

Applied Skills

Taxation – Hong Kong (TX – HKG)

Tuesday 4 December 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.

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TX

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 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 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 To which of the following does the standard tax rate of 15% apply?

- (1) A corporation which is chargeable to property tax
- (2) The assessable profits of a partnership business which has a corporate partner
- (3) An individual who has elected for personal assessment and whose tax liability based on the progressive tax rates on his/her net chargeable income is higher than the tax liability based on the standard tax rate on his/her reduced total income

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

2 Andy works for B Ltd, a Hong Kong trading company, at a monthly salary of \$40,000. On 1 May 2017, Andy married Amy. He received a gift voucher for a package tour to Japan from B Ltd with a value of \$24,000. The package tour was transferable and could be resold for \$20,000. B Ltd also paid \$600 to take out a family travel insurance policy for Andy.

What is the amount of Andy's assessable income for the year of assessment 2017/18?

- A** \$500,600
- B** \$504,600
- C** \$480,600
- D** \$480,000

3 Cathy, Doris and Eddie were partners in a partnership business sharing profits/losses equally. Cathy died on 30 September 2017. The accounts of the partnership for the year ended 31 March 2018 show an assessable profit of \$120,000. In her will, Cathy appointed her son as her executor.

Which of the following statements in respect of Cathy's share of the partnership profit for the year of assessment 2017/18 is/are correct?

- (1) Cathy's share of the partnership profit was \$20,000
- (2) Cathy's share of the partnership profit was \$40,000
- (3) Cathy's husband may elect to transfer Cathy's share of the assessable profit to personal assessment

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

- 4 Philip is employed by A Ltd as the company's tax manager. During the year ended 31 March 2018, Philip was paid a salary of \$910,000 and was provided with a hotel serviced apartment with one room by A Ltd. Philip is a member of the Taxation Institute of Hong Kong and ACCA for which he pays membership fees of \$1,200 and \$2,500 respectively.

What is Philip's net assessable income for the year of assessment 2017/18?

- A \$996,930
- B \$998,250
- C \$943,800
- D \$942,552

- 5 **Which of the following types of income will be chargeable to property tax?**

- (1) Income from letting out the rooftop of a building for the erection of signage on the rooftop
- (2) Income from subletting a room in a residential flat by a tenant
- (3) Income received by a bank from letting out an office which the bank took possession of from a borrower (the owner of the office) who went bankrupt
- (4) Income from letting out the common area of a building as a car parking space by an incorporated owner

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

- 6 C Ltd, a company carrying on a manufacturing business in Hong Kong, obtained the right to use a trade mark registered in Hong Kong by way of a five-year licence during the year of assessment 2017/18. The consideration included an upfront payment of \$600,000 for the grant of the licence and an annual licence fee of \$60,000. C Ltd manufactures goods bearing the trade mark in Hong Kong. These goods are all sold by C Ltd in China.

What is the amount of the allowable deduction which C Ltd can claim in respect of the trade mark for profits tax purposes in the year of assessment 2017/18?

- A \$180,000
- B \$60,000
- C \$90,000
- D \$0

- 7 **Which of the following statements concerning partnership business are correct?**

- (1) A partner who has elected for personal assessment is still liable to pay the tax of the partnership business
- (2) Each partner will receive a separate notice of assessment in respect of his/her share of the partnership profits
- (3) A single profits tax assessment will be raised in the name of the partnership
- (4) A partner's share of the loss brought forward cannot be transferred to personal assessment

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

8 Which of the following persons is/are likely to be eligible to elect for personal assessment for the year of assessment 2017/18?

Kitty, aged 17, resides with her mother in Hong Kong. She regularly performed as a singer and received \$200,000 for the year 2017/18.

Caroline retired on 1 July 2017 after working in Hong Kong for 35 years, and migrated to Canada.

Mandy, aged 25, worked in the Shenzhen office of her Hong Kong employer. She comes back to Hong Kong every weekend and stays with her family.

- A** Kitty only
- B** Mandy only
- C** Caroline and Mandy only
- D** Kitty, Caroline and Mandy

9 Cherry is an airhostess employed by a British airline company. The following table gives details of her presence in Hong Kong and her earnings for the relevant years of assessment:

Year of assessment	Present in Hong Kong (in days)	Earnings
2015/16	70	\$550,000
2016/17	58	\$690,000
2017/18	62	\$750,000

What is Cherry's assessable income for each of the years of assessment 2015/16, 2016/17 and 2017/18?

