



Examiner's report

F6 (CZE) Taxation

June 2017

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 did attempt all of the questions. 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, sample questions discussed here provide a good basis for this. 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

Oskar is a private entrepreneur. In 2016, his total income from his business activity was CZK 355,000 and his total costs were CZK 285,000. In 2016, he also had a part-time employment with a company, where he worked 25 hours a week for a monthly gross salary of CZK 16,000.

What are the social security contributions (SSC) and health insurance contributions (HIC) payable by Oskar in respect of his entrepreneurial activity for the year 2016?

	SSC	HIC
A	CZK 10,220	CZK 4,725
B	CZK 66,284	CZK 30,645
C	CZK 31,098	CZK 14,378
D	CZK 23,659	CZK 21,875

This question tested the knowledge of calculating the social security and health insurance contributions of the private entrepreneur. When calculating the contribution it must be considered if the business activity performed by the private entrepreneur is considered to be main or secondary activity.

The correct answer was A. Oskar had also part-time employment and therefore his business is considered to be secondary activity thus the base for calculating the social security contribution is CZK 35,000.

Example 2

Jarmila started her own business as a hairstylist in 2016, but has not yet registered for value added tax (VAT). To date she has had the following sources of income:

- (1) The sale of a car which had been included in her business assets at its purchase cost including VAT
- (2) Hairstyling services provided by Jarmila to her clients in the Czech Republic
- (3) Sale of hairstyling products to a customer in Italy

(4) Rent received from Michal, a VAT non-payer, for the use of Jarmila's hair studio for one week so he could organise his birthday party

Which of these sources of income will be included in Jarmila's turnover for VAT registration purposes?

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

This question tested the knowledge of which income is to be considered when calculating the threshold for VAT registration. Certain income is excluded from the income that must be considered at calculating the threshold for VAT registration.

The correct answer was B. The income from the sale of business assets and also income from occasional rent that does not relate to Jarmila's business is not included in the threshold calculation for VAT registration.

Section B

Question One

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

As already stated in previous years there have been some improvements in candidates' knowledge of tax administration principles and rules. However, there is still some room for improvement as this question remained one of the poorest answered questions. A number of candidates did not address some parts of this question at all. Future candidates should pay more attention to the knowledge of time limits for assessment of tax, general rules for penalty calculation as well as taxpayers' rights and obligations.

Part (a) for two marks had two parts. First candidates had to state what action needed to be done and second what was the time limit for this action.

The candidates showed good knowledge of general principles of the requirement to submit an additional tax return and pay any outstanding tax as the omission of sales was discovered after the deadline for submission of the tax return, i.e. after 1 July 2017. Some candidates indicated that there is a need to submit a corrective tax return, which is incorrect. The corrective tax return is submitted only if mistake is discovered before the submission deadline and the tax return has been already submitted. A number of candidates correctly stated the deadline for submission of the additional tax return is by the end of the month following the month in which the omission of sales has been discovered, i.e. by 31 October 2017. There was no calculation required in this part of the question.

Part (b) for three marks required to calculate additionally assessed tax and late payment interests. This was based on the fact that additional tax return has been voluntarily submitted by the company.

Many candidates failed to correctly state the additional tax base from which the additional tax has been calculated. The originally declared loss of CZK 70,000 will be increased by the amount of the omitted sales of CZK 350,000, thus resulting in the tax base of CZK 280,000. Further, future candidates should focus on knowledge of the correct calculation of the original due date from which the late payment interest is calculated. In our question this is five working days while two public holiday days must be taken into consideration. It was pleasing to see that most of the candidates correctly used the interest rate for late payment calculation, i.e. 14% plus 0,05% repo interest rate and gained marks for it.

Part (c) for three marks required calculating penalties and late payment interest under different scenarios, i.e. in case the company decides to do nothing and additional tax has been assessed based on the audit.

Again future candidates should focus on stating correctly the original due date. It was pleased to see that a number of candidates differentiated between the penalty and the late payment interest. The penalty is imposed by the tax authority for the incorrectly stated loss amounting to 1% of the loss and also for the additionally assessed tax amounting to 20% of the additionally assessed tax. A number of candidates did not spot the fact that the company paid the additionally assessed tax in 2018 and presumed it was 2017 thus had an incorrect number of days for the calculation of the late payment interest.

Part (d) for one mark required to state statute of limitation provided additional tax return has been submitted by the company in the last 12 months of the original statute of limitation.

