

Fundamentals Level – Skills Module

Taxation (Hong Kong)

Tuesday 2 December 2014



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)

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.
4. Ignore provisional tax and statutory tax reductions, unless specified otherwise.

TAX RATES AND ALLOWANCES

The following 2013/14 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	19,000/38,000
– additional	19,000/38,000
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)	76,000
Mandatory provident fund contributions (maximum)	15,000

Depreciation allowance rates

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

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Question 1 begins on page 4.**

ALL FIVE questions are compulsory and MUST be attempted

1 David Brown, an American citizen, is employed by Sun Corporation (Sun), a large multinational corporation based in the United States (US). According to his employment contract, which is enforceable in the US, David's duties are performed exclusively to oversee and supervise operations of Sun's various affiliated companies in the Far East region. David's salary is paid in US dollars into his bank account in the US. However, for convenience purposes, most of his work is performed in Hong Kong. David's travelling schedule for the year ended 31 March 2014 was as follows:

Hong Kong	210 days
China	90 days
Other Asian countries	30 days
USA	35 days (including 15 days annual leave)
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	365 days

In relation to the year ended 31 March 2014, David had the following income and expenditure (all amounts are denominated in Hong Kong dollars):

- (1) Annual salary of \$2,000,000.
- (2) A home-leave travelling allowance of \$80,000, of which \$55,000 was actually expended for air tickets for home-leave purposes.
- (3) An entertainment allowance of \$120,000.
- (4) Sun provided David with a car and a driver. The car was leased from a car agency in the name of Sun, at a monthly rental of \$6,000. The driver was hired at \$10,000 per month by Sun. The total petrol and maintenance costs for the car for the year were \$50,000, all of which were paid by David and reimbursed by Sun. David estimated that about 20% of the usage of the car did not relate to Sun's business.
- (5) David lived in a hotel room during his stays in Hong Kong until 31 December 2013. Total hotel charges of \$180,000 were paid by Sun. It was agreed that 5% of the hotel charges would be deducted from David's salary.
- (6) On 1 January 2014, David acquired a flat in Hong Kong as his residence at the price of \$8 million, and mortgaged it to a bank for \$6 million at a market interest rate. Sun agreed to subsidise any interest charged by the bank in excess of 2% per annum by paying the difference into David's bank account each month. During the period from 1 January to 31 March 2014, David paid a total interest of \$45,000 to the bank, and received a total subsidy of \$15,000 from Sun.
- (7) After David moved into the flat on 1 January 2014, Sun employed a Philipino domestic helper for him at a cost of \$4,000 per month, and refunded his utilities bills, which totalled \$6,000 for the three months ended 31 March 2014. Because of the Labour Department requirements, the contract with the domestic helper was signed by David.
- (8) Sun operates a medical insurance scheme for all its employees through an insurance company, to which it pays an annual premium of \$4,000 per employee. In June 2013, David became seriously ill and was hospitalised for three weeks. As David preferred a more comfortable environment so that he could carry out part of his employment duties whilst in hospital, he paid an extra \$60,000 for a private room. The basic hospital fees and public ward fees of \$25,000 were reimbursed by the insurance company and half of the extra fees for the private room were reimbursed by Sun.
- (9) David is entitled to a discretionary bonus, which is normally one month's salary plus a top-up which is determined based on Sun's profitability during the captioned year. During the year, David was paid the following amounts:
 - (i) \$30,000 paid in April 2013, being the top-up payment for the 2012/13 bonus;
 - (ii) \$100,000 paid in December 2013, being the one-month's salary bonus for 2013/14. Consistent with prior years, David authorised Sun to donate half of this amount to the Red Cross.

(10) On 1 May 2012, David was granted 10,000 shares in Sun subject to a vesting period. The shares would only become vested on condition that he remained an employee of Sun on the vesting dates. 5,000 shares were vested in him on 1 May 2013. During the year ended 31 March 2013, David was in Hong Kong for 200 days. The fair market values per share were as follows:

1 May 2012	\$10
1 May 2013	\$12

(11) On 1 February 2014, David was granted an option to acquire 60,000 shares in Star Ltd, a Hong Kong subsidiary of Sun, at \$5 each. He paid \$6,000 for this option. On 1 March 2014, he sold the option in respect of 20,000 shares for \$45,000; and exercised the option to take up 30,000 shares. The 30,000 shares were all sold on 25 March 2014. The fair market values per share were as follows:

1 February 2014	\$8
1 March 2014	\$9
25 March 2014	\$10
31 March 2014	\$11

(12) Upon recommendation of a director, David successfully joined the Hong Kong Jockey Club with effect from 1 April 2013. He paid an annual subscription of \$40,000 and was reimbursed half of this amount by Sun. David often met with the Sun directors and with clients in the Club.

