
Answers

Cases are given in the answers for educational purposes. Unless specifically requested, candidates are not required to quote specific case names to obtain the marks. Only the general principles involved are required.

Section B

Marks

1 Mr Ho

(a) Partnership allocation – Year of assessment 2015/16

	Fu \$	Li \$	Ho \$	Total \$	
Salaries	100,000	100,000	–	200,000	0.5
Balance (1:1:2)	<u>(62,500)</u>	<u>(62,500)</u>	<u>(125,000)</u>	<u>(250,000)</u>	0.5
	37,500	37,500	(125,000)	(50,000)	
Reallocation	<u>(37,500)</u>	<u>(37,500)</u>	<u>75,000</u>	<u>–</u>	1
Net share of loss	<u>0</u>	<u>0</u>	<u>(50,000)</u>	<u>(50,000)</u>	
Loss transferred to personal assessment			<u>50,000</u>	<u>50,000</u>	1
Loss carried forward			<u>0</u>	<u>0</u>	
					<u>3</u>

(b) Personal assessment computation for Mr and Mrs Ho
Year of assessment 2015/16

	Mr Ho	Mrs Ho	Total	
Net assessable profits from proprietorship after ACD [50,000 x (1 – 35%)]	32,500			1
Net assessable income from employment		200,000		0.5
Net assessable value [15,000 x 12 x (1 – 20%)]	<u>144,000</u>			1
Total income	176,500	200,000		
Less: Mortgage interest	<u>(30,000)</u>	<u>–</u>		1
	146,500	200,000		
Share of partnership loss	<u>(50,000)</u>			0.5
Less: Concessionary deduction				
– ACD [39,900 – (50,000 x 35%)]	(22,400)			0.5
maximum: [(146,500 + 17,500) x 35% – 17,500] =				1
39,900				
– ACD transferred to spouse (50,000 – 39,900)		(10,100)		1
– MPF contribution		<u>(10,000)</u>		0.5
Reduced total income	<u>74,100</u>	<u>179,900</u>	<u>254,000</u>	
				<u>7</u>
				<u>10</u>

2 Mr Ma

Property tax assessment
Year of assessment 2014/15 (original)

	\$	
Rental (32,000 x 7)	224,000	0·5
Premium (27,000 x 8/36)	6,000	1
Repair to water pipe	5,000	0·5
Assessable value	<u>235,000</u>	
Less: 20% statutory allowance	(47,000)	0·5
Net assessable value	<u>188,000</u>	
Tax at 15%	<u>28,200</u>	0·5

Non-adjusted items: rental deposit \$64,000, management fee \$16,000, property agency fee \$16,000, mortgage interest \$57,000.

0·5 marks each, maximum 1·5

Property tax assessment
Year of assessment 2015/16 (original)

	\$	
Rental (32,000 x 2 (April to May 2015))	64,000	0·5
Premium (27,000 – 6,000)	21,000	1
Less: Irrecoverable rent ((32,000 x 5) – 64,000)	(96,000)	1
Irrecoverable rent carried back	<u>(11,000)</u>	

Property tax assessment
Year of assessment 2014/15 (revised)

	\$	
Rental	224,000	
Premium	6,000	
Repair to water pipe	5,000	
	<u>235,000</u>	0·5
Less: Irrecoverable rent carried back	(11,000)	1
Assessable value	<u>224,000</u>	
Less: 20% statutory allowance	(44,800)	0·5
Net assessable value	<u>179,200</u>	
Tax at 15%	26,880	0·5
Less: Tax paid	(28,200)	
Tax refunded	<u>(1,320)</u>	0·5
		<u>10</u>

3 Mrs Li

- (a) Any person who without reasonable excuse makes an incorrect return by omitting or understating their taxable income is guilty of an offence (s.80(2)). The Commissioner of Inland Revenue (CIR) may institute proceedings in the court, which may impose a fine of \$10,000 plus treble the amount of tax which has or would have been undercharged as a result of the omission or understatement. The CIR may also compound the offence (s.80(5)). 1

Where the taxpayer is suspected of having evaded tax with fraud and wilful intention, the CIR can prosecute him/her (s.82). Fraud and wilful evasion include:

- (1) an omission from a return;
- (2) a false entry or statement in a return;
- (3) a false statement in a claim for a deduction or an allowance; and
- (4) signing a statement or return without reasonable grounds for believing that it is true. 2

Any person who is prosecuted for fraud and wilful evasion is guilty of a misdemeanour and the following maximum penalties may be imposed:

- (1) On summary conviction: a fine of \$10,000, an additional fine of three times the tax which was or would have been underpaid, and imprisonment of six months.
- (2) On indictment: a fine of \$50,000, an additional fine of three times the tax which was or would have been underpaid, and imprisonment of three years.

