

Fundamentals Level – Skills Module

Taxation (Hong Kong)

Monday 7 June 2010

Time allowed

Reading and planning: 15 minutes

Writing: 3 hours

ALL FIVE questions are compulsory and MUST be attempted.
Tax rates and allowances are on page 2.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

Paper F6 (HKG)

The ACCA logo consists of the letters 'ACCA' in a bold, white, sans-serif font, centered within a solid black rectangular background.

SUPPLEMENTARY INSTRUCTIONS

1. Calculations and workings should be rounded down to the nearest HK\$.
2. Apportionments need only be made to the nearest month, unless the law and prevailing practice require otherwise.
3. All workings should be shown.

TAX RATES AND ALLOWANCES

The following 2009/10 tax rates and allowances are to be used in answering the questions

Allowances

| | \$ |
|----------------------------------------------------|---------------|
| Basic allowance | 108,000 |
| Married person's allowance | 216,000 |
| Single parent allowance | 108,000 |
| Child allowance – 1st to 9th child (each) | 50,000 |
| – additional allowance in the year of birth (each) | 50,000 |
| Dependent parent/grandparent allowance – basic | 15,000/30,000 |
| – additional | 15,000/30,000 |
| Dependent brother/sister allowance | 30,000 |
| Disabled dependant allowance | 60,000 |

Deductions

| | \$ |
|--------------------------------------------------|---------|
| Self-education expenses (maximum) | 60,000 |
| Home loan interest (maximum) | 100,000 |
| Elderly residential care expenses (maximum) | 60,000 |
| Mandatory provident fund contributions (maximum) | 12,000 |

Tax rates

| | |
|-----------------------------------|-------|
| Salaries tax rates: | |
| First \$40,000 | 2% |
| Next \$40,000 | 7% |
| Next \$40,000 | 12% |
| Remainder | 17% |
| Standard rate | 15% |
| Profits tax rate for corporations | 16.5% |

Depreciation allowance rates

| | |
|------------------------|---------------|
| Initial allowance: | |
| Plant and machinery | 60% |
| Industrial buildings | 20% |
| Annual allowance: | |
| Computers | 30% |
| Motor cars | 30% |
| Furniture and fixtures | 20% |
| Machines | 20% |
| Industrial buildings | 4% or formula |
| Commercial buildings | 4% or formula |

**This is a blank page.
Question 1 begins on page 4.**

ALL FIVE questions are compulsory and MUST be attempted

1 Yan is employed as the financial controller of Beta Ltd (Beta), a Hong Kong incorporated subsidiary of a US based company, Alpha Inc (Alpha). Beta is managed in Hong Kong but conducts business in Hong Kong and China. During the year ended 31 March 2010, Yan spent seven months working in China. He received the following income and made the following payments in 2009/10:

- (1) Annual salary: \$840,000.
- (2) Bonus: \$30,000. The bonus was received for winning a competition organised by Beta. The competition, which was open to all employees of Beta, was designed to promote greater efficiency in the way the company could collect its accounts receivable.
- (3) A Filipino domestic helper employed by Beta at an annual wage of \$45,000 was assigned to serve Yan's family. Because of Labour Department requirements, the contract with the domestic helper was signed by Yan.
- (4) A rent refund of \$20,000 per month in respect of a flat leased by Yan at a monthly rent of \$19,000. Yan was required to submit rental receipts to Beta to support the claim for the refund.
- (5) A car rented by Beta at an annual rental of \$30,000 was given to Yan for his private use. Yan received a total reimbursement of \$8,000 from Beta to cover the petrol cost.
- (6) Yan is a member of Beta's mandatory provident fund (MPF), to which he makes contributions of \$2,500 per month.
- (7) Yan is also a director of Cyma Ltd (Cyma). Cyma is a subsidiary of Alpha and is incorporated and managed in Singapore. 20,000 shares in Cyma were allotted to Yan on 1 April 2009 for taking up the directorship. Yan paid \$10,000 on allotment when the market value of the shares was \$90,000.
- (8) Whilst working in China the tax authority told Yan that \$300,000 of his salary was chargeable to income tax in China and he paid tax of \$60,000 on that income in April 2010. Half of this China tax was refunded by Beta in May 2010.
- (9) Annual membership fees were paid to:

| | |
|----------------------------------------------------|----------|
| The Association of Chartered Certified Accountants | \$2,500 |
| The Taxation Institute of Hong Kong | \$1,000 |
| The Hong Kong Jockey Club | \$20,000 |
- (10) A tuition fee of \$35,000 was paid by Yan to The City University for his enrolment on a part-time course on Accounting in China. Beta approved the programme and refunded half of the tuition fee to Yan.

