Fundamentals Level – Skills Module

Taxation (Hong Kong)

Tuesday 12 June 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

ALL FIVE questions are compulsory and MUST be attempted

1 On 1 April 2011, George Young was appointed as the general manager of Diamond (HK) Ltd (Diamond), a company carrying on business in Hong Kong. George is in charge of Diamond's office in Beijing and starting from May 2011, he has travelled to Hong Kong on a regular basis.

The following information is available in respect of George for the year ended 31 March 2012:

(1) George's basic salary is $100,000 per month.

(2) During the year, George spent nine months in China. The total salary paid for his nine months' services rendered in China was subject to individual income tax in China, and George was required to pay $200,000 to the Chinese tax authority. This tax was paid and borne by Diamond in April 2012.

(3) For the month of April 2011, George was given a cash allowance of $15,000 to cover his accommodation costs. From 1 May 2011 onwards, he was provided with a house owned by Diamond in Beijing, and 5% was deducted from his monthly salary. Diamond also employed an amah for George at a cost of $2,000 per month and refunded George his utilities bills for the house, which were $12,000 for the year.

(4) During his stays in Hong Kong, George lived in a hotel room. Hotel charges totalling $110,000 for the year were paid by Diamond.

(5) Diamond provided George with a car and a driver. The car was rented by Diamond at an annual rental of $36,000. The driver was hired by Diamond at $3,000 per month. George received a total reimbursement of $18,000 from Diamond to cover the petrol costs of the car for the year. The Assessor agreed that the extent of private use of the car was 20%.

(6) Diamond has set up an educational trust. The trustee made a grant of $40,000 to George's son who is studying in the UK.

(7) On 1 October 2011, George was given an option to purchase 100,000 shares in Diamond (International) Ltd, a company listed on the London Stock Exchange, at a price equivalent to $15 per share. George paid $2,000 for the option. The market price of Diamond (International) Ltd shares on 1 October 2011 was $16 per share. George exercised the option to purchase 50,000 shares on 30 November 2011 when the price of the shares was $20 per share.

(8) George purchased a note book for $10,000 and used it both for work and private purposes.

(9) George is studying for a MBA degree at the Tsinghua University, Beijing. During the year, he paid a tuition fee of $100,000, half of which was reimbursed by Diamond.

(10) George's wife is a housewife. The couple have two sons, aged 21 and 15. The elder son is attending a full-time masters degree course at a UK university (see note (6) above).

(11) George's mother, aged 68, lives with his family in Beijing. His mother has a Hong Kong identity card and travels frequently to Hong Kong.

(12) During the year, George contributed $18,000 to the mandatory provident fund.

All currency amounts are given in Hong Kong dollars.

Required:

(a) Advise George Young on the extent to which he is liable to Hong Kong salaries tax for the year of assessment 2011/12. (5 marks)

(b) (i) Calculate the Hong Kong salaries tax payable by George Young for the year of assessment 2011/12;

Note: you should ignore provisional taxes and overseas tax. (12 marks)

(ii) Give reasons for the treatment of the items referred to in notes (4), (5), (6), (8) and (9). (4 marks)

(c) Diamond has a wholly owned subsidiary, Diamond (BVI) Ltd. The subsidiary is incorporated in the British Virgin Islands and carries on its business in Hong Kong. George has been advised by Diamond's accountant that his Hong Kong tax liabilities can be reduced if his employment is transferred to this subsidiary.

Required:

Comment on the advice given by the accountant regarding George Young. (4 marks)

(25 marks)

2 Bookie Ltd (Bookie), a Hong Kong incorporated company, carries on business in Hong Kong printing and selling books. For the year ended 31 December 2011, Bookie has the following trading results:

