

Examiners report

F6 (MWI) Taxation

June 2014

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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 at this sitting was satisfactory. The responses to questions provided by most candidates were of an acceptable level. Most candidates generally provided answers which were of an acceptable level. However, there were candidates that did not perform well and this was because they did not read and understand the question and its requirements before starting to answer; this therefore resulted in them not fully addressing the requirements of the question being attempted. Further it was clear that candidates once they start answering they do not constantly refer back to the question to see if they are still addressing what is required of them.

Those students who did well were the ones who attempted all questions and demonstrated knowledge (even if only in part) in all questions. That is, students who attempted all questions had a higher chance of passing than those who left one whole question unanswered. The structure of this exam is that all questions are compulsory. It therefore follows that students need to know the entire syllabus. There were of course some candidates who attempted only parts of each question. There were also some candidates, who attempted only three or four questions, although these were not many.

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 question 1(b),(c),(d), 2, 3(a), 4(a), (c) and question 5. The questions candidates found most challenging were questions 1(a),(e), 3(b), and 4(b). 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:

- Not reading the question requirement carefully and therefore providing irrelevant answers which scored few, if any, marks.
- Not presenting answers in a logical and clear manner,
- Not labelling answers;
- Not starting each new answer 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 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
- poor layout of answers
- Inability for candidates to express themselves clearly

Specific Comments

Question One

This 30-mark question was based on Deluxe Engineering Limited, a company incorporated in Malawi. The question dealt with the taxation of income generated by the company from its operations of manufacturing and selling bus bodies and trailers. The company was a subsidiary of Mango limited a company also incorporated in Malawi. The question was in five parts. Generally this question was well answered except for parts (a) and (e).

Part (a) for 3 marks required candidates to calculate the withholding tax that would be calculated and paid by the company for the financial year. Almost all candidates attempted this part. However the majority of candidates only calculated the withholding tax on rental and management fees. Very few candidates applied withholding tax to capital assets. The question clearly indicated withholding tax on expenses and purchases and yet some candidates applied this to income received.

Part (b) for 11 marks required candidates to calculate the capital allowances and balancing charge. This part was well answered except for a few candidates who did not treat pickups and passenger carrying vehicles separately. No initial allowances are available on passenger carrying vehicles.

Part (c) for 8 marks required candidates to compute the taxable profits for Deluxe Engineering Limited for the year ended 31 December 2013. This involved candidates adjusting net profit for the year to arrive at profits that are chargeable to taxation. Generally this involved adding back to profits, expenses items that were not allowable for taxation, such as impairment of goodwill, and allowing other items such as capital allowances, and removing income which was not taxable for example, dividends, profit on sale of assets credited to the income statement. This part of the question was well answered by the majority of candidates. However, a few candidates did not appropriately adjust the disallowed portion of pension contribution by the company. The allowable portion of pension is restricted to 15% of the employee's salary.

Part (d) for 3 marks required candidates to calculate the tax payable by Deluxe Engineering Limited for the year ended 31 December 2013. This part was generally well answered, with most candidates giving credit for the provisional tax paid and the withholding taxes that were deducted on interest and rental received. Even though the company had a withholding tax exemption certificate this does not apply to interest and rentals.

Part (e) was for 5 marks. This required candidates, to state the taxes that would be payable if the holding company was foreign registered. This was not well answered as most candidates dwelt on Deluxe Engineering being foreign registered as opposed to the holding company. The taxes paid would be resulting from transactions between Deluxe Engineering and the holding company. This would essentially be on management fee (VAT) and border tax on remittance of the same.

Question Two

This 25-mark question is on the taxation of an individual who runs a wholesale business but at the same time he is employed as a manager at a different organisation. He is married and his wife earns a salary from his business.

Part (a) for 4 marks required candidates to explain how the benefits provided to Mabvuto Soko by the employer would be taxed. On the whole this part was well answered. Most candidates correctly stated that benefits provided to Mabvuto in cash would be added on the payroll and the appropriate PAYE deducted. Any benefits with no cash benefit will be subject to fringe benefits tax and the tax paid by the employer.

Part (b) for 4 marks required candidates to calculate the taxable income of Mabvutos wholesale business. On the whole this part was also very well answered, even though most candidates did not treat the salary earned by Esmie as earned income. She worked in the business and was being paid for service rendered; therefore the salary was earned in her own right and should have been treated as such.

Part (c) for 3 marks required candidates to calculate the tax payable on Mabvuto Soko's earnings from employment for the year ended 30 June 2013. Most candidates handled this part well. They added all the income from employment including the benefits paid to him in cash. The total was then subject to rates applicable to individuals. Those who did not do well did not include the cash benefits as his employment earnings. Some candidates also included non cash benefits such as use of motor vehicle and electricity as his earnings and included this in his income which was not supposed to be the case.

