

Fundamentals Level – Skills Module

Taxation (Hong Kong)

Thursday 7 June 2018



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.

Think Ahead

ACCA

The Association of
Chartered Certified
Accountants

Paper F6 (HKG)

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 2017/18 tax rates, allowances and deductions are to be used in answering the questions.

Profits tax rates

Companies	16.5%
Unincorporated business	15%

Tax rates

Salaries tax rates:	
First \$45,000	2%
Next \$45,000	7%
Next \$45,000	12%
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)	100,000
– additional allowance in the year of birth (each)	100,000
Dependent parent/grandparent allowance – basic	23,000/46,000
– additional	23,000/46,000
Dependent brother/sister allowance	37,500
Disabled dependant allowance	75,000

Deductions

	\$
Self-education expenses (maximum)	100,000
Home loan interest (maximum)	100,000
Elderly residential care expenses (maximum)	92,000
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 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** Crown Ltd (Crown) was incorporated on 1 July 2017 to engage in the trading of second-hand handbags in Hong Kong. Crown rented a shop under a two-year lease starting on 1 August 2017, but with an initial two-month rent-free period. The shop was renovated during this initial rent-free period and only became available for use on 10 September 2017. A shop manager and a sales assistant were employed with effect from 16 September 2017.

Management accounts have been prepared for the first six months of operation. Crown is considering closing its accounts on either (1) 31 March 2018; or (2) 30 June 2018.

Required:

- (a) Set out the general principles and practices in Hong Kong for determining the date of commencement of a business for tax purposes. Based on the facts given in the question, give your assessment of the likelihood of each of the following dates being regarded as the date of commencement of Crown Ltd's business, concluding with which date is most likely to be adopted by the Inland Revenue Department (IRD):**
- (i) 1 July 2017;**
 - (ii) 1 August 2017;**
 - (iii) 10 September 2017; and**
 - (iv) 16 September 2017.**
- (6 marks)**
- (b) Determine the basis periods, where relevant, for each of the years of assessment 2017/18 and 2018/19 for Crown Ltd, assuming that the company's first accounts are to be closed on (1) 31 March 2018; and (2) 30 June 2018 respectively.**
- (4 marks)**

(10 marks)

2 Duncan is employed by a Hong Kong company and renders all of his services in Hong Kong. Other than a monthly basic salary of \$100,000, Duncan does not receive any income from his employment. Duncan's employer runs its own provident fund registered under the Occupational Retirement Scheme Ordinance and deducts 6% from Duncan's monthly salary as his contributions to this scheme. Duncan's wife, May, does not have any income derived from Hong Kong. During the year ended 31 March 2018, the couple recorded the following transactions:

- (1) Donations made during the year:
 - (a) Duncan donated \$80 per month by automatic bank transfer to the Hong Kong Red Cross;
 - (b) Duncan donated \$500 by cheque to the Tung Wah Group of Hospitals for two banquet tickets;
 - (c) May donated \$2,000 in cash to the Community Chest of Hong Kong; and
 - (d) May donated \$800 by cheque to her secondary school alumni association.
- (2) Bank mortgage interest of \$420,000 was paid for two properties. \$190,000 relates to a Hong Kong commercial property which is owned by Duncan and is leased out for rental purposes. The balance, \$230,000, relates to a Hong Kong residential property which is owned by May's parents and is used by the couple as their primary residence.
- (3) Duncan and May are professional physiotherapists, and paid annual subscriptions of \$3,400 each to the Chartered Society of Physiotherapy in the UK.
- (4) Duncan is currently studying for a part-time masters degree at The Chinese University of Hong Kong. Total tuition fees of \$135,000 were paid during the year.
- (5) The couple have two children, aged 22 and 25. Their 22-year-old daughter was studying in the UK until January 2018 when she graduated. Their daughter started to work in Hong Kong in March 2018. Their 25-year-old son is currently studying for a part-time masters degree at The University of Hong Kong.
- (6) The couple have sponsored a child from Po Leung Kuk in Hong Kong, at a maintenance fee of \$4,000 per month. The couple regularly visited the child once a month.
- (7) May's mother is aged 55 and lives with the couple in Hong Kong. May's father is aged 62 and lives in a nursing home in Hong Kong at a cost of \$7,000 per month. The cost is fully paid by Duncan. May's father is disabled and is eligible to claim the disability allowance from the Hong Kong government, but he has not made the claim.
- (8) Duncan's parents are aged 81 and 75 respectively. They are currently living in mainland China but regularly visit Duncan and May. A guest room has been reserved by Duncan for his parents' use during their stays in Hong Kong.

