Fundamentals Level – Skills Module

Taxation (Hong Kong)

Monday 6 June 2011

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 tax rates and allowances for 2009/10 and 2010/11 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)	50,000
– additional allowance in the year of birth (each)	50,000
Dependent parent/grandparent allowance – basic	15,000/30,000
– additional	15,000/30,000
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)	60,000
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%

75% of salaries tax and tax under personal assessment for the year of assessment 2009/10 will be waived subject to a ceiling of $6,000.

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

ALL FIVE questions are compulsory and MUST be attempted

1 Roger was a teacher at the Buddhist School (the School). He retired on 31 March 2011 at the age of 55, after having served the School for 30 years. He supplies you with the following information relating to the year ended 31 March 2011:

(1) Roger received an annual salary of $600,000.

(2) As part of an exchange programme between the School and a primary school in China, Roger was sent to teach in the primary school in China for two months. He was not required to pay any tax in China.

(3) Roger was provided with a housing allowance of $15,000 per month. He used $10,000 per month to rent a flat in Tai Po, but he was not required to provide details of his accommodation to the School.

(4) Roger visited an in-house doctor of the School four times for medical treatment. The total cost to the School was $1,000.

(5) Roger was elected the best teacher of the year and received a cash prize of $5,000.

(6) Under his contract of employment, Roger should have retired at the age of 60. Due to disputes with the Board of Directors of the School, he was compelled to retire five years earlier, and was paid a lump sum of $500,000 as compensation. Upon retirement, he also received a lump sum of $1,800,000 from the School's provident fund. The fund is a recognised occupational retirement scheme.

(7) As an expression of their affection towards Roger, his students gave Roger a gold Buddha as a retirement gift. The market value of the gold Buddha was estimated to be $1,200.

(8) Roger was entitled to overtime pay of $36,000 for the period from 1 April 2007 to 31 March 2011. He received all of this overtime pay in April 2011, and elected to relate back the lump sum for tax purposes.

(9) Roger had purchased a special projector for his teaching on 1 May 2009 for $20,000. The Inland Revenue Department accepted that it was essential for the performance of his duties. The rate of annual allowance for the projector was 20%. Upon retirement, he sold the projector for $9,000.

(10) His wife, Rebecca, is also a teacher, earning an annual salary of $120,000. In September 2010 she spent $24,000 on a correspondence course on education offered by a university in the United Kingdom, half of which was reimbursed by her employer.

(11) Roger and Rebecca maintain two sons aged 24 and 22 respectively. The elder one is a son from Roger's previous marriage. The younger one is married. Both of the sons were full-time students during the year of assessment.

(12) Roger contributed a total of $18,000 to the School's provident fund; and Rebecca contributed a total of $9,000 (including the mandatory portion and the voluntary portion) to the Mandatory Provident Fund. The mandatory portion made to the Mandatory Provident Fund is computed at 5% of the employment income but capped at $1,000 per month.

Required:

(a) Compute the salaries tax payable by Roger and Rebecca under separate taxation for the year of assessment 2010/11.

Note: you should ignore provisional tax. (11 marks)

(b) Briefly explain the tax treatments you have applied to items (2) to (8), (10) and (11) above. (12 marks)

(c) Advise whether or not an election for joint assessment should be made by Roger and Rebecca in respect of the year of assessment 2010/11. (2 marks)

(25 marks)

2 Andy, Bobbie and Champion Ltd (Champion) were in partnership as garment manufacturers from 1990 to 30 June 2009 when Bobbie retired. The partnership made up its accounts to 31 December each year and it was agreed that Andy and Bobbie should receive salaries of $60,000 and $70,000 per annum respectively, and that any remaining profits and losses should be shared in the ratio of 2:1:2.

After Bobbie retired, Andy and Champion continued to carry on the business in partnership. It was agreed that Andy would continue to receive a salary of $60,000 per annum and that they would share the remaining profits equally.

In late 2009, the partners decided to change their business to the manufacture of toys. The partnership was dissolved and the trade ceased on 31 December 2009. On 1 January 2010, the partners formed a corporation, ToyStory Ltd (ToyStory), in which Andy and Champion held 40% and 60% of the issued share capital respectively. The toys are manufactured in Hong Kong, and sold in Japan and Singapore through ToyStory's agents there.

