



Examiner's report

F6 (CHN) Taxation

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

A number of candidates studied the UK variant but incorrectly registered for the China variant and only found out their mistake during the examination. Candidates have the responsibility to check carefully which examination they have registered for.

Some candidates did not use the tax rates table and as a result used incorrect tax rates (e.g. the value added tax (VAT) rate and the enterprise income tax (EIT) rate for non-residents). Some candidates read the wrong line from the individual income tax (IIT) tax rate table and this careless mistake could have been avoided by using a ruler.

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 (CHN) 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

Kitsta Ltd, a consulting company, acquired an office costing RMB15,000,000 exclusive of value added tax (VAT) on 1 November 2016. The property developer is a VAT general taxpayer who pays VAT using the input-credit method. Kitsta Ltd has obtained a VAT special invoice from the property developer.

What is the amount of input value added tax (VAT) which can be credited by Kitsta Ltd in 2016 in respect of the acquisition of the office?

- A RMB990,000
- B RMB1,530,000
- C RMB1,650,000
- D RMB891,982

This question tested the input tax credit under the new VAT reform from 1 May 2016 onwards. Candidates who lacked knowledge of the VAT reform were unable to calculate the amount of input VAT that was creditable.

Candidates needed to have the following knowledge:

- the VAT rate for property is 11% (from the tax rate table at the beginning of the examination) for the input-credit method;
- the meaning of "exclusive of VAT" to be able to calculate the VAT of RMB15,000,000 x 11% = RMB1,650,000; and
- that only 60% of the input VAT can be credited for the purchase of immovable property on acquisition, i.e. RMB1,650,000 x 60% = RMB990,000 (the balance of 40% can be credited in the 13th month).

The correct answer was therefore A, RMB990,000

Most candidates chose option C (i.e. not knowing that only 60% input VAT could be credited and incorrectly giving full credit in the month of acquisition).

Example 2

Which of the following transactions can be exempt (or temporarily exempt) from customs duty?

- (1) Importation of foods by a restaurant from overseas to a Free Trade Zone for consumption
- (2) Importation of goods by a factory from overseas to a bonded warehouse
- (3) Importation of materials by a factory from overseas under a processing trade agreement
- (4) Importation of materials by a trading company from overseas under a general trade

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

This question tested the area of customs exemption on importation. Most candidates knew that importation under "general trade" means taxable on importation, hence, option B was ruled out. A number of candidates had the misconception that all importation to Free Trade Zones can be tax exempt, which is wrong. Importation into Free Trade Zones (customs special zones) for consumption (including food) and construction (e.g. building materials) are taxable.

The correct answer is D. Most candidates selected option C.

Section B

Question one

This 10-mark question covered the topic of VAT reform since 1 May 2016. In general, this question was not well-answered. It showed that candidates lacked knowledge of the VAT reform.

Part (a) for three marks required candidates to calculate the VAT and EIT of a non-resident representative office. Many candidates were unable to calculate the taxable revenue by using the cost and the mark-up (i.e. divide by (1 - 15%), not multiply by (1+15%)). Many candidates did not use the "profit" to calculate the EIT but used revenue multiplied by the EIT rate. A number of candidates used the incorrect VAT rate of 17% instead of the correct rate of 6%; and the incorrect EIT rate of 10% instead of the correct rate of 25% for non-resident enterprises with a permanent establishment (the tax rate stated in the tax rate table).

Part (b) for four marks required candidates to know the input credit for taxable, tax exempt and zero-rated activities. Similar to part (a), some candidates used 17% instead of 6% (which was evidence of not reading the

tax rate table). Many candidates could not differentiate the input tax treatment under exemption and zero-rating, i.e. exemption - no input VAT credit; zero-rated - input tax can be credited or refunded. Most candidates did not know how to calculate irrecoverable input tax on commonly shared items but there is no need to calculate irrecoverable for fixed assets unless that asset is specifically used for exempt supplies. A small number of candidates did not read the question carefully and treated the input VAT as purchases and applied the incorrect VAT rate again.

Part (c) for three marks required candidates to differentiate the VAT treatment of small-scale taxpayers with general taxpayers. A common mistake for most candidates was to use the incorrect tax rates and to not differentiate between the "tax inclusive" and "tax exclusive" amount. Some candidates used 17% for both output tax and input tax without knowing that the VAT rates could be different for sales and purchases. Some candidates mixed up the taxation of small-scale taxpayers and the calculation of selling fixed assets by small-scale taxpayers (i.e. incorrectly divide by $(1+2\%)$).

Question Two

This 10-mark question tested EIT. This question was not well-answered.

Part (a) for seven marks was about foreign tax credit. Most candidates did not know how to calculate the underlying income tax paid on the dividend received. Some candidates considered that the dividend and the profit from which the dividend was distributed were two income streams.

Part (b) for three marks required candidates to calculate EIT on the incomes of a non-resident enterprise. Most candidates incorrectly used the same EIT rates (i.e. either using 25% or 10%) for all three incomes instead of treating each differently.

