Examiners report

F6 Taxation (MWI)
December 2013

ACCA

General Comments

The examination consisted of five questions which were compulsory. Question 1 was for 30 marks, question 2 was for 25 marks, whilst questions 3 to 5 were for 15 marks each.

Overall, the performance was below what had been expected at this sitting. Candidates generally provided answers which did not fully meet the question requirements. It was clear that many candidates did not fully read and understand the question and its requirements before starting their answers; this therefore resulted in them not fully addressing the requirements of the question being attempted. Additionally, some candidates had the tendency to give explanations when the question clearly requested them to compute or calculate.

The candidates who performed well were those who attempted all five questions and demonstrated relevant knowledge (even if only in part) in all questions. However, some candidates attempted only parts of each question whilst others attempted only three or four questions. The structure of this paper is that all questions are compulsory; it therefore follows that candidates need to be familiar with the entire syllabus.

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 in question1 (a), (c), (d), question 2, question 3 and question 4 (a) and (b). The questions candidates found most challenging were questions 1(b), 4 (c) and question 5. This was mainly due to candidates not understanding the core syllabus areas sufficiently well; a lack of technical knowledge and also due to a failure to read the question requirements carefully.

It is important that candidates cover all core areas of the syllabus as part of their exam preparation. There is a tendency amongst candidates to regurgitate memorised answers - particularly in descriptive type questions and those involving Value Added Tax. .

A number of common issues were noted in candidate's answers:

- Failing to read the question requirement clearly and therefore providing answers that do not address the question. Such answers ended up scoring few marks, if any.
- Failing to present answers in a logical and clear manner,
- No labelling of answers;
- Not starting answers to a question on a new page as per the instructions
- Unnecessarily splitting an answer to a question and spreading it over several pages
- Where explanations were required candidates often gave overly brief answers. Others gave long-winded answers which were off the mark.
- Not learning lessons from previous examiner's reports and hence making the same mistakes, especially in relation to presentation
- Providing more information than was required
- Workings that did not tie in to other sections of the answers.
- Poor and ineligible handwriting making answers difficult to follow
- Failing to properly split out and present answers as was required by the question
- Poor layout of answers.

Specific Comments

Question One

This 30-mark question was based on Phiri Dengu Limited, a company incorporated in Malawi. The question dealt with the taxation of income generated by the company from its operations. The question was in five parts. Generally this question was well answered except for part (b). Performance on part (c) was mixed with some strong answers alongside some unsatisfactory answers.

Part (a) for 6 marks required candidates to state the capital allowances that would be claimed other than annual allowances.

Almost all candidates attempted this part. However, some candidates included other allowances such as export and transport allowances. These were not required as the question specifically only asked for capital allowances. This was a clear illustration of candidates not carefully reading the question.

Part (b) for 6 marks required candidates to explain and calculate the taxes that should have been paid as a result of the company selling the motor vehicle to an employee at less than market value. The majority of candidates did not perform well on this question. Very few candidates realised that a balancing charge or allowance would be calculated as capital allowances had been claimed on the asset. The charge or allowance would be based on the actual sales proceeds. Regarding the fact that the sale had been for less than market value, the market value was only relevant in working out the Value Added Tax payable and the fringe benefit was the difference between actual selling price and the market price. Very few candidates mentioned and calculated the Value added Tax (VAT) and fringe benefit tax.

Part (c) for 15 marks required candidates to compute the taxable profits of Phiri Dengu Limited for the year ended 30 June 2013. This involved candidates making adjustments to profits before taxation to arrive at the profits chargeable to taxation. Generally this involved adding back to profits the expense items that were not allowable for taxation and deducting other items, such as capital allowances and income which was not taxable (for example, dividends and the proceeds on the sale of a house and motor vehicle credited to the income statement). The proceeds on the sale of the house would be taxed as a capital gain, whilst the proceeds on the sale of the vehicle would be dealt with through the balancing charge. It also required candidates to make adjustments to allow for international transport allowance and export allowance. This part of the question was well answered by the majority of the candidates. However, a few candidates did not deduct the transport allowance on exports and the export allowance from taxable income. The export allowance should have been calculated as 25% of the profit on exports. Very few candidates made an adjustment to remove the VAT paid on local sales from the taxable income

Part (d) for 3 marks required candidates to calculate the tax still to be paid or refunded to Phiri Dengu Limited for the year ended 30 June 2013. This was generally well answered except for some candidates failing to remove VAT from local sales for the purpose of working out the withholding tax deducted from such sales. Other than that, candidates generally made the required adjustments to reduce the tax payable by the provisional tax paid and also the withholding tax deducted on the interest received.

