



Examiner's report

F6 (CHN) Taxation December 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. Section B questions test the candidates' understanding and application of tax knowledge in more depth.

In addition to the specific issues on each question, there are some general exam points that future candidates should be aware of:

- Candidates have the responsibility to check carefully which paper they have registered for. For example, some candidates had studied the UK variant but had incorrectly registered for the China variant and did not realise until they had started the examination.
- Take time to read the instructions carefully. This should help candidates to avoid spending time writing points which will not score marks and to prevent them overlooking important points stated in the question. For example, when asked to calculate the income or cost of enterprise income tax (EIT) purposes, a number of candidates did not pay attention to the words "income" or "cost" but simply calculated the EIT, which was irrelevant.

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

Pro Ltd manufactures two types of goods (Product K and Product L) using the same type of materials. The value added tax (VAT) position and VAT exclusive selling price of the two products in 2015 was as follows:

	VAT position	Selling price (VAT exclusive)
Product K	VAT exempt	RMB900,000
Product L	Export VAT refund rate 16%	RMB600,000

Pro Ltd's total input VAT in 2015 was RMB50,000.

What is the VAT refundable to Pro Ltd in 2015?

- A. RMB44,000
- B. RMB14,000
- C. RMB20,000
- D. RMB50,000

This question tested candidates' knowledge of calculating irrecoverable input VAT on exports under the "exempt, credit and refund" method which was RMB6,000 (RMB600,000 x (17% - 16%)) and under the "exempt" method which was RMB30,000 (RMB50,000 x 900,000/1,500,000). The recoverable input VAT is refundable. The majority of candidates selected option A which only takes into account the irrecoverable VAT in relation to the product with a VAT refund rate, but does not take into account the irrecoverable VAT for the VAT exempt product.

The correct answer is B, RMB14,000 (RMB50,000 – RMB30,000 – RMB6,000).

Example 2

Pater Co is a Cayman Island company which has lent money to a Chinese company, Company A. In 2015, Company A paid Pater Co net-of-tax interest income of USD50,000.

What are the amounts of business tax and enterprise income tax (EIT) that were withheld from this interest income and paid to the tax authorities by Company A?

Note: Ignore local taxes and surcharges such as city maintenance and construction tax and education levy.

	Business tax	Enterprise income tax
A.	USD2,941	USD5,882
B.	USD2,500	USD5,000
C.	USD2,500	USD12,500
D.	USD3,571	USD17,857

This question tested the knowledge of calculating taxes to be withheld from the income of a non-resident enterprise by a Chinese company. It was a straightforward question but a number of candidates did not realise that the interest income of USD50,000 was net of tax and so needed to be grossed up (gross interest before China taxes = $USD50,000 \div (1 - 5\% - 10\%) = USD58,823$).

The business tax is therefore USD2,941 (USD58,823 x 5%) and the EIT is USD5,882 (USD58,823 x 10%). The correct answer is therefore A.

Section B

Question One

This 10 mark question covered the topics of tax administration and appeal. This question was generally well-answered. A number of candidates wrote too much for each part of this question, despite being told to simply "state" or "state, with reasons".

Part (a) for 2 marks required candidates to state the consequences for the taxpayer and the withholding agent on non-compliance. Candidates were also expected to state the range of penalty (50% to 3 times).

A number of candidates mixed up the transfer pricing adjustment methods with the deemed profit margin method which was asked for in part (b).

Part (c) for 3 marks was straight forward. Candidates were required to state the actions to be taken by a taxpayer to appeal a decision by the district tax bureau. Most candidates answered correctly. Candidates were also expected to write the time period within which the taxpayer should take action (i.e. within 60 days after making payment).

Part (d) for 4 marks tested candidates' knowledge of the statute of limitation on tax evasion and errors made by tax bureaus. This part was generally well-answered.

Question Two

This 10 mark question tested the knowledge of EIT. Candidates did not perform well in this question.

Part (a) for 5 marks was about the taxation of foreign income and foreign tax credits, and the taxation of dividends received by a resident enterprise from another resident enterprise. Most candidates misread the instruction to "calculate the net of enterprise income tax income" and calculated the "enterprise income tax" instead.

A number of candidates did not know how to calculate China EIT on foreign income and the foreign tax credit (which includes both the withholding tax on the dividend and the underlying foreign tax paid).

A number of candidates also did not know that dividends received by a resident enterprise from another resident enterprise are tax exempt and should not be taxed again.

Part (b) for 5 marks tested the concept of establishment and tax residence. This part was straight forward but many candidates simply copied the facts from the question as the reason to support their answer, rather than applying their knowledge to the scenario. Some candidates did not know that Hong Kong Special Administrative Region is considered as an overseas region for tax purposes.

Question Three

This 10 mark question covered land appreciation tax (LAT) and differentiated LAT cost and EIT cost. This question was well-answered.

