

Fundamentals Level – Skills Module

Taxation (Hong Kong)

Tuesday 3 December 2013



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 (HKKG)

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 in the question.

TAX RATES AND ALLOWANCES

The following 2012/13 allowances, deductions and tax rates are to be used in answering the questions.

Allowances

	\$
Basic allowance	120,000
Married person's allowance	240,000
Single parent allowance	120,000
Child allowance – 1st to 9th child (each)	63,000
– additional allowance in the year of birth (each)	63,000
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)	60,000
Home loan interest (maximum)	100,000
Elderly residential care expenses (maximum)	76,000
Mandatory provident fund contributions (maximum)	14,500

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	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 Mr Mak is a Hong Kong resident and has been employed as the financial controller by Gold Ltd (Gold), a company incorporated and carrying on business in Hong Kong. On 31 March 2013, Gold without prior notice terminated Mr Mak's employment and paid him a termination payment of \$600,000, being 'in settlement of all or any claims you may have against the company'.

In relation to the year ended 31 March 2013, Mr Mak had the following income and expenditure:

- (1) A monthly salary of \$80,000.
- (2) An annual meal allowance of \$36,000, of which only \$30,000 was actually spent.
- (3) An annual entertainment allowance of \$60,000.
- (4) A reimbursement of medical expenses which cost \$35,000 from the Blue Cross Medicare Scheme. Gold was contracted to pay an annual premium of \$5,000 to the Scheme for each of its staff members.
- (5) During the year, Gold paid \$80,000 to a travel company to purchase a package tour to Canada to be taken by Mr Mak with his wife and two children for holiday purposes. The package tour could not be transferred to any other persons. Gold also paid \$2,000 to take out a family travel insurance policy for Mr Mak.
- (6) Gold provided Mr Mak with a company car for his use. The market value of the car was \$250,000 and the second-hand value as at 31 March 2013 was \$200,000. Gold also provided him with a corporate credit card which he used to pay for his petrol costs of \$2,000 per month. The credit card balance was settled by Gold. It was agreed with the assessor that about 80% of the usage of the car related to Gold's business.
- (7) For business purposes, Mr Mak joined the International Golf Club for an entrance fee of \$150,000 together with an annual membership fee of \$37,000. Gold agreed to reimburse half of the annual membership fee.
- (8) During the period from 1 April 2012 to 31 July 2012, Mr and Mrs Mak lived in a flat leased at a monthly rental of \$30,000, of which \$24,000 was reimbursed by Gold. With effect from 1 August 2012, Mr and Mrs Mak moved into a newly acquired property in North Point. The property was purchased in the name of Mr Mak for \$7 million, and was financed by a low interest rate mortgage loan offered by Gold. During the year, Mr Mak paid interest of \$140,000 to Gold. If a market interest rate had been charged by Gold, Mr Mak's interest cost would have been \$200,000.
- (9) From 1 August 2012 when Mr and Mrs Mak moved into their own property, Gold paid their electricity and water bills for them which totalled \$20,000. Also a domestic helper with a monthly wage of \$4,000 was employed by Gold and assigned to serve Mr Mak's family.
- (10) On 1 April 2011, Mr Mak was granted 5,000 shares by Gold subject to a vesting period. On 30 April 2013, the 5,000 shares vested on him. The market value of the 5,000 shares was \$48,000 on 31 March 2013 and \$50,000 on 30 April 2013.
- (11) Mr Mak paid the following membership fees:

The Association of Chartered Certified Accountants	\$2,500 p.a.
The International Golf Club (as in (7) above)	\$37,000 p.a.
- (12) In order to keep his knowledge up-to-date, Mr Mak enrolled for an evening course in Chinese Accounting with The Hong Kong Polytechnic University and paid a tuition fee of \$35,000. The enrolment was fully supported by Gold, which planned to expand its business in Mainland China. Gold reimbursed Mr Mak half of the tuition fee.
- (13) Mr Mak contributed \$18,000 to the mandatory provident fund in the year 2012/13.

Apart from the above, the following additional information is available:

- (14) Mrs Mak is a housewife.
- (15) Mr and Mrs Mak have two children. The eldest child is 19, studying part-time in the UK; the second child was born on 4 December 1998.
- (16) Mrs Mak's mother, aged 65, lives in Wanchai and Mrs Mak wholly supports her.

