



Examiner's report

P6 (HKG) Advanced Taxation

June 2017

General Comments

The examination consisted of two compulsory questions in Section A and two to be selected out of three questions in Section B. Section A contained question 1 for 35 marks and question 2 for 25 marks. Section B comprised three optional questions of 20 marks each.

It was very pleasing to see that almost all candidates attempted all the questions required. Unfortunately, the examiners were disappointed to find that a number of candidates did not score enough marks to pass mainly because they simply repeated the facts given in the question or barely gave the tax treatments instead of explaining with a rationale or principle or legal justifications. Candidates are reminded that P6 (HKG) is an advanced paper at professional level, and thus they are required to demonstrate an adequate level of competency in justifying their answers with valid reasoning in words. Moreover, candidates are strongly reminded to present their answers in a clear, legible and orderly manner so as to help the markers to read and understand their answers. Another common phenomenon is that more and more candidates gave both sides of an argument without taking a position, even in clear-cut scenarios; for example, such income is taxable if the Inland Revenue Department (IRD) accept it as revenue or non-taxable if argued it as capital. Candidates are strongly encouraged to confidently apply their knowledge to the scenarios given.

In general, candidates did reasonably well for question 2(a), question 3(a)(i), and question 5(a) and performed unsatisfactorily for question 1(b)(ii) and question 4. The following paragraphs report on each question and focus on some of the key learning points.

Specific Comments

Section A

Question One

This 35-mark question covered the scenario of a Hong Kong company proposing to re-engineer its business in order to sustain in the down-turning business environment. The main issues included terminating retail stores, selling properties, making staff redundant and obtaining additional funding from shareholders. The tax issues involved are straightforward and have been commonly examined in past diets and especially in tax computations in the F6 (HKG) examinations. At the advanced level, candidates are required to demonstrate not only the knowledge of tax treatments but also the ability to explain the implications with valid reasoning taking into account tax concepts and principles. In general, the performance in this question was average. A number of candidates did not score well enough mainly because they were unable to clearly explain the reasoning behind the tax treatment. Some candidates made use of confusing terminology or made contradictory conclusions, indicating that their foundations of tax knowledge were not solid enough.

Common mistakes made by candidates in were:

- In part (a), candidates either spent too much time repeating the facts given or only stated that the rental deposit was capital and non-taxable whilst the rental expense was revenue and deductible. Not many candidates were able to explain the issue of 'incurred' under the s16 deduction rule and the implication of the Secan decision in crystallising the deduction when a rental deposit is written off as expense.
- In part (b) most candidates were able to explain the balancing adjustment arising from the disposal of the commercial building, but did not perform well on the calculation. Common errors included using the purchase price as qualifying expenditure (due to the building being purchased from property

developer), and continuing to apply 4% on the purchaser for Commercial Buildings Allowance (CBA) under sub-part (ii) instead of using the special formula based on 25 years. Some other candidates wrongly calculated the annual rate by simply deducting the years of CBA claims from 25 without making reference to the years of first use.

- In part (c) a significant number of candidates only answered whether the redundancy payment and gratuity were revenue or capital in nature and then their respective tax treatments, without explaining why they were revenue or capital. In sub-part (i), candidates should have focused on the profits tax deductibility rule, but quite a number of candidates referred to whether the payments were included in the employment contracts, which was irrelevant (probably confused with the rationale on the taxability of the employee). Many candidates claimed that the redundancy payment must be deductible as it was required by law, and that the gratuity was non-deductible as it was not legally required. For sub-part (ii), some candidates mixed up redundancy payments with retirement benefits.
- For part (d), in sub-part (i), most candidates simply recited all the criteria for interest deductibility but did not give valid reasoning to support their conclusion in this case. Interest deductibility is a difficult topic but is very important, hence commonly examined. Candidates are strongly encouraged to master the deduction rules well. Common errors included stating that interest is not taxable to the shareholder and therefore not deductible to the subsidiary without referring to s16(2)(c) or stating that the shareholder will be taxable on interest if the same is deductible to the subsidiary. Interestingly, quite a number of candidates referred to the newly enacted law on intra-group financing interest deduction (s16(2)(g)). Unfortunately, this was not relevant at all in the scenario.