It appears that not too many candidates are aware of the rule that provided the additional tax return has been submitted by the company in the last 12 months of the original statute of limitation there is a new statute of limitation which is prolonged by one year. The original statute of limitation was 1 July 2019 and since the additional tax return has been submitted by the company on 5 December 2018, the new statute of limitation is 1 July 2020.

Part (e) for one mark required candidates to list any two persons entitled to participate in the tax audit.

Candidates should consider carefully persons who are legally entitled to act on behalf of the tax payer during the tax audit. For example only employees nominated by the legal representative of the company such as statutory representative (*jednatel*) or persons authorized base on the power of attorney such as tax advisor etc. Only relevant answers gained marks in this question.

Question Two

This 10 mark question focused on employment income of Erik and its payroll tax aspects. The question tested various incomes within an employment relationship and its correct treatment.

The question was answered well by most candidates. They were able to judge appropriately the classification of income in different time periods, i.e. in February or June 2016. Furthermore, they were able to gain marks for correctly explaining the reason for the exemption in case of life insurance income which shows good knowledge of payroll calculation technique. Also the interest free loan exemption gained marks only if reasoning was appropriate, i.e. interest free loan received from the employer is exempted up to CZK 300,000. Only a small number of candidates spotted that the cash advance payment for English course received by Erik on his bank account is of monetary nature thus subject to taxation within the payroll calculation for June 2016. The non-monetary gift received by Erik for his 20th anniversary is exempted only up to CZK 2,000 and the remaining part of CZK 5,500 must be taxed within the February 2016 payroll. Future candidates should focus on the taxation rules in the case of monetary and non-monetary benefits as well as gifts received within employment income. Most candidates have a good knowledge of the solidarity tax surcharge calculation in June 2016 payroll which gained them mostly full marks.

Question Three

This 10-mark question was a two part question on value added tax. Performance on this question was quite satisfactory mainly due to its computational part. Future candidates should, however, focus more on understanding the general principle of value added tax on particular practical situations. The important part of value added tax calculation technique is not only the ultimate value added tax liability calculation but also the importance of the tax base inclusion either in input or output side for further reporting purposes such as EC Sales list, import declarations and control statement reports.

Part (a) required candidates to state if Valeta, a.s. can claim input value added tax on purchased machine in the current VAT return, i.e. in May 2016. The aim of this question was to test the tax rule for pre-registration input value added tax recovery.

Most of the candidates stated correctly that input value added tax can be reclaimed in 12 months before the registration, however, did not spot the basic tax rule that Valeta, a.s. can claim it only in the first month of its value added tax registration, i.e. in February 2016. Only relevant answers gained marks in this question. No calculation was required in this question so no marks were awarded for any type of calculation. In the future candidates are required to focus on this specific tax rule not only with respect to assets and goods but also with respect to services purchased before the registration.

Part (b) required candidates to prepare the value added tax return. The question tested the knowledge of principal value added tax calculation in practical situations.

Performance on this part of question was mostly satisfactory. Where the candidates scored less marks was when they did not use the value added tax coefficient for input value added tax reclaim in the case of the purchase of chairs and tables. General knowledge of reverse charge mechanism in case of local supplies within the Czech Republic as well as intra-community supplies was satisfactory. It was also nice to see that candidates understand the ultimate place of delivery of goods and respective application of the Czech value added tax. For the future candidates should focus also on the principle of tax base reporting on both input and output side of the value added tax calculation, especially in case of local reverse charge.

Question Four

This 10-mark question covered the topic of tax depreciation and taxation of dividends between related parties within European Union.

Part (a) for seven marks required candidates to calculate straight line and accelerated depreciation. It is pleasing to see that the candidates are skilled in depreciation formulae. The question did not state whether the generator Alfa was new or used, therefore both depreciation calculations were accepted as correct during the marking process. Where candidates scored less was because of omission of including only half of the annual depreciation costs in case of the generator Alfa in ELENA CZ's costs due to the fact that the asset represented an asset contribution made by Melana, a.s. in 2016. Only a limited number of candidates correctly concluded that there is no tax depreciation for the car bought and sold in the same year. Further, most common mistakes were seen in the incorrect computation of number of months in case of software depreciation.

Part (b) for three marks asked candidates about tax treatment of dividends paid out to ELENA BV. The question focused on the taxation of dividends between related parties within specific scenario.

