

Examiner's report

F6 (ROM) Taxation

December 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 taxation 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(ROM) are advised to work through the 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(ROM) 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

Leonid had the following revenues in May 2015:

- (1) Rent revenue of 10,012 lei
- (2) Employment revenue of 2,000 lei
- (3) Revenue based on a contract concluded under the Civil Code provisions of 7,000 lei

What is the amount of the healthcare insurance contribution due for Leonid's revenues for May 2015?

- A 908 lei
- B 1,046 lei
- C 661 lei
- D 523 lei

This question tested the area of social contributions, dealing with the computation of healthcare insurance contribution for different types of income, and was not well answered by the majority of candidates.

The correct answer was A, where the healthcare insurance contribution was computed as follows:

Healthcare insurance contribution: $5.5\% \times (10,012 - 25\% \times 10,012) + 5.5\% \times 2,000 + 5.5\% \times 7,000 = 413 + 110 + 385 = 908$ lei

The answer in B involved computing the healthcare insurance contribution by applying the 5.5% rate to gross revenue, for all types of revenues, thus failing to subtract the 25% lump-sum deduction for rent revenues, which is incorrect.

Healthcare insurance contribution = $5.5\% \times 10,012 + 5.5\% \times 2,000 + 5.5\% \times 7,000 = 551 + 110 + 385 = 1,046$ lei

The answer in C was also incorrect, as there were two mistakes: (i) healthcare insurance contribution was computed only for rent and employment types of revenue and (ii) the 5.5% was wrongly applied to the gross value of rent revenues.

$$\text{Healthcare insurance contribution} = 5.5\% \times 10,012 + 5.5\% \times 2,000 = 551 + 110 = 661 \text{ lei}$$

The answer at D was also incorrect as the healthcare insurance contribution was computed only for rent and employment types of revenue. Although the computation was correct for these types of revenues, the computation was not complete, as Civil Code contracts were not included.

$$\text{Healthcare insurance contribution} = 5.5\% \times (10,012 - 25\% \times 10,012) + 5.5\% \times 2,000 = 413 + 110 = 523 \text{ lei}$$

Thus, although A was the correct answer, all the other possible answers were plausible as they were based on commonly made mistakes. That is why candidates are encouraged to take their time when completing the multiple choice questions (MCQs) and spend the appropriate time computing the correct answer, and reading the questions properly rather than guessing.

Example 2

Radiera SA, a company based in Ploiesti, was founded in 2013 and has a share capital of 20,000 lei. When computing its corporate income tax for 2013, Radiera SA deducted a legal reserve of 1,000 lei. Before computing its final corporate income tax for 2014, Radiera SA had recorded total taxable revenues of 100,000 lei and total expenses of 41,000 lei, including a corporate income tax expense of 4,000 lei, all other expenses being deductible.

What is the maximum amount of legal reserves which may be deducted by Radiera SA in 2014?

- A 2,950 lei
- B 3,000 lei
- C 3,150 lei
- D 2,150 lei

This question tested the area of corporate income tax which is an important part of the syllabus. Less than half of candidates answered correctly.

The correct answer was B, as the legal reserve may be deducted within the limits:

- $5\% \times \text{gross profit} = 5\% \times (100,000 - 41,000 + 4,000) = 3,150 \text{ lei}$; and
- $(20\% \times 20,000) - 1,000 = 3,000 \text{ lei}$

which should have led to choosing the minimum amount of 3,000 lei.

The answer in A was incorrect as this was calculated by applying the 5% limit to net profit and not to the gross profit. Thus, if a candidate computed the limits for legal reserve deductibility as follows:

- $5\% \times \text{net profit} = 5\% \times (100,000 - 41,000) = 2,950 \text{ lei}$
- $(20\% \times 20,000) - 1,000 = 3,000 \text{ lei}$

this would have led to an incorrect answer of 2,950 lei for the legal reserve deductibility.

The answer in C was also incorrect and was calculated without subtracting the previously deducted legal reserve from the maximum level of 20% share capital mentioned by the law. This mistake would have generated the following computation for the limits within which the legal reserve may be deducted:

- $5\% \times \text{gross profit} = 5\% \times (100,000 - 41,000 + 4,000) = 3,150 \text{ lei}$
- $20\% \times 20,000 = 4,000 \text{ lei}$

which would have led to choosing 3,150 lei as the correct answer.