Below is a summary of the income statement of the partnership and ToyStory for each of the years ended 31 December 2008, 2009 and 2010:

Year ended 31 December	2010 $	2009 $	2008 $
Income			
Gross profit	1,558,000	1,043,000	460,000
Interest income (Note 1)	46,000	–	–
Compensation received (Note 2)	–	70,000	–
	1,604,000	1,113,000	460,000
Expenses			
Exchange loss (Note 3)	(40,000)	–	–
Compensation payment (Note 4)	(280,000)	–	–
Rent, rates, electricity and water	(412,000)	(287,000)	(241,000)
Salaries	(468,000)	(413,000)	(419,000)
Legal and professional fees	(47,000)	–	–
Scientific research	(55,000)	–	–
Technical education	(40,000)	–	–
Sundry expenses (all tax deductible)	(41,000)	(20,500)	(17,000)
Depreciation	(30,000)	(18,000)	(14,000)
Net profit/(loss)	191,000	374,500	(231,000)

Notes:

(1) Interest income comprised:

	$
Interest income from deposits with a bank in Hong Kong	26,000
Interest income from deposits with a bank in Singapore	20,000
	46,000

(2) In March 2009, one of the partnership's customers suddenly cancelled the long-established purchase agreement with the partnership. Upon a decision in the District Court, the partnership received compensation of $70,000.

(3) The exchange loss of $40,000 arose from a time deposit with a bank in Singapore. The source of the deposit came from sales proceeds collected from customers in Singapore.

(4) The compensation payment comprised:

	$
Payment to a staff member who promised not to join any company in the same line of business after he left ToyStory	100,000
Payment to induce a director who was not performing satisfactorily to cancel his contract of employment	180,000
	280,000

Additional information:

(i) Depreciation allowances for the partnership were agreed as follows:

	$
Year ended 31 December 2008	42,000
Year ended 31 December 2009	58,000

(ii) During the year ended 31 December 2010, ToyStory purchased the following assets:

- Manufacturing and moulding machines on hire purchase terms for a price of $450,000. ToyStory paid a deposit of $150,000 and the balance was repayable by 20 monthly instalments of $18,000 each. The first instalment was payable on 15 January 2010.
- Second-hand office furniture for $150,000.
- Computer system for $100,000.

(iii) Champion was also engaged as a trader in computers. The results of its trading activities showed an assessable profit of $80,000 for the year ended 30 June 2008, and an adjusted loss of $120,000 for the year ended 30 June 2009.

(iv) Bobbie elected for personal assessment in 2008/09 and 2009/10.

Required:

(a) Compute the assessable profit/adjusted loss of the partnership for each of the years of assessment 2008/09 and 2009/10 and the tax payable thereon, claiming for Champion Ltd any relief that is available.
(10 marks)

(b) Briefly explain the main points to be taken into account when considering the tax treatment of the following expenditure items:

(i) the legal and professional fees;
(ii) the scientific research; and
(iii) the technical education. (6 marks)

(c) Assuming that all the expenditure items in (b) above are tax deductible, compute the assessable profits/adjusted loss of ToyStory Ltd for its first year of trading, clearly identifying the year of assessment and the basis period.

Note: you should ignore provisional tax and overseas tax. (8 marks)

(d) Explain the tax treatments you have accorded to the various issues arising from notes (1) to (4) above.
(6 marks)

(30 marks)

3 The following is a summary of the income and expenses of Mr and Mrs Siu for the year ended 31 March 2011:

Mr Siu'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
(3)	Rental received from Property A (Note (ii))	150,000
(4)	Interest on a loan made to a relative	10,600

Mr Siu's expenses/losses

		$
(1)	Share of loss from a partnership business	48,000
(2)	Loss from property dealing (after deducting interest of $62,000: see Note (iii))	36,000
(3)	Interest paid (Note (iii))	108,000
(4)	Cost of repairs to Property A	24,000
(5)	Donations made to the Community Chest	210,000

Mrs Siu's income

		$
(1)	Salary from employment	300,000
(2)	Share of profits from a partnership business (Note (iv))	92,000

Mrs Siu's expenses

		$
(1)	Donations made to the Tung Wah Group of Hospitals	80,000
(2)	Cost of a medical chair donated to the above group of hospitals	10,000
(3)	Contributions to mother (Note (v))	60,000

Notes:

(i) Cayman Ltd is a company incorporated in the Cayman Islands. It is managed and controlled in Hong Kong. Its profits, however, are agreed by the Assessor as being derived from outside Hong Kong.

