

Examiner's report

F6 Taxation (CZE)

June 2015



General Comments

The examination consisted of five compulsory questions. One question for 30 marks, one question for 25 marks and three questions of 15 marks each.

The vast majority of candidates attempted all five questions, and there was little evidence of time pressure. Where questions were left unanswered by candidates, this appeared to be due to a lack of knowledge or poor exam technique, as opposed to time pressure.

A small minority of candidates answered question 1 last. This question focussed on a corporate tax liability computation and it seems the majority of candidates are strong in this area. However, this question required a significant amount of computational work and leaving this question until last can be a risky strategy.

Candidates performed particularly well on questions 1(a), 1(b), 2(a), 3(b), 5(a) and 5(c). The questions candidates found most challenging were questions 2(b), 3(a)(i), and 4(a) to 4(f). This is mainly due to candidates not understanding core syllabus areas well enough and a lack of technical knowledge.

A number of common issues arose in candidates' answers:

- Failing to read the question requirement carefully and therefore providing irrelevant answers which scored few, if any, marks.
- Poor time management between questions, some candidates wrote far too much for some questions and this put them under time pressure to finish remaining questions.
- Illegible handwriting and poor layout of answers.

Specific Comments

Question One

This 30-mark question was based on a production company, Material, a.s., and tested candidates' ability to make necessary adjustments to the accounting profit for tax purposes. It also tested candidates' knowledge of cross-border payments of dividends and royalties, mainly in respect of group companies.

Part (a) for 24 marks required candidates to prepare the corporate income tax return and tested candidates' capability of preparing the corporate income tax return by calculating the accounting profit first and deriving the tax base from it, including adjustments to comply with the relevant tax legislation, namely tax deductible and non-deductible costs. The majority of candidates were able to complete this requirement to a good standard.

Weaker answers were presented in a columnar format whereby candidates used a number of columns to set out revenues, expenses, addbacks and deductions and a further column for explanations and calculations. This format for calculations was not easy to follow, and for future candidates it is recommended that they start with revenues and expenses and calculate the accounting profit first, followed by addbacks and deductions, as shown in the published suggested answers.

The majority of candidates demonstrated sound knowledge of tax depreciation rules. However some candidates made mistakes when calculating residual values for the stolen and sold assets. A significant proportion of candidates were unable to make the necessary adjustments to receivables and candidates are reminded to familiarise themselves with the rules that are being applied from 2014.

Most candidates showed very good knowledge of various structural elements of the tax base and the structure of calculating the tax liability.

Part (b) was a four mark question requiring candidates to state how dividends paid to two shareholders from EU states were to be taxed. The vast majority of candidates proved able to discuss the treatment of dividends under EU Parent/Subsidiary directive rules. However, mistakes occurred in determining the time limit for paying withholding tax.

Part (c) was a two mark requirement focused on the taxation of royalties paid among group companies within the EU. This requirement was poorly attempted and most candidates did not know the relevant rule under the EU Interest/Royalties directive. Candidates who recognised that as the exemption is given based on an appeal to the financial authority if they mentioned that the tax is withheld according to the particular double tax treaty they were awarded credit.

Question Two

This 25-mark question covered the personal income tax calculation for Ivan, an employee who during 2014 also earned business and rental income and income from the sale of assets. Candidates were provided with detailed information regarding his family situation to allow candidates to decide what personal tax allowances could be applied in his 2014 tax return.

Part (a) for 21 marks required candidates to prepare Ivan's 2014 income tax return. Candidates demonstrated the ability to apply rules for the computation of separate partial tax bases for employment, business and rental income. Candidates proved less able to deal with the capital and other income. It was pleasing to see that many candidates managed to structure the whole income tax return correctly, using tax allowances that were to be subtracted from the tax base and tax credits to be subtracted from the tax liability. Many candidates showed a good knowledge of computations of solidarity surcharge and foreign tax credit. Where candidates opted to use the exemption method according to the local law marks were awarded accordingly.

Common mistakes in part (a) included:

- Lack of knowledge of how gifts to employees are taxed. Only the value of the gift up to CZK 2,000 is exempt. Where candidates included the whole value and subjected it to social security premiums this was limited to ½ marks.
- Uncertainty over how to deal with Ivan's contract income. The level of income compared to the limit of CZK 10,000 monthly from one employer determines whether this income is subject to social security and health insurance premiums and also whether it is taxed by withholding tax or by tax advances. Even when the income was taxed by withholding tax the taxpayer may opt to include this income in the annual tax return and use the withholding tax as tax advances. Candidates gained marks for both alternatives. However one should still keep in mind that such income, even when included in the tax return is not part of the supergross salary.
- Lack of knowledge regarding the treatment of the sale of shares. Many candidates did not know the new rules valid from 2014. The previous 6-month holding period was substituted by a 3-year holding period and CZK 100,000 annual threshold. Candidates were awarded marks for assuming that the situation involved either a minority shareholder or majority shareholder.
- Failing to classify the spouse's income correctly, though many candidates knew the limit, there was a lack of knowledge regarding what type of income is or is not included in this limit.

The layout and calculations of workings provided by some candidates was poor resulting in lost marks. Future candidates should pay attention to layout and to remember to include explanations regarding decisions and key assumptions, such as stating why they did not include certain income in the tax base, e.g. it was exempt or not subject to tax.

Part (b) for four marks required candidates to calculate the social security and health care contributions from business income. This question was not answered very well. Many candidates produced irrelevant answers providing details of premiums for employment income, and many ignored the cap for social security premiums on business income thus missing out on marks for this question.

