
Answers

Cases are given in the answers for educational purposes. Unless specifically requested, candidates were not required to quote specific case names to obtain the marks, only to provide the general principles involved.

	Marks
1 (a) Section 8(1) of the IRO only taxes employment income arising in or derived from a source in Hong Kong. In this regard, the relevant tests for determining the location of employment as set out in <i>Goepfert's</i> case and DIPN 10 are:	
(i) the place where the contract of employment was negotiated and concluded;	
(ii) the residence of the employer; and	
(iii) the place where the remuneration was paid.	1·5
Since First Ltd (the Company) is a Hong Kong company, Sammy's employment is obviously located in Hong Kong and all his remuneration for services under this employment, wherever rendered, is within the scope of salaries tax. However, s.8(1A)(b) provides an exemption where all services are rendered outside Hong Kong. Whether there is any employment service rendered in Hong Kong is a matter of fact. It is usually not sufficient merely to demonstrate that the most important aspects of the employment are rendered abroad or that only incidental or minor duties are undertaken in Hong Kong. If any duties at all are rendered in Hong Kong in the relevant year of assessment, the exemption will be lost. In particular, Sammy is the project manager and he has provided services of an administrative nature (attending meetings) in Hong Kong which cannot be ignored.	2·5
It is further provided in s.8(1B) that only services rendered in Hong Kong during visits not exceeding a total of 60 days are ignored. Since Sammy has provided services of an administrative nature in Hong Kong, he would not be exempted under s.8(1A)(b) as he did perform services in Hong Kong during visits of more than 60 days.	1·5
Since Sammy had rendered services in Macau and was liable to income tax in Macau, any income taxed in Macau in respect of services rendered in Macau would be exempt from salaries tax under s.8(1A)(c), so long as Sammy had paid the income tax in Macau. However, since Sammy has not paid the tax, the exemption is not available.	1·5
	<u>7</u>

(b) **Salaries tax assessment for Sammy**
Year of assessment 2011/12

	\$	
Salary (70,000*12)	840,000	0·5
Fees from overseas companies	30,000	0·5
Difference between market value and purchase price of the flat	100,000	0·5
Reimbursement of medical expenses	28,000	0·5
Bonus (40,000 + 70,000)	110,000	1
	<u>1,108,000</u>	
Rental value [(1,108,000 – 100,000)*11/12*10%]	92,400	1·5
Assessable income	<u>1,200,400</u>	
Approved charitable donations	(35,000)	0·5
Elderly residential care expenses (maximum)	(72,000)	0·5
Contributions to mandatory provident fund (maximum)	(12,000)	0·5
	<u>1,081,400</u>	
Married person's allowance	(216,000)	0·5
Child allowance (son)	(60,000)	1
Net chargeable income	<u>805,400</u>	
Salaries tax payable at progressive rates	<u>124,918</u>	0·5
Salaries tax at standard rate is not applicable (1,081,400*15%)	<u>162,210</u>	0·5

Explanations:

- (i) **Note (3):** Although not paid by the employer, the fees of \$30,000 received from the overseas companies which have supplied construction materials to the Company are part of Sammy's income from employment. These fees are assessable under salaries tax as they are paid for Sammy's services performed in his employment with the Company: *Calvert v Wainwright*.

