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 the general principles involved are required.

Section A

1 The correct answer is: 2 only

Hong Kong has no thin capitalisation rule.

2 The correct answer is: 3 and 4 only

A corporation can claim exemption from property tax, or set off its property tax against its profits tax.

3 The correct answer is: 2018/19 HK$0; 2019/20 HK$1,464,000

Since the employer was resident in Hong Kong, David was under a Hong Kong employment. For the year of assessment 2018/19, David was exempt from salaries tax as his visits did not exceed 60 days. For the year of assessment 2019/20, David was fully chargeable to salaries tax as his total visits exceeded 60 days.

4 The correct answer is: 12 May 2020

An employer is required to file a 'notification by employer of employee about to depart from Hong Kong' (Form IR56G) one month before the expected date of departure which is 12 June 2020 in this case.

5 The correct answer is: 2m x 300% + ((3·5m – 2m) x 200%) + 1·5m = $10·5m

The staffing costs and the expenditures on consumable items would be eligible for enhanced deduction as Type B expenditures whereas the consultancy fee paid to the independent expert and the testing fee would be eligible for 100% deduction as Type A expenditures. For Type B expenditures, the first $2m qualifies for 300% deduction, and the remaining amount qualifies for 200% deduction.

6 The correct answer is: 1 and 4

Lump sum payment for agreeing not to engage in the same industry for three years is compensation for the deprivation of rights and not taxable. Reimbursement of medical expenses pursuant to an insurance contract entered into between the employer and the insurance company is not income from employment and not taxable.

7 The correct answer is: option 4

2019/20 (final) = [(20,000 x 3) + (60,000 x 3/24) – 1,400) x 80% x 15%] = $7,932
2020/21 (provisional) = (7,932 x 4) = $31,728

Under property tax, only rates and 20% statutory deduction can be deducted from the assessable value; and the premium is spread over the term of the lease.

8 The correct answer is: 2 only

Only the executor can elect for personal assessment for the deceased.

9 The correct answer is: 1 and 4 only

Capital expenditure is normally not deductible. Profits must be received, accrued or earned, and unrealised profits are not taxable. However, unrealised losses may be deductible if they are incurred in the production of chargeable profits.

Marks

10 The correct answer is: option 4

Taxable amount $270,000; Accrues in 2019/20

Share award benefits accrue and are taxable at the time when shares are vested without restrictions, which was 1 July 2019 in this case. However, since Simon had ceased employment, the share award benefits were deemed to accrue on the last day of employment, which was 1 September 2018 in this case. The market value of the shares on 1 July 2019 would be assessed in 2018/19.

11 The correct answer is: 24,000 + 400 = $24,400

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.

12 The correct answer is: 1m/5 x 3 – 500,000 = $100,000

The cost of a trade mark is deductible over five years. When the trade mark is subsequently sold and the unclaimed amount exceeds the sale proceeds, the balance is deductible.

13 The correct answer is: Share of partnership profit transferred to personal assessment is $0

When personal assessment (PA) is elected for any year, assessable profits for that year after deducting any loss brought forward from previous years will be transferred to PA, which is zero in this case. Any remaining loss cannot be transferred to PA but will be carried forward under profits tax.

14 The correct answer is: 30,000 – (28,000 x 1/2·8) = $20,000

Part of the offshore deposit is used to secure the loan which is used to produce chargeable profits. Allowable interest is reduced by a portion of the tax-free interest on the offshore deposit.

15 The correct answer is:

(180,000 x 80% + 360,000 – 180,000 x 80%) – 126,000 (360,000 x 35%) – 85,000 = $149,000

The joint reduced total income is the aggregate of net assessable value as reduced by allowable mortgage loan interest and salary income, and after deducting business loss and approved charitable donations, which is restricted to 35% of total income before business loss.

2 marks each **30**

Section B *Marks*

1 Mr and Mrs Ho

(a) Obligation to inform the Commissioner of chargeability to property tax

Every person chargeable to tax for any year of assessment shall inform the Commissioner in writing that they are so chargeable not later than four months after the end of the basis period for that year of assessment unless they have already been required to furnish a return (s.51(2)). 1

Mr and Mrs Ho started to derive rental income in October 2018 and are chargeable to tax for the year of assessment 2018/19. They are obliged to inform the Commissioner of their chargeability to tax not later than 31 July 2019. However, since they had been required to furnish a return, the statutory obligation under s.51(2) would not apply. 2

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(b) Consequences of failing to pay property tax due

If there is any default in payment, a surcharge will be imposed, amounting to 5% of the total amount unpaid (including the second instalment of the tax payment, if any). In the case of Mr and Mrs Ho, since the first instalment is not paid by 3 January 2020, a surcharge of $7,560 (151,200 x 5%) will be imposed. If the tax payment is late for six months or more, an additional surcharge will be imposed, amounting to 10% of the total outstanding payment including the initial 5% surcharge. The Inland Revenue Department (IRD) is also empowered to recover the tax amount from any debtor of the property owner or from any person who holds money for or on account of the property owner (such as the tenant of the property paying rent to the owner, the bank where the property owner holds his accounts or the employer of the property owner). 3

