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 **C** 100,000 x (4 – 1) x 240/730 = 98,630

The two year vesting period is looked at and the part of the gain relating to exempt services (i.e. services rendered in Hong Kong during visits of not more than 60 days and outside Hong Kong) is not taxable.

2 **A**

An individual must notify the Inland Revenue Department of his/her chargeability to tax within four months of the end of the relevant assessment year unless a tax return is received.

3 **B**

The gain on disposal of an asset is not taxable if it is capital in nature, but taxable if it is revenue in nature.

4 **D** 2m/5 x 3 – 1m = 200,000

The cost of the trademark is deductible over five years, i.e. $400,000 per year, multiplied by two years (2016/17 and 2017/18), leaving an unclaimed cost of $1,200,000. The proceeds of $1,000,000 are taxable, offsetting the unclaimed deduction of $1,200,000, giving an allowable deduction of $200,000.

5 **C**

The chief executive officer is not responsible for complying with the corporation's obligations imposed under the Inland Revenue Ordinance.

6 **D**

An individual is eligible to elect for personal assessment if he/she is (a) 18 years of age or above (or if below 18, both parents are deceased), and (b) ordinarily resident in Hong Kong or temporarily resident in Hong Kong, or his/her spouse is.

7 **A** 5m x 3% = 150,000

Interest expense is allowed because L Ltd is a corporation carrying on an intra-group financing business in Hong Kong and the interest was payable on money borrowed from a non-Hong Kong associated corporation, M Ltd, in the ordinary course of an intra-group financing business carried on in Hong Kong. M Ltd was subject to a similar tax on the interest in Country M at a rate which was not lower than the reference rate; and M Ltd was the beneficial owner of the loan interest income. As N Ltd was also chargeable to a similar tax on the interest in Country N at a rate which was not lower than the reference rate; the limitation under s.16(2CA) does not apply.

8 **B** 35,000 x 12 x 80% x 15% = 50,400

Only the owner of the property situated in Hong Kong is subject to property tax, based on the standard rate at net assessable value (being the annual rental less the 20% statutory deduction).

9 **C** RV = (910,000 + 110,000) x 10% = 102,000

The rental value (i.e. taxable housing benefit) is based on 10% of income from the employer and its associates excluding any share option or termination payment but after any deductible expenses and depreciation allowance (but not self-education expenses). In this case, Philip's income from his employer includes annual salary plus the market value, as at the end of the vesting period, of the shares granted to him.

10 D

The Board of Review does not have the power to summon witnesses to appeal hearings.

11 B 180,000 x 9/12 x 1/3 = 45,000

If X elected for personal assessment for 2018/19, X's share of partnership profit would be for the nine months ended 31 December 2018 (the date of death). One-third of this gives $45,000 (profits/losses being shared equally amongst the partners). As X consistently elected for personal assessment, his share of loss from prior years is assumed to have been transferred to personal assessment in prior years and thus not eligible for carry forward for 2018/19.

12 C

A partnership cannot claim exemption from property tax (although a corporation can).

13 B

The taxable amount of the compromise package includes Kitty's salary for March 2019 ($50,000), leave pay ($30,000) and payment in lieu of notice ($100,000). The severance pay calculated in accordance with the Employment Ordinance is exempt. The total amount of $180,000 is taxable in 2018/19 because it is treated as accruing to that year of assessment, although not received by Kitty until 2019/20.

14 A RV = (900,000 + 90,000 – 2,500) x 10% = 98,750
NAI = 900,000 + 90,000 + 98,750 – 2,500 = 1,086,250

The rental value (i.e. taxable housing benefit) is calculated as 10% of the salary plus the gratuity less the subscription, giving $98,750.

The net assessable income is calculated as the salary plus the gratuity and housing benefit, less the subscription, giving $1,086,250.

15 D (1m x 8·25% + 300,000 x 16·5%) = 132,000

Because Daniel elected for personal assessment, his share of profits ($1,300,000) will be transferred to and assessed under personal assessment. As E Ltd is a corporation, its share of profits must be assessed at the rate applicable to a corporation. Under the two-tiered profits tax rate regime, the first $1,000,000 is assessed at 8·25%, being half of the normal rate. The excess is assessed at the normal rate of 16·5%.

