

Fundamentals Level – Skills Module

Taxation (Hong Kong)

Tuesday 2 June 2015

**Time allowed**

Reading and planning: 15 minutes

Writing: 3 hours

This paper is divided into two sections:

Section A – ALL 15 questions are compulsory and MUST be attempted

Section B – ALL SIX 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.

Do NOT record any of your answers on the exam paper.

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 when answering Section B.
4. Ignore provisional tax and statutory tax reductions, unless specified otherwise.

TAX RATES AND ALLOWANCES

The following 2014/15 tax rates, allowances and deductions are to be used in answering the questions.

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%

Allowances

	\$
Basic allowance	120,000
Married person's allowance	240,000
Single parent allowance	120,000
Child allowance – 1st to 9th child (each)	70,000
– additional allowance in the year of birth (each)	70,000
Dependent parent/grandparent allowance – basic	20,000/40,000
– additional	20,000/40,000
Dependent brother/sister allowance	33,000
Disabled dependant allowance	66,000

Deductions

	\$
Self-education expenses (maximum)	80,000
Home loan interest (maximum)	100,000
Elderly residential care expenses (maximum)	80,000
Contributions to recognised retirement schemes (maximum)	17,500

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

Section A – ALL 15 questions are compulsory and MUST be attempted

Please use the grid provided on page two of the Candidate Answer Booklet to record your answers to each multiple choice question. Do not write out the answers to the MCQs on the lined pages of the answer booklet.
Each question is worth 2 marks.

- 1 X Ltd owns three properties, A, B and C. Property A is located in Hong Kong and is let out at a monthly rental of \$10,000. Property B is also located in Hong Kong and is currently occupied by a shareholder of X Ltd, rent-free. The rateable value of Property B is \$180,000. Property C is located in London and is let out at a monthly rental of \$16,000.

What is the property tax payable by X Ltd for the year of assessment 2014/15?

- A \$14,400
- B \$18,000
- C \$36,000
- D \$59,040

- 2 X, Y and Z were partners in a partnership, sharing profits and (losses) equally. Z, who had consistently elected for personal assessment, died on 1 December 2014. The accounts of the partnership for the year ended 31 March 2015 showed an assessable profit of \$90,000.

Which of the following statements concerning Z are correct?

- (1) His share of the partnership profit for 2014/15 was \$20,000
- (2) His share of the partnership profit for 2014/15 was \$30,000
- (3) His executor may claim to transfer his share of the partnership profit to personal assessment for 2014/15
- (4) If personal assessment was NOT elected for 2014/15, his share of profits would remain in the partnership for profits tax assessment purposes

- A 1 and 3 only
- B 2 and 3
- C 1, 3 and 4
- D 2 and 4

- 3 Miss Chung is an air hostess employed by a Hong Kong airline company. The following table shows how long she was present in Hong Kong and her earnings for the relevant years of assessment:

Year of assessment	Present in Hong Kong (in days)	Earnings
2012/13	80	\$350,000
2013/14	45	\$390,000
2014/15	65	\$430,000

What is Miss Chung's assessable income for each of the years of assessment 2012/13, 2013/14 and 2014/15?

- | | 2012/13 | 2013/14 | 2014/15 |
|---|-----------|-----------|-----------|
| A | \$76,712 | Nil | \$76,575 |
| B | \$76,712 | \$48,082 | \$76,575 |
| C | \$350,000 | \$390,000 | \$430,000 |
| D | \$350,000 | Nil | \$430,000 |

- 4** Albert, Benny and Chris Ltd are partners in a partnership. Profits and (losses) are shared equally after charging annual salaries for Albert and Benny of \$14,000 and \$10,000 respectively. For the year ended 31 December 2014, the partnership has an agreed tax loss of \$27,000, and Albert elects for personal assessment.

Which of the following statements in respect of the partnership for the year of assessment 2014/15 are correct?

