
Answers

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

1 (a)	Yan's salaries tax computation for the year of assessment 2009/10	Marks
	\$	
	Salary	840,000 0·5
	Bonus	30,000 0·5
	Domestic helper's salary	45,000 0·5
	Unutilised rent refund (20,000 – 19,000)*12	12,000 1
	Car petrol refund	8,000 0·5
	Hotel journey benefit	
	– air ticket for wife [(16,000 + 2,000)/2 – 2,000]	7,000 0·5
	– hotel room charges (30,000*5/20)	7,500 0·5
		<u>949,500</u>
	Income subject to China tax	(300,000) 0·5
		<u>649,500</u>
	Rental value (649,500 – 2,500)*10%	64,700 1
	Assessable income	714,200
	Professional subscription	(2,500) 0·5
	Self-education expenses (35,000/2)	(17,500) 0·5
	Mandatory provident fund contributions (maximum)	(12,000) 0·5
	Net assessable income	<u>682,200</u>
	Concessionary deductions	
	Approved charitable donations (40,000 + 30,000)	(70,000) 1
		<u>612,200</u>
	Personal allowances	
	Married person's allowance	(216,000) 0·5
	Child allowance (x 2)	(100,000) 0·5
	Dependent parent allowance (Yandy's mother)	(30,000) 0·5
	Additional dependent parent allowance	(30,000) 0·5
	Net chargeable income	<u>236,200</u>
	Tax payable at progressive rates	<u>28,154</u> 0·5
	Tax payable at standard rate (\$612,200*15% = \$91,830) is not applicable	0·5
	Correct treatment of:	
	Provision of car	0·5
	Payments made to Yan's father and his ex-wife's mother	0·5
	Yandy's property tax computation for the year of assessment 2009/10	
	Annual rental	180,000 0·5
	20% statutory allowance	(36,000) 0·5
	Net assessable value	<u>144,000</u>
	Property tax payable at 15%	<u>21,600</u> 0·5
	Statement of loss for Yandy's gift shop for the year of assessment 2009/10	
	Agreed loss	<u>(120,000)</u> 0·5
		<u>14</u>

(b) **Personal assessment computation for Yan and Yandy**
Year of assessment 2009/10

	Yan \$	Yandy \$	
Net assessable income	682,200	–	0.5
Net assessable value (NAV)	<u>682,200</u>	<u>144,000</u>	0.5
Less: Mortgage interest (restricted to NAV)		(144,000)	0.5
Approved charitable donations (ACD)	(40,000)		0.5
Unabsorbed ACD transferred from spouse	(30,000)		0.5
Business loss transferred from spouse	<u>(120,000)</u>		0.5
Reduced total income	<u>492,200</u>	<u>0</u>	
Joint total income		492,200	
Less: Personal allowances (as in part (a))		<u>(376,000)</u>	0.5
Net chargeable income		<u>116,200</u>	
Tax payable at progressive rates (by Yan)		<u>7,944</u>	0.5
			<u>4</u>

(c) **Note 7: Allotment of shares** – Since Cyma Ltd is managed and controlled in Singapore, the directorship is a foreign office. The gain accrued to Yan from the foreign office is therefore not taxable. 1

Note 8: PRC tax paid – Section 8(1A)(c) and DIPN 32 exclude income from services rendered outside Hong Kong if the taxpayer is chargeable to tax in the country in which the services are rendered, and tax of substantially the same nature as salaries tax in Hong Kong has been paid in respect of the income attributable to the services rendered in that country. It does not matter that the tax was only paid in 2010/11 and half was reimbursed by the employer. However, the reimbursement of \$30,000 would be fully taxable in Hong Kong in 2010/11, unless the amount has been reported to the PRC tax authority and PRC tax has been paid on it. 1.5

Note 9: Membership subscriptions – Strictly speaking, professional subscriptions are not incurred in producing income and not allowable. In practice, the IRD allows subscriptions made to one professional body if the qualification is a pre-requisite of employment and retention of membership and keeping abreast of current developments are of regular use and benefit in the performance of the individual's duties. Thus, Yan can claim a deduction for one subscription, the ACCA subscription the amount of which is higher. 1

The membership fee paid to the Hong Kong Jockey Club is not necessarily incurred in the production of income and is thus not an allowable expense. 0.5