- (17) Mr Mak's father, aged 55, lives in a nursing home. He was declared disabled by the Tung Wah Hospital during the year ended 31 March 2013. He submitted an application for the Government's Disability Allowance and approval was received in May 2013. Mr Mak paid all the nursing home bills amounting to \$120,000 for the year.
- (18) During the year, Mr and Mrs Mak made various charitable donations with an aggregate amount of \$80,000 to The Community Chest of Hong Kong.

Required:

- (a) **Explain whether, and if so to what extent, the termination payment received by Mr Mak will be chargeable to salaries tax.** (3 marks)
- (b) **Assuming that the termination payment is not chargeable, compute the salaries tax liability of Mr Mak, if any, for the year of assessment 2012/13.** (15 marks)
- (c) **Briefly explain the tax treatments you have accorded to items (4) to (10).** (7 marks)

(25 marks)

- 2 Mr Chen, a resident of Mainland China, wholly owns a limited company carrying on business in Hong Kong, CC Ltd (the Company). The Company purchases second-hand leather products in Hong Kong and sells these products to individual customers in Mainland China. The Company's statement of profit or loss for the year ended 31 March 2013 is shown below:

	Notes	\$	\$
Sales income			2,900,000
Cost of goods sold			(1,200,000)
			<u>1,700,000</u>
Gain from trading in Hong Kong listed shares		400,000	
Loss from trading in China listed shares		(30,000)	
Dividends from Hong Kong listed shares		3,400	
Dividends from China listed shares		1,600	
Gain from buying and selling foreign currencies		150,000	
Exchange gain (unrealised) from the year-end conversion of foreign currency deposits		22,000	
Interest income	(1)	14,000	
Rental income	(2)	120,000	681,000
			<u>2,381,000</u>
Salaries and wages	(3)	600,000	
Rent and rates	(4)	150,000	
Director's remuneration	(5)	252,000	
Travelling and entertainment expenses	(6)	12,000	
Contributions to retirement funds	(7)	36,800	
Donations	(8)	5,000	
Interest expenses	(9)	31,200	
Legal and professional fees	(10)	138,000	
Depreciation	(11)	100,000	
Miscellaneous expenses	(12)	46,400	(1,371,400)
Net profit			<u><u>1,009,600</u></u>

Notes:

- (1) Interest income comprises the following:

	\$
Interest on a RMB deposit with a bank in Hong Kong	2,000
Interest on a HK\$ deposit (HK\$100,000) with a bank in Hong Kong; used as security for the loan referred to in note (9) below	1,500
Interest on other foreign currency deposits with a bank in Hong Kong	3,500
Interest from a China customer on his long overdue account	3,000
Interest on a HK\$ loan made to Mr Chen's wife in China	4,000
Total	<u><u>14,000</u></u>

- (2) The Company owns a residential property in Hong Kong, which has been leased to its director for a rental of \$10,000 per month. The Company has been filing a property tax return each year, and has paid property tax for the year of assessment 2011/12 in the amount of \$14,400 during the year. The same amount has been accrued for the current year of assessment under miscellaneous expenses (see note (12) below).

- (3) Salaries and wages comprise:

	\$
Salaries and bonuses to staff	500,000
Wages to a driver for use by the Company's director	100,000
	<u><u>600,000</u></u>

(4) The rent and rates were paid in respect of the following:

	\$
Management fee and rates for the leased residential property (see note (2) above)	35,000
Management fee, rent and rates for the Company's office	55,000
Management fee, rent and rates for the store in China	60,000
	<u>150,000</u>

(5) Director's remuneration includes:

	\$
Director's fee	230,000
Hong Kong salaries tax paid on behalf of the Company's director	22,000
	<u>252,000</u>

(6) Travelling and entertainment expenses include \$5,000 in hotel bills settled for the Company's staff retreat, which was held in Thailand.

(7) Contributions to retirement funds comprise:

	\$
Mandatory contributions to MPF schemes, 5% of basic salary	24,000
Voluntary contributions to MPF schemes, 1% of basic salary	4,800
Special contributions to MPF schemes, one-off payment	8,000
	<u>36,800</u>

(8) The donations were all made to the Community Chest of Hong Kong.

