

Examiner's report

F6 (CZE) Taxation

December 2016

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 Czech taxation system in more depth. 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 all candidates attempted all of the questions. Candidates preparing for the next examination of F6 are advised to work through the specimen questions 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 two questions are 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 Questions for Discussion

Example 1

Petra has her permanent home in Pardubice where she lives with her family. In 2016, she received the following benefits in kind from her employer: (1) A watch with a value of CZK 1,800 on the occasion of her 50th birthday.

(2) The use of a flat in Prague in May where Petra lived during the working week, for which her employer paid a monthly rent of CZK 9,000.

(3) CZK 30,000 for her family holiday trip, which was paid direct to the travel agency from her employer's social and cultural fund.

(4) CZK 11,000 for her son's German language course, paid directly to the language agency from her employer's social and cultural fund.

What total amount of the benefits-in-kind on which Petra will be taxable in 2016??

- A CZK 15,500
- B CZK 18,300
- C CZK 20,800
- D CZK 10,000

This question tested the knowledge of how the benefits-in-kind are treated on the side of an employee. Certain benefits in kind are tax exempt without any limitation, some of them are exempt up to certain thresholds. Mostly it is also important how they are treated on the side of the employer, whether they are paid from funds after corporate taxation, or whether the employee claim is included in certain employer's guidance.

The correct answer was A. A birthday present up to CZK 2,000 is tax exempt, rent for temporary dwelling is exempt up to CZK 3,500, a holiday trip is exempt up to CZK 20,000. The language course is exempt.

Example 2

Which of the following payments made by the company Hrana, a.s., a Czech tax resident, will be subject to withholding tax at source?

- (1) CZK 67,000 to a branch of a German company, which forms a permanent establishment in the Czech Republic for maintenance work on Hrana's equipment.
- (2) CZK 8,900 to Mr Dvorak, a Czech citizen and resident, based on a contract on work done (dohoda o provedeni prace). Mr Dvorak did not sign a Declaration for credits
- (3) CZK 23,000 to Lease Ltd, a UK tax resident, as an instalment under a financial lease contract
- (4) CZK 50,000 as a dividend to Brana, a.s., a Czech company, which had held 15% of Hrana, a.s.'s shares for 18 months at the time the dividend was paid.

- A 1, 2 and 3
- B 2 and 4
- C 2 and 3 only
- D 3 only

This question tested withholding tax and its application by a company making various types of payment. The payer of the income must decide whether the income is taxed by the recipient himself in his tax return, or whether he shall apply withholding at source. There could also be a situation where withholding is generally applied, but under certain conditions the income is tax exempt.

The correct answer was C. Income on Dohoda o provedeni prace up to 10 thousand monthly is taxed by 15% WHT. Financial lease payments paid abroad are also subject to WHT (5%). The payment to a German branch is taxed in its tax return and the dividends in the example (4) are tax exempt as they meet statutory conditions.

Section B

The structure of this section was similar to the previous examinations. The questions require the students to prove knowledge in basic rules and computation of taxes, and of basic schemes. Nevertheless each test is different in detail, i.e. it tries to make students to reflect the basic knowledge and apply it to particular situations of companies or individuals. Though the questions aim at testing new provisions of tax law, candidates will be better prepared if they spend time on issues commented on in previous examiner's reports. We see that the candidates are good at using schemes, formulae and prescribed computations. Where they score less marks, is when they are required to think about a tax solution, when they have to reflect and reason a certain situation from the tax view. Again we have to point out that layout and clarity of presentation is important in order to gain good marks.

Question One

This 10-mark two-part question was on various aspects of tax administration.

From comparison with previous years candidates are showing a better knowledge of tax administration principles and rules. This is a good development as in previous years we always stated that tax administration answers had been unsatisfactorily answered. However, a number of candidates did not address some parts of this question at all. Candidates generally showed a good knowledge of penalty computation. Future candidates should pay more attention to the knowledge of time limits for assessment of tax and for paying and withholding tax. Candidates should pay more attention as well to general rules of tax audits and tax procedure, including taxpayers' rights and obligations.

