

Examiner's report

F6 Taxation (CHN)

December 2013



General Comments

The examination consisted of five compulsory questions - question 1 for 35 marks, question 2 and question 3 for 20 marks each, question 4 for 15 marks and question 5 for 10 marks.

The vast majority of candidates attempted all five questions, and there was little evidence of time pressure. Where questions were left unanswered by candidates, this appeared to be due to a lack of knowledge or poor exam technique, as opposed to time pressure.

Question 1 (a) and question 2 (b) were calculation-type questions on income tax. These questions were relatively straightforward and, in general, very well answered. Question 2(c) and 3(d) which required candidates to state or list out certain criteria were well answered. Question 5(b) which required understanding of the differences between a transfer pricing adjustment (special adjustment) and tax evasion was not handled well.

Candidates performed particularly well on questions 1(a), 1(b), 2, 3(a) and 3(d). The questions candidates found most challenging were questions 1(c)(i)(ii)(iii), 3(c), 4(b) and 5. This was mainly due to a lack of technical knowledge on certain topics and also due to a failure to read the question requirements carefully.

A number of common issues arose in candidate's answers:

- Failing to read the question requirement clearly and therefore providing irrelevant answers which scored few, if any, marks.
- Not learning lessons from earlier examiner's reports and hence making the same mistakes
- Providing more than the required number of points.
- Not differentiating between the concepts of "not subject to", "out of scope", "exempt" and "not taxable"
- Confusion in the use of appropriate wording, e.g. an expense is not deductible was written as "an expense is taxable", an item of income is exempt was written as "an item of income is not allowable"; the discount has no effect on VAT was written as "the discount is exempt from VAT" (which can mean the discount can be deducted from sales instead of meaning that the discount has no effect).

Specific Comments

Question One

This 35-mark question was on Enterprise Income Tax (EIT). Parts (a) (i) and (ii) for 22 marks required candidates to explain the EIT treatment of each item and to calculate the EIT payable. This was designed to test candidates' knowledge of EIT computation. Most candidates performed very well on parts (i) and (ii) since this is a standard type of question which appears every year in the exam. A common problem encountered by candidates was mixing up terms such as "deductible", "taxable", "allowable", "exempt". For example, a penalty on late tax filing should be not deductible but some candidates described it as "taxable". Therefore, while it was correctly included in the calculation as an add-back item, the wording was incorrect. In part (ii), some candidates did not list out the items where no adjustment was required and thus lost marks. For part (ii), it is expected that the tax calculation is organised either by addition and then subtraction or by listing the items based on the order in the question. Merely stating the words "no adjustment" without reference to the number of the item whilst the items were not chronically in order scored no marks as it was impossible to guess which items the "no adjustment" related to. Another common mistake was treating the interest of RMB 300,000 as the loan principle and calculating the non-deductible interest accordingly.

Part (b) carried 5 marks and was designed to test candidates' knowledge of tax losses. This was well answered with some candidates scoring full marks in this part. However, some candidates simply calculated the tax loss instead of explaining the treatment as required.



Part (c) for 8 marks tested candidates' knowledge of non-resident enterprises. Part (i) and (ii) were generally not well answered as most candidates could not differentiate between "net-of-tax interest" and "gross" and hence, calculated the gross interest without grossing up (i.e. divided by $(1 - \text{the tax rates})$). For part (iii) and (iv), candidates were weaker in handling the requirement asking "why" (i.e. part (iv)) and stronger when dealing with stating the facts (i.e. part (iii)).

Question Two

This 20-mark question covered the topic of individual income tax (IIT). This is also a standard type of question which appears every year. Candidates, in general, did well in this question.

Part (a) for 4 marks required candidates to explain the concept of tax residency. It was generally well answered. However, some common problems were that candidates could not explain the word "domicile" and some candidates confused the 90-day exemption rule for non-residents with income from wages and salaries with other income.

Part (b) carried 11 marks for an IIT calculation. It was, in general, well answered. Some common errors included overlooking the deductible allowance for foreign nationals of RMB 4,800 and using the allowance of RMB 3,500 for Chinese nationals in the calculation (item 1); calculating the monthly IIT instead of 12-monthly (item 1); not treating the lecture fees from two classes as one income in the tax calculation (item 3); and not knowing the formula to calculate the IIT from sole proprietorship (item 7). There were some careless mistakes involving use of the wrong tax rates and casting errors.

Part (c) for 5 marks asked the candidates to list out the circumstances in which an individual is subject to IIT self-assessment. This was a factual question and well answered.

Question Three

This 20-mark question was about VAT and import taxes (including customs tariff, consumption tax and VAT).

Part (a)(i) for 4 marks required candidates to calculate the three import taxes. This was well answered although some candidates did not know how to calculate the tax base for VAT and consumption tax and some did not know that the same tax base applies for both these taxes.

Part (a)(ii) for 1 mark asked about the deadline to make a customs import declaration. Some candidates confused this with the timing of the tax payment and stated 15 days.

Part (b) for 8 marks was a calculation question and, in general, well answered. However, some candidates could not differentiate between the terms "no adjustment" and "not taxable", e.g. an early settlement discount would result in "no adjustment" but some candidates stated that it was "not taxable". VAT is tax-exclusive and some candidates got confused here and treated the price as tax-inclusive. For item (8), some candidates were not aware that the tax rate table includes the tax credit of 7% for transportation charges. For item (9), some candidates were not aware of the 3% rate for small-scale taxpayers or did not use the total amount (tax inclusive price) to calculate the input VAT.

Part (d) for 4 marks asked for four deemed sales transactions. Again, this part was well answered and a lot of candidates achieved full marks. Some common problems were listing out more than 4 points and not listing out the different types of goods for which the transfer will be deemed VAT sales.

Question Four

This 15-mark question was about Business Tax (BT) and Land Appreciation Tax (LAT).



Part (a) was for 8 marks, of which 7 marks dealt with BT. This part was not well answered and a lot of candidates lost marks because they simply calculated the BT instead of stating the tax treatment. Some confused “not subject to” with “outside the scope” and “exempt”. For example, the sale of the used computers is not subject to BT but subject to VAT which is different from being exempt from BT and the bank deposit interest is exempt from BT which is different from being not subject to BT.

Part (b) for 7 marks is about LAT. Except for a few candidates who achieved full marks, this requirement was not generally well answered. LAT is not a commonly examined area but it is a topical issue in China. The calculation was straightforward and the unsatisfactory answers reflected a lacking of technical knowledge in this area.

Question Five

This 10-mark question was about tax administration, in particular, transfer pricing matters, which is a very topical issue in China in recent years.

Part (a) carried 5 marks and asked for the definition of various terms. This is a typical knowledge-based question and those candidates who had studied this area could have scored very well. Those without the technical knowledge would have scored poorly.

Part (b) carried 5 marks and was a short case study that required candidates to apply the law in a scenario and to identify which type of non-compliance each case concerned. This was poorly answered by most candidates. Many candidates confused the transfer pricing adjustment (special adjustment) with tax evasion and wrote down the same consequences for both. Candidates should ensure that they are able to apply the tax rules to a scenario.