to calculate FBT for each and every taxable fringe benefit. This is time consuming. Candidates should always sum up the taxable values for all taxable fringe benefits; calculate the taxable amount and the FBT. In addition, some candidates assumed that exempt fringe benefits such as medical expenses are not part of fringe benefits. . Candidates should note that fringe benefits can either be exempt or taxable. Another mistake in most answers was deduction of maintenance allowance from the car fringe benefit. This allowance is part of gross income. Most candidates were not familiar with the period when the quarterly FBT returns should be filed.

Part (c) required candidates to explain the tax position of employer and employee if employer was a Public International Organisation (PIO), based on the given scenario. Candidates were expected to indicate that PIO is exempt from both income tax and FBT, and all the taxable fringe benefits, (as opposed to all the benefits) will constitute part of employment income to the employee.

The last part of this question required candidates to explain the tax obligation of the withholding tax agent regarding fixed deposit interest given in the question. Majority of candidates did not perform well on this part. As mentioned earlier most candidates incorrectly treated this interest as a nominated savings account interest, and they continued to deduct the first M500 exemption before charging 10% withholding tax. The 10% withholding tax is charged on the gross amount of interest. Another obligation of the agent is to remit the tax withheld to the Lesotho Revenue Authority (LRA) within 15 days from the time when it was withheld. This last obligation was however ignored by most candidates.

Question Two

This 30-mark question covered the general principles of corporation tax. The performance in general was not satisfactory. Again candidates did not read the question carefully. Most of them ignored the requirements and adopted their own approach in answering this question.

Part (a) for 6 marks required candidates to describe the conditions which must met by the taxpayer to use a substituted accounting period and to state the reasons why the Commissioner may impose conditions where a permission to use this period is granted. Majority of candidates ignored this part completely, probably because they did not revise it. For those who attempted this part, most of them failed to mention that not all the taxpayers are allowed to use substituted accounting period, that is, it is granted to companies only, and compelling need should be provided.

Part (b) for 12 marks required candidates to calculate chargeable income. The question was given in the form of the income statement, and candidates were to start with the figure for net profit before tax. Most of them ignored this requirement. Basically, candidates were expected to add back disallowed deductions and deduct tax deductible expenses, which were not considered when calculating net profit. Most candidates seemed to prefer copying the information from the question, starting with taxable income, tax deductible expenses, and then calculation of tax payable which was not even part of the requirement, wasting valuable time which could have otherwise been utilised efficiently to score some more marks. As noted in previous examiner's reports, majority of candidates are conversant with principles of corporation tax. But the question can appear in different ways. It is therefore very crucial to always read the question very carefully.

Part (c) for 6 marks required candidates to calculate tax payable and state the due date for the tax return. The last part was frequently omitted in most answers. Again, in this part candidates were required to start with the chargeable income in part (b). There was a lot of confusion on this part. Candidates who calculated tax payable in part (b) were now stuck, and unable to provide the answer. The fact that the answers were mixed up, most candidates failed to recognise that the taxpayer in question is a manufacturing company, the income of which is subject to 10%, and there is also other non-manufacturing income taxable at 25%. In most answers all the income was taxed either at 10% or 25%.

Part (d) for 3 marks to calculate withholding tax payable by the taxpayer. Most candidates appeared to be struggling a lot as most of them attempted to calculate withholding tax on the wages and salaries, which was impossible with the information available. Some of them provided the withholding tax paid on the income of the taxpayer. Another challenging factor for most candidates who managed to identify payments subject to withholding tax, was to apply the correct withholding tax rates, they were not sure whether to use 10% or 25%. Again, most of them could not explain when withholding tax should be remitted to the LRA. Candidates could have scored better marks had they recognised that withholding tax is basically charged on the payments to non residents.

The last part of the question required candidates to calculate the income tax instalment payable by the taxpayer, and state due dates for each instalment. Hardly, anyone of the candidates got the instalments correct. However most candidates scored more marks on the due dates. On the same note, the due date should always show a day, month and year. Most answers showed incorrect years.

Question Three

This 15 -mark question was based on value added tax (VAT). The performance on this question in general was relatively satisfactory.

Part (a) of 9 marks tested the calculation of VAT payable by or refundable to vendor. However, a number of common mistakes in candidates' answers were as follows:

- Failure to distinguish between input VAT and output VAT. As noted before, the difference between the two is very crucial.
- Charging VAT on instalments rather than fair market value of equipment purchased on hire purchase agreement.
- Charging VAT on items which are not taxable supplies such as wages and salaries.
- Failure to distinguish between exempt and zero rated supplies. For instance export sales are zero rated, but in some answers it was exempt. Similarly, water is exempt, but it was zero rated. Again, for items which are excluded, candidates are advised to provide a brief explanation why an item is excluded, instead of showing zero only.
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Part (b) for 2 marks required candidates to explain the difference between zero rated and exempt supply. Majority of the candidates couldn't establish the difference between the two as the end result in both cases is zero. The main difference is that zero rated supplies are taxable supplies, they are considered in determining the threshold whereas exempt supplies are not. Again, input VAT on zero rated supplies is claimable, and it's not case with exempt supplies.

Part (c) for 1 mark required candidates to explain the advantage of voluntary registration. A few candidates got the answer correct. In most cases the answer was not provided. Voluntary registration allows a vendor to claim input VAT.

The last part of the question required candidates to state tax obligations of a registered vendor. Some confused the tax obligations with the requirements of a valid VAT invoice.

Question Four

This 15-mark question was based on the calculation of chargeable income where the taxpayer has both chargeable gains and business income. The overall performance on this question was not satisfactory.

Part (a) for 13 marks required candidates calculate chargeable income. Most candidates seemed to lack knowledge and understanding of determining the adjusted cost base (ACB) where indexation is required. In some cases proceeds were indexed. More revision is required on this area of the syllabus.

In most answers more focus was on the chargeable gains, and the details relating to business income were ignored.

Part (b) for 2 marks required candidates to explain the tax treatment on the disposal of private assets. Most candidates scored full marks on this part.

Question Five

This 15-mark question focused on taxation of long term contracts. The performance on this part was also very bad. Some candidates did not even attempt the entire question. It was apparent that majority of the candidates did not revise this area of the syllabus.

Part (a) for 5 marks required candidates to calculate chargeable income of the taxpayer for two consecutive years. Chargeable income in this case is based on the estimated profit and the percentage of contract completed. Candidates were supposed to know the formulas used to calculate both the estimated profit and percentage of contract completed.

Part (b) for 2 marks required candidate to calculate the withholding tax available to the taxpayer for two consecutive years in question. Again, candidates couldn't attain better marks as expected due to failure to read and understand the information provided in the question. The question clearly indicated the amounts paid, which were stated after the deduction of 5% withholding tax. For both years of assessment candidates were expected to calculate the 5% withholding tax.

Part (c) for 2 marks required candidates to explain why the taxpayer should withhold 5% withholding tax from payments made. Majority of candidates were aware that the taxpayer is a resident contractor, and hence 5% withholding tax is applicable. However, most of them failed to mention that the tax is withheld provided that the payments are in excess of M3,000.

The last part of the question was fairly answered by most candidates who attempted this question. This part of the question required candidates to explain alternative ways in which a contract overall loss can be utilised for



tax purposes, and also to include any conditions which must be met. While majority of candidates provided excellent answers, some candidates were providing ways in which advance corporation tax (ACT) can be utilised which was irrelevant in this case.