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As an alternative to prosecution, the CIR or Deputy Commissioner of Inland Revenue (DCIR) may impose a penalty (in lieu of prosecution) in the form of an additional tax (s.82A) as a result of the taxpayer's submission of an incorrect return without a reasonable excuse. The maximum amount of additional tax is treble the amount of tax undercharged.

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Tutorial note: *Assessment to additional tax is only applicable if no proceedings have been instituted for making an incorrect return without reasonable excuse and the person has not been prosecuted for fraud or wilful evasion. If additional tax is raised, the taxpayer cannot be prosecuted for an offence on the same facts.*

Before issuing an assessment to additional tax, the CIR or DCIR shall send a notice of intention to assess additional tax to the person concerned, and advise the person to submit written representations in respect of the offence for his consideration. The notice should specify the offence in respect of which the additional tax is being assessed.

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- (b) Illiteracy and ignorance of the law are not acceptable defences in a criminal prosecution. Reliance on professional advice is a reasonable excuse (*BR 80/76*), but that reliance must be reasonable in the circumstances (*D28/84*). Blind reliance on staff without taking reasonable steps to verify their advice would not be accepted as a reasonable excuse. In Mrs Li's case, it is unlikely that the Inland Revenue Department (IRD) would accept her explanation as a reasonable excuse unless she has further proof that professional opinion had been sought. In the event of any doubt, the full details of the transaction should have been disclosed in the return and drawn to the attention of the IRD.

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4 X-mas Ltd

- (a) As Toys-n-Me Inc does not carry on a business in Hong Kong, it will not be charged to Hong Kong profits tax in respect of its royalty income under s.14(1). However, Toys-n-Me Inc may still be subject to Hong Kong profits tax if the royalty income received is deemed as a trading receipt under s.15(1).

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Any payments received for the use of, or right to use, a trademark in Hong Kong or for imparting know-how in connection with the use of a trademark are deemed to be receipts arising in Hong Kong from a trade, profession or business carried on in Hong Kong (s.15(1)(b)). However, in this case, the trademark is not used in Hong Kong, so the \$400,000 income paid in the year ended 31 March 2016 will not fall within the definition of a deemed trading receipt under s.15(1)(b).

2

Where the right to use a trademark is located outside Hong Kong, i.e. as in this case Mainland China, the royalty income may still be subject to Hong Kong tax under s.15(1)(ba), if the royalty payment is claimed by the paying party as a tax deduction against its assessable profits for Hong Kong tax purposes. Based on the facts given, X-mas Ltd has returned all of the sales income as taxable in Hong Kong, despite the fact that the manufacturing process is in Mainland China. In the circumstances, it is reasonable to assume that the royalty payment to Toys-n-Me Inc would have been reported as a business expense and claimed as a tax deduction against the assessable profits by X-mas Ltd, on the basis that the royalty payment was incurred in the production of assessable profits (s.16(1)). If this is the case, s.15(1)(ba) would apply to impose Hong Kong profits tax on Toys-n-Me Inc in respect of the royalty income received.

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- (b) The deemed assessable profits from the chargeable royalty income are 30% of the gross royalty payment received by Toys-n-Me Inc (s.21A). As the recipient is a corporation, the applicable tax rate is 16.5%. Therefore, the estimated profits tax payable by Toys-n-Me Inc in respect of the year of assessment 2015/16 will be \$19,800 (\$400,000 x 30% x 16.5%). X-mas Ltd is required to withhold this tax amount from the gross royalty payment, and only remit the net amount of \$380,200 to Toys-n-Me Inc.

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X-mas Ltd is obliged to notify the Inland Revenue Department (IRD) of Toys-n-Me Inc's chargeability to profits tax within four months after the accounting year-end date of the year in which the royalty payment is paid (i.e. on or before 31 July 2016). X-mas Ltd is also required to file a Hong Kong profits tax return on behalf of Toys-n-Me Inc, reporting the chargeable royalty income and the appropriate tax amount withheld. Upon receiving the assessment, X-mas Ltd will be required to settle the tax liability on behalf of Toys-n-Me Inc.

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5 Frank

- (a) Salaries tax is charged on income from an employment, office and pension arising in or derived from Hong Kong (s.8). Income from employment includes income derived from services rendered in Hong Kong and excludes income derived from services rendered outside Hong Kong (s.8(1A)) but apart from this, no guidance is given in the Inland Revenue Ordinance and the phrase 'arising in or derived from Hong Kong' is to be interpreted according to case law and Board of Review decisions.

