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 B *Marks*

1 Crown Ltd (Crown)

(a) For tax purposes, the date of commencement of a business does not necessarily equate with the date of incorporation of the company. However, the Inland Revenue Ordinance (IRO) does not contain provisions governing the determination of the commencement of a business. It is a question of fact which should be determined based on the merits of the case, making reference to case law principles. In *Birmingham & District Cattle By-Products Co Ltd* v *IRC* (12 TC 92), it was stated that preparatory activities such as research, acquisition of plant and machinery and the signing of agreements with suppliers should not be relevant factors to represent a commencement of a business. For example, a manufacturing business would not commence until raw materials are acquired for processing. 2

In the case of Crown:

(i) 1 July 2017 – the date of incorporation would not be regarded as the date of commencement since the incorporation refers to the establishment of the legal entity rather than the business. 1

(ii) 1 August 2017 – the date of signing the shop lease is unlikely to be regarded as the date of commencement since the shop was not yet ready for use in the business. 1

(iii) 10 September 2017 – the date at which the shop renovation was completed and the shop was ready for use. However, the business was still not able to commence, as staff were not yet employed. 1

(iv) 16 September 2017 – the date at which the staff commenced work. The employment of the shop manager and the sales assistant are significant and relevant activities leading to the receipt of sales income. Therefore, this date will be adopted by the Inland Revenue Department (IRD) as the date of commencement of Crown's trading business. 1

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(b) If Crown closes its accounts on 31 March 2018, the basis periods for the relevant years of assessments will be:

(1)	Year of assessment 2017/18 (year of commencement):	16 September 2017 to 31 March 2018	1
(2)	Year of assessment 2018/19:	1 April 2018 to 31 March 2019	1

If Crown closes its accounts on 30 June 2018, the basis periods for the relevant years of assessments will be:

(1)	Year of assessment 2017/18 (year of commencement):	Not applicable	1
(2)	Year of assessment 2018/19:	16 September 2017 to 30 June 2018	1
			4
			10

2 Duncan – Deductions and allowances for the year of assessment 2017/18

(a) Concessionary deductions:

	$	
Approved charitable donations ((80 x 12) + 2,000)	2,960	1
Elderly residential care expenses (May's father)	84,000	1
MPF contribution (maximum)	18,000	0·5
	104,960	

Part 5 allowances:

	$	
Married person's allowance	264,000	0·5
Child allowance (daughter)	100,000	0·5
Dependent parent allowance (May's mother) – basic	23,000	0·5
– additional	23,000	0·5
Disabled dependant allowance (May's father)	75,000	0·5
	485,000	
		5

Marks

(b) **List of items not qualifying as concessionary deductions or Part 5 allowances:**

Donation to the Tung Wah Group ($500)
Donation to secondary school ($800)
Interest for commercial property ($190,000)
Interest for residential property ($230,000)
Professional subscription for Duncan ($3,400)
Professional subscription for May ($3,400)
Tuition fees ($135,000)
Child allowance for son ($100,000)
Maintenance fee for sponsored child ($4,000 x 12 = $48,000)
Dependent parent allowance for Duncan's parents

(0·5 mark each) 5

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3 **(a)** **The person who has the obligation to prepare and file a profits tax return**

Under s.51(1) of the Inland Revenue Ordinance (IRO), an assessor has the power to issue a return to any person and to require him to complete and submit the return within a reasonable time. If the assessor believes that the person is subject to profits tax in Hong Kong under the IRO, a profits tax return will be issued. 'Person' is defined under s.2 to include a corporation, partnership, trustee, whether incorporated or unincorporated, or a body of persons. Therefore, in general, any person who derives profits from Hong Kong or who has received a notice to file a profits tax return will have the obligation to file a profits tax return within the time period as stated in the return or such extended time allowed by the Inland Revenue Department (IRD). 2