(13) During the year, Sun received and paid the following tax bills in respect of David:

(i) Hong Kong salaries tax	\$140,000
(ii) PRC individual income tax	\$10,000
(iii) Other Asian countries' income tax	\$5,000

(14) David contributed a total of \$15,000 to the Mandatory Provident Fund.

(15) David is single and does not have any relatives living in Hong Kong.

Required:

Calculate the Hong Kong salaries tax payable by David Brown for the year of assessment 2013/14.

(25 marks)

- 2 Success Ltd (SL), a Hong Kong incorporated company, carries on business in Hong Kong in the buying and selling of toy products. SL imports products from its parent company in the United States (US), and sells the products to customers in Hong Kong. For the year ended 31 December 2013, SL had the following trading results:

	Note	\$	\$
Turnover	(1)		7,800,000
Cost of goods sold	(1)		<u>(6,500,000)</u>
Gross profit			1,300,000
Profit from the disposal of Property A	(2)	1,500,000	
Rental income	(2)	360,000	
Interest income	(3)	35,000	
Profit from the disposal of fixed assets	(9)	5,000	1,900,000
			<u>3,200,000</u>
Directors' remuneration	(4)	1,200,000	
Staff costs	(5)	1,300,000	
Office rent, rates and utilities	(6)	410,000	
Legal and professional fees	(7)	210,000	
Interest expenses	(8)	135,000	
Depreciation	(9)	548,000	
Donations	(10)	50,000	
Office consumables (all deductible)		9,000	<u>(3,862,000)</u>
Loss for the year			<u><u>(662,000)</u></u>

Notes:

- (1) Details of turnover and cost of goods sold are:

	\$
Gross sales to regular customers in Hong Kong	5,300,000
Special discounted sales to tourists from China	3,300,000
Less: Sales commission	<u>(800,000)</u>
Turnover	7,800,000
Cost of goods sold (all purchased from US parent)	<u>(6,500,000)</u>
Gross profit	<u><u>1,300,000</u></u>

- (2) SL owned three properties during the year as follows:

	Cost \$	Usage
Property A	20,000,000	For letting until 30 June 2013
Property B	10,000,000	As accommodation for the company's director
Property C	5,000,000	As the company's office

Property A was acquired in 2003 and had been let out for rental since then at a monthly rent of \$60,000. After the lease expired on 30 June 2013, the tenant moved out and the property was disposed of by SL at a book profit of \$1,500,000 (see notes 9 and 11).

- (3) Interest income comprises:

	\$
Interest on a HK\$ deposit with a bank in Hong Kong	9,000
Interest on a HK\$ loan made to an individual director (the loan amount was remitted to the director's bank account in Singapore)	<u>26,000</u>
Total per accounts	<u><u>35,000</u></u>

(4) Directors' remuneration comprises:

	\$
Directors' fees	1,010,000
Wages for a director's family helper	190,000
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Total per accounts	1,200,000
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(5) Staff costs comprise:

	\$
Salaries and allowances	680,000
Regular contribution to a registered pension fund	24,000
Special contribution to a registered pension fund as required by an actuary	170,000
Redundancy payments to staff laid off due to ceasing a product	426,000
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Total per accounts	1,300,000
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(6) Office rent, rates and utilities comprise:

	\$
Government rates and rent for Property A (for letting)	100,000
Government rates and rent for Property B (as a director's accommodation)	120,000
Government rates and rent for Property C (as the company's office)	112,000
Utilities for the office	78,000
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Total per accounts	410,000
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(7) Legal and professional fees comprise:

	\$
Audit and tax filing fees	70,000
Legal fee for acquiring Trademark 'XYZ' (see note 9)	140,000
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Total per accounts	210,000
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(8) Interest expenses comprise:

	\$
Interest on a bank loan, secured by a personal guarantee from the company's director; the loan money was used to acquire Property A (see notes 2 and 9)	50,000
Interest on an unsecured loan from an individual Hong Kong shareholder; the loan money was used to acquire Property C (see note 2)	51,000
Interest on overdue trade accounts payable due to the US parent	19,000
Interest on a bank overdraft, secured by Property C; the loan money was used for the company's daily operations	13,000
Finance charge on the acquisition of a computer system bought under hire purchase (see note 9)	2,000
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Total per accounts	135,000
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(9) Details of the company's fixed assets are as follows:

	Trademark \$	Furniture/ fixtures \$	Motor vehicles \$	Land/ buildings \$
Cost at 1 January 2013	–	235,000	320,000	35,000,000
Additions ((i), (ii) and (iii))	1,000,000	55,000	–	300,000
Disposals (iv)	–	(45,000)	(140,000)	(20,000,000)
Balance at 31 December 2013	<u>1,000,000</u>	<u>245,000</u>	<u>180,000</u>	<u>15,300,000</u>
Depreciation at 1 January 2013	–	145,000	164,000	5,500,000
Charge for the year	–	20,000	28,000	500,000
Disposals	–	(45,000)	(120,000)	(200,000)
Balance at 31 December 2013	<u>–</u>	<u>120,000</u>	<u>72,000</u>	<u>5,800,000</u>
Net book value at 31 December 2013	<u>1,000,000</u>	<u>125,000</u>	<u>108,000</u>	<u>9,500,000</u>
Proceeds from disposal		25,000	–	21,300,000
Net book value of disposal		–	(20,000)	(19,800,000)
Profit/(loss) on disposal		<u>25,000</u>	<u>(20,000)</u>	<u>1,500,000</u>

- (i) Addition to the trademark relates to Trademark 'XYZ' acquired from the US parent for use in SL's business. The trademark is duly registered in Hong Kong. No depreciation charge is provided.
- (ii) Addition to furniture/fixtures represents a new computer system acquired at a cost of \$55,000 under hire purchase (comprising \$30,000 for hardware and \$25,000 for software). A down payment of \$10,000 was paid at the time of purchase and the balance was payable by five monthly instalments of \$10,000 each, starting from 1 November 2013.
- (iii) Addition to land/buildings of \$300,000 relates to the installation of environmental-friendly lighting to Property C which the company uses as its office.
- (iv) Disposal of furniture/fixtures of \$45,000 relates to two photocopying machines which were out of order.
- (v) Disposal of motor vehicle of \$140,000 relates to a company car destroyed in an accident in October 2013.
- (vi) Disposal of land/buildings relates to the disposal of Property A in August 2013 (see note 2). It has been agreed with the Inland Revenue Department that 50% of the total consideration of \$21,300,000 is attributable to the building portion.

The tax written down values brought forward in respect of SL's plant and machinery pools are:

- 10% – nil
- 20% – \$200,000
- 30% – \$100,000

The qualifying costs and written down values brought forward for commercial building allowance are:

	Qualifying cost \$	Written down value \$
Property A	10,000,000	6,000,000
Property B	5,000,000	4,000,000
Property C	2,000,000	1,600,000

(10) SL made the following donations during the year:

	\$
The Community Chest	40,000 (in cash)
Red Cross	10,000 (sponsoring toy products for Christmas)
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Total per accounts	50,000
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(11) Provisional property tax of \$86,400 for the year of assessment 2013/14 has been paid in respect of Property A.

(12) SL has been filing its Hong Kong profits tax returns on the basis that all of its income is subject to Hong Kong profits tax.

Required:

(a) Prepare Success Ltd's profits tax computation for the year ended 31 December 2013, showing the net assessable profits/adjusted loss and profits tax payable, if any. Clearly identify both the year of assessment and the basis period and show full details of the depreciation allowance calculations.

Note: No detailed explanations are required in this part. (25 marks)

(b) Explain the tax treatment you have accorded to the following loan interest expenses (as included in note (8)):

(i) Interest on the bank loan, secured by the personal guarantee from the company's director, used to acquire Property A for rental purposes. (3 marks)

(ii) Interest on the unsecured loan from an individual Hong Kong shareholder used to acquire Property C for the company's own use. (2 marks)

(30 marks)

3 In August 2013, Mr Tan acquired an office located in Sheung Wan and leased it to Tenant Ltd. The following information is provided in respect of the property lease transactions:

