



# Examiner's report

## P6 Advanced Taxation (HKG)

### June 2009

#### General Comments

The style and approach taken in setting the questions for this diet are consistent with the previous diets. Questions are case-oriented, and are designed to cover a wide range of topics required in the syllabus. Except for the anti-avoidance topic in Question 5, the majority of the topics are not new to candidates and are common and popular. Although the examiners and Examination Review Board took the view that candidates should not find the current paper too difficult, it is unfortunately another surprise to the examiners that the overall performance of candidates was not as satisfactory as expected. In general, the major weakness is found in the fundamental tax concepts which are either unclear or incorrect. The performance for Question 5 is also extremely disappointing (please see comments below).

As in previous diets, Question 1 under Section A covers a broad range of topics associated with Hong Kong profits tax issues and Question 2 covers income tax issues in the context of an individual working in Hong Kong. These two questions add up to a total mark of 66. Section B comprises 3 questions for a choice of 2, with each question scoring 17 marks. These 3 questions are comparatively shorter and more straightforward. Total marks awarded for Section B are 34 only and thus candidates need to score average marks from Section A in order to get a pass. Very few marks are awarded to computations or numbers included as part of the answers. Candidates should demonstrate their competence in mastering the fundamental tax concepts and abilities in analysing the questions; and to present their answers with logics and principles rather than detailed calculations. Candidates should expect that this trend would be followed in subsequent diets.

In terms of time management, most candidates managed to finish four questions as required. Candidates are reminded to make use of the pre-exam 15 minutes reading and planning time to finish reading all the questions, get a full picture of the cases described, understand what exactly the requirements are, identify which 2 optional questions to be attempted, decide on the priority of the questions to be attempted, and finally, plan their answers and roughly allocate the time to each question.

#### Specific Comments

##### Question One

This question combined common tax issues found in a simple share acquisition and post-acquisition restructuring within the group. The key issues have been broken down into steps to be followed in the requirements. Weak answers were found in parts (a)(ii), (b)(iii) and (b)(iv). The interest deductibility issue is a hot topic but yet, a lot of answers are still found to reflect that the basic concepts in this area are weak or incorrect. Some examples are highlighted in specific comments below:

- quite a lot of candidates simply repeated the facts given in the question rather than gave the answers;
- re (a)(i), s45 exemption conditions and authority to include loan assignment for stamp duty purpose were ignored – note that the fact that the loan amount is included in the formula used to compute the stamp duty would only enable you to score the 0.5 to 1 mark for the stamp duty payable, but not enough for the marker to give further marks due to the absence of explanations of why;
- re (a)(ii), a lot of candidates answered in detail provisions relating to penalty; others mentioned about s61A; quite a few emphasised that if anything went wrong, it would be Mr Mi who is the shareholder to be liable for any tax after acquisition. Also, some candidates seem to have confused 'undertaking' with 'indemnity'. The following points were ignored by most candidates:
  - undertaking that all tax related records and information are disclosed
  - specific reference to PRC position
  - ineffectiveness of seller's undertaking to handle tax disputes
- re (b)(i), quite a few candidates answered that there was no tax implications since there was no charge for the computer use, or prescribed fixed assets have already been claimed
- re (b)(ii), again s45 was ignored; or even s45 was mentioned but conclusion was wrong as the requirement of the ultimate shareholder to be the incorporated person was overlooked

- re (b)(iii), reporting departure from HK and withholding payment were ignored in most answers; and quite a lot of candidates wrongly focused their answers on s8 salaries tax position and double tax arrangement.
- re (b)(iv) – commonly found wrong concepts are:
  - no interest deductibility given whenever the loan is ‘guaranteed’
  - option D – because dividend is not taxable in the hands of Mr Mi, interest is therefore not deductible in the hands of co-1
  - option B – because loan is borrowed from FI with no guarantee, therefore interest is deductible
  - all options – because loan is made to associates, therefore interest is not deductible
  - all options – personal guarantee by Mr Mi means that the loan is ‘secured’ and thus interest is not deductible
  - option C/D – if fund is sourced from dividend, interest is not deductible

### Question Two

This question was another scenario-based question on individual income tax, covering salaries tax, property tax and personal assessment. Common errors found were:

- some candidates are confused between 60-day rule and 183-day requirement under DTA
- HK employment with DIDO but offshore employment with s8(1A)(c)
- most candidates concluded that there were two contracts and they have two different sources of employment – note that there is only ONE source of employment although different income may have different source
- some candidates concluded that contract 1 has HK source and thus all taxable in HK; while contract 2 has offshore source and thus all taxable in China – wrong concept
- most candidates answered that home loan interest was available
- some candidates granted both home loan interest and rental value
- most candidates correctly explained about the rental value but failed to mention that the rental income was not taxable under salaries tax
- some candidates apportioned share option between 2 contracts
- a lot of answers concluded that corporate credit card was taxable as expenses were personal
- DPA was incorrectly granted, or some candidates managed to take note of the residence issue of the father but incorrectly concluded that DPA was eligible but not additional DPA
- some candidates confused between ‘joint assessment’ and ‘personal assessment’; some even created ‘joint personal assessment’
- wrong % of ceiling used for charitable donation
- child allowance was incorrectly concluded to be only claimable by one parent, and can’t be shared/apportioned

### Question Three

This question examined the tax principle underlying the taxation of branch profits. The performance of this question is poor, especially part (a) where most candidates misunderstood what the question was asking for. Most answered about the scope of chargeability under s14 and PE under part (a), and then repeated the same under part (b). What part (a) required is mainly the difference between setting up a branch or a company in HK, but not all candidates answered correctly. Part (b) was comparatively better than part (a) but was still disappointing given that part (b) only required general chargeability concept. For part (c), most candidates answered 1% on sales similar to consignment sale arrangement.

**Question Four**

This was a straightforward question to the extent that the principles were demonstrated in the pilot paper, and similar concepts have been examined in previous diets. Part (a) was satisfactory except for the counting of no. of days. However, other points required to score marks were general concepts by law. Part (b) was straightforward in the sense that candidates are only required to 'explain' the conditions laid down in the DTA. However, some candidates simply repeated or copied the conditions from the question without explaining further or elaborating with further thoughts or conclusions. Marks will not be given in the absence of analysis or explanations. One critical point is that, most candidates have confused DTA exemption with s8(1A)(c). These two tax outcomes are different.

**Question Five**

This question examined anti-tax avoidance topic which is an advanced level topic but a contemporary issue in today's business world. The case given in the question was designed to be straightforward and candidates were only required to demonstrate the adequate level of understanding about s61A and its application. Unfortunately, this was not found in most candidates' answers. Conditions under s61 and s61A were mentioned in some answers, but the seven specified matters in s61A were very seldom found. This indicates that this topic has not been taken seriously by most candidates. A lot of other answers focused on penalty provisions, while others only copied the facts from the question with personal views drawn from common sense rather than tax authority or principles. Some others focused on accounting impacts. In general, the performance of this question was disappointing.