It was pleasing to see that many candidates had a good general knowledge of the EU Parent-subsidiary Directive, however, not all of them scored full marks in this question. Candidates are recommended for the future to apply reasoning and arguments to reflect the specific scenario given. No marks were granted for general rules stated with respect to taxation of dividends between related parties without specific implications to the question scenario.

Question Five

This 15-mark question was based on situation of Kamil having employment and business activity in cooperation with his wife Kristina. The candidates were asked to prepare Kamil's 2016 income tax return and provide tax administration rule with respect to commencement of his business activity.

Part (a) for 14 marks asked for the 2016 personal income tax liability of Kamil. In general, the performance on this part of the question was very good. Candidates showed good knowledge of setting partial tax bases for

employment, business, rental and other income. Many candidates scored well in attributing part of the business to the cooperating person, in our scenario to Kristina. The question did not request to calculate the most beneficial income tax and therefore candidates should pay attention for the future not to use lump sum expenses in the case of business income if not specifically requested in the scenario just because such option exists in the Czech tax legislation. The question aimed to test candidates on the correct treatment of business expenses such as lump sum fuel costs etc.

It is pleasing to see that the candidates mostly judged correctly that loss from the sale of shares cannot be offset against other income. No marks were awarded for stating that the sale of shares was exempt as it was not correct. The question did not state whether the pension insurance premium is with or without state subsidy and therefore both answers CZK 6,000 and CZK 12,000 were treated as correct during the marking process. The mortgage interest calculation was mostly calculated and treated correctly thus gained full marks to candidates.

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. The layout and working calculations were also quite satisfactory, however, some candidates did not state clearly why certain income is exempt, thus not getting full marks.

Part (b) for one mark asked for the deadline for the tax authority notification on commencement of Kamil's business activity. As the question asked only for the tax authority no marks were awarded for stating the deadlines with other state and insurance authorities. Some candidates incorrectly stated an eight-day limit, however most of them indicated the correct deadline of 20 June 2016, i.e. 15 days after the commencement of Kamil's business activity. Future candidates are advised to study the various deadlines relevant to all state authorities with respect to private individuals and their activities as this is commonly examined area.

Question Six

This 15-mark two-part question was based on the company LAMPY, s.r.o. a Czech resident company and tested corporate income tax liability with variety of tax rules, including tax advances.

Part (a) for 13 marks required candidates to calculate the corporate income tax liability while testing their knowledge of adjusting accounting profit. Specific areas of tax legislation such as thin-capitalisation, R&D expenses and tax allowances were incorporated as well.

As usual the performance on this question was good. Most of the candidates demonstrated good understanding of up or down tax adjustments to accounting profit. The question focused e.g. on tax deductibility of certain expenses that are tax deductible only if they are paid, treatment of interest under thin capitalisation rules, direct and indirect expenses under rules of paying dividends to parent company.

The majority of candidates showed very good knowledge of various structural elements of the tax base and the structure of calculating the tax liability. On the other hand very few candidates spotted that direct shareholding costs are fully tax non-deductible in the total amount of CZK 23,000, but a surprisingly high number of candidates correctly calculated the indirect shareholding costs tax adjustment and compared it to the actual indirect shareholding costs of CZK 16,500. Despite missing information on the accounting residual value of the damaged machine most of the candidates assumed the accounting residual value equals tax residual value and made a correct adjustment of CZK 20,000 with respect to the damaged machine. Both of the answers, i.e. adjustment of CZK 20,000 and no adjustment due to the missing information were considered as correct during the marking process.

Candidates encountered no serious difficulties in calculating the tax non-deductible costs in line with the thin-capitalisation rule. It was also satisfactory to see that a number of candidates correctly calculated the R&D expenses, where the full amount incurred in the year 2015 of CZK 250,000 and 110% of the difference

compared to the previous year represents a tax base deduction item. In this respect for future candidates it is essential to understand the difference between the tax base deductible items (e.g. R&D expenses, gifts) and tax credits which are deductible from the tax liability (e.g. tax credit for disabled persons).

Part (b) worth two marks tested the rule for calculation of tax advances. Most of the candidates scored well and identified the rule of 40% of the tax liability in case of semi-annual tax advances, provided the tax base is between CZK 30,000 and CZK 150,000. Future candidates should keep focusing on tax rules associated with actual payment of the tax including withholding tax and the person responsible for payment of the tax as this is a frequently examined area.