
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.

			<i>Marks</i>
1	David Brown		
	Salaries tax assessment		
	Year of assessment 2013/14		
	\$	\$	
Salary		2,000,000	0·5
Home-leave travelling allowance		80,000	0·5
Entertainment allowance		120,000	0·5
Reimbursement of petrol and maintenance costs (50,000 * 20%)		10,000	1
Private hospital room (60,000 * 1/2)		30,000	1
Bonus (30,000 + 100,000)		130,000	1
Share award (5,000 * 12)		60,000	1·5
Jockey Club annual subscription (40,000 * 1/2)		20,000	1
		<u>2,450,000</u>	
Time apportionment:			
HK: 210 days + (15 days * 210)/(365 – 15) days = 219 days			2
Taxable: 2,450,000 * 219/365		1,470,000	1
Hong Kong salaries tax paid by employer		<u>140,000</u>	0·5
		1,610,000	
Rental value (1,610,000 * 4% * 9/12)	48,300		1·5
Less: Rent suffered (180,000 * 5%)	<u>(9,000)</u>	39,300	1
Interest subsidy	15,000		0·5
Wages for maid (4,000 * 3)	12,000		1
Refund of utilities bill	6,000		0·5
Gain on share option			
– On sale (45,000 – 6,000 * 2/6)	43,000		1
– On exercise [30,000 * (9 – 5) – 6,000 * 3/6]	117,000		1
	<u>193,000</u>		
Apportioned on time basis (193,000 * 219/365)		<u>115,800</u>	1
Assessable income		1,765,100	
Less: Concessionary deductions			
Approved charitable donation (limited to 35% * 1,765,100)		(50,000)	0·5
Home loan interest		(45,000)	1
Contributions to mandatory provident fund (maximum)		<u>(15,000)</u>	0·5
		1,655,100	
Less: Part V allowances			
Personal allowance		<u>(120,000)</u>	0·5
Net chargeable income		<u>1,535,100</u>	
Salaries tax liability at progressive rates		<u>248,967</u>	0·5
Salaries tax liability at standard rate (\$1,655,100 * 15%)		<u>248,265</u>	0·5
Salaries tax payable		<u>248,265</u>	0·5
		<u>22</u>	

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

Taxable/non-deductible items	\$	Deductible/non-taxable items	\$	
Private hospital room	30,000	Car rental	72,000	
Annual subscription	20,000	Wages for driver	120,000	
		Hotel charges	180,000	
		Medical insurance premium	4,000	
		Reimbursement from insurance company	25,000	
		PRC individual income tax	10,000	
		Other income tax	5,000	
		0.5 mark each, maximum	3	
			25	

2 (a)

Success Ltd

Profits tax computation for the year of assessment 2013/14
Basis period: year ended 31 December 2013

	\$	\$	
Loss for the year		(662,000)	0.5
Add: Depreciation	548,000		0.5
Donation	50,000		0.5
Special contribution to pension fund (\$170,000 * 80%)	136,000		1
Legal fee for trademark acquisition	140,000		1
Interest expense to HK shareholder	51,000		1
Balancing charge on Property A	4,000,000	4,925,000	0.5
		4,263,000	
Less: Depreciation allowance for machinery and plant	93,260		0.5
Commercial building allowance	280,000		0.5
Profit from disposal of fixed assets	5,000		0.5
Profit from disposal of Property A	1,500,000		0.5
Interest income – HK\$ deposit	9,000		0.5
Interest income – loan to director in Singapore	26,000		0.5
Installation of environmental-friendly lighting (20% * \$300,000)	60,000	(1,973,260)	1
		2,289,740	
Less: Approved charitable donation (limited to 35% * 2,061,740)		(40,000)	1
Net assessable profits		2,249,740	
Profits tax at 16.5%		371,207	0.5
Less: Property tax paid (s.25 set off)		(86,400)	0.5
Profits tax payable		284,807	0.5

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

Taxable/non-deductible items	\$	Deductible/non-taxable items	\$	
Sales to China tourists	3,300,000	Helpers for director's family	190,000	
Trademark acquisition	1,000,000	Regular contribution to pension	24,000	
		Redundancy payment	426,000	
		Government rates/rent for Property A	100,000	
		Government rates/rent for Property B	120,000	
		Government rates/rent for Property C	112,000	
		Interest on bank loan for Property A	50,000	
		Interest on overdue trade accounts	19,000	
		Interest on bank overdraft	13,000	
		Finance charge on hire purchase	2,000	
		0.5 mark each, maximum	5	

