Examiner's report

F6 Taxation (POL)
December 2014

General Comments

The examination consisted of five compulsory questions. 30 marks was to score for Question 1, 25 marks for question 2 and 15 marks for each of the further three questions.

The vast majority of candidates attempted all five questions, and the time pressure did not seem to be too high to cope with all the requirements. Where questions were left unanswered by candidates, this appeared to be due to a lack of specific knowledge or insufficient exam technique, as opposed to time pressure.

Generally this exam was well answered by the candidates who were well prepared and presented good exam technique.

Candidates performed particularly well on questions 1a (ii), 2a, 3b and 4. The questions candidates found most challenging were questions 1a(i), 3a, 5b and 5c. This is mainly due to candidates not understanding core syllabus areas well enough and due to a failure to read question requirements carefully.

- Failing to read the question requirement clearly and therefore providing irrelevant answers which scored few if any marks.
- Not reviewing past papers and examiner's reports and hence making the same mistakes that often occurred and were highlighted in the past, especially in relation to tax treatment of interest and forex as well as international transactions
- Not indicating by the use of zero (0) any items which were not included in computations with short explanation why the item was excluded from computation.
- Illegible handwriting and poor layout of answers.

Specific Comments

Question One

This 30-mark question was based on a machine manufacturer and service provider, Drucinex Sp. z o.o. (Drucinex), and tested candidates' ability to calculate corporate income tax (CIT) as well as establishing the initial value of land and building for tax purposes.

Part (a) (i) for 11 marks required candidates to calculate the initial value of the land and constructed building for tax purposes. Most candidates performed inadequately on this part of the question. Although most students correctly included purchase price and notary fee in the initial value of the land for tax purposes stating that real estate tax should not be included and adding arrangement fee for the bank, foreign exchange rates (forex) differences and interest were forgotten. While calculating tax value of the constructed building, the candidates correctly added construction cost, architect design fee, salaries of the personnel, fire inspection fee and excluded general management fee, however, only a few students calculated arrangement fee for the bank, forex and interest properly.

Arrangement fee for a bank should have been calculated as the loan value (10m EUR) times rate 4.1 PLN:EUR as of 10 February 2013 times 0.5% fee value times part related to the land 12:40 or 28:40 in case of the value of the building. The split 12:40 should have been computed as the land purchase price to the total loan value as of 1 January 2013. Forex differences should have been calculated as 10m EUR (the loan value) times difference between the PLN:EUR rate as of 1 January 2013 and as of 10 February 2013 times part related to the land 12:40 or 28:40 in case of the value of the building. Interest capitalised in the land value should be calculated as 10% interest rate times 10m EUR (the loan value) times 12:40 times 2:12 (two months of the year) times

PLN:EUR rate as of 28 February 2013 (date of signing the notary deed indicating the land purchase date). Interest capitalised in the building value should be calculated as 10% interest rate times 10m EUR (the loan value) times 28:40 times 6:12 (six months of the year) times PLN:EUR rate as of 30 June 2013 (date of the construction completion and putting the building into use).

The above forex differences calculation is based on prevailing opinion of the tax authorities that only the forex differences cashed/realised before the completion of a fixed asset should be capitalised. However, students who calculated the forex differences capitalised according to the literal wording of the relevant tax provision which refers to the accrued forex were granted equal marks.

Part (a) (ii) for 2 marks required tax depreciation calculation available for 2013 on the tax values calculated in part 1 (a) (i). This part of the question was well answered. Most candidates calculated tax depreciation for the building properly (land is not depreciated) using 2.5% depreciation rate, 1.2 coefficient related to the use of building in the conditions worse than normal and 6 out of 12 months. However, only a few candidates remembered to deduct value of the EU grant (4m PLN) from tax value of the building calculated in part 1(a) (ii).

Part (b) for 17 marks asked for CIT calculation to be paid by Drucinex in 2013. This part of the question was moderately answered. The candidates had some difficulties in CIT treatment of goods sold abroad. Margin on sales of goods sold through a permanent establishment in Czech Republic and in the Germany (20% of the respective sales) should be deducted from Polish tax computation. Goods sold in Italy and France did not generate any adjustments to taxable income calculation.