- (1) Term of lease: two years from 1 September 2013.
- (2) Rental: \$96,000 per quarter (inclusive of a management fee of \$2,000 per month), payable in advance.
- (3) Initial premium: \$30,000, payable on signing the lease agreement.
- (4) Rental deposit: \$60,000, payable on signing the lease agreement. As per the lease agreement, the rental deposit is to be used to compensate any loss of revenue when the tenant defaults in payment of the rent.
- (5) Rates: \$3,000 (net of rates concession) per quarter, payable by Mr Tan to the government.
- (6) Management fee: \$2,000 per month, payable by Mr Tan to the management company.
- (7) Property agency fee: \$15,000.
- (8) Mortgage interest: \$16,000 per month, incurred by Mr Tan on a loan obtained from a local bank to acquire the property.
- (9) Renovation: \$130,000, paid by Mr Tan to a decoration company.
- (10) Repair to keylock: \$500 incurred by Tenant Ltd on 1 February 2014.

From 1 March 2014 onwards, Mr Tan has not received any rental payments from Tenant Ltd. On 1 June 2014, Mr Tan was advised by the management company that Tenant Ltd had moved out without leaving any contact details. Since then, the property has been left vacant.

On 1 October 2014, Mr Tan received an estimated property tax assessment for the year of assessment 2013/14 (final) and 2014/15 (provisional). He found that the 2014/15 provisional tax was calculated based on a full-year's rental.

Required:

(a) Compute the property tax payable by Mr Tan for the year of assessment 2013/14.

Note: Provisional tax should be ignored in this part. (5 marks)

(b) Briefly explain the tax treatment of the irrecoverable rental due from Tenant Ltd. (3 marks)

(c) Advise Mr Tan on his rights as a taxpayer in respect of the provisional tax due for 2014/15. (4 marks)

(d) Assuming that the property is left vacant during the period from 1 June 2014 to 31 March 2015, compute the property tax payable by Mr Tan, if any, for the year of assessment 2014/15; and recompute the property tax payable for the year of assessment 2013/14, if it is advantageous for Mr Tan to do so.

Note: You may assume that the tax rates and allowances for the year of assessment 2013/14 will continue to apply in 2014/15. (6 marks)

(e) Advise how, if Mr Tan wishes to relet the property, he can renegotiate the terms of the lease in relation to the management fee in order to minimise his property tax liability. (2 marks)

(20 marks)

- 4 Perfect Ltd (Perfect) commenced business on 1 January 2014. Since its commencement, Perfect has not finalised any audited accounts, filed a profits tax return, nor exchanged any correspondence with the Inland Revenue Department. Management accounts have been prepared for the period 1 January 2014 to 30 September 2014, and these show a net profit of \$300,000.

Perfect has no preference as to its accounts closing date. The two alternative dates for closing its first set of accounts being considered are:

- (1) 30 September 2014; and
- (2) 31 January 2015.

Required:

- (a) **Determine the basis periods, where relevant, for the years of assessment 2013/14 and 2014/15 for Perfect Ltd, assuming that the company's first accounts are to be closed on (1) 30 September 2014, and (2) 31 January 2015.** (4 marks)
 - (b) **Advise on the compliance obligations of Perfect Ltd under the Inland Revenue Ordinance in respect of:**
 - (i) **The company's own liability to tax, including, where relevant, the due dates for compliance purposes, assuming that the company's first accounts are to be closed on (1) 30 September 2014, and (2) 31 January 2015.** (6 marks)
 - (ii) **A local member of staff who was dismissed with immediate effect, and paid one-month's salary in lieu of notice as required under his employment contract.** (2 marks)
 - (iii) **An expatriate member of staff who has resigned and decided to go back to his home country.** (3 marks)
- (15 marks)**

- 5 Under the Inland Revenue Ordinance, a taxpayer may be required to do a certain act, matter or thing, e.g. filing a tax return, furnishing information to the Inland Revenue Department or paying the assessed tax.

Required:

State who is answerable on behalf of the following categories of taxpayer, to perform such tasks under the Inland Revenue Ordinance:

- (a) **an incapacitated person;** (1 mark)
- (b) **a deceased person;** (1 mark)
- (c) **the joint owners and co-owners of property;** (1 mark)
- (d) **a corporation;** (1 mark)
- (e) **a body of persons;** (1 mark)
- (f) **a non-resident person; and** (2 marks)
- (g) **a partnership.** (3 marks)

(10 marks)

End of Question Paper