The following additional information is available about Yan and his wife, Yandy, for the year 2009/10:

- (11) Yan took a 15-day business trip to the UK, and extended his stay for a further five days to visit his friends. Beta purchased a business class ticket for \$16,000 for Yan, but he paid the airline company \$2,000 to exchange the ticket for two economy class tickets. His wife travelled with him on one of the economy class tickets, and shared the hotel room with him at no extra charge. Beta approved the arrangement and paid the hotel room charges totalling \$30,000 for the entire trip.
- (12) Yandy runs a gift shop. Her agreed loss in respect of the year 2009/10 was \$120,000.
- (13) Yandy also owns a flat in Shatin which earns an annual rental of \$180,000. The total mortgage loan repayment amounted to \$320,000, which included interest of \$200,000.
- (14) Yan and Yandy each made a donation to the Po Leung Kuk in the amount of \$40,000 and \$30,000 respectively.
- (15) Yan and Yandy have three children. The eldest child (aged 23) was born by Yan's ex-wife and is studying for a full-time master degree at a UK University. The second child (aged 21) is studying full time at The Hong Kong University. The youngest child (aged 19) works in a solicitor's firm.
- (16) Yan's father (aged 63) lives in Shanghai. Yan remits \$1,500 per month to his father for his living expenses. Yandy's mother (aged 60) lived with Yan's family throughout the year and was fully supported by them. Yan also paid \$1,000 per month towards the maintenance of his ex-wife's mother (aged 66), who is an ordinary resident of Hong Kong.

Required:

- (a) **Compute the tax payable by Yan and Yandy for the year of assessment 2009/10, assuming no personal assessment was elected.**

Note: you should ignore provisional tax and overseas tax.

(14 marks)

- (b) **Compute the tax payable by Yan and Yandy for the year of assessment 2009/10 under personal assessment.**

(4 marks)

- (c) **Briefly explain the tax treatment you have applied to items (7) to (11) above.**

(7 marks)

(25 marks)

- 2 Quick Relations Services Ltd (Quick), a Hong Kong incorporated company, provides public relationship services in Hong Kong and China. It has engaged a team of executives who are required to travel between Hong Kong and China. For the year ended 30 June 2009, Quick has the following trading results:

| | Note | \$ | \$ |
|-----------------------------------|------|-----------|-------------------------|
| Income | | | |
| Service fees | (1) | 1,200,000 | |
| Investment income | | | |
| – dividend from securities | (2) | 21,000 | |
| – profit from sale of securities | (2) | 400,000 | |
| – bank interest income | (3) | 1,000 | |
| – currency trading gain | (4) | 50,000 | 1,672,000 |
| | | | <u>1,672,000</u> |
| Expenses | | | |
| Staff salaries | | 1,200,000 | |
| Directors' fees | | 150,000 | |
| Staff quarters – Hong Kong | | 600,000 | |
| Hotel accommodation – China | | 140,000 | |
| Travelling and entertainment | | | |
| – Hong Kong | | 30,000 | |
| – China | | 100,000 | |
| Office rent and rates – Hong Kong | | 160,000 | |
| Depreciation | (5) | 60,000 | |
| Loss on asset disposal | (5) | 20,000 | |
| Legal and professional fees | (6) | 90,000 | |
| Interest costs | (7) | 18,000 | |
| Insurance | | 4,000 | |
| Office expenses | | 3,000 | |
| Donations | (8) | 8,000 | (2,583,000) |
| | | | <u>(2,583,000)</u> |
| Loss for the year | | | <u><u>(911,000)</u></u> |

Notes:

- (1) Included in the service fees of \$1,200,000 is a billing of \$400,000 derived from services fully rendered by the executives in China.
- (2) Quick was involved in holding and trading in listed securities in Hong Kong. Apart from the dividend, Quick made a gain of \$550,000 and a loss of \$150,000 from trading in these securities. The net gain is \$400,000.
- (3) Bank interest income comprises the following:

| | \$ |
|--------------------------------------------------|---------------------|
| Interest on RMB deposit with a bank in Hong Kong | 400 |
| Interest on RMB deposit with a bank in China | 600 |
| | <u>1,000</u> |
| Total | <u><u>1,000</u></u> |

- (4) During the year, Quick made a net profit of \$50,000 from the buying and selling of foreign currencies. Part of the fund used for foreign currency trading was sourced from Quick's bank loan.