Part (a) for 5 marks had three parts. First candidates had to compute the penalty. Then they had to state the statute of limitation in a particular case of corporate tax liability. Lastly candidates were asked to list any three obligations of a corporate taxpayer with respect to the conduct of the tax audit.

Candidates showed good knowledge of penalty computation and the general rules for statute of limitation. Future candidates should focus on the practical application of the rules in case a tax audit was opened. Candidates should also particularly know the obligations of taxpayers at tax audit. Mostly they stated only generally that the taxpayer is obliged to provide any documentation, many of them forgot about the facilitation of the discussion with employees, some of them stated the provision of the place for carrying the tax audit. While the provision of the essential information about organisational chart, about employees' roles, about deposition of accounting books, particularly the provision of any evidence proving the facts included in the tax return or the obligation not to hide any evidence that is at the disposal was not mentioned.

Part (b) for 5 marks required candidates to calculate withholding tax in two situations. It was based on a case of company Adria, a.s. which paid dividends to its shareholders, and financial lease payments to a German company. Besides the calculations the students were asked to state the deadlines for payments of the withholding tax to the tax authority.

Where the candidates gained mostly full marks was the part regarding the withholding tax from dividends. The candidates showed good knowledge of exemption for corporations and rules for individuals. Where the performance was unsatisfactory was the question about the finance lease payment abroad. The point was that the candidates should show the knowledge of grossing up the tax base for withholding tax which mostly they did not and therefore could not get full marks for the answer.

Future candidates should read carefully the requirements, e.g. not to compute default interest when it is not required. To gain full marks it is also important to study the basic time limits for paying withholding taxes.

Question Two

This 10 mark question was based on Lukas's situation. He had been an entrepreneur and at the end of 2015 he retired. The question tested the income tax treatment of other income, as pensions, sale of various assets, gifts and inheritance income, and also capital income.

The question was answered satisfactorily by most candidates. They were able to judge appropriately whether income from sale of the cars or of shares is tax exempt or taxable and from what tax base. Candidates were able to gain marks when stating exempt income and the conditions for exemption or when stating interest is not included in the tax return as it had been taxed by withholding tax before.

Many candidates presented their answers well. Again those that explain why certain figures are not included in the calculation, e.g. exempt amounts, were able to gain full marks. Those who scored less marks were e.g. those who were not able to judge what part of pension is taxed exempt, or they confused the inheritance of the garage and the sale of garage, or they did not consider insurance benefit as tax exempt. Future candidates should look at the rule for exemption of gifts for groups of taxpayers that are not relatives.

Question Three

This 10-mark question was a two part question on value added tax. Performance on this question was less satisfactory compared to previous years. Future candidates should focus more on judgement and consideration of various tax rules on particular practical situations. It seems that when the candidates are required to compute and use certain prescribed schemes (as tax return) they have good knowledge and practical skills. While thinking about tax rules and describing them or applying them, it is a little bit more difficult for them.

Part (a) was based on a company Arrmora, a VAT payer, and the candidates were asked to judge four output and three input supplies from the perspective place of supply. Furthermore for output supplies they had to judge

whether the supply was taxable or exempt in the Czech Republic and whether it was necessary for Arrmora to register for VAT in any other state. For the input supplies they were asked to explain how any VAT will be paid or input deduction claimed. They were particularly signaled that no computation is required from them.

Performance on this part of question was mostly satisfactory. Where the candidates scored fewer marks, this was where they stated incorrectly the place of supply.

Part (b) was based on Sekunda, s.r.o. a VAT payer, and their three situations. Candidates were required to consider a sale of “second hand” asset, sale of land which is not a building plot and finally rental of a building and compute VAT payable/deductible. The performance of this part was unsatisfactory. Most of the candidates did not apply a special regime for second hand assets. Only a few candidates knew that from 2016 the reverse charge mechanism is used. Few candidates judged correctly the final situation where VAT deduction previously claimed has to be adjusted as Sekunda started to use the building for exempt supplies.

For future candidates it is recommended not only to know the basic rules for VAT computation in common situations, but also focus on special rules as sale of second hand assets, exemption of land and buildings and adjustment of previously claimed VAT for business assets.

