

Examiner's report

F6 Taxation (POL)
December 2013



General Comments

The examination consisted of five compulsory questions. 30 marks were available for Question 1, 25 marks for question 2 and 15 marks for each of the further three questions.

The vast majority of candidates attempted all five questions, and time pressure did not seem to be a major factor for most candidates - where questions were left unanswered by candidates, this appeared to be due to a lack of specific knowledge or insufficient exam technique, as opposed to time pressure.

Generally this exam was well answered by the candidates who were well prepared and employed good exam technique.

Candidates performed particularly well on questions 2(a), 2(b), 5(a), 5(b). The questions candidates found most challenging were questions 1(c) and 4. This was mainly due to candidates not understanding core syllabus areas well enough and due to a failure to read the question requirements carefully.

A number of common issues arose in candidates' answers:

- Failing to read the question requirement clearly and therefore providing irrelevant answers which scored few if any marks.
- Providing more than the required number of points.
- Illegible handwriting and poor layout of answers.

Specific Comments

Question One

This 30-mark question was based on an expanding Polish IT company, Haj Połer Softłer Sp. z o.o. (HPS). It tested candidates' ability to calculate corporate income tax (CIT) as well as their understanding of the simplified method and standard method for the payment of CIT monthly instalments.

Part (a) for 23 marks required candidates to calculate the CIT payable by or refundable to HPS for the tax year ended 30 June 2013. Candidates' performance was adequate on this part of the question. Most candidates correctly added revenue from products sold in June but invoiced in July to taxable income and deducted the Polish dividend, interest receivable, EU grant and the guarantee refund from taxable income. Commission costs paid to a software solution provider for facilitating a two-year contract for a client should have been included in the taxable income for the current year only in relation to the amount of costs applicable to the current year. In this scenario only 6/24 of the total cost should have been deducted against taxable income.

Some candidates encountered problems with the calculation of the depreciation for the licence and know-how. The gross value should have been calculated as the initial cost of the asset plus any acquisition costs (commission, implementation costs). Adding acquisition costs to the intangible's gross value means that these costs cannot be treated as operational costs in calculating the taxable income. The amortisation rate for the licence is 50% and for know-how is 20%. Amortisation is calculated starting from the month following an asset being acquired and becoming operational (thus 4 months of amortisation for the licence and 8 months for the know-how should have been calculated). Most candidates correctly added back the donation to taxable income. However, many candidates experienced difficulties in analysing low value fixed assets and outstanding receivables for taxable income purposes. Low value fixed assets should be treated as 100% tax deductible, the

loss on the sale of the loan was not a tax deductible taxable cost, while the loss on sale of the trade receivables and waiver of trade receivables should have been treated as tax deductible.

After calculating adjusted taxable income, most students correctly deducted the donation (up to 10% of the adjusted taxable income), new technology relief (50% of the licence gross value), 50% of the tax loss brought forward from 2011 (being EUR 45,000) to arrive at the tax basis. Tax was correctly calculated at 19% of the tax basis. However only some candidates calculated instalments paid during the current tax year properly to arrive at the tax refundable. Tax instalments should be calculated as tax for the period ended 30 June 2010 divided by the number of months in the period (18 months) and multiplied by 12 months in the tax year ended 30 June 2013.

Part (b) for 5 marks required an explanation as to why using the simplified method for the payment of its monthly CIT instalments might not be the most tax efficient in case of HPS and asked for suggested solutions which might help improve the economic efficiency of the tax settlement process. Candidates' performance was adequate on this part of the question. The majority of the candidates noted that, under the simplified method, tax instalments are paid during the tax year based on the tax results accounted for two or three years in the past. Therefore if taxable profits fluctuate, tax instalments might be lower (cash flow advantage) or higher (cash flow disadvantage) than calculated using the standard method. To address this issue, HPS could consider using the simplified method for years with high profits and the standard method for years with lower profits, however the simplified method is not effective for companies which account for profits only at the end of the year. HPS could also consider readjustment of the tax year of the company to include the whole product cycle in one tax year (from the product development to its sales).

Part (c) for 2 marks required an explanation of why the simplified method of payment of CIT monthly instalments would be more advantageous than the standard method in the case of a taxpayer who had understated the amount of income tax due (e.g. by error or incorrect interpretation of the law). The majority of candidates did not adequately answer this part of the question as they focused on describing general differences between those two methods, often repeating the content of their answer to part (b) of the question. Under the standard method, the penalty interest on any unpaid tax is calculated from the moment the particular monthly instalment was understated (20th day of the following month). Under the simplified method, the penalty interest is calculated from the deadline payment of the yearly tax settlement, which normally saves the taxpayer several months of penalty interest.