Note 10: Tuition fee – The self-education expense (half of the tuition fee) is deductible as the course is offered by a university and is an approved course under s.12(6). Reimbursement of a deductible expense (half of the tuition fee) is not taxable. 1

Note 11: Air ticket and hotel room charges – Any amount paid by an employer in connection with a holiday journey is taxable under s.9(2A)(c), and the benefit is assessed by reference to the cost incurred by the employer (see DIPN No. 41, para 6). Where a holiday journey benefit is associated with or attributable to a cost paid by an employer, that benefit is taxable notwithstanding that the employer does not incur additional, or incremental, costs for that benefit (see DIPN No. 41, para 11). In Yan's case, the cost of his wife's ticket is actually borne by Beta and is therefore taxable. 1

Where a trip is taken partly for business and partly for holiday, if a clearly identifiable part of the journey is taken for holiday purposes, the expenses relating to that part of the journey is taxable. In Yan's case, the extended stay cannot be regarded as being incidental to the business trip and is taxable. Since the expenses relating to such part cannot be readily ascertained, an apportionment based on the 'holiday-days basis' will generally be adopted (see DIPN No. 41, para 14 and 15).

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2 (a)

Quick Relations Services Ltd
Profits tax computation for the year of assessment 2009/10
Basis period: year ended 30 June 2009

Marks

	\$	\$	
Loss per accounts		(911,000)	0.5
<i>Add:</i> Depreciation	60,000		0.5
Loss on asset disposal	20,000		0.5
Interest on loan from director	5,000		1
Legal fee for new office lease	4,000		1
Sales proceeds of prescribed fixed asset – computer	20,000		1
Charitable donations	8,000	117,000	0.5
		<u>(794,000)</u>	
<i>Less:</i> Depreciation allowance	100,160		0.5
Prescribed fixed asset – computer	40,000		1
Dividend	21,000		0.5
Bank interest income	1,000	(162,160)	1
Adjusted loss for the year carried forward		<u>(956,160)</u>	0.5
Profits tax payable		<u>Nil</u>	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	\$	
Service fees from China	400,000	Hotel in China	140,000	
Sale of securities	400,000	Travelling and entertainment in China	100,000	
Currency trading gain	50,000	Legal fee – agreement for China work	6,000	
		Legal fee – staff quarter lease renewal	12,000	
		Hire purchase finance charge	1,000	
			(0.5 mark each)	4

Depreciation allowance schedule

	20%	30%	HP – 30%	Allowance	
	\$	\$	\$	\$	
Written down value (WDV) brought forward	50,000	60,000			0.5
Additions					
Furniture/fixtures	40,000				0.5
Computers			40,000		0.5
Motor vehicle		20,000			0.5
	<u>90,000</u>	<u>80,000</u>			
Initial allowance (IA) 60%	(24,000)	(12,000)		36,000	0.5
IA – HP (7,000 + 5,500*2)*60%			(10,800)	10,800	1
Disposals	(5,000)	–	–		0.5
	<u>61,000</u>	<u>68,000</u>	<u>29,200</u>		
Annual allowance	(12,200)	(20,400)	(8,760)	41,360	1
	48,800	47,600	20,440		
Work-in progress	20,000				0.5
IA – 60% on WIP	(12,000)			12,000	0.5
WDV carried forward	<u>56,800</u>	<u>47,600</u>	<u>20,440</u>	<u>100,160</u>	
					<u>20</u>

(b) (i) A charitable donation is strictly speaking not incurred in the production of assessable profits, and thus is not deductible under the general tax deduction principle of s.16(1). But it is specifically allowed as a tax deduction under s.16D, if the following criteria are fulfilled: 1

- (i) the donation must be made in cash or money form, not in kind;
- (ii) the donation must be made to a charitable institution or trust which is exempt from tax under s.88 or to the government for charitable purposes;
- (iii) the donation must be a pure donation without conferring any benefit upon the donor;
- (iv) the aggregate of allowable donations must be not less than \$100;
- (v) the deduction is limited to 35% of assessable profits (25% in 2007/08) after depreciation allowance but before charitable donations; and

- (vi) the same amount must not qualify for deduction under any other profits tax provision or other concessionary deductions under salaries tax and personal assessment. Marks
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In the case of Quick Ltd, as it has incurred a loss for the year, no deduction can be claimed in respect of the charitable donation made, regardless of whether the institution, Red Cross, is approved or whether the purpose is for charity. 1