Most students correctly eliminated cost for January service invoiced in December; interest received, EU grant and additional depreciation from CIT calculation. Majority of candidates did not add increase in share capital of subsidiary and salaries plus fire inspection cost capitalised to tax computation. However, properly added both donations, loan to the employee, contribution in kind transferred by the owner. Unpaid sales invoice did not generate any adjustments.

Some candidates had issues with calculating financial costs capitalised adjustment (as they did not calculate them properly in part (a) (i) of the question) and year-end forex adjustment to CIT for 2013. Year-end forex adjustment should be calculated as 10m EUR times difference between PLN:EUR rate as of 31 December 2013 and 10 February 2013.

After arriving to taxable income, candidates should deduct donation (only donation to public benefit organisation of 400k PLN up to 10% of the income was applicable); use tax loss brought forward (50% allowed in the amount of 1.4m PLN). Then tax should be calculated at 19% rate and deduct credit for foreign tax. Only tax credit for German sales was available in the amount of 26.6k PLN (margin on German sales times 19%).

Students often forgot to deduct tax instalments paid in the year to arrive to CIT due for 2013. Instalments would be posted as equal to tax due in case of standard advances payment method (as there is no double advance for November anymore) or calculated as 400k PLN times 19% times 12 months out of 18-month tax year.

Question Two

This 25-mark question covered various aspects of the personal income tax (PIT) and elements of tax planning in the case of Halina Łebska.

Part a) for 19 marks required the students to calculate PIT due on Halina Łebska's 2013 income. This part of the question was well answered by majority of candidates. Generally there were no issues with calculating gross salary from the hospital and pharmaceutical company. To arrive to the Social Security Contribution (SSC) base on employment, various benefits provided by the pharmaceutical company should have been added to gross salary:

private calls, excess per diem, business suit and family medical package (without a work health and safety examination package). Then SSC on employment was calculated as 13.71% of the base. Gross salary plus emoluments less SSC charge created a base for Health Service Contribution (HSC) on employment. After that employment costs should be deducted to arrive at taxable income from employment.

Business taxable income consisted of 20% gross profit on sales less costs of storage space rent and overheads, less loss on the furniture sale of 1.5k PLN, less SSC (1.6k PLN - minimal salary times 30% times 31.9% SSC rate times 5 months).

Additionally to arrive at total taxable income, Halina should have added the profit on the sale of the second car (17k PLN), insurance proceeds related to the stolen goods (2k PLN) and profit on the apartment rent - rental proceeds less maintenance costs and depreciation (988 PLN times 80 square meters times 1.5%).

Then joint taxation scheme should have been applied. Total taxable income was divided by two, tax of 18% less free amount 556 PLN was calculated and multiplied by two. Finally HSC from the employment (7.75% of the HSC base) and from the business (1.6k PLN of minimal salary times 75% times 7.75% times 5 months) should have been deducted to arrive at tax due figure for 2013.

Part b for 6 marks asked for explanation whether or not it would have been beneficial for Halina to have opted to any of the income to flat rate taxation in 2013. Candidates responded average to this part of the question. Model answer assumed that students would calculate effective tax rate on computation from part 2(a) (tax of 23 994 PLN divided by total taxable income of 139 476 PLN) and compare flat rate tax due to tax calculated based on the effective tax rate on the on the certain activity of Halina. As no one calculated the effective tax rate based on results from the part 2 (a) but used 18% instead, equal marks were granted for such approach.

There were three activities of Halina, which could have been taxed at flat rate: business income could have been taxed at 19%; revenues from selling goods less SSC from the business activity could have been taxed at 3% and apartment rental proceeds could have been taxed at 8.5% flat rate. Only the latter activity resulted in less tax being payable at flat rate then at effective rate.

Question Three

This 15-mark question aimed at examining the candidates knowledge of certain aspects of value added tax (VAT) on the example of Datex case - a Polish based online store selling computer equipment to individual customers in Poland and in the USA and providing an insurance service for the equipment sold.

Part 3(a) required Candidates to account for

(i) output VAT which required the knowledge of impact of exempt supplies (no VAT), exports (zero rated), free of charge supplies (Vatable in most cases where input was recovered and not VAtable if input VAT was not recovered) and reverse charge mechanism,

(ii) input VAT which required the knowledge of impact of mixed supplies ratio reducing input Vat available on purchases connected both to Vatable and exempt sales as well as limitations on recovery of input VAT on purchase or lease of passenger car (PLN 6000 cap) and also the input side computation of reverse charge on imported supplies.

