



Examiner's report

F6 Taxation (CHN)

December 2017

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 tax knowledge in more depth.

Unfortunately, a significant number of candidates studied for F6 UK but wrongly registered for F6 China variant and only found the mistake during the examination. Candidates should ensure they enrol for the correct paper.

Some candidates did not use the tax rates table and applied the wrong tax rates (e.g. VAT rate and EIT rate for non-residents). Candidates should ensure they use the tax tables provided to avoid missing easy marks.

The following paragraphs report on each section and focus on some of the key learning points.

Specific Comments

Section A

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.

A number of candidates who studied for F6 UK did not answer Section A.

Sample Questions for Discussion

Example 1

CL Ltd, a law firm, had the following transactions relating to its value added tax (VAT) in November 2016:

	RMB	Input VAT RMB	Output VAT RMB
Acquisition of office premises	8,000,000	880,000	
Service income, exempt from VAT	300,000		0
Service income, subject to VAT	700,000		42,000

These were the firm's only transactions which had VAT implications in November 2016.

What is the input VAT to be carried forward from November 2016 by CL Ltd?

A RMB838,000

- B** RMB574,000
- C** RMB486,000
- D** RMB327,600

This question tested candidates on the input VAT credit on immovable properties under the new VAT reform starting from 1 May 2016.

There are certain rules on input VAT credit: input VAT incurred specifically for supplies which are VAT exempt or not subject to VAT cannot be credited except for fixed assets, intangible assets and immovable properties which are commonly used by taxable, exempt and non-taxable supplies. As such, the input VAT on acquisition of office premises can be fully credited. In order to maintain financial stability, the input VAT on immovable properties can only be credited by instalment; the first instalment of 60% in the month of acquisition and the balance of 40% in the 13th month. As such, input VAT creditable in the month = 880,000 x 60% = 528,000; minus output VAT of 42,000 which means input VAT carried forward of RMB486,000. The correct answer is C.

A lot of candidates chose A suggesting they were not aware that only 60% of input VAT can be credited in the month of acquisition of immovable properties.

Example 2

Which of the following item(s) is/are not deductible for enterprise income tax (EIT)?

- (1) Depreciation of biological assets
- (2) Expenses incurred for the purposes of earning tax exempt income
- (3) Expenses incurred for the purposes of earning non-taxable income
- (4) An abnormal loss of inventory due to poor management

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

This question tested candidates' understanding of the EIT deduction. Some candidates confused expenses incurred for tax exempt income (can be deductible) and expenses incurred for earning non-taxable income (not deductible). Another area of confusion is the difference between VAT and EIT treatment on abnormal loss of inventory. Input VAT on abnormal loss is not creditable but abnormal loss (both the inventory and the irrecoverable input VAT) can be deductible for EIT. A lot of candidates chose the wrong option 2 and 4 (i.e. D). The correct answer is C – option (3) Expenses incurred for the purposes of earning non-taxable income are not deductible for EIT.

Section B

Question One

This 10-mark question covered the topics of enterprise income tax (EIT) on non-resident enterprises and foreign tax credit.

Part (a) for 4 marks required candidates to calculate the value added tax (VAT) and EIT on interest income earned by a non-resident enterprise. A number of candidates used the wrong tax rates (wrong VAT rate of 17%, 13% and 11%; and wrong EIT rate of 25%), despite the correct rates being included in the tax rate tables. The correct VAT rate is 6% (financial services of 6%) and the correct EIT rate is 10% (non-resident enterprise without establishment in China). Most candidates appeared not to know that the tax base for VAT and EIT is the same and also appeared not to know how to calculate the tax base from the net-of-tax interest. Some candidates did not read the requirement carefully which asked for “the total gross interest”. A lot of candidates appeared not to know that input VAT on financial services cannot be credited, hence, it is part of the cost of borrowing.

Part (b) for 4 marks tested candidates’ knowledge on EIT foreign tax credit. Foreign tax credit is calculated on a country basis instead of category of income basis. The majority of candidates simply adopted a total basis by aggregating the foreign income, calculating the EIT and applying the total foreign tax credit on a combined basis. (The combined basis will be allowed from 1 January 2017 onwards under the new tax notice Caishui [2017] No. 84 issued on 28 December 2017.)

Part (c) for 2 marks required candidates to determine whether an overseas insurance company with a branch in Shanghai is a China tax resident enterprise. A number of candidates mixed up the concept of China establishment (a branch in China) with tax resident which means place of management outside China (non-tax resident).

Question Two

This 10 mark question required the calculation of individual income tax (IIT).

Part (a) for 5 marks required candidates to calculate IIT on stock options. Most candidates lost marks because of a lack of knowledge. Common errors included:

- not knowing there is no IIT on grant day
- incorrectly calculating the rate of IIT - finding the rate for IIT on exercise of stock options is calculated by dividing the gain on exercise by the number of months of employment and is capped at 12. However, some candidates divided the gain on exercise by the number of months from the grant day, or simply divided by 12
- not knowing the special formula to calculate IIT on stock option (which is different from annual bonus)
- not knowing the IIT rate on disposal of stock is 20% with no reduction if the stock is listed in overseas (a lot of candidates mixed up with the A-share listed stock which can be IIT exempt)

Part (b) for 5 marks required candidates to calculate IIT on a Chinese citizen working overseas. A lot of candidates got good marks in this part. Some candidates did not know that there is an additional monthly allowance of RMB1,300 in addition to the RMB3,500 (i.e. a total allowance of RMB4,800) and some candidates could not differentiate between employer’s contribution to social insurance and employee’s contribution to social insurance. Both are tax exempt: one is not added to the taxable income but another is deducted from the taxable income.