The IRD may recover the tax in default as civil debt through the District Court. 0·5

The Commissioner of the IRD or an officer not below the rank of Chief Assessor as authorised by the Commissioner may apply for a departure prevention direction from the District Court if there are reasonable grounds to believe that the property owner intends to depart from Hong Kong to reside elsewhere. 1·5

5

(c) Statutory obligation to keep rental records

Every person who is the owner of land and/or buildings situated in Hong Kong is required to keep sufficient records, either in English or Chinese, of the consideration, in money or money's worth, payable or deemed to be payable to them, to their order or for their benefit in respect of the right of use of that land and/or buildings to enable the assessable value to be readily ascertained. In the case of Mr and Mrs Ho, records should be kept of the actual rental received for each month. Such records should be retained for at least seven years after the transactions to which they relate (s.51D). 2

10

2 **(a) Colour Ltd**

Quarter	HK gross sales turnover	Commission earned by Mr Chan	HK tax payable by Colour Ltd	Net remittance receivable by Colour Ltd	
1	$3,000,000	$300,000	$15,000	$2,685,000	
2	$400,000	$40,000	$2,000	$358,000	
		(1 mark)	*(2 marks)*	*(1 mark)*	4

(b) Mr Chan is regarded as carrying on business in Hong Kong as a consignment agent and is subject to Hong Kong profits tax under s.14(1). 1

The calculation of Hong Kong profits tax payable by Mr Chan is:

	$
Commission income earned ($300,000 + $40,000)	340,000
Less: Display charge ($5,000 x 2)	(10,000)
Assessable profits	330,000
Profits tax payable at 7·5%	24,750

2

3

	Marks
(c) Mr Chan's compliance obligations as a consignment agent	
Under s.20A(3), Mr Chan is obliged to calculate the amount of Hong Kong profits tax payable by Colour Ltd (Colour), and must withhold the tax amount from the sales money before remitting the money to Colour.	1
The tax amount is calculated as 1% of the gross sale proceeds or such lesser sum as may have been agreed by the Commissioner of the Inland Revenue Department (IRD). Based on the prevailing practice, the current rate is reduced to 0·5% as agreed by the Commissioner.	0·5
Mr Chan is also required to file a quarterly tax return to the IRD on behalf of Colour reporting the gross proceeds of the sales made in Hong Kong and the amount of tax withheld.	1
Upon receiving the assessment from the IRD, Mr Chan will be required to settle the tax payable on behalf of Colour.	0·5
	3
	10

3 Miss Boleyn

Property tax computation for the year of assessment 2018/19

	$	
Rental (22,750 x 12)	273,000	1
Premium (24,000 x 12/24)	12,000	1
	285,000	
Less: Irrecoverable debts carried back from 2019/20	(13,750)	0·5
Assessable value	271,250	
Less: Rates (3,000 x 4)	(12,000)	0·5
	259,250	
Less: 20% statutory allowance	(51,850)	0·5
Net assessable value	207,400	
Property tax at 15%	31,110	0·5

Property tax computation for the year of assessment 2019/20

	$	
Rental (22,750 x 2)	45,500	1
Premium (24,000 x 9/24)	9,000	1
	54,500	
Less: Irrecoverable debts ((22,750 x 5) – 45,500 deposit recovered)	(68,250)	1·5
Bad debts carried back to 2018/19	(13,750)	
Net assessable value	Nil	
Property tax payable	Nil	0·5

Statement of items not taxable/deductible:
Management fee of $1,100 per month non-deductible
Rates relating to the 2019/20 year of assessment non-deductible
Mortgage loan interest (either or both year) non-deductible
Property agent letting fee of $11,375 non-deductible ($22,750 x ½)

0·5 mark each, maximum	2
	10

			Marks
4 (a) Miss Yang			
Plan A – cash allowance			
		$	
Salary		1,000,000	0·5
Cash allowance		400,000	0·5
Assessable income		1,400,000	
Plan B – flat owned by employer's subsidiary company			
		$	
Salary		1,000,000	
Rental value at 10%		100,000	1
Assessable income		1,100,000	
Correct treatment of estimated market rent of $400,000: not taxable nor deductible.			0·5
Plan C – flat leased by Miss Yang and partially reimbursed by employer			
	$	$	
Salary		1,000,000	
Rental value at 10%	100,000		1
Less: Rent suffered (480,000 – 400,000)	(80,000)	20,000	1
Assessable income		1,020,000	
Plan D – flat owned by parents			
		$	
Salary		1,000,000	
Reimbursement of rent (30,000 x 12)		360,000	0·5
Reimbursement of utilities		40,000	0·5
Assessable income		1,400,000	
Plan E – flat acquired by Miss Yang with reimbursement by employer			
		$	
Salary		1,000,000	
Mortgage loan reimbursement		400,000	1
Assessable income		1,400,000	
Correct treatment of mandatory provident fund contribution: not deducted from assessable income.			0·5
			7

