

Fundamentals Level – Skills Module

Taxation (Hong Kong)

Thursday 8 December 2016



Time allowed: 3 hours 15 minutes

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.

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

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

Think Ahead

ACCA

Paper F6 (HKG)

The Association of
Chartered Certified
Accountants

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 2015/16 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)	100,000
– additional allowance in the year of birth (each)	100,000
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)	18,000

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 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** Mrs Jonathan is a Canadian citizen who came to Hong Kong for a vacation in January 2016. Before she went back to Canada in February 2016, she acquired an office in Hong Kong and leased it out for rental. The acquisition price of the office was \$20,000,000, 50% of which was financed by Mrs Jonathan's surplus cash and the balance was financed by an interest-bearing staff loan from her employer who carries on business in Canada.

The leasing arrangement was handled by a property agent in Hong Kong. The office was rented out for a term of two years and the rental income is to be directly deposited by the tenant into Mrs Jonathan's bank account in Canada.

In November 2016, Mrs Jonathan advised the property agent that she had resigned from her current employment and asked the property agent to list the office for sale, aiming to make a gain of \$2,000,000.

Required:

Assuming that Mrs Jonathan successfully sells the office at a gain of \$2,000,000, discuss the factors which need to be considered in determining whether she will be subject to profits tax in Hong Kong in respect of the gain made on the sale and give an opinion as to whether this will/will not be the case.

(10 marks)

- 2** Based on the Inland Revenue Ordinance and commonly known prevailing practice of the tax administration in Hong Kong:

(a) Explain the statutory obligations of a company to keep business records. (2 marks)

(b) The consequences where a profits tax return is received but not filed. (5 marks)

(c) The consequences of failing to pay profits tax which has been duly assessed. (3 marks)

Note: You are NOT required to refer to provisional tax.

(10 marks)

3 Mr Lee owns the following properties in Hong Kong, all of which are leased out:

	Property A		Property B
	Lease 1	Lease 2	
Lease term	1 February 2015 for two years, with the first 12 months as a fixed term*	1 March 2016 for two years, with the first 12 months as a fixed term*	1 May 2015 for three years, with the first 12 months as a fixed term*
	* Early termination by the tenant is not allowed during the fixed term unless full rental payment for the first 12 months is paid		
Rental	Monthly rent of \$50,000 (including \$5,000 for the use of furniture)	Monthly rent of \$45,000 (including \$5,000 for the use of furniture)	Monthly rent of \$30,000 starting on 1 June 2015
Rent free period	Nil	Nil	1 May 2015 to 31 May 2015
Premium	\$90,000 paid on 1 February 2015	\$0	\$0
Rental deposit	\$100,000 payable on 1 February 2015 **	\$90,000 payable on 1 March 2016 **	\$60,000 payable on 1 May 2015 **
	** All rental deposit is returnable to the tenant after deduction of any loss of revenue as a result of default by the tenant		
Remarks	The tenant terminated the lease on 30 November 2015 and the rental deposit was forfeited as compensation for the rent payment for December 2015 and January 2016		The tenant failed to pay the rent starting October 2015. Legal actions have been taken by Mr Lee
Expenses	Government rates (\$3,000 per month) and property management fees (\$1,500 per month) payable by the tenant	Government rates (\$3,000 per month) and property management fees (\$1,500 per month) payable by the tenant	Government rates (\$1,000 per month) payable by the landlord and property management fees (\$2,000 per month) payable by the tenant. For convenience, the tenant will pay the management fee to the landlord for onward payment to the management company

Required:

Prepare the property tax computation for Mr Lee for the year of assessment 2015/16.

Note: Ignore the rates concession.

(10 marks)

- 4 Mr Au carries on a business as a distributor of furniture and also has an interest in a partnership business (ABC Co) with Mr Bao and Mr Chow. Mrs Au is employed by a local company as a secretary.