- (1) The loss carried forward under the partnership is \$18,000
- (2) The loss carried forward under the partnership is \$24,000
- (3) The loss carried forward under the partnership is \$27,000
- (4) The loss transferred to personal assessment by Albert is \$3,000
- (5) The loss transferred to personal assessment by Albert is \$9,000

- A** 2 and 4
- B** 1 and 5
- C** 1 only
- D** 3

- 5 Which of the following statements in relation to personal assessment is correct?**

- A** When computing the total income, the net assessable income is net of approved charitable donations
- B** When computing the total income, the net assessable income is before deduction of concessionary deductions
- C** When computing the total income, the assessable profits are before deduction of approved charitable donations
- D** When computing the total income, the net assessable value is net of interest payable on money borrowed for producing rental income

- 6** Mr Leung did not pay profits tax of \$200,000 which as specified in the notice of profits tax assessment was due on 10 January 2015. On 22 January 2015, the Commissioner imposed a surcharge of \$10,000 on the outstanding tax. Mr Leung paid \$40,000 to the Commissioner on 15 February 2015 but has been unable to pay any sum thereafter.

What is the amount of further surcharge which can be imposed by the Commissioner after 10 July 2015?

- A** \$17,000
- B** \$16,000
- C** \$20,000
- D** \$21,000

- 7** The tax system in Hong Kong plays an important role in attracting foreign investment.

Which of the following are the attractions of Hong Kong's tax system to foreign investors?

- (1) Simple tax structure
- (2) Low tax rates
- (3) No capital gains tax
- (4) No tax on dividends
- (5) Absolutely no withholding tax

- A** 1 and 2 only
- B** 2, 3 and 4 only
- C** 1, 2, 3 and 4
- D** 1, 3, 4 and 5

- 8** An import and export trading company has a large investment portfolio. At the year end the cost of the portfolio was \$1,500,000 and during the year concerned, the general supervision and management expenses relating to the portfolio amounted to \$50,000.

What is the amount which will be adjusted in the company's profits tax computation?

- A** Add back \$250
- B** Add back \$1,875
- C** Add back \$7,500
- D** Add back \$50,000

- 9 Which of the following considerations are relevant when ascertaining whether a fringe benefit is taxable?**

- (1) Whether the benefit is paid for the rendering of services
- (2) Whether the benefit is convertible into cash
- (3) Whether the benefit is paid out of a contract made with the employee or with the employer
- (4) Whether the benefit releases the employee's personal liability

- A** 1, 2 and 4
- B** 1, 3 and 4
- C** 2, 3 and 4
- D** 1, 2, and 3

- 10** C Ltd commenced business on 1 January 2014 and prepared its first accounts to 31 March 2015. Its adjusted assessable profits for the 15 months from 1 January 2014 to 31 March 2015 were \$150,000.

What are C Ltd's assessable profits for the year of assessment 2013/14?

- A** Nil
- B** \$30,000
- C** \$120,000
- D** \$150,000

- 11 Which of the following statements regarding rental income received by a business are correct?**

- (1) A corporation can claim exemption from property tax
- (2) A proprietorship business can claim exemption from property tax
- (3) A corporation can set off its property tax against its profits tax
- (4) A proprietorship business can set off its property tax against its profits tax

- A** 1 and 2 only
- B** 3 and 4 only
- C** 1, 3 and 4 only
- D** 1, 2, 3 and 4

- 12** Danny, a UK resident, is a director of a US multinational corporation (MNC). During the year ended 31 March 2015, Danny was seconded to work in MNC's site office in Hong Kong to supervise a construction project. MNC does not maintain any other office or establishment in Hong Kong.

Which of the statements regarding Danny's Hong Kong tax position is correct?

- A** He will pay less tax if he draws more of his remuneration as salary rather than as director's fees
- B** He will pay less tax if he draws more of his remuneration as director's fees rather than as salary
- C** The total tax payable will not change regardless of the proportion of salary and director's fees as his income will be fully taxable
- D** The total tax payable will not change regardless of the proportion of salary and director's fees as his income will be fully exempt

- 13** HK Ltd acquired machinery with a cash price of \$100,000 under hire purchase terms. HK Ltd made a down payment of \$20,000 on 1 September 2013 and settled the balance by 16 equal monthly instalments of \$5,500 each starting on 1 October 2013. HK Ltd closes its accounts on 31 March each year. The annual allowance rate for the machinery is 30%.

Which statement concerning the depreciation allowances for the machinery is correct?

