



Examiner's report

F6 (HKG) Taxation

December 2016

General Comments

There were two sections to the examination paper and all of the questions were compulsory. Section A consisted of 15 multiple choice questions of two marks each, which covered a broad range of syllabus topics. Section B had four questions worth 10 marks each and two longer questions worth 15 marks, each testing the candidates' understanding and application of taxation in more depth.

Specific Comments

Section A

Section A questions aimed to provide a broad coverage of the syllabus. Almost all candidates attempted all of the questions.

The following two questions are reviewed with the aim of giving future candidates an indication of the types of questions asked, guidance on dealing with exam questions and to provide a technical debrief on the topics covered by the specific questions selected. Candidates generally performed poorly in these two questions. Candidates preparing for the next examination of F6 (HKG) should aim to revise all areas of the syllabus, and are advised to work through the pilot paper and the questions discussed here and in the examiner's reports for the past diets; and to carefully review how each of the correct answers were derived.

Sample Questions for Discussion

Example 1

Bobby received a notice of salaries tax assessment for the year of assessment 2014/15. The salaries tax of \$28,000 was payable in two instalments, \$23,000 on 5 January 2016 and \$5,000 on 5 April 2016, respectively. Bobby only paid \$20,000 on 1 February 2016.

Assuming that today's date is 1 March 2016, what is the amount of surcharge that can be imposed on Bobby by the Commissioner?

- A. \$1,150
- B. \$400
- C. \$150
- D. \$1,400

This question required candidates to calculate the amount of surcharge imposed on a taxpayer as a result of the late payment of salaries tax. The correct answer was D, however the majority of candidates selected C.

Taxpayers are allowed to settle the tax payable in two instalments. However, once the first instalment is overdue, the second instalment is due immediately, and a surcharge of 5% is imposed on the whole amount outstanding. Therefore, when the first instalment was overdue, a surcharge of \$1,400 ($28,000 \times 5\%$) was imposed.

Students who chose C ($3,000 \times 5\% = 150$) had mistaken that since the taxpayer had paid \$20,000 (albeit after the first due date), only \$3,000 of the first instalment was outstanding; and the second instalment was not yet due. This was a misunderstanding of the law.

Example 2

D Ltd commenced business on 1 January 1970 and ceased business on 30 September 2016. D Ltd's recent adjusted profits before depreciation allowances are:

12 months to 31 December 2015	\$350,000
9 months to 30 September 2016	\$180,000

D Ltd recorded an adjusted loss before depreciation allowance of \$20,000 for the 12 months to 31 December 1975.

What is D Ltd's basis period and adjusted profits for the year of assessment 2016/17?

Basis period	Adjusted profits
A. 1 October 2015 to 30 September 2016	\$267,500
B. 1 January to 30 September 2016	\$180,000
C. 1 April to 30 September 2016	\$120,000
D. 1 April to 30 September 2016	\$180,000

This question required candidates to determine the basis period and adjusted profits for the year of assessment 2016/17 of a company that ceased to trade. The correct answer was D, whereas the majority of candidates selected B.

D was the correct answer because the company started trading before 1 April 1974. For a company which commenced trading before 1 April 1974, the basis period for the year of cessation is from 1 April in the year of cessation to the date of cessation. Therefore, the basis period for the year of assessment 2016/17 was 1 April to 30 September 2016 and the adjusted profits were computed as follows:

Assessable profits from 1 April to 30 September 2016 [s.18D(2)]	
(\$180,000 x 6/9)	\$120,000

Add: Assessable profits of the relevant period [s.18D(2A)]	
(i.e. the drop-out period from 1 January to 31 March 2016) (\$180,000 x 3/9)	\$60,000

Less: Transitional amount	
(i.e. profits of the equivalent drop-out period in 1974/75, which is a loss and ignored)	_____

Assessable profits for the year of cessation 2016/17	<u>\$180,000</u>
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B had the correct amount of adjusted profits but the basis period was incorrect as it would only have applied if the company started trading after 1 April 1974. Candidates often struggle with basis periods, particularly at the commencement and cessation of a business. Basis periods represent a key area of the syllabus and are commonly examined. Candidates are advised to prepare well for this topic.

Specific Comments

Section B

This section had a standard coverage of topics. Questions 1 to 4 were short questions each worth ten marks, and questions 5 and 6 were long questions each worth 15 marks; with approximately 70% of the available marks being for computation.

The vast majority of candidates attempted all six questions, and there was little evidence of time pressure. Where questions were left unanswered by candidates (such as questions 1 and 2), this appeared to be due to a lack of knowledge or poor exam technique, as opposed to time pressure. Some questions were not answered satisfactorily, and the best performed questions were Questions 5 and 6. Quite a number of candidates failed to complete all parts of Questions 1 and 2; which were the poorest answered questions.

Question One

This 10-mark question on the taxability of a gain made on the sale of property by a non-resident was one of the two questions which were least attempted by candidates. It was also one of the two questions which candidates performed most poorly in. While most candidates were able to list the badges of trade to determine if the profit is revenue or capital in nature, many did not elaborate on their interpretation, and failed to come up with a reasonable conclusion. It was also disappointing to note that quite a number of candidates commented on the tax position of a non-resident, that the person was deemed to carry on a business in Hong Kong by appointing a property agent. Some candidates also provided irrelevant answers on how the person would be subject to property tax and/or profits tax on the rental income, and the relief for possible double taxation.

