



Examiner's report

F6 (HKG) Taxation

June 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 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.

Question One

Designer Ltd, an Italian company manufactures furniture. Designer Ltd. Consigns furniture to Deco Ltd. for sale in Hong Kong and an inventory of this furniture is stored in Deco Ltd's warehouse in Hong Kong. The sales made by Deco Ltd. on behalf of Designer Ltd. for the year of assessment 2015/16 amounted to \$38 million.

What is Designer Ltd's profits tax liability for the year of assessment 2015/16?

- A. Nil
- B. \$380,000
- C. \$190,000
- D. \$1,881,000

This question tested candidates' understanding of the non-resident's profits tax liability arising from sales of goods on consignment in Hong Kong. Although Designer Ltd. is an Italian company, its profits earned from sales of furniture in Hong Kong will still be subject to tax in Hong Kong if (1) the company is carrying on business in Hong Kong and (2) the profit is sourced in Hong Kong. In ascertaining condition (1), a company will be deemed as carrying on business in Hong Kong through a 'permanent establishment' (PE) in Hong Kong. In this case, Deco Ltd. keeps an inventory of Designer Ltd's furniture in Hong Kong and is authorised to agree the sales and fill the sales orders in Hong Kong on behalf of Designer Ltd. As a result, Deco Ltd. is Designer Ltd's PE in Hong Kong (IRR 5), leading to the conclusion that Designer Ltd is deemed as carrying on business in Hong Kong. As for condition (2), as the sales are agreed and concluded in Hong Kong, the profits arising from the sales are sourced in Hong Kong. As a result, profits from the sales of the furniture in Hong Kong are subject to profits tax in Hong Kong. For convenience sake,

0.5% (by law, it's 1%) of the sales proceeds would be deemed as the profits tax liability on the related sales, i.e. \$38 million x 0.5% = \$190,000.

The correct answer was therefore C.

A number of candidates selected answer A which was not correct. This was perhaps due to candidates failing to acknowledge that Designer Ltd. is also deemed as carrying on business in Hong Kong through the PE 'Deco Ltd'.

Question Two

What actions can the Board of Review take if an appellant or his authorised representative fails to appear before the Board of Review at the time for the hearing of an appeal?

- (1) Adjourn the hearing
 - (2) Dismiss the appeal
 - (3) Summon the appellant or his authorised representative to attend before the Board of Review
 - (4) Hear the appeal in the absence of the appellant or his authorised representative
- A. 1 & 3 only
 - B. 2 & 4 only
 - C. 1, 2 and 3
 - D. 1, 2 and 4

This question tested candidates' understanding of the hearing rules in an appeal case heard by the Board of Review. The correct answer was D but a number of candidates gave C as their answer. The difference between D and C is whether statement (3) or (4) is correct. Many candidates expected that the appellant or his authorised representative must be summoned to attend the hearing and did not appear to be aware that a hearing in their absence is acceptable.

Specific Comments

Section B

This section had a standard coverage of topics. Questions 1 to 4 were short questions each worth 10 marks and questions 5 and 6 were longer 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. Some questions were more challenging than others such as Questions 1(a) and 2. The best performed questions were Questions 5 and 6.

Question One

Many candidates found this to be a challenging question, although the topic of partnership was commonly examined in past diets. Part (a) required candidates to allocate the profits/losses of the partnership to respective partners. Some candidates did not allocate partners' salaries before allocating profit/loss, some did not re-allocate the partner's loss to other profit-making partners, and some others mis-read the question and re-calculate the assessable profits from the given profit figure. In some cases, candidates were able to do the allocation correctly, but failed to transfer the relevant partner's balance to PA as given by the question. It is important that candidates revise all syllabus areas and do not try to question spot. Candidates must also spend time reading the questions carefully before they start their answer. As for part (b) which required for a personal assessment computation, most candidates could score reasonably well as the computation items were standard and straightforward. Common errors included treating mortgage loan interest for the rented property as 'home loan interest', and inaccurate calculation of the approved charitable donation for the couple.

Question Two

This 10-mark question required candidates to prepare the property tax computations for two years, taking into account bad debts occurring in the second year. This question was another challenging question, mainly due to the failure to treat the bad debt loss in the second year and failure to carry backward the irrecoverable loss from second year to first year. This treatment is quite unique to property tax, and is not consistent with loss treatment under profits tax. However, most candidates were obviously not aware of the treatment and made mistakes to claim the bad debt in the first year. Moreover, quite a lot of candidates wrongly apportioned the premium by 48 instead of 36. Some others continued to apportion the premium in the second year despite that the lease has been deemed as terminated due to bad debt.

Question Three

This 10-mark question was another one on commonly examined topic on administration: penalty and 'reasonable excuse'. Surprisingly, performance was less than satisfactory.

It is perhaps the case that candidates did not study administrative topics as closely as required. Quite a few candidates answered that 'the IRD would issue additional assessment and charge penalty', without further explaining what penalty actions they could be. Some have not been able to explain what 'reasonable excuse' was. Candidates are urged to pay more attention to administrative topics which are frequently examined.

Question Four

This 10-mark question was a common scenario on a non-resident receiving royalty income from a Hong Kong company. The topic was not new although it was included under section 15. It was surprising to see some candidates answering that no Hong Kong tax would be payable as the income was received by a non-Hong Kong company. Some other candidates wrongly addressed badges of trade for this question. A few candidates who applied the correct approach to the question in the right direction unfortunately applied the wrong deemed profit %.

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 in general was better than the other questions. Common issues that future candidates should learn from were:

- Under part (a), quite a few candidates have incorrect concept by showing that 'salaries are taxable in Hong Kong because employer is Hong Kong Company'.
- Wrongly presented the salary apportionment as 'DIDO' rather than 's8(1)(A)(c)', or simply presented the net figure of \$360,000 without showing the s8(1)(A)(c) income exclusion.
- Wrongly applied the income exclusion on the NAI figure
- Mandatory provident fund deduction was wrongly based on \$20,000 which exceeded the maximum.
- Wrongly applied the standard rate on NCI.
- Wrongly treated tuition fee reimbursement of \$90,000 as taxable.

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 issues that future candidates should be aware of:

- Failure to treat carpets as deduction but wrongly included it in plant and machinery pool
- Wrongly deducted the disposal proceeds as \$5,000 or \$36,000.
- Wrongly disallowing deductions for wages to helper for director's use, and rent and rates for director's residence
- Wrongly disallowing part of the bank loan interest secured by HK\$ deposit
- Wrongly disallowing the deduction for voluntary MPF contribution.