

Fundamentals Level – Skills Module

# Taxation (Hong Kong)

Thursday 9 June 2016



**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.**

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** Mr Ho carries on a boutique business in Hong Kong as a sole proprietor, and a trading business in partnership with two friends, Mr Fu and Mr Li. Mrs Ho works as an executive assistant in a hospital.

The following information relates to Mr and Mrs Ho for the year of assessment 2015/16:

- (1) A draft statement of profit or loss for the boutique business for the year ended 31 March 2016 shows profits (before the deduction of charitable donations) of \$50,000. All the boutique business's income is sourced in Hong Kong and all expenses are directly related to the business and are revenue in nature.
- (2) In the year ended 31 December 2015 the partnership business incurred a tax loss of \$50,000. Under the partnership agreement, Mr Fu and Mr Li are each entitled to an annual salary of \$100,000 before sharing the partnership profits/losses, and the balance of profits/losses are shared amongst the partners in the ratio of: Mr Fu 25%; Mr Li 25%; and Mr Ho 50%.
- (3) Mr Ho owns a flat in Kowloon which has been leased for a rental of \$15,000 per month since 1 January 2015. Under the lease agreement, all related expenditure including rates and the property management fee are payable by the tenant. Mr Ho financed the acquisition of the flat with a bank loan and paid a total of \$140,000 as mortgage repayments to the bank, including \$30,000 as interest. The bank loan was obtained by Mr Ho to finance his acquisition of the flat leased out in the year of assessment 2015/16.
- (4) Total charitable donations of \$50,000 were made in the name of Mr Ho to the Community Chest of Hong Kong in the year of assessment 2015/16.
- (5) Mrs Ho earned a total salary of \$200,000, before a mandatory provident fund deduction of \$10,000 in the year of assessment 2015/16.
- (6) Mr and Mrs Ho elect for personal assessment.

**Required:**

- (a) Compute the allocation of profits/losses for the partnership business.** (3 marks)

- (b) Prepare the personal assessment computation for Mr and Mrs Ho for the year of assessment 2015/16 up to their reduced total income (i.e. before the claim for Part V allowances and the calculation of tax payable).**

(7 marks)

**(10 marks)**

2 Mr Ma acquired a residential property in Hong Kong in July 2014. Following renovation, the property was subsequently leased out to KK Ltd effective from 1 August 2014, with terms as follows:

- (1) Term of lease: four years from 1 August 2014.
- (2) Rent-free period: 1 August to 31 August 2014.
- (3) Monthly rental: \$32,000 (inclusive of management fee of \$2,000), payable in advance.
- (4) Initial premium: \$27,000, paid on signing the lease agreement.
- (5) Rental deposit: \$64,000, paid on signing the lease agreement. As per the lease agreement, the rental deposit will be used to compensate any loss of revenue when the tenant defaults in payment.
- (6) Rates: \$6,000 per quarter, payable by the tenant.
- (7) Management fee: \$2,000 per month, payable by Mr Ma to the management company.

Mr Ma paid an agency fee of \$16,000 upon signing the lease agreement.

During the period from 1 August 2014 to 31 March 2015, Mr Ma incurred a total mortgage loan repayment to the bank of \$260,000, including \$57,000 as interest. Mr Ma had obtained the bank loan to finance his acquisition of the leased property.

In October 2014, the tenant found a fault in the water pipe and spent \$5,000 on the repair. The tenant notified Mr Ma of the repair but did not seek reimbursement from him, or deduct the cost from the rental payment.

From 1 January 2015 onwards, Mr Ma has not received any rental payments from KK Ltd. On 1 June 2015, Mr Ma was advised by the management company that KK Ltd had moved out without leaving any contact details. Since then, the property has been occupied by Mr Ma as his own residence.

**Required:**

**Prepare the property tax assessments (both original and revised, if applicable) for Mr Ma for each of the years of assessment 2014/15 and 2015/16.**

Note: Ignore the rates concession.

**(10 marks)**

- 3** Mrs Li carries on a boutique business in Hong Kong as a sole proprietor. She travels to Korea twice a year to buy merchandise, which she brings back to Hong Kong to sell. The boutique has one full-time sales assistant and a part-time accounts clerk. Mrs Li relies heavily on the accounts clerk to handle, with the help of accounting software, all the business's accounting and tax matters.

