

Examiner's report

F6 (PKN) 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 with a scenario to test the candidates' understanding and application of Vietnamese tax regulations in more depth. The following report on each section and focus on some of the noteworthy issues for each question.

Specific Comments

Section A

Almost all candidates attempted all of the questions in this Section. This Section A covers a broad range of the syllabus and requires candidates to illustrate not only understanding of the issues but also carefulness to avoid potential distractions. And with this third sitting under the new test format, the results were satisfactory.

The following 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 6 August 2015, CST Co entered into a contract to provide consulting services to RCP Co, for a fee of VND1,000 million. As agreed in the contract, RCP Co paid the full amount within two weeks from the signing of the contract, at which time CST Co issued a value added tax (VAT) invoice to RCP Co. At the end of 2015, the parties agreed that the works completed by CST Co accounted for 40% of the contract value. The corresponding costs of implementing the contract incurred by CST Co by the end of 2015 were VND250 million.

What is the corporate income tax (CIT) payable by CST Co in respect of this contract in 2015?

- A VND220 million
- B VND165 million
- C VND88 million
- D VND33 million

This question tested candidate's understanding of the revised provision for taxable revenue recognition of services (*Article 3 of Circular 96/2015 revising Article 5.2 of Circular 78/2014, which provided that revenue for services shall be taxable at the time of completion of, or in progress with services provision*).

Candidates who can apply the above principle to recognise revenue (and taxable profits) in progress, would be able to select the correct answer D. In particular, taxable income would be calculated as:

1,000 million * 40% completion – VND250 million expenses incurred) * 22% = VND 33 million

Example 2

Which of the following are both correct methods for determining the arm's length price in a related party transaction according to Circular 66/2010?

- A** **Comparable uncontrolled price and consumer price method**
- B** **Reselling plus method and cost plus method**
- C** **Comparable profit method and comparable cost method**
- D** **Profit split method and resale price method**

This question tested the candidates' knowledge of transfer pricing methods. This is an area of increasing concern by taxpayers and tax authorities and in prior sittings many candidates failed to remember the names of the methods correctly.

The methods provided in Circular 66 include (*Note: this was raised various times in the past exams*):

- **Comparable Uncontrolled Price Method,**
- **Resale Price Method,**
- **Cost Plus Method,**
- **Comparable Profit Method,**
- **Profit Split Method**

In light of the above, only Answer D contains both correct methods.

Section B

Question One

This 10-mark question is about deductibility of interest expenses on loans borrowed to finance investments in other companies, especially when there are shortfalls in capital contributions.

The candidates are expected to know that from Circular 78/2014, interest on a loan made for investment in other companies would be deductible in full in the year of arising, provided that the capital is contributed in full according to the capital contribution schedule. In case the capital contribution is not contributed in full, the non-deductible interest shall be apportioned corresponding to the shortage in contribution over total loans.

In part (a), answers to the theory question were mixed. Many candidates referred to the rule that interest must be within 150% of prime rate, which was not incorrect but may be irrelevant (since the rule is applicable to borrowings from individuals). Various other candidates correctly pointed

out the relation with capital contributions, however not many could specify the apportionment corresponding to the shortfall of capital contributed.

Part (b) of the answer revealed a different experience:

For InvestHold Co, many candidates were confused between deductible and non-deductible interest. In certain cases, candidates specified that there was no short fall in capital contribution but the whole interest expenses of VND7,200 million were not deductible. In some other cases, it was stated that the short fall in capital contribution was 100% but the whole interest expenses were deductible.

For TarSub, various scripts stopped at shortfall capital contribution by InvestHold Co only (or other investors only) and incorrectly determined the percentage of shortfall over total loans. Some candidates concluded immediately that all interest expenses were non-deductible because the capital contribution was not fully made.

Question Two

Part (b) of the question was a familiar exercise whereby candidates were required to determine which sources of income are taxable and which are not. Part (a) tested a new issue: taxability of insurance payment for Personal Income Tax (PIT) purposes.

The answers in part (a) were to some extent unsatisfactory. Many candidates were confused between voluntary insurance versus compulsory insurance, and commented comprehensively on the deductibility of compulsory insurance while the question required analysis of the tax treatment (i.e. taxability) of voluntary insurance, including non-accumulated and accumulated insurance fee paid by employer directly to insurer. In various answers, candidates commented on the tax treatments of all items (including salary, bonus, relocation allowance etc.) which was not required.

In case candidates were aware of the new provisions regarding these insurance fees, the answers would be simple. Non-accumulated insurance fees (such as medical insurance) are non-taxable, while accumulated insurance fees would be taxable. Either the insurer (in case it is a Vietnam-incorporated company) or the employer (in case the insurer is not incorporated in Vietnam) would be required to withhold PIT.

Part (b) also contains some new provisions which candidates were expected to know. For example, apart from medical insurance and life insurance as asked above, relocation allowance in cash to Vietnamese should also be non-taxable under Circular 92/2015. Many candidates treated the relocation allowance as taxable either because they thought the recipient was Vietnamese (under old regulations the relocation income was taxable), or because they thought that it should be taxable because it was received in cash.

Other common mistakes included:

- The car transportation was not multiplied by 9 months, or
- The uniform allowance in cash was fully taxable or non-taxable (it should be noted that under Circular 92, the cap of VND5 million applied to both cash allowance and kind allowance).