This part was very well answered (close to perfect marks) by Candidates with knowledge of VAT principles (exempt sales, exports). However many Candidates scored average or little marks demonstrating only the basic knowledge of VAT mechanics which led to automatic charging of 23% VAT rate on all sales and purchases.

Part 3(b) was answered very well as almost all Candidates correctly assessed the cash flow impact of Vat refund deadlines and advised to carry forward excess input Vat if the VAT payable in the month to come would be high and obtain the cash refund if the expected sales would be lower.

Answers to part 3(c) were mixed, as it required the Candidates to comment on VAT implications of exporting the VAT exempt services as compared to domestic supply. Candidates who fared well in computation question, which also referred to this element of VAT regulations, did well while those who attempted part (a) rather mechanically were not in position to provide the correct response.

Question four

Question four referred to the specific natural persons taxation method of the tax card.

The difficulty of the part (a) of the question rested mainly with knowledge of tax card specific method of identification of employees who are accounted for as:

(i) employees in view of the tax card (Alfred and Pakosław),
(ii) ancillary workers (Wiesław, Atanazy, Sybiliusz and Teofil for part of the year)
(iii) "non-counted" workers (Atanazy, Sybiliusz and Teofil for part of the year, Zenon, Gryzelda, Kacper, Melchior and Baltazar for the whole year).

This needed to be supplemented with knowledge of the tax card computation mechanism (employees giving rise to basis ancillaries and disabled persons giving rise or decrease respectively) as well as ability to calculate social security contribution on own business activity.

Majority of Candidates scored very well on this part of the exam. As tax card mechanism is relatively straightforward but specific issue so the smaller part of Candidates who skipped this part of the Syllabus scored very low marks.

Par (b) and (c) of the question related to specific situations in which the tax card can not be applied. In part (b) the reason was that after 12 month of employment non-counted workers would become "accounted for" from the perspective of the tax card thus breaching the allowed number of employees (Zenon would be able to employ them however he would have to switch the taxation method to income or revenue taxation).

Part (c) related to specific case where spouses are not allowed to conduct separate business activity of the very same type (but are allowed to conduct similar but differently classified one – another peculiarity of the tax card mechanism).

Again majority of Candidates proved very well knowledge of the tax card rules and answered correctly both or at least one question.

Question 5

Question 5 tested the knowledge of CIT aspects of financing in respect of thin capitalisation and withholding taxation. This question also comprised a tax planning element.

Part (a) required knowledge of the thin capitalisation rules applicable in 2014, being 3:1 debt to equity ratio restriction reducing interest cost deductibility on loans granted by direct parent or sister companies owning at least 25% of shares. This part of the question was answered relatively well by most of the candidates.

Part (b) required application of the knowledge presented to calculation of the debt to equity split in practical case. It also required the knowledge that (i) the ratio is analysed as per interest payment date and (ii) the interest is taken into account in such calculation. This part of the question was not answered very well as many Candidates who provided the correct answer to first part of the question had some problems with practical implementation thereof (e.g. commonly assuming that 3:1 debt to equity ratio translates into equity being 1/3 of financing).

Part (c) put to the test the practical implementation of the thin cap and WHT rules as well as required the Candidates to apply these knowledge to analysis of tax effect of hypothetical situations in which financing would be provided by different entities.

Financing provided by shareholder resulted with no WHT at a cost of thin cap restriction. In turn non shareholder financing from a treaty jurisdiction resulted with WHT charge but no thin capitalisation restriction and at rates and values given proved to be the best solution. Financing provided by non-direct shareholder from non-treaty jurisdiction resulted in no thin-cap restriction at the high cost of uncapped WHT of 20% being the least effective solution.

This part of question proved noticeably most difficult to all Candidates visibly not due to lack of knowledge of regulations (this was proven in part a) or the CIT question) but rather the problem with application thereof to a practical case.

Part (c) of the question related to compliance obligations of the remitter was answered relatively well with Most candidates correctly identifying the necessity to obtain the certificate of residency of the interest recipient as well as the need to supplement additional information.