Question Two

This 25-mark question covered the topic of calculating tax for the natural person Zdzisław Chamlet (ZC) who was planning on running his own business (shoemaking services, production of own shoes and trade of shoes accessories).

Part (a) for 4 marks required candidates to calculate the annual social security and health service contributions (HSC) of ZC. This part of the question was well answered. As ZC had not run a registered business activity before he was entitled to lower social security, calculated as 30% of the minimal monthly salary times 34.35% for the whole year. Students who used the reduced 31.9% rate leaving work fund part were also granted full marks though detailed work fund knowledge is not required for the exam. Annual HSC was calculated as 75% of monthly average private sector salary times 9% for 12 months.

Part (b) for 10 marks required students to calculate the tax payable if ZC chose to settle his tax according to the standard personal income tax (PIT) rules, part (c) for 8 marks if he chose the flat revenue taxation method (ryczałt ewidencjonowany) and part (d) for 3 marks if he chose the flat income tax method. Candidates generally answered well in part (b) of the question and adequately in part (c) and (d).

In part (b) taxable revenue was calculated as the sum of all 3 activities. Taxable costs should have included the annual salaries of the two employees and their social contribution at 20.74%; annual rent; materials and ZC's

annual social security calculated in part (a) of the question. Taxable income was decreased by the donation (up to 6% of the taxable income) to arrive at the tax basis. As ZC was a single parent, the tax basis should have been divided by 2, PIT calculated at 18% less the tax free amount and multiplied by 2 before deducting child relief and HSC as calculated in part (a) of the question to arrive at the tax payable (but at 7.75% rate instead of 9%).

In part (c) of the question many students did not use a proper layout to calculate the tax payable using the flat revenue method, which impacted on the accuracy of their calculations and resulted in an unnecessary loss of marks. The first step of the calculation should have been to establish the level of taxable revenue. It consisted of the total revenue from all 3 activities decreased by ZC's own social security as calculated in part (a) and the donation up to 6%. No other costs were allowed – and stating this earned 1 mark for a candidate. The second step was to calculate the percentage of taxable revenue to total revenue and then apply the percentage to the revenue from each of the 3 activities separately and multiply by 8.5% for services, 5.5% for production and 3.0% for trade respectively to arrive at the tax figure. Finally, the tax should have been reduced by HSC as calculated in part (b) of the question to arrive at the tax payable.

Part (d) of the question allowed to candidates to pick up relatively straightforward marks provided they were well prepared and showed knowledge of the flat income taxation method. Taxable income as calculated in part (b) should have been taxed at 19% and then reduced by HSC as calculated in part (b) to arrive at the tax payable.

Question Three

This 15-mark question was based on Mieszacz Sp. z o.o. (Mieszacz) and involved calculations of value added tax (VAT) on purchases and sales of different kinds of fixed assets. Mieszacz supplied both VAT exempt and VATable services.

Part (a) for 7 marks required candidates to calculate the input VAT correction related to the sale of fixed assets. Candidates responded moderately well to this part of the question. The correction of VAT in respect of the land and building should have been calculated as the difference between the VAT recovered on acquisition (65% from 23% of input VAT) and the full amount of input VAT (100% from 23% of input VAT). The difference needed to be spread over 10 years and, as the sale took place 2 years after the purchase, the correction due on sale (additional input VAT recoverable) should have been adjusted by a fraction of 8/10. Similar treatment should have been applied to the correction related to the sale of machinery. Here, however, the difference should have been spread over 5 years and, as the sale took place 2 years after the purchase, the correction due to on sale (being additional input VAT recoverable) should have been adjusted by a fraction of 3/5. The computer and telephone did not require any corrections as they were worth less than 15,000 PLN.

Part (b) for 3 marks required candidates to calculate the input VAT correction which would have applied to the land and building if the sale had been VAT exempt. Candidates responded moderately well to this part of the question. The VAT correction for the land and building in this part of the question should have been calculated as the difference between the VAT recovered on acquisition (65% from 23% of input VAT) less zero as the sale would have been VAT exempt. The difference needed to be spread over 10 years and, as the sale took place 2 years after the purchase, the correction due to on sale (being a reduction of input VAT recoverable) should have been adjusted by a fraction of 8/10.

