

Examiner's Report

June 2009 Session

Paper 5

Principles of Taxation

General Comments

This paper consisted of three sections. Section A contained multiple-choice questions, Section B one compulsory question on profits tax and Section C long answer questions. The examination questions tested the candidates' understanding of the basic principles of Hong Kong taxation. The candidates' overall performance was quite good. Most of the candidates possessed the basic understanding in computing various types of tax liability. However, many candidates were reluctant to answer the essay-type questions resulting in forfeited marks.

Section A – 15 Multiple-choice Questions

Most Candidates' overall performance in this section was good however some candidates obtained very low marks. Multiple-choice questions can cover every part of the syllabus and this showed that these candidates did not study the course material widely.

Section B – 1 Compulsory Question

Question B1

This was a compulsory question consisting of three parts, Parts (a) and (b) were concerned with the computation of commercial building allowance and profits tax liability by a corporation respectively. Part (c) was concerned with the explanation of the tax treatment of certain items.

For Part (a), many candidates did not include decoration as the qualifying expenditure of the commercial building. Some candidates had wrongly granted the initial allowance under the commercial building allowance

Candidates' performance on part (b) was satisfactory. However, many candidates made the following mistakes:

- (a) Some candidates did not understand how to restrict the deduction amount of MPF contributions to the MPF scheme.
- (b) In relation to the increase of general debt, they had wrongly deducted it from the profit instead of adding it back into the computation.
- (c) Many candidates did not understand that the maximum amount of approved charitable donations deduction was restricted to 25% of assessable profit after the deduction of depreciation allowances.
- (d) The candidates did not realise that the decoration of Property C was not deductible.
- (e) Despite the profits tax liability of a corporation being the corporation profits tax rate on assessable profit, many candidates applied the standard rate or progressive rates.

Not many candidates attempted part (c) as it concerned with essay writing and those that did attempt it did not perform well. They were unable to explain clearly the reasons for deductions and the non-deductibility of the interest incurred by the company. They were not familiar with the conditions to be satisfied for the deduction of interest payments.

Section C – 3 Optional Questions

Question C1

This question concerned salaries tax and was divided into two parts, Part (a) tested the basic principles of salaries tax and Part (b) was concerned with the tax treatment of an aircrew.

Part (a)(i) asked the candidates to specify the conditions to be considered to determine the locality of employment. Some candidates were unable to explain clearly those conditions. For Part (a)(ii), most candidates were able to allocate the contract gratuity correctly. Part (a)(iii) was concerned with the computation of salaries tax, many candidates did not understand what was net assessable

income. They had wrongly computed the net chargeable income resulting in a loss of valuable time. In the computation, candidates showed the following weaknesses:

- (a) Holiday journey benefits should included the benefits enjoyed by the couple;
- (b) Share option gain should not be included in the calculation of rental value;
- (c) They had wrongly applied the rate of 8% for the calculation of rental value;
- (d) No dependent parent allowance should be granted after elderly residential care expense was granted in respect of that parent; and
- (e) The aggregated income under joint assessment was the net assessable income.

Regarding Part (b), many candidates had wrongly apportioned Miss Suki's income in the year of assessment 2006/07 despite the fact that she was having a Hong Kong employment.

Question C2

As Part (b) of this question concerned essay-type question many candidates did not attempt this question. Those attempting this part did not perform well. Many of the candidates were unable to specify the time limit and conditions for the application of *holdover for provisional salaries tax*. They also failed to list out the recovery actions to be taken for recovery of tax by the Commissioner of Inland Revenue.

Part (a) was concerned with the allocation of profits amongst the partners in a partnership. Many candidates showed that they were not familiar with the format of allocating the profits and the treatment of losses brought forward from previous years.

Question C3

This question covered the calculation of the net assessable value under property tax and personal assessment. Candidates' performance was quite good with a few candidates scoring full marks. Candidates showed the following weaknesses:

- (a) They wrongly deducted the yearly rates under property tax despite the fact that the owner was only required to pay rates for one quarter in that year;
- (b) The whole amount of rental from Property B without the deduction of the 20% statutory deduction was wrongly included under personal assessment;
- (c) Mortgage loan interest should be restricted to the net assessable value of each property; and
- (d) Business loss should be deducted from the total income after deduction of concessionary deductions.

[END OF EXAMINER'S REPORT]