

Examiner's report

F6 Taxation (HKG)

June 2014

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General Comments

This examination consisted of five compulsory questions. Question 1 for 25 marks, question 2 for 30 marks, and three further questions of 20, 15 and 10 marks respectively; with an approximate 60:40 split requirement for computation and essay.

Most candidates attempted all five questions with no indication of time pressure, except that some parts of the questions were left unanswered apparently due to lack of knowledge. The poorest performance was found in question 5 which concerned the computation of depreciation allowances. This topic is fundamental, typical and straightforward; yet, students seemed unable to master them well.

Other questions in the paper covered common topics including profits tax computation, salaries tax computation, personal assessment, mortgage loan interest deductions and depreciation allowances. Average students who made efforts in studying the syllabus well should be able to pass the paper. As usual, candidates' performance for essay-type questions was generally weaker than that for computational questions. Examiners would reiterate that both theories 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. Overall, the whole paper was standard and straightforward. As such, the majority of those who failed were due to inadequate preparation for the examination, as well as not being able to demonstrate a reasonable understanding of the fundamental topics.

Candidates achieved average to above-average performance in questions 1(a), 2(a), 3(c), 4(a) and 4(b)(ii). The questions candidates found most challenging were questions 1(b), 2(b) and 5.

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

- Failing to read the question requirement carefully and therefore providing irrelevant answers which scored few (if any) marks. This was particularly the case for questions 1(b) and 2(b).
- Poor time management between questions. Some candidates wrote far too much for some questions and this put them under time pressure to finish the remaining questions.
- Repeating facts given in the question rather than analysing the facts or elaborating the tax principles 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). This normally happened when candidates were not certain about the answers.
- Grouping a few items together and presenting the total figure as one single adjustment item in the profits tax computation, making it extremely difficult for the marker to 'identify' or even 'guess' which items had been included in the total figure. Candidates are reminded to ensure that their scripts are clear enough for markers to follow.
- Presenting poor logics in workings to computations, making it difficult for markers to trace the workings to award marks.
- Not providing clear labelling of which part of the questions the answers were relating to, not answering different parts of the questions in sequence or answering parts of the question before the next question with the other parts continuing 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 that the tax treatments of certain items were not satisfactorily explained.

Part (a) for 20 marks required candidates to compute the salaries tax liabilities and explain the tax treatments accorded to five specified items. One commonly found error was that concessionary deductions (approved charitable donations and contributions to mandatory provident fund) and Part V allowances were mingled together in the tax computation. Candidates are strongly advised to note that the IRO requires that concessionary deductions be deducted first from the assessable income, and Part V allowances may not be granted unless there is assessable income after concessionary deductions. Moreover, the standard tax rate is applied to the assessable income as reduced by concessionary deductions (i.e. Part V allowances are not available to taxpayers paying tax at the standard rate). Other common mistakes were:

- Applying time apportionment to Hong Kong sourced employment income.
- Deducting the China tax paid from the taxable employment income instead of excluding the portion of income subject to China tax.
- Assessing the rent paid by the employer as housing allowance instead of assessing the rental value.
- Deducting the home loan interest.
- Not taxing the holiday journey benefit or taxing the second-hand value instead of the cost of the benefit.
- Deducting the loss on sale of share option from the taxable share option benefit.
- Assessing the medical insurance policy purchased by the employer and the reimbursement of medical expense from the medical insurance scheme.
- Time-apportioning child allowance for the son and/or granting child allowance for the daughter.
- Granting elderly residential care expenses and/or dependent parent allowance.

Part (b) for 5 marks required candidates to address the tax implications of entering into two separate employment contracts. Performance was disappointing. Instead of discussing the possible exemptions for services rendered outside Hong Kong under Contract 2, candidates incorrectly discussed the source of employment by applying the Goepfert principles.

Question Two

This 30-mark question covered the standard question on profits tax computation. In general, performance was good except that presentation of the depreciation allowance schedule was not satisfactory.

Part (a) for 24 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:

- Deducting the interest on a loan made to an individual shareholder in Hong Kong.
- Refurbishment to retail outlets was not allowed, or allowed in full.
- Carpet replacement was not deducted as soft furnishing replacements.
- Not deducting 20% of last year's special contribution to pension fund.
- Disallowing the stamp duty and legal fees for renewing leases of retail outlets.
- Most candidates showed aggregated items in the tax computation, such as interest income, finance income and office rent and rates. This makes it extremely difficult for markers to trace the items, especially when the final figure is not correct. Failure to break down the items may result in no marks being awarded.
- Failing to deduct sales proceeds from the pool.

- Incorrect calculation of the capital payments and using 20% to compute annual allowance for the computer acquired under hire purchase.
- No commercial building allowance was calculated for the false ceiling.

Part (b) for 6 marks required candidates to advise the taxability of the royalty payment to the European trade-name owner and the taxpayer's reporting and compliance obligations. Performance was poor. Only a few candidates were able to correctly apply the deeming provisions of ss.15(1)(b) and (ba) and the withholding obligation of the payer of royalty.

Question Three

This 20-mark question was another one on commonly examined topics: property tax, partnership and personal assessment. However, the general performance of this question was not as encouraging as expected.

Part (a) for 3 marks asked candidates to explain whether the taxpayer's income is assessable to tax in Hong Kong. Performance was poor. Very few candidates were able to apply the exemptions under s.8(2)(j) available to air-hostesses; and correctly exclude the presence during the period the taxpayer did not derive her income as an air-hostess. Instead, many candidates apply the 60-day rule to decide whether the income was taxable or not.

Part (b) for 4 marks asked candidates to explain whether the taxpayer was eligible to elect for personal assessment. Performance was also poor. Many candidates failed to distinguish between permanent resident and temporary resident.

Part (c) for 13 marks required candidates to prepare the personal assessment computation. Performance was fair. Common mistakes included:

- Not deducting the loss brought forward from previous year from the assessable profits of Partnership X before transferring to personal assessment.
- Deducting the approved charitable donations from the profits of Partnership X before transferring to personal assessment.
- Deducting the loss from Partnership Y from the assessable profits of Partnership X before transferring to personal assessment.
- Incorrect calculation of the rental income from Property A and/or B.
- Incorrect calculation of approved charitable donations.
- Applying the corporate tax rate of 16.5% to the partnership business.

Question Four

This 15-mark question asked about the deduction for home loan interest. Performance was satisfactory. For part (a), some candidates wrongly explained that home loan interest was only deductible under personal assessment. For part (b)(i), quite a number of candidates also stated that the couple had to elect joint assessment or personal assessment in order to be eligible to claim a deduction for home loan interest. For part (b)(ii), the deduction of mortgage loan interest under property tax and personal assessment was quite well explained.

Question Five

This last 10-mark question on depreciation allowances was the least-attempted question although it was also compulsory. Performance was poor. Many candidates could not determine which floor qualified for industrial building allowance (IBA) and which floor qualified for commercial building (CBA), could not calculate the qualifying expenditures, treated lift and air-conditioner as part of the building, and did not know how to apportion the qualifying capital expenditures on the basis of floor area for IBA and CBA and the rate used to compute IBA and CBA.