- A** No initial allowance will be given in the year of assessment 2014/15
- B** The annual allowance in the year of assessment 2013/14 is \$20,460
- C** The machinery will be transferred to the 30% pool in 2014/15
- D** The annual allowance in the year of assessment 2014/15 is \$5,700

- 14** Mr Sun started a trading business on 1 December 2013 and closed his first set of accounts on 30 November 2014. He has assessable profits in his first 12 months of operation but has not received a tax return from the Inland Revenue Department.

What is the latest date by which Mr Sun is required to notify the Inland Revenue Department that he is chargeable to tax and for which year of assessment?

	Latest date	Year of assessment
A	31 March 2015	2013/14
B	31 July 2015	2013/14
C	31 July 2015	2014/15
D	31 March 2015	2014/15

- 15** David is the financial manager of A Ltd. During the year ended 31 March 2015, David was paid an annual salary of \$800,000 and was provided with a flat consisting of two bedrooms by his employer. David is a member of the HKICPA and ACCA for which he pays membership fees of \$2,450 and \$2,700 respectively.

What is David's net assessable income for the year of assessment 2014/15?

- A** \$874,335
- B** \$877,030
- C** \$877,305
- D** \$877,300

(30 marks)

Section B – ALL SIX questions are compulsory and MUST be attempted

Please write your answers to all parts of these questions on the lined pages within the Candidate Answer Booklet.

- 1 Alex and Annie are a married couple, who had the following income and outgoings for the year ended 31 March 2015:

	Alex \$	Annie \$
Salary	–	192,000
Profit from sole-proprietorship business (before deduction of any approved charitable donations)	320,000	–
Share of partnership profit	300,000	–
Dividend on Hong Kong listed shares	1,000	–
Loss from property trading	–	(330,000)
Net assessable value from the leasing of property		504,800
Interest on a bank loan secured by the leased property		(280,000)
Contributions to the mandatory provident fund	–	(27,500)
Total approved charitable donations	(260,000)	–

Alex and Annie have incorporated a trading company in Hong Kong, AA Ltd, in which each of them holds a 50% share. For the year ended 31 March 2015, AA Ltd has an after-tax profit of \$40,000.

In filing the individual tax return for the year of assessment 2014/15, Alex and Annie elected to be personally assessed.

Required:

Compute the tax payable by Alex and Annie under personal assessment for the year of assessment 2014/15, showing clearly the amount of tax payable by each of them.

(10 marks)

- 2** Watch Manufacturers Recreational Club (the Club) was established in April 2014 as a social club. The Club owns a block of flats in Shek O which is used partly for club activities and partly for leasing out to the public. The following is a summary of the Club's gross receipts from members and non-members for the year ended 31 March 2015:

	Voting members	Non-voting members	Non-members
	\$	\$	\$
Entrance fees	975,000		
Annual subscriptions	456,750	405,000	
Receipts from bar	502,200	370,050	
Rental from property			386,175
Hire of furniture and equipment			70,500
Sundry sales	64,125	5,850	
	<hr/> <u>1,998,075</u>	<hr/> <u>780,900</u>	<hr/> <u>456,675</u>

Required:

- (a) Explain, supported by calculations, whether or not Watch Manufacturers Recreational Club will be subject to profits tax in Hong Kong in respect of the year ended 31 March 2015. (4 marks)
 - (b) Calculate the tax payable by Watch Manufacturers Recreational Club, if any, in respect of the year ended 31 March 2015. Clearly identify the nature of the tax liability. (2 marks)
 - (c) Define a trade association and state the circumstances in which a trade association will be subject to tax and the income on which it will be taxable. (4 marks)
- (10 marks)

- 3** Andrew owns an office in Central which is leased out under the following terms:

Lease term:	1 March 2014 for two years
Rental:	Monthly rent of \$40,000 plus \$5,000 for the use of furniture
Premium:	\$180,000 paid on 1 April 2014
Rent free period:	One month from 1 March 2014
Rental deposit:	Two months' rental, returnable to the tenant upon expiry of the lease after deducting any outstanding rental in arrears and any cost of damage made to the property
Expenses:	Quarterly government rent and rates, payable by Andrew <ul style="list-style-type: none">- Government rent \$2,400 per quarter- Rates for the 1st and 2nd quarter: Rates of \$7,500 per quarter less a concession of \$1,500, balance payable per quarter \$6,000- Rates for the 3rd quarter and 4th quarter: Rates of \$7,500 per quarter Monthly management fees of \$3,000, payable by the tenant