Section B *Marks*

1 Wendy and HK Ltd

HK Ltd (HKL), as Wendy's employer, is required to fulfil the following compliance reporting obligations in respect of Wendy's resignation from her employment:

(1) An employer is required to notify the Commissioner of Inland Revenue (CIR) in writing of the cessation of employment of an employee at least one month before the cessation (s.52(5)). A shorter period of notice may be accepted if the employer is not aware of the date of cessation at least one month before it occurs. 1

The cessation date of Wendy's employment is 30 November 2018. Strictly speaking, HKL is therefore obliged to inform the CIR of the cessation of Wendy's employment by 31 October 2018. As it would not be possible for HKL to anticipate Wendy's resignation in advance and file the cessation notice before the date of the resignation, the Inland Revenue Department (IRD) is likely to be prepared to accept a shorter period of notice from HKL, provided that the cessation notice is filed within a reasonable and practical timeframe. HKL is advised to file the cessation notice in respect of Wendy's employment as soon as practicable. 2

(2) When, after the cessation of employment, an employee is about to leave Hong Kong for a period longer than one month and the employer is aware of such intended departure, the employer is required to notify the CIR in writing of the departure and the expected date of departure at least one month before the intended departure (s.52(6)). A shorter notice period may be accepted if the CIR deems it reasonable. 1

Since HKL is aware of Wendy's intention of leaving Hong Kong for a period of more than one month, it is obliged to report her intended departure and the expected date of that departure to the IRD. This report should be filed at least one month before Wendy's intended departure date. In practice, HKL may include this departure information in the cessation notice, which (as stated in (1) above) should be filed as soon as practicable after receiving Wendy's resignation. Failure to report the departure of an employee without a justifiable reason may be subject to challenge by the IRD and a penalty may be imposed. 2·5

(3) When an employer has given notice of the expected departure of an employee from Hong Kong (under s.52(6)), the employer must not pay to or on behalf of the employee any money or money's worth, without the CIR's written consent, within one month of giving the notice (s.52(7)). 1

Given that HKL is aware of Wendy's intended departure from Hong Kong for a period of more than one month, HKL is also obliged to retain any payment to be made to her until she has cleared all her Hong Kong tax liabilities and the CIR has given consent to the release of the money. The maximum period of money retention is one month. In complying with the retention requirement, HKL is protected from any action that may be brought against it by Wendy for non-payment. Failure to comply with these obligations would cause HKL to be subject to a fine at level 3, i.e. $10,000. 2·5

10

Marks

2 Winter Ltd

(a) Under s.14, Hong Kong-sourced profit arising from a trade, profession or business carried on in Hong Kong is taxable unless it is capital in nature. Trade includes an adventure in the nature of trade. In determining whether a sale is a trade or an adventure in the nature of trade, it is common to apply the so-called 'badges of trade' which take into account the following factors: 1

(i) Subject matter – in this case, the subject matter of the sale is property. A property which is not held for personal enjoyment nor income generating is likely to be considered as held for trading purposes. As given in the question, the property was initially intended for use by Winter Ltd (Winter), which demonstrates it was the company's original intention of holding the property for long-term use. 1

(ii) Length of ownership/holding – the shorter the period of ownership, the more likely it is to be considered held for a trading purpose. In this case, the holding period is more than two years, which is long enough to demonstrate a long-term intention to hold the property. 0·5

(iii) Frequency or number of similar transactions in the past – this information is absent from the question. 0·5

(iv) Any supplementary work on the property – the property was left vacant until 2018 when it was renovated and sub-divided into smaller units, making the property more available for sale. This may indicate that the intention to hold the property has changed. 1

(v) Circumstances responsible for the sale – the property was found not suitable for the original intended use unless substantial modification was carried out, leading to the property being left vacant. This could explain the decision to sell the property. 1

