

# **Examiner's Report**

**June 2017 Session**

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**Paper 5**

**Principles of Taxation**

## **General Comments**

The paper consisted of three sections. Section A contained multiple-choice questions. Section B had one compulsory question on profits tax. Section C had three long questions and candidates were required to answer any two. The examination questions tested candidates' understanding of the basic principles of Hong Kong taxation. Compared with the previous sessions, candidates' overall performance was average. However, candidates demonstrated a basic knowledge of computation of various types of taxes. As in the past, many candidates avoided answering essay-type questions.

### **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 choices in each question. The overall performance in this section was not satisfactory, particularly the performance in computational questions. This shows that candidates might not have studied the questions carefully and some made common mistakes in calculations.

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

#### **Question B1**

This was a compulsory question on profits tax of a company incorporated in Hong Kong. It consisted of three parts. Parts (a) and (b) concerned the computation of commercial building allowance and profits tax liability of a Hong Kong corporation respectively. Part (c) concerned the explanation of the tax treatment of interest received and interest payment. Candidates generally showed a basic knowledge of profits tax computation. Yet, their performance in the computation of commercial building allowance was not good. Many candidates failed to include the decoration expenditure on director's accommodation in the qualifying expenditure. In the computation of profits tax liability, they should note that:

- (a) the mortgage loan interest to Bank E and professional charges for Property B were not deductible as they were not incurred for the purpose of producing chargeable profit;
- (b) director's benefits were deductible as they were incurred for the purpose of business;
- (c) the renovation expenditure incurred during the year should be allowed by five equal years of assessment; and
- (d) the cost of the environment-friendly vehicle should be fully deductible in the year of purchase instead of being included in the calculation of depreciation allowances.

Candidates' performance in part (c) was not good. They failed to explain clearly the reasons why the interest was taxable or not and why the interest expense to Mr. Tang was not deductible.

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

#### **Question C1**

The question concerned salaries tax of a couple and candidates' performance was good. Part (a) concerned the calculation of share option gain and candidates generally showed the basic knowledge in this area. Part (b) concerned the calculation of salaries tax liability of the couple respectively. Candidates should note that:

- (a) the housing allowance was taxable income and no rental value should be included;
- (b) the gold plate and holiday journey benefit were taxable benefits;
- (c) allowable deductions and concessionary deductions should not be grouped together. Net assessable income and net chargeable income should be separately shown;

- (d) as the dwelling was owned jointly by the couple, each spouse was entitled to 50% of the home loan interest;
- (e) basic allowance should be granted to each spouse respectively;
- (f) additional dependent parent allowance was to be allowed as the parent was living with the taxpayer; and
- (g) standard rate was applied to the net assessable income after concessionary deductions instead of the net chargeable income.

Part (c) concerned the calculation of salaries tax liability under joint assessment. The calculation of joint assessment should start with the net assessable income of each spouse computed under separate assessment. Concessionary deductions should be deducted from the joint income.

### **Question C2**

The question concerned personal assessment and property tax. Part (a) required candidates to explain the time limit for the election for personal assessment and candidates were unable to provide a clear answer.

Part (b) concerned the calculation of property tax payable and candidates generally performed well in this part. However, they should note that mortgage loan interest was not deductible under property tax.

Part (c) concerned personal assessment calculation and candidates in general performed satisfactorily in this part. However, they should note the following:

- (a) dividends were not included in the net assessable income;
- (b) mortgage loan interest allowed was restricted to the net assessable value of each property concerned;
- (c) charitable donations not allowed under profits tax could be allowed under personal assessment, subject to the limit of 35% of the total income;
- (d) business loss should be deducted after the concessionary deductions; and
- (e) tax payable under personal assessment should be paid by Mr. Ho as Mrs. Ho had no reduced total income.

### **Question C3**

Not many candidates attempted this question and their overall performance in this question was poor. Part (a) concerned the computation of industrial building allowance and part (b) was an essay-type question. Candidates' performance in the past were not good in these areas.

In part (a), candidates were unable to compute:

- (a) the qualifying expenditure of the industrial building;
- (b) the residue of expenditure before sale; and
- (c) the sale proceeds attributable to the cost of construction.

No initial allowance should be granted on the used building and annual allowance should be allowed based on the residue of expenditure after sale from the year of first use by C Ltd. (2014/15) to the 25<sup>th</sup> year after first use (2037/38). However, initial allowance and annual allowance at 4% could be allowed on decoration expenditure.

Part (b) was an essay-type question about an employer's and an employee's obligations under the Inland Revenue Ordinance. Candidates were not familiar with these subject areas and they did not answer well.

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