Question Three

This 10-mark question covered the topics of import and export taxes. Candidates did not score well in this question and used the wrong formulae.

Part (a) for 5 marks required candidates to calculate the VAT refund of a manufacturing company. A number of candidates achieved only half of the marks in this part since they did not know the special formulae for import processing trade, i.e. irrecoverable input VAT under import processing which is $(\text{Export price} - \text{VAT exempt import}) \times (17\% - \text{Export refund rate})$; and the cap on the export VAT refund is $(\text{Export price} - \text{VAT exempt import}) \times \text{Export refund rate}$. Some candidates misread the question and incorrectly treated the “other input VAT relating to the production process of RMB130,000” as the VAT exclusive amount and applied 17% to calculate the input VAT.

Part (b) for 2 marks required candidates to calculate export taxes. Most candidates lacked the knowledge that export customs duty is calculated by freight on board (FOB). A significant number of candidates mixed up the formulae of VAT refund of production companies and trading companies.

Part (c) for 3 marks required candidates to calculate import customs duty and consumption tax. This part was relatively well answered. A number of candidates did not know that the replacement items imported into China are also taxable.

Question Four

This 10-mark question covered land appreciation tax (LAT).

Part (a) for 6 marks required calculation of LAT on a property developer. Most candidates scored well in this part. Some candidates did not know that deed tax is part of land cost (development cost).

Part (b) for 4 marks required the identification of taxable, exempt and not subject to LAT for 8 scenarios. A lot of candidates could not differentiate between “exemption” and “not subject to”. A transaction which is “not subject to” LAT is one which falls outside the scope of LAT, for example:

- item (1) a government selling land use right is not taxable
- item (4) a father giving the property to the son as a gift is not a sale of property under LAT and hence, not taxable
- item (5) pledging of property is not a sale transaction and hence, not taxable
- item (8) merger of two entities and with the title of property transfer is not taxable (except that to tackle the tax avoidance loophole, the merger of real estate entities is subject to LAT)

Question Five

This 15-mark question required candidates to calculate the IIT under different categories of income and tax withholding and registration.

Part (a) for 1 mark asked whether tax registration is required for an individual with personal income from e-commerce. The majority of candidates incorrectly answered this question with reference to the tax exempt threshold for VAT (i.e. RMB30,000 per month) or the IIT self-filing threshold (i.e.

RMB120,000 per annum). However, under the current Tax Administration Law, a natural person selling goods via e-commerce is outside the scope of tax registration.

Part (b) for 9 marks required the calculation of IIT under different scenarios, sole proprietorship, partnership and limited company. A lot of candidates got full marks in this part. A few common mistakes included:

- Using the wrong tax rate table
- A lack of knowledge that salaries are not deductible under sole proprietorship
- Not knowing the personal allowance of RMB42,000 is applicable for sole proprietorship and partnership
- Wrongly treating income from partnership as dividend income and incorrectly applying the 20% IIT rate

Part (c) for 3 marks tested the knowledge of tax withholding for non-residents. Most candidates considered tax withholding when the counter-part is an overseas company. However, for cross-border trading, since the income is not sourced from China, the overseas company did not need to pay China tax, hence, the importer does not need to withhold taxes (the importer pays customs duty and import VAT).

Part (d) for 2 marks required an IIT calculation on director's fees under different situations. Most candidates did well in this part; knowing that a director's fee received by a director of a company is taxed under employment income whilst a director's fee received by an independent non-executive director is taxed as service income.

Question Six

This 15-mark question was a typical question on EIT computation. Part (a) for 14 marks was fairly well answered.

A few candidates wasted time stating the reasons or stating "exempt", "deductible", "not deductible" etc. The requirement was to calculate, so reasons were not required, and the note to the requirement clearly indicated that all that was required for items which do not require adjustment was to show a zero '0'. Some of these candidates who gave reasons did not have time to complete the question. Some candidates stated the exempt, tax deductible etc. correctly but then answered incorrectly, e.g. the salaries of disabled employees of RMB380,000 qualifies for an additional deduction, (a further RMB380,000) however, some candidates stated "additional deduction" but, in error, added the amount rather than deducting it. Unfortunately some candidates did not show workings meaning that marks could not be awarded for an incorrect answer, but if workings had been shown some of the available marks would likely have been picked up.

Future candidates should read the past papers and note the presentation of the answers to this style of question.

Some common errors included:

- Item (2), lack of knowledge that if the accounting depreciation period is longer than the shortest tax depreciation period, no adjustment is required

- Item (3), mixed up tax credit and additional deduction. For energy saving equipment, it is a tax credit
- Item (4), lack of knowledge of how to calculate accelerated depreciation for small tools
- Item (5), lack of knowledge of tax treatment for deemed sale (increase deemed sales income and increase advertising expenses)
- Item (8), not understanding the meaning of the words “sole sponsor” and simply treating the amount as sponsorship which was not deductible instead of advertising
- Item (9), lack of knowledge that provision for labour union fees is not deductible and only the actual amount incurred within 2% of the wages and salaries can be deducted
- Item (10), missing the information that only half-year interest to be capitalised
- Item (14), not knowing that only special financial subsidy can be non-taxable and the subsidy for a promise is taxable, hence, no adjustment
- Items (15) and (16), not knowing the different treatments on dividend received from another tax resident (tax exempt and deduct from the income) and dividend received from a non-resident (taxable and foreign tax credit)
- Item (19), omitting the taxable income on donation received and missing the information that depreciation is for half year only
- Item (20), not knowing that the surplus on stock take is taxable

Part (b) for 1 mark tested the knowledge of consolidated filing. Most candidates did well in this section.