Depreciation allowance schedule					Marks
	20%	30%	HP – 30%	Total allowance	
	\$	\$	\$	\$	
Written down value (WDV) brought forward	200,000	100,000			0.5
Additions			55,000		0.5
Initial allowance					
HP asset $(10,000 + 9,000 \times 2) \times 60\%$			(16,800)	16,800	1
Disposals	(25,000)	–	–		0.5
	175,000	100,000	38,200		
Annual allowance	(35,000)	(30,000)	(11,460)	76,460	1.5
WDV carried forward	140,000	70,000	26,740	93,260	
Commercial building allowance					
			Qualifying expenditure \$	Written down value \$	
Property A					
Balance from 2012/13			10,000,000	6,000,000	0.5
Less: Disposal proceeds (building portion)				(10,650,000)	1
Excess of proceeds over residual value				4,650,000	
Balancing charge restricted to CBA claimed				4,000,000	1
Property B					
Balance from 2012/13			5,000,000	4,000,000	
Commercial building allowance $(5,000,000 \times 4\%)$				(200,000)	0.5
WDV carried forward				3,800,000	
Property C					
Balance from 2012/13			2,000,000	1,600,000	
Commercial building allowance $(2,000,000 \times 4\%)$				(80,000)	0.5
WDV carried forward				1,520,000	
					25

(b) (i) Interest on the bank loan secured by the personal guarantee of a director

An interest expense is tax deductible if (1) the interest expense is incurred in the production of assessable profits [s.16(1)]; and (2) the interest expense satisfies any of the conditions stipulated under s.16(2). In any case, the amount to be deducted is subject to restriction or adjustment if either s.16(2A) (i.e. the 'secured loan' test) or s.16(2B) (i.e. the 'interest flow-back' test) is applicable.

In this case, the interest is paid to a bank on a loan obtained to finance the acquisition of Property A. The fact that the loan money is used to acquire a capital asset (Property A) does not render the interest expense to be capital expenditure and non-taxable. The company has been earning rental income from Property A and has included the rental in the company's assessable profits subject to profits tax. Therefore, s.16(1) is satisfied. Further, the interest is paid to a bank and thus s.16(2)(d) is satisfied. Moreover, the bank loan is secured by the personal guarantee from the company's director, not by any deposit or loan, and thus s.16(2A) does not apply. There is also no arrangement under which the interest would flow back to the company, and thus s.16(2B) also does not apply. As a result, the interest on the bank loan of \$50,000 is tax deductible.

3

(ii) Interest on the unsecured loan from an individual Hong Kong shareholder

The interest is paid on a loan obtained to finance the acquisition of Property C which is used by the company as its office. Although no rental income will be generated from the property, the fact that the property is used by the company as an office which provides the environment in which the company operates is sufficient to render the loan interest to be 'incurred in the production of assessable profits'. The general deduction rule under s.16(1) is satisfied. However, as the loan is borrowed from an individual Hong Kong shareholder, it is believed that the interest received by the shareholder would not be taxable in Hong Kong and thus the interest expense incurred by the company does not satisfy the condition under s.16(2)(c). As a result, the interest expense is not tax deductible.

2

30

3 (a)

Mr Tan

Property tax computation for the year of assessment 2013/14

	\$	
Rental (96,000 * 3)	288,000	1
Premium (30,000 * 7/24)	8,750	1
Repair to keylock	500	1
Assessable value	297,250	
Less: Rates (3,000/3 * 7)	(7,000)	1
	290,250	
Less: 20% statutory allowance	(58,050)	0.5
Net assessable value	232,200	
Property tax payable at 15%	34,830	0.5
		<u>5</u>

- (b) Any consideration which is proved to the satisfaction of the assessor to be irrecoverable in any year of assessment can be deducted in the calculation of the assessable value in that year of assessment [s.7C(1)]. The rent from 1 March 2014 to 31 May 2014 did not become bad for property tax purposes until 1 June 2014 when the tenant moved out without leaving any contact details. As 1 June 2014 falls into the year of assessment 2014/15, the bad debt of \$36,000 (rental of \$96,000 less the rental deposit of \$60,000) is therefore to be deducted against the assessable value in 2014/15. 1.5

If the assessable value in 2014/15 is insufficient to cover the bad debt, any excess will be carried back to be deducted from the assessable value of the property in the immediate preceding year, i.e. 2013/14 [s.7C(3)]. 1

Any recovery of amounts previously deducted as irrecoverable should be included as assessable value in the year of recovery [s.7C(2)]. 0.5
3

- (c) Under the Hong Kong property tax regime, provisional property tax for any year of assessment is calculated and payable on the net assessable value of the preceding year. However, if any of the following grounds is valid, the taxpayer can make a claim to hold over the whole or part of the provisional tax assessed [s.63O(2)]:

- (1) the assessable value for the provisional tax year is or is likely to be less than 90% of the assessable value of the preceding year;
- (2) the owner has ceased, or will cease to own the property and the assessable value is or is likely to be less than the sum on which the charge has been made;
- (3) the owner has elected for personal assessment which is likely to reduce the liability to tax;
- (4) a valid objection has been lodged against the preceding year's assessment. 2

In Mr Tan's case, he can make a claim in writing to hold over the provisional tax based on ground (1) above. 1

The claim should reach the IRD not later than 28 days before the payment due date or 14 days after the date of the notice of assessment, whichever is later [s.63O(1)]. 1
4

		Marks
(d)	Property tax computation for the year of assessment 2014/15	
	\$	
Premium (30,000 * 17/24)	21,250	1
Less: Bad debts	(36,000)	1
Bad debts carried back to 2013/14	(14,750)	0.5
Property tax payable	Nil	0.5
	Revised property tax computation for the year of assessment 2013/14	
	\$	
Assessable value (from (a))	297,250	0.5
Less: Bad debts carried back	(14,750)	0.5
Rates (3,000/3 * 7)	(7,000)	0.5
	275,500	
Less: 20% statutory allowance	(55,100)	0.5
Net assessable value	220,400	
Property tax at 15%	33,060	0.5
Less: Property tax paid (from (a))	(34,830)	0.5
Property tax repayable	(1,770)	6
<p>Tutorial note: The balance of the untaxed premium is brought into assessment in the year of assessment 2014/15, which is the year the lease is terminated and therefore the last year of assessment for this lease.</p>		
(e)	The rental should not be inclusive of the management fee. The tenant should be responsible for paying the management fee direct to the management company. In this circumstance, the management fee will not form part of Mr Tan's income.	2
		<u>20</u>

4 Perfect Ltd

- (a) If Perfect Ltd closes its accounts on 30 September 2014, the basis periods for the relevant years of assessments will be:
- | | | |
|--|-------------------------------------|---|
| (1) Year of assessment 2013/14 (year of commencement): | Nil | 1 |
| (2) Year of assessment 2014/15: | 1 January 2014 to 30 September 2014 | 1 |
- If Perfect Ltd closes its accounts on 31 January 2015, the basis periods for the relevant years of assessments will be:
- | | | |
|--|------------------------------------|----------|
| (1) Year of assessment 2013/14 (year of commencement): | 1 January 2014 to 31 January 2014 | 1 |
| (2) Year of assessment 2014/15: | 1 February 2014 to 31 January 2015 | 1 |
| | | <u>4</u> |
- (b) (i) Since Perfect Ltd is chargeable to tax in Hong Kong, it has to notify the Inland Revenue Department (IRD) of its chargeability to tax within four months after the end of the basis period for the relevant year of assessment, unless it has been required to file a tax return by the IRD [s.51(2)]. 0.5
- If the first accounts are closed on 30 September 2014, as stated in (a) the first relevant year of assessment would be 2014/15. The basis period for this year of assessment is 1 January 2014 to 30 September 2014. Four months from the end of the basis period would be 31 January 2015. Therefore, the company will have to notify the IRD of its chargeability to tax on or before 31 January 2015, unless a tax return has been issued to the company before that date. 1
- If the first accounts are closed on 31 January 2015, as stated in (a) the first relevant year of assessment would be 2013/14. The basis period for this year of assessment is 1 January 2014 to 31 January 2014. The due date for notifying chargeability would therefore be 31 May 2014, i.e. four months from 31 January 2014, if the company earns chargeable income for the month of January 2014. It is obvious that this deadline has been missed without giving proper notification. This failure to notify may cause a penalty to be levied on the company. 1

However, if the company did not earn any chargeable income for the month of January 2014 but only for the year ended 31 January 2015, the due date to notify chargeability would be 31 May 2015, i.e. four months from 31 January 2015.

0.5

If a profits tax return is issued by the IRD, the company is obliged to complete and submit the return within the period stipulated, together with the audited accounts and profits tax computation [s.51(1)]. Normally, one month is allowed for filing purposes but in practice, an extension would be given upon application depending on the situation.

1

Perfect Ltd is also required to:

- (1) answer any queries raised by the IRD or supply any information as requested by the IRD within the specified time period [s.51(4)(a)];
- (2) maintain proper business records in respect of transactions conducted for a period of seven years [s.51C];
- (3) inform the Commissioner in writing of the particulars of any change in its address within one month [s.51(8)]; and
- (4) pay the tax due on receipt of a notice of profits tax assessment and demand for tax issued by the IRD on or before the due date, unless the tax has been held over by the IRD on objection or application for provisional tax holdover.

