

Fundamentals Level – Skills Module

# Taxation (Hong Kong)

Thursday 7 December 2017



**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.**

# Paper F6 (HKG)

Think Ahead

**ACCA**

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 2016/17 tax rates, allowances and deductions are to be used in answering the questions.

### Profits tax rates

Companies	16.5%
Unincorporated business	15%

### Tax rates

Salaries tax rates:	
First \$40,000	2%
Next \$40,000	7%
Next \$40,000	12%
Remainder	17%
Standard rate	15%

### Allowances

	\$
Basic allowance	132,000
Married person's allowance	264,000
Single parent allowance	132,000
Child allowance – 1st to 9th child (each)	100,000
– additional allowance in the year of birth (each)	100,000
Dependent parent/grandparent allowance – basic	23,000/46,000
– additional	23,000/46,000
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)	92,000
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** Jimmy has worked for PK Ltd for many years. Jimmy received his 2016/17 composite tax return on 2 May 2017, but as he was very busy with his work, he forgot to file the return. On 18 September 2017, Jimmy received an estimated salaries tax assessment for the year of assessment 2016/17. This estimated assessment showed the following:

	\$
Assessable income	960,000
	<hr/>
2016/17 final tax payable	128,760
Less: 2016/17 provisional tax paid	(93,900)
	<hr/>
	34,860
2017/18 provisional tax payable	128,760
	<hr/>
Total tax payable	163,620
	<hr/>
<b>Payable in two instalments:</b>	
By 13 January 2018	131,430
By 13 April 2018	32,190

The 'assessor's notes' on this assessment indicated that the assessment was estimated based on the employer's return filed by PK Ltd.

Jimmy retired in July 2017. He does not understand why he needs to pay the provisional tax for 2017/18.

**Required:**

- (a) Explain the power of the assessor to raise an estimated assessment.** (6 marks)
- (b) Advise Jimmy of any actions he may take if he does not want to pay the whole or part of the provisional tax for the year of assessment 2017/18.** (4 marks)

**(10 marks)**

- 2** Paul works for Like Ltd, which carries on business in Hong Kong. During a recent meeting with the director of Like Ltd, Paul was offered one of the following two alternative incentives for him to improve the group's performance before the expiry of his employment contract in two years' time. Paul has indicated that he has the intention to leave Hong Kong permanently upon the expiry of his contract. The two alternatives are:
- (a) Share option scheme – Paul will be entitled to receive an option to acquire 10,000 shares in the parent company of Like Ltd at an exercise price of HK\$10. The parent company is listed in Singapore and the average market price of the shares in the last month has been HK\$15. Paul will be required to pay an option cost of HK\$2,000 if he accepts the option. There is no vesting period for the option.
  - (b) Share award scheme – Paul may choose to receive the 10,000 shares in the parent company of Like Ltd as an award. However, in this case the shares will be subject to a vesting period up to the last day of his employment contract.

**Required:**

**Explain Paul's Hong Kong salaries tax positions under each of the alternatives:**

- (a) **Share option scheme; in particular the position when the option is granted, exercised or sold, when the shares are subsequently sold, and when the option is unexercised at the time Paul ceases his employment and leaves Hong Kong in two years' time.** (7 marks)
- (b) **Share award scheme; in particular the position when the award is granted, when a dividend is received before the shares become vested, when the award shares do vest and when the shares are sold.** (3 marks)

**(10 marks)**

- 3** Happy Club (the Club) operates as a recreational club in Hong Kong. The Club owns a clubhouse which provides catering and club facilities to its members. Only members are admitted to the Club facilities except for the lounge café. All members are voting members at all general meetings held by the Club.

For the two years ended 31 March 2016 and 2017, the Club had the following income and expenditure:

		Year ended 31 March 2016	Year ended 31 March 2017
	Notes	\$	\$
Income			
Entrance fees		30,000	20,000
Members' subscriptions		84,000	72,000
Fund-raising sales	(1)	72,000	82,000
Lounge café receipts	(2)	39,000	87,000
Donation	(3)	–	200,000
		<u>225,000</u>	<u>461,000</u>
Expenditure			
Administration expenses	(4)	165,000	104,000
Lounge café expenses		69,000	41,000
Fund-raising sales expenses		30,000	25,000
		<u>264,000</u>	<u>170,000</u>
Surplus/(Deficit)		<u>(39,000)</u>	<u>291,000</u>

**Notes:**

- (1) Fund-raising sales are held annually and records show that half of the attendees were members.
- (2) It is estimated that two-thirds of the receipts of the lounge café are from members.
- (3) The Club received a one-off donation of \$200,000 in October 2016 from a health food company.
- (4) The administration expenses are all tax deductible revenue items.

