

Examiner's report

P6 Advanced Taxation (HKG)

December 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, ranging from 'source' principle to tax administration. Most of the topics examined are popular, and the only area that may possibly trigger a bit of surprise to candidates would be the 'sale and leaseback' transaction under Q1. However, the examiners and Examination Review Board considered that the overall standard of the paper was reasonable and an average candidate should not find it too difficult to get a pass. In general, the overall performance of this paper is satisfactory. Candidates performed best in question Q2, while performance on Q4 and Q5 was comparatively poorer. Examiners are disappointed to see that candidates were not performing well in Q5 regarding tax administration which is meant to be straightforward and direct. Most candidates are found to be weak in fundamental tax concepts, and one of the common failures found in the answers was repeating the facts given without answering the question.

Question 1 under Section A covered a broad range of topics associated with Hong Kong profits tax issues and Question 2 covered income tax issues in the context of an individual working in Hong Kong. These two questions added up to a total mark of 68. Section B comprised 3 questions for a choice of 2, with each question scoring 16 marks. These 3 questions were comparatively shorter and more straightforward. Total marks awarded for Section B were 32 only and thus candidates needed 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 should 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 addressed two issues commonly found in business including cash extraction problem and leasing options. In part (a) on cash extraction issues, some candidates only talked about the cashflow effect but did not address sufficiently the tax implications. Others only repeated the facts given in the question without giving answers that could score marks. Part (b) on sale and leaseback was disappointing, indicating that this might be one of the areas that has been left out from study. Specific comments are highlighted as follows:

- quite a lot of candidates simply repeated the facts given in the question rather than gave the answers;
- re (a) (4), s45 group relief was not addressed at all or wrongly concluded as applicable;
- interest disallowance risk was not addressed by most candidates;
- interest deductibility conditions were not addressed;

- some candidates were confused between 'no tax effect' and 'not tax effective'
- quite a few candidates commented that waiver of receivable would trigger s61A tax avoidance risk;
- 'distribution in specie' was incorrectly taken as 'disposal of asset'
- 'no interest payment' was incorrectly taken as equivalent to 'no tax effect'
- re (a) (5), stamp duty exemption under s27(5) was not addressed by most candidates
- some other candidates did not address stamp duty at all
- incorrect deduction concept for rental deduction: rental deductible in lessee due to rental taxable in lessor
- some candidates correctly mentioned about s39E but gave wrong explanation about the tax impact
- stamp duty on lease was confused with stamp duty on sale
- not all candidates correctly addressed the commercial building allowance entitlement and the annual allowance formula

Question Two

This question was another scenario-based question on individual income tax, covering salaries tax, property tax and personal assessment. This was the best answered question as most of the aspects were commonly found in prior years. However, some common errors were still found:

- wrong fundamental concept between source of employment and source of income: some candidates applied Goepfert principles and then concluded thereafter that income was therefore subject to tax.
- some candidates answered 'days-in-days-out' basis according to tax treaty; and others confused 'days-in-days-out' with 'tax credit'
- not all candidates managed to distinguish the different natures of payments of \$50,000 and \$80,000; while some treated \$50,000 as non-taxable because it did not come from employer
- the year of grant for share option was incorrectly treated as irrelevant
- quite a few candidates confused 'personal assessment' with 'joint assessment'; while others created new terms like 'joint assessment with PA' or 'joint PA'
- Flora's salary from partnership was wrongly treated as taxable under s8 and s9.
- MPF contribution was not added
- most candidates managed to answer that Flora's loss in partnership could be used to offset Ivan's income if PA is elected. However, few candidates added that if no PA was elected, the loss was to be carried forward under the partnership.

Question Three

This question examined the 'source' principle which is highly conceptual. Candidates are expected to be able to address the fundamental rules and principles drawn from the common leading cases. However, it was found that most candidates were weak in their knowledge in this aspect, and were only able to repeat the facts and the points. Some even gave long answers on 'badges of trade'. In offering alternative advice, some candidates suggested taxpayer not to set up business in HK; while some others suggested taxpayers to adopt internet trading which is tax free. Both suggestions for advice are both unrealistic and dangerous, and candidates should be cautious in delivering tax advice.

Question Four

Although this question was focused on construction of the building, the main issue was general deduction principles for loan interest. Those candidates who gave answers along this direction were able to score reasonably high marks. However, answers on industrial building qualifying use and general conditions for claiming IBA and CBA are comparatively weak. Most candidates were not able to address that the completion of construction did not represent that income would start to generate. Most candidates failed to address the availability of 'occupation permit'. Moreover, quite a few candidates incorrectly concluded that depreciation allowance was only available after construction was completed.

Question Five

As mentioned in the introduction paragraph, this question was not answered as satisfactorily as expected by the Examiners, although it was meant to be straightforward and direct. Candidates are reminded that tax administration is an important topic and is the most common issue raised by clients to front-line tax advisors. As a result, this topic should not be left out of study. On this question, all candidates could mention that estimated assessment would be issued when tax return was not filed, but not many candidates managed to state other conditions. Some candidates were confused between estimated assessment and additional assessment.