
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 John Adams

- (a) A concessionary deduction for home loan interest is available to taxpayers under salaries tax. The following conditions must be satisfied for such a deduction to be given (s.26E):
- (1) The person is the owner of the dwelling (sole owner, joint tenant or tenant in common).
 - (2) The dwelling is situated in Hong Kong and is used exclusively or partly for residential purposes.
 - (3) The dwelling is wholly or partly used by the person as their place of residence (or as the principal place of residence if there is more than one place of residence at the same time in the year of assessment).
 - (4) The home loan interest is paid by the person on a loan applied wholly or partly for the acquisition of the dwelling.
 - (5) The loan is secured by a mortgage or charge over the dwelling or over any other property in Hong Kong.
 - (6) The lender is the government, a financial institution, a registered credit union, a licensed money lender, the Hong Kong Housing Society, the person's employer, or any organisation or association approved by the Commissioner of Inland Revenue.

0.5 mark each 3

(b) Salaries tax treatments of options (1) to (3)

- (1) A monthly housing allowance, paid by Sun Ltd (Sun) as a cash allowance, will be treated as assessable income arising from employment and will be added to John's other assessable income and taxed accordingly. 0.5
- However, if John uses the property as his principal place of residence in Hong Kong, the conditions for a home loan interest deduction will be satisfied, and John can get a deduction for the home loan interest against his total assessable income, subject to a maximum allowance of \$100,000 in any year of assessment for up to 15 years. 1.5
- (2) The mortgage loan is made between John and the Hong Kong bank directly, so the loan repayment, including interest repayment, will become the personal liability of John. If Moon Ltd (Moon) subsidises any amount of interest for John, the subsidised amount is an employee benefit and would be added to John's assessable income for salaries tax purposes. This is because the subsidy is convertible into cash and, more importantly, it discharges John's personal liability. 1.5
- However (as in (1) above), if John uses the property as his principal place of residence in Hong Kong, the conditions for home loan interest will be satisfied, and John can get a deduction for the home loan interest against his total assessable income, subject to a maximum allowance of \$100,000 in any year of assessment for up to 15 years. 0.5
- (3) Although the low-interest loan provided by Moon is an employee benefit, it will not be assessable for salaries tax purposes. Since the loan is made between John and Moon, the benefit does not discharge any personal liability of John. Moreover, the benefit is not convertible into cash. Therefore, John will not be assessable on the interest rate differential. 1.5
- However, even if John uses the property as his principal place of residence in Hong Kong, he will not be eligible for the home loan interest deduction. Although the first five conditions for the home loan interest deduction are satisfied, the last condition is not, as the lender, being the employer's subsidiary, does not fall within the definition of 'lender'. 1.5

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2 Mr and Mrs Mak

Personal assessment for the year of assessment 2016/17

	\$	Mr Mak \$	Mrs Mak \$	
Net assessable value (NAV)				
Rental received (15,000 x 10)	150,000			0.5
Premium (180,000 x 10/24)	75,000			1
	<u>225,000</u>			
20% statutory deduction	(45,000)		180,000	0.5
Net assessable income				
Director's fee		120,000		0.5
Assessable profits				
Mr Mak: Profit from sole proprietorship business	166,000			0.5
Approved charitable donations (ACD) 35%	(58,100)	107,900		0.5
	<u>92,000</u>			0.5
Mrs Mak: Share of profit from partnership business	(92,000)		0	0.5
Less: Loss brought forward				
Total income		<u>227,900</u>	180,000	
Less: Mortgage interest			(46,000)	0.5
ACD – Mrs Mak			(40,000)	0.5
ACD – Mr Mak ((227,900 + 58,100) x 35% – 58,100)		(42,000)		1
Unabsorbed ACD transferred from spouse (210,000 – 58,100 – 42,000) = 109,900 limited to ((180,000 – 46,000) x 35% – 40,000)			(6,900)	1
MPF contributions		(6,000)		0.5
Share of partnership loss		(48,000)		0.5
Reduced total income		<u>131,900</u>	<u>87,100</u>	
Reduced joint income (131,900 + 87,100)			219,000	0.5
Less: Married person's allowance			(264,000)	0.5
Net chargeable income			<u>Nil</u>	

