Examiner's report

F6 Taxation (LSO)

June 2014

ACCA

General Comments

The examination consisted of five compulsory questions. Question 1 carried 25 marks and question 2 carried 30 marks. The other 3 questions were for 15 marks each.

The vast majority of candidates attempted all five questions, and there was 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.

Candidates performed particularly well on questions 4(a)(i), 4(b)(i), 5(a), 5(b) and 5(c). The questions candidates found most challenging were questions 1(a), 1(b), 1(c), 2(a)(i), 2(a)(ii), 2(e) and the whole of question 3. Most candidates seemed to have a general knowledge in regard to technical aspects of most of these questions but could not attain higher marks as expected due to failure to read the requirements of the questions carefully.

A number of common issues arose in most candidates' answers and were noted as follows:

- Not reading the question requirement carefully.
- Not effectively revising all parts of the syllabus.
- Not attempting narrative parts of the questions.

Specific Comments

Question One

This 25-mark question was based on a calculation of individual income tax of a self-employed taxpayer. The question in general tested candidates' knowledge of determining the correct gross income and tax deductible expenses of the taxpayer. Most candidates performed inadequately well on this question.

Part (a) for 18 marks required candidates to calculate the tax payable for the year of assessment. Some income was stated net of withholding tax; it was very interesting and pleasing to note that most candidates were aware that the income should be grossed up. The gain on disposal was also included as part of the gross income in most answers, which was correct. However, the cash drawings were frequently omitted. The cash drawings are unallowable expenses and as such should be added back to taxable income. With regard to other allowable expenses, such as pension contributions, most candidates were seen allowing the whole amount contributed by the employer, disregarding the ceiling of 20% on employment income. In addition, the majority of candidates got the interest allowable on finance lease incorrect. Candidates could have got this correct had they recognised that the difference between the instalments and the cash price is the interest element. The allowable interest for the year was therefore for 8 months, from August to March.

The second part of this question was to explain how the maximum allowable deduction for a self –provided pension fund is determined, and to calculate the maximum deduction allowable to the taxpayer in question. Instead of first providing a general explanation, the majority of candidates provided incorrect calculations using in most cases either employment income or chargeable income. This is a clear evidence of those candidates not reading the question carefully. The approach candidates should have taken was first to indicate that maximum allowable deduction in this case is 20% of the gross income of the taxpayer. That was adequate for candidates to get good marks on this question irrespective of incorrect gross income.

The third part of this question was poorly answered by a vast majority of candidates. The question required candidates to provide necessary information for proper recording of withholding taxes and to state by when a year end withholding tax return should be filed. Coupled with failure to read the question carefully, some candidates demonstrated a general lack of knowledge on this part of the syllabus. Some provided the penalties for failure to remit the tax withheld which was not answering the question. There were some who mentioned provision of the withholding tax certificates, which was still acceptable, but candidates could have attained higher marks had they detailed the information which is supposed to be reflected on the withholding tax certificate. Again, there was a lot of confusion regarding the due date for both filing a year end withholding tax return and monthly remittance of withholding taxes. The question required the former, which is 28 days after the end of the year of assessment, instead of 15 days after the tax was withheld, which was suggested by most candidates.

Question Two
This 30-mark question was generally based on corporation tax. The question in general was not well answered. Part (a) for 5 marks covered the topics of narrative notes on insurance compensation and expenses incurred prior to the commencement of trading. Most candidates have the tendency to omit narrative questions. In most instances candidates seemed to be very familiar with these areas of the syllabus, but surprisingly, they appeared to prefer providing calculations which were unfortunately often incorrect. Candidates could have scored higher marks without provision of any calculations because the question required explanations. The general observation with regard to some candidates who attempted this question accordingly was that most of their answers were incomplete and at times too vague. With regard to insurance compensation, no candidates recognised that the gain or loss arising between the insurance compensation and the adjusted cost base (ACB) is deferred until the taxpayer disposes the replacement asset

Part (b) for 3 marks required candidates to calculate income tax instalments and state the due date on which each instalment should have been paid. Again a significant majority of candidates seemed to be very conversant with the calculation of income tax instalments. The major problem was yet again to read carefully the information which was provided. Different answers were given as some candidates used a net figure provided of M29,000, while others added back both withholding taxes and advance corporation tax (ACT) to this figure. The figure which should be used should be net of the withholding taxes only. If the tax payable is after deduction of ACT like in this case, it means ACT should be added back. Stating a due date is still a problem for some candidates. To get the full marks for this kind of question, candidates are expected to show a day, month and year.

