Examiner's report
F6 (ROM) 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 Romania 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 very pleasing to see that almost 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

Example 1
PFA Ionescu is a self-employed person acting in the field of management consultancy. During the whole of 2016 PFA Ionescu had only one employee, an assistant manager with a monthly gross salary of 2,500 lei. In December 2016, PFA Ionescu gave his employee a Christmas present of 900 lei for himself and gave another present, also of 900 lei, to his employee's minor child.

What is the total amount of the expenses which PFA Ionescu can deduct in respect of the two presents?

A   150 lei
B   125 lei
C   300 lei
D   1,500 lei

This question tested the rule of deductibility of social expenses for computing the self-employment income tax and was not well answered by the majority of candidates. The question required candidates to have the necessary technical knowledge. The general mistake was confusing the rule for the expenses deductibility when computing the self-employment income tax with the rule for non-taxable presents for computing employment tax.

The correct answer was D, where the amount of deductible social expenses was computed as follows:

Employment expenses = 2,500*12 = 30,000 lei
Social expenses = 1,800 lei
Limit of deductibility of social expenses = 5%*30,000 = 1,500 lei
Therefore deductible social expenses = 1,500 lei

The answer in A involved computing the amount of deductible expenses applying the limit for non-taxable gifts of 150 lei/person/occasion, but considering the limit applicable only for the present for the minor child (as was the rule before 2016), which is incorrect.
Social expenses = 1,800 lei
Limit of deductibility of social expenses = 150 lei
Therefore deductible social expenses = 150 lei
The answer in B was also incorrect, because it failed to compute correctly the value of salary expenses, which is the base for application of the 5% percent of limitation of social expenses deductibility. Thus, this answer considered that the value of salary expenses in 2,500 lei (the salary for one month) and not 12 * 2,500 lei (the salary for the entire year).
Employment expenses = 2,500 lei
Social expenses = 1,800 lei
Limit of deductibility of social expenses = 5%*2,500 = 125 lei
Therefore deductible social expenses = 125 lei

The C answer was also incorrect as it involved computing the amount of deductible expenses also applying the limit for non-taxable gifts of 150 lei/person/occasion (as in A), but this time considering the limit applicable for both presents, which is incorrect.
Social expenses = 1,800 lei
Limit of deductibility of social expenses = 2*150 = 300 lei
Therefore deductible social expenses = 300 lei

Thus, although D was the correct answer, all other variants were possible answers, if some basic mistakes were made. That is why candidates are encouraged to spend time computing the correct answer, and reading the questions properly rather than guessing.

Example 2
Which of the following statements are true as regards corporate income tax?

(1) When selling a non-current asset, if the non-depreciated tax value of the asset is higher than the selling price, then the part which exceeds the selling price shall be non-deductible
(2) When taking a loan from an affiliated company, the transfer pricing rules are not applicable due to the application of the thin capitalisation rule
(3) The revenues from selling shares representing a participation holding of more than 10% and owned for more than one year are non-taxable
(4) Expenses in respect of sponsorships are fully non-deductible

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

This question tested important areas of the computation of corporate income tax and was not well answered by the majority of candidates. Corporate income tax is one of the most important parts of the syllabus and requires candidates to have the necessary technical knowledge.

Statement 1 referred to a rule which is often applied in practice (due to a very old approach), but which has no legal back-up: "When selling a non-current asset, if the non-depreciated tax value of the asset is higher than the selling price, then the part that exceeds the selling price shall be non-deductible." When selling a non-current asset, the non-depreciated tax-value of the asset (computed according to the tax rules) is entirely deductible, no matter the selling price. There is no limitation of deductibility of non-depreciated tax-value due to the selling price. However, if the selling price is below the market price, tax adjustments may be made in the form of taxing the difference between the market price and the selling price. Therefore statement 1 was incorrect.

Statement 2 was also incorrect because it implied that transfer pricing rules are excluded by the application of thin capitalisation rules. This is not correct, a company should apply both rules, when deducting the interest expenses as the application of thin capitalisation rules, does not exclude transfer pricing adjustment. As both statements were incorrect, so were the answers A, B and C.

Statements 3 and 4 were correct. These rules are mentioned very clearly in the tax code. Thus, the correct answer was D.

