

Examiner's Report

December 2009 Session

Paper 5

Principles of Taxation

General Comments

The paper consisted of three sections. Section A contained multiple-choice questions. Section B contained one compulsory question on profits tax. Section C had three long questions and candidates were required to attempt any two. The questions tested the candidates' basic principle of Hong Kong taxation but their overall performance was not satisfactory. A number of candidates scored no mark for the compulsory question despite it being a common examination question on profits tax computation of a partnership business. A few candidates only attempted Section A. As in the past, candidates avoided answering the essay-type parts of questions.

Section A – 15 Multiple-choice Questions

Candidates' overall performance in this section was not good and many scored very low marks. Candidates should note that multiple-choice questions can cover every part of the syllabus and they have to study the whole syllabus in order to obtain good marks in this section.

Section B – 1 Compulsory Question

Question B1

This was a compulsory question on profits tax. Part (a) was concerned with the computation of profits tax liability of a partnership business. Few candidates were able to show a correct format of the profits tax computation and prepared a revised profit and loss account instead. Many candidates were unable to present the allocation of profits amongst the partners correctly. They should also note the following:

- (a) MPF contributions for a partner's spouse are not deductible.
- (b) Office rent paid to partner's spouse is deductible.
- (c) Salaries tax of an employee paid by the company is deductible.
- (d) Compensation paid for termination of employment with an employee was incurred for the business and hence it is deductible.
- (e) Many had wrongly transferred T Ltd's own business assessable profit to partnership profit.

Part (b) required candidates to explain the treatment of certain items. They were unable to explain the reasons for the treatments correctly and clearly.

Section C – 3 Optional Questions

Question C1

This question consisted of two parts. Part (a) was a question on salaries tax under a non-Hong Kong employment. The candidates' overall performance was satisfactory. However, they showed the following weaknesses:

- (a) many candidates wrongly used the whole year (365 days) in computing the leave days attributable to Hong Kong service instead of using the business days (350 days);
- (b) they did not realise that share option A was not taxable as Mr. Barrows was not liable to Hong Kong salaries tax when the option was granted to him;
- (c) the relocation expense paid by the employer was not taxable as it was not paid for a holiday journey.
- (d) they did not apportion to the holiday journey benefit.
- (e) some candidates wrongly deducted the tax waived from the assessable income.

Part (b) was a question on property tax and candidates' performance was on the good side. Yet, they showed the following mistakes:

- (a) Wrongly deducted the rates paid by the landlord despite it being stated that the landlord was not required to pay any rates due to the Government's remission.
- (b) Wrongly deducted government rent from the assessable value.
- (c) Computed the premium assessed incorrectly.
- (d) Used the progressive tax rate instead of the standard rate to compute the property tax liability.

Question C2

The question concerned the computation of depreciation allowance on plant and machinery (part a) and on industrial building (part b) however the candidates' overall performance was poor.

- (a) Some candidates were not familiar with the computation of a depreciation allowance on assets acquired under hire purchase. They had grouped the assets under hire purchase in the same pool.
- (b) They did not realise that the residue value of Motor A should be transferred into the pool.
- (c) Some had wrongly included the prescribed fixed asset in the pool.
- (d) For the industrial building allowance, candidates were unable to compute the qualifying expenditure of the building.
- (e) Candidates did not apportion the sale proceeds attributable to cost of construction but deducted the whole amount from the residue.
- (f) The decoration expense for the used building should be entitled to an initial allowance and annual allowance.

Question C3

Not many candidates attempted this question, probably because it is due to part (b) being an essay-type question.

Part (a) concerned the computation of assessable profit on cessation of an old business.

- (a) They did not know that for an old business, the basis period started from 1 April to the date of cessation.
- (b) They failed to compute the transitional amount.
- (c) They did not include the sale proceeds of the computer in the assessable profit.

Part (b) was an essay-type question regarding the obligations of an employee and the requirements of a valid objection under the Inland Revenue Ordinance. Again, the performance was poor.

- (a) Candidates did not understand the employee's obligations thoroughly.
- (b) They mixed the requirement of a valid objection with an appeal against the Commissioner's determination.

[END OF EXAMINER'S REPORT]