Fundamentals Level – Skills Module

Taxation (Hong Kong)

Tuesday 4 December 2012

Time allowed

Reading and planning: 15 minutes

Writing: 3 hours

ALL FIVE questions are compulsory and MUST be attempted.

Tax rates and allowances are on page 2.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants

Paper F6 (HKG)

ACCA

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.

TAX RATES AND ALLOWANCES

The following 2011/12 tax rates and allowances are to be used in answering the questions.

Allowances

	$
Basic allowance	108,000
Married person's allowance	216,000
Single parent allowance	108,000
Child allowance – 1st to 9th child (each)	60,000
– additional allowance in the year of birth (each)	60,000
Dependent parent/grandparent allowance – basic	18,000/36,000
– additional	18,000/36,000
Dependent brother/sister allowance	30,000
Disabled dependant allowance	60,000

Deductions

	$
Self-education expenses (maximum)	60,000
Home loan interest (maximum)	100,000
Elderly residential care expenses (maximum)	72,000
Mandatory provident fund contributions (maximum)	12,000

Tax rates

Salaries tax rates:	
First $40,000	2%
Next $40,000	7%
Next $40,000	12%
Remainder	17%
Standard rate	15%
Profits tax rate for corporations	16·5%

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

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Question 1 begins on page 4.

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ALL FIVE questions are compulsory and MUST be attempted

1 Sammy is employed by First Ltd (the Company), a company resident in Hong Kong, as project manager in charge of the Company's construction project in Macau. He commenced this employment in April 2010. The following information is available in respect of Sammy for the year ended 31 March 2012:

(1) His salary was $70,000 per month.

(2) Sammy returns to Hong Kong every Saturday afternoon to stay with his family and goes back to Macau on Monday morning. He also comes back to Hong Kong during his vacations. During the two years ended 31 March 2011 and 2012, Sammy was in Hong Kong for a total of 200 days and 190 days respectively. Because of the nature of his duties, he was rarely required to perform any duties in Hong Kong, except to attend meetings in Hong Kong whenever necessary.

(3) Sammy received fees of $30,000 from overseas companies which have supplied construction materials to the Company, which was approved by the Company.

(4) Remuneration for Sammy's services rendered in Macau is subject to income tax in Macau, and Sammy was required to pay $80,000 to the Macau tax authority. However, Sammy did not pay the tax.

(5) Sammy was provided with a flat in Macau, and meals were provided for him at the construction site at a cost to the Company of $1,000 per month. On 1 March 2012, he purchased the flat from the Company for $800,000. The market value of the flat at that date was $900,000. The flat continued to be the residence of Sammy during his stay in Macau. The cost of his travelling expenses between Hong Kong and Macau of $2,000 per month were paid directly by the Company.

(6) In September 2011, Sammy was hurt in an accident while working on the construction site. The Company reimbursed Sammy's medical expenses of $28,000 that he paid for his stay in the hospital in Macau. In addition, he was paid $80,000 by the Company for the loss of the little finger on his left hand.

(7) Sammy is entitled to a discretionary bonus, which is normally one month's salary plus a top-up which is determined based on the Company's profitability during the captioned year. During 2011/12, Sammy was paid the following amounts:

(i) $40,000 paid in April 2011, being the top-up payment for the 2010/11 bonus;
(ii) $70,000 paid in December 2011, being the one month's salary bonus for 2011/12. Consistent with his practice in prior years, Sammy authorised the Company to pay this $70,000 into his mandatory provident fund scheme.

(8) Sammy's wife is a housewife. The couple have two children aged 22 and 25. The 22-year-old son was a full-time student at Polytechnic University until June 2011 when he graduated. He is now working as a staff accountant. The 25-year-old daughter was a graduate student at The Chinese University of Hong Kong. She lived in college at the University and was employed part-time by the University as a teaching assistant for a salary of $10,000 per month.

