

Examiner's report

F6 Taxation (HKG)

Dec 2011



General Comments

This paper followed a standard and balanced 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 50:50 split requirement for computation and essay.

The topics covered by all the questions in this paper were standard and straightforward. While the most traditional types of salaries tax and profits tax computations were examined in Questions 1 and 2, other common topics such as property tax, partnership, personal assessment, property holding/selling, and tax administration were covered in the rest of the paper. Average candidates who made efforts to study all the topics covered in the syllabus should be able to pass the paper. On one hand, it was observed that most candidates did not perform well on topics that are not commonly examined in previous diets. On the other hand, however, partnership and personal assessment computations, which are examined in almost every diet, were still found unsatisfactorily attempted. This could possibly be explained by the inability of candidates to thoroughly understand the fundamental concepts of different types of tax and their interacting effects on the computational requirements under different scenarios. Examiners would emphasise that concepts and principles are equally, if not more, important than calculations even at this F6 level; and candidates should ensure that they are able to master the concepts well rather than simply focus on drilling the calculation steps.

It is however good to see that most candidates attempted all five questions. Those who failed to complete all questions were found mainly weak in the overall performance. Common topics that were found to be difficult for scoring marks included home loan interests, source rule on securities trading, personal assessment computation, property tax versus profits tax, change of property holding intention, penalty provisions and definition of reasonable excuse. These are further elaborated in the specific comments. Other common errors found were 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 also a lack of clear labeling of which part of the questions the answers were relating to; including different parts of the questions being not answered in sequence or part of a question being answered before the next question with the other parts continued after the next question. It is in the candidate's best interest to ensure that their scripts are clear enough for markers to follow. Candidates are also reminded 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 part (a) only. Common mistakes included:

For Q1(a):

- Club subscription reimbursed was not added back, or full amount instead of half was added, or club subscription wrongly treated as a deduction;
- Air ticket for wife was wrongly calculated, in particular the \$4,000 was not deducted;
- HK salaries tax paid by employer wrongly treated as credit against tax payable;
- Rental value at 8% or 10% was used instead of 4%;
- single person's allowance was used instead of married;

For Q1(b)(i):

- Home loan interest was confused with property mortgage loan interest;
- Sections 16(1) and (2) under profits tax regime were given;
- Answers only included features of home loan interest deductions (eg 10 years with \$100,000 each) but not conditions required for the deduction;

- Conditions required for qualifying as permanent resident (eg 180 days) given;
- Wrongly stated that home loan interest was only allowed if paid to authorised financial institution in Hong Kong;

For Q1(b)(ii):

- Home loan interest was omitted here;
- Answers stopped at stating that the interest subsidy was taxable but no reason was given;
- Failed to distinguish the tax impacts amongst the three options – some gave the same answers for all three.

Question Two

This question covered a standard profits tax computation and required written explanations of tax treatments of securities trading, charitable donations and bank loan interests. These items are common computational items but yet, other than charitable donations, performance was not satisfactory. Common errors included:

Part (a):

- Headings were omitted, or the date of 31 December 2010 was wrongly stated for basis period;
- Wrong % was adopted for approved charitable donations;
- Legal fee on staff quarter lease renewal was disallowed;
- Some candidates still gave a table for correct treatment of items (Note: this table is not required as marks will be given if relevant items did not appear in the tax computations, and this would use up valuable time)
- Balancing charge was wrongly calculated

Part (b):

- Securities trading was not taxable in Hong Kong based on Inland Revenue Department;
- Securities trading income was taxable because the company was carrying on business in HK;
- Failed to explain the source principles applying to securities trading income;
- Only badges of trade were addressed in detail here, not source rule.

Part (c):

- Generally performance in this part was good;
- Answers stopped at stating that the donation must be cash and limited to 35%.

Part (d):

- Most answers gave a recited page of s16(2) conditions without correctly applying the principles on the case.

Question Three

This question was on personal assessment which is a commonly examined topic, but yet performance was again poor. As personal assessment allows different sources of income to be aggregated in one computation, candidates were also required to give answers on different tax payable under separate systems, including sole proprietorship, property tax, salaries tax and partnership. Some candidates are found to have not been able to present these different scenarios well. In particular, quite a few candidates have prepared a 'combined' format of computation for husband and wife under Part (a) and these computations were repeated under Part (c) as personal assessment. This illustrated that candidates were not clear about the concepts of how their tax computations were different if personal assessment was not elected as opposed to that elected. Common errors included:

- Bank loan interest was wrongly disallowed in Part (a);
- 16.5% tax rate was wrongly applied to sole proprietorship;
- Single person's allowance instead of married, was applied to wife's salaries tax computation;
- Home loan interest was deducted in the wife's salaries tax computation;
- In partnership allocation, total prior year's loss of \$44,000 for Mrs Li was deducted against current year's assessable profit of \$10,000, leaving the negative of \$34,000, resulting in a lot of candidates doing a re-allocation of loss from one partner to the other.
- Treatments of approved charitable donations between the couple were confused;
- Total property rental, instead of NAV, was included in personal assessment;
- Total salaries, instead of NAI, was included in personal assessment;

- Partnership loss brought forward from prior years but remained unused was wrongly included in personal assessment to set off other income (Note: only current year's loss from partnership can be transferred to personal assessment).

Question Four

Question 4 was on a common issue relating to property holding, including tax impacts on property income earned, property held for resale or otherwise, and change of intention of property holding. This is one of the questions that have not been performed well. For part (a), most candidates were able to mention about both property tax and profits tax implications, but incorrect conclusions were drawn reflecting a weakness in concepts. For example, the corporate owner has the right to choose between property tax and profits tax; or property tax is not applicable since the owner is a corporate. These concepts are not correct. In other cases, candidates erroneously concluded that property tax applied on the half of the office being used for leasing; while profits tax applied on the other half of the office being used for its own operation. Again, this is fundamentally incorrect.

For candidates who obviously were not able to master the requirements of the questions, answers only included the eligibility for claiming commercial building allowance. Others gave the salaries tax implications to the director who used property B as accommodation. This was not being asked. As for property C, most candidates jumped to conclusion that the profit was taxable because the property was trading stock or was held for short period. This was not sufficient to enable the candidates to score full credits as badges of trade were not analysed.

Question Five

This question was on tax administration which is a common topic, although the area covered was tax penalties which has not been examined as regularly. However, most candidates restricted their answers to objections, appeals, holdover and estimated assessments. Other candidates explained the compliance obligations under s51. It may be the case that candidates only chose to study selected topics and thus were only able to give limited, and sometimes irrelevant answers. The definition of 'reasonable excuse' and its interpretation under common law were not satisfactorily addressed by most candidates. Some candidates borrowed the reasons commonly used to apply for late objections such as sickness and absence from Hong Kong.