Income	**Note**	$	$
Book sales		1,800,000	
Printing income		2,200,000	
Property rental income	(1)	1,200,000	
Profit from disposal of property	(1) & (6)	4,000,000	
Bank interest income	(2)	10,000	
Compensation	(3)	200,000	9,410,000
Expenses			
Directors' fees		300,000	
Staff costs	(4)	2,200,000	
Selling and distribution	(5)	900,000	
Office and storage		400,000	
Depreciation	(6)	1,060,000	
Goodwill impairment	(7)	200,000	
Loss on asset disposal	(6)	20,000	
Legal and professional fees	(8)	79,000	
Interest expenses	(9)	89,000	
Exchange loss	(10)	1,000	
Insurance		40,000	
Office consumables		43,000	
Taxation expenses	(11)	1,238,375	
Donations	(12)	400,000	(6,970,375)
Profit for the year			2,439,625

Notes:

(1) Bookie owned two properties at 1 January 2011 as follows:

(i) Property A acquired in January 2000 at a cost of $15,000,000, which was partially funded by a bank mortgage loan and partially by Bookie's associated company carrying on business in London. The property has been partly used by Bookie as a bookstore and partly leased out at a monthly rental of $100,000.

(ii) Property B acquired in February 2010 from a property developer at a cost of $50,000,000. The cost of construction of this building was $17,000,000. Bookie had intended to use the building for its printing operation but was subsequently prohibited from doing so by the related Incorporated Owners. As a result, the property had been left vacant since acquisition and in August 2011 the directors decided to sell it for $51,500,000. No building allowance was claimed for Property B for the year 2010.

(2) Interest income comprises the following:

	$
Interest on HK$ deposit with a bank in Hong Kong	2,000
Interest on RMB deposit with a bank in Hong Kong	3,000
Interest on GBP deposit with a bank in London	4,000
Tax Reserve Certificates bought from HKSAR government	1,000
Total per accounts	10,000

(3) In October 2011, a customer in China terminated a printing contract with Bookie. Under the terms of the contract, Bookie is entitled to receive a compensation based on the printing revenue lost during the remaining contract terms. The compensation payable by the customer was agreed at $200,000.

(4) Staff costs comprise the following:

	$
Salaries and allowances	1,500,000
Rental for senior manager's accommodation	450,000
Severance payment to a leaving staff member (per Employment Ordinance)	100,000
Compensation payment to a leaving staff member in return for a promise not to join a competitor	150,000
Total per accounts	2,200,000

(5) The selling and distribution expenses of $900,000 include $50,000 paid as rebate commissions to undisclosed agents. This payment was approved by the sales manager.

(6) The depreciation charge for the year includes the following:

	Land and buildings $	Furniture/ fixtures $	Printing machinery $	Motor vehicle $
Cost at 1 January 2011	65,000,000	150,000	80,000	220,000
Additions	0	40,000	80,000	20,000
Disposals	(50,000,000)	(35,000)	0	(40,000)
Balance at 31 December 2011	15,000,000	155,000	160,000	200,000
Depreciation at 1 January 2011	5,700,000	45,000	40,000	60,000
Charge for the year	1,000,000	15,000	25,000	20,000
Disposals	(2,500,000)	(10,000)	0	(28,000)
Balance at 31 December 2011	4,200,000	50,000	65,000	52,000
Net book value at 31 December 2011	10,800,000	105,000	95,000	148,000
Proceeds from disposal	51,500,000	5,000	0	12,000
Net book value of disposal	(47,500,000)	(25,000)	0	(12,000)
Profit/(loss) on disposal	4,000,000	(20,000)	0	0

(i) The addition to furniture/fixtures refers to a new scanner acquired at a cost of $40,000 under hire purchase. Bookie was required to make a down payment of $5,000 at the time of purchase and monthly instalments of $6,000 for seven months from 1 November 2011.

(ii) A new printing machine costing $80,000 had been fully paid for, but only about half of the machine was installed before the year end. The remaining part of the machine will be installed in March 2012.

(7) Bookie acquired a printing business in 2009 for a consideration of $23,000,000, including $2,000,000 for the value of goodwill. A goodwill impairment loss of $200,000 was written off for the year.