(9) Sammy (when he was in Hong Kong) and his family lived with Sammy's mother (aged 70) in a flat in Shatin. In September 2011, his mother was suddenly taken ill, and Sammy was then forced to put her in a nursing home because she needed full-time medical care. His total payments to the nursing home for residential care amounted to $80,000 for the period to 31 March 2012.

(10) During the year 2011/12, Sammy and his wife made cash donations of $25,000 and $10,000 respectively to various charities.

All currency amounts are given in Hong Kong dollars.

Required:

(a) Advise Sammy on the extent to which he is liable to Hong Kong salaries tax for the year of assessment 2011/12. (7 marks)

(b) Assuming that Sammy is chargeable to salaries tax in full, calculate the salaries tax payable by Sammy for the year of assessment 2011/12, giving explanations of the treatment you have accorded for tax purposes to items (3), (5), (6), (7) and (9) above.

Note: You should ignore provisional taxes and overseas tax. (18 marks)

(25 marks)

2 Koko Ltd (Koko) is a Hong Kong-incorporated company carrying on business in Hong Kong. Koko is wholly owned by a Malaysian company which owns huge plantation sites in Malaysia and it imports wood products from its Malaysian parent and sells them to customers in both Hong Kong and Mainland China. Koko makes up its accounts to 31 March. The following is Koko's income statement for the year ended 31 March 2012:

	Notes	$	$
Turnover	(1)		3,900,000
Cost of goods sold	(2)		(1,800,000)
			2,100,000
Profit from securities	(3)	300,000	
Loss from foreign exchange	(4)	(430,000)	
Dividends from securities	(5)	100,000	
Interest income	(6)	12,000	
Rental income	(7)	120,000	102,000
			2,202,000
Salaries and wages	(8)	800,000	
Rent and rates	(9)	350,000	
Directors' fees		220,000	
Travelling and entertainment expenses	(10)	28,000	
Contributions to mandatory provident fund (MPF) schemes	(11)	24,000	
Donations	(12)	20,000	
Sundry write-offs	(13)	200,000	
Legal and professional fees	(14)	134,000	
Depreciation	(15)	100,000	
Interest expense	(16)	30,000	(1,906,000)
Net profit			296,000

Notes:

(1) Turnover includes the following:

	$
Gross sales of wood products made to Hong Kong customers	1,500,000
Net sales of wood products made to China customers (gross sales $2,500,000 less relevant import tax $500,000)	2,000,000
Service fee for repackaging the products according to customers' needs before exporting to China customers	400,000
Total	3,900,000

(2) Cost of goods sold represents the purchase cost of wood products from Koko's Malaysian parent company.

(3) This profit arose from the trading of securities by Koko with the surplus funds available. Details are:

	$
Loss from trading on the Hong Kong Stock Exchange	(100,000)
Profit from trading on the China Stock Exchange	400,000
	300,000

(4) The loss from foreign exchange comprises:

	$
Loss from trading in Australian dollars	(210,000)
Loss from settlement of purchase amount due to Malaysian parent (HK$ v Ringgit)	(220,000)
Net exchange loss	(430,000)

Koko did not revalue its non-HK$ assets and liabilities at the end of the reporting period.

(5) The dividends received from securities purchased from the Hong Kong and China Stock Exchange are $35,000 and $65,000 respectively.

(6) The interest income was received on a loan made by Koko to a director who is resident in Malaysia. The loan was made by direct money transfer to the director in Malaysia.

(7) The rental income was received from property located in China and comprised gross rentals of $140,000 less management fees of $13,000 and an agency fee of $7,000.

(8) Salaries and wages comprise:

	$
Salaries and bonuses to staff	750,000
Wages to a domestic helper of a company director in Hong Kong	50,000
	800,000

(9) The rent and rates comprise $220,000 for the office in Hong Kong and $130,000 for a warehouse in China to facilitate product delivery to China customers.

(10) Travelling and entertainment expenses of $28,000 represent the cost of trips made by a lawyer to China for customers' meetings (the lawyer is appointed by Koko to handle customers' disputes).

(11) The contributions to MPF schemes represent 6% of the basic salary of all staff.

