

Fundamentals Level – Skills Module

Taxation (Hong Kong)

Thursday 8 June 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.

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 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** John Adams is employed by Sun Ltd (Sun), a company carrying on business in Hong Kong. John lives in a serviced apartment, for which the rent is paid directly to the landlord by Sun. John has learnt that interest incurred on a loan to acquire a residential property in Hong Kong can be deducted against his income. He is therefore thinking of buying a flat in Hong Kong for use as his place of residence, using one of the following options:
- (1) John will enter into a mortgage loan with a Hong Kong bank at a market interest rate. Sun will pay John a monthly housing allowance in cash, and he will use all or part of the allowance for the monthly mortgage repayment.
 - (2) John will enter into a mortgage loan with a Hong Kong bank at a market interest rate. Moon Ltd (Moon), the Hong Kong subsidiary of Sun, will guarantee John a maximum interest repayment of 1% per annum. Any excess interest charged by the bank above 1% will be subsidised by Moon by paying the difference into John's bank account each month.
 - (3) Moon will provide a low-interest mortgage loan to John. The interest rate will be fixed at 1% irrespective of the market rate.

Required:

- (a) List the conditions necessary for the deduction of home loan interest for salaries tax purposes.** (3 marks)
- (b) Advise John Adams of the different treatments of options (1) to (3) for salaries tax purposes.** (7 marks)

(10 marks)

2 The following is a summary of the income and expenses of Mr and Mrs Mak for the year ended 31 March 2017:

Mr Mak's income

	\$
(1) Profit from a sole proprietorship business (before deduction of any approved charitable donations)	166,000
(2) Director's fee from Cayman Ltd (Note (i))	120,000

Mr Mak's expenses/losses

	\$
(1) Share of loss from a partnership business	48,000
(2) Donations made to the Community Chest	210,000
(3) Contributions to the mandatory provident fund (MPF)	6,000

Mrs Mak's income

	\$
(1) Rental received from Property A (Note (ii))	150,000
(2) Share of profits from a partnership business (Note (iii))	92,000

Mrs Mak's expenses

	\$
(1) Interest paid (Note (iv))	46,000
(2) Donations made to the Tung Wah Group of Hospitals	40,000

Notes:

- (i) Cayman Ltd is a company incorporated in the Cayman Islands but managed and controlled in Hong Kong. However, its profits are agreed by the Assessor as being derived from outside Hong Kong.
- (ii) Property A is solely owned by Mrs Mak. The property was rented to a tenant on 1 June 2016 for a term of two years at a monthly rent of \$15,000 payable in advance. An initial premium of \$180,000 was also paid. It was agreed that the rates and management fees were payable by the tenant.
- (iii) The partnership in which Mrs Mak was a partner incurred heavy losses in 2015/16. Mrs Mak's share of such losses was \$180,000.
- (iv) The interest paid by Mrs Mak was on a mortgage loan to finance the purchase of Property A.
- (v) Mr and Mrs Mak did not elect personal assessment for 2015/16.

Required:

Compute the net chargeable income of Mr and Mrs Mak under personal assessment for the year of assessment 2016/17.

(10 marks)

3 West Ltd (West) carries on business in Hong Kong, providing event planning and advisory services. During the year ended 31 December 2016, West had the following transactions in fixed assets:

- (1) Spent \$430,000 renovating its offices comprising:
 - \$250,000 for refurbishing the conference room;
 - \$30,000 for a new carpet in the entrance lobby; and
 - \$150,000 for replacing the old carpets in the general office area.
- (2) Installed ten new computers for \$18,000, including \$14,000 for hardware and \$4,000 for software.
- (3) Bought a new computerised photocopier under a hire purchase agreement on 15 October 2016. A down payment of \$10,000 was paid at the time of purchase and two monthly instalments of \$10,000 each were paid on 1 November and 1 December 2016 respectively. Three more monthly instalments are payable in 2017. The cash price of the photocopier is \$55,000.
- (4) Paid \$400,000 for a new motor van by trading in an old van at a value of \$50,000. The new motor van was awarded the title of ‘Best Green Car of the Year’. The old van was purchased ten years ago.
- (5) Spent \$280,000 to install an energy saving lighting system in the office.

West’s tax depreciation schedule from its 2015/16 tax return shows tax written down values for its 20% and 30% pools of \$20,000 and \$30,000 respectively.

