

Examiner's report

F6 Taxation (CHN)

December 2014



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.

Candidates performed particularly well on questions 1(a), 2(a), 2(b), 2(d) and 4(a). The questions that candidates found most challenging were questions 1(c), 1(d) and 3(a). This is mainly due to candidates not understanding how to apply their knowledge to the case, a lack of technical knowledge and also due to a failure to read question requirements carefully.

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

- Failing to read the question requirement carefully and therefore providing irrelevant answers which scored few, if any, marks.
- Not reading / using the Tax Rates and Allowances Table; for example, candidates often used the wrong tax rates or even the wrong table
- Illegible handwriting
- Not giving sufficient space in the answer booklet between different parts and omitting some points from the previous sections when preparing the next part
- Casting / calculation errors
- A minority of candidates used 10K instead of 10,000 and 45 became 0.045K, and then made casting errors.
- Poor English and an inability to use the correct words to explain tax concepts
- As stated in last year's Exam Report, candidates should know that:
 - The words used to describe the tax treatment of income are: "taxable", "not subject to tax" or "tax exempt"
 - The words used to describe the tax treatment of an expense are: "deductible" or "not deductible"

Overall, candidates appear not to have learned from earlier examiner's reports and hence make the same mistakes. Some of these mistakes were careless and, if avoided, could have resulted in a different outcome for candidates who were marginal. Future candidates should make note of the above errors and try to avoid them.

Specific Comments

Question One

This 35-mark question was on Enterprise Income Tax (EIT) which comprised of a calculation and some short narrative questions. It tested candidates' knowledge of EIT adjustments, computations and concepts.

Part (a) was based on a topic which has been frequently tested in past papers. Part 1(a)(i) for 13 marks required candidates to explain the tax treatments of 11 items with some simple calculations. Most candidates performed well but some common mistakes were:

- incorrect technical language which made the candidate's explanation unclear.
- failing to read the requirements of the question
- failing to explain the treatment of specific items often merely stating "no adjustment"



- not using the tax rates as stated in the Tax Rates and Allowances Table, with some candidates using an incorrect rate which shows they had not read the table)
- copying the tax treatment of entertainment expense and advertising expense which were stated in the Tax Rates and Allowances Table without applying the numbers to calculate the answers
- lack of knowledge of various treatments:
 - interest on shareholder's loan at a rate lower than market can be fully deductible without adjustment (only those higher than market needs adjustment)
 - unrealised exchange loss is deductible (similarly, unrealised exchange gain is taxable) [*Prior to 1 January 2008, under the old law, the unrealised foreign exchange gain was not taxable and unrealised loss was not deductible*]
 - foreign tax is not deductible but can be credited against the EIT payable [a lot of candidates could not differentiate the difference between "deduction" and "tax credit"]; some candidates performed an incorrect calculation on taxation on foreign income and foreign tax income
 - dividend to shareholder involved two parties, Company A which paid the dividend and the shareholder which received the dividend. A lot of candidates could not differentiate the difference between the one which paid and the one which received

Part (a)(ii) for 4 marks was a familiar EIT computation question and most candidates performed well. Some candidates omitted the points of part (a)(i) (not stating clearly the tax treatment and the numbers), hence, even though the explanation of tax treatment was correct, the computation was wrong.

It is recommended that future candidates adopt good practices such as stating clearly in part (a)(i) "no adjustment", "amount added back by RMBxxx", "amount reduced by RMBxxx" etc along with the reasons. As such, when preparing part (a)(ii), candidates can easily adopt the treatment they have already worked out in the previous part.

Part (a)(iii) for 1 mark tested the knowledge of using the correct tax rate on a non-resident taxpayer. Some candidates used 25% which was the tax rate for resident enterprises and non-resident enterprises with a Chinese establishment. The shareholder receiving the dividend did not have a Chinese establishment relating to the dividend income and the tax rate should have been 10%. Some candidates used 20% (which was the tax rate per the EIT Law but reduced to 10% under the EIT Regulations, hence the Tax Rates and Allowances Table only shows 25% and 10% without showing 20%). A minority of candidates stated that the normal wastage was a cost of production instead of cost of sales and hence, the amount should be adjusted; but they did not understand that the cost of production \pm inventory would become cost of sales.

Part (b) for 5 marks tested the knowledge of calculating the EIT on a non-resident with a permanent establishment. Similar to Part (a)(iii), some candidates used the wrong tax rate even though the question stated clearly that there was a permanent establishment in China. Some candidates used the calculation method applicable to representative office.