Correct treatment of balance of partnership loss of \$88,000 (180,000 – 92,000): carried forward and not included in personal assessment

0.5

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3 West Ltd

(a) Item	Description	To be included in the tax depreciation allowance schedule? (Yes/No)	To be adjusted in the tax computation? (Yes/No)	If yes, state the treatment basis and the amount of the adjustment	
1	Office renovation: Refurbishment	No	Yes	Deduction of \$50,000 (20% x \$250,000)	1
	New carpet	No	No	–	0.5
	Replacement carpets	No	Yes	Deduction of 100% of \$150,000	1
2	Computers	No	Yes	Deduction of 100% of \$18,000	1
3	Photocopier	Yes	No	–	0.5
4	Motor van	No	Yes	Deduction of 100% of \$450,000	1
5	Lighting system	No	Yes	Deduction of \$56,000 (20% x \$280,000)	1
					<u>6</u>

(b) Depreciation allowance schedule for the year of assessment 2016/17

	20%	30%	HP – 30%	Total allowance	
	\$	\$	\$	\$	
Written down value (WDV) brought forward	20,000	30,000			0.5
Additions: photocopier			55,000		0.5
Initial allowance (10,000 + (9,000 x 2)) x 60%			(16,800)	16,800	1
			<u>38,200</u>		
Disposal proceeds: motor van		(50,000)			0.5
Balancing charge		(20,000)		(20,000)	0.5
Annual allowance	(4,000)		(11,460)	15,460	1
WDV carried forward	<u>16,000</u>		<u>26,740</u>		
				<u>12,260</u>	
					<u>4</u>
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4 East Ltd

- (a)** Under the Inland Revenue Ordinance (IRO), when a new staff member commences employment in Hong Kong and is likely to be subject to tax in Hong Kong, an employer is obliged to report the commencement of employment to the Inland Revenue Department (IRD) within three months from the date of such commencement (s.52(4)). 1.5
- The employer is also required to file an annual employer's return in respect of each member of staff each year (s.52(2)). 0.5
- When an employee resigns from employment in Hong Kong, the employer is obliged to file another notification of cessation of employment to the IRD within one month before such cessation (s.52(5)). In practice, the official effective date of resignation is taken as the date of cessation. In certain circumstances, a shorter period of notice may be accepted if the employer only becomes aware of the cessation in less than one month before the effective date. 1.5
- In the event that an employee is about to leave Hong Kong for a period of longer than one month other than for business purposes, the employer is required to notify the IRD of such departure and the expected date of departure within one month before the intended departure (s.52(6)). Shorter notice may be accepted in reasonable circumstances. 1
- The employer is also obliged to retain any money payable to the leaving employee (including payable to and on behalf of the employee in money or money's worth) within one month of having given the notice of departure from Hong Kong, unless written consent from the IRD is received (s.52(7)). The employer is protected from any action which may be brought against it by the employee for retention of the money. 1.5

6**(b) Application to Mr Chan**

- In the case of Mr Chan, the cessation date of employment was 31 May 2016. Strictly speaking, East Ltd (East) is obliged to file the cessation notice to the IRD by 30 April 2016. Given that East was only aware of the resignation on 30 April 2016, the date of receiving Mr Chan's resignation, the IRD would be prepared to accept a shorter period of notice, but expects such notice of cessation of employment to be filed before the effective date of cessation of 31 May 2016. 1.5
- Knowing that Mr Chan has the intention to depart from Hong Kong without indicating the date of return, but would stay in Malaysia for more than a month, East is obliged to file a notice of such departure to the IRD within one month before the intended departure date of 20 May 2016. Given that East only received the resignation on 30 April 2016, the IRD would normally be prepared to accept a shorter period of notice, but expects such notice of cessation of employment and departure from Hong Kong to be filed before the departure date of 20 May 2016. Combining the obligation for notifying the cessation and departure as above, the IRD would therefore require the notice of cessation as well as the departure to be filed before 20 May 2016. 1.5

East is also obliged to retain the final payment to Mr Chan within one month of having filed the above cessation/departure notice, until the IRD's written consent is received. Normally, the consent will be given after Mr Chan has cleared all Hong Kong tax liabilities or the IRD is satisfied that Mr Chan has no intention to depart from Hong Kong for good. The fact that Mr Chan requested his final payment to be remitted overseas does not alter the nature of the payment nor the obligation of East to retain the payment.