(vi) Motive for disposal – the case for the sale not being treated as a trade could be stronger if there was evidence to support the original intention of acquiring the property for Winter's use, and to support the disposal not being driven by a profit-making motive. 1

Other factors could also be considered such as long-term financing and utilisation of sale proceeds. 1

7

(b) Assuming that there is a change of intention from holding the property for long-term investment to a profit-making motive, part of the disposal gain would be regarded as revenue profit and taxable. The estimated profit is:

	$	$	Marks
Sale proceeds		80,000,000	1
Less: Deemed cost of sale (tutorial note)	70,000,000		1
Renovation cost	2,000,000		0·5
Legal costs	1,000,000	(73,000,000)	0·5
Estimated assessable profit from disposal		7,000,000	
			3
			10

Tutorial note: *If the Inland Revenue Department considers the change of intention occurs when the directors' meeting resolved to sell the property in February 2018, the capital property is deemed to be disposed of in February at the then market value of $70,000,000. Any gain arising would be capital profit and not assessable. The same property with trade intention is also deemed to be acquired at $70,000,000 and disposed of in March 2019 at $80,000,000.*

3

Mr Yu
Property tax assessment
Year of assessment 2018/19

	$	Marks
Rent (15,000 x 2 + 20,000 x 5)	130,000	0·5
Premium (24,000 x 5/24)	5,000	1·0
	135,000	
Less: 20% statutory deduction	(27,000)	0·5
Net assessable value	108,000	

Correct treatment of items that require no adjustment: no irrecoverable debt is claimed for lease 1. 0·5

2·5

Tutorial note: *As the tenant defaulted on two months rent the deposit is not returned.*

	Mr Yu	Mrs Yu	Joint	*Marks*
	$	$	$	
Net assessable income (480,000 – 90,000)		390,000		1·0
Net assessable value – Tai Po property	108,000			0·5
Net assessable profits (260,000 – 60,000)	200,000			1·0
	308,000			
Less: Mortgage loan interest – Tai Po proprety	(108,000)			0·5
	200,000			
Less: Concessionary deduction				
Approved charitable donations (maximum: 480,000 x 35%)		(168,000)		1·0
Donations transferred from spouse (180,000 – 168,000)	(12,000)			1·0
Home loan interest – Shatin property (maximum)	(40,000)	(40,000)		1·0
Contributions to mandatory provident fund (MPF) (maximum: 360,000 x 5%)		(18,000)		0·5
Reduced total income	148,000	164,000	312,000	
Less: Part 5 allowance				
Married person's allowance			(264,000)	0·5
Net chargeable income			48,000	

Mr and Mrs Yu
Personal assessment computation for the year of assessment 2018/19

Correct treatment of items that require no adjustment: no home loan interest for additional loan. 0·5

7·5

10

Tutorial note: *Mr Yu's approved charitable donation (ACD) of $50,000 does not exceed the maximum 35% of Mr Yu's assessable profits before the ACD [35%*($260,000 + $50,000)] and thus is allowed to remain deductible, leaving assessable profits of $260,000 before the tax loss brought forward of $60,000. He may also deduct the excess donation unclaimed by his spouse.*

4 (a) Whether 60-day rule applies:

Arriving Hong Kong	Departing Hong Kong	Number of days in Hong Kong (both arriving and departing days counted)	
1 April 2018	15 April 2018	15	0·5
10 June 2018	25 June 2018	16	0·5
8 November 2018	29 November 2018	22	0·5
16 January 2019	17 January 2019	2	0·5
19 February 2019	24 February 2019	6	0·5
		61 days	

Conclusion: Mr Johnson is under a foreign employment and visits Hong Kong for more than 60 days. Thus, he is subject to Hong Kong salaries tax on the income attributable to his services in Hong Kong. 1·5

4·0

Marks

(b) **Calculation of time-apportionment ratio for 2018/19:**

Arriving Hong Kong	Departing Hong Kong	Number of business days in Hong Kong (either arriving or departing days counted)	Number of leave days	
1 April 2018	15 April 2018	14		0·5
10 June 2018	25 June 2018	9	6	1·0
8 November 2018	29 November 2018	21		0·5
16 January 2019	17 January 2019	1		0·5
19 February 2019	24 February 2019	5		0·5
		50		0·5
Vacation taken other than in Hong Kong			14	
Total vacation days in 2018/19			20	
Vacation days attributable to Hong Kong services: 20 x [50/(365 – 20)]			3	1·5