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(ii) Interest incurred on a loan borrowed is tax deductible if:

- (i) the interest is incurred in the production of assessable profits (s.16(1) and s.16(1)(a)); and
 (ii) one of the conditions stipulated under s.16(2) is satisfied. 1

Section 16(2)(d) provides that interest on money borrowed from a financial institution or an overseas financial institution would be allowed provided that the restrictions under s.16(2A) and s.16(2B) are not applicable. In general, the conditions under s.16(2A) and s.16(2B) include:

- (i) the loan is not secured or guaranteed, wholly or in part, directly or indirectly, by a deposit made by the taxpayer (or its associate) with the bank (or its associate), and the interest on the deposit is not taxable in Hong Kong (s.16(2A)); and
 (ii) an arrangement is not in place such that any interest on the money borrowed or part thereof is payable to the taxpayer (or its connected person) which is not taxed on such interest received (s.16(2B)). 2

In the case of Quick Ltd, part of the bank loan was used to fund its trading in foreign currencies and securities. If Quick Ltd is returning its gain/loss arising from these trading activities as assessable to profits tax under s.14, the interest incurred on the bank loan would satisfy s.16(1). As regards s.16(2), the interest would be tax deductible under s.16(2)(d), provided that s.16(2A) and s.16(2B) are not applicable. 2

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3 (a)

Depreciation allowance schedule
Year of assessment 2008/09 – 1 January to 31 March 2009

	20%	Motor car 30%	Allowance	
	\$	\$	\$	
Additions				
Photocopier	20,000			0.5
Motor car		400,000		
Fax machine	5,600			0.5
Initial allowance (IA)	<u>(15,360)</u>	<u>(240,000) *1/2</u>	135,360	1
	10,240	160,000		
Annual allowance (AA)	<u>(1,600) *</u>	<u>(48,000) *1/2</u>	<u>25,600</u>	1
Written down value (WDV) carried forward	<u>8,640</u>	<u>112,000</u>		
Total allowances for 2008/09			<u>160,960</u>	

* No AA for the fax machine as it was not in use during the basis period.

Year of assessment 2009/10 – year ended 31 March 2010

	20%	30%	Motor car 30%	Allowance	
	\$	\$	\$	\$	
WDV brought forward	8,640	–	112,000		
Additions					
Motor car		600,000			0.5
IA		(360,000)		360,000	0.5
		<u>240,000</u>			
Disposals					
Motor car			(280,000)		0.5
Balancing charge			<u>168,000</u> *1/2	(84,000)	1
AA	(1,728)	(72,000)		<u>73,728</u>	0.5
WDV carried forward	<u>6,912</u>	<u>168,000</u>			
Total allowances for 2009/10				<u>349,728</u>	<u>6</u>

(b)

ABC Co

Computation of assessable profit for 1 January 2009 to 31 March 2010

	\$	
Net profit per account	481,150	0.5
Wages to partner	150,000	0.5
Legal fee for drafting the lease agreement – capital	1,500	0.5
Purchase of prescribed fixed asset – computer	(18,000)	0.5
Depreciation	112,500	0.5
Loan interest to City Ltd	30,000	0.5
Adjusted profit before depreciation allowance	<u>757,150</u>	

Profits tax computation

Year of assessment 2008/09

Basis period: 1 January to 31 March 2009 [s.18C(1)(b)]

	\$	
Adjusted profit before depreciation allowance (\$757,150*3/15)	151,430	0.5
Depreciation allowance	(160,960)	0.5
Adjusted loss	<u>(9,530)</u>	

Year of assessment 2009/10

Basis period: 1 April 2009 to 31 March 2010 [s.18C(1)(b)]

	\$	
Adjusted profits before depreciation allowance (\$757,150*12/15)	605,720	0.5
Depreciation allowance	(349,728)	0.5
Assessable profits	<u>255,992</u>	<u>6</u>