The answer in D assumed that the previously deducted legal reserve would have been subtracted from the 5% x gross profit limit and not from the 20% x share capital limit. As such, the computation of deductibility limits for legal reserve would have been:

- $5\% \times \text{gross profit} - 1,000 = 5\% \times (100,000 - 41,000 + 4,000) - 1,000 = 2,150 \text{ lei}$
- $20\% \times 20,000 = 4,000 \text{ lei}$

which would have led to choosing 2,150 lei as the correct answer.

Again candidates are encouraged to be precise when completing the Section A MCQs as all answers were possible if some very basic mistakes were made.

Section B

Question One

This 10-mark question covered the topic of value added tax (VAT), which again proved to be an area which candidates find challenging.

Part (a) for 5 marks required candidates to compute the VAT adjustments needed to be made when a company registers for VAT, for the goods bought before registration. Candidates were required:

- to identify goods for which VAT was paid on the moment on acquisition (merchandise, apartment, car);
- to identify goods which qualify as capital goods (apartment, car) and which do not qualify as capital goods (merchandise);
- to compute the VAT adjustment for capital goods (based on remaining adjustment period) and for non-capital goods (based on acquisition price).

This part was very poorly answered, as very few candidates attempted it and even fewer answered correctly. Those candidates who did attempt made the following common mistakes:

- not computing the VAT value by subtracting it from the acquisition cost, although the question clearly stated that the acquisition costs includes VAT;
- computing the VAT adjustment for capital goods using the depreciation period and not the adjustment period;
- not recognising the fact that VAT had to be paid on the car on acquisition

Many of these mistakes were due to a failure to read the question carefully and also to lack of knowledge on VAT suggesting that candidates are not sufficiently prepared to answer questions on this area of the syllabus.

Part (b) for 5 marks required the computation of VAT due when the deduction right is limited. Candidates were required to:

- compute Output VAT, Input Vat and VAT due to/to be reimbursed from, applying a provisional VAT pro-rata
- compute a final pro-rata final and any necessary VAT adjustments.

Again, very few candidates attempted this part and those who attempted made basic mistakes, such as:

- confusing Output VAT with Input VAT;

- applying the VAT pro-rata both to supplies and acquisitions;
- applying VAT pro-rata to all acquisitions, no matter their destination;
- failing to clearly identify that for exempt supplies no VAT is applicable, and for acquisitions allocated to exempted supplies no VAT shall be deducted;
- failing to compute the final pro-rata based on supplies, but using acquisitions.

Candidates are reminded more question practice in this area is needed and candidates are advised to give as many explanations as they can on how they derived their answers and to clearly show their workings to ensure that maximum credit can be awarded.

Question Two

This 10-mark question covered the obligations of taxpayers and the question presented three options for obtaining revenues: (1) as a self-employed person, (2) starting a company (3) raising rental revenues and requested information on the system of self-assessment and filing of returns, time limits for submission of returns and payment of taxes, and obligation to pay interest and penalties.

Part (a) required candidates to state the tax filing obligations for each option. Although many candidates presented good answers, some candidates failed to clearly present tax filing obligations and wasted time presenting unnecessary information. Again candidates are advised to carefully read the question requirement and to carefully consider what is required before attempting the question. Thus, if every option presented tax-prepayments and final tax for 2015, the candidates were asked to specifically present the tax filing obligation as regards tax prepayments and final tax. Many candidates gave information as regards taxpayers' obligations to register with Trade Registry or social security contributions.

Also, many candidates presented the payment obligations and not tax filing obligation. For example, if a candidate answered "For option 1 Mr Cactus has to make pre-payments of tax and pay final tax", no marks would have been awarded, as the candidate simply reproduced the text of the question. But if a candidate answered: "For Option 1 Mr Cactus has to file, in 15 days after starting activity, a declaration of estimated income based on which pre-payments are computed. Then Mr Cactus has until 25 May 2016 to file a final tax declaration upon which final tax shall be computed".

Part (b) required candidates to state the deadlines for making pre-payments and final tax. If the deadlines for making pre-payments were identified by many candidates, it was surprising to see that so many candidates failed to identify correctly the deadline to make the final tax payment. Some common incorrect answers were given as:

- 25 February, 25 March or even 25 May for paying the final personal income tax, instead of the correct answer: "60 days after receiving the Decision from the Tax Administration".
- 25 February or 25 May for the corporate income tax.

