

Applied Skills

# Taxation – Hong Kong (TX – HKG)

Tuesday 4 June 2019



**Time allowed:** 3 hours 15 minutes

This question 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 question paper until instructed by the supervisor.**

**Do NOT record any of your answers on the question paper.**

**This question paper must not be removed from the examination hall.**

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Think Ahead

**ACCA**

The Association of  
Chartered Certified  
Accountants

## 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 2018/19 tax rates, allowances and deductions are to be used in answering the questions.

### Profits tax rates

Assessable profits	Companies	Unincorporated business
First \$2 million	8.25%	7.5%
Over \$2 million	16.5%	15%

### Salaries tax rates

First \$50,000	2%
Next \$50,000	6%
Next \$50,000	10%
Next \$50,000	14%
Remainder	17%
Standard rate	15%

### Allowances

	\$
Basic allowance	132,000
Married person's allowance	264,000
Single parent allowance	132,000
Child allowance – 1st to 9th child (each)	120,000
– additional allowance in the year of birth (each)	120,000
Dependent parent/grandparent allowance – basic	25,000/50,000
– additional	25,000/50,000
Dependent brother/sister allowance	37,500
Disabled dependant allowance	75,000
Personal disability allowance	75,000

### Deductions

	\$
Self-education expenses (maximum)	100,000
Home loan interest (maximum)	100,000
Elderly residential care expenses (maximum)	100,000
Contributions to recognised retirement schemes (maximum)	18,000

### 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

**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 Dave is employed by a British company, which is managed and controlled in London. He was assigned to work in Hong Kong for two years from 1 January 2017, and was granted an option to acquire 100,000 shares at \$1 each in consideration of his taking up the assignment. The option was subject to a vesting period of two years, during which Dave rendered services in Hong Kong as follows:

1 January 2017 to 31 March 2017	40 days
1 April 2017 to 31 March 2018	140 days
1 April 2018 to 31 December 2018	100 days
	<hr/>
	280 days
	<hr/>

Dave exercised the option on 1 April 2019. The market value of the shares on 1 January 2017 was \$3 each and on 1 April 2019 was \$4 each.

**What is the taxable amount of Dave's share option benefit?**

- A \$65,753  
B \$115,068  
C \$98,630  
D \$76,712
- 2 Diana graduated in July 2018 and joined HK Airline Ltd on 1 August 2018 as a flight attendant at a monthly salary of \$20,000. Diana has no other income and she has not received a tax return from the Inland Revenue Department.

**What is the latest date by which Diana is required to notify the Inland Revenue Department that she is chargeable to tax?**

- A 31 July 2019  
B 1 November 2018  
C 30 June 2019  
D 1 December 2018
- 3 Aircraft Leasing Ltd carries on business in Hong Kong as a qualifying aircraft lessor. The company acquired an aircraft for \$200 million in 2018, leased it to a non-Hong Kong aircraft operator and then sold the aircraft for \$220 million in 2019.

**Which of the following statements regarding the disposal of the aircraft by Aircraft Leasing Ltd is/are correct?**

- (1) The gain on disposal of the aircraft is NOT taxable if it is capital in nature  
(2) The gain on disposal of the aircraft IS taxable if it is revenue in nature  
(3) The gain on disposal of the aircraft IS taxable because Aircraft Leasing Ltd has not used the aircraft for a qualifying aircraft leasing activity for a continuous period of not less than three years  
(4) The disposal proceeds are to be deducted from the 20% pool
- A 3 only  
B 1 and 2 only  
C 1, 2 and 4  
D 3 and 4

- 4 HKCo, a company carrying on a manufacturing business in Hong Kong, purchased a trade mark registered in Hong Kong during the year of assessment 2016/17, at a cost of \$2,000,000. HKCo manufactured and sold goods bearing the trade mark in Hong Kong. The trade mark was sold in the year of assessment 2018/19 for \$1,000,000.

**What is the amount of the allowable deduction and taxable trading receipt in respect of the trade mark which HKCo can claim and will be assessed on for profits tax purposes in the year of assessment 2018/19?**

- A Allowable deduction of \$400,000 and taxable trading receipt of \$1,000,000
- B No allowable deduction and taxable trading receipt of \$1,000,000
- C Allowable deduction of \$400,000 and no taxable trading receipt
- D Allowable deduction of \$200,000 and no taxable trading receipt

- 5 **Which of the following persons are responsible for complying with a corporation's obligations imposed under the Inland Revenue Ordinance?**

- (1) The director of the corporation
- (2) The chief executive officer of the corporation
- (3) The liquidator of the corporation
- (4) The secretary of the corporation

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

- 6 **Which of the following person(s) is/are likely to be eligible to elect for personal assessment for the year of assessment 2018/19?**

Annie: Aged 16 and resides with her grandmother in Hong Kong. She inherited a property in Shatin from her late father and mother on 1 April 2018. The property has been let out since that date for rental income.

