

Examiner's report

P6 Advanced Taxation (HKG)

December 2010

General Comments

This paper covered topics which are commonly examined as well as share-based payments. Common topics included source of profits, interest deduction rules, salaries tax treatments on common employment items and tax administration. Less expected topics included stamp duty and anti-tax avoidance. The style and approach taken in setting the questions for this diet were consistent with those adopted in previous diets. In most cases, candidates demonstrated that they could finish the four questions within the time limit.

In Section B, Question 4 on share-based payments was found to be the least attempted, possibly due to the lack of knowledge about the difference between share options and share award payments. Fortunately, candidates who chose to attempt the other two elective questions, being one on tax administration and the other one on tax avoidance, were found to have performed quite fairly.

One of the common problems found in the answers was that candidates kept repeating the facts given in the question but not giving any answers; or giving answers in an accounting perspective rather than tax. This was particularly found in Questions 1 and 5. Another problem was that most candidates combined their answers for Question 1(a)(i) and (ii); and Question 2(a) and (b). This is not wise since marks are allocated separately. It is in their interests to ensure that their scripts are clear and tidy in writing, 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 question involved a multi-phase restructuring to enable a property to be ultimately transferred to a third party. Both stamp duty and profits tax implications were examined. A common mistake found in this question was that parts 1(a)(iii) and (iv) were mistaken as stamp duty rather than profits tax implications. As a result, irrelevant answers were given, which could not score marks. Other specific comments and mistakes/errors were highlighted as follows:

- not many candidates were able to correctly answer that the property involved was non-residential property and thus the conveyance on sale, rather than sale and purchase agreement, was stampable.
- quite a number of candidates wrongly applied 3.75% instead of 3%.
- some candidates wrongly concluded that Vendor Ltd is not subject to HK tax for the reason that it is a BVI co.
- other candidates wrongly concluded that speculation income is not taxable in HK.
- for part (b)(i), some candidates spent too much time expanding 'badges of trade' but did not explain the source rule.
- for part (b)(ii), quite a few candidates wrongly concluded that the personal guarantee by the director meant that interest would flow back to the director.
- for part (b)(iii), it was quite disappointing that most candidates could only mention about the 35% maximum limit and the charitable organisation must be 'approved', but not other requirements for deduction.

Question Two

This question was another standard question on personal taxation covering salaries tax and treatments on remuneration items. Performance was comparatively better than other questions. One most common problem was that many candidates started their answers with Goepfert principles and spent the whole page analysing the source of employment of Mr and Mrs Chan. This was totally irrelevant since the question already stated that the employment was HK based employment, and there was no requirement to identify the source of employment. Other common errors were:

- most candidates could answer correctly the maximum deduction of \$12,000 as the contribution to the retirement fund, but not many candidates correctly mentioned that the monthly gross salary is taxed on gross basis.
- some candidates spent time explaining the tax treatments on withdrawals from a retirement fund.
- the bonus paid in April 2009 was incorrectly recognised as 2008/09 income instead of 2009/10.
- holiday flat was mistaken as holiday benefit which is taxable by law.
- mortgage loan interest was confused with home loan interest; e.g. some candidates stated that home loan interest would only be deductible under personal assessment.
- many candidates correctly explained the tax treatments on car park rental, but incorrectly treated both rates and government rent as deductible.
- quite a few candidates failed to explain clearly that the car park rental was taxable and that the rates were deductible under property tax, rather than salaries tax.
- the payment made by Mrs Chan to buy the store was mistaken as payment for the tradename, thus irrelevant answers were given on royalty payments and s21A requirements.

Question Three

This was a question on tax administration plus identification of contract of service and contract for service. Performance on part (a) was good as it was straightforward. Part (b) required the candidates to draft a notice of objection. Although this appears to be practical, examiners only required candidates to demonstrate that they understand what important information needed to be included. However, it was quite disappointing that most candidates simply mentioned in a letter to the IRD that the assessment was wrong. The date of the assessment was not given, file number was not stated, the ground of the objection was not given, and the reasons for late objection (such as absence from HK) were not mentioned at all. Moreover, not many candidates were able to include a request for holdover of tax pending the settlement of objection.

As for part (c), most candidates could score high marks by analysing the case according to the three common tests, control, integration and economic risk.

Question Four

This question was the least attempted. Part (a) was simply the general tax deduction rule. Some candidates tried to differentiate the deduction rules on share option from those rules on share award payments, e.g. the charge on share option would only be deducted when the share option is exercised. The timing of exercising the share option was within the control of the employees. It would not be sensible for the employer company to rely on the employees' exercising the option before the deduction could be claimed.

Many candidates demonstrated a lack of knowledge about share award payments, by stating that share awards are taxed when they are 'exercised'. Examiners fully appreciate that the topic of share-based payments is new and current, but with the issuance of the relevant DIPN, consider that candidates should ensure that they are up to speed with current tax developments.

Question Five

This was a question on tax avoidance. Examiners found that the performance on this question was generally satisfactory, although some candidates repeated the facts from the question rather than analysed the facts from a tax perspective. Most candidates were able to state the seven factors to be considered under s61A, but failed to give detailed and relevant analysis with the facts of the case. However, in general, examiners were glad to see that candidates have an adequate knowledge of, and have paid attention to, anti-tax avoidance issues.