Examiner’s report
F6 (POL) Taxation
June 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 taxation in Poland in more depth. The following paragraphs report on each section and focus on some of the key learning points.

Specific Comments

<u>Section A</u>

It was pleasing to see that all candidates attempted the multiple choice questions. Section A questions aim is 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

Example 1
In 2015 Wierzyciel Sp. z o.o. wrote off a loan receivable of PLN 1,250,000 of which PLN 250,000 was interest capitalised in the year 2015. The loan had been granted to another company which went bankrupt. The bankruptcy procedure had formally ended and the loan receivable was documented as non-recoverable. In addition, Wierzyciel Sp. z o.o.’s general allowance for irrecoverable receivables increased from PLN 100,000 on 31 December 2014 to PLN 300,000 at 31 December 2015.

What is the amount of tax deductible costs related to irrecoverable receivables which can be recognised by Wierzyciel Sp. z o.o. in 2015?

A PLN 1,450,000
B PLN 450,000
C PLN 1,000,000
D PLN 250,000

This question tested the understanding of tax deductible costs related to loan receivables, interest on loans granted and general receivables write-offs. The question mentioned 3 items and asked for interpretation if they are tax deductible or not. The first item was a loan of PLN 1,000,000, which was written off. As the loan originally was a receivable not connected to taxable revenue, the cost of writing it off cannot be treated as tax deductible, even if the loan was documented as irrecoverable. The second item was interest capitalised of PLN 250,000, which was written off. This item was recognized as taxable interest revenue before and the interest receivable was documented as irrecoverable therefore it can be recognized as tax deductible cost. The third item was the increase in the general allowance for irrecoverable receivables of PLN 200,000, which cannot be treated as tax deductible cost as it did not relate to a particular receivable, which was documented as irrecoverable and general provisions are not tax deductible.

The correct answer was therefore D.

Example 2

Nierzetelna Sp. z o.o. has been deliberately not paying its due taxes. This situation was effected by the actions of the company's accountant, Adam, who is not a board member of Nierzetelna Sp. z o.o.

What penalties may be imposed on the discovery of this situation, and on whom may they be imposed?

A Penalty interest payable by Nierzetelna Sp. z o.o. only
B Penalty interest payable jointly by Nierzetelna Sp. z o.o. and Adam
C Penalty interest payable by Nierzetelna Sp. z o.o. and Fiscal Criminal Code sanctions for Adam
D Penalty interest payable by Nierzetelna Sp. z o.o. and Fiscal Criminal Code sanctions for both Nierzetelna Sp. z o.o. and Adam

This question checked understanding the responsibility for preparing proper tax returns. Although the company acting in a form of limited responsibility company (spółka z ograniczona odpowiedzialnoscia - sp. z o.o.) is responsible for tax returns and pays penalty interest in case of proven mistakes, also the person who is responsible for preparing and filing the tax return is responsible for deliberate misconduct. Even if the person is not a formal member of the company's board.

The correct answer was therefore C.

<u>Section B</u>

Question One

This 10-mark question covered the topic of thin capitalisation regulation.

The question required candidates to calculate the amount of non-deductible interest to be reported by Cienki Sp. z o.o. for 2015 under the new thin capitalisation regulation. This question was answered moderately. Many candidates were able to confidently identify the elements of qualifying debt as the loans from the related parties Mama Sp. z o.o. and Wujek Sp z o.o. and indicate that the loans from the unrelated banks from the Cayman Islands and Poland were excluded from the qualifying debt. However only a few students added interest from the related parties loans for 2015 to the qualifying debt.

The qualifying equity comprised of the registered share capital decreased by the value of the know-how contribution increased by share premium, prior year earnings and adjusted by loss for the period 1 January - 30 November 2015 (not to the 31 December 2015 as profit/loss for the period should be calculated till the end of the month before the interest payment). Debt to equity swap on the share premium account of PLN 2,000,000 should not decrease the qualifying debt as it related to supplementary capital, not to share capital.

It was pleasing that the most candidates were aware of the qualifying debt to qualifying equity ratio of 1:1 under the new thin capitalisation regulations and calculated properly the amount of disallowed interest.

Question Two

This 10-mark question required an identification of the alternative methods of taxation available for Edyta in respect of her planned business activity. In each case, the candidates were asked to briefly explain how the tax base and rates would be calculated and how the tax would be paid. Performance on this question was unsatisfactory.

Although many students identified four taxation options available for Edyta: standard taxation at progressive rate, taxation of income at the flat rate, flat rate revenue taxation and tax card, the answers were not comprehensive and in some cases the exam technique was poor. For the first option the majority of the candidates properly described how Edyta should arrive at the taxable income, what rates should be used and how the tax would be paid, however the fact that income on business activity should be cumulated with other types of income and that the taxable basis could be decreased by the losses carried forward was rarely mentioned.

When describing the second option (taxation of income at flat rate) the students mentioned correctly similar items as in the first option: how to calculate income tax, what rate would be used and how the tax would be paid. Only a few candidates added that taxable income would not be cumulated with other types of income, no reliefs would be available but the income could be reduced by the losses carried forward.