Barbara: Retired on 1 June 2018 immediately after working in Hong Kong for 35 years, and migrated to London.

Cindy: Aged 30 and was seconded to work in her Hong Kong employer's Beijing office for two years from 1 January 2018. She regularly returns to Hong Kong and stays with her family.

- A Cindy only
- B Barbara only
- C Barbara and Cindy only
- D Annie, Barbara and Cindy

- 7 L Ltd, which is resident in Hong Kong, is not associated with M Ltd, which is resident in country M. On 1 April 2017, L Ltd received a loan of \$5 million from M Ltd at an interest rate of 3% per annum in the ordinary course of its intra-group financing business. On 1 October 2017, \$3 million of this loan was sub-participated to N Ltd, an associated company of M Ltd, which is resident in country N. M Ltd was the beneficial owner of the loan interest income received from L Ltd and was chargeable to tax on this interest income at the rate of 15% in Country M. N Ltd was chargeable to tax in country N at the rate of 20%.

**What is the amount of allowable interest which L Ltd can claim for profits tax purposes for the year ended 31 March 2018?**

- A \$150,000
- B \$75,000
- C \$105,000
- D \$60,000

- 8 Good Hope Ltd owns a residential property in Hong Kong which is let to its subsidiary company at a monthly rental of \$35,000, which is \$8,000 below the market rent. Good Hope Ltd leases its office premises from Landlord Ltd at a monthly rental of \$48,000, and sublets half of the office space to its associated company at a monthly rental of \$25,000.

**What is the property tax payable by Good Hope Ltd for the year of assessment 2018/19?**

- A \$61,920
- B \$50,400
- C \$86,400
- D \$97,920

- 9 Philip is employed by B Ltd as the company's tax manager. On 1 April 2017, Philip was granted 6,000 shares by B Ltd subject to a vesting period, which ended on 30 September 2018. The market values of the shares on 1 April 2017 and 30 September 2018 were \$75,000 and \$110,000 respectively. During the year ended 31 March 2019, Philip was paid an annual salary of \$910,000 and was provided with the use of a flat. Philip paid allowable self-education expenses of \$60,000.

**What is the amount of Philip's taxable housing benefit for the year of assessment 2018/19?**

- A \$98,500
- B \$96,000
- C \$102,000
- D \$85,000

- 10 Which of the following statements relating to the procedures for Board of Review appeal hearings are NOT correct?

- (1) The Board has the power to summon witnesses and to hear evidence
- (2) The onus of proving that an assessment is not excessive or incorrect is on the Inland Revenue Department
- (3) The appellant cannot withdraw his appeal after the hearing has commenced
- (4) The appellant must attend the hearing in person

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

- 11 X, Y and Z were partners in a partnership, sharing profits and losses equally. X, who had consistently elected for personal assessment, died on 31 December 2018. In his will, X appointed his son as his executor. The accounts of the partnership for the two years ended 31 March 2018 and 31 March 2019 showed an agreed loss of \$120,000 and an assessable profit of \$180,000 respectively.

**What would be X's share of the partnership profit transferred to personal assessment, assuming personal assessment was elected for 2018/19?**

- A \$20,000
- B \$45,000
- C \$60,000
- D \$5,000

**12 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 partnership 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

- 13** Kitty was dismissed by her employer, C Ltd, on 31 March 2019 and her salary was due to be paid on 5 April 2019. However, due to a dispute regarding Kitty's entitlement to a severance payment, C Ltd did not pay her until 25 July 2019 when a compromise package of \$380,000 was agreed. This amount comprised her salary for March 2019 of \$50,000, leave pay of \$30,000, a payment in lieu of notice of \$100,000, and a severance payment of \$200,000 calculated in accordance with the Employment Ordinance.

**What is the taxable amount of the compromise package and in which year of assessment is it assessable?**

	Amount	Year of assessment
<b>A</b>	\$80,000	2018/19
<b>B</b>	\$180,000	2018/19
<b>C</b>	\$80,000	2019/20
<b>D</b>	\$380,000	2019/20

- 14** On 1 August 2017, Clement was employed as the financial manager of A Ltd on an initial contract of one year. On 1 August 2018, Clement's contract was renewed for another two years and he received a gratuity of \$90,000. During the year ended 31 March 2019, Clement was paid an annual salary of \$900,000 and was provided with a flat. Clement is a member of ACCA for which he pays membership fees of \$2,500.