Required:

(a) Explain the tax treatment of each of the items (1) to (5) by copying the following table into your Answer Booklet and completing it:

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 – New carpet – Replacement carpets			
2	Computers			
3	Photocopier			
4	Motor van			
5	Lighting system			

(6 marks)

(b) Based on the treatments identified in part (a), prepare the tax depreciation allowance schedule for West Ltd for the year of assessment 2016/17, showing clearly the eligible deduction of tax depreciation allowance.

(4 marks)

(10 marks)

- 4 East Ltd (East) carries on business in Hong Kong, and employs a team of 20 staff for its operation. On 30 April 2016, Mr Chan submitted his resignation to terminate his employment with East with effect from 1 June 2016. After deducting his outstanding annual leave entitlement, Mr Chan's official last day in the office was 15 May 2016. Mr Chan advised East that he would leave Hong Kong on 20 May 2016 and go to Malaysia to buy a property there. Being in need of money, he requested East to remit his final payment (including salary and bonus) to his bank account in Malaysia. Mr Chan did not indicate whether he would be returning to Hong Kong but did say that he expected to stay in Malaysia for at least six weeks.

During the year of assessment 2016/17, East also hired two new staff. However, East did not report this change in employees to the Inland Revenue Department.

Required:

- (a) **Based on the Inland Revenue Ordinance and prevailing practice of the Inland Revenue Department, explain the general reporting obligations of an employer in respect of the hiring of new staff and the resignation of existing staff.** (6 marks)
- (b) **Pertaining to the case of Mr Chan, advise East Ltd of its reporting obligations including the due dates of compliance.** (4 marks)

(10 marks)

- 5 Mr Li worked in Hong Kong as financial director for South Ltd (South) which carries on business in Hong Kong. On 31 March 2017, Mr Li received a notice from South to terminate his employment with effect from 1 April 2017. Mr Li was requested to sign an undertaking to waive any right of claim against South, and in return for such undertaking, he was paid a termination payment of \$200,000.

In relation to the year ended 31 March 2017, Mr Li had the following income and expenditure:

- (1) A monthly salary of \$80,000, subject to a deduction of 7% as his contribution to a registered retirement fund.
- (2) A reimbursement of a medical claim in the sum of \$20,000 from South's insurance company under a group employee medical plan. The annual premium paid to this plan by South for each staff member is \$1,000.
- (3) A travel package (flight and accommodation) with a value of \$118,000 purchased by South for Mr Li and his family's holiday in Paris. The package could not be transferred to other persons.
- (4) A company motor car provided for Mr Li's use. The purchase cost of the motor car was \$250,000 and its second hand value as at 31 March 2017 was \$100,000. Mr Li used the car for both business and personal purposes on a 80:20 basis, which was agreed with the Inland Revenue Department for tax purposes. He was also provided with a corporate credit card which he used to pay for his petrol costs of \$2,000 per month. The credit card balance was settled by South. During the year ended 31 March 2017, Mr Li did not use the corporate credit card for any other purpose.
- (5) Mr Li spent \$62,000 to join the Shenzhen Golf Club plus an annual membership fee of \$12,000. He was reimbursed half of the joining fee by a shareholder of South.
- (6) During the period from 1 April 2016 to 31 July 2016, Mr Li's family lived in a flat leased at a monthly rental of \$30,000, of which \$20,000 was reimbursed by South under the company's staff rental reimbursement scheme. With effect from 1 August 2016, the family moved into a new property purchased by Mr Li. The property is jointly owned by Mr Li and his wife and its purchase was financed by a staff loan provided by South. The property is mortgaged against the loan. The total interest paid on the staff loan for 2016/17 was \$150,000. If a market interest rate had been charged by South, the interest cost would have been \$200,000.
- (7) Since Mr Li's family moved into their own property, the electricity and water bills totalling \$8,000 have been paid by South.
- (8) Mr Li incurred the following annual membership fees in the year:

The Association of Chartered Certified Accountants	\$2,300
The Shenzhen Golf Club (see (5) above)	\$12,000
- (9) On 1 April 2013, Mr Li was granted 5,000 shares by South subject to a vesting period up to 30 September 2016. Mr Li sold the 5,000 shares on 1 October 2016. The market price of each share was \$5 on 1 April 2013, \$7 on 30 September 2016 and \$7.50 on 1 October 2016.
- (10) Mr Li paid a tuition fee of \$200,000 for a part-time MBA course. Half of this tuition fee was reimbursed by South.
- (11) Mr Li made a monthly contribution of \$2,000 to an approved charitable organisation.

