



# Examiner's report

## F6 Taxation (CHN)

June 2015

### General Comments

There were two sections to the examination paper and all of the questions were compulsory. Section A consisted of 15 multiple choice questions (two marks each) which covered a broad range of syllabus topics. Section B had four questions worth 10 marks each and two longer questions worth 15 marks, each testing the candidates' understanding and application of tax knowledge in more depth.

In addition to the specific issues on each question, some bad practices which future candidates should avoid are:

- Not leaving enough space between lines, in particular those candidates with poor handwriting
- Not starting a new page for a new question

This is the first examiner's report since the introduction of the new exam format and question types. The following paragraphs report on each section and focus on some of the key learning points.

### Specific Comments

#### Section A

It was very pleasing to see that almost all candidates attempted all of the questions. However, candidates are reminded to use the answer grid provided for Section A, and not put the Section A answers on the Answer Book of Section B.

Candidates preparing for the next examination of F6 are advised to work through the pilot paper and sample questions discussed here and to carefully review how each of the correct answers were derived. Section A questions aim to provide a broad coverage of the syllabus, and future candidates should aim to revise all areas of the F6 syllabus, rather than attempting to question spot. The following question is reviewed with the aim of giving future candidates an indication of the types of questions asked, guidance on dealing with exam questions and to provide a technical debrief on the topics covered by the specific questions selected.

#### Sample Question for Discussion

##### Example 1

A Chinese company has borrowed a USD500,000 loan from an overseas bank. Interest on the loan is accrued and paid annually at the rate of 12% per annum. The relevant business tax rate is 5% and neither surcharges nor treaty relief apply.

**What is the amount of enterprise income tax (EIT) the Chinese borrower needs to withhold from the annual interest paid to the overseas bank?**

- A USD6,000
- B USD15,000
- C USD5,700
- D USD14,250

This question tested the knowledge of (1) the tax rate applicable to a non-resident which (2) does not have a China permanent establishment and (3) whether business tax can be deducted before calculating the EIT.



The EIT rates of 25% and 10% were given in the tax rates table. Candidates need to select the correct tax rate, which is 10%. Before the 2008 EIT Law, business tax could be deducted in calculating EIT but since 2008, EIT (or withholding tax) is calculated without deduction of business tax [tax notice Guo Shui Fa (2009) No. 3, Article 8].

The correct answer was A. Interest = USD500,000 x 12% = USD60,000; EIT = Interest x 10% = USD6,000.

## **Section B**

### **Question One**

This 10-mark question covered the topic of land appreciation tax (LAT)

Part (a)(i) for 1 mark was about the tax exemption threshold for ordinary residential property. Performance was good and many candidates got the right answer.

Part (a)(ii) for 6 marks is a typical LAT calculation for property developers. A few candidates got full marks. Key items which candidates need to calculate were "Costs of constructions" (or Development Costs) as the limit of Management and Administrative Expenses and Additional deduction for property developers are calculated based on this. Some candidates did not know that Deed Tax should be treated as the cost of obtaining the land and treated it as the taxes on sales. When the interest was from borrowing from financial institutions, the cap of Management and Administrative Expenses (excluding interest) is 5%; if the borrowing was not from financial institutions, the cap is 10%. Some candidates could not differentiate and used 10% instead.

Part (b) for 3 marks required candidates to calculate the LAT on the sale of used properties. Most candidates lacked the knowledge on the special formula. Some candidates counted the number of years incorrectly (correct answer was 18 years = year 2014 – year 1997 + 1).

A typical careless mistake was using 3% as the business tax rate while the 5% could be found from the tax rate table.

### **Question Two**

This 10 mark question was on anti-avoidance and application of tax administration concepts on simple cases. This question was poorly answered and some candidates did not attempt this question.

Anti-avoidance is a worldwide concern of all countries, including China. This was also one of the major changes in the 2008 Enterprise Income Tax Law. However, no candidates were able to get part (a)(i) correct.

