

Examiners' report

F6 Taxation (POL)

June 2009



General Comments

This Polish Tax examination followed the standard format of five compulsory questions. The long corporate income tax question comprised a computation of loss and how to deal with it, together with opening year rules. The personal tax question tested deductions from a variety of earnings. The value added tax (VAT) question primarily concerned partial exemption, the fourth question covered three simple tax options, and the fifth a permanent establishment and computation of tax for a company with foreign branch and other foreign source income.

Performance was disappointing and many candidates were not well prepared. Personal income tax deductions and credit for foreign tax were often not understood, and two elements asking for analysis, planning and explanation (losses in Question 2 and tax options in Question 4) were often answered poorly. However, well prepared candidates passed comfortably.

Specific Comments

Question One

The first part of this question required a simple profit adjustment to arrive at the tax loss for the opening period of a new business. It presented few difficulties, and well prepared candidates achieved most of the 15 marks available. A few mistakes were made often:

- Only one or two candidates realised that the receivable from Mr Desczczotworca the rainmaker could not have resulted from Nowomiejska's revenues receivable (it presumably was some form of advance), and thus did not qualify as a tax allowed bad debt.
- Whilst most spotted that the rental related to a finance lease and was to be disallowed, a large number allocated the finance cost proportionally over the total committed lease payment (which is only done if the lease agreement fails to stipulate the finance element in each repayment), and many also time-apportioned the finance charge that overlapped the year-end. Once we have determined that a cost is a finance cost, it is allowed on a "paid", not accrued, basis.
- Depreciation for 4 marks was done reasonably well, with some miscalculations, failure to depreciate the leased equipment, and most candidates failing to charge a double rate for the computers (double as "fast technological degradation", not "reducing balance"). Up to one extra mark was awarded to those who attempted to claim the 50,000 Euro write-off for new businesses, although sufficient details had not been given in the question. Such candidates needed also to claim normal depreciation on the rest of the asset.
- Some had trouble with the motor insurance which has both a prepayment and disallowance to be added back.
- Most understood the thin capital restriction, although the 70% holding caused a fair number to limit the borrowing to three times the 70%, not three times the full capital.

The second part tested knowledge of the opening year rules, and many candidates did not understand that the first period would be to the earlier December, with the option to extend to December 2009, and most got confused as regards choosing a different year end upon commencement, either restricting the choice to a 12 month period or referring to 12-23 month periods, which of course happens when dates are changed subsequently. Few earned all 4 marks.

Since six marks were available for the third part, concerning irrecoverable tax losses, candidates were given some thinking time, and the results, with a few exceptions, were disappointing: only a handful picked up 4 or 5 marks. Some had trouble identifying that at present 5 loss-making years followed the first period, and whilst most explained that the 2008 loss would not be recovered, relatively few stated that neither would half of the 2009 loss, thus failing to earn the full mark. Clues for schemes to remedy the situation abounded in the question, in particular the possibility of extending the opening period, or creating a longer period or two by changing accounting dates appropriately (not mentioned by many of those who had incorrectly written about 23 month periods in part (b)): each idea would have earned two marks, but the latter was spotted by a handful, the former by relatively few. Slowing down or stopping depreciation was mentioned often, but almost no-one considered not claiming immediate write-down of small assets, of which there would be many, as new restaurants opened. Some bonus marks were awarded for valid suggestions not included in the suggested solutions. Ideas to improve profitability were not asked for (“irrecoverable” can only refer to tax losses), and reduction of management fees and exceptional items were not relevant since in the event they were tax-disallowed.

The examiner stated in his last report against question 1 that he would examine the ability to plan and apply rules intelligently, so candidates are advised to apply a little analytical thinking and explanation, since simple planning is a part of the syllabus. Unfortunately, this warning seems to have gone unheeded by most. Despite good and (generally) well laid out computations, the failure to achieve many marks out of 10 for parts (b) and (c) was disappointing.

Question Two

The question dealt with a taxpayer who earns income from employment, contracts and then registered business activity, and it tested in depth the rules for social security (ZUS), health care (HSC) contributions and on account income tax deductions/payments, from each source, as well as the interplay of these “taxes”, finishing with the annual computation for the individual. There was a lot to do, but 30 marks were available: almost an hour. The facts and requirements were straightforward, set out systematically, and most students followed the instructions in sequence. However, some students exhibited lack of understanding of some issues: indeed most candidates made significant errors in part (c).

As regards employment earnings, only about half of candidates exempted the termination payment from ZUS, and many did not include the excess travel allowance in the ZUS calculation: a few failed to exempt the flowers. The first error above resulted in having to calculate ZUS on excess over the upper earnings limit, taking time. The considerable majority failed to try to earn 3 marks for the required PIT deduction by employer, where it was necessary to spot that Dorota crossed the lower PIT threshold in May, so her tax in June was at 30%, and most simply took tax per table, but were still awarded a mark out of the 3 available.

It should have been clear that the earlier contract was not charged ZUS and the later one was, which many did not realise, and a fair number charged ZUS on the basis of average earnings in the economy. Allowed costs were often incorrectly taken at 50% or ignored, or charged before the ZUS deduction.

Most candidates found the correct HSC basis in part (b), but unnecessarily calculated the whole employee 9% contribution as well or instead of the 7.75% to be deducted from PIT that was requested.