Question Four

This 10-mark question covered the topic of tax deductible expenses connected to usage of certain assets in the business of the company DENG0. The candidates were required to compute tax depreciation charges and any other tax deductible expenses.

Overall the performance of this question was unsatisfactory. It is pleasing to see that the candidates are pretty skilled in the computing formulae for straight forward and accelerated depreciation. Where they scored less was because of wrong judgement of the input price, or where they omitted to include among tax deductible expenses other expenses as repair of roof, or maintenance expenses for software. The most common mistakes could be seen for the premature termination of the finance lease contract. This was a situation where candidates had to compare the residual value with the purchase price for which the straight forward method has to be applied.

Future candidates should carefully read the question background in order to judge the situation of an asset as a whole, not only from a tax depreciation perspective. Tax depreciation rules for intangible assets are pretty straightforward, unless technical appreciation is applied. Future candidates should know the formula in such a situation.

Question Five

This 15-mark question was based on situation of Libor, an executive manager of Bluma, who also runs his own business in real estate and writes articles in technical journals. His family situation was described in order that candidates may decide what personal credits should be applied in his tax return. Libor had income from abroad as well so the question also tested foreign tax credit computation. Candidates were asked to prepare Libor's 2016 income tax return and calculate the tax payable

Performance on this question was very satisfactory. Candidates showed good knowledge of setting partial tax bases for employment, business, capital and other income. Candidates managed to structure the whole income tax return correctly, using tax allowances that are to be subtracted from the tax base and tax credits to be subtracted from the tax liability. It is pleasing to see that candidates mostly judged correctly that the income from writing articles in newspapers is taxed by withholding up to 10 thousand monthly. Higher amounts had to be included in the tax return. Also the knowledge of how to use and compute solidarity surcharge is quite common among candidates.

Future candidates should be aware of special situations when using common rules, e.g. fringe benefit for having a business car at disposal also for private purposes is included, though Libor did not actually use it. Additional taxation of life insurance when it is terminated and the taxpayer used tax allowances in previous years is a quite important rule.

In some cases, the layout and working of calculations were unsatisfactory, thus some candidates were not able to obtain marks as markers could not follow the answer. Future candidates should pay attention to layout and explain why they did not include certain income in the tax base, e.g. it was exempt or not subject to tax.

Question Six

This 15-mark two-part question was based on a situation of the company MOWE, a Czech resident company whose income tax return was prepared by a tax advisor. It tested candidates' knowledge of the corporate income tax rules regarding determination of the income tax base.

In part (a), the accounting profit was stated directly in the question itself, the question further listed situations in the corporation that test candidates' knowledge how to adjust this accounting result in the tax return.

Part (a) for 13 marks required candidates to calculate the corporate income tax liability coming from the accounting profit set in the question. It tested candidates' capability of preparing the corporate income tax return, doing adjustments to the accounting profit to comply with the relevant tax legislation and using tax allowances as for tax losses, gifts and R&D expenses.

Performance on this question was very good. Many candidates were able to determine what adjustments – up or down – had to be made to the accounting profit. The question focused e.g. on tax deductibility of employees' benefits (vitamin packages, injury insurance, rental for temporary dwelling of employees, severance payment), treatment of interest under thin capitalisation rules, indirect expenses under rules of paying dividends to parent company, treatment of certain expenses that are tax deductible only if they are paid (tax on immovable, contractual penalty). The candidates had also to judge whether there is a need for adjustment when a liability is due for certain number of months.

The majority of candidates showed good knowledge of various structural elements of the tax base and the structure of calculating the tax liability. Where candidates did not tend to score well this was when they judged incorrectly the tax deductibility of some of the fringe benefits. Future candidates should pay attention to explicitly mentioning items where no adjustment is necessary with the explanation, in order to gain full marks. Further they should focus on better layout and way of showing up and down adjustment figures.

Part (b) tested provisions for overdue receivables. It is pleasing to see that many candidates are aware of the difference between rules used until the end of 2013 and rules applied from 2014. The performance on this part was good.