(5) Quick's balance sheet contains the following assets:

| | Furniture/ fixtures \$ | Computer \$ | Motor vehicle \$ | Work in progress \$ |
|--------------------------------|------------------------------|----------------|------------------------|---------------------------|
| Cost at 1 July 2008 | 150,000 | 80,000 | 220,000 | – |
| Additions | 40,000 | 80,000 | 20,000 | 20,000 |
| Disposals | (35,000) | (40,000) | – | – |
| Balance at 30 June 2009 | <u>155,000</u> | <u>120,000</u> | <u>240,000</u> | <u>20,000</u> |
| Depreciation at 1 July 2008 | 45,000 | 40,000 | 60,000 | |
| Charge for the year | 15,000 | 25,000 | 20,000 | |
| Disposals | (10,000) | (20,000) | – | |
| Balance at 30 June 2009 | <u>50,000</u> | <u>45,000</u> | <u>80,000</u> | |
| Carrying value at 30 June 2009 | <u>105,000</u> | <u>75,000</u> | <u>160,000</u> | <u>20,000</u> |
| Carrying value of disposal | 25,000 | 20,000 | | |
| Proceeds from disposal | 5,000 | 20,000 | | |
| Profit/(loss) on disposal | (20,000) | 0 | | |

(i) Work-in-progress represents upfront payments made to acquire furniture to be used in the staff quarters.

(ii) All the additions to furniture/fixtures qualify for a 20% annual allowance. The additions to computers comprise two new computers of \$40,000 each. One of these computers was acquired under hire purchase. Under the hire purchase agreement, Quick was required to make a down payment of \$7,000 at the time of purchase and pay monthly instalments of \$6,000 for six months from 1 May 2009.

(iii) The full cost of the computer disposed of in the year had been fully deducted in the tax return filed in the year of purchase.

(6) Legal and professional fees comprise the following:

| | \$ |
|---------------------------------------------|---------------|
| Legal fees for drafting service agreements | |
| – Hong Kong projects | 28,000 |
| – China projects | 6,000 |
| Audit and accountancy fees | 40,000 |
| Legal fees for new office lease | 4,000 |
| Legal fees for staff quarters lease renewal | 12,000 |
| Total | <u>90,000</u> |

(7) Interest costs comprise the following:

| | \$ |
|--------------------------------------------------------------------------------|---------------|
| Hire purchase finance charge on computer | 1,000 |
| Interest on a loan from a director to finance the renovation of staff quarters | 5,000 |
| Interest on bank loan | 12,000 |
| Total | <u>18,000</u> |

(8) Quick made an \$8,000 donation to the Hong Kong Red Cross for the Sichuan Earthquake in 2008.

Additional information:

(9) Quick has been filing its Hong Kong profits tax return on the basis that all of its income is subject to Hong Kong profits tax.

(10) The tax written down values brought forward from the previous year in respect of fixed assets are:

- 10% – nil
- 20% – \$50,000
- 30% – \$60,000

Required:

(a) Compute Quick Relations Services Ltd's Hong Kong profits tax liability in respect of the year ended 30 June 2009, clearly identifying both the year of assessment and the basis period.

Notes:

- (1) Your workings should include a depreciation allowances schedule and details of the hire purchase depreciation allowances calculations.
- (2) You should ignore provisional tax and overseas tax.
- (3) No detailed explanations are required in this part. (20 marks)

(b) Give explanations to illustrate the correct tax treatment, the underlying reasoning and any conditions which need to be satisfied in respect of:

- (i) the donation made to the Red Cross; and** (5 marks)
- (ii) the bank loan interest cost.** (5 marks)

(30 marks)