Time-apportionment ratio:

Business days of services in Hong Kong	50	
Vacation days attributable to services in Hong Kong	3	
Total days attributable to services in Hong Kong	53	
Total days in 2018/19	365	
Therefore, time-apportionment ratio	53/365	1·0
		6·0
		10

5 **John's salaries tax assessment**
Year of assessment 2018/19

	$	$	
Salary and commission		1,300,000	0·5
Discretionary bonuses		80,000	0·5
Electricity and water bills		15,000	0·5
School fees		84,000	0·5
Reimbursement of travelling expenses (1,000 x 12)		12,000	0·5
Second hand value of watch		25,000	0·5
Share award benefit (8,000 x 6)		48,000	1·0
Holiday passage allowance		32,000	0·5
Reimbursement of removal expenses		7,000	0·5
Reimbursement of medical expenses		18,000	0·5
Salaries tax paid		160,000	0·5
		1,781,000	
Rental value (1,781,000 – 15,000 – 7,000) x 2/12 x 8%	23,453		1·5
Less: rent paid	(4,000)	19,453	0·5
Assessable income		1,800,453	
Less: Part 4A concessionary deductions			
Donations	(12,000)		0·5
Home loan interest	(40,000)		0·5
Contributions to mandatory provident fund (MPF) (maximum)	(18,000)	(70,000)	0·5
		1,730,453	
Less: Part 5 allowances			
Married person's allowance	(264,000)		0·5
Child allowance	(120,000)	(384,000)	0·5
Net chargeable income		1,346,453	
Tax at progressive rates		210,897	0·5

Tax at standard rate (1,730,453 x 15% = 259,567) is not applicable. 0·5

Marks

Correct treatment of items that require no adjustment:

Taxable/non-deductible items	$	Deductible/non-taxable items	$	
Hotel service charge	1,200	Interest saved	45,000	
Souvenir	2,000	Compensation	33,000	
Removal expenses	7,000	Discretionary bonuses	90,000	
Ticket for fund-raising show	3,000			
			(0·5 mark each) maximum	3·5
				15

6

Summer Ltd
Profits tax computation for the year of assessment 2018/19 0·5
Basis period: year ended 31 March 2019 0·5

	$	$	Marks
Profit for the year per accounts		15,000	0·5
Add: Excess mandatory provident fund (MPF) contribution (maximum 15%) (100,000 x 5/20)	25,000		0·5
Donation	20,000		0·5
Loan to staff written off	30,000		0·5
Commission to undisclosed agent	20,000		1·0
Depreciation	100,000		0·5
Interest on loan from shareholder	9,000	204,000	0·5
		219,000	
Less: Loan interest to director in China	20,000		0·5
Environmental protection vehicle	440,000		1·0
Depreciation allowance	74,400	(534,400)	0·5
		(315,400)	
Less: Donation (maximum 35%)		(0)	0·5
Adjusted loss		(315,400)	
Profits tax payable		0	0·5
Less: Property tax paid set-off (s.25)		(25,920)	1·0
Tax refund		25,920	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	$	
Sales to China	400,000	Rent and rates for warehouse in China	100,000	
Interest income from customer	12,000	Club fee (entrance and subscription)	58,000	
Net rental income	200,000			
			0·5 mark each	2·5

Depreciation allowance schedule

Plant and machinery	**20%**	**30%**	**Total allowance**	
	$	$	$	
Written down value (WDV) b/f	30,000	40,000		0·5
Disposal – motor car		(12,000)		0·5
	30,000	28,000		
Annual allowance	(6,000)	(8,400)	14,400	1·0
WDV carried forward	24,000	19,600		

Commercial building allowance:			
Qualifying expenditure	1,500,000		
Annual allowance at 4%		60,000	1·0
		74,400	
			15