1

	Marks
(ii) Note (5): The flat provided by the Company is considered as a place of residence, which includes representative occupation. Rental value equivalent to 10% of Sammy's income derived from the Company for the period during which the residence is provided (i.e. from 1 April 2011 to 28 February 2012) will therefore be included as a taxable benefit under s.9(1)(b).	1·5
Purchasing the flat in Macau at a price lower than the market value is a benefit that is convertible into cash and taxable. The taxable benefit is the difference between the market value and the price paid. As the benefit is not derived for the period during which rent-free accommodation is provided, it is not included in the rental value calculation.	1·5
The cost of the meals provided is not taxable as the benefit cannot be converted into cash. The travelling costs between Hong Kong and Macau are also not taxable, as these costs are incurred by the Company directly and the journey is not a holiday journey.	1
(iii) Note (6): Reimbursement of the medical expense of \$28,000 is taxable under s.9(2A)(a), but the \$80,000 payment represents a compensation for personal loss; it is not income for services rendered and is not taxable.	1
(iv) Note (7): The bonus is taxable as a reward for Sammy's employment. But the question arises as to when a particular bonus should be taxed and in which year. Under s.11D(b), an income accrues to a person when he is entitled to receive it, whether he actually receives it or not. As his bonus is discretionary, it will not accrue until it is made known to Sammy that it will be paid and, in the absence of a stated date of payment, will accrue when actually paid. Therefore, Sammy's bonus paid in April 2011 would fall within the year of assessment 2011/12 in which it is paid, although it may relate to his employment for 2010/11. Moreover, s.11D(a) further provides that an income is deemed to have been received by a person when it has either been made available to him or has been dealt with in accordance with his instructions. This is relevant to Sammy's December 2011 payment of \$70,000 which would be deemed as having been received by Sammy, although the same amount has been paid into the retirement fund according to his instruction.	2·5
(v) Note (9): Sammy's mother would qualify for the basic dependent parent allowance, but not the additional dependent parent allowance as she did not live continually with him throughout the year of assessment. However, in this case, it is preferable for Sammy to claim the concessionary deduction for elderly residential care expenses under s.26D (up to the maximum allowance of \$72,000), assuming the nursing home qualifies as a 'residential care home' within s.26D(5).	1
	18
	25

		Marks	
2 (a)	Koko Ltd		
	Profits tax computation for the year of assessment 2011/12		0.5
	Basis period: year ended 31 March 2012		0.5
		\$	\$
Profit for the year per accounts		296,000	0.5
Add: Donations	20,000		0.5
Depreciation	100,000		0.5
Club debenture written off	160,000		0.5
Loan to staff written off	30,000		0.5
Commission to undisclosed agent	10,000		0.5
Advisory fee for tax appeals	40,000		0.5
Stamp duty on lease preparation	4,000		0.5
Interest on loan from parent	11,000		0.5
Finance fee on loan for China property	5,000	380,000	0.5
		676,000	
Less: Dividend income	100,000		0.5
Profit from securities trading in China	400,000		0.5
Interest income	12,000		0.5
Property income from China	120,000		0.5
Building repainting	13,000		1
Replacement of soft furnishing – carpeting	20,000		1
Replacement of soft furnishing – curtains	10,000		1
Prescribed fixed asset – computer	18,000		1
Environmental protection machinery	55,000		1
Environmental protection installation (20%)	6,000		1
Depreciation allowance for machinery and plant	319,160		0.5
Commercial building allowance	800	(1,073,960)	0.5
Tax loss for current year		(397,960)	
Profits tax payable		Nil	0.5

Correct treatment of items that 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	\$
Net sales to China	2,000,000	Loss from Hong Kong securities trading	100,000
Service fee for repackaging	400,000	Loss from A\$ trading	210,000
		Exchange loss from payment to parent	220,000
		Wages to domestic helper of director	50,000
		Rent and rates for China warehouse	130,000
		Trips to China for lawyer	28,000
		Contribution to MPF	24,000
		Legal fee for China disputes	30,000
		(0.5 mark each) Maximum	

4

	Depreciation allowance schedule				Marks
	20%	30%	HP – 20%	Total allowance	
	\$	\$	\$	\$	
Written down value (WDV) brought forward	20,000	30,000			0.5
Additions					
Photocopier	20,000				0.5
Motor vehicle		400,000			0.5
Fax machine			25,600		0.5
	40,000	430,000	25,600		
Initial allowance (IA) 60%	(12,000)	(240,000)		252,000	1
IA – HP (5,600 + 2,000*1)*60%			(4,560)	4,560	1
	28,000	190,000	21,040		
Annual allowance	(5,600)	(57,000)	–	62,600	1
WDV carried forward	22,400	133,000	21,040		
				319,160	
Commercial building allowance					
New storeroom				20,000	
Commercial building allowance at 4%				800	0.5
					25

(b) Estimated impact on Koko Ltd's profits tax position for 2011/12 arising from an offshore claim

	\$	\$	
Tax loss for current year (as per part (a))		(397,960)	
Add: Sales made to China customers		(2,000,000)	0.5
		(2,397,960)	
Less: Cost of goods sold to China customers disallowed:			
[1,800,000*2,500,000/(1,500,000 + 2,500,000)]	1,125,000		1
Loss from settlement of purchase amount due to parent			
[220,000*2,500,000/(1,500,000 + 2,500,000)]	137,500		1
Rent for warehouse in China disallowed	130,000		0.5
Travelling cost to China disallowed	28,000		0.5
Legal cost for China customer disallowed	30,000	1,450,500	0.5
Estimated revised tax loss for current year		(947,460)	
Correct treatment of service fee for repackaging the products.			1
			5
			30

