

Examiner's report

F6 Taxation (MWI)

June 2013



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.

The majority of candidates attempted all five questions. 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.

Overall the performance was not as good as had been expected. This was so because of lack of understanding of the subject matter which was demonstrated by poor answers. Candidates had the general tendency of giving out explanations when the questions requested them to compute or calculate. There was evidence that candidates do not take time to read and understand the questions before attempting and this therefore results in them not fully addressing the requirements of the question being attempted.

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

It is important that candidates cover all core areas of the syllabus. There is a tendency of most candidates giving out memorised answers, this is particularly so in Value Added Tax questions. The answers given in certain cases do not relate to the question.

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

- Failing to read the question requirement clearly and therefore providing irrelevant answers which scored few if any marks.
- Failing to present answers in a logical and clear manner,
- No labelling of answers;
- Not starting each new answer to question on new page as per instructions
- unnecessarily splitting an answer to a question and spreading it over several pages
- Where explanation was required candidates gave very brief answers to address the requirements of the question. Others gave long winded answers which were off the mark.

- Not learning lessons from earlier 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 illegible handwriting making answers difficult to follow
- Not properly splitting and presenting answers as was required by the question
- Illegible handwriting and poor layout of answers.



Specific Comments

Question One

This 30-mark question was based on Madimba Engineering 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 parts (a) and (b).

Part (a) for 9 marks required candidates to calculate the capital gains or losses resulting from sale of assets by the company for the particular year of assessment.

A majority of candidates did not apply the indices provided correctly. They confused the tax adjustment to those arising from accounting adjustments. The fair value adjustment applied to disclosure of the asset for accounting purposes and did not affect the value of the asset for capital gain. What was needed was to adjust the asset using the appropriate indices and compare that value to the sales proceeds to arrive at the capital gain or loss. Many candidates after apply the index to the cost also adjusted the value of the asset by the fair value adjustment; this therefore resulted in wrong conclusions being arrived at. It was also noted that some candidates tried to calculate capital gains or losses on assets on which capital allowances were claimed by applying indices to these as well. In such a case what is appropriate is the tax written down value of the asset

Part (b) for 1 mark required candidates to calculate balancing charge or allowance on its assets that had been disposed. A majority of candidates failed to do so and confused the assets on which capital gains were going to be calculated and the assets on which capital allowances were claimed. In this particular instance balancing charge/ allowance could only be calculated on the office equipment and not the office building.

Part (c) for 12 marks required candidates to compute the taxable profits for Madimba Engineering Limited for the year ended 31 December 2012. This involved candidates in adjusting profits to arrive at profits that are chargeable to taxation. Generally this involved adding back to profits, expenses item that were not allowable for taxation and allowing other items such as capital allowances and removing income which was not taxable for example, dividends, profit on sale of property and fair value adjustment credited to the income statement. This part of the question was well answered by the majority of the candidates. However, a few candidates did not deduct from the taxable income the loss that was brought forward from the previous year.

Part (d) for 5 marks and required candidates to explain the basis of paying provisional tax and to calculate the penalties that would be payable by Madimba Engineering on the basis that it did not pay provisional tax during the year. This part of the question was well answered as most candidates ably explained the basis of calculation of provisional tax and the penalties that would be payable. However, the majority of the candidates did not apply this to Madimba's situation and hence work out the penalty that would be applicable to Madimba Engineering Limited.

Part (e) was for 3 marks. This required candidates, to state the requirements for offsetting trading losses. A majority of candidates answered this part very well and ably stated how losses are set off against income and carry forward losses are treated. However some candidates did state that trading losses can be offset against capital gains.

Question Two

This 25-mark question is on a partnership of Mwai and Dengu who are trading as fishmongers, with one of the partners not being full time in the business. Essentially the question involved taxation of one of the partners Mwai. The question was divided in four parts.

Part (a) for 9 marks required candidates to compute the taxable profits of the partnership and to further explain how the fishing nets would be treated in the tax computations. Mostly this part was well answered by a majority

of the candidates and the computed adjusted profits for tax purposes by adding disallowable items. Further they calculated capital allowances for the assets in use by the partnership. However, there were some candidates who wrongly claimed investment allowances. Investment allowances are claimed by manufacturers, the partnership is not as they do not carry out fish processing.

Some candidates correctly dealt with the nets as a revenue expenditure item which should not have been capitalised for capital allowance purposes.

Part (b) for 3 marks required the candidates to allocate the taxable profits amongst the partners. This also required the expense items particular to a partner to be allocated to that partner before arriving at profits to be shared. This part was very well answered by a majority of the candidates.

Part (c) for 5 marks required candidates to calculate the tax payable by both Mwai and his employer for the year ended 30 June 2012. This part of the question was not well answered as most candidates mixed income from employment with other income which should have been taxed under part (d). The question clearly stated that tax paid by Mwai and his employer, this referred to income from employment. Further, the question referred to Mwai and yet some candidates included the other partner who was not part of the question. Over all this part was answered poorly as candidates failed to read the question properly.