Where profits are derived and assessable, but no notice to file a profits tax return has been received, the person is obliged under s.51(2) to inform the Commissioner in writing that they are so chargeable within four months after the end of the basis period for the relevant year of assessment. 1

A tax return may be prepared by the person, or by their authorised tax representative, but the return should be signed by the person, and in the case of a company, by its secretary, manager or director (or liquidator in the event of liquidation). 1

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(b) **The time for filing the profits tax return**

In practice, a profits tax return is normally issued around 1 April each year for corporations and partnership businesses, and 2 May for proprietorship businesses (unless in exceptional cases, e.g. the year of commencement or cessation); and the taxpayer is usually allowed one month from the date of issue to submit the return. 1

However, if the taxpayer engages a tax representative to handle the profits tax return, an extension of the time to submit the return with reference to the accounting year end date of the business will be allowed by the IRD. For example, if the taxpayer has an accounting period which ends in December, he may apply for an extension up to mid-August for submission of the return. For taxpayers with an accounting period ending between 1 January and 31 March, the due date may be extended to mid-November for profits cases; and to the end of January for loss cases. 1

2

(c) **The consequences of not filing a return**

If a person fails to file a profits tax return within the time period as required by the IRD without reasonable excuse, they are guilty of an offence under s.80(2) for which the maximum penalty is a fine at level 3 (i.e. $10,000) plus treble the amount of the tax which was either underpaid or would have been underpaid. However, the Commissioner may compound the penalty to a smaller amount depending on the circumstances. 1

Alternatively, instead of prosecuting via the court, the Commissioner or a deputy commissioner may personally raise an assessment of 'additional tax' under s.82A and demand such payment from the person up to treble the amount of the tax which was either underpaid or would have been underpaid had the offence not been detected. 1

Before either a penalty or additional tax is raised, the Commissioner may issue an estimated assessment based on his estimation of profits or income and demand tax payment accordingly. If the taxpayer considers the estimated assessment excessive, an objection may be lodged. However, for an objection to be valid in this situation, it needs to be accompanied by a properly completed tax return. 1·5

		Marks
If he considers it to be reasonable and necessary in the circumstances, the Commissioner may still take further action at a later stage, including issuing additional assessments to demand further tax, applying for a court order to direct or require the tax return to be filed, and/or commencing a field audit or tax investigation on the taxpayer.		
	Any of the additional points	0·5
		4
		10

4 Andy

Property tax computation for the year of assessment 2018/19

	$	
Rental (36,000 x 1·5)	54,000	1
Premium (48,000 – 22,000)	26,000	1
	80,000	
Less: Bad debts ((36,000 x 4·5) – 72,000)	(90,000)	1·5
Bad debts carried back to 2017/18	10,000	
Property tax payable	Nil	0·5

Property tax computation for the year of assessment 2017/18

	$	
Rental (36,000 x 10·5)	378,000	1
Repair cost paid by tenant	12,000	0·5
Premium (48,000 x 11/24)	22,000	1
	412,000	
Less: Bad debts carried back	(10,000)	0·5
Assessable value	402,000	
Less: Rates (3,000/3 x 11)	(11,000)	0·5
	391,000	
Less: 20% statutory allowance	(78,200)	0·5
Net assessable value	312,800	
Property tax at 15%	46,920	0·5

Correct treatment of items not taxable/deductible:

Management fee of $2,000 per month
Rates relating to the 2018/19 year of assessment
Mortgage interest of $105,000
Property agency letting fee of $18,000

(0·5 mark each) maximum	1·5
	10

Tutorial notes:

1. *The balance of the untaxed premium is brought into assessment in the year of assessment 2018/19, which is the year the lease is terminated and therefore the last year of assessment for this lease.*
2. *The rent from 1 January 2018 to 15 May 2018 did not become bad for property tax purposes until 16 May 2018 when the tenant moved out without leaving any contact details in the year of assessment 2018/19.*

