

# Examiner's report

## P6 Advanced Taxation (MYS)

### December 2014



#### General Comments

The examination consisted of two sections. Section A contained two compulsory questions: question 1 for 35 marks and question 2 for 25 marks. Section B comprised three further questions of 20 marks each. Candidates were required to answer two out of the three Section B questions.

There was a new format adopted in the presentation of questions one and two. The examiner had written an article published on the ACCA website explaining the new format in Section A. This new format appeared to have been well understood and well received.

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

Candidates performed well on questions 2 (c), 3 (b), 3 (c), 4 (a), 5 (a), 5 (b) and 5 (c). The questions candidates found most challenging were questions 1 (a), 2 (a), 3 (a) and 4 (b). This was mainly due to candidates not understanding the fundamental tax principles well enough and a lack of technical knowledge.

#### Specific Comments

##### Question One

This 35-mark question was based on a manufacturer, AtoZ Sdn Bhd (AtoZ), and tested candidates' knowledge of tax incentives for research and development (R&D), deductibility of legal expenses and assessability of compensation received.

Part (a) for 17 marks required candidates to explain the tax incentives involved if AtoZ were to conduct the R&D itself and if it were to outsource the R&D to a third party.

Many candidates performed inadequately on this part of the question. Time was wasted on irrelevant discussions, for example, some candidates wrote at length about the contract R&D company when the relevant point to be made was that AtoZ qualified for a double deduction in respect of the RM15 million fee paid.

Part (b), for seven marks, tested the deductibility of legal expenses. Candidates must bear in mind that merely stating that an expense item is deductible because "it is incurred wholly and exclusively in the production of the gross income" will not gain more than a half mark. The answer should explain, with reference to the context, why the expense is incurred wholly and exclusively in the production of the gross income.

Part (c), for seven marks, requires explanations about the assessability of the compensation received for breach of contract, the accruals concept for the business receipt and the revision of tax estimates. Many candidates coped well with explaining why the compensation received would be taxable, but did not realise that although the compensation was receivable in many instalments, the lump sum was taxable based on the accruals concept. The impact on the tax estimate was well discussed by most candidates.

As regards professional marks, many candidates failed to gain the full available marks as they did not adopt the correct format for a report or attach an appendix in support of the explanations in the report.

##### Question Two

This 25-mark question covered the following topics:



- three methods of raising capital by a group of companies,
- alternative modes of procuring business assets; and
- the comparison of the tax treatment of the group holding company before and after its listing on the stock exchange.

This question was satisfactorily answered by most candidates. The definition and relative tax treatment of the unlisted and listed investment holding company (IHC) were very well grasped and this bodes well as the IHC is a common entity encountered at the work place.

Nevertheless, a few weak areas were detected as follows:

- Some candidates routinely, without much thought, discussed interest restriction whenever the deductibility of interest was broached;
- Quite a few candidates were not exactly clear as to what an operating lease is compared with a finance lease;
- A few candidates did not fully comprehend what an outright purchase entails; and
- A majority of candidates did not realise that, in an outright purchase, the full cost of the business asset, instead of the principal sum paid up, constituted the qualifying capital expenditure for the purposes of capital allowances.

### **Question Three**

This 20-mark question was based on a real estate investment trust (REIT). It covered basis periods, computation of total income of a REIT, and how the unit holders are taxed in respect of the REIT distributions received by them.

Part (a), for five marks, tested the determination of the basis periods for a REIT in respect of the initial three years on commencement of operations. In general, this was not well answered as many candidates still applied the old rules [in section 21A]. It must be stressed that the correct determination of basis periods, under various circumstances, is fundamental and every P6 candidate should be well versed and up-to-date with the technical rules before attempting the exam.

Part (b), for 10 marks, dealt with the tax computation for Prosperous REIT and its eligibility for exemption from income tax. This was very well attempted by the majority of candidates.

Part (c), for 5 marks, required candidates to explain how the different groups of unit holders of Prosperous REIT were effectively and procedurally taxed. Most candidates understood well the reporting requirements involved for the individuals and resident companies. However, many did not demonstrate their understanding of the concept of the effective tax rate.

### **Question Four**

This 20-mark question comprised two equal parts, both involving individuals.

Part (a) (i) and (ii), for 10 marks, examined the tax treatment of lump sum payments related to employment including a retirement gratuity, compensation for loss of employment, and court awards for premature termination of contract and for damage to reputation. This part was generally well answered.

Part (b) (i), (ii) and (iii), for 10 marks, required candidates to apply their understanding of the fundamental concept of tax residence and its significance in relation to double tax treaties and territorial double taxation. Furthermore, it tested the understanding of the concept of derivation of business income.



This part was not answered as well as part (a). Some candidates plunged into a discussion of permanent establishment although this was not required.

#### **Question Five**

This 20-mark question related to real property gains tax (RPGT) in respect of three pieces of land acquired and sold by Happy Toys. It tested allowable losses, the meaning of disposal, the date of disposal in a conditional contract, the categories of expenditure included in arriving at the disposal price and acquisition price, the holding period and the applicable tax rates.

Many candidates performed well in this question. Only a small minority did not grasp the proper composition of disposal price and acquisition price.

#### **Reminder**

Future candidates are reminded that they must be able to fully comprehend the general tax principles of revenue versus capital as applied to receipts and expenditure, bases of recognition of income, deductibility of expenses, deduction of CA and losses. At this advanced stage of their tax studies, candidates must be adept in applying these principles to draw reasoned conclusions in the specific context of the scenarios depicted in the questions.