**What is Clement's net assessable income for the year of assessment 2018/19?**

- A** \$1,086,250
- B** \$1,077,250
- C** \$1,089,000
- D** \$1,080,000

- 15** Daniel and E Ltd carry on a partnership business in Hong Kong, sharing profits and losses equally. For the year ended 30 June 2018, the partnership business had an assessable profit of \$2,600,000. Daniel elected for personal assessment for the year of assessment 2018/19.

**What is the profits tax payable by the partnership business for the year of assessment 2018/19?**

- A** \$107,250
- B** \$214,500
- C** \$195,000
- D** \$132,000

**(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** Wendy had been employed by HK Ltd (HKL), a company which carries on business in Hong Kong. On 30 November 2018, Wendy submitted her resignation to HKL and terminated her employment with immediate effect by foregoing one-month's salary in lieu of notice. This was due to Wendy's father being very ill such that she needed to fly to Canada in the following week to take care of him.

As it was possible Wendy might need to stay in Canada for a few months, she requested that HKL remit any outstanding payment owed to her (including her leave pay and payment from HKL's provident fund, and after deducting the one-month's salary in lieu of notice) to her bank account in Canada.

**Required:**

**Advise HK Ltd on its tax reporting obligations in respect of Wendy's resignation, and any other possible compliance obligations arising from Wendy's request to remit any outstanding payment owed to her to her bank account in Canada.**

**(10 marks)**

- 2** Winter Ltd (Winter) acquired an industrial building from a property developer in October 2016 at a cost of \$50,000,000. The acquisition was funded by a ten-year mortgage loan from a bank in Hong Kong. Winter intended to use the property for its own manufacturing operations but due to a change in environmental regulations subsequent to acquisition, the property was found not to be suitable for the operation unless substantial modification work was done to it. The property has therefore been left vacant since acquisition.

In February 2018, it was agreed in the directors' meeting that the property would be renovated and sub-divided into smaller units, before being listed for sale. Renovation was completed in October 2018 and the whole property was sold in March 2019 for \$80,000,000, generating an accounting profit of \$30,000,000. Winter closes its accounts on 30 June, and has never claimed any depreciation allowance for the property. Records show that the estimated market values of the property in February 2018 and October 2018 were \$70,000,000 and \$72,000,000 respectively. The total cost of disposal includes \$2,000,000 for renovation and \$1,000,000 for legal fees.

**Required:**

- (a) Explain the principles which will generally be applied to determine whether the sale of property by Winter Ltd constitutes a trade.** (7 marks)
- (b) Assume the Inland Revenue Department determined that Winter Ltd's intention at the time of acquisition was to hold the property for long-term investment but changed to a profit-making motive prior to the property disposal. Calculate the estimated assessable profits of Winter Ltd arising from the property disposal.**

Note: You should ignore land value and concessionary treatment for profits tax. (3 marks)

**(10 marks)**

- 3 Mr Yu runs his own trading business as a sole proprietor. In the year ended 31 March 2018, the business incurred an adjusted tax loss of \$60,000 which was carried forward, and in the year ended 31 March 2019, the business made an assessable profit of \$260,000 (after deducting approved charitable donations of \$50,000 but before offsetting the tax loss brought forward).

Mr Yu's spouse, Mrs Yu, is employed as an accountant by a Hong Kong company, and received assessable income (before a 5% mandatory provident fund (MPF) deduction) of \$380,000 and \$480,000 for the years ended 31 March 2018 and 31 March 2019 respectively.

The couple jointly owns a property in Shatin, which is occupied by them as their primary residence. Mr Yu also wholly owns another property in Tai Po, which has been leased out for rental since 1 January 2017 under two-year lease agreements. The Shatin and Tai Po properties were both financed by bank mortgage loans. On 1 January 2019, the couple re-mortgaged the Shatin property and obtained an additional loan in order to finance Mr Yu's trading business. The lease details and bank loan interest for both years ended 31 March 2018 and 31 March 2019 are as follows:

	Primary residence: Shatin \$	Leased property: Tai Po \$	Total \$
Lease details			
Lease 1: Tai Po	–	Lease 1	180,000
– two years from 1 January 2017 at \$15,000 per month			
– two-month rental deposit received upfront			
– rates paid by tenant			
– tenant failed to pay rent since 1 April 2018; moved out on 31 May 2018 and could not be contacted			
Lease 2: Tai Po	–	Lease 2	130,000
– two years from 1 November 2018 at \$20,000 per month			
– two-month rental deposit received upfront			
– premium at \$24,000 received upfront			
– rates paid by tenant			
Bank mortgage interest			
– year ended 31 March 2018	120,000	160,000	280,000
– year ended 31 March 2019 (excluding additional loan)	80,000	140,000	220,000
– year ended 31 March 2019 (additional loan only)	18,000	–	18,000