Part (c) for 2 marks required candidates to state the situations in which a taxpayer supplying both VATable and VAT exempt services does not need to make the input VAT correction related to mixed supplies. Candidates responded reasonably well to this part of the question. The VAT correction is not needed in two situations. Firstly if VATable sales are above 98% and input VAT related to the exempt supplies is less than 500 PLN - then the mixed supplies ratio is deemed to be 100%. Secondly if the VATable sales are below 2% - then the ratio is deemed to be 0%.

Part (d) for 3 marks required candidates to state the deadlines for the receipt of a cash refund of input VAT. Candidates responded reasonably well to this part of the question. The standard deadline for a cash refund of the input VAT is 60 days from the filing of the return. The accelerated deadline of 25 days is available if the taxpayer applies for the accelerated refund, the respective invoices are paid and/or VAT on respective import is settled.

Question Four

This 15-mark question was based on Para Sp. z o.o. (Para) which operated as a software reseller. Additionally Para held 100% of the shares in 2 subsidiaries, one in Italy and one in Australia. The question required candidates to calculate the CIT payable in Poland by Para for the tax year 2012. Candidates performed rather poorly on this question and presented limited knowledge on calculating adjustments to Para's 2012 net revenue and tax credits both related to dividends, interest and royalties. The amount of dividend received from Italy should have been deducted from the net revenue. The other adjustments increased net revenues – being the Australian dividend, Italian interest, Australian interest, royalties (for GTBD and for Mogiła) – and all needed to be grossed up for tax purposes (although candidates who assumed that the revenue was given gross in the question and calculated credit values correctly showing knowledge of the topic were also granted adequate marks). The last adjustment also increased net revenues and related to shareholders' cost of managing Para (4,000 PLN) - as the cost were not accounted for or paid they should have been treated as a free of charge benefit. Adjusted net revenue constituted taxable income, which should have been taxed at 19%. Then tax credits should have been deducted to arrive at the tax due in Poland. The first tax credit related to the Australian dividend and was calculated as the lower of withholding tax plus underlying tax and the Polish tax on the dividend. The second tax credit related to the Italian interest, Australian interest and GTBDT royalties in the same amount as net revenue adjustments. The third tax credit related to Mogiła royalties and was calculated as the lower of withholding tax and Polish income less amortisation in 2012 related to Mogiła taxed at 19%.

Question Five

This 15-mark question involved Tempus Fugit Sp. z o.o. (TF), which used a variety of fixed assets in 2012.

Part (a) for 11 marks required a calculation of tax deductible costs to be claimed in 2012 by TF in relation to those assets. This part of the question was well answered. Candidates correctly recognised that land and perpetual usufruct right is not depreciated but the usufruct yearly fee is the 2012 taxable cost. A whole year's depreciation of the building calculated at 2.5% depreciation rate multiplied by 1.2 due to the building's worse than normal condition; annual rent; depreciation of adaptation works calculated at 10% depreciation rate for 9 months of 2012 were also taxable costs of 2012. Candidates experienced some difficulties in calculating tax deductible costs related to the three leasing contracts. In the case of the first contract related to computers, the November and December interest as well as the December depreciation were tax deductible costs of 2012. In the case of the second contract related to machinery, candidates needed to calculate the depreciation for 2011, which was based to calculate accelerated depreciation for 2012. The interest component for 2012 required to be calculated by candidates being 12/24 of the difference between the total lease payments plus buy out price and the machinery value at purchase. The third leasing contract was for 8 passenger cars and was classified as an operating lease – here the 7 monthly lease instalments were the tax deductible costs for 2012.

Part (b) for 4 marks required candidates to state, with reasons, whether based on Tax Ordinance, CIT and VAT rules, the expense described in this part of the question would be allowed as a tax deductible cost for CIT and if input VAT would be recoverable. The expense was paid in 2012 (confirmed by the bank statement) and was directly connected with 2012 tax revenue, however, the invoice for the expense was missing and obtaining the duplicate was not possible as the service provider had gone bankrupt and had been liquidated. This part of the question was well answered. Most students correctly mentioned that, based on the Tax Ordinance, tax events may be proven by any means. However while specific CIT rules allow for evidencing tax costs by any means (e.g. by bank statement), specific VAT rules specifically require invoice or invoice duplicates as the basis for the deduction of input VAT.