In part (c) most reasonably prepared candidates found the correct monthly salary and percentage to arrive at bases for charge and applied the correct ZUS rate to earn the 3 marks. Interestingly, few of the candidates who had taken Dorota’s earnings over the upper earnings limit in part (a) remembered to charge reduced contributions here, but they were still awarded the mark.

Unfortunately almost every candidate forgot, or had not learned, that business PIT is charged on a cumulative basis, nor that is the tax table applied to cumulative income, giving full benefit of the free amount from the beginning, even if the activity commences later in a tax year. Only two candidates remembered that December

tax is not computed but an identical sum to the November tax is paid. Apart from failing to earn 4 marks these errors increased the calculation work. One mark was given for the October tabulation if ordered correctly.

The final computation, part (d), was in fact done well, correctly gathering the various incomes (neat workings in the earlier parts helped considerably) and correctly claiming reliefs for donations, double taxation and child deduction.

Generally this question was not done very.

Question Three

This question mainly concerned partial exemption, and was generally well answered, although some demonstrated a lack of basic knowledge.

While most candidates understood that prior year taxable/ total activity proportion applies during a year, very few for half a mark correctly rounded it up to the nearest full percentage (a rare benefit given by the legislator!). This, being 80% in this example, made calculations easier. Many failed to self charge output on the import of services, or to claim input at the 80% proportion, although the service clearly concerned the whole activity of Edukon. Format of the VAT account was a little chaotic in some cases: candidates make life easier for themselves and the marking process by using two clear columns for input and output, and by not accumulating items in the question, which asked for each item to be booked/ described. Many erroneously treated the data given as gross, despite clear instructions.

The majority knew that at 2% or less exempt activity, full input recovery applies, and also explained well the year end correction procedure, which will continue while the fixed asset correction period continues. Identifying details required on a VAT invoice presented no difficulty.

Question Four

This question tested candidates' ability to make an intelligent choice of taxation method in circumstances where an option is available. Basic knowledge of VAT, taxation of rental income and the alternative flat rate method, and the tax card method were required.

The decision of Adrian as to whether or not to register for VAT surely depended on the input tax he would now recover balanced by the loss of revenue he would need to suffer to keep his existing non-registered customers (only). Many candidates got confused trying to compute his results if registered/ not, and many treated the output tax he would charge on all sales as a cost, or did other inappropriate calculations on output tax.

Similarly with Barbara's decision on whether to opt for flat rate tax on revenue from rental. A considerable number unnecessarily calculated her entire income tax liability, when the salary was provided simply to inform that she was a top rate taxpayer, and the comparison was between 40% marginal tax on income and flat rate tax on revenue. A few calculated the overall effective rate, which is irrelevant. Common errors included taxing income, not revenue at flat rate; forgetting that rent revenue has a sliding scale; miscalculation of depreciation; and often applying the 19% business rate, which is an entirely different form of flat rate tax.

The tax card method was usually generally understood, with a few errors of principle, omissions, and some misapplications of the "% increase" rules.

Suggestions as to why the legislation permitted such options were not well answered. Reduction of administration is a valid reason for all 3 cases, ease of checking and reduction of non-disclosure (points (b) and (c)), a perceived lack of taxpayer income tax knowledge as regards rent, simplicity and even reduction of unemployment in the case of the tax card would all earn a mark.

Although many candidates earned 4 marks out of 4 for particular parts, many wasted time on incorrect calculations and overall this question was answered poorly.

Question Five

This question examined permanent establishments, and computation of final tax for a Polish company with a foreign branch plus other foreign income, all involving credit relief. Rules for determination of permanent establishment and the effect were generally known. The straightforward computation was not done well. Apart from layout and calculation errors:

- Almost no candidates grossed up the subsidiary's dividend for the underlying foreign tax as well as the dividend withholding tax in the computation. This method was fought for hard and won a few years ago, and is of course more beneficial than simply grossing up and then allowing for withholding tax. This was particularly surprising in that a fair number of candidates did use the correct grossing up when doing the test of whether foreign tax was higher or lower than Polish equivalent tax on the foreign income, which would be illogical when the entire gross foreign revenue had not been included in the computation of income. These candidates were awarded their mark for the test (although it was illogical) but failed to earn the full 2 marks for grossing up the dividend.
- Some candidates failed to compute "Polish taxable income" for "head office" and "branch" the way they are taught, in two columns, thus making the branch local tax test impossible, and also throwing a lot of disorder and confusion into the actual computation, for depreciation, cross-charge of management charges, and disallowable cost of entertaining. As mentioned in the last examination report with reference to personal tax, whichever relief method is applied it is crucial to arrive at the separate income from each source.

As a small warning to future candidates, the test for Polish equivalent tax at 19% of the relevant income is permitted in this case, since the company had no reliefs, and its effective rate was exactly 19%: this will not apply in personal income tax questions, nor in any where the effective rate is reduced by reliefs: the strict and correct wording in both income tax laws is "Polish tax applicable to ("przypadający na") the relevant income".

In arriving at credit for foreign taxes many failed to test whether the foreign tax deducted was less than equivalent proportion of Polish tax on the particular income: this was not important in the case of Norwegian interest withholding tax, which was only 5%, but the extra half marks available for Swedish branch income and dividend were not earned.

As stated in the last report: This test is for proportional tax. The law states that this is done by taking total Polish tax times the proportion of the foreign income to total income, but equally acceptable is computing the effective rate and applying that to each foreign income.

The computational part of the question was generally done poorly and often untidily, pulling down performance on this question.