Part (c) required candidates to explain whether or not any late payment interest and penalties were due. The question clearly requested an explanation rather than a computation, however many candidates started computing the level of interests and penalties unnecessarily. Also, many candidates provided a vague answer by simply stating: "Interests and penalties are due", instead of clearly explaining for each option whether or not any penalties are due.

Candidates are again advised to consider the structure of their answers and are reminded to use the instructions present in the question. For example in this question candidates were asked specifically to provide answers for each option separately and this approach was not adopted by all candidates.

Question Three

This 10-mark question covered the topic of personal income tax.

This question required the computation of self-employment tax and was well answered by many candidates. However, there were still some mistakes commonly made, as follows:

- failure to identify insurance revenues as non-taxable revenues;
- computing expenses with raw materials on 12 months instead of 11;
- not limiting the tax depreciation to a maximum of 1,500 lei/month;
- failure to compute limitation of social expenses. It was surprising to see that very few candidates knew to limit the deductibility of social expenses to 2% of salary expenses. Almost all candidates applied the limitation of 150 lei/present/child, which is applicable only when computing employment tax;
- not specifying the final tax for Mr Orchid. Many candidates simply stated: "Tax due by Mr Orchid is $97,000 \times 16\% = 15.520$ lei" without identifying if this is the final tax, the prepayment of tax or both.

Question Four

This 10-mark question covered corporate income tax and required candidates to recalculate a corporate income tax computation.

Many candidates correctly identified many elements of the calculation. However, very few candidates:

- identified that revenues from selling shares are non-taxable and, as consequence, the expenses with the cost of shares sold are non-deductible;
- mentioned that an exemption for reinvested profit would be allowed;
- correctly calculated the tax and accounting depreciation.

It was surprising to see that some candidates provided explanations regarding the correct tax treatment of some elements, but failed to include them into their computation. Thus, candidates are advised to sense check what they wrote and to ensure their computations are in accordance with the explanations provided.

Question Five

This 15-mark question was on employment income tax and social contributions.

Part (a) required candidates to compute the employment tax for an employee who benefitted from different kinds of insurances. Thus candidates were required to have knowledge of the tax treatment of these insurances. Although many candidates provided good answers, the most common mistakes were:

- considering the voluntary health insurance premium as non-taxable. Many candidates confused the rules for corporate income tax deductibility with the rules for employment taxation;
- considering the liability insurance for managers' premium as taxable;
- dividing insurances by 12, although the question clearly stated that insurances are paid in full in December, which should indicate to candidates that the full value of insurance should be considered for December tax;
- failure to correctly identify the social contributions' taxable base;
- failure to identify that the personal deduction is 0.

Part (b) required candidates to compute the employment tax for an employee who had children in her care. Almost all candidates provided strong answers and when mistakes were made they generally related to the computation of the personal deduction or failure to compute social contribution.

Part (c) required candidates to compute the social security contribution due by the employer and performance in this requirement was strong with the majority of candidates able to answer this correctly.

Part (d) required candidates to compute the income tax on gains from selling shares. The most common mistake was using an average purchasing price for the shares. Candidates are again advised to read the question carefully. In this question there were shares issued by 3 different companies, purchased at different prices. When sold, they were all sold at the same price, but as they were issued by different companies, candidates should have computed the gain/loss for each transaction, as no average can be made using prices of shares issued by different companies.

Question Six

This 15-mark question was on corporate income tax and it was generally well answered.

Part (a) for 8 marks required knowledge on transfer pricing rules and received many good answers. Candidates proved they are well prepared as regards transfer pricing rules. However, there are still some common mistakes including:

- Failure to state the rule of arm's length for transactions between affiliates;
- Failure to identify the decrease of corporate income tax for Daisy, on transfer pricing adjustment;
- Failure to identify that the consultant's advice was unethical.

Part (b) for 7 marks required candidates to apply thin capitalisation rules and transfer pricing rules for deducting interest expenses. Again, many candidates gave good answers and few mistakes were made here. When mistakes were made, they were made regarding the computation of deductible interest for the loan denominated in lei or the applicability of transfer pricing limitation of deductibility, which further limited the deductibility of interests, already limited by thin capitalisation rules.