Required:

Based only on the information given:

- (a) Calculate the total amount of 'concessionary deductions' and 'Part 5 allowances' which Duncan is entitled to claim for Hong Kong salaries tax purposes for the year of assessment 2017/18; and (5 marks)
- (b) List the items which do not qualify as either 'concessionary deductions' or 'Part 5' allowances. (5 marks)

(10 marks)

3 Based on the Inland Revenue Ordinance and commonly known prevailing practice of the tax administration in Hong Kong, explain the following in relation to the annual profits tax return:

(a) The person who has the obligation to prepare and file the return. (4 marks)

(b) The time for filing the return. (2 marks)

(c) The consequences of not filing the return. (4 marks)

(10 marks)

4 In April 2017, Andy acquired a flat in Tsimshatsui with finance obtained from a local bank. He signed a lease with the following terms with Ms Wong on 28 April 2017:

(1) The lease runs from 1 May 2017 for two years.

(2) Monthly rental: \$36,000 (inclusive of a management fee of \$2,000 per month), payable in advance.

(3) Initial premium: \$48,000, payable on signing the lease agreement.

(4) Rental deposit: \$72,000, payable on signing the lease agreement. As per the lease agreement, the rental deposit is to be used to compensate any loss of revenue when the tenant defaults in payment of the rent.

(5) Rates: \$3,000 (net of rates concession) per quarter, payable by Andy.

(6) Ms Wong asked for a rent-free period to facilitate a minor repair to the flat. Andy agreed to give a half-month rent-free period from the date the lease started to take effect. The repair cost of \$12,000 was paid by Ms Wong.

During the year ended 31 March 2018, Andy incurred bank mortgage interest of \$105,000. A property agency fee for letting the property, equivalent to half of the monthly rental, was also paid on 28 April 2017.

Since 1 January 2018, Andy has not received any rental payments from Ms Wong. On 16 May 2018, Andy was advised by the management company that Ms Wong had moved out without leaving any contact details. The property was left vacant until it was sold on 31 May 2018.

Required:

Compute the property tax payable by Andy (if any) for each of the years of assessment 2017/18 and 2018/19 using the most favourable method.

Note: You should assume the tax rates for 2017/18 will continue to apply for 2018/19.

(10 marks)

- 5 Peter Jones, an American citizen, is single and does not have any relatives in Hong Kong. Peter is employed by a US-operated entity, JK Technology Inc (JK). His employment contract, which is enforceable in the US, requires Peter to travel to Asian countries to oversee the operations of JK's subsidiaries. During the year ended 31 March 2018, Peter's travelling schedule was as follows:

Hong Kong	210 days
Singapore	90 days
USA	65 days (including 15 days' annual leave)
	<u>365 days</u>

For the year ended 31 March 2018, Peter's remuneration from JK together with his relevant personal expenditures were as shown below (all amounts are denominated in Hong Kong dollars):

