Examiner's report
F6 Taxation (HKG)
June 2013

General Comments
This paper covers a wide range of topics, most of which are standard and common. Questions 1 and 2 were for a total of 55 marks and three further questions were for 20, 15 and 10 marks respectively. Total marks allocated to computational answers are approximately 67% representing two-third of the whole paper.

Most candidates earned most of their marks from Questions 1 and 2 which examined the most traditional topics of salaries tax and profits tax computations. Yet, a lot of marks were lost on careless mistakes and those items that required updated knowledge. For example, candidates were not alert to the changes in MPF deduction and personal allowance in the YA 2012/13 and lost marks on these items when they adopted the YA 2011/12 figures, despite that the two sets of different figures were readily provided to them in the table. Moreover, candidates were not able to provide the newly enacted tax treatments on trademarks and patents. This indicates that candidates on this paper were not updated enough with the development of tax rules. As for the other questions, most of the topics were not new, including partnership, club and property tax, change of accounting date and objection requirements. However, the overall performance of this paper was disappointing, although a small group of competent candidates were able to score full marks on partnership and club. This is in contrast with the expectations of examiners as well as the examination review board which recognized that the level of this paper was average and manageable. Most candidates were found to be generally weak in Questions 3, 4 and 5. Performance on partnership and personal assessment computations which were almost examined in each diet, were still found unsatisfactory. Moreover, as in previous diets, candidates tend to perform weaker in essay-type questions especially those relating to the fundamental concepts and interacting effects of basic tax elements, e.g. deductibility issues on different types of tax payment expenses (Q4(a)). This could possibly reflect that candidates were not able to thoroughly understand the fundamental concepts of tax rules and their interacting implications. Examiners would emphasize that concepts and principles are equally, if not more, important than calculations even at this F6 level; and candidates should ensure that they are able to master the concepts well rather than simply focus on drilling the calculation steps.

It is perhaps encouraging to see that most candidates managed to complete all the five questions. Time management appears to be well-handled. Other than time management, examination skills are also important. For example, it was quite a common phenomenon that candidates, when doing the profits tax computation, tend to group a few items together and present the total figure as one single adjustment item. For example, interest income from HK$ deposit, RMB deposits and US$ deposits were added up (instead of separately shown) and the total amount was shown as one adjustment item called 'interest income'. In marking the computation, it would be extremely difficult for the marker to 'identify' or even 'guess' which items had been included in the total figure. This could be even more complicated if some items were in fact wrong. Although all markers would make full attempt to ensure that all answers were marked as relevant and appropriate, candidates have the responsibility to ensure that their scripts are clear enough for markers to follow. Candidates are also reminded that it is in their interests to ensure that their writing is clear and tidy, and each question as well as each part of the question answered should be clearly and properly numbered or indicated where appropriate.

Specific Comments

Question One
This 25-mark question examined salaries tax. Most candidates managed to score high marks for this question especially the computation in part (c). Common mistakes included:

For Q1(a) and (b):
- Source of director was confused with, or not distinguished from the source of employment
- Goepfert principles were erroneously used to determine source of 'income'; eg some candidates concluded that due to the three principles being all offshore, the income must be sourced offshore and not taxable in Hong Kong.

For Q1(c):
- Calculation of time apportionment ratio was not correct, especially the leave days attributable to HK services
- Share option gain was incorrectly calculated
- Share option gain was wrongly included in time apportionment
- MPF and personal allowance for YA2012/13 were following the YA2011/12 figures
- Home loan interest was not dealt with
- Standard tax rate was wrongly computed based on net chargeable income rather than net assessable income

Question Two

This question covered standard profits tax computation. No written explanations of tax treatments were required. In general, the performance was satisfactory except for the following:

- Various interest income, exchange gain, and sundry income items were shown in aggregate figure without clear identification of different sources
- Trademark acquisition was either not deducted, or wrongly deducted with 100%.
- Refurbishment was either not deducted, or wrongly deducted with 100%
- Energy saving electric motor car was either not deducted, or wrongly deducted with 20%
- MPF special contribution was either not adjusted, or fully added back
- Travelling costs and legal fee re dispute with the China factory were added back incorrectly
- Patent registration fee in HK was incorrectly added back
- Trademark registration fee in HK was incorrectly added back
- Hire purchase pool was erroneously treated as 30% instead of 20%
- Energy saving car was included as 30% pool
- Disposal proceeds of photocopier were wrongly deducted from 30% pool instead of 20%
- Disposal proceeds were wrongly stated as $100,000
- Commercial building allowance at 4% was wrongly computed based on reducing value instead of qualifying expenditure or cost.
- Reception area was not included as commercial building.

Question Three

This question was on partnership with focus on allocation of profits between years of assessment, and between periods before and after the change in profit sharing ratio. This question involves less technical knowledge on tax rules but more on the logical thinking as to how allocation should be made taking into account the underlying concepts of depreciation allowance and sharing of assessable profits amongst partners. It was not uncommon to find allocation computation in the previous diets, but yet, performance was again poor. Common errors included:
- Depreciation allowance was computed for one year only, and deducted from the 16-month adjusted profit. This indicates that candidates were not aware that depreciation allowance entitlement was on yearly basis.
- Salary paid to partner's daughter, contribution to MPF, and severance payments were erroneously adjusted
- Balancing allowance was either not computed at all, or wrongly computed
- Some candidates even time-apportioned the accounting net profit, before doing any tax adjustment. This again demonstrated a weak foundation of tax concept.
- Adrian's shares of partnership profits under each of the 4-month and 8-month periods were transferred to personal assessment, instead of the aggregated total to be transferred

Question Four

Question 4 was partly on tax deduction rules and partly on club's tax treatments. Three types of payment expenses were analysed, being salaries tax paid for company's director, property tax paid by the company, and overseas tax withheld for overseas income. Most candidates were found extremely weak in addressing the tax deduction principles and how they were differently applied in these scenarios. Most answers were simply given as 'yes deductible' or 'no, not deductible' without giving any explanation.

For 4(a)(i), most candidates spent time to explain the rules on director's salaries tax liability, but did not address the profits tax deduction implication in the company's tax return. For 4(a)(ii), most candidates focused on explaining property tax and profits tax on rental income, and s25 set-off. However, no explanation was given on the deduction principles. Some other candidates wrongly concluded that the property tax was deductible from the assessable profits under s25. For 4(a)(iii), performance was the poorest. Most candidates simply concluded that the overseas tax was not deductible due to its offshore nature, without any indication of any knowledge about the deemed taxable receipt provision under s15 and the tax rule under s16(1)(c).

Q4(b) was on club and most candidates were able to give answers on the 50% rule. However, the relationship between carrying on business or not and the tax treatment of rental income was clearly not well understood.

Question Five

Question 5 was partly on change of accounting date and partly on the objection requirements. Both parts were poorly answered, demonstrating that candidates on this paper were not well-prepared on topics relating to tax administration. Basis periods for affected years of assessment caused by the change of accounting date were wrongly determined. Most candidates simply answered that taxpayer company would need to notify the IRD regarding the change of accounting date. For part (b), some candidates clearly mixed up the requirements of objection due date with the holdover due date. Some others wrongly gave answers on how to successfully present the case to the IRD.