(12) A donation of $20,000 was made to the Hong Kong Red Cross for China flood disaster.

(13) Sundry write-offs comprise:

	$
Cost of a country club debenture written off due to closure of the club (the club membership was for the staff's benefit)	160,000
Loan to a member of staff written off on his resignation	30,000
Commission charged by the Malaysian parent to an undisclosed agent in China	10,000
	200,000

(14) Legal and professional fees comprise:

	$
Audit and taxation fee	60,000
Tax advisory fee for tax appeals	40,000
Legal fee re customers' dispute in China	30,000
Stamp duty on property lease preparation	4,000
	134,000

(15) The total accounting depreciation charge for the year is $100,000, which was calculated based on the book value of Koko's fixed assets as at 31 March 2012. During the year, the following additions were made:

Date	Particulars
10 August 2011	Spent $63,000 to renovate the office, including $13,000 for repainting, $20,000 for re-carpeting, $10,000 for replacing curtains and $20,000 for a new storeroom.
3 December 2011	Bought a photocopier for $20,000 and a computer for $18,000.
1 February 2012	Bought a motor car for $400,000.
2 March 2012	Paid $5,600 in cash for a fax machine acquired under hire purchase. The balance is repayable by ten monthly instalments of $2,200 each, starting on 2 March 2012. The cash price of the machine was $25,600. The machine was delivered to the Hong Kong office for use on 3 April 2012.
4 March 2012	Bought a cutting machine for $55,000, incurring an installation cost of $30,000. The machine satisfies the environmental control requirement under the Air Pollution Control Ordinance.

(16) The interest expense comprises:

	$
Finance charge on the purchase of the fax machine	200
Interest on loan from Malaysian parent	11,000
Interest on bank overdraft and credit line	13,800
Finance fee on a bank loan used for acquiring the lease property in China	5,000
	30,000

(17) Koko's tax depreciation schedules show the tax written down values for its 20% and 30% pools are $20,000 and $30,000 respectively.

Required:

(a) Assuming that no offshore claim is made by Koko Ltd, prepare Koko Ltd's profits tax computation for the year ended 31 March 2012, showing the net assessable profits/adjusted loss and profits tax payable, if any. Clearly identify both the year of assessment and the basis period and show all your workings, including the hire purchase depreciation allowance calculation.

Notes:
(1) You should ignore provisional tax and overseas tax.
(2) No detailed explanations are required. (25 marks)

(b) Assuming Koko Ltd were to make an offshore claim in respect of the sales made to China customers, compute the estimated impact on Koko Ltd's Hong Kong profits tax position for the year ended 31 March 2012, based on your computation in (a) above.

Notes:
(1) No apportionment for indirect expenses is required.
(2) You may make assumptions where appropriate. (5 marks)

(30 marks)

3 Mr Li runs a sole proprietorship business in Hong Kong. During the year ended 31 March 2012, the business made a profit of $266,000 (before deducting any approved charitable donations). During the year, Mr Li made a donation in cash to the Hong Kong Community Chest of $150,000.

Mr Li also participates in a partnership in Hong Kong. The partnership incurred a tax loss of $100,000 for 2011/12, out of which 50% is attributable to Mr Li. Mr Li does not have any tax loss carried forward under the partnership.

On 20 April 2012, Mr Li received a notice from Seafish Ltd, a Hong Kong incorporated company owned by a friend of Mr Li, advising him that a director's fee of $120,000 had been declared and approved in the board of directors' meeting on 22 March 2012. Mr Li has been acting as the director of Seafish Ltd for the last two years but has never attended any meetings of the company.

Mr Li acquired two office units in June 2011 together with their leases.

The first unit was sold after just two weeks, incurring a loss of $36,000 (before deducting mortgage interest).

In respect of the second unit, Mr Li signed a new lease with the tenant starting on 1 June 2011, at a monthly rental of $15,000, with an initial premium of $24,000 paid at the time of signing the lease. The lease term is two years. All the rates and management fees are to be paid by the tenant. Upon the request of the tenant, Mr Li spent $24,000 to repair this unit.