(9) Interest expenses comprise:

	\$
Finance charge on the purchase of a photocopier machine	200
Interest on a loan from the Company's shareholder Mr Chen	17,000
Interest on the bank overdraft and credit line	11,800
Interest on a bank loan of HK\$100,000; secured by the HK\$ deposit referred to in note (1) above	2,200
	<u>31,200</u>

(10) Legal and professional fees comprise:

	\$
Audit and tax filing fee	50,000
Legal fee relating to disputes with customers	60,000
Agency fee for the residential property lease renewal (as in note (2) above)	10,000
Legal fee for purchasing a trademark (the trademark was acquired for \$400,000, and has been registered in Hong Kong and used by the Company in its operation)	18,000
	<u>138,000</u>

(11) The total accounting depreciation charge for the year of \$100,000 was calculated based on the book value of the Company's fixed assets as at 31 March 2013. During the year, the following additions/disposals were made:

Date	Particulars
3 April 2012	Spent \$40,000 to replace the office carpets.
2 July 2012	Bought a microwave for \$6,000 and a computer for \$38,000.
1 October 2012	Bought a truck for \$200,000, settled partly by the trade-in of an old truck at the value of \$32,000.
2 March 2013	Paid \$5,000 in cash for a photocopying machine acquired under hire purchase. The balance is repayable by ten monthly instalments of \$1,200 each, starting on 2 March 2013. The cash price of the machine was \$15,000. The machine was delivered to the office for use on 31 March 2013.
4 March 2013	Bought a motor car for \$240,000. The car qualifies as an environment-friendly vehicle under the tax incentive scheme administered by the Environmental Protection Department of Hong Kong.

As shown in the Company's tax depreciation schedules, the tax written down values for its 20% and 30% plant and machinery pools carried forward to 2012/13 are \$20,000 and \$30,000 respectively. The qualifying cost and written down value for commercial building allowance purposes are \$3,000,000 and \$2,640,000 respectively.

(12) Miscellaneous expenses comprise the following:

	\$
Property tax accrued for 2012/13 (per note (2) above)	14,400
Stock loss due to fire	20,000
Other office consumables and petty cash	12,000
	<u>46,400</u>

(13) The Company's profits tax return for 2011/12 shows a tax loss carried forward to 2012/13 of \$600,000. The Company has been reporting all of its sales income as sourced and taxable in Hong Kong.

Required:

(a) **Assuming that no offshore claim is made by CC Ltd, prepare CC Ltd's profits tax computation for the year ended 31 March 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 all your workings, including the hire purchase depreciation allowance calculation.**

Note: No written explanations are required. (26 marks)

(b) **Advise CC Ltd whether there is any effective way for it to avoid paying both property tax and profits tax on the rental income earned from the leased residential property, and, if so, how this can be achieved.**

(4 marks)

(30 marks)

- 3** Mr Chan carries on a business as a distributor of Chinese herbs. Apart from this, Mr Chan has also joined a partnership with Mr Chu and Mr Lau to run a business of selling ginseng. Mrs Chan is employed by a local university as a lecturer.

Mr and Mrs Chan have provided the following information for the year of assessment 2012/13:

- (1) A draft profit or loss account of the distributorship business showing that the accounting profit for the year ended 31 March 2013 was \$60,000. A brief scrutiny of the income and expenditure items revealed that all of them were taxable and deductible for tax purposes. No charitable donation has ever been deducted against the account.
- (2) The partnership business made an accounting loss of \$300,000 in the year ended 31 December 2012. Mr Chan and Mr Chu each received an annual salary of \$120,000, and the balance of profits and losses was shared amongst the partners in the ratio of 1:1:2 (Mr Chan:Mr Chu:Mr Lau). On 1 October 2012, Mr Lau retired from the partnership. Thereafter, Mr Chan and Mr Chu continued with the partnership, receiving the same annual salaries and sharing profits and losses equally. All other items of business income and expenditure were taxable and deductible.
- (3) Mr Chan owns a flat in Chai Wan which was leased to tenants for \$15,000 per month. The flat was still under a mortgage with an annual repayment of \$264,000 including \$60,000 interest.
- (4) Mr Chan made a donation of \$100,000 to the Community Chest during the year.
- (5) Mrs Chan's total salary for the year was \$500,000, and she contributed \$15,000 to the mandatory provident fund.
- (6) During the year, Mrs Chan enrolled onto a PhD course offered by an overseas university which had tuition fees of \$100,000 per annum.
- (7) Mr and Mrs Chan have two children, one of them is an adopted child. Both children are below the age of 15. The adopted child is studying in Hong Kong while the other child is studying in Canada.
- (8) Mr and Mrs Chan elected for personal assessment for the year of assessment 2012/13.

