

Examiner's report

F6 Taxation (HKG)

June 2012

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General Comments

The examination consisted of five compulsory questions. Question 1 for 25 marks and question 2 for 30 marks, and three further questions of 20, 15 and 10 marks respectively.

The vast majority of candidates attempted all five questions, and there was little evidence of time pressure. Where questions were left unanswered by candidates (such as question 4), this appeared to be due to a lack of knowledge or poor exam technique, as opposed to time pressure.

As in previous sessions, the topics covered by all the questions in this paper were standard and common, except for question 4 which asked about special tax treatment for club and association. Other topics included profits tax computation, salaries tax computation, property tax and partnership, personal assessment, badges of trade and tax compliance. It is believed that an average student who made efforts in studying the syllabus well should be able to pass the paper. Candidates' performance in essay-type questions was generally weaker than that in computational questions. Examiner's report on previous diets have highlighted that both theory and computations are equally important even at this F6 level; and candidates are encouraged to master the tax concepts and principles well, rather than simply focus on drilling the calculation steps.

Candidates performed particularly well on questions 1(a), 1(b), 2(a), 2(b), 3(a) and 5. The questions candidates found most challenging were questions 1(c) and 4. Question 1(c) was not answered well mainly due to candidates' weakness in source rule on employment. Question 4 was the poorest performed question and it asked about the tax treatment on a club. This reflects that candidates paid less attention to certain unpopular topics from their studies although these topics were included in the syllabus.

A number of common issues arose in candidate's answers:

- Failing to read the question requirement clearly and therefore providing irrelevant answers which scored few, if any, marks.
- Poor time management between questions, some candidates wrote far too much for some questions and this put them under time pressure to finish remaining questions.
- Repeating facts given in the question rather than analysing the facts or elaborating the tax rationale to support their answers, or replicating their answers for the same question (or part), or even providing contradicting answers for the same question (or part).
- Presenting poor logics in workings to computations making it difficult to trace the workings to award marks.
- Not providing clear labelling of which part of the questions the answers were relating to, including different parts of the questions being not answered in sequence or part of the question being answered before the next question with the other parts continued after the next question.
- Illegible handwriting and poor layout of answers.

Specific Comments

Question One

This 25-mark question on salaries tax was one of the most popular topics examined, and the issues were standard and straightforward, except for the amount subject to the PRC tax, hotel accommodation, and school fee reimbursed.

Part (a) for 5 marks required candidates to address the tax principles on source of employment and implications on employment income. Most candidates were able to address the scope of salaries tax under section 8, and the need to apply Goepfert principles. However, quite a number of candidates have erroneously applied Goepfert principles to determine whether services (as opposed to employment) are sourced in Hong Kong or not. Some

other candidates demonstrated confusing understanding of source rules, by saying that Hong Kong employment was subject to time apportionment. As this paper is at fundamental level, fewer marks are allocated for theory or conceptual questions. However, theories and concepts are fundamental to the learning of Hong Kong taxation at advanced level. Therefore, candidates are urged to ensure that their fundamental concepts of Hong Kong taxation are clear and well-mastered.

Part (b) for 16 marks required candidates to compute the salaries tax liabilities and explain the tax treatments accorded to five specified items. Common mistakes found in the computation were:

- Time apportionment was incorrectly applied, instead of section 8(1A)(c)
- Deduction of portion of amount charged to PRC income tax under section 8(1A)(c) was ignored.
- Reimbursement of petrol cost to be assessable should be 20% instead of 80%
- Rental value should have been 10% instead of 4%, and only 11 months were counted.
- The housing allowance of \$15,000 for the month of April was not eligible for rental value, although it was fully taxable.
- Rental deduction of 5% from basic salary should have been treated as rent suffered against rental value, but only 11 months should be included.
- The deductible cost for share option benefit should be \$1,000 instead of \$2,000.
- Tuition fee reimbursed by employer should have been excluded from the total tuition fee paid before self-education expense deduction was claimed, rather than the reimbursed amount being treated as taxable whilst half of self-education expense was claimed. The latter treatment was a double-count.

