

Examiner's report

P6 Advanced Taxation (HKG)

December 2012



General Comments

The examination consisted of five questions, of which two questions in Section A are compulsory and two out of three questions in Section B are required to be attempted. Section A contained question 1 for 39 marks and question 2 for 29 marks. Section B comprised three further questions of 16 marks each. Effective from this diet, the total professional marks awarded for format, presentation and communication are 4 in one question as compared to 2 in each of 2 questions in previous diets. This is to encourage candidates to pay more attention to present their answers effectively in this one question.

Most of the candidates were able to finish four questions, and there was little evidence of time pressure. This could be an indication that candidates have got used to the style of the questions. Where questions were left unanswered by candidates, this appeared to be due to lack of knowledge.

Candidates who have achieved above average performance in Section A (questions 1 and 2) were mostly able to get an overall pass for the paper. A small proportion of candidates were found to have answered question 1 last, but in these cases, answers presented were usually incomplete or appeared rushed. Examiners do not recommend leaving questions 1 and 2 to the last minute as these two questions require more efforts and time to study the case and combined they count for the majority of the marks.

Candidates achieved average performance on questions 1(a)(i), 1(b)(i), 1(c)(ii), 1(d), 2(a), 3(a), 4(a), and 5(c). Questions that candidates found most challenging were questions 1(a)(ii), 1(a)(iii), 1(c)(i), 1(c)(ii), 1(e), 2(b), 4(b) and 5(b). Candidates were found weak in their applicability skills to apply technical knowledge in practical scenarios, as well as failing to read question requirements carefully and failing to master a complete understanding of all aspects covered in the syllabus. For example, in question 1, quite a number of candidates made fundamental errors such as applying initial allowance to commercial building, or continuing to use 4% for calculating commercial building allowance for the new purchaser. Question 2 was not answered as well as expected although the question was standard and straightforward. The most disappointing areas were the tax treatment on royalties and the consignment income. Question 3 was the most well-attempted especially the scope of stamp duty charge, the rates, and the group relief. Question 4 was well-attempted to the extent of part (a) which required the general principles for source determination. However, part (b) required candidates to apply these principles to the case, and most candidates were not able to demonstrate their ability to understand the case and the rules. Some candidates simply chose to repeat the general principles as in part (a). Question 5 was another challenge to candidates who have not prepared well in the area of anti-avoidance rules as required in part (b). Candidates who chose to attempt question 5 mostly gained marks from part (c).

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). For example, some candidates answered question 1(a) with both industrial building allowance and commercial building allowance.
- Providing more than the required number of points for question (or part) to which only a few marks were allocated; but providing not enough points for question (or part) to which higher marks were allocated. For example, some candidates gave 2-3 pages of detailed explanations of section 61A and 20 to question 1(c)(i) that only worth 4 marks; but for question 5(a) that worth 4 marks, most candidates simply answered losses to be carried forward.
- Illegible handwriting and poor layout of answers.



- Providing answers based on the tax law or rules of other jurisdictions (eg UK) instead of HK.

Specific Comments

Question One

This 39-mark question was a practical scenario discussing the tax related issues faced by a loss making company. The question involved a discussion of selling the land and building, equipment and trading stock. Staff redundancy payments are also examined.

Part (a) for 11 marks required candidates to address the tax issues arising from the sale of land and building. The store building should qualify as a commercial building but quite a number of candidates mis-classified it as industrial building. For those who correctly treated the building for commercial building allowance, 20% initial allowance was wrongly applied, or 6 years instead of 5 years of annual allowance was calculated. The most common error found was the calculation of 4% annual allowance on reducing balance basis. A few candidates tried to explain that the land sale was capital in nature hence not taxable, while the sale of the building was revenue in nature and taxable. The effect of demolition to the eligibility of balancing allowance was examined in part (ii), and not many candidates were able to address this. In most answers, candidates gave detailed answers surrounding badges of trade as they considered the counter-offer being a sign of profit-making act. Part (iii) was one of the worst-attempted areas, as most candidates were not able to calculate the 'residue before sale' and to determine the annual allowance for the purchaser based on the 25th-year formula. Perhaps one of the possible reasons for this is that candidates focused their studies on principles and theories for this paper but have ignored those fundamental areas involving computations.