**This is a blank page.
Question 3 begins on page 10.**

- 3 ABC Co is a partnership between Andrew, Benny, and City Ltd. The partners share profits and losses in the ratio of 2:1:1 respectively. The partnership commenced business on 1 January 2009, and will make up its accounts to 31 March. The following is the first profit and loss account of the partnership drawn up for the 15 months from 1 January 2009 to 31 March 2010:

| | Notes | \$ | \$ |
|---------------------------------------------------------|-------|---------|-----------------------|
| Turnover | | | 4,140,000 |
| Cost of goods sold | | | (1,800,000) |
| | | | <u>2,340,000</u> |
| Wages | (1) | 650,000 | |
| Other direct expenses | | 108,000 | (758,000) |
| | | | <u>1,582,000</u> |
| Gross profit | | | |
| Rent | (2) | 600,000 | |
| Salaries | | 280,000 | |
| Contributions to mandatory provident fund (MPF) schemes | (3) | 24,000 | |
| Other expenses | (4) | 54,350 | |
| Depreciation | | 112,500 | |
| Loan interest to City Ltd | | 30,000 | (1,100,850) |
| | | | <u>481,150</u> |
| Net profit | | | <u><u>481,150</u></u> |

Notes:

- (1) Wages included \$150,000 paid to Andrew and \$180,000 paid to Benny's son.
- (2) Rent of \$600,000 was paid to City Ltd, the landlord of the premises in which the business is operated. The rateable value of the premises is \$480,000.
- (3) Contributions to MPF schemes include \$24,000 paid for Andrew and Benny's son (\$12,000 each).
- (4) Other expenses include:
- (i) A legal fee for drafting the lease agreement of \$1,500.
 - (ii) An accountancy fee for preparing the tax computation of \$3,000.
- All other items under this category are deductible.

Additional information:

- (5) A summary of the movements in plant and machinery is as follows:

| Date | Particulars |
|------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 30 December 2008 | Bought a photocopier for \$20,000 and a computer for \$18,000. |
| 18 February 2009 | Bought a motor car for \$400,000. The extent of its non-business use was agreed to be 50%. |
| 22 March 2009 | Paid \$5,600 in cash for a fax machine. The machine was delivered to the business for use on 3 April 2009. |
| 20 November 2009 | The motor car bought on 18 February 2009 was traded-in for a new one, which cost \$600,000. The trade-in value was \$280,000. The balance of the purchase price was paid in full, by cash. The new car was wholly for business use. |

- (6) City Ltd also carries on another business in Hong Kong, which has an assessable profit of \$10,000 for the year ended 30 June 2008 and an adjusted loss of \$20,000 for the year ended 30 June 2009.
- (7) Only Andrew elected for personal assessment in 2009/10.

Required:

- (a) Calculate the depreciation allowances and balancing adjustments where appropriate for the partnership for each of the relevant years of assessment. (6 marks)
- (b) Compute the assessable profit/adjusted loss of the partnership for each of the relevant years of assessment, clearly identifying the basis period. (6 marks)
- (c) Compute the allocation of profits and tax payable by each of the partners, if any, for each of the relevant years of assessment, claiming any relief that is available to City Ltd.

Note: you should ignore provisional tax. (8 marks)

(20 marks)

4 Your tax manager is going to give a presentation in a tax seminar.

Required:

Based on the Inland Revenue Ordinance and the commonly known prevailing practice in Hong Kong, prepare short notes showing the key points to be included under each of the following topics:

- (a) **The person who has the obligation to prepare and file a profits tax return.** (4 marks)
- (b) **The time for filing the profits tax return.** (2 marks)
- (c) **The supporting documents required to be filed with a profits tax return.** (3 marks)
- (d) **The consequences of non-filing.** (4 marks)
- (e) **The timing of profits tax assessment and payment of any tax due.** (2 marks)

Note: reference to the assessment of provisional tax is not required.

(15 marks)

5 HK Co is carrying on business in Hong Kong using a patent, Patent A. It is considering selling Patent A to its associated company, O/S Co at a profit of \$2 million. HK Co and O/S Co have the same shareholder but O/S Co is incorporated overseas and has no presence in Hong Kong. Subsequent to the sale, HK Co will license Patent A back from O/S Co to enable it to continue using the patent in its business in Hong Kong. An annual royalty of \$500,000 will be payable to O/S Co for this licence.

Required:

- (a) **Explain the potential Hong Kong tax implications for HK Co in respect of the profits arising from the sale of Patent A to O/S Co.** (3 marks)
- (b) **Explain the Hong Kong tax implications to O/S Co and calculate the effective tax rate payable on the income it will receive in respect of the royalty from HK Co.** (7 marks)

(10 marks)

End of Question Paper