Partnership allocation and tax payable					Marks
Year of assessment 2008/09					
	Andrew \$	Benny \$	City Ltd \$	Total \$	
Wages	30,000	–	–	30,000	0·5
Interest	–	–	6,000	6,000	0·5
	30,000	–	6,000	36,000	
Balance (2:1:1)	(22,765)	(11,383)	(11,382)	(45,530)	0·5
Share of profit/(loss)	7,235	(11,383)	(5,382)	(9,530)	
Reallocation of profit	(7,235)	4,912	2,323	0	1
Adjusted loss	0	(6,471)	(3,059)	(9,530)	
Loss transferred – s.19C(5)	–	–	3,059	3,059	0·5
Loss carried forward	0	(6,471)	0	(6,471)	0·5
Profits tax payable				Nil	0·5
Year of assessment 2009/10					
	Andrew \$	Benny \$	City Ltd \$	Total \$	
Wages	120,000	–	–	120,000	0·5
Interest	–	–	24,000	24,000	0·5
	120,000	–	24,000	144,000	
Balance (2:1:1)	55,996	27,998	27,998	111,992	0·5
Share of assessable profit	175,996	27,998	51,998	255,992	
Loss brought forward – s.19C(2)	–	(6,471)	–	(6,471)	0·5
Loss transferred – s.19C(4)	–	–	(20,000)	(20,000)	0·5
Transferred to personal assessment – s.19C(3)	(175,996)	–	–	(175,996)	0·5
Net assessable profit	0	21,527	31,998	53,525	
Profits tax payable at 15%/16·5%		3,229	5,279	8,508	1
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4 Short notes for presentation on topics in relation to tax filing requirements in Hong Kong:

(a) The person who has the obligation to prepare and file a profits tax return

Under s.51(1) of the Inland Revenue Ordinance (IRO), an assessor has the power to issue a return to any person and to require him to complete and submit the return within a reasonable time. If the assessor believes that the person is subject to profits tax in Hong Kong under the IRO, a profits tax return will be issued. 'Person' is defined under s.2 to include a corporation, partnership, trustee, whether incorporated or unincorporated, or a body of persons. Therefore, in general, any person who derives profits from Hong Kong or who has received a notice to file a profits tax return will have the obligation to file a profits tax return on time.

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Under s.20A, a non-resident person shall be chargeable to tax either directly or in the name of his agent in respect of all his profits arising in or derived from Hong Kong from any trade, profession or business carried on in Hong Kong. The non-resident and his agent is obliged to file a profits tax return. Moreover, under s.20B, any person in Hong Kong who paid or credited a non-resident sums which are chargeable under s.15(1)(a) (b) or (ba); or sums which are chargeable in respect of the performance in Hong Kong by a non-resident entertainer or sportsman are required to withhold tax from such sums and to file a profits tax return on behalf of the non-resident.

Where profits are derived and assessable, but no notice to file the profits tax return has been received, the person is obliged under s.51(2) to inform the Commissioner in writing that he is so chargeable within four months after the end of the basis period for the relevant year of assessment.

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A tax return may be prepared by the person, or by his authorised tax representative, but the return should be signed by the person, and in the case of a company, by its secretary, manager or director (or liquidator in the event of liquidation).

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(b) The time for filing the profits tax return

In practice, a profits tax return is normally issued around 1 April each year for corporations and partnership businesses, and 2 May for proprietorship businesses (unless in exceptional cases, e.g. year of commencement or cessation); and the taxpayer is usually allowed one month to submit the return.

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However, if the taxpayer engages a tax representative to handle the profits tax return, an extension of time to submit the return with reference to the accounting year end date of the business will be allowed by the IRD.

For example, if the taxpayer has an accounting period that ends in December, he may apply for an extension up to mid-August for submission of the return. For taxpayers with an accounting period ending between 1 January and 31 March, the due date may be extended to mid-November for profits cases; and the end of January for loss cases.

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(c) The supporting documents required to be filed with a profits tax return

In general, a profits tax return requires the return to be completed, signed and submitted, together with details of the income and expenditure items, as well as the movement of fixed assets. Unless the gross income for the year of assessment is below \$500,000, the profit and loss account and balance sheet must be submitted. For an incorporated company, audited accounts are normally required, unless the company is exempt from preparing audited accounts under the Companies Ordinance in Hong Kong or the company is incorporated in a jurisdiction that does not require accounts to be audited. Although not statutorily required, a tax computation with supporting schedules is usually filed to support the amount of profit or loss reported in the return.

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There may be some other additional forms or returns required for specified circumstances, and these are stipulated in the tax return form.

0.5

Upon submission of the tax return, if the assessor is not satisfied with the information provided, he may require the taxpayer to submit further information. Under s.51C, all persons carrying on business in Hong Kong are required to keep business records for at least seven years.