	2015/16	2016/17	2017/18
A	\$105,191	\$109,643	\$127,397
B	\$105,191	\$0	\$127,397
C	\$550,000	\$690,000	\$750,000
D	\$550,000	\$0	\$750,000

10 D Ltd is resident in Hong Kong and is an associated company of E Ltd which is resident in Country X. On 1 April 2017, D Ltd borrowed a loan of \$6 million from E Ltd at an interest rate of 4% per annum in the ordinary course of its intra-group financing business. On 1 January 2018, \$4 million of this loan was sub-participated to F Ltd, another associated company of E Ltd, which is resident in Country Y. E Ltd was the beneficial owner of the loan interest income and was chargeable to tax on the interest income at the rate of 15% in Country X. F Ltd was chargeable to tax at the rate of 5% in Country Y.

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

- A** \$0
- B** \$240,000
- C** \$200,000
- D** \$80,000

- 11** Mary started a boutique business on 1 September 2017 and closed her first set of accounts on 31 October 2018. She earned assessable profits in her first 14 months of operation but has not received a tax return from the Inland Revenue Department.

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

	Latest date	Year of assessment
A	28 February 2018	2017/18
B	28 February 2019	2018/19
C	31 January 2018	2017/18
D	31 January 2019	2018/19

- 12** Ginny let out a flat in North Point for four years from 1 January 2018 for a premium of \$90,000 and a monthly rent of \$30,000. Ginny is responsible for paying the rates of \$3,000 per quarter and a monthly management fee of \$2,000 to the management company. In March 2018, the tenant forgot to turn off the water tap. The floor was flooded, and the tenant paid the repair cost of \$20,000 directly to the repairer.

What is Ginny's property tax liability for the year of assessment 2017/18?

- A** \$13,515
- B** \$13,020
- C** \$11,340
- D** \$13,740

- 13** During the year ended 31 March 2018, Yanny earned an annual salary of \$950,000 and incurred an allowable professional membership fee and self-education expenses of \$3,000 and \$120,000 respectively. Yanny is single and made a donation of \$350,000 to the Community Chest, an approved charitable organisation, in July 2017.

What is Yanny's statutory maximum limit of allowable donation and net chargeable income for the year of assessment 2017/18?

	Maximum limit of allowable donation	Net chargeable income
A	\$332,500	\$362,500
B	\$289,450	\$405,550
C	\$296,450	\$418,550
D	\$331,450	\$383,550

- 14** Which TWO of the following statements correctly identifies the basis period in which depreciation allowances are granted for capital expenditure incurred?

- (1) Capital expenditure incurred in the interval between the basis periods for two years of assessment is treated as incurred in the first basis period
- (2) Capital expenditure incurred in the interval between the basis periods for two years of assessment is treated as incurred in the second basis period
- (3) Capital expenditure incurred in the common basis period for two years of assessment is treated as incurred in the first basis period
- (4) Capital expenditure incurred in the common basis period for two years of assessment is treated as incurred in the second basis period

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

- 15** Brian received a notice of salaries tax assessment for the year of assessment 2016/17. The salaries tax of \$34,000 was payable in two instalments, \$26,500 on 15 January 2018 and \$7,500 on 15 April 2018, respectively. Brian only paid \$14,000 on 15 February 2018.

Assuming that today's date is 15 March 2018, what is the amount of surcharge the Commissioner of Inland Revenue can impose on Brian?

- A** \$1,700
- B** \$1,325
- C** \$625
- D** \$1,000

(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** GoGo Ltd (GGL) carries on a trading business in Hong Kong. It closes its accounts on 30 June each year. In May 2018, GGL filed its profits tax return for the year of assessment 2017/18 reporting an assessable profit of \$500,000. On 15 October 2018, it received a notice of assessment showing the following:

	\$
Assessable profits	500,000
	<hr/>
2017/18 final tax payable	82,500
Less: 2017/18 provisional tax paid	(62,700)
	<hr/>
	19,800
2018/19 provisional tax payable	82,500
	<hr/>
Total tax payable	102,300
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Payable in two instalments:	
By 20 January 2019	81,675
By 20 April 2019	20,625

On 1 December 2018, GGL discovered that it had over-reported its assessable profits in its 2017/18 profits tax return. Due to an oversight, the accountant had omitted a commission expense of \$100,000 paid to an overseas agent.