(8) Legal and professional fees comprise:

	$
Audit and tax filing fees	60,000
Tax advisory fees for lodging a tax appeal	5,000
Legal fees for claiming compensation on the early termination of a contract (see note (3) above)	8,000
Legal fees on the sale of Property B	6,000
Total per accounts	79,000

(9) Interest expenses comprise:

	$
Hire purchase finance charge on scanner (see note (6) (i) above)	2,000
Interest on a loan from Bookie's associate company to finance the acquisition of Property A (see note (1) (i) above)	15,000
Interest on a bank loan for the acquisition of Property A	70,000
Interest on bank overdraft line	2,000
Total per accounts	89,000

(10) The exchange loss comprises:

	$
Exchange gain from RMB bank deposit	9,000
Exchange loss from GBP bank deposit	(10,000)
Net exchange loss	(1,000)

All Bookie's bank deposits in foreign currencies are sourced from the proceeds from book sales made to overseas customers.

(11) Taxation expenses comprise:

	$
Property tax accrued for Property A	144,000
Stamp duty on sale of Property B	1,094,375
Total	1,238,375

(12) Bookie made cash donations of $320,000 to the Hong Kong Red Cross and books valued at $80,000 as free gifts to the Tung Wah Group of Hospitals.

(13) Bookie has been filing its Hong Kong profits tax returns on the basis that all of its income is subject to Hong Kong profits tax. As shown in its last profits tax return for the 2010/11 assessment year, Bookie has a tax loss of $330,000 eligible for carry-forward to future years.

The tax written down values brought forward in respect of its plant and machinery pools are:

10% – nil
20% – $200,000
30% – $460,000

It has been agreed with the IRD that all the furniture/fixtures qualify as 20% pool, and the printing machinery and motor vehicle qualify as 30% pool.

The qualifying expenditure for commercial building allowance in respect of Property A was $5,000,000.

Required:

(a) Discuss whether the profit arising from the sale of Property B of $4,000,000 (note 1) would likely be accepted by the IRD as not subject to profits tax. (5 marks)

(b) Assuming that the sale of Property B is accepted as not taxable by the IRD, compute Bookie Ltd's profits tax liability in respect of the year ended 31 December 2011. Clearly identify both the year of assessment and the basis period and show the hire purchase depreciation allowance calculation.

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

(30 marks)

3 Mrs Lo owns an office unit in Hong Kong which is leased out under the following terms:

Lease term:	1 April 2010 for two years
Rental:	Monthly rent of $45,000 plus $6,000 for the use of furniture
Premium:	$90,000 paid on 1 April 2010
Expenses:	Government rates and property management fees are payable by the landlord

In respect of the above property, Mrs Lo incurred the following expenditure during the year ended 31 March 2012:

Government rates:	$15,000 per quarter (after deducting the rates concession of $1,500)
Management fees:	$3,000 per month
Cleaning fees:	$1,000 per month
Repairs:	$8,000 paid in December 2011
Bank mortgage interest:	$600,000

Mrs Lo added that the tenant has been delaying the monthly rental payment since January 2012. As of 31 March 2012, the rental for March 2012 was in arrears, but was subsequently paid in May 2012.

Mrs Lo earns an annual salary of $320,000 from her employment as a registered nurse. She contributed a total of $16,000 to the mandatory provident fund each year.

Mrs Lo's husband, Mr Lo, operates a stationery store in partnership with Mr Chan. The two partners agreed that each of them would receive an annual salary of $120,000 and after that, the balance of profit or loss would be shared equally. Moreover, Mr Chan's wife would be appointed as the partnership's accountant and would be paid an annual salary of $108,000 for her services. For the two years ended 31 March 2011 and 2012, the partnership has the following results:

Year ended 31 March 2011:	Allowable loss	$450,000
Year ended 31 March 2012:	Assessable profit	$670,000

With effect from 1 April 2011, Mr Chan retired from the partnership and his share was taken up by ABC Ltd. Mrs Chan's service was also terminated, effective the same day.

The new partners agreed that Mr Lo would continue to receive the same amount of annual salary from the partnership, and ABC Ltd would be paid interest on its capital contribution of $2,000,000 at the rate of 5% p.a. The new profit sharing ratio between Mr Lo and ABC Ltd is 1:2. During the year ended 31 March 2012, ABC Ltd incurred a tax loss of $250,000.