1.5

In accordance with the principle in the *Goepfert* case, Frank's employment has its source in Hong Kong as his employer is a Hong Kong company resident in Hong Kong. Therefore, his income will be fully chargeable to salaries tax unless he has rendered all his services outside Hong Kong (s.8(1A)(b)). As Frank has performed services in Hong Kong during visits of more than 60 days, he cannot claim the exemption for services rendered in Hong Kong during visits not exceeding 60 days (s.8(1A)(b) as qualified by s.8(1B)). However, Frank has paid tax in the Mainland, so will qualify for the exemption under s.8(1A)(c), which excludes income from services rendered outside Hong Kong if the taxpayer is chargeable to tax in the country in which the services are rendered and tax of substantially the same nature as salaries tax in Hong Kong, has been paid in respect of the income attributable to the services rendered in that country. It does not matter that the tax was paid or reimbursed by the employer.

2.5
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(b) **Salaries tax assessment**
Year of assessment 2015/16

	\$	
Salary (90,000 x 12)	1,080,000	0.5
Less: Amount charged to income tax in China (1,080,000 x 2/3)	(720,000)	1
	<u>360,000</u>	
Holiday benefit	30,000	0.5
	<u>390,000</u>	
Rental value (390,000 x 5/12 x 10%)	16,250	1.5
	<u>406,250</u>	
Cash allowance to cover accommodation cost	12,000	0.5
Difference between market value and purchase price of the flat	500,000	1
	<u>918,250</u>	
Assessable income	918,250	
Less: Self-education expenses (maximum)	(80,000)	1
	<u>838,250</u>	
Net assessable income	838,250	
Less: Concessionary deductions		
Home loan interest (28,000 + 10,000)	(38,000)	0.5
Contributions to mandatory provident fund (maximum)	(18,000)	0.5
	<u>782,250</u>	
Less: Part V allowances		
Married person's allowance	(240,000)	0.5
Child allowance (100,000 x 2)	(200,000)	0.5
	<u>342,250</u>	
Net chargeable income	342,250	
Salaries tax payable at progressive rates	<u>46,182</u>	0.5
Salaries tax at standard rate is not applicable (782,250 x 15%)	<u>117,337</u>	0.5

Non-taxable/non-deductible items for which marks are allocated:

1. China income tax paid by Hi-tech of \$120,000 (not taxable).
2. Interest savings of \$4,000 (14,000 – 10,000) on Hi-tech's staff loan (not taxable).
3. Share option cost of \$5,000 (not deductible).
4. Reimbursement of deductible expense (half of the tuition fee) of \$90,000 (not taxable).
5. Dependent parent allowance (not available/deductible).

0.5 mark each, maximum

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Tutorial note: As Frank's mother lives in Shanghai, she is not ordinarily resident in Hong Kong, so Frank is not entitled to any dependent parent allowance.

6 Winner Ltd

Profits tax computation for the year of assessment 2015/16

Basis period: year ended 31 March 2016

0.5

	\$	\$	
Profit for the year per accounts		33,000	0.5
<i>Add:</i> Loss from trading in China listed shares	30,000		0.5
Donation	5,000		0.5
Depreciation	40,000		0.5
Loss on disposal of fixed asset	5,000		0.5
Special contribution to MPF (22,000 x 80%)	17,600		1
Interest expense on shareholder loan	17,000		0.5
Balancing charge	1,000	115,600	0.5
		<u>148,600</u>	
<i>Less:</i> Dividend income from HK listed shares	23,000		0.5
Dividend income from China listed shares	11,000		0.5
Exchange gain (unrealised) from year-end conversion	20,000		0.5
Interest income on RMB deposit	6,000		0.5
Interest income on loan made to director	17,000		0.5
Replacement of carpets	70,000		0.5
Depreciation allowance for plant and machinery	4,000	(151,000)	0.5
		(2,400)	
<i>Less:</i> Donation		0	0.5
Adjusted loss for the year		<u>(2,400)</u>	
Tax payable		<u>Nil</u>	0.5

Correct treatment of items which require no adjustment (candidates are NOT required to prepare the following table in their answer. Marks will be awarded if they are not adjusted in the tax computation):

Taxable/non-deductible items	\$	Deductible/non-taxable items	\$
Gain from HK listed shares	500,000	Wages to helper for director's use	100,000
Gain from foreign currencies	150,000	Rent and rates for director's residence	150,000
Interest income on HK\$ deposit	1,000	Contribution to MPF (10,000 + 4,000)	14,000
Rental income	120,000	Interest on bank loan of \$100,000	2,000
		Interest on bank overdraft and credit line	12,000

0.5 mark, maximum

3.5

Depreciation allowance schedule	20%	30%	Total allowance	<i>Marks</i>
	\$	\$	\$	
Written down value (WDV) brought forward	20,000	30,000		0·5
Disposal: motor car	<u>20,000</u>	<u>(31,000)</u>		0·5
Annual allowance	(4,000)	(1,000)	<u>4,000</u>	0·5
Balancing charge		<u>1,000</u>	<u>(1,000)</u>	0·5
WDV carried forward	<u>16,000</u>	<u>0</u>		
				<u>15</u>