In order to finance the acquisition of the two units, Mr Li obtained a loan from Hong Kong Bank and paid a total of $150,000 as interest during the year. Out of the total interest, $10,000 was attributed to the first unit that had been sold. Mr Li has had discussions with the assessor regarding the loss incurred on the sale of the first unit, and it has been agreed that the loss can be claimed.

Mrs Li is a teacher with an annual salary of $330,000. During the year ended 31 March 2012, she made a donation of $50,000 to Po Leung Kuk in cash. Mrs Li participates in a partnership with her sister, on a 50:50 basis, to run a fashion boutique. For the two years ended 31 March 2011 and 2012, the partnership had the following results:

Year ended 31 March 2011	Allowable loss	$220,000
Year ended 31 March 2012	Assessable profits	$200,000

Mr and Mrs Li elected for personal assessment for the year of assessment 2011/12, but not for the year of assessment 2010/11. The couple currently live in a leased property with a rental payment of $40,000 per month. They have two children, aged 23 and 17, both studying full-time in Hong Kong. Throughout the year, Mr Li paid $2,000 per month towards the maintenance of his mother (aged 70), who is an ordinary resident of Hong Kong.

Required:

(a) Compute the tax payable by Mr and Mrs Li under personal assessment for the year of assessment 2011/12. (16 marks)

(b) Explain the tax treatment of Mrs Li's share of the partnership loss for the year of assessment 2010/11. (4 marks)

(20 marks)

4 Milan Ltd (the Company) is engaged in the trading of second-hand handbags in Hong Kong. The Company commenced business on 1 January 2012. Since commencement, the Company has not finalised any audited accounts, filed a profits tax return, nor exchanged any correspondence with the Inland Revenue Department. Management accounts have been prepared for the period 1 January 2012 to 31 October 2012, which show a net profit of $200,000.

The Company is considering closing its accounts either on (1) 31 October 2012, or (2) 31 March 2012 and has come to you for advice.

Required:

(a) Determine the basis periods, where relevant, for the years of assessment 2011/12 and 2012/13 for Milan Ltd, assuming that the company's first accounts are to be closed on (1) 31 October 2012, and (2) 31 March 2012. (4 marks)

(b) Advise on the compliance obligations of Milan Ltd under the Inland Revenue Ordinance in respect of:

(i) the company's own liability to tax, including, where relevant, the due dates for compliance purposes, assuming that the company's first accounts are to be closed on (1) 31 October 2012, and (2) 31 March 2012; and (7 marks)

(ii) the company's liability in its capacity as an employer. (4 marks)

(15 marks)

5 David is employed by Star Ltd, a Hong Kong company. On 1 September 2011, David was granted the right to subscribe for 2,000 shares in Moon (Holdings) Ltd, the UK parent company of Star Ltd, at the price of $20 for each share. On that date the shares were worth $24 each. David did not have to pay for this option. The option could be exercised at any time prior to 31 March 2012. David exercised the option on 1 March 2012, when the shares were worth $28 each. He sold the shares on 31 March 2012 at their then market price of $30 each.

When David was completing his Tax Return – Individuals for 2011/12, he wondered whether he should report in that return details of the share option income. He approached his friend, Danny, who had just completed his professional accountancy examinations. Danny told him that he did not have to disclose any such details in his return because the option scheme related to the shares of an offshore company and this company was not his employer. Danny also said that if his advice was wrong, David should not worry because (1) the Inland Revenue Department would not assess any penalty tax if the taxpayer has doubts about the taxability of the income; and (2) no penalty tax could be assessed because David had acted upon professional advice (Danny's advice) and David therefore had a 'reasonable excuse' for failing to complete a proper return.

Required:

(a) Advise David, in detail, of the Hong Kong tax consequences of his share option benefit, quantifying any taxable amount(s) arising. (4 marks)

(b) Comment on Danny's advice and explain, giving reasons, what David should do now. (6 marks)

(10 marks)

End of Question Paper