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.

Section B *Marks*

1 Jimmy

(a) An assessor can issue an estimated assessment in the following circumstances:

(1) Returns are not furnished but the assessor thinks that the taxpayer is chargeable to tax under the Inland Revenue Ordinance (s.59(3)). 0·5

If a taxpayer fails to file the required return after the expiry of the specified period and the assessor is of the opinion that such person is chargeable to tax, he may estimate an assessment. 0·5

(2) The returned profits furnished by the taxpayer are not accepted (s.59(2)). 0·5

Such a return may be considered insufficient to establish the tax payable based on the information given or the assessor may be in disagreement with certain aspects of the return. The assessor may then make an estimate based on the information available or by reference to his past experience or according to the results of similar taxpayers. 2

(3) The assessor finds that business accounts or books have not been satisfactorily kept (s.59(4)). 0·5

When the assessor is of the opinion that the accounts or books maintained by a trade or business are inadequate such that the returns are unreliable, the assessor may assess the profits or income of such trade or business on the basis of the usual rate of net profit on turnover of such trade or business. The usual rate of net profit on turnover may be that prescribed by the Board of Inland Revenue for particular classes of trade or business or an estimated rate as thought fit by the assessor. 2

6

(b) Jimmy may apply to hold over part of the provisional salaries tax in respect of 2017/18 if it is anticipated that his assessable income for 2017/18 will be, or is likely to be, less than 90% of the amount assessed to provisional tax. This may be as a result of his retirement in July 2017. The application for holdover must be made in writing and lodged with the Commissioner 28 days before the due date, i.e. by 30 December 2017. 2·5

If no holdover of provisional salaries tax is made, Jimmy is required to pay the tax at the amount demanded on the date specified. However, should it ultimately be determined that his 2017/18 salaries tax liability is lower, any excess provisional salaries tax paid will be offset against the provisional salaries tax payable for 2018/19 (if any) and any remaining excess will be refunded. 1·5

4

10

2 Paul

(a) Share option scheme

As Paul will be granted the option as remuneration for his employment services under a Hong Kong employment, the benefit from the option will be taxable under s.9(1)(d), at the time when the option is exercised, assigned or released. This remains true even though the share option relates to shares in the parent company of Like Ltd for the reason that both companies are associated. Moreover, the fact that the shares in the Singapore parent company are not listed in Hong Kong does not affect the taxability of the deemed gain arising from the share option. 1

No tax liability will arise at the time when the option is granted. The time of grant is only relevant to determine the source of the share option. As Paul is working for Like Ltd which is a Hong Kong employer company carrying on business in Hong Kong, he is regarded as holding a Hong Kong employment at the time of being granted the option, hence the option is Hong Kong sourced. However, as stated above, Paul will only be chargeable to tax when he exercises, assigns or releases the option. 1

When the option is exercised, the taxable value equals the total value of the shares, by reference to the share market price at the time of exercise, and deducting the total cost incurred on the option as well as on exercising the option to acquire the shares. This remains taxable even if the shares may not have been sold at the time of exercise. When the shares are subsequently sold at a gain, the gain would, however, not be taxable under salaries tax as it will be regarded as a return from personal investment. If the option is assigned or released, the taxable value is calculated by reference to the total consideration/compensation received after deducting the related cost of the option. 2

Marks

If Paul exercises, assigns or releases the option after he ceases his employment or after he leaves Hong Kong, the tax positions are the same as above. However, if Paul leaves Hong Kong permanently with the share option unexercised, he may elect to be deemed to have 'notionally' exercised the share option before leaving Hong Kong, and be assessed on the deemed gain in his final Hong Kong tax assessment. The deemed taxable value will be calculated by reference to the share price on a day within seven days before the day when the final Hong Kong tax return is filed by Paul, or when the election is made within three months from the date he left Hong Kong, by reference to the share price on the date of leaving Hong Kong. 2

