

Examiner's report

F6 Taxation (POL)
December 2009



General Comments

Performance in this exam was somewhat disappointing, in particular since although well prepared candidates passed easily, others did not perform as well. Candidates scoring a marginal fail should not be discouraged, but should take good note of the comments below and concentrate their preparation on the subjects and techniques outlined to achieve success next time.

Examiners' reports are intended to help students preparing for an exam to eliminate areas of weakness and to point to direction of study. Candidates should read this report carefully, and also earlier reports, since many of the weaknesses highlighted here have been discussed in the past.

The following major general points arise.

- Poor time allocation. Unusually, in this session many students did not attempt the long CIT Question 1 first, and often did the tax planning Question 5, clearly feeling more comfortable on the topics raised. Unfortunately many then got lost in detailed discussion and calculation, taking much more time than intended, with 4 or 5 page answers not uncommon to that 15 mark question. This led to hasty, untidy work later, with easy marks lost.
- Inadequate knowledge of rules governing reliefs. In this exam New Technology Relief (Question 1) and Rehabilitation Relief (Question 2) were tested in depth, and many candidates exhibited large gaps in their knowledge. I have in the past stated that remaining Polish Income Tax Reliefs are few and good knowledge is expected. A total of 14 marks were offered to these two areas (including depreciation of development cost and claim for costs not forming part of capitalised development expense) but unprepared candidates missed out on these marks. Be warned: the fact that these 2 reliefs were examined in December 2009 does not mean that they will not be tested again.
- Lack of understanding of the basic income tax computation structures, as regards how reliefs are given, and where they go, was shown in Questions 1(c), 2, 4(b) and 5(c).
- A certain lack of computational/numerate skill was noted. Simple requirements were made complicated through candidates performing long and unnecessary computations, generally with incorrect results. This not only led to abandoning the question or giving incorrect tax advice, but also to considerable waste of time.. Study carefully the analysis of Questions 2(c), 2(d), and all 3 parts of question 5, for advice on how to improve performance in the future. This technical requirement will not go away, and this skill will continue to be tested.

Specific Comments

Question One

The calculation of available losses brought forward was generally done correctly, though often in an unwieldy manner. Knowledge of the rules for new technology relief was often poor. Almost all failed to include previous year's expense, despite the clue given in the analysis of the intangible costs. No marks were awarded for such statements as the expense having to be paid for (it does not), owned, booked as an intangible (given in question) or discussing amortisation.

The most common errors, in descending order of frequency, were:

- Relief for withholding tax on the foreign patent receipt. Of those who claimed it, some failed to attempt to restrict it to Polish tax on the income, and of those who did try to make the restriction none remembered that relief is limited to Polish tax on the foreign income, which in

this case is not 19% as a result of the reliefs for losses and investment relief. A half mark was awarded to those remembering to claim, and a further half mark for attempting to limit it, albeit invariably incorrectly.

- Almost no-one computed the payments on account correctly. Candidates had forgotten that in the normal basis year (2006) there had been no tax to pay as a result of losses claimed, so the basis year becomes 2005. Strangely most forgot to take 19% of the “income” for the chosen year, but at least scored a half mark out of 2 if 16/12 featured somewhere in the calculation.
- Most failed to identify the items claimable for new technology relief correctly, and most got the depreciation wrong, failing to amortise the whole amount over 12 months for the 7 remaining months of the tax year, as well as claiming the relief.
- The considerable majority failed to claim as costs against revenue the general expenses that were not part of the new technology claim.
- About half did something with the deferred taxation charge, which is an accounting entry of no relevance to “real” taxation.
- Although many candidates did not put the reliefs in the computation after arriving at income, but included them in calculating income, they were not penalised.
- Some claimed the 50% cost that is allowed in PIT against patent fees, and some failed to gross up the net fees received. A few removed the fees from CIT.
- There was some confusion about which way round the movements in provision and accrued interest should go. Some disallowed the new provision for bad debts, instead of adjusting for the change in provision.

Identification of four of the many areas where application of Polish tax depreciation rules fails to concur with IFRS presented few difficulties for those who attempted the last part of Question 1. Invalid points included the reducing balance method itself and the commencement of depreciation in month following acquisition, both quite acceptable under IFRS. Also stating the 3,500 limit without explaining that it might be inconsistent with materiality failed to earn full marks. Oddly, no-one picked up the possibility under tax rules of applying straight line and reducing balance to different assets in the same category, but there were plenty of other items to discuss. A dozen feature in the model answer, and there are more.