Part (c) for 4 marks was not satisfactorily performed. Most candidates simply replied that Hong Kong salaries tax would be reduced without giving the rationale, or incorrectly explained by the reason that the employer was an overseas company. This reflected a lack of correct tax concept of these candidates concerning source the rule of employment.

Question Two

This 30-mark question covered the standard question on profits tax computation and written explanations of tax treatments on certain items. 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.

Part (a) for 5 marks asked about badges of trade to determine the nature of the profit from disposal of a property. Most candidates were able to correctly address the issues and score high marks in this part.

Part (b) for 25 marks required candidates to prepare the profits tax computation including the depreciation allowance schedule. Most candidates were able to score high marks under this part, except for the following common mistakes:

- Donation to be added back was erroneously stated as \$320,000 or \$80,000.
- Property tax set-off was not treated correctly
- Hire purchase asset was included in the 20% pool
- Printing machine should not be included in the pool as no annual allowance was to be claimed. (If candidates included the machine in the pool but was excluded from calculating the annual allowance, marks would still be awarded)
- Disposal proceeds were either wrongly positioned after annual allowances, or treated in wrong figures.
- Commercial building allowance was incorrectly calculated on reducing balance basis.

Question Three

This 20-mark question was another one on commonly examined topics: property tax, partnership and personal assessment. The whole question was computational and thus welcomed by most candidates, despite that the general performance of this question was not as encouraging as expected.

Part (a) for 4 marks asked about property tax computation. Surprisingly, not all candidates were able to get full credits. Mistakes made included rental of \$6,000 being overlooked, premium being either included in lump sum or apportioned based on 36 months, other expenses being claimed as deduction, and the wrong property tax rate.

Part (b) for 8 marks asked about partnership allocation schedules for two years of assessment. Some candidates overlooked that the figures given in the question already represented assessable profits or allowable losses. Therefore, candidates were not required to compute the assessable profits or allowable losses again by adjusting the salaries to partners/spouses. Moreover, the loss occurred to Mr Chan would lapse upon his retirement, which was not correctly addressed by most candidates. As regards the next year of assessment, the most common mistake was to offset Mr Lo's profits with his total tax loss brought forward from previous year with the excess being transferred to personal assessment. This is incorrect. Loss eligible for transfer to personal assessment is only restricted to current year's tax loss. The \$9,000 unused tax loss of Mr Lo should be carried forward in partnership.

Part (c) for 8 marks required candidates to prepare the personal assessment computation for the couple. The common mistakes included the property tax amount being mistakenly treated as net assessable value, wrong calculation of approved charitable donation deduction claimed by Mr Lo and transferred to Mrs Lo, failure to aggregate the couple's income before Part V allowance, and failure to allocate the tax payable between the couple. Although the topic of personal assessment appeared nearly in each diet, 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 Four

This 15-mark question was the least-attempted question although this question was also compulsory. The obvious reason was that the topic of clubs and associations was not receiving enough attention from candidates. Although this area belongs to special business, the candidates are reminded that clubs and associations is the only special business that is covered in F6 syllabus, and same topic has been examined in past years' diets. Candidates should have no excuse to exclude this topic from their studies.

For those who attempted this question, the common mistakes were:

- The 50% rule was erroneously applied to exemption rather than carrying on business.
- Entrance fee and subscription were overlooked
- Incorrectly applying the general profits tax computation skills to calculate the taxable profits for the club.
- Incorrectly applying the loss incurred in 2010/11 to offset profits in 2011/12
- Corporation rate of 16.5% was wrongly applied
- Only property tax was computed, ignoring profits tax.
- Property tax set-off was ignored.

Question Five

This last 10-mark question on general tax compliance to an employer was again not satisfactorily answered although this is another commonly examined topic at this level. Some candidates appear not to have read the question carefully and thus spent excessive time discussing the operational issues arising from the resignation of a staff, instead of tax compliance issues. Some other candidates failed to address the date issues, while other



candidates sought to provide better planning for the leaving staff. Candidates are advised to read the question carefully before attempting it.