If Paul pays the finalised tax on the notional exercise of the share option before leaving Hong Kong, he is no longer required to report to the Inland Revenue Department (IRD) when he subsequently exercises the share option overseas. No further Hong Kong tax will be imposed even if there is an increase in the share market price at the time of the subsequent exercise. However, in the case that the share market price is lower than that used for tax assessment before leaving Hong Kong, Paul may submit an application to the IRD to have his tax assessment revised and any excess tax paid refunded. 1

7

(b) Share award scheme

If Paul chooses to receive the shares as an award, he will be taxed on the total market value of the shares as a perquisite under s.9(1)(a) at the time he is entitled to the ownership of the shares. 0·5

As the shares will only become vested in two years' time, he will not be taxed at the time the shares are granted as he is not yet entitled to the ownership. After the shares become fully vested, the tax liability arises (the 'back-end approach'), regardless of whether the shares are sold. The taxable value will be determined by reference to the shares' market value at the time when the shares are fully vested. 1

During the vesting period, no tax liability will arise to Paul. If a dividend is distributed during the vesting period, Paul will not be taxed. However, when the shares are fully vested Paul will receive a lump sum payment equivalent to the amount of any dividends distributed during the vesting period, and this lump sum payment will then become part of Paul's taxable income from the employment. Again, when the shares are subsequently sold at a gain, no tax liability arises. 1·5

3

10

3 Happy Club

(a) A club is deemed not to be carrying on a business if not less than half of its gross receipts on revenue account (including entrance fees and subscriptions) are received from its voting members (s.24(1)). 1

Otherwise a club is deemed to be carrying on a business and the whole of its income including entrance fees (although they are capital in nature) and subscriptions are chargeable to profits tax after adjustments for allowable deductions. 1

2

(b)

	2015/16 Year ended 31 March 2016 $	2016/17 Year ended 31 March 2017 $	
Receipts from members			
Entrance fees	30,000	20,000	1
Members' subscriptions	84,000	72,000	1
Fund-raising sales (50%)	36,000	41,000	1
Lounge café receipts (2/3rds)	26,000	58,000	1
	176,000	191,000	
Total gross receipts	225,000	461,000	
% of receipts from members	78·22%	41·43%	1

For the year ended 31 March 2016, Happy Club is deemed not to be carrying on a business, so not subject to profits tax. Since Happy Club is not deemed to be carrying on a business, the loss is not allowed to be carried forward. 1·5

For the year ended 31 March 2017, Happy Club is deemed to be carrying on a business and all its receipts are subject to profits tax, including entrance fees and the donation. 1

		Marks
Profits tax payable = $291,000 x 15% = $43,650		0·5
		8
		10

4 **Mr Mo – Property tax computation for the year of assessment 2016/17**
Basis period: 1 April 2016 to 31 March 2017

	$	
Rental (48,000 x 6)	288,000	1
Premium (30,000 x 7/24)	8,750	1
Repair to keylock	500	0·5
Assessable value	297,250	
Less: Rates (3,000/3 x 7)	(7,000)	0·5
	290,250	
Less: 20% statutory allowance	(58,050)	0·5
Net assessable value	232,200	
Property tax at 15%	34,830	0·5

Correct treatment of the following items: rental deposit, management fee, agency fee, mortgage interest, renovation cost, no deduction of bad debt, water dripping repair cost, legal cost.

(0·5 mark each, maximum) 3

Mr Mo – Property tax computation for the year of assessment 2017/18
Basis period: 1 April 2017 to 31 March 2018

	$	
Rental (48,000 x 3)	144,000	0·5
Premium (30,000 x 17/24)	21,250	1
Assessable value	165,250	
Less: Rates (3,000/3 x 3)	(3,000)	0·5
	162,250	
Less: 20% statutory allowance	(32,450)	0·5
Net assessable value	129,800	
Property tax at 15%	19,470	0·5
		10

5 **(a)** **Mrs Shi – Computation of net assessable income for the year of assessment 2016/17**
Basis period: 1 April 2016 to 31 March 2017