			Marks
5 Peter Jones			
Salaries tax assessment Year of assessment 2017/18			
	$	$	
Salary		2,400,000	0·5
Hardship allowance (10,000 x 12)		120,000	0·5
Bonus		160,000	0·5
		2,680,000	
Time-apportionment:			
HK: 210 days + [15 days x 210/(365 – 15) days] = 219 days			2
Taxable: 2,680,000 x 219/365		1,608,000	0·5
Reimbursement of petrol and maintenance costs in HK (50,000 x 20%)		10,000	1
Hospital bill reimbursed by employer		140,000	0·5
Hong Kong salaries tax paid by employer		240,000	0·5
		1,998,000	
Rental value (1,998,000 x 4%)	79,920		1
Less: Rent suffered (300,000 x 5%)	(15,000)	64,920	0·5
Gain on share option			
– On sale (45,000 – 6,000 x 1/3)	43,000		1
– On exercise [(40,000 x (9 – 5)) – (6,000 x 2/3)]	156,000		1
	199,000		
Apportioned on time basis (199,000 x 219/365)		119,400	0·5
Assessable income		2,182,320	
Less: Part 5 allowances			
Basic allowance		(132,000)	0·5
Net chargeable income		2,050,320	
Salaries tax liability at progressive rates		335,054	0·5
Salaries tax liability at standard rate (2,182,320 x 15%)		327,348	0·5
Salaries tax payable		327,348	0·5

Correct treatment of:

Taxable/non-deductible items	$	**Deductible/non-taxable items**	$	
Hospital bill reimbursed by insurance company	300,000	Cost of the car	400,000	
		Driver's wages	240,000	
Jockey Club subscription	10,000	Gain on sale of shares	any amount	
US Red Cross donation	48,000	Singapore tax bill	10,000	
		(0·5 mark each) maximum		3
				15

Marks

6 (a) **Buddies Co**

Assessable profits/adjusted loss for the year of assessment 2017/18
Basis period: Year ended 31 December 2017 0·5

	$	$	Marks
Net profit per accounts		1,143,000	0·5
Add: Depreciation	60,000		0·5
Salaries to partners (200,000 + 300,000)	500,000		1
Payment for promise not to compete	220,000		0·5
One-off MPF contribution (160,000 x 80%)	128,000		1
Loan interest paid to Bond Ltd	45,000		0·5
Sale proceeds of prescribed fixed assets (computers)	2,000	955,000	1
		2,098,000	
Less: Interest income on bank deposit	(3,000)		0·5
Dividend	(1,000)		0·5
Prescribed fixed assets (computers)	(190,000)		0·5
Depreciation allowance (working)	(18,000)	(212,000)	0·5
Assessable profits		1,886,000	

Correct treatment of deductible/non-taxable items:

	$	
Salary to Brian's daughter	180,000	
Severance payment	80,000	
MPF for partners (500,000 x 5%)	25,000	
Interest to China supplier	5,000	
Loss on foreign exchange trading	122,000	
	(0·5 mark each) maximum	2

Working – Depreciation allowance schedule

	20%	30%	Total	
2017/18	$	$	$	
Written down value brought forward	30,000	40,000		0·5
Annual allowance	(6,000)	(12,000)	18,000	1
Written down value carried forward	24,000	28,000		
				11

(b) **Partnership allocation**
Year of assessment 2017/18

	Billy	Brian	Bond Ltd	Total	
	$	$	$	$	
Salaries	200,000	300,000	–	500,000	0·5
Interest	–	–	45,000	45,000	0·5
	200,000	300,000	45,000	545,000	
Balance (1:1:1)	447,000	447,000	447,000	1,341,000	1
Assessable profits	647,000	747,000	492,000	1,886,000	
Profit transferred to personal assessment	(647,000)	–	–	(647,000)	0·5
Profit transferred to own business			(50,000)	(50,000)	0·5
Net assessable profits	0	747,000	442,000	1,189,000	
Tax rates applicable	15%	15%	16·5%		
Tax payable	0	112,050	72,930	184,980	1
					4
					15