3 (a)

Personal assessment computation for Mr and Mrs Li
Year of assessment 2011/12

	\$	Mr Li \$	Mrs Li \$	
Assessable profits				
Profits from sole proprietorship business	266,000			0.5
Approved charitable donations (ACD) 35%	<u>(93,100)</u>	172,900		1
Share of partnership profits (100,000 – 100,000 (loss brought forward))			0	1
Net assessable income				
Director's fee		120,000		0.5
Salary			330,000	0.5
Net assessable value (NAV)				
Rental received (15,000*10)	150,000			0.5
Premium (24,000*10/24)	<u>10,000</u>			1
	160,000			
20% statutory deduction	<u>(32,000)</u>	128,000		0.5
		420,900	330,000	
Less: Mortgage interest (restricted to NAV)		(128,000)		1
ACD – Mr Li				
((420,900 + 93,100 – 128,000)*35% – 93,100)		(42,000)		1.5
ACD – Mrs Li			(50,000)	1
Unabsorbed ACD transferred from spouse (150,000 – 93,100 – 42,000) = 14,900 (limited to 65,500 (330,000*35% – 50,000))			(14,900)	1
Share of partnership loss		(50,000)	0	1
Loss from property sale (36,000 + 10,000)		<u>(46,000)</u>		1
Reduced total income		<u>154,900</u>	<u>265,100</u>	
Joint total income			420,000	0.5
Less: Married person's allowance		216,000		0.5
Child allowances		120,000		0.5
Dependent parent allowance		<u>36,000</u>	(372,000)	0.5
Net chargeable income			<u>48,000</u>	
Tax payable at progressive rates			<u>1,360</u>	0.5
Tax payable at standard rate is not applicable (420,000*15%)			<u>63,000</u>	0.5
By Mr Li \$1,360*154,900/420,000			<u>502</u>	0.5
By Mrs Li \$1,360*265,100/420,000			<u>858</u>	0.5
			<u>16</u>	

- (b) The adjusted tax loss of a partnership should be allocated to the respective partners and carried forward under the name of the partnership and can only be offset by the partners against their share of future profits from the partnership. However, the partners may be able to offset their share of any partnership loss against their other income if they elect for personal assessment for the year of assessment in which the loss is incurred. Personal assessment allows an individual to aggregate assessable income (including business losses, if applicable) from various statutory heads of charge (profits tax, salaries tax and property tax), and to offset any business loss, including a share of a partnership loss, against the total income. 2.5

Therefore, since the couple did not elect for personal assessment for the year 2010/11, Mrs Li's share of the partnership loss of \$110,000 will be carried forward to offset her share of partnership profit of \$100,000 in 2011/12. The balance of the loss of \$10,000 not yet utilised will continue to be carried forward under the name of the partnership and cannot be transferred to personal assessment.