Additional information relating to the property:

- (1) Andrew has engaged a property agent to manage the lease on his behalf, including collecting the rentals, settling property related expenses, and handling any lease affairs. A monthly agency fee of 5% of the gross monthly lease rental is payable to the agent.
- (2) In September 2014, the office was repaired for \$50,000, which was paid equally by Andrew and the tenant.
- (3) Since January 2015, the tenant has failed to make the monthly rental payment although he had advised Andrew that all outstanding rentals would be settled in a few months.
- (4) It was made known to Andrew that part of the office was sub-let by the tenant to a third party from 1 September 2014, for a monthly rental of \$10,000.
- (5) To finance the acquisition of the office, Andrew borrowed \$4,000,000 from a bank in Hong Kong. The interest paid on this bank loan for the year ended 31 March 2015 amounted to \$280,000.

Required:

(a) **Prepare a computation of Andrew's property tax liability for the year of assessment 2014/15.** (7 marks)

(b) **Explain the tax treatments accorded to each of items (1) to (4) under the property tax regime.** (3 marks)

(10 marks)

- 4** Alan Lo has been employed by HKC Ltd, a Hong Kong company, for the last two years. On 31 May 2015, he submitted his resignation to terminate his employment with HKC Ltd with effect from 1 July 2015. After deducting his outstanding annual leave entitlement, his official last day in the office will be 5 June 2015.

Alan has indicated to HKC Ltd that he will take a few months' break overseas before coming back to Hong Kong to report for duty with his new employer. He has therefore requested that HKC Ltd remit his last month's salary, as well as any other outstanding payment, to his wife's overseas bank account for use during their holiday.

Required:

Advise HKC Ltd on its tax reporting obligations in respect of Alan's resignation, and any other possible compliance issues arising from Alan's request to remit his last month's salary and any other outstanding payment to his wife's overseas bank account.

(10 marks)

- 5** George is a British citizen, whose permanent residence, together with his wife and 12-year-old son, is in the UK. On 1 April 2014, George was appointed as the Asian sales manager of Goodwell Ltd (Goodwell), a company carrying on business in London, and became responsible for the sales promotion of Goodwell's properties in the Asian region. His employment contract was negotiated and concluded in London and his salary is paid directly into his bank account in London.

George is remunerated by a fixed monthly salary of \$80,000 and a fixed monthly travelling allowance of \$5,000. He is provided with a flat in Hong Kong by his employer, for which George pays Goodwell a monthly rent of \$1,000.

The other benefits enjoyed by George from his employment with Goodwell in 2014/15 were as follows:

- (1) On 1 April 2014, he was directed by Goodwell to move his home in the UK from Birmingham to London. He incurred removal expenses of \$12,000 which were reimbursed by Goodwell.
- (2) In November 2014, he received a passage allowance of \$20,000 of which \$16,000 was spent by his wife and son on holiday travel and the balance was kept by him.
- (3) On 15 December 2014, he was granted an option to acquire 10,000 shares at \$15 each in Staywell Ltd, an associate of Goodwell. He paid \$8,000 for this option. On 2 January 2015, he sold the option for 2,000 shares for \$9,000. On 3 February 2015, he exercised the option on the remaining 8,000 shares and sold the shares on the next day. The market values per share of Staywell shares were as follows:

15 December 2014	\$17
2 January 2015	\$18
3 February 2015	\$19
4 February 2015	\$20

- (4) On 25 March 2015, he was injured in an accident and hospitalised for two weeks. Medical expenses totalling \$38,000 were claimed against Goodwell's insurance company, and \$2,000 was paid and borne by George. The annual premium per employee paid by Goodwell for the medical scheme was \$5,000.

During the year ended 31 March 2015, George spent a total of 193 days (including his days of arrival and departure) in Hong Kong as follows:

1 June 2014 to 9 September 2014	101 days
1 November 2014 to 31 January 2015	92 days (including 16 days annual leave)
	<u>193 days</u>

By virtue of his employment status, George and his employer are not required to make any contribution to the mandatory provident fund in Hong Kong.

