

Examiner's report

F6 Taxation (HKG)

June 2015



General Comments

This is the first diet of examination under the new exam format and question types. 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. This was expected as there was no penalty mark for incorrect attempts.

The following two questions where most students could not get the correct answer 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 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 to carefully review how each of the correct answers were derived.

Question one

Miss Chung is an airhostess employed by a Hong Kong airline company. The following table shows how long she was present in Hong Kong and her earnings for the relevant years of assessment:

Year of assessment	Present in Hong Kong (in days)	Earnings
2012/13	80	\$350,000
2013/14	45	\$390,000
2014/15	65	\$430,000

What is Miss Chung's assessable income for each of the years of assessment 2012/13, 2013/14 and 2014/15?

	<u>2012/13</u>	<u>2013/14</u>	<u>2014/15</u>
A.	\$76,712	Nil	\$76,575
B.	\$76,712	\$48,082	\$76,575
C.	\$350,000	\$390,000	\$430,000
D.	\$350,000	Nil	\$430,000

This question tested candidates' understanding of the exemption for aircrews. Income is fully exempt from salaries tax if the aircrew is present in Hong Kong for not more than 60 days in one year of assessment and not more than 120 days in two consecutive years of assessment, one of which is the year of assessment concerned. Otherwise, for Hong Kong employment, the income will be fully chargeable.

As Miss Chung was present in Hong Kong for more than 60 days in 2012/13 and 2014/15, she was fully chargeable to salaries tax. However, since she was present in Hong Kong for not more than 60 days in 2013/14 and not more than 120 days in 2013/14 and 2014/15, the income for 2013/14 was fully exempt.

The correct answer was therefore D.

It is worth noting that the majority of candidates opted for A, which treated the same years as taxable as the correct answer, but which pro-rated the earnings by the number of days present in Hong Kong. This was incorrect as time apportionment does not apply to employment sourced in Hong Kong.

Question two

David is the financial manager of A Ltd. During the year ended 31 March 2015, David was paid an annual salary of \$800,000 and was provided with a flat consisting of two bedrooms by his employer. David is a member of the HKICPA and ACCA for which he pays membership fees of \$2,450 and \$2,700 respectively.

What is David's net assessable income for the year of assessment 2014/15?

- A. \$874,335
- B. \$877,030
- C. \$877,305
- D. \$877,300

This question tested candidates' understanding of the calculation of rental value and deductible expenses. When an employee is provided with a flat by their employer, rental value is calculated as 10% of the income from the employer less outgoings, expenses and depreciation allowance for the period during which a residence is provided. By concession, the IRD allows a deduction for subscriptions to one professional body if the qualification is a prerequisite of employment and retention of membership and keeping abreast of current developments are of regular use and benefit in the performance of duties. Therefore, rental value was calculated as \$79,730 $[(800,000 - 2,700) \times 10\%]$; and net assessable income was calculated as \$877,030 $[800,000 + 79,370 - 2,700]$.

The correct answer was therefore B.

It is worth noting that most candidates opted for A, which included the same calculation, but allowed both professional fees, when only one of the two was allowable.



Specific Comments

Section B

This section had a standard coverage of topics, except a club and trade association were examined in Question 2. Questions 1 to 4 were short questions for a total of 40 marks, and questions 5 and 6 were long questions for a total of 30 marks; with an approximate 5:2 split requirement for computation and essay.

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 question 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 2 and 4; which were also the poorest answered questions.

Question One

This 10-mark question required candidates to prepare the personal assessment computation for the couple. The issues were standard and straightforward, except for the treatment of loss and donations. Overall performance was satisfactory. The common mistakes included deducting donations from share of partnership profits, wrong calculation of approved charitable donation deduction claimed by Alex and transferred to Annie, failure to transfer unutilised loss to the spouse, to aggregate the couple's income before Part 5 allowances, and to allocate the tax payable between the couple. Although the topic of personal assessment appears regularly in exams, the general performance of this topic was found less than satisfactory. Candidates are urged to practise the computational skills well enough in order to secure higher marks.

Question Two

This 10-mark question was one of the two least-attempted questions, although this question was compulsory. This would suggest that candidates had not prepared for the topic of club and trade association. Although this area belongs to special business, the candidates are reminded that club and trade association are the only special business that are covered in F6 (HKG) syllabus, and the same topic has been examined in past years' diets every now and then. Candidates should have no excuse to exclude this topic from their studies.

In part (a), in general, candidates were aware of the 50% rule applicable to clubs but could not explain it clearly. For some candidates, the distinction between voting and non-voting members was overlooked; and the entrance fees were excluded in computing the gross receipts from voting members.

In part (b), many candidates simply calculated the profits tax liability of the club based on the wrong conclusion that the club is carrying on a business. Moreover, the corporation rate of 16.5% was wrongly applied, and for some candidates the tax treatment of rental income was clearly not well understood.

In part (c), many candidates either applied the same 50% rule for clubs to trade associations, or applied the 50% rule to determine whether a trade association was exempted from profits tax rather

than whether it was deemed to be carrying on a business. Candidates are also reminded that for the purpose of applying the 50% rule, founders' contributions and entrance fees are excluded.

Question Three

This 10-mark question was another one on commonly examined topics: property tax. In general, performance was good.

Part (a) for 7 marks asked candidates to prepare the property tax computation. Surprisingly, not all candidates were able to get full credits. Many candidates were careless in calculating the rates to be deducted for the year of assessment. Other common mistakes included premium being either included in lump sum or apportioned based on 36 months, not taxing the payment for the use of furniture and repairs borne by the tenant, other expenses being claimed as a deduction, and wrong property tax rate.

Part (b) for 3 marks required candidates to explain the tax treatments accorded to various items. Performance was satisfactory.

Question Four

This last 10-mark question was another question not attempted by all candidates, on tax administration, although it is also a compulsory question. In general, the question was poorly answered. This was probably due to poor time management, and candidates' inadequate knowledge of the tax reporting obligations of the employer and the related compliance issues. Some candidates had not read the question clearly and thus spent excessive time discussing the operational issues arising from the resignation of a member of staff, instead of the tax compliance issues. Some other candidates failed to address the related time limit, while other candidates sought to provide better planning for the leaving member of staff. Candidates are advised to read the question carefully before attempting it.

Question Five

This 15-mark question on salaries tax was one of the most popular topics examined. Candidates were required to compute the salaries tax liabilities and performance was good. Common mistakes found in the computation were:

- Basis for time apportionment was wrongly determined as the attributable leave was not considered.
- Only taxing the balance of the passage allowance which was not expended.
- Treating the reimbursement of removal expenses as a non-taxable benefit.
- Income for calculating the rental value was correctly time-apportioned, but rent suffered was not deducted in full.
- Treating the reimbursement of medical expenses from the insurance company, which was not a reward for services rendered, as a taxable benefit.
- Treating the annual premium paid by the employer, which represented a discharge of the employer's liability, as a taxable benefit.

Question Six

This 15-mark question covered the standard question on profits tax computation including the depreciation allowance schedule. In general, the performance was good except that more attention

should be paid to the presentation of different plant and machinery pools under the depreciation schedule. Most candidates were able to score high marks, except for the following common mistakes:

- Not allowing the rent, rates and utilities for the director's apartment.
- Not allowing, or only allowing 20% of, the regular contributions to pension.
- Allowing the full cost of the energy-saving lighting system, instead of 20%; or included the asset in the 20% pool.
- Deducting disposal proceeds of plant and machinery after the calculation of annual allowance.
- Calculating commercial building allowance on reducing balance basis, instead of on cost; and granting initial allowance.