	$	$	
Salary (55,000 x 12)		660,000	0·5
Travelling allowance		16,000	0·5
Petrol cost (12,000 x 20%)		2,400	0·5
Reimbursement of membership fee (35,000 x 20%)		7,000	0·5
		685,400	
Rental value: ((685,400 – 2,600) x 4/12 x 10%)	22,760		1·5
Less: Rent suffered (3,000 x 4)	(12,000)	10,760	0·5
Reimbursement of utilities bills		3,000	0·5
Share option gain [(15·5 – 5) x 5,000 – 10,000 x 5,000/20,000]		50,000	1
Assessable income		749,160	
Less: ACCA membership fee		(2,600)	0·5
Net assessable income		746,560	

Marks

Non-taxable/non-deductible items for which marks are allocated:

1. Medical expense reimbursement ($35,000) (not taxable)
2. Company car ($300,000/$50,000) (not taxable)
3. Interest savings of $40,000 (150,000 – 110,000) on low-interest loan (not taxable)
4. Sale of shares (not taxable)

	0·5 mark each	2
		8

(b) Mr and Mrs Shi – Personal assessment computation for the year of assessment 2016/17
Basis period: 1 April 2016 to 31 March 2017

	$ Mr Shi	$ Mrs Shi	
Net assessable income (from part (a))		746,560	
Net assessable value (NAV) of rental property	48,000		0·5
Less: Interest on leased property (limited to NAV)	(48,000)		1
	0	746,560	
Less: Concessionary deductions			
Approved charitable donations [limited to 35% of $746,560]		(25,500)	0·5
Elderly residential care expenses – Mr Shi's step-mother (maximum)		(92,000)	0·5
Home loan interest (maximum)		(100,000)	0·5
Contributions to mandatory provident fund (MPF) (maximum)		(18,000)	0·5
	0	511,060	
Reduced total income		511,060	
Less: Part 5 allowances			
Married person's allowance	(264,000)		0·5
Child allowance	(100,000)		0·5
Dependent parent allowance – Mrs Shi's father	(46,000)		0·5
Disabled dependant allowance – Mr Shi's step-mother	(66,000)	(476,000)	0·5
Net chargeable income		35,060	
Tax at progressive rates (35,060 x 2%)		701	0·5
Tax at standard rate (511,060 x 15%) is not applicable		76,659	0·5
Tax payable by Mrs Shi		701	0·5
			7
			15

			Marks
6 Grape Ltd – Profits tax computation for the year of assessment 2016/17			0·5
Basis period: year ended 31 December 2016			0·5
	$	$	
Profit for the year per accounts		16,000	0·5
Add: Depreciation	110,000		0·5
Special mandatory provident fund (MPF) contribution (100,000 x 80%)	80,000		1
Payment to leaving staff member for restrictive covenant	90,000		0·5
Interest on loan from associate	15,000		0·5
Taxation expense accrued	28,800		0·5
Donations	38,000	361,800	0·5
		377,800	
Less: Depreciation allowance for machinery and plant (see working)	(45,000)		0·5
Commercial building allowance (see working)	(160,000)		0·5
Environment-friendly vehicle	(200,000)		1
Interest income – bank deposits (4,000 + 7,000 + 8,000)	(19,000)	(424,000)	1
		(46,200)	
Less: Donation (Red Cross) not deductible as there is no profit		0	0·5
Adjusted loss for the year carried forward		(46,200)	0·5
Net assessable profits		0	
Profits tax payable		0	0·5
Less: Property tax set-off (s.25)		(27,600)	0·5
Tax refundable		(27,600)	

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**	$	
Property rental income	240,000	Regulatory MPF contribution	110,000	
Donation (books)	8,000	Interest on bank overdraft	6,000	
			0·5 mark each	2

Working – Depreciation allowance schedule

	20%	30%	Allowance	
	$	$	$	
Written down value (WDV) brought forward	20,000	46,000		0·5
Additions				
Filing cabinet	40,000			0·5
	60,000			
Less: Initial allowance	(24,000)		24,000	0·5
	36,000			
Annual allowance	(7,200)	(13,800)	21,000	1
WDV carried forward	28,800	32,200		
			45,000	

Commercial building allowance

Qualifying expenditure	4,000,000	
Commercial building allowance at 4%	160,000	0·5
		15