Question Two

This 25-mark question was on a partnership of Mayeso and Chakudza who were involved in the produce business. The question involved working out the taxable profits of the partnership and the calculation of tax to be paid by one of the partners, Chakudza. The question was divided in five parts.

Part (a) for 3 marks required candidates to state how the income of a partnership is taxed. This part was well answered. However, many candidates wasted a lot of time explaining how the profits of the partnership are arrived at, as opposed to how the profits are taxed.

Part (b) for 8 marks required candidates to compute the taxable profits of the partnership for the year ended 30 June 2013. The results were from an income and expenditure statement. This was well answered, although some candidates seemed to have problems because they were not given the usual profit and loss statement. Candidates were required to start with the loss as per the income and expenditure statement and add-back disallowable items of expenditure such as salaries for the partners and capital assets bought and charged to the income and expenditure statement. The capital introduced to the business should have been subtracted as this was not a revenue item. Capital allowances (as calculated by the candidate) should have been subtracted.

Items of expenditure not in the income and expenditure statement such as interest on capital should not have been considered in arriving at the taxable profits.

Part (c) for 6 marks required candidates to show the allocation of profits amongst the partners. This part was well answered. Candidates correctly allocated salaries, interest on capital, and school fees paid on behalf of one of the partners to each of the relevant partners. This total was then deducted from the total profit and the difference allocated amongst the partners according to the profit sharing ratio.

Part (d) for 7 marks required candidates to calculate the total tax payable by or refundable to Chakudza for the year ended 30 June 2013. This question was well answered despite the fact that some candidates also included Mayeso. However, although the instructions stated candidates should indicate income not taxable by the use of a "0", some candidates ignored this instruction. Tax credits were in most cases correctly given for PAYE, withholding tax on bank interest earned by the partnership and the Chakudza's share of provisional tax paid by the partnership. However, many candidates failed to take into account the withholding tax on the interest paid by the partnership

Some commonly-made mistakes included:

- Not grossing up bank interest
- Not deducting the exempt portion of interest earned by an individual
- Treating the dividend as taxable income
- Wife's salary being treated as income of Chakudza
- Calculating a capital gain on the personal car and including this in income

Part (e) was for 1 mark and required candidates to state when provisional tax is paid. Almost all candidates stated this tax is paid quarterly but very few candidates mentioned it is paid on the 25th day of the month following the end of the quarter.

Question Three

This 15-mark question was based on the provisions of the VAT. The question tested candidates' understanding of VAT provisions. This question was divided into two parts, part (a) and part (b). Part (a) was further subdivided into two parts, (i) and (ii).

Part (a) (i) was for 4 marks and required candidates to explain how output tax is calculated under the retailer's special scheme when a retailer makes both taxable and exempt supplies, including any subsequent adjustments that will be made to the output tax payable.

This part was generally well answered by the majority of the candidates who gave the options available both where the retailer has records of the exempt supplies and when such records are not maintained. This basically is using the sales record or the alternative of using the purchase method. In either case the results would be multiplied by the VAT fraction which is the rate of VAT divided by the sum of 100 plus the rate of VAT to arrive at the output VAT.

Those who did not do well in this part of the question generally did not understand the question and focused on the general requirements for registration for VAT.

Part (a) (ii) was for 3 marks and required candidates to calculate the output VAT for John Mwasi for the month of June 2013 using each of the options.

This was generally well answered. Those who did not do well generally made the mistake of using the VAT rate in arriving at the output tax instead of the VAT fraction. Furthermore, they mixed the operations of the two methods and ended up transposing the numbers and also substituting purchases for sales.

Part (b) was for 8 marks and required candidates to calculate the VAT payable or carried forward by Piringu Properties Limited for the month of June 2013.

