

Fundamentals Level – Skills Module

Taxation (Hong Kong)

Thursday 10 December 2015



Time allowed

Reading and planning: 15 minutes

Writing: 3 hours

This question paper is divided into two sections:

Section A – ALL 15 questions are compulsory and MUST be attempted

Section B – ALL SIX questions are compulsory and MUST be attempted

Tax rates and allowances are on page 2.

Do NOT open this question 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.

Do NOT record any of your answers on the question paper.

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

The Association of Chartered Certified Accountants

Paper F6 (HKG)

ACCA

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 when answering Section B.
4. Ignore provisional tax and statutory tax reductions, unless specified otherwise.

TAX RATES AND ALLOWANCES

The following 2014/15 tax rates, allowances and deductions are to be used in answering the questions.

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% |

Allowances

| | |
|--|---------------|
| | \$ |
| Basic allowance | 120,000 |
| Married person's allowance | 240,000 |
| Single parent allowance | 120,000 |
| Child allowance – 1st to 9th child (each) | 70,000 |
| – additional allowance in the year of birth (each) | 70,000 |
| Dependent parent/grandparent allowance – basic | 20,000/40,000 |
| – additional | 20,000/40,000 |
| Dependent brother/sister allowance | 33,000 |
| Disabled dependant allowance | 66,000 |

Deductions

| | |
|--|---------|
| | \$ |
| Self-education expenses (maximum) | 80,000 |
| Home loan interest (maximum) | 100,000 |
| Elderly residential care expenses (maximum) | 80,000 |
| Contributions to recognised retirement schemes (maximum) | 17,500 |

Depreciation allowance rates

| | |
|------------------------|---------------|
| Initial allowance: | |
| Plant and machinery | 60% |
| Industrial buildings | 20% |
| Annual allowance: | |
| Computers | 30% |
| Motor cars | 30% |
| Furniture and fixtures | 20% |
| Machines | 10%–30% |
| Industrial buildings | 4% or formula |
| Commercial buildings | 4% or formula |

Section A – ALL 15 questions are compulsory and MUST be attempted

Please use the grid provided on page two of the Candidate Answer Booklet to record your answers to each multiple choice question. Do not write out the answers to the MCQs on the lined pages of the answer booklet. Each question is worth 2 marks.

1 Which of the following are NOT grounds for lodging a correction of error or omission claim (section 70A) under the Inland Revenue Ordinance?

- (1) An arithmetical error made by the assessor in calculating the assessable income
- (2) A wrong estimate of the assessable income made by the assessor in the absence of a return
- (3) An omission to claim a professional membership subscription in the tax return
- (4) An assessment made in accordance with a prevailing practice which has now changed

- A** 1, 2 and 3
- B** 2, 3 and 4
- C** 1 and 3 only
- D** 2 and 4 only

2 HKCo, a company carrying on a trading business in Hong Kong, purchased a trade mark registered in Hong Kong during the year of assessment 2012/13, at a cost of \$1,000,000. HKCo contracted a Mainland manufacturer to produce in the Mainland goods bearing the Hong Kong registered trade mark. The goods produced by the Mainland manufacturer were sold in Hong Kong by HKCo, and the profits derived from the sales were chargeable to tax in Hong Kong. The trade mark was sold in the year of assessment 2014/15 for \$500,000.

What is the amount of the allowable deduction or taxable trading receipt in respect of the trade mark that HKCo can claim or will be assessed for profits tax purposes in the year of assessment 2014/15?

- A** Allowable deduction of \$200,000 and taxable trading receipt of \$500,000
- B** Taxable trading receipt of \$500,000
- C** Allowable deduction of \$200,000
- D** Allowable deduction of \$100,000

3 Mr Cheung died in an accident on 15 June 2014. In his will, he appointed his mother as the executrix.

Who can elect personal assessment for Mr Cheung for the year of assessment 2014/15?