Question Two

This 10-mark question on tax administration was another of the questions least attempted by candidates. In general, performance was poor. This was probably due to poor time management, and a lack of knowledge of tax reporting obligations, the related compliance issues and penalties.

Part (a) examined candidates' knowledge of the statutory obligation to keep business records. Whilst many candidates understood the requirement to keep business records, no candidate was able to explain when the requirement would not apply. Part (b) examined the consequences where a profits tax return was received but not filed. Instead of explaining the right of the Inland Revenue Department (IRD) to issue an estimated assessment, the taxpayer's right to object and the penalties under s.80(2) and s.82A, many candidates had not read the question carefully and thus spent excessive time discussing whether the taxpayer had a 'reasonable excuse' for not filing a return. Part (c) examined the consequences of failing to pay profits tax which had been duly assessed. Disappointingly, most candidates were not aware that if there is any default in payment, surcharges of 5% and 10% may be imposed. Instead, they simply answered that the IRD would issue an additional assessment and charge a penalty, which was incorrect, without explaining what recovery action the IRD could take.

Question Three

This 10-mark question was a straight-forward question on a commonly examined topic: property tax. Surprisingly, performance was less than satisfactory.

Many candidates did not take care when calculating the rental to be assessed and the rates to be deducted for the year of assessment 2015/16 and so made unnecessary mistakes. Other common mistakes included:

- Incorrect spreading over of the premium.
- Not taxing the forfeited rental deposit.
- Claiming other expenses as a deduction.
- Applying a property tax rate of 16.5%.

A few candidates calculated the property tax payable for lease 1 and 2 separately, although the two leases were for the same property. Candidates are encouraged to practise the computational aspects of questions on property tax in order to secure higher marks.

Question Four

This 10-mark question was on the commonly examined topics of partnership and personal assessment. Part (a) required candidates to allocate the profits/losses of the partnership to respective partners. This part was poorly answered. Many candidates did not split the allocation into two periods, one before (from 1 January to 30 September 2015) and one after (from 1 October to 31 December 2015) the change in partnership due to a partner's retirement on 1 October 2015. Some did not reallocate the partner's loss to other profit-making partners, and some misread the question and recalculated the assessable profits from the given profit figure. In some cases, candidates were able to do the allocation correctly, but failed to indicate that the relevant partner's share of loss had lapsed upon retirement. The main reason for poor performance for this part was lack of adequate knowledge of this topic, and failure to read the question carefully.

Part (b) required candidates to prepare the personal assessment computation. The issues were standard and straightforward, except for the treatment of partnership losses and donations. Overall performance was satisfactory. Common mistakes included the failure to deduct donations from the net assessable profits from the proprietorship business to be transferred to personal assessment, the incorrect transfer of the partnership loss to the spouse, and the incorrect calculation of the approved charitable donations for the couple.

Question Five

This 15-mark question on salaries tax was one of the most popular topics examined. Part (a) required candidates to determine whether the taxpayer was subject to salaries tax in respect of the director's fee he received. Performance was, however, poor. Candidates were not aware of the distinction between office and employment, and treated the director's fee as income from employment and incorrectly applied the principles in the *Geofert's* case to determine the source of the director's fee.

In part (b), candidates were required to compute the salaries tax liabilities. Performance was good. Common mistakes found in the computation were:

- Incorrectly determining the basis for time apportionment as the attributable leave was not considered.
- Wrongly taxing the director's fee and gain on exercise of share options as Hong Kong-sourced income.
- Treating the cost of the serviced apartment, reimbursement of medical expenses from a medical insurance scheme (which was not a reward for services rendered), annual insurance premium, car rental, driver's wages and amah's wages paid by the employer (which represented a discharge of the employer's liability) as taxable benefits.
- Not taxing the reimbursement of the clubhouse joining fee (which represented a discharge of the employee's liability), and incorrectly calculating the reimbursement of petrol.
- Not taxing the salaries tax borne by the employer, or incorrectly time-apportioning this chargeable income.
- Income for calculating the rental value was correctly time-apportioned, but not all chargeable income was included in the calculation of rental value.

Question Six

This 15-mark question was a standard question requiring candidates to prepare a profits tax computation including a depreciation allowance schedule. In general, performance was good except that more attention should be paid to the presentation under the depreciation schedule of different plant and machinery pools and

the fax machine acquired under hire purchase. Most candidates were able to score high marks. Some of the common mistakes made were as follows:

- Failing to treat the environment protection vehicle as a deduction and incorrectly including it in the plant and machinery pool and claiming a depreciation allowance instead.
- Incorrectly allowing the cost of the club debenture and loan to staff written off.
- Incorrectly disallowing the loss from Hong Kong securities trading.
- Incorrectly calculating the excess MPF contribution to be added back.
- Incorrectly calculating the capital portion of instalments paid for the fax machine during the basis period for the calculation of the depreciation allowance.