Generally this part was well answered by the majority of candidates. There was a list of transactions entered into by Piringu Properties Limited provided in the question and candidates were supposed to calculate the respective output or input VAT or if no VAT was payable indicate with a "0". Most candidates followed the instructions given and separated output tax from input tax. They deducted input tax from output tax to arrive at the VAT payable. However, there were some candidates who seemed unfamiliar with the operation of VAT as far as it concerns property transactions. No VAT is charged on residential rental or the sale of such property. As a consequence any VAT charged on expenses related to such property would not be claimable. Output VAT is charged on commercial property transactions and the related input tax on such property expenses would be claimable.

The question stated the candidates should calculate the tax, but instead there were some candidates who gave lengthy explanations of the treatment of each of the items and in the end did not actually calculate the tax as required. In some cases, candidates seemed unsure which item was part of output tax and which formed part of input tax. What was required was for candidates first to work out the output tax and from this deduct the input tax claimable. The total input tax would be deducted from the output tax. Many candidates just listed the amounts from the question and it was not clear from the presentation of their answers if they understood what they were trying to achieve.

Question Four

This 15-mark question was in three parts. The question essentially dealt with the taxation of Munali Sports Club, a club formed for recreation purposes.

Part (a) for 4 marks required candidates to explain how the taxable income of a club formed for recreational purposes is determined. This part of the question was well answered by the majority of the candidates. Most candidates correctly stated that income arising from dealings with members, except from subscriptions and entrance fees, would be subject tax. The tax is not based on profitability, therefore expenses are ignored. The tax is calculated on 6.25% of such income at a corporate rate.

Part (b) for 5 marks required candidates to calculate the tax to be paid by Munali Sports Club for the year ended 31 December 2012. Overall, this part was well answered. However, many candidates added bank interest to the total income which was subject to the 6.25% fraction. Interest should have been added gross to 6.25% of the income from dealings with members and be subject to the corporate tax rate.

Many candidates who performed less strongly also deducted expenses from the income to arrive at taxable income, which is not the correct treatment.

Part (c) was for 6 marks and required candidates to list any six transactions that would require the taxpayer to obtain a tax clearance certificate before finalisation. This part was poorly answered overall. Many candidates did not know the transactions and, as such, were not specific. For example, they might state the renewal of the certificate of fitness of motor vehicles as a transaction when this should be specifically commercial vehicles as other vehicles do not qualify.

Candidates should make sure they obtain the relevant tax amendments which provide a list of the transactions.

Question Five

This 15-mark question dealt with tax planning. It involved the options available to Betheza Company Limited, a company that manufactures consumer goods, that is considering operating a wholesale unit (Mwatipeza) as either a division or a subsidiary.

The question was divided in two parts -part (a) and (b). Part (a) was further divided into part (i) and (ii). Part (a) (i) was for 5 marks and required candidates to work out tax payable by Bestheza Company Limited if Mwatipeza is operated as a division:

This part, as far as working out the taxable profit of the divisional unit, was handled well. Most candidates properly adjusted the profits of the division for tax purposes. However, many candidates failed to realise that as a division (not a limited company in its own right), the profits of the division are taxable through the main company. In this case the results of Mwatipeza would be added to those of Bestheza Company Limited. The tax rate of 30% would then be applied to the aggregated profits.

Given many candidates did not consider the profits of Bestheza Company Limited, the overall performance in this section was poor.

Part (a) (ii) was for 5 marks. This required candidates to work out the tax payable by Bestheza Company Limited and Mwatipeza if Mwatipeza is operated as a subsidiary. This part was, again, poorly answered. The question requirement refers to the tax payable by both Bestheza and Mwatipeza, implying the two should be considered separately. However, many candidates treated the subsidiary as a division which meant they added the results of Bestheza and Mwatipeza together. A subsidiary is a separate legal entity and should be taxed separately.

This also demonstrated that candidates had not read the requirement carefully.

However, there were some candidates who answered this question very well.

Part (b) this part was for 5 marks. Based on the calculations performed, this part required candidates to advise Bestheza company Limited, the operating strategy it should adopt (division or subsidiary).

Due to the confusion in the earlier parts of the question the wrong advice was often given.

If the correct scenarios had been used, it should have been noted that losses incurred by
Mwatipeza as a division could have been set off against the main company resulting in lower taxable profits for Bestheza. Conversely, as a subsidiary these losses were not available to offset against the profits of Bestheza and therefore would be carried forward to be offset against future profits of the subsidiary only.

The preferred option was therefore for Mwatipeza to operate as a division and not a subsidiary, as operating as a division would result in lower taxes for the group.