- (1) Mr Cheung's widow (wife)
- (2) Mr Cheung's mother
- (3) Mr Cheung's father

- A** 2 only
- B** 1 and 2 only
- C** 2 and 3 only
- D** 1, 2 and 3

4 In determining whether a person is liable to property tax, which of the following statements is correct?

- A** A sole proprietor can claim exemption from property tax
- B** A partnership can claim exemption from property tax
- C** A corporation can claim exemption from property tax
- D** An owner does not have to pay property tax if the rental is in arrears

5 Mr White, an American, signed a two-year employment contract with a company managed and controlled in Hong Kong. The contract was negotiated, concluded, and enforceable in the US. His annual salary of HK\$1 million was paid to him in US currency in the US. Under the contract, Mr White was required to station in China to supervise the Hong Kong company's joint venture there. During the years of assessment 2013/14 and 2014/15, Mr White stayed in Hong Kong for 25 days (for attending meetings) and 70 days (50 days for attending meetings and 20 days for holiday) respectively.

What is Mr White's assessable income for the years of assessment 2013/14 and 2014/15?

| | 2013/14 | 2014/15 |
|----------|----------|-------------|
| A | Nil | \$1 million |
| B | Nil | \$191,780 |
| C | Nil | Nil |
| D | \$68,493 | \$136,986 |

6 Which of the following are responsible for complying with the obligations imposed on a corporation under the Inland Revenue Ordinance?

- (1) The director of the corporation
- (2) The liquidator of the corporation
- (3) The secretary of the corporation
- (4) The chief accountant of the corporation

- A** 1 and 3 only
- B** 3 and 4 only
- C** 1, 2 and 3
- D** 1, 2 and 4

7 Fortune Ltd borrowed \$1 million from a bank to finance its business earning chargeable profits in Hong Kong. The loan was secured by an overseas fixed deposit of \$1 million and some shares which were worth \$500,000. In the year of assessment 2014/15 Fortune Ltd earned interest of \$30,000 from the overseas fixed deposit and paid \$50,000 interest on the bank loan.

What is the amount of allowable interest that Fortune Ltd can claim for profits tax purposes?

- A** \$20,000
- B** \$30,000
- C** \$35,000
- D** \$50,000

- 8** Clement is employed by a foreign company. His annual salary for the year of assessment 2014/15 was \$730,000. He was also provided with a flat in Hong Kong for the whole of the year of assessment for which he paid a monthly rent of \$1,000. During the year of assessment, Clement visited Hong Kong for 200 days.

What is Clement's assessable income for the year of assessment 2014/15?

- A** \$428,000
- B** \$438,800
- C** \$433,424
- D** \$791,000

- 9 Which of the following statements about tax avoidance is/are correct?**

- (1) Tax avoidance may be achieved by ensuring that a non-resident does not have a permanent establishment in Hong Kong
- (2) Tax avoidance may result in penalties being imposed
- (3) Tax avoidance may be challenged by anti-avoidance provisions
- (4) Tax avoidance is achieved when the payment of tax is postponed

- A** 3 only
- B** 1 and 2
- C** 3 and 4 only
- D** 1, 3 and 4

- 10 For personal assessment purposes, a temporary resident in the year of assessment 2014/15 is an individual who:**

- A** Ordinarily resides in Hong Kong during the year ended 31 March 2015
- B** Works in Hong Kong during the year ended 31 March 2015
- C** Stays in Hong Kong for more than 160 days during the year ended 31 March 2015
- D** Stays in Hong Kong for more than 300 days during the two years ended 31 March 2015

- 11** Mr Chan let out a flat in Causeway Bay for four years from 1 July 2013 for a premium of \$120,000 and a monthly rent of \$22,500. The tenant is required to pay the rates of \$3,000 per quarter and a monthly management fee of \$2,250 to the management company. In February 2015, the tenant forgot to turn off the water tap. The floor was flooded with water and the tenant paid the repair cost of \$60,000.

What is Mr Chan's property tax liability for the year of assessment 2014/15?