1.5
4
20

		Marks
4	(a) If Milan Ltd (the Company) closes its accounts on 31 October 2012, the basis period for all relevant years of assessments will be as follows:	
	(1) Year of assessment 2011/12 (year of commencement): Nil	1
	(2) Year of assessment 2012/13: 1 January 2012 to 31 October 2012	1
	If the Company closes its accounts on 31 March 2012, the basis period for all relevant years of assessments will be as follows:	
	(1) Year of assessment 2011/12 (year of commencement): 1 January 2012 to 31 March 2012	1
	(2) Year of assessment 2012/13: 1 April 2012 to 31 March 2013	1
		<hr/> 4
	(b) (i) As Milan Ltd (the Company) carries on business in Hong Kong, it is required to observe the following compliance obligations:	
	Since the Company has received income chargeable to tax in Hong Kong, under s.51(2) it has to notify the Inland Revenue Department (IRD) of its chargeability to tax within four months after the end of the basis period for the relevant year of assessment in which the chargeable income is received, unless it has been required to file a tax return by the IRD.	1
	If the first accounts are closed on 31 October 2012, as stated in (a) the first relevant year of assessment would be 2012/13. The basis period for this year of assessment is 1 January 2012 to 31 October 2012. Four months from the end of the basis period would be 28 February 2013. Therefore, the Company will have to notify the IRD of its chargeability to tax on or before 28 February 2013, unless a tax return has been issued to the Company before that date.	1
	If the first accounts are closed on 31 March 2012, as stated in (a) the first relevant year of assessment would be 2011/12. The basis period for this year of assessment is 1 January 2012 to 31 March 2012. The due date for notifying chargeability would be 31 July 2012, i.e. four months from 31 March 2012. It is obvious that this deadline has been missed without giving proper notification. This failure to notify may cause a penalty to be levied on the Company.	1
	If a profits tax return is issued by the IRD, the Company is obliged under s.51(1) to complete and submit the return within the period stipulated, together with the audited accounts and profits tax computation. Normally, one month is allowed for filing purposes but, in practice, an extension would be given upon application depending on the situation.	1
	The Company is also required to answer queries raised by the IRD or supply any information as requested by the IRD within the specified time period.	1
	Under s.51C, the Company has to maintain proper business records in respect of transactions conducted for a period of seven years.	1
	If the Company changes its address, it is required by s.51(8) to inform the Commissioner in writing of the particulars of the change within one month.	1
		<hr/> 7
	(ii) Where a company employs staff and incurs salary expenses, it is obliged:	
	(1) to complete and submit notification of commencement of employment within three months of commencement as well as an annual employer's return in respect of each member of staff, giving details of the staff involved and remuneration paid (ss.52(2) and 52(4));	1
	(2) to submit notification of any employee who is about to cease to be employed within one month before cessation (s.52(5));	1
	(3) to submit notification of any employee who is about to leave Hong Kong for more than one month other than for a business purpose, one month before the employee's departure (s.52(6)); and	1
	(4) to retain money payable to any employee who will cease employment and leave Hong Kong for one month from the date of the notice (s.52(7)).	1
		<hr/> 4
		<hr/> 15 <hr/>

	Marks
<p>5 (a) Section 9(1)(d) deems any gain realised on the exercise, release or assignment of a share option to be income from employment or office. The gain arising from the share option is assessed at the time of exercise, release or assignment, not at the time of grant. The taxable gain is the difference between the market price of the shares at the time of exercise, or the consideration received for the assignment or release, and the cost paid for the option and the shares.</p> <p>In David's case, the gain arising from the exercise of the share option is assessed at the time of exercise as follows: [\$28 (value at date of exercise) – \$20 (cost of shares)] x 2,000 = \$16,000.</p> <p>Any gain arising from the subsequent sale of the shares is considered as a return from investment rather than from employment, and thus is disregarded. Therefore the difference in value between 1 March (date of exercise) and 31 March 2012 (date of sale) is not assessable.</p>	<p>1·5</p> <p>1·5</p> <p><u>1</u> <u>4</u></p>
<p>(b) David must be advised that Danny's advice is wrong and must not be followed.</p> <p>Specifically, David must report his gain of \$16,000 (part (a) above) from the share option scheme. It is taxable in accordance with the IRO and David has an obligation to file a full and correct return issued to him by the Assessor under s.51. The fact that the shares relate to a foreign company which is not his employer is not relevant to any charge under s.9(1)(d), as the share option was granted in respect of David's employment services with Star Ltd.</p> <p>If David does not report his gain, there is a strong likelihood that the Commissioner may take penalty action including prosecution under s.80(2) or raise additional (or penalty) tax under s.82A. Even if David doubts the taxability of the income, this does not absolve him from stating all relevant details before the Commissioner so that an assessment can properly be raised. Failure without reasonable excuse to properly complete a return is an offence under s.80(2), and it is likely that David would be assessed under s.82A.</p> <p>In D31/85, the Board of Review explained 'reasonable excuse' as follows: '<i>We consider that the correct test to be applied in determining reasonable excuse is what one would expect a reasonable person to do in all of the circumstances.</i>'</p> <p>While it is true that reasonable reliance upon professional advice would or may constitute a 'reasonable excuse' for the purposes of s.82A (see BR 80/76), that reliance must be reasonable in the circumstances (D28/84). Reliance upon Danny's advice (an unqualified accountant) is not reasonable in this context (compare D46/89).</p> <p>If David considered there was doubt as to the tax position, he could approach the IRD for an explanation or engage a professional accountant for advice.</p>	<p>0·5</p> <p>1·5</p> <p>2</p> <p>0·5</p> <p>1</p> <p>0·5</p> <p><u>6</u> <u>10</u></p>