Question Two

What seemed to be a straightforward tax computation for a professional partnership was done perfectly by a considerable minority of candidates, with general confusion over the ZUS cost of the partners, which is clearly allowed. Some mistakes were made in the other adjustments for travel, and not all candidates disallowed the hotel VAT expense. If a candidate stated that the newspaper costs he was disallowing related to non professional papers he was awarded the mark, although the purchase of periodicals by a firm seems a legitimate cost.

The confusion on ZUS extended to the individual partners’ computations, with many claiming it a second time, though those who had disallowed it in part (a) and now claimed it for the individual were not penalised. Some interesting but incorrect treatments of the private pension contribution were done (they are not allowed in Poland), and a surprising number claimed the standard “getting to work” cost that is allowed for salaried workers, but never to the self-employed. Students repeating these errors for all partners lost marks only once. Most candidates correctly computed Ludwika’s tax on a “joint” basis, though several took the internet relief in the wrong stage of the computation, either effectively giving it

twice or giving it as a direct tax reduction. A few failed to restrict the relief to the PLN 760 limit, or invented fictitious limits.

Knowledge of the rehabilitation relief for Maria's disabled child was generally very poor. Only a few claimed the child tax reduction for the 4 months that the child resided with the taxpayer.

A common feature of many answers was computing health service contributions, clearly asked to be ignored in the requirements, which should be read carefully. This confused the answers to this and later parts, and wasted time.

The third part asking for a comparison with 19% tax was worth only 2 marks and thus expected to be easy, so students who did complex recomputations should have realised that they were wasting time. The most common error of those who attempted this part sensibly was taking the incorrect income figure, using tax base after reliefs instead of income. Again this demonstrated lack of understanding of the basic computation format.

The final part asked for intelligent reasoning of the effect of a proposed plan, and, as seen in the model answer, needed only a calculation of the increase or decrease in each partner's tax base at MARGINAL rate, which can easily be performed for 3 marks: again candidates who spent a lot of time on complete recomputations (with health contributions, costs of getting to work, reliefs thrown in for good measure) should first have paused to think what was really required. The marks on offer are an accurate measure of the complexity and time that a problem should take.

Question Three

The VAT "T" account required good knowledge of the treatment of a variety of not so unusual transactions. The most common errors demonstrated were:

- Self charging output tax when the Customs Authority has charged the input tax which the importer must pay.
- Restricting input tax on the delivery vehicle to 60%.
- Failure to restrict the lease payments on the passenger car correctly to 60%, and thus exceeding the PLN 6,000 limit with the first monthly payment. This was done correctly by very few, but the failure to restrict both payments only lost one mark.
- Charging output tax on materials taken out of stock for valid samples was incorrect, but not penalised.
- Some confusion on the gift packages distributed outside and within the company.
- Failure to recover the output tax on the bad debt. However, claiming it as an input, as opposed to a reduction of output tax, was kindly allowed, since the effect is the same, although this is technically incorrect.

Deep knowledge of correct tax points was rarely shown, with a lot of guesswork going on. Tax point rules are very precise.

Nonetheless, performance on the whole on this question was satisfactory.

Question Four

No candidate was able to correctly state what to do about ZUS when a taxpayer has more than one source of earnings: the suggestion often made that he can choose which source to pay from is naïve! Although some stated that employment may eliminate need to pay ZUS from registered business

activity, few stated that the employment earnings must exceed a minimum (but were not penalised), and no-one picked up the full points on assignment contracts, where contracts for employer are treated as employment, and thus not exempted.

Whilst most identified the upper earnings limit for disability contributions, few picked up both points on accident insurance, and although it is only assignment contracts outside the employer's premises that avoid this contribution the mark was given for stating "work done away from employer's premises". No-one mentioned that the guaranteed workers' benefit fund payment is not made for millions of State employees.