Part (d) for 8 marks required candidates to calculate total tax payable by or refundable to Mwai for the year ended 30 June 2012. This question was well answered despite the fact that some candidates repeated the information in part c. Most candidates just copied the information from part c as they had treated the information which was supposed to be included here in part c of the question.

Generally it was well answered by most candidates as they followed the instructions given in the question. For example although dividend was taxable it was shown in the listing of income but with a "0". Tax credits were in most cases correctly given for PAYE, withholding tax on director's fees and withholding tax on amounts paid to the partners during the year.

However, some candidates made mistakes such as:

- Not grossing up directors fees
- Not deducting the exempt portion of interest earned by an individual
- Treating dividend as taxable income

Question Three

This 15-mark question was based on the provision of the Value Added Tax. The question was testing the candidates understanding of Value Added Tax provisions.

Part (a) was for 5 marks required to state five circumstances where input VAT is not claimable. This part was well answered by most of the candidates. Those who did not do well were those that did not understand the question, as instead of circumstances they gave examples of items on which VAT is not charged. Those who understood the question who were in majority performed very well.

Part (b) was for 10 marks and required candidates to calculate the VAT payable or any excess that would be carried over to the next accounting period. There was a list of items provided in the question and candidates were supposed to calculate the respective VAT or if no VAT was payable indicate with a "0". Most candidates did not perform well in this part as they did not follow the instructions. The question stated they should calculate the tax, but instead most candidates gave long winded answers of the treatment of each of the items and in the end did not actually calculate the tax as was required. It was clear that candidates were unsure which items were part of output tax and which formed 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. Most



candidates just listed the amounts from the item list and it was not clear from the presentation of the answers if they understood what they were trying to achieve.

The performance therefore in this part was not satisfactory.

Question Four

This 15-mark question was in three parts. The question essentially dealt with the taxation of income generated from growing of timber by a farmer, James Phiri.

Part (a) for 4 marks required the candidates to state how the taxable income derived from timber will be determined. This part of the question was well answered by a majority of the candidates. Most of the candidates correctly stated that such costs including the 5% amount added to the cost of planting is carried forward until the timber reaches maturity

Part (b) for 7 marks required candidates to calculate the taxable income of James Phiri derived from timber for the year ended 31 December 2012. This part was poorly answered by a majority of the candidates. Although most candidates were able to calculate the revenue from the sale, they did not calculate the costs appropriately. Most of the candidates although they seemed to know they had to apply the 5% addition to costs incurred in the growing of the timber. However, very few candidates were able to demonstrate that this uplifting was to apply for the entire period from when the costs were incurred to the date the timber reached maturity. As a result of this the cost of was not appropriately arrived as it excluded this 5% uplifting of costs for the entire period. The costs would then be prorated based the hectares which had been harvested.

Part (c) was for 4 marks and required candidates to explain how subsidies for expenditure and expenditure for future crop are dealt with for tax purposes. Again this part was not well answered. Some candidates confused this with the Farm Input Subsidy Programme, which is applicable to subsistence farmers for maize and do not apply in this case. However in this case if subsidy was received then the cost would be reduced by the subsidy and only the net would be claimable or carried forward in the case of the timber.

Similarly, with future crop some candidates were not very familiar with this term. It is basically expenditure incurred by a farmer which is for the next season's crop. If the crop will be harvested in the next financial period this cost would be carried forward and offset against the revenues from that crop. Again this part was not well answered. It is important that candidates are aware of all the core areas of the syllabus.

Question Five

This 15-mark question was dealt with tax planning. It involved options available to Zakeyu for starting a business and the best option for operation. That is whether to operate as a sole trader or as a limited liability company. The performance in this question was generally good. However, some did not perform well. Candidates failed to calculate the taxable profits under each of the scenarios, solo trader or limited company. They were also candidates who were not able to distinguish the expenditure that would be disallowable as a sole trader from that would be disallowed as a company. Certain expenditures that were disallowed as a sole trader were allowed expenditure when operating as a limited company.

With regard to capital allowances on the motor vehicle, for sole trader most candidates did no adjust this for the portion relating to private use. They claimed the same amount under both scenarios.

Interest received by an individual, the first K10, 000 is exempt from taxation, but this not so for the company. Also what needed to be taken into account was the fact that the benefits provided , which were treated as disallowable under the sole proprietor would be allowed in the company but be subject to fringe benefits tax under the company. The tax effect therefore needed to be adjusted for fringe benefits tax.

After working the tax and the after tax profit, this would be the basis for arriving at the best scenario for Zakeyu.

To get maximum marks the candidates should have under each option:

- Add items disallowable for taxation
- Deduct the items allowable such as capital allowances, taking into account the personal use for the sole trader option
- Calculate the tax payable under each option
- For the company add the fringe benefits tax that will be paid
- Compare the tax and profits after tax under each option
- Provide advice to Zakeyu