

# **Examiner's Report**

**June 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. The overall performance in this examination was not good. As in the past examinations, many candidates were reluctant to answer 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 in computational questions. Candidates should note that multiple-choice questions could cover every part of the syllabus and the unsatisfactory result shows that they might not have studied the syllabus thoroughly and read the questions carefully.

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

#### **Question B1**

This was a compulsory question on profits tax of a sole-proprietorship business in Hong Kong. It consisted of three parts. Parts (a) and (b) concerned the computation of depreciation allowance of plant and machinery and profits tax liability of the sole proprietor respectively. Part (c) concerned the explanation of the tax treatment of interest expenses and charges for late settlement of trade debts. Candidates generally showed a basic knowledge of profits tax computation. Yet, their performance in the computation of depreciation allowance was not good. They did not have a thorough understanding of the pooling system of plant and machinery and did not realise that although the compensation received for the loss of the motor car was not taxable, it should be deducted from the 30% pool. In the computation of profits tax liability, candidates should note that:

- (a) salaries of the sole proprietor's son were deductible;
- (b) rates for Property A were not deductible;
- (c) the amount of non-deductible interest paid to Bank B was restricted to the amount of tax-free interest;
- (d) interest paid to Mr. So was deductible as it satisfied the condition in section 16(2)(e);
- (e) loss brought forward should be deducted from the assessable profit of the year to arrive at the net assessable profit;
- (f) the standard rate (15%) instead of the corporate profits tax rate or the progressive tax rates should be applied to compute the profits tax payable.

Candidates' performance in part (c) was not good. They failed to explain clearly the reasons why the interest paid to Bank B was not fully deductible or why the interest paid to Mr. So was deductible. They also failed to explain properly why the charges on the late settlement of trade debts were deductible.

### **Question C – 3 Optional Questions**

#### **Question C1**

The question concerned salaries tax and consisted of three parts. Candidates' overall performance in this question was good. Part (a) asked about the factors determining the locality of employment and many candidates could explain the factors properly. Part (b) concerned the computation of share option gain and most candidates could present it properly. However, some failed to apportion the gain as the share option was obtained while Edwin's employment was a

non-Hong Kong employment. Part (c) concerned salaries tax of a taxpayer having a Hong Kong employment. In general, candidates showed basic knowledge in this area. However, it should be noted that:

- (a) the whole amount of expenditure paid by the employer for the holiday journey was taxable;
- (b) although the additional bonus was received in the year of assessment 2017/18, it was taxable in the year of assessment 2016/17 as Edwin ceased his employment with the employer on 31 March 2017 and the bonus was deemed to have accrued to him on the last day of the employment;
- (c) the contract gratuity and the additional gratuity should not be included in the calculation of the rental value;
- (d) Edwin was not entitled to married person's allowance as his spouse had income chargeable to salaries tax;
- (e) the provisional salaries tax for the year of assessment 2016/17 paid by Edwin should be deducted from the final salaries tax payable computed in that year.

### **Question C2**

Part (a) of the question concerned profits and losses allocation of a partnership business and part (b) concerned personal assessment. Part (a) was not answered well. Candidates were not familiar with the scenario of the cessation of a partner in a partnership and the treatment of unutilised losses of the retired partner. The profits for the year should be apportioned between two periods, one before Kelvin's retirement and one after. Kelvin's unutilised losses would be lapsed upon his retirement. Part (b)(i) asked for the definition of "permanent resident" and "temporary resident" as provided under the Inland Revenue Ordinance. Many candidates wrongly gave the definitions as provided under other Ordinances. Part (b)(ii) concerned the calculation of the reduced total income of a couple under personal assessment. Candidates generally performed well in this part. However, they were not familiar with the calculation of approved charitable donations to be allowed for the couple. Also, they had included the gross rental value in the total income instead of the net assessable value.

### **Question C3**

Very few candidates attempted this question and their overall performance was not satisfactory. Part (a) concerned the calculation of property tax liability. With this being a common type of question, it was unexpected that the performance was only average. Candidates had difficulty in the computation of irrecoverable rent. They should have realised that the rates allowed should be restricted to the letting period instead of one full year.

Part (b) was an essay-type question regarding the requirements of a valid objection, the finality of an assessment and the section 70A claim. Candidates were not familiar with these subject areas and they did not answer well.

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