(ii) Property A was solely owned by Mr Siu. It was rented to a tenant on 1 June 2010 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 were payable by the tenant and the costs of repairs were payable by Mr Siu.

(iii) The interest paid by Mr Siu consisted of the following:

	$
On a mortgage of Property A to finance its purchase	46,000
On a further charge on Property A to finance Mr Siu's property dealing business (already taken into account in determining the property dealing loss)	62,000
	108,000

(iv) The partnership in which Mrs Siu was a partner had incurred heavy losses in 2009/10. Mrs Siu's share of such losses was $180,000, of which $76,000 was unabsorbed in her personal assessment for 2009/10 and was therefore carried forward to 2010/11.

(v) Mrs Siu's mother, a Hong Kong resident, is aged 68. She did not live with the Siu family.

Mr and Mrs Siu have three children. Their eldest son, aged 22, is a full-time student at the Hong Kong University. Their elder daughter, aged 17, has been employed as a junior secretary in a Hong Kong company since 1 April 2010. Their younger daughter, aged 15, is studying in a secondary school.

Required:

(a) State the conditions that must be satisfied before an election for personal assessment can be made.
(5 marks)

(b) Compute the tax payable by Mr and Mrs Siu under personal assessment for the year of assessment 2010/11.
(15 marks)

(20 marks)

4 David Brown is a US resident. He arrived in Hong Kong and has worked for HK Ltd as an engineer since 1 February 2009. On 2 May 2010, David received his 2009/10 composite tax return. On 25 May 2010, before the due date for filing the return, David tendered his resignation and urgently flew to the US to take care of his mother who was seriously ill. David returned to Hong Kong in November 2010 and found that an estimated salaries tax assessment for the year of assessment 2009/10 had been issued to him on 10 September 2010 [under s.59(3)]. This estimated assessment showed the following:

	$
Assessable income	840,000
2009/10 final tax payable	112,440
2010/11 provisional tax payable	112,440
Total tax payable	224,880
Payable in two instalments:	
By 15 January 2011	196,770
By 15 February 2011	28,110

The 'assessor's notes' on this assessment indicated that the assessment was estimated based on the Employer's Return filed by HK Ltd.

Since his return, David has not been able to find a job. He wonders if he needs to pay any tax for 2010/11.

Required:

(a) Advise David Brown of his obligations under the Inland Revenue Ordinance in relation to his employment in Hong Kong. (6 marks)

(b) Explain the power of the assessor to raise an estimated assessment under s.59 of the Inland Revenue Ordinance. (5 marks)

(c) Advise David Brown of any appropriate actions he may take in respect of the provisional tax payable for the year of assessment 2010/11. (4 marks)

(15 marks)

5 HK Ltd carries on business in Hong Kong as an agent of its parent company, O/S Ltd, which is incorporated in the British Virgin Islands. Under the terms of the Agency Agreement, HK Ltd is required to negotiate with customers in Hong Kong on behalf of O/S Ltd, and has the sole and exclusive authority to fix prices and accept orders. In return for its services, HK Ltd is paid an agency fee based on 3% of the annual profits made on the contracts negotiated.

Sales contracts are made in the name of O/S Ltd and administered in Hong Kong by HK Ltd. All sales and purchases are recorded in the books of O/S Ltd. O/S Ltd purchases the goods from overseas suppliers, but the shipments are often made directly to the customers in Hong Kong.

Required:

(a) Explain the Hong Kong tax implication of the profits earned by O/S Ltd in respect of the sales made to the Hong Kong customers through HK Ltd. (6 marks)

(b) State, giving reasons, whether the agency fee earned by HK Ltd is taxable in Hong Kong. (3 marks)

(c) In May 2011, O/S Ltd was approached by a customer in Taiwan who was interested in placing a substantial order. HK Ltd sent its sales director to negotiate with the customer in Taiwan, and signed the contract there. Shipment was then made directly to the customer in Taiwan.

Explain the Hong Kong tax implications to HK Ltd in respect of the sale transaction conducted in Taiwan. (1 mark)

(10 marks)

End of Question Paper