The computation for an individual with foreign earnings was generally confused, with the following common errors:

- Failure to correctly arrive at total Polish and South African income separately before cumulating. This step is crucial to the later part of any such computation, irrespective of which double taxation relief method is to be applied.
- Not claiming the standard cost (for 3 months) of employment in South Africa. Polish tax law is kind here, in that the "cost of getting to work" is deductible wherever the work is and however the worker travels to get to it, even if he walks or lives on the premises.
- Failure to take 30% of the meal allowance for South Africa.
- Using credit rather than exclusion relief, and also somehow reducing income by South African Tax.
- Not computing the on account PIT collection in Poland
- Charging Polish ZUS on the South African salary. Who would collect it?

Finally, the reason for Dziki's Polish residence status is neither employment, nor citizenship, nor staying over 183 days, which he did not. However, most candidates somewhere mentioned the "centre of interests" to earn the mark.

Overall, large gaps in knowledge were exhibited in both parts of this question, which had the lowest average mark.

Question Five

This was the most popular question, often attempted first. However, with the exception of quite a few excellent texts from candidates who clearly enjoyed the analytical elements required, it was generally poorly answered. This was generally due to failure to grasp the effects of the 3 proposed actions: instead candidates went into a mass of often fruitless and irrelevant computations. To assist in future I analyse below each of the 3 scenarios to demonstrate how straightforward the requirement was.

The first involved utilising a bank instead of parent company to provide funding and thus, quite legitimately, avoiding the thin capital interest disallowance. The strategy was spotted by all but a very few, but the effects were rarely analysed properly. Firstly it was necessary to compute the Polish tax saving of 19% on interest on PLN 5mln at 5%, i.e. 47,500 for 2.5 easy marks to date. (Here many got lost with multiple unnecessary calculations). Then, and this most failed to do, this needed to be compared to the additional cost to the group of using the bank, which was 0.5% on 8mln, an annual cost of PLN 40,000, for a simple mark. For half a mark, which few earned, it was merely necessary to state that the arrangement fee of 20,000 needed to be considered in the overall picture, and perhaps venture to state that the whole activity did not warrant the effort, to score a bonus half mark.

The second part was a transparent transfer price manipulation, and again the overall tax saving should have been computed to earn 2 marks. The third mark was awarded if candidates mentioned the risk of investigation and big penalties, or at least the need for documentation, although it is difficult to see what quality of documentation could cover such abuse. This bit was well done.

Since 5 marks were on offer for the question of the employee asking to delay her bonus to the new year, and the drop in PIT was accurately described in the question, it clearly demanded more of candidates than stating the obvious (for 1 mark) that she was attempting to have the bonus taxed at a lower rate. Most candidates proceeded to undertake annual tax computations for each year with and without the bonus, getting into a mess and rarely concluding, often quite missing the correct ZUS and PIT rates. The answers were so confused that a further mark was awarded for computing any apparent saving, although not all quite correct. Few spotted the ZUS rate point in their lengthy computations. The CIT cost allowance this year as opposed to next was not a relevant point.

Now, please see how a little thought makes the thing simple. The only issue is the marginal taxations (plural) on the PLN 10,000 bonus, so the allowed cost and ZUS deduction from Helena's normal salary and earlier bonus are of no relevance, and health service contribution is identical whenever the bonus is paid. It should be easy to see that her existing pay to date for 2008 is 86,000 but ZUS of 13.71% on most of it and the cost allowance come off that, so she is marginally suffering only 30% tax on this 10,000 bonus, but most candidates automatically stated that the bonus was subject to 40% PIT. This gross pay of 86,000 was not chosen by chance, but to point candidates to the fact that she is now over the upper earning limit for the year (of 85,290) so she bears only the sickness insurance of 2.45%. And of course if the bonus is delayed to the new year she will indeed suffer PIT at only 18%, but the full ZUS cost of 13.71%.

Hence, simplifying the model answer (qv):

If paid in 2008 she gets $10,000 \times 97.55\% \times 70\% = 6,829$

If paid in 2009 she gets $10,000 \times 86.29\% \times 82\% = 7,076$, saving 247 only.

This was all that was required for 4 easyish marks. The fifth mark? Well, the question asked for the overall saving, and no-one thought to deduce that the employer might not be overly happy to suffer the additional employer ZUS of 1,426, giving the scheme a negative saving.

Fortunately the ethical aspects were well identified, with impressive protest about the dreadfully immoral multinational the like of which is rarely seen in real life in Poland. A very few were overly cautious about the first and third schemes, often experienced by practitioners. Some confused the risk of being caught with the ethical rights and wrongs.