



# Examiners' report

## P6 Advanced Taxation (HKG)

### December 2007

This examination is the first diet of Paper P6 (HKG) under the new syllabus. Although most aspects of the new syllabus are in line with the old syllabus under Paper 3.2H, the format and style of the question have changed towards more practical and case-oriented. The main changes only occur in the style of Questions 1 and 2, but the requirements of the questions were more structured so that an average and 'well-prepared' candidate should be able to follow them. Questions 1 and 2 were for a total mark of 66 in this exam, and 2 further questions out of a choice of 3 were for 17 marks each. Candidates would also note that very few marks were awarded to computations or numbers included as part of the answers. This is following one of the objectives of the professional level of examination that candidates are expected to demonstrate their abilities to analyse the questions and present their answers with logics and principles rather than detailed calculations. Candidates should expect that this trend would be followed in the subsequent diets.

The performance of this paper was poor. Although examiners did appreciate that the changes in question format and style might cause some difficulties to candidates to fully understand the facts of the questions (mainly Q1 & 2), it was however found that the performance on other questions was also unexpectedly much disappointing. The poor performance of this paper was partly due to the failure of candidates to get themselves well-prepared for all topics, and inability of candidates to present their knowledge or analysis clearly and correct.

In terms of time management, some candidates found that they did not have time to attempt the other two optional questions after answering Questions 1 and 2. Although the first two questions made up to 66 marks out of 100, it would not normally be expected that a pass mark could be achieved only from these two questions. Since candidates were given 15 minutes reading and planning time before the examination started, they are urged to finish reading all the questions with a view to firstly, determine which 2 optional questions to be attempted; secondly, the priority of attempting the questions and thirdly, the time allocated to each question. The balance of the reading and planning time should be spent on understanding the facts of the scenario given in Questions 1 and 2 and their requirements.

#### **Marks available in respect of professional skills**

Marks were available for professional skills in questions 1 and 2. In order to earn these marks candidates first had to satisfy the requirement in relation to the format of the document requested. Further marks were then available for the clarity of the answer, including the ease with which it could be marked and the degree to which the conclusions reached followed logically from the explanations and calculations provided. These latter marks were more likely to be earned by those candidates who thought about the manner in which they intended to satisfy the requirement such that there was a sense of purpose and a coherency to their answers.

#### **Specific Comments**

##### **Question 1**

This question contained a scenario with a lot of information and facts. Candidates should be aware that at this professional level of examination, a mixture of facts relevant to the requirement and some facts that may not be relevant will be given in the question. They should be able to identify which facts are relevant to be used for their answers. Although the case was long, the requirements of the questions were structured in the way that different examinable aspects were clearly identified and broken down into parts, and candidates should be able to analyse the case by following the flow of logics as required. Most of the requirements should be answerable even the candidates might not be able to fully understand all the facts given. Therefore, candidates should not be too frustrated and affected if some of the facts or information were not fully understood. Alternatively, they may give assumptions to support their answers.

The average mark scored for this question was very low. Some of the common errors found were:

- (a)(i), the various criteria for tax deductibility of management fee payment were not completely answered by most candidates. It was not the first time that this aspect was examined and thus candidates who have studied past papers should be able to score marks easily.
- (a)(ii), many candidates did not get the adjusted profit/loss correct. Some candidates simply adjusted the aggregated management fee for all prior years in 2006/07, which was not technically correct. More importantly, not many candidates were able to mention the obligation to notify chargeability even though they correctly adjusted the management fee giving rise to chargeable profits in some years.
- (a)(iii), a lot of candidates did not attempt this part probably because they might have not been able to think of any idea to rectify the situation. Some candidates were able to suggest that the current agreement for management services should be revised to make it more tax effective. Although this is contrary to the fact given in the question (the requirement actually assumed that the current arrangement need to be continued), these suggestions were appreciated and should at least score some marks, better than nil.
- (b)(i), many candidates were able to score high marks as this part was on the common topic of interest deductibility. Some candidates were found to have listed out all the conditions under s16(2) without elaborating how the conditions applied to this case. For a professional level of examination, this approach of answering the question would not be acceptable. Whilst most candidates focused on s16(2)(b) on the topic of interest deductibility, a lot of candidates have actually overlooked the fundamental criteria of s16(1).
- (c), a lot of candidates did not get this simple computation right.
- (d)(i), quite a few candidates were confused s61A with s61B. Some others claimed that the loss of Losing can be offset against profits of Gain. Although anti-tax avoidance provisions are one of the areas in the syllabus, examiners and markers found that not many candidates were able to present the implications under s61B well and correctly.
- (d)(ii), this part was quite straightforward, yet not many candidates were able to answer it well .
- at the end of the report, most candidates added 'yours faithfully or truly', which is not required. By the same token, a memorandum or report does not normally start with 'Dear xx'. Please refer to the model answers to see the suggested format.

### Question 2

This question was another scenario-based question on individual tax, covering salaries tax, property tax, partnership, and personal assessment. In general, the performance was comparatively better than Question 1. However, most candidates spent too much time and efforts in presenting the computations which only scored a few marks. Other common errors found are:

- in relation to 'personal assessment', not many candidates were able to mention the criteria to decide whether the couple was eligible for electing PA.
- some candidates mentioned that if the employment was sourced outside HK, the income was 100% exempt from HK tax. This is fundamentally incorrect by concept.
- the compensation was mistaken as share option, and treated wrongly for tax purposes.
- some candidates confused 'personal assessment' with 'joint assessment'
- the discounted tickets were mistaken as holiday benefits
- reallocation of loss from one partner to another was commonly found to be missed out

### Question 3

This was one of the three optional questions, and this question was on the topic of interest deductibility and change of intention. The performance on the first part on interest deductibility was generally better than the second part, mainly due to the fact that change of intention was not a common topic in the previous examination. Therefore, some candidates were not able to master what exactly was required by the question, and thus presented the answer surrounding badges of trade and principles of taxability.

**Question 4**

This was a question on HK salaries tax implication to a non-resident individual who was a resident in a country that has double tax arrangement with HK. Both HK domestic salaries tax regime and implications under the double tax arrangement have to be addressed. Although this aspect was new, similar case has been demonstrated in the pilot paper. Candidates who attempted this question still indicated a certain degree of confusion between the domestic tax regime and the double tax arrangement. Examples are 60 days requirement under domestic law, and 183 days required under the double tax arrangement. Another example of confusion was that the exemption from HK tax in this case was mistaken as exemption from China tax.

**Question 5**

This was a question on tax administration and penal actions, which are comparatively less common in the previous examination. As a result, this question was the least attempted, and for those attempted, scores were not high. Candidates should be aware that at professional level of examination, compliance issues and administrative issues should not be overlooked, as these are common aspects of attention in practical life of providing tax consultancy.