- (1) Annual salary of \$2,400,000.
- (2) A hardship allowance of \$10,000 per month.
- (3) A company car and a driver for use in Hong Kong. The car is worth \$400,000 and is registered in the name of JK. The driver was hired by JK at \$20,000 per month. Peter incurred \$50,000 for petrol and car maintenance during the year, for which he was fully reimbursed by JK. Peter estimated that about 20% of the car's usage was for his personal use.
- (4) Peter lives in a hotel room during his stays in Hong Kong. The total hotel charges of \$300,000 were paid by JK. Peter agreed that 5% of the hotel charges would be deducted from his salary in return for an upgrade of the hotel package.
- (5) In June 2017, Peter had a car accident on his way to a client meeting in Hong Kong and was hospitalised for three weeks. The total hospital bill of \$440,000 was paid by Peter. He subsequently made a claim to JK to recover these costs. In January 2018, Peter obtained a full refund from JK, comprising \$300,000 reimbursed by JK's insurance company under JK's employees' group insurance policy and \$140,000 subsidised directly by JK.
- (6) Peter received a bonus of \$160,000, 30% of which he donated to the US Red Cross.
- (7) On 1 February 2018, Peter was granted an option to acquire 60,000 shares in JK, at \$5 each. He paid \$6,000 for this option. On 1 March 2018, Peter sold one-third of the share option for \$45,000 and on the same day, exercised the balance of the option himself. On 31 March 2018, Peter sold all of the shares acquired. The fair market values per share were as follows:

1 February 2018	\$8
1 March 2018	\$9
31 March 2018	\$10
- (8) Peter paid an annual subscription of \$10,000 to the Hong Kong Jockey Club.
- (9) JK settled Peter's Hong Kong and Singapore tax bills of \$240,000 and \$10,000, respectively.
- (10) No mandatory provident fund contribution was made in Hong Kong.

Required:

Calculate the Hong Kong salaries tax payable by Peter Jones for the year of assessment 2017/18.

Note: You should ignore overseas tax, including the effect of any comprehensive double taxation agreement between Hong Kong and other countries.

(15 marks)

- 6 Buddies Co is a partnership between Billy, Brian and Bond Ltd, sharing profits on an equal basis. The partnership's income statement for the year ended 31 December 2017 was as follows:

	Notes	\$	\$
Turnover			12,000,000
Cost of goods sold			(7,900,000)
Gross profit			<u>4,100,000</u>
Rent	1	1,200,000	
Staff costs	2	1,489,000	
Net finance costs	3	168,000	
Depreciation		60,000	
Other expenses (all tax deductible)		<u>40,000</u>	<u>(2,957,000)</u>
Net profit			<u><u>1,143,000</u></u>

Notes:

- (1) Rent of \$1,200,000 was paid to Bond Ltd, the landlord of the office leased by the partnership.

(2)	\$
Salary paid to Billy	200,000
Salary paid to Brian	300,000
Salary paid to secretary (Brian's daughter)	180,000
Salaries paid to other operating staff	300,000
Severance payment to a leaving staff member	80,000
Payment to a leaving staff member for a promise not to compete for five years	220,000
Regular MPF contributions of 5% for staff and partners	49,000
One-off MPF contribution due to a shortfall in fund value	<u>160,000</u>
Total	<u><u>1,489,000</u></u>

(3)	\$
Interest paid to Bond Ltd for a loan used for business operations	45,000
Interest paid to a China supplier for overdue accounts payable	5,000
Interest income earned on RMB deposit with a bank in HK	(3,000)
Loss on foreign exchange trading	122,000
Dividend from investment	<u>(1,000)</u>
Net finance costs	<u><u>168,000</u></u>

- (4) Depreciation was charged after disposing of two old computers for \$2,000 and buying three new computers for \$190,000.

- (5) The tax written down values as at 31 December 2016 were: 20% pool \$30,000; 30% pool \$40,000.

Other information:

- (i) During the year 2017, Billy elected for personal assessment.
- (ii) Bond Ltd carries on business in Hong Kong and incurred a loss of \$50,000 for the year ended 31 December 2017. The company had no tax losses brought forward from prior years.

Required:

- (a) **Compute Buddies Co's assessable profits or adjusted loss for the year of assessment 2017/18. Clearly identify the relevant basis period.** (11 marks)
- (b) **Compute the allocation of profits to each of the partners and the tax payable by each partner, if any, for the year of assessment 2017/18.** (4 marks)

(15 marks)

End of Question Paper