



Examiner's report

F6 (ZAF) Taxation

December 2015

General Comments

This is the second 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 ten 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 no marks were deducted for incorrect answers.

Most candidates were unable to answer the following questions correctly. These 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 specimen questions and the questions discussed here and in the examiner's report for the June 2015 diet; and to carefully review how each of the correct answers were derived.

Example one

Mr White, an American, signed a two-year employment contract with a company managed and controlled in Hong Kong. The contract was negotiated, concluded, and enforceable in the US. His annual salary of HK\$1 million was paid to him in US currency in the US. Under the contract, Mr White was required to station in China to supervise the Hong Kong company's joint venture there. During the years of assessment 2013/14 and 2014/15, Mr White stayed in Hong Kong for 25 days (for attending meetings) and 70 days (50 days for attending meetings and 20 days for holiday) respectively.

What is Mr White's assessable income for the years of assessment 2013/14 and 2014/15?

	<u>2013/14</u>	<u>2014/15</u>
A.	Nil	\$1 million
B.	Nil	\$191,780
C.	Nil	Nil
D.	\$68,493	\$136,986

This question tested candidates' understanding of the source of income from an employment. Section 8(1) of the IRO only taxes employment income arising in or derived from a source in Hong Kong. In this regard, the relevant tests for determining the location of employment as set out in the *Goepfert* case and DIPN No. 10 are:

- (1) the place where the contract of employment was negotiated, entered into and enforceable;
- (2) the residence of the employer; and
- (3) the place where the remuneration was paid.

In accordance with the principles in the *Goepfert* case, Mr White's employment had its source in Hong Kong as his employer was a Hong Kong company resident in Hong Kong. His income would be fully chargeable to salaries tax unless he had rendered all his services outside Hong Kong. For this purpose, services rendered in Hong Kong during visits not exceeding 60 days are ignored. As Mr White had performed services in Hong Kong

during visits of 25 days in 2013/14 and 70 days in 2014/15, his income would be fully exempt for 2013/14 but fully chargeable to salaries tax for 2014/15.

The correct answer was therefore A.

It is worth noting that many candidates opted for either option B or C. B wrongly treated Mr White's employment as being from an overseas source and assessed his income on a time basis ($\$1 \text{ million} \times 70/365 = \$191,780$). C treated the income for 2014/15 as fully exempt on the basis that Mr White worked in Hong Kong for 50 days only. This was wrong as visits for any purpose are aggregated, not just days on which duties are performed.

Example two

X Ltd paid the following sums for scientific research related to its business:

- (1) \$10,000 for the purchase of plant and machinery
- (2) \$20,000 for the extension of a building
- (3) \$30,000 for the purchase of rights in scientific research carried on by another company

What is the amount of the allowable deduction in respect of scientific research that X Ltd can claim for profits tax purposes?

- A. \$10,000
- B. \$30,000
- C. \$40,000
- D. \$60,000

This question tested candidates' understanding of the allowable deductions for expenditure on scientific research [under section 16B] which include:

- (1) Payments to an approved research institute for research and development related to the taxpayer's trade, profession or business;
- (2) Payments to an approved research institute, the objective of which is the undertaking of research and development related to the class of trade, profession or business to which the taxpayer's trade, profession or business belongs; and
- (3) Expenditure on research and development related to the taxpayer's trade, profession or business, including capital expenditure except to the extent that it is expenditure on land or buildings.

Therefore, only \$10,000 for the purchase of plant and machinery was deductible and the correct answer was A. It is worth noting that many candidates opted for either B or C.

Specific Comments

Section B

This section had a standard coverage of the syllabus. Questions 1 to 4 were short questions for a total of 40 marks, and questions 5 and 6 were longer questions for a total of 30 marks. The questions were predominantly computational but contained some narrative elements.

The vast majority of candidates attempted all six questions, and there was little evidence of time pressure. Quite a number of candidates failed to complete all parts of Questions 1 and 4; which were also the questions in which candidates performed less well than expected. Where questions were left unanswered by candidates, this



appeared to be due to a lack of knowledge or poor exam technique as opposed to time pressure. The questions where candidates' performance was the most satisfactory was Questions 5 and 6.

Question One

This 10-mark question was on tax administration. In general, the question was not well attempted with some candidates even failing to attempt the question at all. This was probably due to candidates' misunderstanding of the question and inadequate knowledge of this area of the syllabus.

Part (a) required candidates to explain the conditions for lodging a valid objection. Some candidates had not read the question clearly and gave explanations on whether Merry Ltd had a reasonable excuse for the late submission of return, or the right to apply for a revision of assessment [under s.70A]. Candidates are thus advised to read the question carefully before attempting it. Part (b) required candidates to explain how the taxpayer could apply to hold-over the tax in dispute. It is disappointing that most candidates were not familiar with this topic or had misunderstood the question; and explained taxpayers' obligations or right to appeal instead.

Question Two

This 10-mark question required candidates to prepare the personal assessment computation. The issues were standard and straightforward, except for the treatment of the partnership loss and donations. Overall performance was satisfactory. The common mistakes made included deducting donations from the share of partnership profits, failure to deduct loss brought forward from partnership profit, and not restricting the mortgage loan interest to the net assessable value of the respective property.

Question Three

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

Many candidates were careless in calculating the rates to be deducted for the year of assessment 2013/14 and the amount of irrecoverable rent deductible in the year of assessment 2014/15 and carried back to 2013/14. Other common mistakes included incorrect spreading over of the premium, claiming other expenses as a deduction, and applying a wrong property tax rate of 16.5%. Candidates are urged to practise the computational skills well enough in order to secure higher marks.

Question Four

This 10-mark question was another question on which performance was not satisfactory. The obvious reason was that the topic of commercial building allowance was not receiving enough attention from candidates. Although this topic is not commonly examined, candidates should not exclude any topic within the syllabus from their studies.

In part (a), most candidates were not able to correctly ascertain the qualifying expenditure for commercial building allowance. Many of them included the cost of levelling the land and the cost of the lift as qualifying expenditure. In part (b), many candidates simply calculated the annual allowance at a constant rate of 4% on qualifying expenditure for all years prior to and after 1998/99. Some even calculated commercial building allowance on a reducing balance basis, instead of on cost; and granted initial allowance.

Question Five

This 15-mark question on salaries tax was one of best performing questions. 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 entertaining allowance which was not expended.
- Treating the reimbursement of medical expenses from a medical insurance scheme (which was not a reward for services rendered), annual premium paid by the employer (which represented a discharge of the employer's liability), value of the car (which was not convertible into cash), and reimbursement of tuition fee (which was deductible as self-education expenses) as taxable benefits.
- Not taxing the share award benefit, or not including it in the calculation of rental value.
- Income for calculating the rental value was correctly time-apportioned, but rent suffered was not deducted in full.
- Income for calculating the rental value was before the deduction of allowable expenses (membership fee to Chartered Association of Marketing), or after the deduction of the self-education expenses.

Question Six

This 15-mark question was a profits tax computation including the depreciation allowance schedule. In general, performance was satisfactory except that more attention should be paid to the presentation of different plant and machinery pools under the depreciation schedule. The most commonly encountered issues were as follows:

- Deducting disposal proceeds of plant and machinery after the calculation of annual allowance.
- Failure to offset property tax paid against the profits tax payable.
- Wrong calculation of the capital portion of instalments paid during the basis period.