- A** \$44,400
- B** \$35,760
- C** \$36,000
- D** \$42,960

- 12** Tommy made a 15-day business trip to the UK, and extended his stay for a further five days to visit friends. His employer purchased a business class ticket for \$16,000 for Tommy, but he paid the airline company \$2,000 to exchange the ticket for two economy class tickets. Tommy's wife travelled with him on one of the economy class tickets, and shared the hotel room in London with him at no extra charge. His employer approved the arrangement and paid the hotel room charges totalling \$30,000 for the entire trip.

What is the amount of Tommy's taxable holiday journey benefits?

- A** \$7,500
- B** \$14,500
- C** \$22,000
- D** \$25,750

- 13** X Ltd paid the following sums for scientific research related to its business:

- (1) \$10,000 for the purchase of plant and machinery
- (2) \$20,000 for the extension of a building
- (3) \$30,000 for the purchase of rights in scientific research carried on by another company

What is the amount of the allowable deduction in respect of scientific research that X Ltd can claim for profits tax purposes?

- A** \$10,000
- B** \$30,000
- C** \$40,000
- D** \$60,000

- 14** Which of the following are conditions for the election for the joint assessment of a husband and wife?

- (1) The wife is not living apart from the husband
- (2) Either the husband or wife is entitled to concessionary deductions and personal allowances which, in aggregate, are in excess of his/her net assessable income
- (3) Both the husband and wife have a net chargeable income but the aggregate of their salaries tax calculated separately for the couple exceeds the aggregate tax under joint assessment
- (4) Both the husband and wife have assessable income

- A** 1 and 4 only
- B** 2 and 3 only
- C** 1, 3 and 4 only
- D** 1, 2, 3 and 4

- 15** Which of the following statements concerning a partnership business is correct?

- A** A partner who has elected for personal assessment is not liable to pay the tax of the partnership business
- B** Each partner will receive a separate notice of assessment in respect of his share of the partnership profits
- C** A single profits tax assessment will be raised in the name of the partnership
- D** The share of the loss of a partner can be transferred to the other partners

(30 marks)

Section B – ALL SIX questions are compulsory and MUST be attempted

Please write your answers to all parts of these questions on the lined pages within the Candidate Answer Booklet.

- 1** Merry Ltd carries on business in Hong Kong. Due to an unexpected delay, Merry Ltd's audited accounts were not issued in sufficient time to enable the company's profits tax return for the year of assessment 2014/15 to be filed before the required due date. As a result, Merry Ltd received an estimated assessment issued under s.59(3) Inland Revenue Ordinance showing estimated assessable profits of \$2,000,000 and tax payable of \$330,000. The date of issue of the estimated assessment was 20 November 2015. Based on Merry Ltd's draft audited accounts, the projected assessable profits for the year would be \$1,700,000 and the tax payable \$280,500.

Required:

- (a) Explain the conditions to be satisfied for Merry Ltd to lodge a valid objection against the 2014/15 estimated tax assessment. (4 marks)
- (b) Assuming Merry Ltd does lodge a valid objection against the estimated assessment, explain the company's obligation(s) with regard to the payment of tax, and what further action the company may take to suspend the payment of tax in dispute. (6 marks)

(10 marks)

- 2 John Ma, a Hong Kong resident, is unmarried, and works for a Hong Kong employer. During the year ended 31 March 2015, he had the following income and expenditure:

| | Note | \$ |
|--|------|---------|
| Salary | | 800,000 |
| Share of profit from a boutique business | (1) | 200,000 |
| Rent and deposit from Property A | (2) | 420,000 |
| Rent from Property B | (2) | 20,000 |
| Repayment of mortgage loan | (3) | 600,000 |
| Maintenance of mother | (4) | 102,000 |
| Contributions to mandatory provident fund (5% of salary) | | 40,000 |
| Donations | (5) | 15,000 |

Notes:

- (1) The boutique business is run in partnership with John's brother. The business incurred a tax loss of \$100,000 in 2013/14, out of which John's share is \$50,000. John did not elect for personal assessment in 2013/14.
- (2) Property A was rented to a tenant on 1 April 2014 for a term of two years at a monthly rent of \$30,000 payable in advance. A rental deposit of \$60,000 was also received, which would be refundable after offsetting any rental in arrears at the end of the lease. All the property expenses including rates and management fees are payable by the tenant.