Two years ago, Mrs Yu started to study a part-time master's degree in accounting offered by a UK-based university at an annual tuition fee of \$150,000, of which \$90,000 was paid during the year. Mr Yu and Mrs Yu made approved charitable donations of \$50,000 and \$180,000 respectively during the year. As mentioned above, Mr Yu's charitable donation was deducted as an expense against his business profit. The couple did not elect for personal assessment for the year of assessment 2017/18, but did so elect for 2018/19.

**Required:**

**Compute the couple's net chargeable income for 2018/19 under personal assessment.**

**Note:** You are not required to compute the tax payable.

**(10 marks)**



- 4 Mr Johnson is employed by a US company as a regional operations controller, looking after the company's operations in Asian countries, including Hong Kong. During the year ended 31 March 2019, he visited Hong Kong to exercise his duties on the following dates:

Arriving Hong Kong	Departing Hong Kong	Remarks
1 April 2018	15 April 2018	
10 June 2018	25 June 2018	20 June–25 June on vacation
8 November 2018	29 November 2018	
16 January 2019	17 January 2019	
19 February 2019	24 February 2019	

**Vacation details:**

As well as taking vacation in Hong Kong from 20 June to 25 June inclusive, Mr Johnson took vacation for another 14 days in Europe during December 2018.

**Note:** The total number of days in 2018/19 is 365.

**Required:**

- (a) Calculate the number of days that Mr Johnson visited Hong Kong in 2018/19 and determine whether Mr Johnson is exempt from or subject to Hong Kong salaries tax. (4 marks)
- (b) Regardless of your answer to part (a) above, calculate the time-apportionment ratio for Mr Johnson assuming that he is subject to salaries tax for 2018/19. (6 marks)

**(10 marks)**

- 5 John has been employed by Better Ltd (Better), a trading company carrying on business in Hong Kong, as its chief sales executive since 1 May 2017. The following information relates to John concerning the year of assessment 2018/19:
- (1) Salary and commission of \$1,300,000, subject to a deduction of 5% as his contribution to the mandatory provident fund (MPF).
  - (2) Discretionary bonuses declared by Better and credited to John's account on:
    - 16 May 2018: \$80,000 for the period from 1 May 2017 to 31 March 2018
    - 19 May 2019: \$90,000 for the period from 1 April 2018 to 31 March 2019
  - (3) Accommodation
    - **1 April 2018 to 31 May 2018**  
John accommodated a two-room hotel suite. The rent was directly paid by Better to the hotel, although John had to contribute \$4,000 for the period. In addition, John paid \$1,200 directly to the hotel as a service charge.
    - **1 June 2018 to 31 March 2019**  
John resided with his family in a flat in Discovery Bay. He purchased the flat with a loan of \$5,000,000 which was provided to him under a low-interest staff housing loan scheme by Better. During the year, John paid total interest of \$40,000 to Better. Had John paid interest at market rate, the total interest would have been \$85,000.
  - (4) Electricity and water bills  
From 1 June 2018, when John and his family moved into their own flat in Discovery Bay, the electricity and water bills totalling \$15,000 were paid by Better.
  - (5) Education allowance  
John placed his 12-year-old daughter into the International School of Hong Kong. The tuition fees were directly borne by Better for which it paid \$84,000.
  - (6) Travelling allowance  
John incurred travelling expenses of \$2,000 each month which were reimbursed in full by Better. It was agreed with the assessor that half of these expenses were for journeys between John's home and his office, whereas the remainder were for journeys between John's office and the offices of potential customers.
  - (7) Gift from employer  
In December 2018, in recognition of John's outstanding sales record, Better purchased and gave him a watch at a cost of \$30,000. The watch had a second-hand market value of \$25,000.
  - (8) Shares from employer  
On 1 February 2018, John was granted 8,000 shares by Better subject to a vesting period up to 31 January 2019. John sold the 8,000 shares on 15 February 2019. The market price of each share was \$5 on 1 February 2018, \$6 on 31 January 2019 and \$7 on 15 February 2019.
  - (9) Holiday passage allowance  
John was granted an allowance of \$32,000 in March 2019 for the purchase of a holiday passage, of which he spent \$30,000 when he was on vacation leave in April 2019. He spent the remaining \$2,000 buying a souvenir for his secretary during the trip.
  - (10) Removal expenses  
Half of the total removal expenses of \$14,000 which John incurred on 1 June 2018 were refunded to him by Better.
  - (11) Compensation and medical expenses  
In July 2018, John was injured while visiting Better's warehouse in Shenzhen, China. John received compensation of \$33,000 from Better's insurer. In addition, his medical treatment expenses of \$18,000 were fully reimbursed by Better.