Part (a) was straight forward. A few common mistakes were:

- Not knowing how to calculate the land appreciation percentage (e.g. wrongly using the land appreciation value ÷ sales)
- Not knowing how to calculate LAT (e.g. wrongly using sales x quick deduction ratio instead of using the LAT cost)
- Not reading the note of "business tax, city maintenance and construction tax, education levy and local education levy total 5.6%" and calculating business tax at 5% and city maintenance and construction tax, education levy and local education levy at 5.6%
- Not knowing how to calculate LAT for a non-property developer using the valuation method and not knowing that there should be no additional deduction of 20% which is for property developers only
- Not knowing the cap of 10% on interest on loan and administration expenses

It is good practice to state the LAT cost in the computation since it will be used again.

Part (b) for 3 marks tested candidates' knowledge of differentiating LAT cost and EIT cost. A number of candidates did not know that business tax and surtaxes and LAT can be deductible for EIT. Again, some candidates did not read the instructions to "calculate the profit before EIT" and calculated the EIT instead.

Question Four

This 10 mark question covered consumption tax (CT) and VAT.

Part (a) for 5 marks related to the importation and sale of goods which are subject to CT. This was straight forward. However, a number of candidates were unable to recognise the differences in calculating CT on importation and CT on domestic sales. For importation, the composite price for CT and import VAT is the same, which needs to be divided by $(1 - \text{CT rate})$. A number of candidates demonstrated difficulty in understanding the VAT exclusive (which was stated in the question) and VAT inclusive price and incorrectly divided the number by $(1 + 17\%)$.

For part (a)(ii), it was apparent that a number of candidates did not read the instructions and calculated the input VAT, which was not required. Some candidates were not aware that:

- Watches for personal use are deemed sales for VAT purposes; and
- CT is not levied on the sale of non-self-produced consumable goods in China in general (except for certain specific goods)

Part (b) for 5 marks tested the candidates' knowledge of VAT. Most candidates answered this part well. Some common mistakes were:

- Multiplying the numbers by 1000 (pens)
- Not knowing that "the cost of purchasing for both accounting and EIT purposes" is the same and that the question was asking for the cost, not the EIT

Question Five

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

Part (a) for 4 marks is about IIT on stock options. This topic was newly introduced in year 2016 and this was the second time it was tested. The question was straight forward but poorly answered. This may be due to candidates not being familiar with the changes to the syllabus in 2016.

Part (b) for 3 marks required the calculation of IIT for a Chinese citizen working overseas. Common mistakes by candidates were:

- Not using the RMB4,800 monthly allowance for citizens working overseas
- Not knowing that the employee's contribution is "tax exempt" meaning the amount should be deducted from the salary
- Not knowing that hardship allowance is taxable
- Not crediting the African tax paid

A few candidates multiplied the numbers by 12 and then calculated the IIT by deducting the "personal allowance". Candidates should be aware that China IIT on wages and salaries is calculated on a monthly basis, which is different from UK tax.

Part (c) for 2 marks tested the knowledge of tax residence without domicile. Most candidates scored well in this part.

Part (d) for 6 marks required candidates to calculate IIT for different categories of income. Except for a few common mistakes, most candidates answered well. Common mistakes were:

- Not knowing that director's fees received by a general manager should be added to salary for IIT purposes; while director's fees to an independent director is taxed as "service income"
- Not knowing that an amount lent to a shareholder without repayment is taxed as a dividend (at 20% IIT rate)

Question Six

This 15 mark question was about EIT.

Part (a) for 14 marks was a typical EIT computation. Candidates should read the instructions clearly to see that a separate statement explaining the tax treatment was NOT required and that they were required to calculate the EIT directly with the description.

Candidates' performance in part (a) was subject to some common errors that future candidates can learn from:

- Not knowing that an abnormal loss for VAT is still tax deductible for EIT (item 1)
- Not knowing that accruals is in general, tax deductible (item 3)
- Not knowing that deemed sales are treated as deemed income and deemed cost/expense at the same time with the same amount (item 5)
- Not knowing that expenses incurred for closure of branch are tax deductible (item 6)
- Not knowing the tax incentive on accelerated depreciation (item 9) - this was the new tax incentive introduced in 2015 and candidates were expected to know these new incentives
- Not knowing that an unrealised exchange loss is tax deductible (item 10)
- Not knowing that a loss on disposal of A-shares is tax deductible (item 10) (candidates mixed up with IIT of which the gain is tax exempt)

Again, some candidates did not read the instructions telling them to identify "any items do not require adjustment by the use of zero (0)". Stating "yes" or "no" could not get any marks.

Part (b) was about the statute of limitation in relation to a transfer pricing adjustment which was worth 1 mark. While there is no statute of limitation for tax evasion, the statute of limitation for transfer pricing adjustments is ten years.