Part (d) for 14 marks required candidates to calculate total tax payable by Mabvuto and Esmie Soko for the year ended 30 June 2013. This question was well answered despite the fact that some candidates repeated the information in part (b) and (c). Instead of just taking the total income for the business as calculated and also from employment, most candidates recopied the information to part (d).

Further there were some candidates who did not show the salary earned by Esmie as her salary, but instead included the unearned income being from rental and interest as her earned income. There were also candidates who did not follow the instruction indicated in this part of the question which required for candidates to indicate with a zero any items which were not taxable or deductible. This mostly applied to Dividend income and expenses on the drive way. Further there was no tax credit available on rental income as withholding tax had not been deducted.

Question Three

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

Part (a) was for 8 marks, and a list of transactions that had taken place in a month were listed and required candidates to explain what the correct VAT treatment would be; whether VAT would be charged and whether it would be indicated on the VAT return.

Most candidates did well on this part, except those who did not seem to understand the requirement. Those who explained the VAT implications of the transactions did well. Candidates considered whether it was a taxable supply and was the amount subject to be claimed as an input, or could VAT be subject as an output. Those who understood the question who were in majority performed very well.

Part (b) was for 7 marks and required candidates to prepare an adjusted VAT return. Again instructions were given but a majority of candidates did not follow the instructions. What was required was to prepare an adjusted VAT return on the basis as the question. Candidates needed to make adjustments either to sales, purchases, capital goods or other adjustments.

What most candidates did was just to list the items and calculate the VAT on them, rather than making adjustments to the return and calculating the VAT on the revised figures as was requested.

Question Four

This 15-mark question was in three parts. The question essentially dealt with the taxation of mining activities in part (a) and (b) whilst part (c) dealt with the submission of returns and payment of final tax.

Part (a) for 6 marks required candidates to list the types of expenditure which if incurred by persons involved in mining operations would be allowable in determining the taxable income and the basis of the deduction. This part of the question was well answered by a majority of candidates. Most candidates correctly listed such expenditure and stated that expenditure is allowable 100%. There were of course a few candidates who confused this with expenditure incurred by farmers.

Part (b) for 6 marks required candidates to calculate the income tax payable by JNJ Mining a company that mines coal. This part of the question was not very well answered as most candidates did not adjust for the premium paid on the land over the 20 year period. As a result the expenditure for the 19 years paid in advance would be disallowed. Further 50% of the social responsibility expenditure was to be disallowed and not the

whole of the expenditure. Other candidates also disallowed the expenditure on the royalties which was not to be the case.

However, most candidates correctly allowed the mining expenditure incurred and also the loss brought forward was given relief.

Part (c) was for 3 marks and required candidates to state when a company under self assessment rules is required to submit a return and pay the balance of the taxes and penalties charged for failing to submit a return on the due date.

This part was well answered and the majority of candidates correctly stated that this must be done within 180 days from the end of the financial year of a company and pay the balance of the tax on submission of the return.

However, very few candidates knew that the penalty for late submission of returns for a company was a flat charge of K200,000.

Question Five

This 15-mark question was dealt with tax planning. It involved options available to Millenium Limited for remunerating the sales manager who was to be employed.

Part (a)(i) required candidates to work out the option that would have the least annual cost to the company out of the two options available. This part was well answered as it required candidates to list the expenditure by the company under each option on employing the sales manager.

This involved adding the salaries, bonus (under option 1), pension contributions, commissions (under option2), school fees (option1) and housing allowance together. The fringe benefits tax on the benefits were the added to the total.

The cost of these options to the company would then be compared to arrive at a better option for the company taking into account any capital cost on the motor vehicle to be purchased.

Part (a) (ii) required candidates to work out the best option for the sales manager taking into account the same scenarios as in part (a)(i).

Most candidates did not answer this part well as most did not consider the amounts of monies that were going to the employee only , they included the cost to the employer as well, which should have only been included in part (a)(i). As a result they arrived at the wrong take home pay. The take home pay should have been arrived at by taking remuneration less PAYE, then pension contributions. But to compare the potential benefit the school fees paid by the employer would need to be added back to the take home pay as this expenditure would be relevant in considering the best option.

Part (b) this required candidates to consider why as a financial controller advice would be given against the lower cost option in (a)(i). Most candidates correctly considered the effect of capital cost, possible escalation of commission should sales increase, and the disallowance of fringe benefits.