



# Examiner's report

## F6 (CHN) 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 six questions, questions 1 to 4 worth 10 marks each and two longer questions worth 15 marks, each testing the candidates' computation and application of income taxes. 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 almost all candidates attempted all of the questions. Candidates preparing for the next examination of F6 are advised to work through the pilot paper 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 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

KINO Ltd is a company set up in China, which is subject to enterprise income tax (EIT) of 25%. KINO Ltd has a wholly (100%) owned subsidiary, Company A, set up in Country X.

In 2014, Company A had a profit of USD200,000 and paid enterprise income tax in Country X at the rate of 15% (USD30,000). Company A declared a dividend of USD170,000 and paid this to KINO Ltd after deduction of withholding income tax of 10% (USD17,000).

**What is the additional enterprise income tax (EIT) that KINO Ltd will pay on the dividend income received from its subsidiary, Company A?**

- A. USD25,500
- B. USD3,000
- C. USD42,500
- D. USD0

This question tested the calculation of foreign tax credit under enterprise income tax. Candidates need to know that foreign tax credit covers the underlying income tax paid in the foreign countries for three layers of subsidiaries. As a result, the foreign income which is subject to enterprise income tax in China should be the gross profit before any foreign income tax, which is USD200,000; and the foreign income tax of USD30,000 and USD17,000 can be credited.

The correct answer was B - USD3,000 and was calculated as follows:  $((200,000 \times 25\%) - 30,000 - 17,000)$ .

#### Example 2

The sales manager of a supermarket has proposed a marketing promotion of selling a pack of shampoo with a free bottle of hair-conditioner. This is termed as a "buy-one-get-one-free" offer. The retail price (i.e. inclusive of value added tax (VAT)) of the items is as below:



Shampoo (on its own)	RMB50
Hair-conditioner (on its own)	RMB20
Offer pack of shampoo and hair-conditioner	RMB50

In January 2015, the supermarket sold 2,000 of the offer packs.

**What is the amount of value added tax (VAT) charged on the sale of the 2,000 offer packs?**

- A. RMB14,530
- B. RMB17,000
- C. RMB20,342
- D. RMB23,800

This question tested the areas of bundled sales and deemed sales under VAT. A packed item is not a gift and therefore should not be treated as deemed sales even though the price of the packed item is the same as a single item. Candidates also need to know that the retail price is a VAT-inclusive price.

The correct answer was A - RMB14,530 and was calculated as follows:  $(50 \times 2,000 \div 1.17 \times 17\%)$

## **Section B**

### **Question One**

This 10-mark question covered the topics of a few taxes involved in sale of different items.

Part (a) for 4 marks required candidates to calculate business tax and land appreciation tax on the sale of a factory building. Many candidates got the correct answer of deducting the cost of acquisition when calculating business tax. However, many candidates could not differentiate between the cost and replacement value for used property under land appreciation tax (LAT). Future candidates are advised to learn the difference in the calculation of LAT for newly built property and used property.

Part (b) for 1 mark required candidates to calculate consumption tax (CT) under a tax inclusive price. Some candidates used the formula to calculate CT for imported goods.

Part (c) for 2 marks was about the definition of abnormal loss and should have been applied to whether the situation was an abnormal loss. While some candidates could state the definition that an abnormal loss is the losses due to theft, spoilage and deterioration due to poor management, they could not apply that an item passing the expiry date does not mean poor management and it is not abnormal loss.

Some candidates used a 13% VAT rate for part (d).

A number of candidates could not differentiate between a VAT inclusive price and a VAT exclusive price. Future candidates are advised to read the question carefully on the description of prices.

### **Question Two**

This 10 mark question required calculation of individual income tax (IIT) for different types of income.

In general, this question was well answered.

For item (1), some candidates only stated that the employee's contribution to social security was tax exempt but did not deduct it from the taxable salary.

For item (2) to (7), the common mistakes were applying the wrong formulae in calculating IIT.



For item (8), some candidates mis-read that was a listed company and treated the income as tax exempt.

### **Question Three**

This 10-mark question covered the topic of tax administration.

Most candidates answered Part (a) well. A few candidates used the wrong tax rates in their calculations even though the tax rates could be found in the tax rate tables.

Part (b) was about the consequences of non-compliance. This was fairly well answered. Some candidates could not differentiate between late payment surcharge (for late tax payment) with additional interest under transfer pricing.

### **Question Four**

This 10-mark question covered the topics of tax incentives for small enterprises and turnover taxes.

Most candidates got Part (a) for 4 marks correct.

As usual, many candidates did not perform well in answering the narrative type questions. Part (b)(ii) was badly answered and some candidates did not attempt this part.

### **Question Five**

This 15-mark question was about individual income tax (IIT).

Part (a) for 10 marks required the computation of IIT under different options. Most candidates answered this part well and some candidates got full marks. Some common mistakes were: forgetting to calculate the IIT for the salary under option D; forgetting to apply the deduction of RMB42,000 for sole proprietorship. Same as previous years, some candidates used the wrong tax rate tables for different types of income.

Part (b) for 5 marks needed candidates to apply the concept of tax residence. This part was not well answered. A lot of candidates simply copied the facts from the question and were unable to apply the terms "domicile", "habitually stayed in China", "full-year", "China-sourced income" etc.

### **Question Six**

This 15-mark question was a typical question on enterprise income tax (EIT).

Part (a) for 11 marks required candidates to do an EIT computation. This type of question is repeated in almost every exam. This part was well answered.

Part (b) for 4 marks asked candidates to briefly describe tax preferential policies which Sware Ltd could consider applying. In addition to the two items proposed in the answer, candidates describing other relevant tax preferential policies could get marks. However, some answers were irrelevant, e.g. "invest in a subsidiary and get tax exempt dividend" was not a preferential policy for application but rather an investment policy.