Required:

- (a) Advise GoGo Ltd of its right of action, if any, to correct the omission of the commission payment from its 2017/18 profits tax return. (6 marks)
- (b) Advise GoGo Ltd of any appropriate actions it may take in respect of the tax payment as demanded under the 2017/18 notice of assessment. (4 marks)

(10 marks)

- 2 Glory Ltd is carrying on business in Hong Kong. Below is an extract of its fixed asset movements during the year ended 31 March 2018:

Date	Particulars
1 May 2017	Bought a cutting machine at a cost of \$40,000 under hire purchase. A down payment of \$5,000 was made and monthly instalments of \$6,000 for seven months started from 1 May 2017. Sold the old machine for \$10,000, making a profit of \$2,000.
1 June 2017	Acquired a trademark registered in Hong Kong for \$500,000. The trademark is being used by the company for manufacturing in Hong Kong to generate Hong Kong taxable income.
1 August 2017	<p>Bought one retail outlet for \$3,000,000. The outlet was first used by the vendor in the fiscal year of 2006/07. The qualifying expenditure for commercial building allowance purposes is agreed with the Inland Revenue Department as \$1,200,000.</p> <p>Subsequent to the acquisition, the outlet was renovated at a cost of \$400,000, including \$200,000 being refurbishment and \$200,000 being for wall panelling.</p>
1 February 2018	Bought an energy saving electric motor car for \$400,000.

The company's 2016/17 profits tax return shows the following information:

Plant and machinery pools:

20% – tax written down value carried forward	\$200,000
30% – tax written down value carried forward	\$300,000

Required:

Prepare Glory Ltd's tax depreciation allowance schedule for the year of assessment 2017/18 showing the eligible depreciation allowance for plant and machinery and commercial buildings allowance.

(10 marks)

- 3 Mr Li, a Hong Kong resident, is working as an accountant under Hong Kong employment. He also runs a trading business under a partnership with his brother. Two years ago, he bought a car park for investment purposes. During the year ended 31 March 2018, he had the following income and expenditure:

	Note	\$
Salary from employment		600,000
Share of partnership profit	(1)	200,000
Rent and deposit from car park	(2)	42,000
Car park expenses	(2)	2,800
Repayment of mortgage loan and interest	(3)	510,000
Maintenance and education fee for stepson	(4)	480,000
Support and maintenance of mother	(4)	107,000
Support and maintenance of former wife and her daughter	(4)	96,000
Contributions to mandatory provident fund (MPF): 5% of salary		30,000
Donations	(5)	8,000
Tuition fee for a master's degree which Mr Li is studying		32,000
Membership fee to ACCA		2,300
Membership fee to HK Jockey Club		9,600

Notes:

- (1) The partnership incurred a tax loss of \$100,000 in 2016/17, out of which Mr Li's share is \$50,000 and is being carried forward under the partnership. Mr Li did not elect for personal assessment in 2016/17.
- (2) The car park was leased out on 1 April 2017 for a term of two years at a monthly rent of \$3,000 payable in advance. Mr Li is responsible for rates and management fee. The net assessable value of the car park as agreed with the Inland Revenue Department for 2017/18 is \$28,000.
- (3) During the year, Mr Li repaid the following bank mortgage loans with interest:
 - (i) Loan to acquire Mr Li's accommodation – \$400,000 (including \$230,000 interest)
 - (ii) Loan to acquire car park – \$110,000 (including \$30,000 interest)
- (4) Mr Li is married with a stepson aged 19 who is studying in the USA as a full-time student. Mr Li's mother is aged 60 and is living in a government elderly home in Hong Kong. The total cost for the elderly home is \$95,000 per year. Each month, Mr Li also pays his mother \$1,000. Mr Li also supports his former wife and her daughter with \$8,000 per month.
- (5) Donations were made to the following approved charitable institutions in Hong Kong:
 - Community Chest of Hong Kong – cash of \$3,000
 - Red Cross of Hong Kong – toys worth \$3,000
 - Standard Chartered Marathon – distilled water worth \$2,000

Required:

Assuming that Mr Li has elected for personal assessment for the year of assessment 2017/18 only, compute his NET CHARGEABLE INCOME for 2017/18 under personal assessment.