Property B is an office and was rented to a relative of John for two months. The total rent received from the relative was \$20,000. No rental deposit was received. No rates have been paid for this property.

- (3) During the year, John repaid the following bank loans with interest:

Loan to acquire Property A – \$400,000 (including \$300,000 interest)

Loan to acquire Property B – nil

Loan to acquire Property C – \$200,000 (including \$120,000 interest)

Property C was acquired by John eight years ago, and is occupied by John as his residence. The loan was obtained from John's employer under a staff incentive scheme. The property was mortgaged to the employer to secure repayment of the loan. John's employer financed the loan with surplus cash from its business.

- (4) John's mother is aged 60 and is living in a government elderly home in Hong Kong. John is responsible for all the elderly home expenses of \$90,000 per year. Each month, John also pays his mother \$1,000.
- (5) During the year, John made the following donations to approved charitable institutions in Hong Kong:

Community Chest of Hong Kong – cash of \$10,000

Red Cross of Hong Kong – toys worth \$3,000

Standard Chartered Marathon – distilled water worth \$2,000

Required:

Assuming that John Ma has elected for personal assessment for the year of assessment 2014/15 only, compute his net chargeable income for 2014/15 under personal assessment.

Note: You are not required to compute the tax payable.

(10 marks)

3 Mr Ho bought a shop unit in Mongkok in April 2013. On 1 May 2013 the shop unit was let to X Ltd on the following terms:

- (1) Term of lease: Three years from 1 May 2013 plus a two-year renewal option.
- (2) Rent free period: 1 May 2013 to 30 June 2013.
- (3) Rent: \$75,000 per month payable in advance.
- (4) Rental deposit: \$150,000 payable on 1 May 2013. As per the lease agreement, the rental deposit is used to compensate any loss of revenue when the tenant defaults on the rent.
- (5) Initial premium: \$135,000.
- (6) Rates: \$12,150 per quarter, payable by the landlord.
- (7) Management fees: \$6,750 per month, payable by the tenant directly to the management company.

Starting from 1 November 2013, X Ltd failed to pay the rent to Mr Ho. It also failed to pay the management fees to the management company. On 31 May 2014, X Ltd moved out of the property and could no longer be contacted. Mr Ho was required to pay the overdue management fees of \$47,250 to the management company in respect of the period from October 2013 to April 2014; and agreed to settle the management fees on time for the subsequent months until further notice.

On 1 February 2015, Mr Ho let the shop again to Y Ltd on the following terms:

- (1) Term of lease: Two years from 1 February 2015.
- (2) Monthly rent: \$45,000 for the first year and \$52,500 for the second year, payable in advance.
- (3) Rental deposit: \$90,000. As per the lease agreement, the rental deposit is used to compensate any loss of revenue to the landlord when the tenant defaults on the rent.
- (4) Initial premium: \$360,000.
- (5) Rates: \$12,150 per quarter, payable by the tenant.
- (6) Management fees: \$7,200 per month, payable by the tenant directly to the management company.

In April 2015, X Ltd paid half of the overdue rent it owed to Mr Ho.

Required:

Prepare the property tax assessments (both original and revised, if applicable) for Mr Ho for each of the years of assessment 2013/14 and 2014/15.

Note: Ignore the rates concession.

(10 marks)

- 4 CC Ltd purchased a piece of land at Shatin and constructed a ten-storey office on the site. Construction began in May 1992 and was completed in January 1995. The office building construction account showed the following costs:

| | \$ |
|---|--------------------|
| Land purchase cost | 45,500,000 |
| Cost of levelling the land | 4,000,000 |
| Foundation cost | 3,000,000 |
| Cost of site investigation | 2,600,000 |
| Cost to lay drains, water mains, etc. | 2,400,000 |
| Architectural fee | 5,000,000 |
| Cost of the lift including installation | 1,500,000 |
| Construction cost | 50,000,000 |
| Total | <u>114,000,000</u> |

On completion of the construction the offices were immediately leased out for rental. CC Ltd has claimed depreciation allowance in respect of the property in each year of assessment since 1995/96.