Required:

Calculate the Hong Kong salaries tax payable by George for the year of assessment 2014/15.

Note: Ignore any overseas tax.

(15 marks)

- 6** Digital Technology Ltd (DTL), is a Hong Kong incorporated company, which carries on business in Hong Kong providing consultancy services on digital technology. DTL commenced business on 1 February 2014 and its first set of accounts prepared for the period ended 31 December 2014 shows the following:

	Note	\$
Service income	(1)	2,900,000
Profit/loss from investments	(2)	680,120
Interest income	(3)	57,000
		<hr/>
		3,637,120
Donation	(4)	188,000
Director's remuneration	(5)	910,000
Staff costs	(6)	1,644,000
Rent, rates and utilities	(7)	481,000
Legal and professional fees	(8)	74,000
Interest expenses	(9)	42,000
Depreciation	(10)	331,000
Office consumables (all deductible)		9,000
		<hr/>
Loss for the year		(3,679,000)
		<hr/>
		(41,880)
		<hr/>

Notes:

- (1) DTL earned the majority of its service income from two major customers:

	\$
Hurricane Development (China) Ltd (Hurricane)	1,400,000
Sunshine Hardware (HK) Ltd (Sunshine)	1,500,000
	<hr/>
Total per accounts	2,900,000
	<hr/>

Hurricane is a company carrying on business in China. DTL's director met, discussed and signed the service contract with Hurricane's director in China. Under this contract, DTL is required to render all the technical support services to Hurricane when necessary, and all these support services were provided by DTL's employees in Hong Kong.

DTL signed the service contract with Sunshine in Hong Kong and provided all the services to Sunshine in Hong Kong.

- (2) Profit/loss from investments:

	\$
Gain from trading in Hong Kong listed shares	690,120
Loss from trading in China listed shares	(30,000)
Dividends from Hong Kong listed shares	20,000
	<hr/>
Total per accounts	680,120
	<hr/>

- (3) Interest income comprises:

	\$
Interest on HK\$ deposit with a bank in Hong Kong	19,000
Interest on HK\$ loan made to Hurricane's director (the loan amount was remitted to the director's bank account in Hong Kong)	38,000
	<hr/>
Total per accounts	57,000
	<hr/>

- (4) A one-off donation of \$188,000 was paid to Red Cross Hong Kong, specifically to the flood in China in June 2014.

(5) Director's remuneration comprises:

	\$
Director's fee	850,000
Utilities of director's apartment	60,000
Total per accounts	<u>910,000</u>

(6) Staff costs comprise:

	\$
Salaries and allowances	1,580,000
Regular contributions to registered pension fund	64,000
Total per accounts	<u>1,644,000</u>

(7) Rent, rates and utilities comprise:

	\$
Rates and utilities for DTL's office	73,000
Rent, rates and utilities for the director's apartment	408,000
Total per accounts	<u>481,000</u>

(8) Legal and professional fees comprise:

	\$
Incorporation fee	4,000
Legal fee for setting up DTL	40,000
Audit and tax filing fees	30,000
Total per accounts	<u>74,000</u>

(9) Interest expenses comprise:

	\$
Interest on a bank loan, secured by a personal guarantee from DTL's director; the loan money was used to acquire DTL's office (see 10 (v) below)	39,000
Bank charges on daily transactions	3,000
Total per accounts	<u>42,000</u>

(10) DTL acquired all of its fixed assets after 1 April 2014, as follows:

	Cost \$
(i) Microwaves and distilled water dispensers for use in the office by staff	29,000
(ii) Computer lap-tops for use by staff	176,000
(iii) Energy saving lighting system for the office	123,000
(iv) Car for use by DTL's director	232,000
(v) Commercial building acquired from a property developer and used as DTL's office	5,000,000

DTL has agreed with the Inland Revenue Department that 50% of the acquisition cost of the commercial building is attributable to the cost of the land.

There were no disposals of fixed assets during the year.

Required:

Prepare Digital Technology Ltd's profits tax computation for the year of assessment 2014/15, showing the net assessable profit/adjusted loss and profits tax payable, if any. Clearly identify the basis period and show full details of the depreciation allowance calculations.

(15 marks)

End of Question Paper