Apart from the partnership, Mr Lo also owns a delivery van and operates a delivery service business on a part-time basis. During the year ended 31 March 2012, this business earned a total assessable profit of $200,000. Mr Lo made an approved charitable donation of $210,000 in cash in December 2011. None of this donation has been claimed as a tax deduction in Mr Lo's delivery business or in the partnership business.

Mr and Mrs Lo elected personal assessment for the year of assessment 2011/12, but not for the year 2010/11. Other than the above, the couple did not have any other sources of income. The couple have no children nor do they maintain any other dependants.

Required:

(a) Compute the property tax liability of Mrs Lo for the year of assessment 2011/12, assuming that personal assessment is NOT elected. (4 marks)

(b) Compute the allocation of profit/loss and the tax payable by the partnership, if any, for each of the years of assessment 2010/11 and 2011/12, assuming that only Mr and Mrs Lo have elected personal assessment for 2011/12. (8 marks)

(c) Compute the tax payable by Mr and Mrs Lo under personal assessment for the year of assessment 2011/12, clearly showing the amount of tax payable, if any, by each of them. (8 marks)

(20 marks)

4 The All Friends Club was established in 2010 as a social club. As at 31 December 2011, the total number of members was 4,000. According to the Articles of Association, all members are voting members at all general meetings held by the Club. For the two years ended 31 December 2010 and 2011, the Club produced the following income and expenditure accounts:

	Year ended 31 December 2010	Year ended 31 December 2011
Income	$	$
Members' subscriptions (1)	125,000	180,000
Rental from property (2)	350,000	500,000
Car parking fees (3)	120,000	130,000
Lounge Café receipts (4)	240,000	270,000
Fund raising sales (5)	90,000	110,000
Donation (6)	–	100,000
	925,000	1,290,000
Expenditure		
Administrative expenses (7)	(748,000)	(740,000)
Property tax	(42,000)	(60,000)
Lounge Café expenses (4)	(190,000)	(230,000)
Fund raising sale expenses (5)	(58,000)	(50,000)
Surplus/(deficit)	(113,000)	210,000

Additional information:

(1) Members' entrance fees were credited directly to the Club's accumulated fund in the following amounts: $100,000 for the year ended 31 December 2010 and $50,000 for the year ended 31 December 2011.

(2) The Club owns a property in Clear Water Bay which is used partly for the Club's own activities and partly for leasing out to the public.

(3) The Club's car park is for the exclusive use of members only.

(4) The Lounge Café is open to both members and non-members. It is estimated that two-thirds of the receipts are from members.

(5) Fund raising sales are held annually. It is estimated that half of the sales receipts are from members.

(6) The Club received a one-off donation of $100,000 in October 2010 from a health food company.

(7) The administrative expenses are all tax deductible revenue items.

Required:

(a) Explain under what circumstances the All Friends Club would be subject to tax under the Inland Revenue Ordinance. (4 marks)

(b) Based on the information available, ascertain whether or not the All Friends Club is subject to tax in respect of the two years ended 31 December 2010 and 2011, and calculate any tax payable/refundable.

Note: You should ignore depreciation allowance and provisional tax. (11 marks)

(15 marks)

5 In a meeting with a client's personnel manager, you discovered the following:

(1) One of their expatriate staff, Henry, has submitted his resignation after five years of service with the company. His resignation letter was dated 30 April 2012, advising that he intended to resign with effect from 1 June 2012. However, after deducting his entitled annual leave his official last day in the office will be 15 May 2012.

(2) Upon request from Henry, the company remitted his final salary, bonus and other employment income accrued up to 31 May 2012 directly to his bank account in Singapore on 15 May 2012, to enable him to buy a property in Singapore.

(3) Henry advised the company that he would depart for Singapore on 31 May 2012, but would return to Hong Kong in two months' time. On this basis, the company filed the employer's notification for cessation of employment on 31 May 2012, without indicating that Henry would leave Hong Kong on the same day.

Required:

As tax advisor to the company, identify and explain the key compliance issues arising from the above.

(10 marks)

End of Question Paper