Part (a)(ii) required candidates to apply the tax appeal knowledge in a simple case, and some candidates got full marks.

Part (b)(i) tested the application of transfer pricing knowledge. The majority of the candidates forgot to mention the company receiving the income needs to pay tax in full.

Part (b)(ii) asked candidates to state the taxes on interest. While almost all candidates could get one correct answer, i.e. business tax, a number of candidates stated VAT and some even stated customs duty and consumption tax. It seems that some candidates did not know the scope of these taxes.

### **Question Three**

This 10-mark question covered value added tax (VAT). While most candidates attempted this question, it was poorly answered.



In 2009, China adopted the consumption-type VAT which allowed input VAT on fixed assets to be credited against future output VAT. Construction materials for building and construction services are still under the business tax regime and this is the next stage of VAT reform. However, performance on part (a) was disappointing. Only a few candidates mentioned fixed assets but still got the answer incorrect.

Part (b) was poorly answered because of the lack of knowledge. Under the tax law, some terminologies have special definitions, for example, the term "abnormal loss" is defined in VAT Rules. Hence, "not normal loss" is not equal to "abnormal loss". From a logical point of view: All losses = Normal loss + Abnormal loss + Other losses which are not normal but not fall under the definition of abnormal loss.

Part (c) was unexpectedly poorly answered. Most candidates did not know the mechanism of the VAT calculation, i.e. firstly, calculate each item of input VAT; then, calculate the irrecoverable input VAT. Some candidates added up total purchases, less the losses and applied a VAT rate; some calculated each item of creditable VAT. Some used the wrong VAT rates on electricity (e.g. 13%, 11% and 6%).

#### **Question Four**

This 10-mark question covered the topics of consumption tax and business tax.

Part (a) for 4 marks required calculations of consumption tax under different scenarios. Unfortunately, a lot of candidates did not read the requirement carefully and did not calculate the tax under the existing model. This part was either right or wrong, those candidates lacking the knowledge got wrong, and those candidates who were prepared scored well.

Parts (b) and (c) for 8 marks were about business tax. Those with the knowledge on the special formula got the correct answers. However, a lot of candidates forgot to calculate the business tax on sale of property under part (b)(ii).

#### **Question Five**

This 15-mark question was the typical enterprise income tax calculation and a lot of candidates got high marks from this question.

However, in addition to lack of knowledge of some candidates, some bad practices were:

- Not stating "no adjustment" (or zero) which is required in the question but used "deductible", "not deductible", "taxable" etc
- Using the candidate's own numbering system but at the same time without any description. Some candidates had 17 items but some had 18 items. It is difficult to determine what is meant by item (15).
- Grouping (a), (b) and (c) as one item and stated "no adjustment" while the treatments of (a), (b) and (c) were different

Having said that, there were improvements from previous exams that a lot candidates stated in their working clearly the "+" or "-" and no candidates used "irrelevant".

Part (b) for 4 marks was unexpectedly well answered and a lot of candidates got 3 of the 4 marks. Some candidates were not aware that the company was a high and new technology enterprise and could enjoy the 15% enterprise income tax rate.

#### **Question Six**



This 15-mark question was another typical question for individual income tax (IIT). Again, this question was well answered.

Part (a) for 4 marks was about the IIT on sole proprietorship. Some candidates gave contradicting answers by stating salary of proprietor was not deductible except for the allowance of RMB3500 per month in (a)(i) but deducted all the salaries in (a)(ii). Only some candidates knew that the deduction was RMB42,000 for a year.

For part (b) for 2 marks, some candidates used complicated grossed-up methods to calculate part (b) without reading the question that the amount was gross of tax, not net of tax.

Part (c) for 4 marks tested candidates' knowledge on taxable and tax exempt items for wages and salaries. Candidates were recommended to use the "addition method" instead of the "deduction method" in calculate the tax base.

Part (d) for 5 marks was well answered. However, it's a pity that minority candidates who could not finish the paper had not attempted this part, which indicates that they had spent too long on other questions.