Mr and Mrs Au have provided the following information for the year of assessment 2015/16:

- (1) A draft statement of profit or loss of the distributorship business showing that the accounting profit for the year ended 31 March 2016 was \$200,000. A scrutiny of the income and expenditure items revealed that they are all taxable and deductible for tax purposes.
- (2) The partnership business made an accounting loss of \$600,000 in the year ended 31 December 2015. The partnership agreement provided for Mr Au and Mr Bao each to receive an annual salary of \$240,000, and for the balance of profits and losses to be shared amongst the partners in the ratio of 1:1:2 (Mr Au:Mr Bao:Mr Chow). On 1 October 2015, Mr Chow retired from the partnership. Thereafter, Mr Au and Mr Bao 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) During the year, Mr Au made a donation of \$80,000 to Po Leung Kuk and Mrs Au made a donation of \$30,000 to the Community Chest.
- (4) Mrs Au's total salary for the year 2015/16 was \$750,000, and she contributed 5% of her salary to the mandatory provident fund. No voluntary contribution was made to the mandatory provident fund.
- (5) Mr and Mrs Au elect for personal assessment.

Required:

- (a) **Compute the allocation of profits/losses of ABC Co to each of the partners for the year of assessment 2015/16.** (6 marks)
- (b) **Prepare the personal assessment computation for Mr and Mrs Au for the year of assessment 2015/16 up to their reduced total income (i.e. before the claim for Part 5 allowances and the calculation of tax payable).** (4 marks)

(10 marks)

- 5 Roger is employed by Golden Inc (Golden), a company incorporated in the US, as regional finance director. His employment contract was discussed and signed in New York and his salary is paid directly into his bank account in New York. Since 2012, Roger has been based in the Hong Kong office but is required to travel within the region when necessary. During the year ended 31 March 2016, he made the following overseas trips:

PRC	120 days
Other Asian countries	50 days
US	55 days (including 15 days annual leave)

For the rest of the year, Roger stayed in Hong Kong and did not take any annual leave in Hong Kong.

The following additional information relates to Roger for the year ended 31 March 2016 (all amounts are denominated in Hong Kong dollars):

- (1) Annual salary: \$1,440,000.
- (2) Director's fee: \$36,000 from Silver Ltd (Silver), the Hong Kong subsidiary of Golden. Silver trades with exporters in the South-East Asian countries. Directors' meetings are conducted in Hong Kong to comply with the Companies Ordinance, but all business decisions are made by Golden and the directors of Silver in the US. Occasionally Roger acts as an alternative director of Silver.
- (3) On becoming a director of Silver, Roger was granted an option to buy 50,000 shares in Silver. He paid a nominal amount of \$5,000 for this option. On 1 February 2016, Roger exercised the option to take up 30,000 shares for \$45,000. The fair market values of a Silver share were as follows:

1 February 2016	\$3.00
31 March 2016	\$3.50

- (4) Roger lives with his family in a serviced apartment in Causeway Bay. The cost of the apartment is \$30,000 per month and this is paid by Silver. Roger paid \$12,000 to join the clubhouse and was reimbursed half of this amount by Golden as he would meet clients at the clubhouse for the purpose of fostering business contacts.
- (5) Golden provided Roger with a car and a driver. The car was leased from a car agency in the name of Golden, at a monthly rental of \$6,000. The driver was hired by Golden at \$9,600 per month. The total petrol and maintenance costs for the car for the year were \$60,000, all of which were paid for by Roger and reimbursed by Golden. Roger estimated that about 20% of the usage of the car did not relate to Golden's business.
- (6) Golden employed an amah for Roger at a cost of \$4,500 per month and refunded Roger his utilities bills, which were \$38,000 for the year.
- (7) Golden operates a medical insurance scheme for all of its employees through an insurance company, and pays an annual premium of \$5,500 per employee. During the year, Roger was hospitalised for two weeks. In order that he could continue to carry out his employment duties whilst in hospital, he paid an extra \$24,000 for a private room. The basic hospital fees and public ward fees of \$45,000 were reimbursed by the insurance company, while two-thirds of the extra fees were reimbursed by Golden.
- (8) During the year, Golden received and paid the following tax bills in respect of Roger:

Hong Kong salaries tax	\$63,000
PRC individual income tax	\$110,000
Other Asian countries' income tax	\$50,000
- (9) Roger contributed a total of \$18,000 to the Mandatory Provident Fund.
- (10) Roger is married with two children, aged 24 and 15. The elder child is studying full-time in Canada.