During the year of assessment 2014/15, the boutique made sales to a group of Mainland visitors. Mrs Li discussed the tax reporting position of these sales with the accounts clerk, and these discussions led to the conclusion that the profits from these sales would not be reported on the understanding that both the purchases and the sales were offshore.

Two months ago, Mrs Li was advised by the Inland Revenue Department (IRD) that the 2014/15 tax assessment was under investigation. The IRD also issued an additional assessment imposing tax on the under-reported sales, together with a letter advising that a penalty action including prosecution might be taken against Mrs Li. Mrs Li has alleged that she does not understand the Hong Kong tax rules and fully relied on the accounts clerk to handle all accounting and tax matters.

**Required:**

- (a) With reference to the Inland Revenue Ordinance, explain the penalty actions which the Commissioner of Inland Revenue can take against a taxpayer for understating their taxable profits without reasonable excuse or with fraud and wilful intention.**

Note: Your answer to this part should include an explanation of what constitutes fraud and wilful intention. (8 marks)

- (b) Advise Mrs Li on whether she has a reasonable excuse for the purpose of defending against any penalty action which might be taken against her by the Inland Revenue Department.** (2 marks)

Note: You are NOT required to include the Board of Review definition of 'reasonable excuse' in your answer to either part of the question.

**(10 marks)**

- 4** X-mas Ltd (X-mas) carries on business in Hong Kong as a manufacturer and trader of toys. During the year ended 31 March 2016, X-mas incurred a royalty expense of \$400,000 in respect of the trademark 'TnMe'. 'TnMe' is owned by a US incorporated company, Toys-n-Me Inc, and has been developed by its in-house research team.

Under the trademark licence agreement, X-mas is granted the right to use 'TnMe' in its manufacturing process in Mainland China. All of these manufactured products are then sold by X-mas in Hong Kong, and all the profits arising from their sale are returned as taxable profits by X-mas for Hong Kong tax purposes. The royalty cost for the use of the trademark is payable to Toys-n-Me at the rate of 1% of the gross sales of the products bearing the trademark.

Toys-n-Me Inc does not carry on a business in Hong Kong and has no relationship to X-mas, except for the trademark licence agreement.

**Required:**

- (a) Discuss whether or not Toys-n-Me Inc will be subject to tax in Hong Kong in respect of the income received from X-mas Ltd.** (6 marks)

- (b) Assuming that Toys-n-Me Inc is subject to tax in Hong Kong, calculate its estimated profits tax liability for the year of assessment 2015/16, and advise on X-mas Ltd's tax compliance obligations in respect of the royalty payment.** (4 marks)

**(10 marks)**

**5** Frank is the general manager of Hi-tech Ltd (Hi-tech), a company carrying on business in Hong Kong. Frank is in charge of Hi-tech's office in Shanghai and travels to Hong Kong on a regular basis. The following information is available in respect of Frank for the year ended 31 March 2016:

- (1) Frank's basic salary is \$90,000 per month.
- (2) During the year, Frank spent eight months in Mainland China. Two-thirds of his salary was attributable to services rendered in Mainland China, upon which he was required to pay \$120,000 income tax to the China tax authority. The Chinese income tax was paid and borne by Hi-tech.
- (3) For the month of April 2015, Frank was given a cash allowance of \$12,000 to cover his accommodation costs. From 1 May 2015 to 30 September 2015, he was provided with a flat owned by Hi-tech in Shanghai, rent-free. On 1 October 2015, he purchased the flat from Hi-tech for \$4,000,000. The market value of the flat at that date was \$4,500,000. Frank mortgaged the flat to a bank for \$2,000,000, and obtained a staff loan of \$1,000,000 from Hi-tech at a below-market interest rate. During the year ended 31 March 2016, Frank paid interest of \$28,000 to the bank, and \$10,000 to Hi-tech. If Hi-tech had charged Frank a market interest rate, his interest cost would have been \$14,000.
- (4) Hi-tech gave Frank an allowance of \$30,000 to spend during his holidays in France. He actually spent \$26,000 and retained the balance.
- (5) On 1 September 2015, Frank was granted options for 15,000 shares in Hi-tech at a cost of \$5,000. There is no vesting period but the options will expire at the fifth anniversary from the date the options were granted.
- (6) Frank is studying for the EMBA degree at the Shanghai University of Finance and Economics. During the year, he paid a tuition fee of \$180,000, half of which was reimbursed by Hi-tech.
- (7) Frank's wife is a housewife. The couple have two children, aged 10 and 12 years.
- (8) Frank supports his mother, aged 68, who lives with his family in Shanghai. His mother has a Hong Kong identity card and travels frequently to Hong Kong.
- (9) During the year, Frank contributed \$20,000 to the Mandatory Provident Fund.