Required:

- (a) **Compute the allocation of profits/losses to each of the partners and the tax payable by the partnership, if any, for the year of assessment 2012/13.** (6 marks)
- (b) **Compute the tax payable by Mr and Mrs Chan under personal assessment for the year of assessment 2012/13.** (10 marks)
- (c) **Explain the treatment you have accorded for tax purposes to each of the items (1), (3), (4) and (6).** (4 marks)

(20 marks)

- 4 Mrs Gwen came to Hong Kong in December 2011 for a holiday. In January 2012, she acquired a residential property in Hong Kong for \$8,000,000. She settled 50% of the acquisition cost in cash and financed the balance with a one-year loan from a bank. Immediately upon acquisition, Mrs Gwen placed the property for sale with a few property agents at a price of \$9,000,000, but she was not successful in securing a buyer.

In April 2012, Mrs Gwen entered into a one-year lease with High Ltd. The terms of the lease as well as other related information are as follows:

- | | |
|-------------------------|--|
| (1) Term of the lease: | one year from 1 April 2012, renewable on the anniversary date |
| (2) Monthly rental: | \$25,000, payable in advance |
| (3) Rent free period: | one month from 1 April 2012 |
| (4) Rental deposit: | two months' rental, paid on signing the lease agreement |
| (5) Management fee: | \$3,000 per month, payable by Mrs Gwen |
| (6) Government rent: | \$1,000 per quarter, payable by Mrs Gwen |
| (7) Rates: | \$1,400 per quarter, payable by Mrs Gwen. (The rates were fully reduced by the rates concession of \$1,500 granted by the Hong Kong government.) |
| (8) Bank loan interest: | \$12,000 per month |
| (9) Renovation: | \$80,000, incurred by Mrs Gwen before the tenant moved in |
| (10) Repairs: | \$2,000, incurred by High Ltd to pay for the air-conditioner, which was not reimbursed by Mrs Gwen nor deducted from the monthly rental payment |
| (11) Agency fee: | 50% of one month's rental, payable by Mrs Gwen upon signing the lease |

In November 2012, High Ltd failed to pay the rent but advised Mrs Gwen that the liability would be settled once the company's cash flow problem had been resolved.

On 1 January 2013, Mrs Gwen sold the property together with the lease, making a profit of \$800,000.

Required:

- (a) Prepare a computation of Mrs Gwen's property tax liability for the year of assessment 2012/13. (5 marks)
- (b) Discuss, and give your opinion on, whether Mrs Gwen will be subject to tax in respect of the \$800,000 profit made from the sale of the property. (10 marks)

(15 marks)

- 5 HK Ltd carries on business in Hong Kong. During the year ended 31 March 2013, it entered into a licence agreement with OS Ltd, a Singapore company, under which HK Ltd is granted the right to use a trademark for its manufactured products in both Hong Kong and Mainland China.

HK Ltd is required to pay a royalty to OS Ltd at the rate of 1% of the gross sales of the products bearing the trademark. The products are manufactured and sold in both Hong Kong and Mainland China, and all the profits arising from their sale are returned as taxable profits by HK Ltd for Hong Kong tax purposes. For the financial year ended 31 March 2013, the gross sales of the products bearing the trademark were \$100,000,000, all of which has been returned as assessable profits and HK Ltd claimed a tax deduction for the total royalty payment it made to OS Ltd.

Required:

- (a) Assuming that OS Ltd does not carry on business in Hong Kong, advise OS Ltd of the Hong Kong tax implications, if any, in respect of the royalty received from HK Ltd. Your answer should cover the royalty attributable to the trademark used in Hong Kong and in Mainland China, and, if applicable, include a calculation of the estimated profits tax liability of OS Ltd for the year of assessment 2012/13. (8 marks)
- (b) Advise HK Ltd of its Hong Kong tax compliance obligations in respect of the royalty payment made to OS Ltd. (2 marks)

(10 marks)

End of Question Paper