



# Examiner's report

## F6 Taxation (HKG)

December 2010

### General Comments

This paper had a standard coverage of topics. Questions 1 and 2 were for a total of 55 marks and three further questions were for 20, 15 and 10 marks respectively; with an approximate 6:4 split requirement for computation and essay.

Most candidates attempted all five questions, although there was some evidence of poor time management; and some questions were not answered satisfactorily. The best performed questions were Questions 1 and 2. A few candidates failed to complete all parts of Question 5; which was also one of the poorest answered questions.

Common errors included poor display of logics in the workings to computations and the use of confusing terminologies; e.g. 'non-taxable income' was wrongly termed 'deductible income' and 'non-deductible expense' was wrongly termed 'taxable expense'. There was a lack of clear labeling of which part of the questions the answers were relating to; different parts of the questions were not answered in sequence and part of a question was answered before the next question and the other part after the next question; making it very difficult for to follow.

Candidates are reminded again that it is in their interests to ensure that their writing is clear and tidy, and each question as well as each part of the question answered should be clearly and properly numbered or indicated where appropriate.

### Specific Comments

#### Question One

This 25-mark question examined salaries tax. Most candidates managed to score high marks for this question. Common mistakes included:

- incorrect fundamental concept of source of employment;
- applying time apportionment to salaries income only, and not to other income and share option gains;
- taxing the air tickets to relocate the taxpayer's family to Hong Kong as a holiday benefit;
- not taxing the child's air ticket as education benefit;
- failed to recognise that the cost of living allowance accrued to the taxpayer when he was entitled to claim payment thereof;
- wrongly taxing the first share option which, although exercised in Hong Kong, was attributable to services rendered in the UK before the taxpayer was assigned to Hong Kong;
- instead of calculating the rental value, the rent refund was assessed in full as an allowance;
- in calculating rental value, management fee was not included as part of the rent paid by the taxpayer and share option gains were included;
- incorrect treatment of the Hong Kong salaries tax and PRC individual income tax paid by the employer;
- mandatory provident fund contributions were deducted after personal allowances;
- applying the standard rate to the net chargeable income, instead of the net assessable income before personal allowances;
- in Part (b), some candidates failed to give reasons to explain the tax treatment; some just repeated the tax treatment.

#### Question Two

This question was on profits tax and the majority of the marks were attributable to computations. Most candidates scored high marks for part (a), which required the preparation of a profits tax computation and a depreciation allowance schedule. Most candidates correctly added back property tax paid but some failed to set off the property tax paid against the profits tax payable. Profit from the sale of property B was correctly excluded,

but the implication of its sale on the calculation of commercial building allowance was overlooked by many candidates. Presentation of the basis period for the tax computation was wrong, and no breakdown or workings were shown for the interest income to be excluded and the interest expense to be disallowed. On the depreciation allowance, many candidates could not identify the residue of expenditure before sale for property B, and failed to restrict the balancing charge to the allowances granted. Some candidates completely ignored the calculation of commercial building allowance.

Part (b) was poorly answered. Many candidates were not able to discuss the requirements of s.14, whether the profit from the disposal of property C was capital in nature or a trading stock which was revenue in nature, and the implications of selling the property to a director at cost which was below the market price. Instead, many candidates gave irrelevant answers such as the badges of trade, and some even discussed the deductibility of interest on loans obtained from a director and a bank to finance the acquisition of property C.

### **Question Three**

This question was on a partnership and the cessation of business. Partnerships and commencement of business have been examined before, and the examiners did expect a very good performance for this question. However, in parts (a) and (b), quite a number of candidates had problems in identifying the basis period for the profits tax computation and depreciation allowance purposes. Although some candidates were able to calculate profits of the relevant period, almost all candidates did not understand the calculation of the transitional amount on the cessation of business. Many did not know how to split the sales proceeds of assets to the respective pools, and were not aware that the depreciation allowance, unlike the deduction for prescribed fixed assets, should not be included in the computation of assessable profits for apportionment. In part (c), not all candidates could master the partnership allocation. For those who did not score good marks for this question, common errors included wrong adjustment of air tickets and salary paid to a partner in the partnership allocation; inability to do the allocation of profit/loss among partners; not understanding the loss reliefs available to corporate partners; and failure to distinguish the tax rates for a corporate and an individual. In part (d), candidates were not aware that losses incurred by the proprietorship business were not eligible for set off against the partnership profit, unless personal assessment was elected.

### **Question Four**

This question focused on property tax and personal assessment. Performance was fair. In part (a), it was a bit surprising that only very few candidates obtained full marks for the computation of property tax payable, which was very straight forward. Common mistakes included taxing the rental deposit and the rent-free period, allowing a bad debt deduction before it was proved to be irrecoverable, allowing the government rent, and not taxing repairs borne by the tenant. In part (b), many candidates were not able to explain the eligibility for personal assessment election; and to advise whether and how the taxpayer was eligible.

### **Question Five**

Question 5 was another poorly answered question; and the one not answered by those who did not attempt all questions either because of lack of time; or they were not familiar with the tax administration in the context of an "error or omission" claim under s.70A, a valid objection under s.64 and hold over of provisional tax. This gave the impression that candidates at the fundamental level tend to focus on computational questions only; and avoid studying tax administration. Since all questions are compulsory, it is important that candidates study each and every topic of the syllabus; and this will help prepare them for advancing to the professional level.