Required:

- (a) **Determine whether Roger is subject to salaries tax in Hong Kong in respect of the director's fee as described in (2) above.** (3 marks)

- (b) **Calculate the Hong Kong salaries tax payable by Roger for the year of assessment 2015/16.**

Note: You should ignore overseas tax. (12 marks)

(15 marks)

- 6 Snow Ltd (Snow) is a Hong Kong-incorporated company carrying on business in Hong Kong, which makes up its accounts to 31 March each year. Snow imports products from South-East Asia and sells them to customers in both Hong Kong and Mainland China.

The following is Snow's statement of profit or loss for the year ended 31 March 2016:

	Notes	\$	\$
Turnover	(1)		3,000,000
Cost of goods sold			(800,000)
			<u>2,200,000</u>
Profit from securities trading	(2)	300,000	
Dividends from securities	(3)	10,000	
Interest income	(4)	12,000	
Rental income	(5)	120,000	442,000
			<u>2,642,000</u>
Salaries and wages		800,000	
Rent and rates	(6)	740,000	
Contributions to mandatory provident fund (MPF) schemes	(7)	100,000	
Donation	(8)	200,000	
Sundry write-offs	(9)	580,000	
Depreciation	(10)	100,000	
Interest expense	(11)	19,000	(2,539,000)
Net profit			<u><u>103,000</u></u>

Notes:

- (1) Turnover includes the following:

	\$
Gross sales made to Hong Kong customers	1,000,000
Gross sales made to China customers (including re-packaging)	2,000,000
Total	<u><u>3,000,000</u></u>

- (2) Profit/(loss) from the trading of securities using Snow's surplus funds comprises:

	\$
Loss from trading on the Hong Kong Stock Exchange	(100,000)
Profit from trading on the China Stock Exchange	400,000
	<u><u>300,000</u></u>

- (3) Dividends received from securities purchased on the Hong Kong and China Stock Exchange are \$4,000 and \$6,000 respectively.
- (4) The interest income was received on an overdue accounts receivable from a China customer on sales made to him in the year ended 31 March 2015.
- (5) The rental income was received from a property located in China, comprising gross rentals of \$140,000 less management fees of \$13,000 and an agency fee of \$7,000.
- (6) Rent and rates all relate to Snow's office in Hong Kong.
- (7) The contributions to MPF schemes represents 20% of the basic salary of all staff.
- (8) The donation of \$200,000 was made to the Hong Kong Red Cross for the China earthquake.

(9) Sundry write-offs comprise:

	\$
Cost of a country club debenture written off due to the club's closure (the club membership was for business entertainment)	260,000
Loan to an employee written off on his resignation	300,000
Undisclosed commission charged by a China agent	20,000
	<u>580,000</u>

(10) The total accounting depreciation charge for the year is \$100,000 based on the book value of fixed assets as at 31 March 2016.

During the year, Snow bought the following assets:

(i) A fax machine under hire purchase. \$5,600 in cash was paid upon placing the order, and the balance is payable by ten monthly instalments of \$2,200 each, starting on 2 March 2016. The cash price of the machine was \$25,600. The machine was delivered to the Hong Kong office for immediate use on 31 March 2016.

(ii) An electronic vehicle which satisfies the environmental control requirement under the Air Pollution Control Ordinance for \$400,000.

(11) The interest expense comprises:

	\$
Finance charge on the purchase of the fax machine	200
Interest on the company's bank overdraft and credit line	13,800
Interest on a personal loan from a shareholder, who is a China resident	5,000
	<u>19,000</u>

(12) Snow's tax depreciation schedule from its 2014/15 tax return shows tax written down values for its 20% and 30% pools of \$20,000 and \$30,000 respectively.

Required:

Assuming that no offshore claim is made by Snow Ltd, prepare the company's profits tax computation for the year ended 31 March 2016, 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 include a full depreciation allowance schedule.

Note: You should ignore overseas tax.

(15 marks)

End of Question Paper