During the year ended 31 December 2014, CC Ltd sold the property for \$150 million, of which \$90 million was attributable to the land portion.

Required:

- (a) **Compute the qualifying expenditure of the property for commercial building allowance purposes.** (3 marks)
- (b) **Prepare a commercial building allowance table for CC Ltd for the years of assessment 1995/96 to 2014/15 inclusive, which shows:**
- **the qualifying expenditure and/or deemed qualifying expenditure (where applicable),**
 - **the annual allowance for each year, and**
 - **the balancing allowance or charge in the year of disposal.**

Note: The annual allowance rate prior to the year of assessment 1998/99 was 2%. (7 marks)

(10 marks)

- 5 Simon Smith, a US resident, is working as a marketing manager for a US company (USCo). From 1 April 2014, he started to travel around the region visiting USCo's operations and meeting clients. During the year ended 31 March 2015, Simon spent a total of 230 days in Hong Kong as follows:

| | | |
|------------------------------------|------------|----------------------------------|
| 7 April 2014 to 1 May 2014 | 25 | |
| 12 June 2014 to 9 September 2014 | 90 | (including 20 days annual leave) |
| 14 October 2014 to 5 February 2015 | 115 | |
| | <u>230</u> | |

All his remuneration is paid into Simon's bank account in the US. For the year ended 31 March 2015, Simon had the following income and expenditure:

- (1) A monthly salary of \$96,000.
- (2) An annual entertainment allowance of \$48,000, of which only \$40,000 was actually expended.
- (3) Simon was provided with a hotel serviced apartment in Hong Kong with a a monthly rental of \$12,000. The total annual charges for this serviced apartment of \$144,000 were paid directly to the hotel company by USCo; and 5% of the total charges was deducted from Simon's salary.
- (4) Received a reimbursement of medical expenses in the sum of \$45,000 from a medical insurance scheme. USCo is contracted to pay an annual premium of \$6,000 to the scheme for each of its staff.
- (5) During the year, USCo paid \$45,000 to a travel company to purchase a package tour to Canada to be taken by Simon for holiday purposes. The package tour could be transferred to another person for \$40,000. USCo also paid \$1,000 to take out a travel insurance policy for Simon.
- (6) USCo provided Simon with a company car for his use. The market value of the car was \$280,000 and the second hand value as at 31 March 2015 was \$210,000. USCo also provided Simon with a corporate credit card which he used to pay for his petrol costs of \$3,000 per month. The credit card balance was settled in full by USCo. It has been agreed with the assessor that 75% of the usage of the car was for USCo's business.
- (7) For business purposes, Simon joined the International Golf Club for an annual membership fee of \$35,000. USCo agreed to reimburse half of the annual membership fee. Simon also paid an annual membership fee of \$2,600 to The Chartered Association of Marketing.
- (8) During the year, Simon enrolled onto a Putonghua course offered by a local university and paid a tuition fee of \$15,000. The enrolment was fully supported by USCo, as it plans to expand its business in China. USCo reimbursed Simon half of the tuition fee.
- (9) On 1 April 2013, Simon was granted 5,000 shares by USCo subject to a vesting period. The shares vested in him on 30 September 2014. The market value of the shares on 1 April 2013 and 30 September 2014 was \$55,000 and \$66,000 respectively.
- (10) On 1 October 2014, Simon was given an option to purchase 100,000 shares in Diamond Inc, a subsidiary of USCo which is listed on the New York Stock Exchange, at a price equivalent to \$15 per share. Simon paid \$2,000 for this option. The market price of Diamond Inc shares on 1 October 2014 was \$16 per share. Simon exercised the option to purchase 50,000 of the shares on 30 November 2014 when the market price of the shares was \$18 per share.