Apart from the above, the following additional information is available:

- (12) Mrs Li is a housewife. Mr and Mrs Li have two children. The elder child is aged 19 and studying part-time in the UK; and the younger child is aged six.
- (13) Mrs Li's mother, aged 65, who lives in her own apartment in Hong Kong, is maintained by Mrs Li.
- (14) Mr Li's father, aged 55 and disabled, lives in a nursing home in Hong Kong. The total nursing home bills amounting to \$220,000 for 2016/17 were paid by Mr Li.

Required:

Compute the Hong Kong salaries tax payable by Mr Li, if any, for the year of assessment 2016/17.

(15 marks)

- 6 North Ltd (North), a Hong Kong incorporated company, carries on a business in Hong Kong. For the year ended 31 December 2016, North has the following trading results:

	Note	\$	\$
Income			
Income from the export of recycled products		2,200,000	
Income from recycled by-products		200,000	
Property rental income	(1)	120,000	
Profit from a residential property transfer	(2)	400,000	
Interest income	(3)	10,000	2,930,000
Expenses			
Directors' fees		300,000	
Staff costs	(4)	910,000	
Distribution costs	(5)	600,000	
Storage and container costs		400,000	
Building depreciation	(6)	100,000	
Small assets written off	(6)	10,000	
Legal and professional fees	(7)	73,000	
Interest expenses	(8)	92,000	
Insurance		8,000	
Office consumables		4,000	
Taxation expenses	(9)	14,400	
Donations	(10)	110,000	(2,621,400)
Profit for the year			308,600

Notes:

- (1) North owns a workshop which is used partly for its own business operation, and partly leased to an unrelated party at a rental of \$10,000 per month. The workshop was acquired in January 2010 at a cost of \$5,000,000, which was partially funded by a bank mortgage loan and partially by an interest-bearing loan from North's shareholder who carries on business in China. The qualifying expenditure for commercial building allowance in respect of the workshop is \$2,500,000.
- (2) In March 2016, North signed a sale and purchase agreement to acquire a residential property from a property developer at a price of \$10,000,000. Before completion, North was approached by a market buyer who offered to take up the assignment of the property and pay North a profit of \$400,000. North accepted the offer. All the related costs including stamp duty and legal costs were paid and borne by the ultimate buyer.
- (3) Interest income comprises:

	\$
Interest on a HK\$ deposit with a bank in Hong Kong	2,000
Interest on a RMB deposit with a bank in Hong Kong	3,000
Interest on overdue accounts receivable from customers in China	4,000
Tax reserve certificates bought from the HKSAR government	1,000
Total per accounts	10,000

(4) Staff costs comprise:

	\$
Salaries and allowances	400,000
Mandatory provident fund (MPF) contributions (special contribution \$100,000; regular contributions \$50,000)	150,000
Rental for director's accommodation	280,000
Severance payment to a leaving staff member (per the Employment Ordinance)	30,000
Compensation payment to a leaving staff member in return for a promise not to join a competitor	<u>50,000</u>
Total per accounts	<u><u>910,000</u></u>

(5) Distribution costs comprise:

	\$
Transportation costs paid to Hong Kong shipment companies	300,000
Transportation costs paid to a China shipment company	240,000
Commission paid to an undisclosed agent in China	<u>60,000</u>
Total per accounts	<u><u>600,000</u></u>

All payments were approved by North's director.

(6) Other than the workshop (see (1) above), North only has small fixed asset items which are all written off upon purchase. This treatment has been agreed by the Inland Revenue Department and thus no tax depreciation allowance is calculated on small asset items. There were no other movements in fixed assets during the year.

(7) Legal and professional fees comprise:

	\$
Audit and tax filing fees	30,000
Tax advisory fees for lodging a tax appeal	25,000
Legal fees for the recovery of an overdue receivable from a China customer	<u>18,000</u>
Total per accounts	<u><u>73,000</u></u>

(8) Interest expenses comprise:

	\$
Interest on shareholder's loan to acquire the workshop (see (1) above)	55,000
Interest on bank loan to acquire the workshop (see (1) above)	35,000
Interest on bank overdraft line	<u>2,000</u>
Total per accounts	<u><u>92,000</u></u>

(9) Taxation expenses refer to the Hong Kong property tax accrued for 2016/17 in respect of the rental income from leasing part of the workshop at \$10,000 per month. Property tax for 2015/16 of \$14,400 was settled in November 2016.

(10) The cash donations were \$30,000 made to the Hong Kong Red Cross and \$80,000 made to the China Refugee Fund.

(11) North's profits tax return for the assessment year 2015/16 shows a tax loss of \$70,000 eligible for carry-forward to future years.

Required:

Prepare North 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