It is possible that some candidates were unsure about some statements, so a good strategy might be elimination. Statement 4 included some very basic knowledge which is tested at almost every paper: "Expenses in respect of sponsorships are fully non-deductible". If a candidate had this basic knowledge then he/she could identify that the only possible answers were B or D. Knowing that statement 2 was incorrect required more in-depth knowledge, but this would have led the candidate to the correct answer, D. This is not always the case and candidates are encouraged to spend time reading the questions properly rather than guessing.

Section B

Question One
This 10-mark question covered the topic of social security. The question proved to be challenging in some areas, as new legislation was introduced on 01.01.2016.

Part (a) for 4 marks required candidates to explain the procedure for declaring and paying social contributions due by a self-employed person, together with the relevant deadlines. Many candidates gave good answers proving that they know the procedure. Usually candidates missed one or two phases of the procedure, but generally they identified the main steps.

Part (b) for 3 marks required candidates to compute the pre-payments of compulsory social contributions. Many candidates failed to compute the estimated net income as a monthly income and either made no comparison with the minimum level required by the law (35%*average monthly earning), or compared the annual net income with the monthly average earnings*35%, which lead to incorrect results.

Part (c) for 3 marks required candidates to compute the final values of compulsory social contributions. Again, many candidates failed to compute the realised net income as a monthly income and thus failed to make the correct limitations imposed by the law to the monthly taxable

base for social security contribution (minimum = 35%*average monthly earning; maximum = 5*average monthly earning). Many candidates, however, computed correctly the differences to be paid/recovered on settlement.

Question Two
This 10 question covered the topic of value added tax. This session, VAT was one of the well answered questions.

Part (a) required candidates to compute VAT for specific transactions, when the VAT rate changed. This part received good answers, but still some mistakes were made. The most common mistakes were:

- Applying the 20% VAT rate for the phone sold in December 2015, for which the invoice was issued in January 2016. Candidates are reminded that the VAT rate applicable is the one valid at the moment of the chargeable event, meaning when the transactions was carried out, not when the invoice was issued.
- Failure to apply the 20% to the entire value of a service performed in January 2016, for which an advance payment was made and invoiced in December 2015. Many candidates applied the 20% VAT rate only to the difference not covered by the advance payment, which was not correct. The correct approach was to cancel the advance payment using the 24% rate, valid when the advance payment was paid and invoiced, and then apply the new 20% VAT rate for the entire value of services performed in 2016.
- Not applying the reverse charge rules for the sale/acquisition of laptops in 2016.

In Part (b) candidates were asked to compute output VAT, input VAT and VAT due/to be reimbursed for each month: December 2015 and January 2016. Although many good answers were presented, the most common mistake was to make the computations for the output VAT based on the date when the invoice was issued and not on the date when the VAT was chargeable. Candidates are reminded that VAT is due based on the chargeable event, not on the date of the issued invoice. Even if an invoice was not issued, the VAT is due if the chargeability occurred.

Question Three

Question three was a 10 marks question which tested the area of employment income tax. Many good answers were received on question three.

Part (a) required candidates, for 9 marks, to compute the employment income tax for December 2016 for an individual that had two employment contracts. Candidates usually managed to apply correctly the algorithm for computing the personal income tax and generally knew that deductions are to be taken into consideration only at the basic activity job and not at the second job. When mistakes were made, they included:

- Failure to apply the 150 lei/person/occasion non-taxation limit for the present received by Andrei himself.
- Failure to deduct from Andrei's income with Forest SRL the voluntary pension contribution and the voluntary health insurance premium paid by Andrei from his own resources.

For 1 mark part (b) requested candidates to state who has the obligation to pay and declare the tax due for each of Andrei's employment contracts. Candidates are advised to carefully read the

requirements and solve them all. In this case, the question asked: who has the obligation to declare and pay. Some candidates presented answers referring only to the obligation to pay or only to the obligation to declare, thus losing marks.

Question Four

Question four was a 10 marks question which tested the area of corporate income tax, most specifically the computation of corporate income tax for a Romanian company having two permanent establishments in other countries. The question requested application of methods to relieve double taxation.