(b) Miss Yang's home loan interest deductions		
Plan F(1) – flat owned by Miss Yang under bank mortgage:	$100,000	1
Home loan interest (maximum)		
Plan F(2) – flat jointly owned by Miss Yang and her brother, lived in by Miss Yang:	$48,000	1
Home loan interest (lower of actual or maximum, divided by 50% ownership)		
Plan F(3) – flat jointly owned by Miss Yang and her brother, lived in by her brother:	Nil	1
Home loan interest		
		3
		10

Marks

5 Edmund

Salaries tax assessment
Year of assessment 2019/20

	$	$	Marks
Salary (100,000 x 12)		1,200,000	0·5
Entertainment allowance		60,000	0·5
Reimbursement of extra hospital bills (21,000 x 2/3)		14,000	0·5
		1,274,000	
Time-apportioned income: 1,274,000 x 220/366 (W1)		765,792	1
Rental value: (765,792 – 2,500) x 10%	76,329		1
Less: Rent suffered (240,000 x 5%)	(12,000)	64,329	0·5
Share option gain:			
– assignment of option (8,000 – 9,000 x 3/10)	5,300		1
– exercise of option ((9 – 5) x 7,000) – (9,000 x 7/10)	21,700		1·5
	27,000		
Apportioned on the number of days: 27,000 x 220/366		16,229	0·5
Assessable income		846,350	
Less: Membership fee	2,500		0·5
Self-education expenses	4,000	(6,500)	0·5
Net assessable income		839,850	
Less: **Part 5 allowances**			
Basic allowance		(132,000)	0·5
Net chargeable income		707,850	
Tax at progressive rates		102,334	0·5

Tax at standard rate ($839,850 x 15% = $125,977) is not applicable. 0·5

Working 1:

Calculation of time-apportionment basis (midnight rule)

			Marks
2 April 2019 to 21 April 2019	19		
3 May 2019 to 31 July 2019	89	(including 20 leave days)	
6 August 2019 to 18 September 2019	43		
4 January 2020 to 21 March 2020	77		
Total days spent in Hong Kong	228		
Less: Leave days in Hong Kong	(20)		
Total business days spent in Hong Kong	208	(A)	
Total business days in year excluding annual leave	346		
Leave days attributable to Hong Kong service [20 x 208/(366 – 20)]	12	(B)	
Total attributable days in Hong Kong	220	(A + B)	
Time apportionment basis	**220/366**		4

Listing of non-deductible/non-taxable items

Non-deductible items	$	Non-taxable items	$	Marks
Extra hospital bill	7,000	Health insurance premium	5,000	
		Hospital bill reimbursed by insurance company	40,000	
			(0·5 mark each)	1·5
				15

			Marks

6 Sunny Ltd

Profits tax computation for the year of assessment 2019/20 0·5
Basis period: year ended 31 March 2020 0·5

	$	$	
Profit for the year per accounts		4,621,200	0·5
Add: Depreciation	330,000		0·5
Donation	400,000		0·5
Special contribution to MPF ($150,000 x 80%)	120,000		0·5
Interest on loan from shareholder	15,000	865,000	0·5
		5,486,200	
Less: Profit from sale of commercial property	3,200,000		0·5
Leasing income from China property	500,000		0·5
Interest income on director's loan	10,000		0·5
Energy saving lighting	270,000		0·5
Carpet replacement	150,000		0·5
Refurbishment ($280,000 x 20%)	56,000		0·5
Prescribed non-current asset – computers	200,000		0·5
Depreciation allowance	41,260	(4,427,260)	
		1,058,940	0·5
Less: Donation (maximum 35% x 1,058,940)		(370,629)	1
Assessable profits		688,311	
Profits tax payable at 8·25%		56,785	0·5

Correct treatment of items which 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	**$**	**Deductible/non-taxable items**	**$**	
Compensation income	120,000	Regular MPF contribution	50,000	
Bank deposit interest income	2,000	Litigation fee for compensation claim	80,000	
		Interest on bank overdraft	3,800	
		Finance charge	2,000	
			0·5 mark each, maximum	3

Depreciation allowance schedule

	20%	**30%**	**HP – 30%**	**Total allowance**	
	$	**$**	**$**	**$**	
Written down value (WDV) brought forward	20,000	30,000			0·5
Additions – data processing machine			55,000		0·5
Initial allowance (10,000 + ((55,000 – 10,000)/5 x 2)) x 60%			(16,800)	16,800	1
			38,200		
Annual allowance	(4,000)	(9,000)	(11,460)	24,460	1
WDV carried forward	16,000	21,000	26,740		
				41,260	
					15