

Examiner's report

F6 Taxation (ROM)

June 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. This is the first examiner's report since the introduction of the new exam format and question types. 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 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 (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

On 1 June 2015 Maria signed a contract with a magazine for writing articles. According to the contract the magazine shall pay her 10% of the magazine's sales as intellectual property revenue. The standard tax treatment shall apply to Maria's intellectual property revenue.

Which of the following statements are true in relation to Maria's income tax obligations?

- (1) The magazine has to declare to the tax authorities the pre-payments of income tax on Maria's revenue in 2015
- (2) Maria has to declare to the tax authorities her estimated income for 2015 by 15 June 2015
- (3) Maria has to declare to the tax authorities the realised income for 2015 by 25 May 2016
- (4) The magazine has to declare to the tax authorities the difference of income tax for 2015 by 25 May 2016

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

This question tested the obligation of taxpayers for intellectual property income. When the standard tax procedure is applied, the payer of intellectual property income has to withhold income tax at 10% from each payment, and declare and pay this tax to the state. But this withheld tax is only a prepayment. The taxpayer remains liable to declare the final income tax, just like for any self-employment income, by 25 May of the following year.

The obligations listed in this question were a combination of obligations for self-employed income using real and quota systems and intellectual property income.

The obligations mentioned in statements 1 and 3 were applicable to intellectual property income, whereas obligation 2 was specific to self-employment income using the real system and quotas system. The obligation listed in 4 is not specific to any type of income, as the difference of income tax always has to be declared by the taxpayer and not by the payer of income.

The correct answer was therefore, B, statements 1 and 3.

Example 2

Andrei started a self-employed activity on 1 January 2015. Andrei applies the real system for computing his personal income tax and is not registered for value added tax (VAT) purposes. In 2015, Andrei has sales of 3,000 lei each month, which were paid for by his clients in the following month. He had one employee, who was paid monthly on the last day of the month and the monthly salary expenses (including gross revenue and employer's contributions) were 1,200 lei. Andrei made prepayments of tax during 2015 of 2,500 lei. No other revenue or expenses were recorded. No social contributions are applicable.

What is Andrei's total income tax liability in respect of the income realised from his self-employed activity in 2015?

- A 2,976 lei
- B 3,456 lei
- C 5,760 lei
- D 2,576 lei

This question tested the area of personal income tax, dealing with the computation of tax for a self-employed person applying the real system.

The correct answer was A, where the tax liability was computed as follows:

Taxable income = $(3,000 * 11) - (1,200 * 12) = 33,000 - 14,400 = 18,600$ lei

Income tax = $16\% * 18,600 = 2,976$ lei

The answer in B involved computing the taxable revenues for all 12 months of 2015, which was not correct, as self-employed persons apply a cash-based accounting, and only cashed invoices should be taken into account when computing taxable revenues for a specific year.

B answer:

Taxable income = $(3,000 * 12) - (1,200 * 12) = 36,000 - 14,400 = 21,600$ lei

Income tax = $16\% * 21,600 = 3,456$ lei

The answer in C was incorrect as the taxable income was equal to the taxable revenue with no deduction for expenses.

C answer:

Taxable income = $3,000 * 12 = 36,000$ lei

Income tax = $16\% * 36,000 = 5,760$ lei

The answer in D was incorrect as the taxable base was computed by subtracting the pre-payments of tax from taxable revenue along with the salary expenses. This is incorrect as pre-payments of tax are a non-deductible expense.

D answer:

Taxable income = $(3,000 * 11) - (1,200 * 12) - 2,500 = 33,000 - 14,400 - 2,500 = 16,100$ lei

Income tax = $16\% * 16,100 = 2,576$ 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 be precise when attempting the Section A multiple choice questions (MCQs) and to spend time computing the correct answer and reading the questions properly rather than guessing.

Section B

Question One

This 10-mark question covered the topic of personal income tax, namely self-employment income tax using the real system.

Part (a) for 2 marks required candidates to compute the prepayments due at each quarterly deadline. Almost all candidates showed good knowledge on this area.

Part (b) for 6 marks required the computation of the final income tax due for 2015. Many candidates were able to confidently identify the deductible expenses. When mistakes were made, they included:

- incorrect computation of the computation base to which the limit of deductibility for sponsorship expenses and subscription to professional association expenses applies.
- including as deductible expense the entire value of the sewing machine, instead of depreciating it.

Also, some candidates confused the rules of deductibility for the sponsorship expenses applicable to personal income tax with those applicable to corporate income tax. Those candidates who made this mistake tended to also compute the taxable base as Total revenues - Total expenses - Non-Taxable Revenues + Non-Deductible Expenses, instead of computing it as Taxable revenues - Deductible expenses. This was not considered a mistake; as long as the computation was correct, but candidates are reminded that not using the correct pro-forma of calculation for a specific tax may easily lead to other mistakes (such as using the wrong rule for deductibility) and can also result in time being wasted.

Part (c) for 2 marks required candidates to compute the maximum amount of charitable gift which the taxpayer was permitted to make within the limits allowed under the personal income tax legislation. Many candidates confused the 2% rule for charitable gifts for personal income tax with the rules which apply to sponsorship.

Question Two

This 10 mark question was on the special scheme for corporate income tax.

Part (a) required candidates to list two types of revenues not included in the corporate income tax base for very small companies. Many candidates were able to give satisfactory answers, but some candidates confused the special scheme for corporate income tax with the standard corporate income

tax regime and gave examples of non-taxable revenues such as dividend revenue, which are taxable as regards the special scheme for corporate income tax.