This question was poorly answered by many candidates. It was surprising to see how many candidates failed to cumulate the revenues and expenses of Safirul SA when computing the corporate income tax in Romania. Many candidates computed the corporate income tax in Romania based only on the values obtained in Romania and then applied tax credit for the tax paid abroad, which proved that candidates did not understand the logic of tax credit. Candidates are reminded that a company resident in Romania is liable to pay tax for all revenues, obtained from any source and any territory. Thus, in Romania all revenues and expenses had to be cumulated and any tax credit/exemption to be applied to cumulated values. Also, it was surprising to see many candidates failing to identify penalties paid to the state as being non-deductible expenses.

Question Five

Question five was a 15 marks question which tested the area of self-employment income tax, but also VAT and other income tax. This question was poorly answered by many candidates.

Part (a), requested candidates for 10 marks, to compute the pre-payments of income tax, the final tax and the difference of tax to be paid on settlement for a self-employed person in 2016. Many basic mistakes were made, although this is a very important area which is tested at almost every session, so candidates should prepare thoroughly for it. Many candidates simply failed to compute the pre-payments at all. When the pre-payments were computed, they were computed correctly, but somehow many candidates simply did not compute them, thus losing marks. Candidates are reminded to carefully read the requirements, break them down into items requested and answer each of them. Another basic mistake was not computing revenues and expenses on a cash basis. Moreover, many candidates did not follow the logic of determining the self-employment income tax. Thus, they applied the same mechanism as the one for the corporate income tax, i.e. computing the taxable income as: Total Revenues - Total Expenses + Non-deductible expenses.
Candidates are reminded that for self-employment income tax the algorithm mentioned by the law is:
Taxable income = Taxable revenues - Deductible expenses. Even if the candidates applied a different algorithm, when it led to the correct results, the marks were allowed. However, applying the corporate income tax algorithm led to some logical mistakes, such as computing the taxable income as: Taxable revenues - Deductible expenses + Non-deductible expenses, which was less logical and led to incorrect results. Moreover, candidates who applied the wrong algorithm tended to apply rules of corporate income tax also for expenses deductibility, which again was incorrect and made them lose important marks.

Part (b) was on VAT and, for 3 marks, asked candidates to determine whether the self-employed person should register for VAT in 2016. It was very surprising to see so few correct answers here, although this is very basic knowledge. First, some candidates failed to identify the taxable base based on sales actually made (and invoiced). Thus, they concluded that the self-employed person did not surpass the threshold for VAT registration in 2016. Other candidates simply said that the self-employed person should be registered from the beginning of the year, giving no reasons for this statement. Other candidates recognised that the threshold was exceeded in November 2016, but failed to present the correct procedure for registration, and said that VAT should immediately be charged starting 01 December 2016 or even November 2016.

Part (c) requested candidates to categorise the income received from an arbitration contract and state how and by whom should the tax for this income be paid. Unfortunately almost all candidates failed to present a correct answer. Many candidates included it into the "independent income" category and not "other income" category, thus gaining very few marks here.

Future candidates must take note that self-employment tax is and will continue to be an important element of the syllabus and must be understood, and they would do well to practice self-employment tax questions.

Question Six

This 15-marks question covered the topic of corporate income tax.

Part (a) for 3 marks required the computation of quarterly pre-payment of tax. Very few candidates presented correct answers to this part. As the company applied the pre-payments system, but registered a loss in the previous year, it should have computed the corporate income tax based on the accounting quarterly result, which was a quick and easy calculation. However, many candidates failed to apply this rule and made actual computation of corporate income tax for each quarter, thus losing time for unmarked solutions.

Part (b) for 12 marks required the computation of the final corporate income tax for 2016 and the difference of tax on settlement. This part presented some good answers. Usually answers were well organised, showing a correct calculation algorithm. When mistakes were made, they included:
- Failure to identify that dividend revenues from Romanian companies are non-taxable without any other supplementary condition
- Failure to compute transfer pricing adjustments in revenues
- Failure to tax the legal reserve
- Missing the carry-forward of the tax loss
- Not computing the tax exemption for reinvested profit

Yet again future candidates are reminded that the corporate income tax is a key element of the syllabus and hence an understanding of how the corporate income tax rules are applied, is considered very important for this exam.