**Required:**

- (a) Explain under what circumstances Happy Club would be subject to Hong Kong profits tax under the Inland Revenue Ordinance. (2 marks)
- (b) Explain the tax position of Happy Club for each of the two years ended 31 March 2016 and 2017, and calculate any tax payable. (8 marks)

**(10 marks)**

- 4 During the year ended 31 March 2017, Mr Mo leased out his office in Hong Kong under the following terms:
- (1) Term of lease: two years from 1 September 2016.
  - (2) Rental: \$48,000 per month (inclusive of a management fee of \$2,000 per month), payable in advance.
  - (3) Rent-free period: one month from 1 September 2016.
  - (4) Initial premium: \$30,000, payable on signing the lease agreement.
  - (5) Rental deposit: \$96,000, payable on signing the lease agreement. As per the lease agreement, the rental deposit is used to compensate any loss of revenue when the tenant defaults in payment.
  - (6) Rates: \$3,000 per quarter, payable by Mr Mo to the government.
  - (7) Management fee: \$2,000 per month, payable by Mr Mo to the management company.
  - (8) Property agency fee: \$24,000 payable by Mr Mo for sourcing the tenant.
  - (9) Mortgage interest: \$16,000 per month, incurred by Mr Mo on a bank loan used to acquire the property.
  - (10) Renovation: \$130,000, paid by Mr Mo for office renovation before the start of the lease.
  - (11) Repair to keylock: \$500 incurred by the tenant on 1 February 2017. The tenant did not deduct the repair cost from the rental payment.

On 1 March 2017, the tenant advised Mr Mo that they had moved out of the office due to a water dripping problem, and refused to pay the rental for the month of March. Mr Mo immediately paid \$40,000 to repair the property and fixed the water dripping problem in a week. The tenant moved back into the property on 1 April 2017 and continued to pay rental from that date. Mr Mo hired a lawyer to recover the March rental from the tenant and incurred a legal fee of \$5,000.

On 30 June 2017, the tenant terminated the lease and moved out of the office. Mr Mo deducted one month's rental from the rental deposit and refunded \$48,000 to the tenant upon termination of the lease. Since then, the property has been left vacant.

**Required:**

**Prepare Mr Mo's property tax computations for the years of assessment 2016/17 and 2017/18, showing the net assessable values and the property tax payable (or repayable if appropriate) for each year.**

**Note:** You should assume the tax rates for 2016/17 continue to apply for 2017/18.

**(10 marks)**

5 Mrs Shi, a Hong Kong resident, is currently employed as the accounting controller of KK Ltd, a company incorporated and carrying on business in Hong Kong. In relation to the year ended 31 March 2017, Mrs Shi had the following income and expenditure:

- (1) A monthly salary of \$55,000, out of which KK Ltd deducted a mandatory provident fund (MPF) contribution of \$2,750 (5%).
- (2) A travelling allowance of \$16,000, of which Mrs Shi spent \$10,000 on a holiday and is supported with vouchers. The balance of \$6,000 was kept by Mrs Shi.
- (3) A reimbursement of medical expenses of \$35,000 under the Blue Cross Medicare Scheme entered into by KK Ltd for all staff members.
- (4) KK Ltd provided Mrs Shi with a company car for her use. The original cost of the car was \$300,000 and the second hand value as at 31 March 2017 was \$50,000. The total petrol cost for the year of \$12,000 was reimbursed by KK Ltd. Mrs Shi has agreed with the Inland Revenue Department (IRD) that 80% of the car usage was related to company business.
- (5) Mrs Shi was requested by KK Ltd to join the Chinese Recreation Club for client entertainment purposes. During the year, Mrs Shi paid a club entrance fee of \$30,000 and an annual membership fee of \$5,000. KK Ltd agreed to reimburse 20% of the total costs incurred by Mrs Shi.
- (6) Mrs Shi's family was provided with a two-room flat by KK Ltd at a nominal cost of \$3,000 per month for the period 1 April to 31 July 2016.
- (7) With effect from 1 August 2016, the family moved into a property newly acquired by Mrs Shi with the finance obtained from KK Ltd under the company's low-interest mortgage loan scheme. The property was registered in the joint names of Mr and Mrs Shi. During the year, the total loan repayment paid to KK Ltd by Mrs Shi amounted to \$180,000, including \$110,000 as loan interest. If a market interest rate had been charged Mrs Shi's total interest cost would have been \$150,000.
- (8) During the period from 1 August 2016, when the family lived in the property purchased by Mrs Shi, KK Ltd reimbursed Mrs Shi the total utilities cost of \$3,000.
- (9) On 31 March 2014, Mrs Shi was granted an option at a cost of \$10,000 to purchase 20,000 shares in KK Ltd's parent company at an exercise price of \$5 per share. On 30 April 2016, Mrs Shi exercised the option to acquire 5,000 shares and sold the shares on the following day. The market values per share were \$9.5 on 31 March 2014, \$15.5 on 30 April 2016, and \$17 on 1 May 2016.
- (10) Mrs Shi paid the following annual membership fees:

The Association of Chartered Certified Accountants (ACCA)	\$2,600
The Chinese Recreation Club (as in (5) above)	\$5,000

The following additional information is available:

- (11) Mrs Shi's husband owns a property which is leased for rental. During the year ended 31 March 2017, Mr Shi paid total interest of \$60,000 on a bank loan which was acquired to finance the property acquisition two years ago. The net assessable value of the property for the year of assessment 2016/17 is \$48,000.
- (12) Mr and Mrs Shi have a son, aged 24, who is studying full time overseas.
- (13) Mrs Shi's father, aged 70, lives in a flat next to Mrs Shi and her family. Mrs Shi paid a total of \$12,000 to her father during the year.
- (14) Mr Shi's step mother, aged 55, has been living in a nursing home in Hong Kong since January 2014, when she was disabled in an accident. She is paid the Government Disability Allowance of \$2,000 per month. The total bills from the nursing home, amounting to \$100,000 for the year, were paid by Mrs Shi.
- (15) During the year, Mr Shi made a total charitable donation of \$26,000 to the Red Cross of Hong Kong (comprising \$500 for raffle tickets and \$25,500 cash).
- (16) Mr and Mrs Shi elected for personal assessment for the year of assessment 2016/17.

**Required:**

- (a) Compute the net assessable income of Mrs Shi for the year of assessment 2016/17. (8 marks)
- (b) Prepare the personal assessment computation for Mr and Mrs Shi for the year of assessment 2016/17, showing the tax payable, if any, by the couple. (7 marks)

**(15 marks)**



- 6 Grape Ltd (Grape), a Hong Kong incorporated company, carries on a printing business in Hong Kong. For the year ended 31 December 2016, Grape had the following income and expenditure:

	Note	\$	\$
Income			
Printing income		1,500,000	
Property rental income	(1)	240,000	
Interest income	(2)	19,000	1,759,000
Expenses			
Directors' fees		(333,000)	
Staff costs	(3)	(690,000)	
Depreciation	(4)	(110,000)	
Audit and tax filing fees		(59,000)	
Interest expenses	(5)	(21,000)	
Taxation expense accrued	(6)	(28,800)	
Donations	(7)	(38,000)	
Other deductible expenses		(463,200)	(1,743,000)
Profit for the year			16,000

**Notes:**

- (1) Grape leases part of its office to an unrelated third party for \$20,000 per month. The office was acquired by Grape in 2006 directly from the property developer on its construction, at a cost of \$8,000,000, which was funded by a loan from an associated company carrying on business in China [see note (5) below].

- (2) Interest income comprises:

	\$
Interest on a HK\$ deposit with a bank in Hong Kong	4,000
Interest on a RMB deposit with a bank in Hong Kong	7,000
Interest on a GBP deposit with a bank in London	8,000
Total per accounts	19,000

- (3) Staff costs comprise:

	\$
Salaries and allowances	390,000
Regulatory mandatory provident fund (MPF) contribution (5% per staff)	110,000
Special MPF contribution (one-off payment)	100,000
Payment to a leaving staff member for a promise not to join a competitor	90,000
Total per accounts	690,000

- (4) The depreciation charge for the year was calculated after taking into account the following additions to fixed assets during the year:

- (a) Purchase of a new filing cabinet at \$40,000.  
(b) Purchase of the company's first energy saving truck for delivery purposes at \$200,000.

- (5) Interest expenses comprise:

	\$
Interest on a loan from an associated company for acquiring the office [see note (1) above]	15,000
Interest on bank overdraft credit line	6,000
Total per accounts	21,000

- (6) The accrual of \$28,800 is for the 2016/17 property tax. The property tax for 2015/16 of \$27,600 was duly paid in November 2016.
- (7) Donations were made to the Hong Kong Red Cross of \$30,000 in cash and to the Tung Wah Group of Hospitals of children's books valued at \$8,000.
- (8) Grape has been filing its profits tax returns on the basis that all of its income is subject to Hong Kong profits tax. In Grape's profits tax return for 2015/16, the tax written down values brought forward in respect of its plant and machinery pools are:
- 10% – nil
  - 20% – \$20,000
  - 30% – \$46,000
- The qualifying expenditure in respect of the office property for commercial building allowance purposes is \$4,000,000.

**Required:**

**Prepare Grape Ltd's profits tax computation for the year ended 31 December 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.**

Note: You should ignore overseas tax.

**(15 marks)**

**End of Question Paper**