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

(10 marks)

- 4 Mr Ng bought a shop unit with a car park space in Shatin in April 2017. On 1 May 2017, the shop unit was leased out on the following terms:

- (1) Term of lease: Three years from 1 May 2017.
- (2) Rent free period: 1 May 2017 to 30 June 2017.
- (3) Rent: \$25,000 per month payable in advance.
- (4) Rental deposit: \$50,000 payable on 1 May 2017. As per the lease agreement, the rental deposit is used to compensate any loss of revenue when the tenant defaults on the rent.
- (5) Initial premium: \$100,000 payable upon lease signing.
- (6) Rates: \$2,400 per quarter, payable by the tenant.
- (7) Management fees: \$1,750 per month, payable by the tenant directly to a management company.

Starting from 1 November 2017, the tenant failed to pay the rent and the management fee. On 30 March 2018, the tenant moved out of the property and could no longer be contacted. Mr Ng was required to pay the overdue management fee from November 2017 onwards. Fortunately, it was found that rates had been paid by the tenant in advance up to March 2018.

In April 2018, Mr Ng spent \$50,000 to replace the door, which had been damaged whilst let, and he subsequently occupied the shop unit for his own business. He sold the car park space in May 2018 for \$800,000. On 1 June 2018, Mr Ng received a lump sum of \$30,000 from the former tenant in compensation for part of the outstanding rental balance.

Required:

- (a) **Prepare the property tax assessments (both original and revised, if applicable) for Mr Ng for each of the years of assessment 2017/18 and 2018/19.** (8 marks)
- (b) **Briefly explain whether Mr Ng is eligible for any tax relief (deduction or depreciation allowance) in respect of the expenditure of \$50,000 for replacing the damaged door.** (2 marks)

Note: You should ignore the rates concession.

(10 marks)

- 5 Mr Black is a British citizen working for a computer company in London. Effective from 1 April 2017, he was promoted to regional IT director looking after the group's IT services. For convenience, he is seconded to a group company in Hong Kong (HK-Co) to facilitate his travelling in the region. No separate employment contract was signed. He continues to receive his salary in GBP from HK-Co payable to his bank account in London, and HK-Co will recharge the cost to the London company.

During the secondment period from 1 April 2017, Mr Black was remunerated \$90,000 salary per month and \$10,000 travelling allowance per month. The residential flat in London which was provided by the London company is still kept for Mr Black. He was also provided with a two-room serviced apartment in Hong Kong.

Other remuneration details of Mr Black included:

- (1) In April 2017, he arranged for the shipment of his belongings from London to Hong Kong at a cost of \$58,000, of which \$50,000 was settled by HK-Co.
- (2) He was entitled to a holiday passage of \$20,000 per year. In August 2017, he used the passage to book a family trip to New Zealand on vacation.
- (3) On 15 December 2017, he was granted an option to acquire 10,000 shares at \$15 each in HK-Co at a cost of \$2,000. On 2 January 2018, he sold part of the option to acquire 2,000 shares to a colleague for \$9,000. On 3 February 2018, he exercised the option for the remaining shares and sold all of them the next day. The market values per share were as follows:

15 December 2017	\$17
2 January 2018	\$18
3 February 2018	\$19
4 February 2018	\$20

- (4) On 25 March 2018, he was hospitalised for two weeks and incurred a total medical cost of \$60,000. Mr Black settled the hospital bill and then made a claim against HK-Co's insurance company. In May 2018, 80% of the total hospital bill was reimbursed by the insurance company. HK-Co paid an annual insurance premium of \$1,500 per employee to the medical scheme.
- (5) HK-Co paid the monthly salary to Mr Black through remittance to his bank account in London. No mandatory provident fund (MPF) contribution in Hong Kong is required.
- (6) On 1 February 2018, Mr Black enrolled on a master's degree in a Hong Kong university to develop his IT knowledge. The total tuition fee paid by Mr Black upon enrolment was \$45,000.
- (7) During the year ended 31 March 2018, Mr Black spent a total of 200 days (including his days of arrival and departure) in Hong Kong as follows:

	Days
1 April 2017 to 30 September 2017	122
1 January 2018 to 19 March 2018	78 (including 10 days annual leave)
	<u>200</u>

Required:

- (a) Explain Mr Black's liability to Hong Kong salaries tax for the year of assessment 2017/18. (3 marks)
- (b) Compute the NET ASSESSABLE INCOME of Mr Black for the year of assessment 2017/18. Ignore any overseas tax and Hong Kong provisional tax. (12 marks)

(15 marks)

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Question 6 begins on page 14.**

- 6 Purple Ltd (PL) carries on business in Hong Kong providing financial planning advisory services. PL's statement of profit or loss for the year ended 31 March 2018 is as shown below:

	Notes	\$	\$
Income			
Advisory service fee	(1)	1,200,000	
Income from sub-letting part of office area	(2)	120,000	
Interest income	(3)	21,000	
Finance income	(4)	865,000	2,206,000
Less: Expenses			
Salaries and wages	(5)	1,140,000	
Rent and rates	(6)	810,000	
Donations	(7)	70,000	
Interest expenses	(8)	6,000	
Audit and tax filing fees		43,000	
Depreciation	(9)	40,000	
Loss on the disposal of a fixed asset	(9)	15,000	
Miscellaneous expenses (all deductible)		19,000	(2,143,000)
Net profit			63,000

Notes:

- (1) PL provides advisory services in Hong Kong to customers from Hong Kong and mainland China. About 25% of the client profile is China customers who usually seek advice from PL when they travel to Hong Kong.
- (2) PL sub-lets part of its office to its director for rental at \$10,000 per month.
- (3) Interest income comprises:

	\$
Interest on HK\$ loan to a member of staff for financing his HK accommodation	18,000
Interest on HK\$ deposits with a bank in Hong Kong	1,000
Interest on RMB deposits (HK\$200,000) with a bank in Hong Kong; used as security for a loan (as referred to in note (8) below)	2,000
Total	21,000

- (4) Finance income comprises:

	\$
Gain/(loss) from trading in Hong Kong listed shares	800,000
Gain/(loss) from trading in People's Republic of China (PRC) listed shares	(300,000)
Dividends from Hong Kong listed shares	13,000
Dividends from China listed shares	22,000
Gain/(loss) from trading in foreign currencies	330,000
Total	865,000

- (5) Salaries and wages comprise:

	\$
Salaries and bonuses paid to staff	700,000
Mandatory provident fund (MPF) contributions for staff:	
5% of basic salary	100,000
MPF voluntary contributions for director	140,000
Wages paid to a driver for PL's director	200,000
Total	1,140,000

Note: PL made a special contribution to MPF in the year ended 31 March 2016 in the amount of \$300,000.

- (6) The rent and rates were paid in respect of:

	\$
PL's office	360,000
The director's residence	450,000
	<u>810,000</u>

- (7) The donations included cash of \$50,000 to the Community Chest of Hong Kong and \$20,000 gift coupons as a prize for the Financial Planners Club's lucky draw at their annual conference.

- (8) Interest expenses comprise:

	\$
Interest on a bank overdraft and credit line	2,000
Interest on a bank loan of HK\$200,000 for operational use; secured by the RMB deposit (as referred to in note (3) above)	<u>4,000</u>
	<u>6,000</u>

- (9) The total accounting depreciation charge for the year of \$40,000, was calculated based on the book value of PL's fixed assets as at 31 March 2018. During the year, PL incurred \$300,000 to acquire an electric vehicle and \$50,000 on carpet replacement. The old carpet was scrapped with zero value, giving rise to the loss on the disposal of a fixed asset of \$15,000.
- (10) The tax depreciation schedules in PL's 2016/17 tax return showed the tax written down value carried forward to 2017/18 for its 20% plant and machinery pool to be \$20,000.

Required:

Prepare Purple Ltd's profits tax computation for the year ended 31 March 2018, showing the net assessable profit/adjusted loss and profits tax payable, if any. Clearly identify both the year of assessment and the basis period and show all workings, including the depreciation allowance calculation.

Notes:

- (1) You should ignore overseas tax.
(2) No detailed explanations are required.

(15 marks)

End of Question Paper