Question Two

This 25-mark question required candidates to ascertain the source of employment of the taxpayer in the given scenario, explain the tax position of the proposed remuneration package and identify the possible tax planning opportunities through applying the relevant salaries tax rules and principles. This topic is examined in every diet and most candidates were relatively more prepared for it than other questions.

Part (a) for eight marks required an analysis of the taxpayer's source of employment based on the Goepfert principles. Some candidates referred to the employer being incorporated in Hong Kong and concluded that the employer is resident in Hong Kong. A large number of candidates did not realise that the Goepfert principles apply to determine whether income is taxable in Hong Kong or not.

As for the tax planning opportunities under part (b), most candidates were able to describe the rental value issue for accommodation provided by the employer. However, not many candidates were able to explain the reasoning, in particular the difference between fully assessable and assessable based on rental value. Some candidates simply suggested that rent should be 'paid' by the employer for the rental value to be calculated, without elaborating that 'control' must exist in a reimbursed accommodation arrangement. For other benefits, a common observation was that candidates were only able to state the tax treatments but not the rationale. For example, utilities paid directly by the employer were non-taxable but this would only be workable when the utilities were arranged in the name of the employer and the liabilities were taken up by the employer. Candidates could only score minimal marks if they failed to give an explanation as to why the benefits were treated the way they were.

Question Three

This 20-mark question focused on property letting, home loan interest deductions, and tax recovery action for tax in default. Most candidates did well in sub-part (a)(i) under Option 1 of the scenario. However, some candidates confused terminology such as mistaking 'assessable value' for 'assessable income', and 'mortgage interest deduction' to be claimed under personal assessment as 'home loan interest deduction' under personal assessment. There was no explanation of the eligibility of personal assessment, and it was commonly

misunderstood that a home loan interest deduction was only allowed under salaries tax and thus the deduction was no longer valid just because there was no more income under salaries tax. A number of candidates obviously overlooked the eligibility criteria for home loan interest deduction. Under sub-part (a)(iii) under Option 3, only a few candidates were able to correctly conclude that the loan repayment amount paid by the son might arguably be considered as 'consideration in money's worth' and thus property tax would be imposed. The performance in this question was not as good as expected mainly because answers were not detailed enough to score marks and explanations lacked justifications with reasoning and tax law.

Question Four

This 20-mark question covered two special businesses: clubs and insurance companies. The topic of special business is included in the syllabus but not commonly examined in each diet. However, amongst the different special business, clubs and insurance companies are the most common. Unfortunately, this question was attempted the least and for those candidates that attempted it, performance was not satisfactory. This indicates that candidates were not well-prepared for this topic and may not have included this topic in their studies. In addition, some candidates incorrectly concluded that the scenario given under part (a) was about a trade association rather than a club. Other candidates incorrectly concluded that the scenario given under part (b) was about life insurance.

Generally, performance on this question was unsatisfactory.

Question Five

This last 20-mark question tested candidates' knowledge of the tax treatment of some common items encountered in corporate tax computations. However, given that this is an advanced paper, candidates were required to give adequate and valid reasoning and justification to be awarded full marks. Unfortunately, most candidates were only able to state the tax treatments but provided weak explanations. For example, the cost of the computer system under part (a) was fully deductible without justifying that this is so under s16G as a prescribed fixed asset. A very common observation from this question is that candidates tend to explain whether an item is taxable/non-taxable or deductible/non-deductible with the reason that the item is revenue or capital in nature. However, this answer is not sufficient without further elaboration as to why the item is revenue or capital in nature. In the last part (f) on interest expense deductions, most candidates gave a detailed description of the deduction criteria but incorrectly concluded that the interest was not deductible because the loan was used to acquire a capital asset. Candidates are strongly recommended to study an earlier article written by the examiners on 'The Pitfalls on Interest Deduction Claims by Corporate Taxpayers' at:

<http://www.accaglobal.com/africa/en/student/exam-support-resources/fundamentals-exams-study-resources/f6/technical-articles/interest-deduction-corp.html>.

Candidates should refer to point (1)(c) which is most relevant to the case in this question.