0.5

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(d) The consequences of non-filing

If a person fails to file a profits tax return without reasonable excuse, they are guilty of an offence under s.80(2) and the penalty is a fine at level 3 (i.e. \$10,000) plus treble the amount of the tax that was either underpaid or would have been underpaid. However, the Commissioner may compound the penalty to a smaller amount depending on the circumstances.

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Alternatively, instead of prosecuting via the court, the Commissioner or a deputy commissioner may personally raise an assessment of 'additional tax' and demand such payment from the person up to treble the amount of tax that was either underpaid or would have been underpaid had the offence not been detected.

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Before the penalty or additional tax is raised, the Commissioner may issue an estimated assessment based on its estimation of profits or income and demand tax payment accordingly. If the person considers the estimated assessment excessive, he would need to lodge an objection in writing within the specified time limit but an objection will only be considered valid if a properly completed tax return is filed together with the objection or within such further time allowed by the IRD. Regardless of whether an objection is lodged against an estimated assessment, the Commissioner may still at a later stage issue additional assessments to demand further tax if he considers it to be reasonable and necessary. If the person still fails to file the tax return, a court order may be issued to direct or require certain information to be filed. In the extreme case, the Commissioner may obtain a search warrant and enter the taxpayer's office to seize and retain possession of relevant information.

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(e) The timing of profits tax assessment and payment of tax due

Upon filing the profits tax return, the amount of tax will be calculated and assessed. Under normal circumstances where the tax assessed is consistent with the tax return filed, a notice of assessment will be issued to the taxpayer showing the amount of tax due and payable, and the due date for payment.

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If there is no objection to or holdover of the assessment, the tax must be paid on or before the due date as stipulated. Default in tax payment will result in a surcharge of up to 5% of the unpaid amount, and an additional surcharge of up to 10% for any default for six months or more.

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<p>5 (a) Patent A has been owned and used by HK Co for its business in Hong Kong, and thus it is assumed to be a capital asset shown in the accounts of HK Co. In the case of the disposal of a capital asset, any gain arising from its disposal would be capital in nature and not taxable in Hong Kong, except when the original cost of the patent has been claimed as a tax deduction under s.16E by HK Co in the year when the patent was first acquired or registered. Thus, if the original cost of the patent has been claimed as a tax deduction under s.16E by HK Co in a prior year, the whole of the sale proceeds would be taxable.</p>	<p><u>3</u></p>
<p>(b) Under s.14, any person carrying on business in Hong Kong and deriving profits that are sourced in Hong Kong is subject to profits tax. In the case of a person who does not carry on business in Hong Kong, any income deemed as trading receipts under s.15 would also be assessable.</p> <p>Under s.15(1)(b), payment received for the use of, or right to use, in Hong Kong a patent, design, trademark, copyright material, secret process or formula or any other similar property or for imparting know-how in connection with the use of any of those intellectual properties is deemed a trading receipt arising in or derived from Hong Kong. A non-resident in receipt of such a payment will be subject to profits tax.</p> <p>In the case of O/S Co, the royalty is received from HK Co by granting HK Co the right to use Patent A for its business in Hong Kong. Since O/S Co has no presence in Hong Kong and the royalty income is derived from the use of Patent A in Hong Kong, the royalty will be deemed a trading receipt under s.15(1)(b) and subject to profits tax in Hong Kong.</p> <p>Under s.21A, the assessable profit in respect of an amount deemed assessable by s.15(1)(b) is in general 30% of the amount received by or accrued to the recipient. Based on the current profits tax rate of 16·5%, the effective tax rate becomes 4·5% of the gross royalty payment (i.e. 15% x 30%).</p> <p>However, in circumstances where the recipient is an associate of the payer, and the intellectual property has been owned, partly or wholly by any person carrying on business in Hong Kong, 100% of the royalty payment will be deemed assessable. In the case of O/S Co, Patent A has been owned by HK Co before it is transferred to O/S Co and licensed back for use. HK Co and O/S Co are associated. As a result, 100% of the royalty received by O/S Co from HK Co will be assessable. The effective tax rate is thus, the same as the current statutory profits tax rate of 16·5%.</p>	<p>1</p> <p>1·5</p> <p>1</p> <p>1·5</p> <p><u>2</u></p> <p><u>7</u></p> <p><u>10</u></p>