Part (b) required a computation of the quarterly corporate income tax due under the special scheme for very small companies. There were a number of instances where the answers provided were unsatisfactory. The main mistakes made by candidates were:

- computing the taxable base, each quarter, as revenues - expenses, although the special scheme for corporate income tax requires only revenues to be included in the taxable base, the only expense available for deduction was the expense relating to the cash register
- applying the 16% tax rate, instead of the 3% tax rate
- not computing the net difference of exchange rate revenues and expenses. Very few candidates knew how to deal with the exchange rate differences. Candidates are reminded that, as regards the special scheme for corporate income tax, exchange revenues and expenses are not to be taken into account until the 4th quarter. When computing the income tax for the 4th quarter first a comparison should be made between all exchange rate revenues (for the entire year) and all exchange rate expenses (for the entire year). Should the exchange rate revenues be higher than the exchange rate expenses, then the net difference should be added to the taxable base in the 4th quarter. Should the exchange rate expenses be higher than exchange rate revenues, no adjustment should be made to the taxable base

Part (c) required candidates to list any three conditions that must be fulfilled on 31 December by any company that wishes to continue to apply the special scheme for corporate income tax. Again, many answers provided were unsatisfactory. Some candidates confused the corporate tax rules with VAT rules and listed rules for the quarterly/monthly VAT tax period. Other candidates listed rules that are a number of years out-of-date (such as the 100,000 euro revenue threshold).

Question Three

This 10-mark question covered the topic of social contributions.

Part (a) for 8 marks was well answered by many candidates. It required the computation of employee and employer's social contributions. Almost all candidates knew to compute the social contribution taxable base from the revenues given in the question. When mistakes were made, these commonly included the following:

- not limiting the taxable base for social security contribution to 5 times the average monthly earnings;
- not limiting the taxable base for the healthcare insurance indemnities fund to 12 times the minimum monthly salary.

Part (b), for 1 mark required candidates to compute social contributions due on intellectual property revenue for a taxpayer who also had employment income. The majority of candidates knew that social security contribution is not due, but most candidates failed to recognise that health insurance contribution is also not due.

Part (c) for 1 mark required candidates to compute social contributions due on civil contract revenue for a taxpayer who also had employment income. The majority of candidates knew to only calculate the healthcare contribution here.

Question Four

This 10-mark question tested value added tax (VAT) and, as in previous sittings, VAT proved to be a challenging area of the syllabus for candidates.

Part (a) for 4 marks required identification of when chargeability to VAT occurred for certain transactions. Very few candidates gave fully satisfactory answers here, which demonstrates that many candidates are not sufficiently prepared for the VAT elements of the syllabus.

Part (b) required a computation of the VAT for the month of May. Candidates were much better prepared for this part of the question and generally answered well. Candidates should note that they were awarded the appropriate marks in part (b) if they correctly applied their answer regarding the time of chargeability in part (a) – even if this answer to part (a) was incorrect. For example, if for a transaction, a candidate mentioned at (a) that it was chargeable in May (whilst the correct answer was June) and computed the VAT for this transaction in (b) (in line with their answer to (a)), they were awarded appropriate credit in part (b).

Part (c) required candidates to explain the impact of *ex-officio* VAT deregistration by the tax authorities. This part of the question was generally not well answered. The majority of candidates knew that the person whose VAT registration is cancelled *ex-officio* by the tax authorities should not deduct VAT on any purchases during the VAT deregistration period. However, only a few candidates knew that customers who purchase goods and services from persons whose VAT registration was cancelled *ex-officio* by the tax authorities may not deduct VAT on those purchases. Even fewer candidates knew that the person whose VAT registration is cancelled *ex-officio* by the tax authorities should continue to charge and pay VAT on any deliveries made during this period. Again, very few candidates knew that, at the moment of VAT deregistration, VAT adjustments must be made.

Question Five

This 15-mark question was on corporate income tax.

It was nice to see that many candidates organized their answers well. However, some mistakes were made as follows:

- Very few candidates knew that in Q3, when the taxpayer was declared inactive, all expenses were non-deductible. A common mistake was to consider that for Q3 no tax was due.
- Many candidates identified correctly the thin capitalisation rules, but failed to correctly compute deductible and non-deductible interest expenses
- Many candidates failed to make a cumulative corporate income tax computation
- Many candidates recognized dividend revenue as being non-taxable, but failed to include this into the computation of corporate income tax for Q3 and the total year income tax.

Question Six

This 15-mark question was on personal income tax.

Part (a) for 7 marks received many satisfactory answers. Candidates proved they are well prepared as regards income tax on employment income. However, there were still some mistakes commonly made, as follows:

- Many candidates did not tax the Easter present in full, and applied the 150 lei non-taxable limit. Candidates are reminded that such a limit is applicable in the case of presents given to the minor children of employees. As the taxpayer in the question had no children, such a gift was fully taxable
- Most candidates applied a 250 euro non-taxable limit to the healthcare insurance premium which was not correct, as the personal income tax legislation does not allow any non-taxable amounts for healthcare insurance premiums. The confusion here was made with the corporate income tax legislation where a 250 euro deductibility limit is applicable to such healthcare insurance premiums paid by the employer for its employees.
- Only a few candidates knew that the employees' union contribution should be deducted from the taxable base for employment tax

Part (b) for 4 marks required candidates to compute the income tax for revenues received by Mrs Microphone, other than employment income. Many candidates provided satisfactory answers to this part.

Part (c) for 4 marks required candidates to list the declaration and payment obligations of Mrs Microphone for income tax for all her sources of income. Again, some satisfactory answers were presented. When mistakes were made, they were made in respect of the obligations relating to the rental income.