Part (c) of the question for 18 marks required candidates to calculate the corporation tax payable and state the due date of payment. The question appeared to be very straight forward to most candidates. In most answers the gross income was well accounted for. The main problem was with the adjustment of tax deductible expenses. For instance, staff costs were given as MM220,000. The approach which candidates were expected to take was to identify if the figure was inclusive of a disallowed expense, in which case the adjustment would simply be to reduce the figure by the amount disallowed, which was 50% of entertainment expenses. Some answers showed only 50% of entertainment as an allowable expense, with the rest of the costs remaining undisclosed. It is crucial for candidates to know how to adjust either income or expenses to get the correct calculations. The company in question was a manufacturing company as laid out from the scenario, and there was no need to make any assumptions as some candidates did. Most candidates realised that the instalments calculated in (b) above were supposed to be deducted, as it was clearly indicated that the taxpayer was tax compliant and all the instalments were fully paid up on the due dates. However, there were a significant number of candidates who deducted the ACT figure which appeared under additional information. This is highly possible that they didn't carefully read that scenario paragraph as that information was solely meant to calculate tax instalments already paid up, and the ACT had nothing to do with the year of assessment in question.

Part (d) of the question for 2 marks was well done by most candidates. However, most candidates did not mention the deductibility of fringe benefit tax (FBT) amounting to M6,462 (12,000*35/65).

Part (e) of the question was not answered well by the majority of candidates. The question required candidates to explain the company's tax obligation with regard to distribution expenses given as part of sundry expenses. Most answers were based on the deductibility of an expense, which was not a question in this case. Deducting an expense is an entitlement not an obligation. Candidates could have gained more marks had they answered this question in the context of withholding taxes. That is, how much the company is obliged to withhold from the payments, and when to remit the tax so withheld to the Lesotho Revenue Authority (LRA).

Question Three

This 15-mark question was based on the value added tax (VAT). The performance on this question in general was extremely poor. The objective of the question was to test candidates understanding on exempt and zero-rated supplies; including the supplies taxable at standard rate. The taxpayer in the question provided public transport and rental services.

Part (a) for 2 marks required candidates to explain whether the taxpayer was eligible to use a cash method of accounting for VAT. Instead of focusing on the eligibility of the taxpayer which should be based on the nature of the business, most candidates provided the advantages of cash method, and concluded that the taxpayer should use the cash method. The VAT Act provides that the taxpayer is eligible provided they are tax compliant, and this was clearly stated from the scenario. Again, the taxpayer is eligible if 90% or more of the taxable value of the supply consist of services. Based on the scenario the taxpayer is undoubtedly eligible to use the cash basis.

Part (b) of the question required candidates to calculate VAT payable or refundable, and indicate clearly any items which were zero-rated, exempt or disallowed. Candidates should note that this last phrase is very crucial as far as this type of question is concerned. Whether a supply is exempt, zero-rated or disallowed, the end result is zero. For instance, public local transport is exempt, but public transport to a foreign country is zero-rated, the same treatment for exported supplies. A zero without any explanation is unlikely to score any marks. The VAT Act further provides that VAT incurred regarding exempt supplies is not claimable, while VAT incurred regarding zero-rated supplies is claimable. This means that the taxpayer is entitled to claim VAT on zero-rated supplies only. Again, candidates should note that the input VAT on the finance lease is calculated on the fair market value which was supposedly a cash price in this case. The explanation on entertainment expenses was correct for most candidates, though some confused the VAT treatment with income tax treatment. Part (c) of the question was not well done. Most candidates omitted this part, or for those who attempted it, confused time of supply with cash and accrual methods of accounting for VAT. The question focused on the time of supply with regard to goods not services, which is, the earlier of the time the goods are removed from the supplier's premises; or the time the goods are made available to the person to whom they are supplied; or the time when payment is received; or the time when the invoice is received. On the contrary, the method of accounting either cash or accrual method determines the tax period when the VAT should be accounted for, which was irrelevant in this regard.

Question Four

This 15-mark question was based on the difference between tax evasion and tax avoidance, as well as calculation of minimum chargeable income. The performance in general was very good on this question with some candidates scoring full marks in some parts of the question.

However, a number of common mistakes in candidates' answers were noted as follows:

- Not differentiating between tax evasion and avoidance
- Not calculating additional tax in relation to false or misleading information. This seemed to be a problem to all the candidates. It was evident from their answers that this part was not revised effectively.

- Not explaining the basis on which chargeable income is determined in the case where minimum chargeable income has been calculated. The Act provides that the chargeable income is the higher of the chargeable income declared and the minimum chargeable income.

Question Five

This 15-mark question was based on the definition of employment income and allowable expenses against this income. Though the taxpayer in question had other sources of income, a clear understanding of employment income and related expenses were enough to score higher marks on this question.

Part (a) for 4 marks required candidates to give the types of benefits or payments which are not included in employment income. The question was not necessarily based on the scenario, rather knowledge based. Excellent answers were presented by most candidates except for those who appeared not prepared for the examination.

Part (b) for 9 marks required candidates to calculate chargeable income of the taxpayer. Most candidates capitalised on this part as well. The common mistake highlighted was that most of them could not recognise a loss as a result of excess expenditure against rental income. The main reason was due to not categorising different sources of income.

Part (c) for 2 marks was also well answered. The question required candidates to explain circumstances in which a gift can be treated as part of chargeable income. The majority of candidates correctly stated that it is when it is from employer to employee. Equally correct, the value of a gift was included as part of employment income in part (b) of the question. However, most candidates ignored the fact that any income derived from property which is the subject of a gift, should also be treated as part of employment income.