Some candidates provided a calculation of PIT liabilities for Mr Hieu Minh, including a complicated “gross-up” process, which was not required and did not earn any marks.

Question Three

This question tested candidate’s understanding of Foreign Contractor Withholding Tax (“FCT”) in various situations under provisions in the Circular 103/2014.

Part (a) was relatively well answered. Most candidates knew that when all supplies were sub-contracted to Vietnamese entities, the foreign contractors would be subject to FCT at 5% CIT and 5% VAT on the remaining services value, and that training overseas was exempted from FCT. Just a few candidates failed to perform “gross-up” calculation and thus could not obtain full marks. A small number of candidates broke down the services and constructions / installation activities into items – which was not required until part b (ii).

Part (b)(i) was generally quite well answered. The correct tax rates and grossing up calculation were correctly applied in the majority of scripts. The most common omission would be that some candidates treated training overseas as non-taxable. This was not true, because in a lump sum fixed price contract, training overseas would be subject to FCT at the rate of 2% CIT plus 3% VAT.

Part (b)(ii) was also well answered, with correct application of tax rates on items. The answers would be less time-consuming, if all candidates had re-used the amount of tax liabilities on the services in part (a) to avoid excessive calculations.

In certain cases, it was observed that in some scripts the amounts were all converted into VND, although it was very clearly specified that all calculations should be made in USD.

Like the prior sitting, this question was attempted by most candidates with satisfactory results. It showed a significant improvement and confidence from candidates with regard to FCT questions.

Question Four

The experience with this question was also mixed. Various candidates struggled with part (a), but performed satisfactorily in part (b).

Part (a) tested the candidates on a fundamental (but difficult) issue in VAT regulation: how input VAT can be creditable in case the company provides both taxable and exempt supplies. Not all candidates were aware that for the cases similar to Project A of RBP Co, the input VAT for fixed assets can be creditable in full despite that they are used for both taxable exempt supplies (Note that this would be totally different from the banking industry with specific treatments to the reverse. And also note that in case all the supplies are exempt such as Project B, the whole input VAT would become non-creditable).

Most candidates could however provide correct answers with regard to the input VAT from operations (i.e. input VAT should be apportioned using revenue ratio).

Most candidates also performed satisfactorily in part (b), when it came to the validity of invoices. It should be noted that:

- The input VAT would only be deductible if the bank account is registered with the tax authorities
- For manually issued invoices, the blank space must be crossed out, or the invoices become invalid (note: for computer-issued invoices, crossing out is not needed)
- A seller's chop is not compulsory, especially on invoices issued by supermarkets.

Question Five

This question is the first of two 15-mark long questions.

This question was generally well answered. However, like the previous sitting, various candidates did not answer this question or did not answer fully (probably because they did not allocate the time properly for this). An improvement for this session was that the reproduction of the Income Statements with adjustments to Sales revenue, costs of sales and expenses were significantly reduced. However, various candidates showed confusion when making adjustments, with mistakes between negative (deduct) and positive (add back) adjustments.

Common mistakes from this question include:

- Internal consumption of stock for further processing and business meetings are non-deductible with an add-back adjustment.
- Additional accounting expense of VND 200 million regarding incentive bonuses this year were added back. There should be no adjustment, as this is a deductible expense this year for tax purposes.
- The disallowed provision in 2014 of VND550 million was added back, rather than being deducted (because candidates thought that this was non-deductible). In fact this is an additional deductible expense in 2015 despite that it was not reflected as an expense in 2015 financial statements.
- Expenses for the unredeemed vouchers in June 2015 of VND500 million was added back as a taxable income (or as a non-deductible expense). However there should be no adjustment for this item as it has been (correctly) reflected as income in the financial statements.
- The whole rent or tax in 2015 of one or both Lease A and B were added back as non-deductible expenses. There would be no reason for adding back because the expenses were fully deductible and properly reflected in the financial statements.
- The rent and tax for Lease C meanwhile was sometimes not adjusted while these must be adjusted, because:
 - the payments were made in cash, and
 - RTM has to bear tax that should have been paid by the landlord (non-deductible expenses as it was not specified in the lease agreement that RTM would bear tax)

- Also for Lease C, many candidates have the whole tax amount adjusted. This showed that those candidates did not read the question carefully as it was said that the landlord has paid tax for the first three months of the lease (so RTM only had to bear $\frac{3}{4}$ of the tax).

Question Six

As with various previous sittings, this PIT question was generally very well answered.

In part (a) some candidates did make some minor mistakes. The most noteworthy mistakes comprised of the following:

- Only one round of gross-up was performed (while two rounds would be required – without and with housing)
- Omission of compulsory insurance deduction
- No deduction of self relief, dependant relief and insurance in calculating assessable income
- The gross-up was performed on combined income from two sources (incorrect because it is allowed in the regulations that gross-up is performed for *each* source).
- The income from HNP was grossed up using the highest rate (while the net income fell into a lower tax band).

In part(b) performance was generally satisfactory. However, it appears common that:

- Various candidates confirmed that remittances were subject to PIT while they were not;
- Many candidates said that the inheritance from Ms Phu's aunt was free from PIT. This was a misstatement, because the aunt was not "close family" (many candidates used "blood relationship" which may not be fully correct: the aunt should still have "blood relationship", but not "close" enough for the exemption.
- Some candidates incorrectly calculated the taxable income from the inherited building without the VND10 million deduction.