Question Three

This 15-mark question was a two-part question on value added tax (VAT) testing both tax administration aspects of VAT and the ability to calculate a VAT liability. Performance on tax administration was poor while the computational aspect of the question was well answered.

Part (a) (i) for four marks required candidates to establish when Stefan, an employee and an entrepreneur, would need to register as, and become, a VAT payer. Candidates' performance in this requirement was unsatisfactory. The most important aspect of determining when Stefan would be liable to register centred on establishing when he breached the CZK 1 million limit. Candidates needed to assess the information provided in the scenario to determine which were relevant taxable supplies for this purpose, which for many depended on the place of supply. Many candidates lacked the necessary knowledge to make this decision and further there was also a lack of knowledge regarding time limits for registration and the date of becoming a VAT payer. Most candidates correctly identified the 25th of the month was the due day for filing a VAT return but this earned minimal credit.

Part (a) (ii) for two marks required computation of sanctions for late registration for VAT. Many candidates were able to provide strong answers in this area and marks were awarded for either narrative or computational answers demonstrating the application of relevant sanctions.

Part (b) for nine marks was based on Kosa s.r.o, a quarterly VAT payer. Candidates were asked to prepare Kosa's VAT return for the first quarter of 2014. The structure of the question was similar to previous years. Performance on this question was very good and only minor mistakes occurred.. For the building real estate services, candidates were awarded marks for any appropriate treatment in terms of whether the services were rendered to a VAT or non-VAT payer. Likewise regarding the sale of flats to the real estate company, candidates were awarded credit if they assumed that the VAT payer did not subject the supply to VAT if it was appropriately explained.

Question Four

This 15-mark question was a six-part question on various aspects of tax administration.

Overall this question was the poorest attempted question in the paper, and a significant number of candidates did not address all parts of the question. Some candidates did not show satisfactory knowledge regarding the computation of penalties and interest. As mentioned in previous examiner's reports questions on tax administration remain unpopular and performance was again disappointing, Future candidates should pay more attention to topics related to tax management and administration. The sanction system in tax administration follows specified rules and learning those rules can allow candidates to apply and gain marks easily in this area.

Part (a) for two marks required an explanation of the type of sanction for non-monetary non-compliance. Most candidates demonstrated little understanding of this sanction.

Part (b) for four marks required candidates to calculate sanctions for late filing of a tax return and late payment of tax. It was pleasing to see that many candidates are aware of the 'grace period' (generally 5 days) for which the tax administrator does not compute interest and penalty. Where candidates did not score full marks, this was mainly due to a failure to know when the computation of the delay days commences.

Part (c) for one mark required a calculation of the penalty the tax authority would assess on Beta following a tax audit that resulted in a change to the tax loss declared by Beta. Many candidates performed well on this question. Some did not use the correct percentage (1%) and thus gained $\frac{1}{2}$ rather than 1 mark.

Part (d) for one mark required candidates to state the time limit for reassessment of a VAT return by the tax authority. Though most candidates know the timescale is three years many did not demonstrate an understanding at the point from which that time limit is computed.

Part (e) for five marks required four situations in which a taxpayer may ask the financial authority for a ruling. Surprisingly this was a very poorly answered question. Candidates did not show satisfactory knowledge of this topic. Though the Czech legislation includes seven of such situations few candidates listed more than two situations. Many candidates gained marks for explaining that no appeal can be filed against such ruling. Some candidates spent unnecessary time providing information that was not asked for in the question, such as the administration fees for rulings.

Part (f) for two marks required a decision as to whether Martina is obliged to file a tax return in a situation when she has four types of income including employment income. Answers to this question were reasonable but many candidates failed to explain their answer, despite the requirement asking them to 'state, with reasons'. Future candidates are reminded to provide reasons as to how they reached the decision in order to be able to score full marks.

Question Five

This 15-mark question tested monthly payroll procedures and also the obligations of employers relating to tax deductibility of certain benefits.

Part (a) for ten marks required calculation of the monthly payroll for the individual concerned, Tomas, including both tax advances and social security and health insurance premiums. Candidates who realised that the fundamental information in the scenario was that Tomas signed the Declaration by his employer proceeded to answer most elements of the question well. It was encouraging to see that most candidates were able to gain appropriate marks for including gross salary, vacation compensation and compensation from employer above the statutory limit. As regards the fringe benefits many candidates included the correct figure for the use of a business car for private purposes (1% of the acquisition cost of the car), and value of flat rent (after subtracting CZK 3,500 – the amount that is exempt).

Candidates were able to gain marks when stating exempt income, i.e. contribution to pension savings, vitamin package and flu vaccination and also stating that the interest free loan had no impact on the tax base. Income from contract on work done up to CZK 10,000 is not subject to social security however it shall be included in the tax base as Tomas signed the Declaration. This was the trickiest aspect of the question and where candidates made most mistakes.

Most candidates gained marks for correctly rounding up the tax base to hundreds and stating the correct date for paying the advances to the tax authority. Fewer candidates were able to state the correct time limit. It seems that candidates are much less confident on the procedural aspects of tax administration than when calculating tax liabilities.

Part (b) for two marks required a decision as to whether Tomas's employer may prepare the annual tax reconciliation on his behalf given that he had other income as stated in the question. Many candidates were able to score at least 1 mark by deciding the answer was yes. However to gain full marks an explanation was required. Those who explained that interest, dividends and income from Dohoda up to CZK 10,000 are taxed by



withholding tax and inherited income is exempt, or even stated that Tomas had no other income greater than CZK 6,000 were rewarded full marks.

Part (c) for three marks tested candidates' knowledge of tax deductibility of five types of fringe benefits for the employer. Candidates' performance was satisfactory on this question.