Part (b) for 7 marks required candidates to explain the requirement for tax deduction of donations and conclude whether the donation of equipment was eligible. Most candidates were only able to describe one to two conditions for donation deduction, such as in cash/money form and the ceiling of 35% assessable profits. However, not all of them were able to relate the 35% ceiling to the company's tax loss position, and thus failed to draw the appropriate conclusion. Some other candidates wrongly explained that the donation of equipment would be deducted based on the market value.

Part (c) for 9 marks required candidates to address the sale of trading stock. Very few candidates could explain section 15C effect, but most candidates focused on discussing arm's length or market price issues. Some gave too much detail on section 61A and 20, but not enough details on transfer pricing issues as mentioned in the requirement.

Part (d) and (e) for 4 marks respectively required candidates to analyse the tax impact on the waiver of an inter-company balance and the redundancy and gratuity payment. Most candidates wrongly interpreted the waiver of the inter-company balance as irrecoverable debt. For the redundancy payment, most candidates claimed it as non-deductible for the reason that this was not taxable to employees. Other candidates tried to explain the relationship of section 16(1) with the redundancy payment, but failed to draw the effect of the Cosmopolitan case or its principles.

Question Two

This 29-mark question covered the standard question on personal taxation covering salaries tax and profits tax. Most candidates were able to score high marks on this question, except that the majority has spent excessive time and space under part (a) talking about Goepfert principles, which were not asked at all by the requirement.

The common mistakes found included:

- The deduction of MPF contribution was wrongly calculated as 5% on salary.
- Rental value was computed instead of taxing the housing allowance in full.

- Payment of petrol credit card was wrongly treated as non-taxable while the provision of company car was wrongly treated as taxable due to private use.
- Cash payment in lieu of share option was correctly explained as taxable but in wrong year; failed to deem it as accrued on the last day of previous employment.
- Income received from writing articles and royalties were treated as taxable under salaries tax; others simply answered that they were not employment income, but did not charge them to profits tax.
- Royalty income was mis-treated as taxable under s15(1) deemed trading receipt.
- Royalty income was claimed as non-taxable for the reason of being used offshore, without addressing the place of acquiring and granting the intellectual property.
- Commission income earned by Rebecca was confused with the consignment income earned by the Taiwan company.
- Compliance obligations of Rebecca relating to the consignment income were not correctly addressed; some candidates simply answered the requirements of notifying chargeability and filing annual return.

Question Three

Being one of the three questions for choice under Section B, this 16-mark question was asking about stamp duty on transfer of Hong Kong stock and leasing of property. Most candidates were able to correctly explain the scope of charge, the rates, and the group relief. This may be due to the fact that stamp duty has become a commonly examined topic in recent diets. However, not all candidates included the loan assigned in the stampable value. Moreover, most candidates were mistaken that the liquidation of A Ltd would give rise to the withdrawal of group relief. As for part (b) on the leasing of property, most candidates were able to address the scope of charge and rates, but failed to correctly explain the contingency principles. Some others wrongly applied the conveyance on the sale to leasing situation.

Question Four

This 16-mark question was asking about the source rule under section 14(1). Most candidates were able to address most of the points of the general principles as required under part (a), but failed to apply the principles to the case as required in part (b). Some candidates did not demonstrate a good understanding of the facts given. Some candidates were found to have given answers of both sides, taxable and non-taxable. This was disappointing as it was not certain whether the candidates truly considered that the case warranted both sides of tax positions or the candidates deliberately gave both choices in an attempt to gain marks on either answer. The later approach is considered un-ethical and will not be awarded marks, unless it is made clear from the explanations that a candidate believes that either tax position could apply.

Question Five

This last 16-mark question under Section B was concerning losses and financing cost. Part (a) was supposed to be the most straightforward and fundamental, but yet not all candidates were able to enjoy the privilege. Part (b) was poorly answered as candidates did not appear to have studied well the anti-avoidance rule on a loss company, section 61B. Some candidates only addressed the stamp duty issue on transferring the loss company. Others were able to address the anti-avoidance issue, but incorrectly explained that the loss of the loss-making company would be transferred to the profitable company. Part (c) was the best answered as it involved the most commonly examined topic of interest expense.