Examiner's report
F6 (HKG) Taxation
June 2017

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. 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. The majority of candidates 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 specimen exam and the questions discussed here and in previous examiner's reports; and to carefully review how each of the correct answers were derived.

Sample questions for discussion

Example 1

Home Furniture Ltd (HFL) manufactures furniture in Italy. HFL consigns furniture to HK Ltd for sale in Hong Kong. The sales made by HK Ltd on behalf of HFL for the year of assessment 2016/17 amounted to $20 million.

What is Home Furniture Ltd's profits tax liability for the year of assessment 2016/17?

A $16,500
B $200,000
C $100,000
D $990,000

This question required candidates to calculate the profits tax liability of a non-resident company selling furniture on consignment in Hong Kong. The correct answer was C, whereas the majority of candidates chose B and D.

Under s.20A(3), any person who sells any goods in Hong Kong on behalf of a non-resident person shall pay to the Inland Revenue Department, on behalf of the non-resident person, a sum equal to 1% of gross proceeds (or such lesser sum as the Commissioner may agree) as the profits tax liability. In practice, only 0.5% is demanded. Therefore, the correct answer is C ($20m x 0.5% = $100,000).

Candidates who chose A ($20m x 0.5% x 16.5% = $16,500) had misunderstood that the 0.5% represents the deemed assessable profits and so applied the tax rate of 16.5% to calculate the profits tax liability.

Candidates who chose B ($20m x 1% = $200,000) did not fully understand that in practice, only 0.5% is demanded by the Commissioner.

Candidates who chose D ($20m x 30% x 16.5% = $990,000) did not understand s.20A(3) and wrongly applied s.21A which deems 30% of the sums received as assessable profits. This was a misunderstanding of the law.

Example 2

Alex works for AB Co, a Hong Kong trading company, at a monthly salary of $40,000. On 1 April 2016, Alex married Angela. He received a voucher for a honeymoon tour to Phuket from AB Co with a value of $8,400. With effect from 1 April 2016, AB Co provided Alex with a flat, rent-free, but Alex and Angela only moved into the flat on 1 May 2016.

What is Alex's assessable income from employment for the year of assessment 2016/17?

A $528,000
B $524,000
C $537,240
D $533,170

This question required candidates to calculate an individual's assessable employment income taking into account salary and benefits. The correct answer was A, whereas the majority of candidates chose C.

The monthly salary and the rental value of the flat provided (being 10% of the assessable income) were taxable. Rental value was taxable for the whole year, despite the fact that the taxpayer only moved into the flat on 1 May 2016. On the other hand, the voucher for a honeymoon tour was not a taxable holiday benefit as it was a wedding gift and not a reward for services rendered. Therefore, the correct answer is A ($480,000 + $480,000 x 10% = $528,000).

Candidates who chose B ($480,000 + $480,000 x 10% x 11/12 = $524,000) had incorrectly calculated rental value for 11 months only.

Candidates who chose C (($480,000 + $8,400) x 110% = $537,240) incorrectly believed that the voucher was taxable holiday benefit.

Candidates who chose D ($488,400 + $488,400 x 10% x 11/12 = $533,170) had wrongly taxed the voucher and incorrectly calculated rental value for 11 months only.

Assessable income represents a key area of the syllabus and is 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 for a total of 40 marks, and questions 5 and 6 were long questions for a total of 30 marks; with an approximate split of 5:2 for computational and narrative requirements.

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 4), 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 4; which were also the poorest-answered questions.

Question One

This 10-mark question was one of the two least-attempted and worst-performed questions on the conditions necessary for the deduction of home loan interest for salaries tax purposes; and the different treatments of the options.

In general, the question was poorly answered. Most candidates were not able to list the necessary conditions; and some related the conditions to those necessary for the election of personal assessment. It was also disappointing to note that quite a number of candidates commented on the financial implications of the different options, instead of the tax implications. Besides, most candidates simply stated the tax treatment without providing any explanations.

Question Two

This 10-mark question was on the commonly examined topic of personal assessment. It required candidates to prepare a personal assessment computation. The issues were standard and straightforward, except for the treatment of partnership loss and donations. Overall performance was satisfactory. Common mistakes included the incorrect spreading over of the premium under property tax, failure to deduct donations from the assessable profits from the proprietorship business to be transferred to personal assessment, failure to deduct the loss brought forward from the share of partnership profits, incorrect transfer of the previous year's loss of the partnership business to personal assessment, and incorrect calculation of the approved charitable donations for the couple.

Question Three

This 10-mark question was on depreciation allowances for machinery and plant, and the specific deductions for capital expenditure on (i) refurbishment of non-domestic buildings under s.16F, (ii) replacement of implements, utensils, or articles under s.16(1)(e), (iii) prescribed fixed assets under s.16G, and (iv) environment-friendly vehicles and environmental protection installation under s.16I. Surprisingly, performance was less than satisfactory.

Whilst most candidates were able to calculate the depreciation allowance for machinery and plant correctly, including the photocopier acquired under hire purchase, many were not familiar with the specific deductions. Candidates are urged to revise the specific deduction rules under profits tax.

Question Four

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

Part (a) examined candidates' knowledge of the general reporting obligations of an employer in respect of the hiring of new staff and the resignation of existing staff. Whilst many candidates understood the reporting obligations, they had mixed up the due dates of compliance.

Part (b) examined candidates' ability to apply the relevant reporting obligations to a given scenario. The examiner was very disappointed that most candidates simply repeated the discussions under part (a), without advising the due dates of compliance.

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 liability of an individual. Performance was good. Common mistakes found in the computation were:

- Treating the termination payment (which was a compensation payment), reimbursement of a medical claim from an insurance company (which was not a reward for services rendered), annual insurance premium, cost of the motor car provided by the employer, reimbursement of tuition fee (which was an allowable self-education expense), and the saving of loan interest (which was not convertible into cash) as taxable benefits.
- Not taxing the reimbursement of the club joining fee and the cost of petrol for private use paid by the employer (which represented a discharge of the employee's liability).
- Incorrect calculation of the rental value as 10% of the assessable income before the deduction of allowable professional membership fees and/or after deduction of self-education expenses.
- Incorrect calculation of the taxable share award benefit.
- Granting the incorrect amount of dependent parent allowance ($23,000).
- Granting child allowance to the 19-year-old son who was studying part-time only.

Question Six

This 15-mark question covered the standard question on the computation of profits tax. In general, performance was good. Most candidates were able to score high marks, except for the following common mistakes:

- Incorrectly allowing the donations to the China Refugee Fund (which was not an approved charitable organisation) and the compensation payment to leaving staff (which created an enduring benefit and was a capital expenditure).
- Incorrect calculation of the special MPF contribution to be added back (80% and not 100%).
- Treating the profit from sale of a residential property (which was revenue in nature), and interest on overdue accounts receivable from customers in China (which was sourced in Hong Kong) as non-taxable income.
- Treating the loss brought forward as an allowable expense, rather than a set-off against the assessable profits.
- Failure to set off the property tax paid against the profits tax liability.