The tax rates table states that non-residents with an establishment in China are taxed at 25% and non-residents with other incomes is taxed at 10%.

Future candidates are recommended to read and use the tax rates table provided.

Question Three

This 10-mark question covered the topics of tax avoidance and tax evasion. This narrative question was generally not answered well.

Part (a) for two marks required the definition of tax avoidance under the EIT law. Most candidates lacked knowledge in this area.

Part (b) for one mark required candidates to identify which out of two tax schemes was tax avoidance and most candidates got the correct answer.

Part (c) for five marks was about the consequences of tax avoidance and tax evasion. A lot of candidates were confused. A number of candidates were able to answer the question regarding the consequences of tax evasion but not tax avoidance.

Part (d) for two marks required candidates to state the statute of limitation for the collection of taxes in the case of tax avoidance and tax evasion, which is a straight forward question. However, most candidates did not know the meaning of the words "statute of limitation" which was disappointing.

Question Four

This 10-mark question covered the topics of turnover taxes, i.e. consumption tax, customs duty, VAT refunds and VAT on the sale of goods.

Part (a) for three marks required the calculation of consumption tax and VAT refundable on exports. A number of candidates did not know that there is no consumption tax on exports but is taxable on domestic sales only. Some candidates wrongly used the VAT refund calculation method for trading companies instead of the correct method of "exempt, credit and refund" for production and export.

Part (b) (i) for two marks required the calculation of customs duty to test candidates' knowledge of the tax base for customs duty. Most candidates got the correct answers but some did not know the meaning of cost, insurance and freight price (CIF) and free on board price (FOB), hence just added some numbers together and applied the duty rates.

Part (b) (ii) for one mark required the calculation of consumption tax on importation. Some candidates did not know how to calculate the tax base for import consumption tax (i.e. divide by (1- consumption tax rate)).

Part (b) (iii) for one mark tested candidates' knowledge of abnormal losses for VAT. Performance in this part was mixed.

Part (b) (iv) for three marks required the calculation of output VAT on domestic sales and input VAT. Some candidates did not know how to calculate output VAT on deemed sales.

Question Five

This 15-mark question was a typical IIT question. Most candidates performed well. A few candidates used the correct tax rate table but read the wrong line from the table. This careless mistake could be avoided by using a ruler.

Part (a) for two marks required candidates to calculate IIT under two options; partnership income and salary from a company. Some candidates forgot to include the allowance of RMB42,000 and some used the incorrect tax rate. Many candidates, however, got full marks in this part.

Part (b) for six marks required the calculation of IIT for an expatriate. This was to test candidates' knowledge of tax exempt allowances. Most candidates got high marks for this part. However, some candidates did not know how to use the "quick deduction factor" method to calculate IIT. Some candidates did not know that expatriates could have an additional allowance of RMB1,300 (i.e. a total monthly allowance of RMB4,800).

Part (c) for seven marks required the calculation of IIT under different categories of income. Most candidates got high marks in this part. However, some candidates incorrectly combined the different types of income together in tabular form for tax calculation. It is possible that these candidates had learnt UK tax before and switched to the China variant as it appeared that they used the method of UK tax calculation. Some candidates lacked knowledge of the definition of "one income" when calculating the consultancy fee and authorship income. Common mistakes included using the income of one year instead of one month for service income and treating the publication income from the same publisher as two incomes.

Question Six

This 15-mark question was another typical question, which was an EIT computation from accounting profit. This question covered a wide scope of different tax treatments in EIT. The performance in this question was mixed. A few common issues with exam technique included:

- not stating the item numbers or a description of the item, but stating the amount only;
- spending a lot of time writing an explanation of the adjustments (which were not required in this question);
- inconsistencies between answers given in words and in amounts (e.g. writing "no adjustment" but stating an amount to be adjusted); and
- incorrectly read the amount (e.g. reading the amount of RMB5,340,000 in item (17) as RMB340,000).

A number of candidates came up with incorrect answers for the following items:

- (1) donation to qualified charity - there is a cap for the amount of tax deduction, which is 12% of accounting profit;
- (2) loan interest - no adjustment is required for interest paid on borrowings from unrelated non-bank financial institutions even though in this case the interest rate was higher than the rate from the bank, since this is still at arm's length;
- (8) depreciation - lack of knowledge of how to calculate depreciation under the sum-of-years'-digit method;
- (15) government subsidy - lack of knowledge of treatment of a non-taxable government subsidy under which the corresponding expenses were not deductible;
- (16) employee insurance - lack of knowledge of the tax treatment of commercial insurance and social insurance contributions;
- omitting the foreign tax credit on tax paid overseas; and
- using the 25% EIT rate instead of the reduced rate of 15% for high and new technology enterprise.

Future candidates are recommended to improve their time management in the examination. A few candidates were obviously running short of time to complete question six.