

# **Examiner's Report**

**December 2018 Session**

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**Paper 5**  
**Principles of Taxation**

## **General Comments**

The paper consisted of three sections. Section A consisted of multiple-choice questions and Section B had one compulsory question on profits tax. Section C had three questions from which candidates were required to choose to answer any two. The examination questions tested candidates' understanding of the basic principles of Hong Kong taxation. Their overall performance in this examination was not good, showing that their revision had not covered the syllabus.

### **Section A – 15 Multiple-choice Questions**

This section was divided into two broad categories: non-computational questions of which each correct answer was worth one mark and computational questions of which each was worth two marks. Candidates were required to choose the best answer out of four options in each question. The overall performance in this section was not satisfactory, particularly in computational questions. Candidates should note that multiple-choice questions could cover every part of the syllabus and the unsatisfactory result shows that candidates might not have prepared thoroughly nor studied the questions carefully.

### **Section B – 1 Compulsory Question**

#### **Question B1**

This was a compulsory question on profits tax. It consisted of four parts. Part (a) was concerned with the computation of assessable profits of a non-resident. Candidates did not know that the assessable profit accounted for 30% of the royalty income. Part (b) was concerned with the computation of depreciation allowance of plant and machinery. Candidates did not realise that the machinery used wholly and specifically for manufacturing was a prescribed fixed asset and should not be included in the pool as full deduction was allowed in the year of acquisition. Many candidates also forgot to include the second-hand motor car into the pool. Part (c) concerned the computation of profits tax liability of a corporation in Hong Kong. Candidates generally showed some basic knowledge of profits tax computation. However, they should note that:

- (a) the machinery was a prescribed fixed asset and should be fully deducted;
- (b) industrial building allowance was 4% of the decoration expenditure;
- (c) donations of ward beds were not approved charitable donations; and
- (d) the limitation of approved charitable donations was 35% of the profits before deduction of approved charitable donations but not 35% of the amount donated.

Candidates' performance in part (d) was not good. They failed to explain clearly the proper treatment of the interest expenses, including the application of section 16(2).

### **Section C – 3 Optional Questions**

#### **Question C1**

The question concerned salaries tax of a non-Hong Kong employment and consisted of five parts. Candidates' overall performance in this question was satisfactory. Part (a) asked about the conditions for granting married person's allowance. Many candidates could not explain the conditions properly.

Part (b) concerned the computation of days of vacation leave attributable to Hong Kong services and the total number of days attributable to Hong Kong services. Candidates' performance was poor. They had no idea about the computation of days attributable to Hong Kong services under a non-Hong Kong employment.

Part (c) concerned the computation of holiday journey benefit and most candidates were able to present it properly.

Part (d) concerned the computation of share option gain and many candidates used the selling price instead of the market price at the time of exercise to compute the gain. Also, they did not compute the portion of gain chargeable to salaries tax.

Part (e) concerned the computation of salaries tax liability of a taxpayer having a non-Hong Kong employment. It was unexpected that many candidates did not apply time apportionment to the calculation of the income chargeable to salaries tax under non-Hong Kong employment. Also, it should be noted that:

- (a) the amount of self-education expenses allowed was the amount paid by the taxpayer;
- (b) approved charitable donations made by his wife could be claimed by the taxpayer; and
- (c) standard rate was applied to the net assessable income after concessionary deductions and not net chargeable income.

### **Question C2**

Very few candidates attempted this question, probably because the question concerned the computation of commercial building allowance and cessation of an old business. Candidates might prefer to attempt those traditional topics and might not have covered their revision on these areas in depth. However, those who attempted it obtained good results.

### **Question C3**

Part (a) concerned property tax and candidates generally performed well. However, they should note that:

- (a) the rent receivable for the first floor should be for the whole year and not based on the actual amount of rent received during the year;
- (b) the premium should be spread over 36 months but not 48 months (the lease period). Some wrongly included the whole amount in the assessable value.

Part (b) was an essay-type question asking about the time limit for raising an assessment or additional assessment, badges of trade and the requirements of a valid objection. Candidates were not familiar with these subject areas and they did not answer this question well.

**[ END OF EXAMINER'S REPORT ]**