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5 Mr Li

Salaries tax assessment for the year of assessment 2016/17

	\$	\$	
Salary (80,000 x 12)		960,000	0.5
Holiday travel package		118,000	0.5
Petrol cost (2,000 x 12 x 20%)		4,800	1
Reimbursement of club's joining fee (62,000 x 50%)		31,000	0.5
		<u>1,113,800</u>	
Rental value: ((1,113,800 – 2,300) x 4/12 x 10%)	37,050		1.5
Less: Rent suffered (10,000 x 4)	(40,000)	0	0.5
		<u>8,000</u>	0.5
Electricity and water bills		8,000	0.5
Share award benefit (5,000 x 7)		35,000	1
		<u>1,156,800</u>	
Assessable income		1,156,800	
Less: ACCA membership fee	2,300		0.5
Self-education expenses (maximum)	80,000	(82,300)	0.5
		<u>1,074,500</u>	
Net assessable income		1,074,500	
Less: Concessionary deductions			
Approved charitable donations (limited to 35% of (1,156,800 – 2,300))	24,000		0.5
Elderly residential care expenses – Mr Li's father (maximum)	92,000		0.5
Home loan interest (maximum)	100,000		1
Contributions to mandatory provident fund (maximum)	18,000	(234,000)	0.5
		<u>840,500</u>	
Part V allowance			
Married person's allowance	264,000		0.5
Child allowance: younger son	100,000		0.5
older son (not eligible)	0		0.5
Dependent parent allowance – Mrs Li's mother	46,000		0.5
Disabled dependant allowance – Mr Li's father	66,000	(476,000)	0.5
		<u>364,500</u>	
Net chargeable income		<u>364,500</u>	
Salaries tax payable at progressive rates		49,965	0.5
Salaries tax at standard rate (\$840,500 x 15%) not applicable		126,075	0.5

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

1. Medical claim reimbursement of \$20,000 (not taxable)
2. Annual premium on medical plan \$1,000 (not taxable)
3. Provision of company car of \$250,000 or \$100,000 (not taxable)
4. Loan interest saving of \$50,000 (not taxable)
5. Shenzhen Golf Club annual fee of \$12,000 (non-deductible)
6. Termination payment of \$200,000 (non-taxable)

0.5 mark each, maximum 2
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6 North Ltd

Profits tax computation for the year of assessment 2016/17

Basis period: year ended 31 December 2016

0.5

	\$	\$	
Profit for the year per accounts		308,600	0.5
<i>Add:</i> Special contributions to MPF (100,000 x 4/5)	80,000		1
Compensation payment to leaving staff	50,000		0.5
Commission to undisclosed agent	60,000		0.5
Building depreciation	100,000		0.5
Legal fees for tax appeal	25,000		0.5
Interest on loan from shareholder	55,000		0.5
Property tax accrued	14,400		0.5
Donations	<u>110,000</u>	<u>494,400</u>	0.5
		803,000	
<i>Less:</i> Commercial building allowance (2,500,000 x 4%)	100,000		1
Interest income from bank (2,000 + 3,000)	5,000		1
Interest income from tax reserve certificates	<u>1,000</u>	<u>(106,000)</u>	0.5
		697,000	
<i>Less:</i> Donation (Hong Kong Red Cross)		<u>(30,000)</u>	0.5
		667,000	
<i>Less:</i> Tax loss brought forward		<u>(70,000)</u>	0.5
Net assessable profits		<u><u>597,000</u></u>	
Profits tax payable at 16.5%		98,505	0.5
<i>Less:</i> Property tax set-off (s.25)		<u>(14,400)</u>	1
Profits tax payable		<u><u>84,105</u></u>	

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	120,000	Regular contributions to MPF	50,000
Profit from residential property	400,000	Rental for director's accommodation	280,000
Interest on overdue receivable	4,000	Severance payment	30,000
Donations to China Refugee Fund	80,000	Distribution costs to China shipment company	240,000
		Legal fee – audit and tax filing	30,000
		Legal fee for overdue receivable	18,000
		Interest on bank loan	35,000
		Interest on bank overdraft	2,000

0.5 mark each, maximum 4.5

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