**Required:**

**(a) Advise Frank on the extent to which he is liable to Hong Kong salaries tax for the year of assessment 2015/16.** (4 marks)

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

**Note:** You should ignore overseas tax. (11 marks)

**(15 marks)**

- 6 Winner Ltd (WL) carries on business in Hong Kong as an investment company. WL's statement of profit or loss for the year ended 31 March 2016 is as shown below:

	Notes	\$	\$
Gain from trading in Hong Kong listed shares		500,000	
Loss from trading in China listed shares		(30,000)	
Dividends from Hong Kong listed shares		23,000	
Dividends from China listed shares		11,000	
Gain from buying and selling foreign currencies		150,000	
Exchange gain (unrealised) from the year-end conversion of foreign currency deposits		20,000	
Interest income	(1)	24,000	
Rental income	(2)	120,000	818,000
Salaries and wages	(3)	300,000	
Rent and rates	(4)	350,000	
Contributions to retirement funds for staff	(5)	36,000	
Donation	(6)	5,000	
Interest expenses	(7)	31,000	
Audit and tax filing fees		13,000	
Depreciation	(8)	40,000	
Loss on the disposal of a fixed asset	(8)	5,000	
Miscellaneous expenses (all deductible)		5,000	(785,000)
Net profit			<u>33,000</u>

**Notes:**

- (1) Interest income comprises:

	\$
Interest on RMB deposit with a bank in Hong Kong	6,000
Interest on HK\$ deposit (HK\$100,000) with a bank in Hong Kong, used as security for a loan (as referred to in note (7) below)	1,000
Interest on HK\$ loan made and remitted to a director in Canada	17,000
Total	<u>24,000</u>

- (2) WL leased out part of its office for a short period and received total rentals of \$120,000 for the year.

- (3) Salaries and wages comprise:

	\$
Salaries and bonuses to staff	200,000
Wages to a domestic helper for use by WL's director	100,000
Total	<u>300,000</u>

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

	\$
WL's office	200,000
The director's residence	150,000
Total	<u>350,000</u>

(5) Contributions to retirement funds comprise:

	\$
Mandatory contributions to MPF schemes, 5% of basic salary	10,000
Voluntary contributions to MPF schemes, for a director	4,000
Special contributions to MPF schemes, one-off payment	22,000
	<u>36,000</u>

(6) The donation was made in cash to the Community Chest of Hong Kong.

(7) Interest expenses comprise:

	\$
Interest on a loan from WL's shareholder Ms Wong	17,000
Interest on a bank overdraft and credit line	12,000
Interest on a bank loan of HK\$100,000 for operational use, secured by the HK\$ deposit (as referred to in note (1) above)	2,000
	<u>31,000</u>

(8) The total accounting depreciation charge for the year of \$40,000 was calculated based on the book value of WL's fixed assets as at 31 March 2016.

During the year, the following additions/disposals were made:

Date	Particulars
1 April 2015	Replaced the office carpets at a cost of \$70,000
4 March 2016	Sold a motor car for \$31,000. The net book value of the car was \$36,000

(9) The tax depreciation schedules in WL's 2014/15 tax return showed tax written down values carried forward to 2015/16 for its 20% and 30% plant and machinery pools of \$20,000 and \$30,000 respectively.

**Required:**

**Prepare Winner Ltd's profits tax computation for the year ended 31 March 2016, showing the net assessable profit/adjusted loss and profits tax payable, if any. Clearly identify both the year of assessment and the basis period and show all workings, including the depreciation allowance calculation.**

Notes:

- (1) You should ignore overseas tax.
- (2) No detailed explanations are required.

**(15 marks)**

**End of Question Paper**