(12) Charitable donations

John made cash donations of \$12,000 in January 2019 to the Tung Wah Group of Hospitals (the Hospitals). He also paid \$3,000 for a ticket to attend a fund-raising show organised by the Hospitals in March 2019.

(13) Tax liability

John's salaries tax liabilities of \$160,000 for the year of assessment 2017/18 were paid and borne by Better on 20 January 2019.

(14) John is married with one daughter aged 12. His wife is a housewife.

**Required:**

**Compute the Hong Kong salaries tax payable by John for the year of assessment 2018/19.**

**(15 marks)**

- 6 Summer Ltd (Summer) is a Hong Kong-incorporated company carrying on business in Hong Kong, which prepares its accounts to 31 March each year. Summer imports recycled paper from South-East Asia and sells it to customers in both Hong Kong and mainland China.

The following is Summer's income statement for the year ended 31 March 2019:

	Notes	\$	\$
Turnover	(1)		2,000,000
Cost of goods sold			(800,000)
			<u>1,200,000</u>
Interest income	(2)	32,000	
Net rental income	(3)	<u>200,000</u>	<u>232,000</u>
			<u>1,432,000</u>
Salaries and allowances		600,000	
Rent and rates	(4)	480,000	
Staff mandatory provident fund (MPF) contribution	(5)	100,000	
Donation	(6)	20,000	
Miscellaneous	(7)	108,000	
Depreciation	(8)	100,000	
Interest expense	(9)	<u>9,000</u>	<u>(1,417,000)</u>
Net profit			<u><u>15,000</u></u>

**Notes:**

- (1) Turnover comprises:

	\$
Gross sales made to Hong Kong customers	1,600,000
Gross sales made to China customers	<u>400,000</u>
Total	<u><u>2,000,000</u></u>

- (2) Interest income comprises:

	\$
Interest income on overdue trade receivable from a China customer	12,000
Interest income on loan made to a director, loan remitted to him in China	<u>20,000</u>
Total	<u><u>32,000</u></u>

- (3) Net rental income was received from a shop located in Hong Kong, comprising gross rentals of \$240,000 less management fees of \$40,000. The shop was acquired in January 2017 at a cost of \$7,000,000 (including land cost of \$5,000,000). It was agreed with the Inland Revenue Department that the qualifying expenditure for commercial building allowance in respect of the shop is \$1,500,000.

- (4) Rent and rates comprises:

	\$
Rent and rates for office in Hong Kong	200,000
Rent and rates for warehouse in Hong Kong	180,000
Rent and rates for warehouse in China	<u>100,000</u>
Total	<u><u>480,000</u></u>

- (5) The contributions to MPF schemes for staff represents 20% of the basic salary of all staff.
- (6) The donation of \$20,000 was made to the Hong Kong Red Cross for floods in China.
- (7) Miscellaneous comprises:

	\$
Club entrance and annual subscription for director	58,000
Loan to an employee in 2017 written off on his resignation	30,000
Commission charged by an undisclosed China agent	20,000
Total	<u>108,000</u>

- (8) The total accounting depreciation charge for the year is \$100,000 based on the book value of non-current assets as at 31 March 2019. During the year, a motor car was traded-in to acquire an electronic van which had a cost of \$440,000. The trade-in value was \$12,000.
- (9) Interest was paid on a personal loan provided to Summer Ltd by a shareholder who is a China resident.
- (10) Summer's tax depreciation schedule from its 2017/18 profits tax return shows carried forward tax written down values for its 20% and 30% pools of \$30,000 and \$40,000 respectively.
- (11) Summer's property tax assessment for 2017/18 shows tax payable of \$25,920 which was settled in November 2018.

**Required:**

**Assuming that no offshore claim is made by Summer Ltd, prepare the company's profits tax computation for the year ended 31 March 2019 showing the net assessable profits/adjusted loss for the period, and the profits tax payable, if any. Clearly identify the year of assessment and the basis period and include a full depreciation allowance schedule.**

Note: You should ignore overseas tax.

**(15 marks)**

**End of Question Paper**