0.5

0.5

0.5

0.5

6

- (ii) Perfect Ltd is required to file a Notification By Employer Of Employee About To Cease To Be Employed (Form IR56F) one month before the date of cessation of employment. However, given that the member of staff was dismissed with immediate effect, the one-month notice period as required under the Inland Revenue Ordinance (IRO) cannot be fulfilled. Generally, the IRD would agree to a shorter notice period under this situation. The company has to report the one-month payment in lieu of notice in the employer's return on the basis that it is a remuneration for service and taxable.

2

- (iii) Perfect Ltd is required to file a Notification By Employer Of Employee About To Depart From Hong Kong (Form IR56G). This notification has the same effect as Form IR56F and should be submitted one month before the expected date of departure. Where circumstances require, the IRD may accept a shorter notice period provided there are reasonable grounds.

1

Perfect Ltd should also withhold any money payable to the departing member of staff effective from the date of filing the Form IR56G, for a period of one month. This retained money, e.g. the last month's salary or provident fund, may be released to the employee when the company receives a letter from the IRD indicating that the departing employee has already cleared his tax liabilities and thus the company may then release any money withheld.

2

3

15

- 5 The persons responsible under the Inland Revenue Ordinance (IRO) on behalf of the following categories of taxpayer are:

(a) An incapacitated person

The trustee of such an incapacitated person [s.53] being any trustee, guardian, curator, manager, or other person having the direction, control, or management of any property on behalf of any person, but does not include an executor [s.2].

1

Tutorial note: *Incapacitated person means any minor, lunatic, idiot, or person of unsound mind [s.2].*

(b) A deceased person

The executor of the deceased person [s.54].

1

Tutorial note: *The executor of a deceased person shall be chargeable with the tax for all periods prior to the date of such person's death with which the said person would be chargeable if he were alive. However, the liabilities of an executor are subject to the following limitations:*

- (i) *No proceedings, other than an assessment to additional tax under s.82A, shall be instituted against the executor under the IRO in respect of any act or default of the deceased person [s.54 proviso (a)].*
- (ii) *No assessment or additional assessment, other than an assessment to additional tax under s.82A, in respect of a period prior to the date of such person's death shall be made after the expiry of the three years immediately after that year of assessment [s.54 proviso (c)].*

(c) The joint owners and co-owners of property

Any of the joint owners or owners in common appearing from any deed, conveyance, judgement or other instrument in writing registered in the Land Registry to be such an owner [s.56A].

1

(d) A corporation

The secretary, manager, any director or the liquidator of the corporation [s.57(1)].

1

Tutorial note: *If no secretary, manager, director or liquidator of a corporation is ordinarily resident in Hong Kong, the corporation shall inform the Commissioner, and keep him so informed at all times, of the name and address of an individual ordinarily resident in Hong Kong who shall be answerable for doing all such acts, matters and things as required to be done by such corporation [s.57(2)].*

(e) A body of persons

The principal officer of such a body of persons [s.57(1)].

1

Tutorial note: *If no principal officer of a body of persons is ordinarily resident in Hong Kong, the body of persons shall inform the Commissioner, and keep him so informed at all times, of the name and address of an individual ordinarily resident in Hong Kong who shall be answerable for doing all such acts, matters and things as required to be done by such body of persons [s.57(2)].*

(f) A non-resident person

The trustee or the agent of such a non-resident person [s.53]; the agent, attorney, factor, receiver or manager of that person in Hong Kong and any person in Hong Kong through whom that person receives any profits or income arising in or derived from Hong Kong [s.20A]; and the resident person who pays or credits a non-resident sums chargeable under ss.15(1)(a), (b) or (ba) or sums which are derived from a performance given in Hong Kong by a non-resident entertainer or sportsman [s.20B(1)].

2

(g) A partnership

The precedent partner of a partnership [s.56(1)] being the partner who, of the active partners resident in Hong Kong:

- (1) is first named in the agreement of partnership; or
- (2) if there is no agreement, is specified by name or initials singly or with precedence to the other partners in the usual name of the partnership; or
- (3) is first named in any statutory statement of the names of the partners, e.g. in the Business Registration applications.

2

However, should a person be named in a notice under the IRO as the precedent partner of the partnership, he shall be deemed to be the precedent partner thereof unless he proves that he is not a partner in such partnership or that some other person resident in Hong Kong is the precedent partner [s.56(1) proviso].

1

3

10