Part (c) for 6 marks tested the knowledge of tax exempt and non-taxable income. A lot of candidates could not differentiate between "tax exempt income" and "non taxable income".

Part (d) for 6 marks was about the valuation of fixed assets and calculation of depreciation for EIT purposes. Most candidates were not aware of the period in calculating the interest to be capitalised and calculating depreciation, or using a daily basis to calculate depreciation.

Candidates performed particularly well on part 1(a).

Question Two

This 20-mark question covered the individual income tax (IIT) computation and concepts. Some candidates made careless mistakes such as using wrong tax rate table (the one for entrepreneurs instead of the one for employment income), using the correct table but copying the wrong quick deduction factor, copying the wrong amount of additional allowance (e.g. the table clearly showed the number RMB3,500 for a China local but a few candidates used RMB4,800 for expatriates or even RMB3,800).

Part (a) for 6 marks required candidates to calculate IIT under two plans while the total salaries received by the individual were the same. The common mistakes due to lack of knowledge were:

- Not aware that one bonus in June should be added together with the salary to calculate IIT
- Not knowing the formula to calculate IIT on bonus

Part (b) for 8 marks required candidates to calculate IIT for different types of income and state clearly any items which were "exempt from IIT" or "not subject to IIT". Most candidates performed well in this part except for a few common mistakes due to lack of knowledge:

- Incorrectly treating supermarket coupons as taxable (taxed as incidental income)
- Incorrectly treating director's fee received on a monthly basis as one income, rather than 12 months
- Not adding salaries received in a month together for IIT purposes
- Incorrectly considering tax withheld by the withholding agent as "not taxable"

Part (c) for 4 marks tested the knowledge of tax residence. A lot of candidates lacked the knowledge that a non-resident travelling to China for less than 90 days (or 183 days under tax treaties / arrangements) and with salaries paid outside China can be tax-exempt.

Part (d) for 2 marks tested the knowledge of self-reporting. Some candidates incorrectly considered that when the tax was withheld by the employer, that meant not taxable and hence, no need to file the annual IIT return.

Candidates performed particularly well on parts (a), (b) and (d).

Question Three

This 20-mark question was on value added tax (VAT), including the VAT reform [or commonly referred to as B2V (Business tax to VAT)]. Some candidates made careless mistakes by not reading / using the tax rates as provided in the Tax Rates and Allowances Table.

Part (a) for 6 marks compared the tax payable and gross profit under a general taxpayer and small-scale taxpayer. A lot of candidates did not calculate the gross profit and most got the gross profit incorrect. An accountant should know how to calculate gross profit after taking VAT into account.

Part (b) for 3 marks was about an export VAT refund. Most candidates did not know how to calculate VAT refundable by a trading company and less than five candidates got the right answer.

Part (c) for 5 marks required candidates to apply the concept of crystallisation of a VAT liability. Performance on this question was fair, but not great, due to lack of knowledge. A few candidates did not read the requirements and merely wrote what they remembered about the VAT rules.

Part (d) for 6 marks was about the VAT including B2V. Again, careless mistakes included the use of the wrong tax rates (without referring to the Tax Rates and Allowances Table). Common mistakes due to lack of knowledge were:

- Not differentiating between tax inclusive and tax exclusive amounts
- Not knowing that VAT withheld for overseas taxpayer could be creditable
- Not knowing that VAT on fixed assets partially for tax exempt services can be fully creditable



- o Not knowing that a small-scale taxpayer can request a tax bureau to issue a VAT special invoice and hence, the VAT can be creditable

Question Four

This 15-mark question included 11 marks on business tax (BT) and 4 marks on consumption tax (CT).

Part (a) for 11 marks tested the knowledge of taxability and how to calculate BT. This part was well answered although no candidate achieved full marks. Some candidates made the careless mistake of using the wrong tax rates and a few did not read the requirement and wrote "relevant to BT" or "irrelevant to BT".

Part (a) for 4 marks required a calculation of CT. Candidates who had obviously studied CT got high marks in this part and those who had not prepared got low marks.

Question Five

This 10-mark question was a narrative question on tax administration and transfer pricing. The results were polarised and those who had prepared achieved high marks and those who had not prepared only achieved low marks or were unable to answer.

Future candidates should be aware that tax administration is an important part of the whole tax system and they should not skip this part when preparing for the examination.