The flat rate revenue taxation (the third option) would be calculated based on the taxable revenues less social security contributions and taxed at 8.5%. The tax would be paid in monthly instalments and reconciled by 20 January of the following year.

The fourth option - tax card would be paid based on the tax office decision based on the tax card factors (number of employees, type of activity, size of town etc.). Tax would be payable monthly.

Many candidates mentioned only selected information related to the third and fourth option.

Question Three

This 10-mark question required calculations to advise whether or not it would be profitable for Stefan to voluntarily register for value added tax (VAT). This question was well answered and relatively many candidates scored full marks.

Output VAT should be calculated as VAT on sales of goods in Poland and on gifts included in the prices for the customers and input VAT as VAT on local purchases in Poland. Export sales to the US were vatable at 0%, the salary and the purchase of paints from the person who did not conduct the regular business were outside VAT and they did not impact the Stefan's situation. The calculation showed that output VAT was lower than the input VAT by PLN 1,870 therefore it was profitable for Stefan to register for VAT and receive the VAT refund.

Question Four

This 10-mark question asked the students to calculate the Polish corporate income tax payable by Stara Sp. z o.o. (Stara) to the Polish tax office for 2015. This question was not well answered although a few candidates, who were well prepared, scored full marks.

The key to answer this question properly was to calculate the transfer pricing adjustment on sales of Stara to Młoda Sp. z o.o. as the value of the sales from Stara to Młoda of PLN 1,250,000 multiplied by 3 and divided by 7 due to the fact that the sales were 30% below the arm's length rate. Similar adjustment should be calculated on the amount of the interest from Stara to Młoda as additional PLN 200,000 (interest rate 50% below the arm's length rate).

Tax income of Stara should be calculated as revenue from Stara to customers and Młoda, revenue of the French branch to the customers, interest revenue from Stara to Młoda and the transfer pricing adjustments as described above. The tax should be calculated at 19% rate and decreased by the tax credit for double taxation related to the French branch.

The tax credit should be calculated as lower of French branch taxable income taxed at 19% and tax paid in France of PLN 50,000. To calculate the taxable income of the French branch, the transfer pricing adjustments should be taken into account.

Question Five

This 15-mark question covered the topic of taxation for a natural person who has income from different sources based on the Pafnucy's situation.

Part (a) for 4 marks required a calculation of the social security contributions and health service contributions payable by Pafnucy in 2015 in relation to his own business activity. This part of the question was answered above average. The majority of the students properly calculated the social security contribution as 60% of the average salary at proper rate for 4 months. In terms of the health service contributions many candidates calculated 75% of the average salary at 9% rate but for 4 months instead of 12, it should be noted that in case of individual business activity the HSC is still due even if the obligation to pay social security contributions is overridden by e.g. simultaneous employment.

Part (b) for 11 marks asked for a calculation of the personal income tax (PIT) payable by Pafnucy in relation to each of his taxable activities in 2015. This part of the question was averagely answered. Only a few candidates properly calculated tax on business activity using the flat rate taxation scheme. Revenue from services and from the sale of the assets should be decreased by the social security contributions as calculated in point (a). Then tax should be calculated proportionally as 8.5% on the part related to services and 3% on the part related to the assets sale less health service contribution as calculated in point (a) at 7.75%.
Taxable income on employment should be calculated as gross salary for 8 months less social security contribution at 13.71% less employee costs of 139 PLN times 8 months plus the value of the motor bike won in promotion. Then due to joint taxation relief taxable income should be divided by two, the tax at 18% should be calculated and multiplied by two. Then tax calculated should be decreased by the health service contribution and child relief of PLN 1,112 times 2). Tax on stock exchange gains should be calculated separately at 19% rate.

Question Six
This 15-mark question was based on a manufacturing company Ekspansywna Sp. z o.o. (Ekspansywna). The question tested the area of non-current assets tax treatment.

Part (a) for 11 marks required a calculation of the initial value of the non-current assets acquired by Ekspansywna in 2015, together with related 2015 tax depreciation, assuming that Ekspansywna always claims the maximum available depreciation write offs.

This part of the question was averagely answered. The majority of the candidates properly assigned the purchase price, notary costs and legal fees to the land value and commented that land is not depreciated. Also building services, the cost of materials and the inspection costs were correctly assigned to the factory building and the machinery purchase price, customs duty and forex difference built the value of the production machinery. However, not all students qualified the interest as part of a non-current asset. The value of each non-current assets item should be increased by the capitalised interest, calculated as the value of the asset before adding interest times number of days it was used in 2015 out of 365 days and 10% interest rate.

Many students properly calculated depreciation for the factory building`g as 2.5% for 7 months out of 12 and as 14% times 2 times 6 months out of 12 for production machinery.

Part (b) for 4 marks required the candidates to calculate the taxable income/loss of Ekspansywna for 2015. This part of the question was moderately answered. Taxable income of Ekspansywna before adjustments should be decreased by the legal costs post the assets acquisition, building repairs, insurance post completion, employee training, depreciation as calculated in point (a) of the question and the balance of the interest which was not capitalised in the non-current assets value.