Required:

Calculate Simon Smith's net assessable income, if any, for the year of assessment 2014/15.

Note: You are not required to calculate the tax payable.

(15 marks)

- 6 Moonshadow Ltd (Moonshadow) is a company incorporated in Hong Kong and carrying on a business in Hong Kong. For the year ended 31 December 2014, Moonshadow has the following trading results:

| Income | Note | \$ | \$ |
|---|------|-----------|------------------|
| Property rental income | (1) | 120,000 | |
| Profit from the sale of property | (2) | 3,500,000 | |
| Securities trading | (3) | (80,000) | |
| Interest income | (4) | 8,000 | 3,548,000 |
| Expenses | | | |
| Directors' fees | | 623,000 | |
| Staff costs | | 2,000,000 | |
| Office rent and rates | | 600,000 | |
| Depreciation | (5) | 214,000 | |
| Audit and tax filing fees | | 40,000 | |
| Interest expenses | (6) | 11,000 | |
| Miscellaneous expenses (all deductible) | | 60,000 | |
| Donations | (7) | 400,000 | (3,948,000) |
| Loss for the year | | | <u>(400,000)</u> |

Notes:

- (1) Moonshadow owned a property which was leased out to a member of staff at a rent, until July 2014 when the property was sold (see (2) below). The total rental received from January to June 2014 was \$120,000. Rates were not paid by the company. The rental income has been reported for property tax purposes, and property tax of \$14,400 was paid during the year.
- (2) The property was sold in July 2014 for \$14,000,000. The original cost of the property was \$12,000,000. The net book value of the property before disposal was \$10,500,000, resulting in a book profit of \$3,500,000. The reason for the sale was the land redevelopment proposed by the government, and not profit-making. The disposal of the property resulted in a balancing charge of \$4,000,000.
- (3) Moonshadow is involved in the trading of listed securities in Hong Kong and China. Investment returns earned during the year comprise:

| | \$ |
|---|-----------------|
| Profit from securities traded on the Hong Kong Stock Exchange | 200,000 |
| Loss from securities traded on the China Stock Exchange | (300,000) |
| Dividends from securities listed in Hong Kong | 8,000 |
| Dividends from securities listed in China | 12,000 |
| Total per accounts | <u>(80,000)</u> |

- (4) Interest income comprises:

| | \$ |
|---|--------------|
| Interest on HK\$ deposit with a bank in Hong Kong | 5,000 |
| Interest on RMB deposit with a bank in China | 3,000 |
| Total per accounts | <u>8,000</u> |

- (5) Moonshadow had the following fixed assets and their movements during the year were:

Land and building: The leased property purchased ten years ago, was sold in July 2014.
 Furniture/fixture: Addition of furniture costing \$10,000; no disposals.
 Computer: Addition of computer costing \$30,000 under hire purchase; no disposals. The hire purchase terms provide for a down payment of \$6,000, which was paid in September 2014, followed by six monthly instalments of \$5,000 each, starting from 1 October 2014.

(6) Interest expenses comprise:

| | \$ |
|---|--------|
| Hire purchase finance charge on computer | 3,000 |
| Interest on a loan from the company's director to finance the company's operation | 6,000 |
| Interest on bank overdraft | 2,000 |
| | <hr/> |
| Total per accounts | 11,000 |

The bank overdraft facility was secured by the personal guarantee of the company's director.

(7) Moonshadow made donations of \$400,000 to the Community Chest of Hong Kong.

(8) As per Moonshadow's profits tax return for 2013/14, the tax written down values brought forward for the respective plant and machinery pools are:

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

Required:

Prepare Moonshadow Ltd's profits tax computation for the year of assessment 2014/15, showing the net assessable profit/adjusted loss and the net profits tax payable, if any. Clearly identify the basis period and show full details of the depreciation allowance calculations.

Note: No detailed explanations are required.

(15 marks)

End of Question Paper