

Preparing Taxation Computations (Hong Kong)

ACCA CERTIFIED ACCOUNTING TECHNICIAN EXAMINATION

ADVANCED LEVEL

TUESDAY 14 DECEMBER 2004

QUESTION PAPER

Time allowed **3 hours**

ALL FOUR questions are compulsory and **MUST** be answered

Tax rates and allowances are on page 3

Do not open this paper until instructed by the supervisor

This question paper must not be removed from the examination hall

The Association of Chartered Certified Accountants

Paper T9(HKGG)



**This is a blank page.
The question paper begins on page 3.**

The following tax rates and allowances are to be used in answering the questions:

	2003/04
	\$
Allowances	
Basic allowance	104,000
Married person's allowance	208,000
Child allowance – first child	30,000
second child	30,000
third child	30,000
Dependent parent allowance	30,000
Additional dependent parent allowance	30,000
Deductions	
Self-education expense	40,000
Home loan interest	100,000
Tax rates	
Salaries tax rates:	
First \$32,500	2%
Next \$32,500	7.5%
Next \$32,500	13%
Remainder	18.5%
Standard rate	15.5%
Corporation rate	17.5%
Capital allowance rates	
	2002/03 and 2003/04
Initial allowance:	
Industrial building	20%
Plant and machinery	60%
Annual allowance:	
Industrial building	4%
Commercial building	4%
Plant and machinery:	
– Concrete pipe mould	30%
– Lorry	30%
– Motor car	30%

All calculations are to be rounded to the nearest \$.

ALL FOUR questions are compulsory and MUST be attempted

- 1** Mr Sham is employed as the Sales Director of Bingo Ltd, a company incorporated in Hong Kong. He provides you with the following information for the year ended 31 March 2004:
- (1) Mr Sham received from Bingo Ltd an annual salary of \$980,000.
 - (2) Bingo Ltd declared a Chinese New Year Bonus of \$40,000 in February 2004. Mr Sham gave an instruction to the company to have the sum fully invested in the shares of its holding company, Dingo Inc, a company incorporated in the United States with its shares listed on the New York Stock Exchange.
 - (3) Bingo Ltd hired a domestic helper at an annual wage of \$36,000 to serve Mr Sham's family.
 - (4) Rent refund of \$28,000 per month was provided to Mr Sham in respect of a flat leased by him at a monthly rent of \$30,000. Mr Sham submitted rental receipts to Bingo Ltd every month to claim the refund.
 - (5) Mr Sham was given a car rented by Bingo Ltd at an annual rent of \$20,000 for his travelling from home to office. He also received a total reimbursement of \$9,000 from the company to cover the cost of petrol.
 - (6) Bingo Ltd paid \$10,000 to purchase a tour coupon, which entitled Mr Sham to take a 5-day tour to Japan. The coupon was fully transferable and could be sold for \$7,000. He took the coupon and spent the holiday with his family.
 - (7) On 1 April 2003, Mr Sham was allotted 1,000 shares in Dingo Inc for taking up the directorship in Bingo Ltd. He paid \$3,000 on allotment of the 1,000 shares on 15 February 2004 when their market value reached the record high of \$10 each. Due to the listing requirements imposed on Mr Sham as a director of Bingo Ltd, he was unable to sell the shares in the market until 15 March 2004 when the share price had dropped to \$5 each.
 - (8) During the year ended 31 March 2004, Mr Sham spent eight months working in the People's Republic of China (PRC). He was told by the PRC tax authority that \$150,000 included in his salary from Bingo Ltd was chargeable to PRC income tax. He paid tax of \$40,000 on his income to the PRC tax authority in April 2004.
 - (9) On 1 April 2003, Mr Sham was admitted as an associate member of the Hong Kong Society of Marketing Executives. He paid an entrance fee of \$10,000 and an annual membership fee of \$2,500 on the same date.
 - (10) Mr Sham was notified on 2 March 2004 of his successful enrolment on a part-time MBA programme conducted by the University of Hong Kong. He forgot to pay the tuition fees totalling \$75,000 until 5 April 2004.
 - (11) Mrs Sham runs a florist shop. She has just received a statement from the Inland Revenue Department informing her that the tax loss of the shop for the year of assessment 2003/04 was agreed at \$200,000.
 - (12) Mrs Sham owns two flats in Wanchai each earned her an annual rental (net of rates) of \$200,000. She paid mortgage interest in respect of these two properties in the amounts of \$150,000 and \$180,000 respectively.
 - (13) Mr and Mrs Sham each made donations to the Community Chest in the amount of \$20,000.
 - (14) Mr Sham has three children. The eldest child (aged 23) was born by his ex-wife and is studying full-time at the University of London. The second child (aged 21), was married on 1 March 2003, and is studying on a full-time master degree at the Chinese University of Hong Kong. Mr Sham paid all the tuition fees of these two children. The youngest child (aged 17) has been working as a cook in a famous hotel in Hong Kong since leaving school in 2002.
 - (15) Mr Sham's father (aged 68) lives in Shenzhen, PRC. Mr Sham remitted \$1,000 per month to his father for his living expenses. Mrs Sham's mother (aged 60) lives with Mr Sham's family throughout the year and is fully supported by them. Mr Sham also paid \$6,000 towards the maintenance of his ex-wife's mother (aged 70), who lives in a public housing estate in Hong Kong.

Required:

- (a) Compute the tax payable by Mr and Mrs Sham assuming they elect for personal assessment for the year of assessment 2003/04 (apportionment of the liability between husband and wife is not required). Show all your workings. (24 marks)
- (b) State why it is beneficial for Mr and Mrs Sham to elect for personal assessment in the year of assessment 2003/04. (3 marks)
- (c) State the requirements in the Inland Revenue Ordinance under which a person is entitled to deduct a dependent parent allowance for the year of assessment 2003/04. You are not required to provide a definition of 'parent'. (6 marks)

(33 marks)

- 2 (a) State the circumstances under which an assessment becomes final and conclusive under the Inland Revenue Ordinance. (4 marks)
- (b) State, in each of the following situations, the time limit within which an assessor is empowered to raise an additional assessment in pursuance of the Inland Revenue Ordinance:
- (i) non-assessment or under-assessment other than due to fraud or wilful evasion;
 - (ii) non-assessment or under-assessment due to fraud or wilful evasion; and
 - (iii) in the case of a deceased person. (5 marks)
- (c) You have the following clients:
- (i) Ms Lam got divorced in February 2003. She held a 50% share in the flat she has been residing in, which was under a mortgage in favour of Bank A. On 1 March 2003, Ms Lam obtained a judgment from the court ordering her ex-spouse to transfer the remaining 50% share in the flat to her, which was given effect by the execution of an assignment on 1 May 2004. She paid all the mortgage interest totalling \$100,000 in respect of the flat to Bank A during the year ended 31 March 2004.
 - (ii) Mr Hui successfully acquired a flat under the Home Ownership Scheme in 1994, which he used as his residence. He paid off the mortgage loan in respect of the flat in 2002. On 1 April 2003, Mr Hui pledged the flat as a security with Bank B for a mortgage loan of \$600,000. He used this loan to pay off the land premium attached to the flat with the Housing Authority. He paid mortgage interest of \$30,000 to Bank B during the year ended 31 March 2004.
 - (iii) Mr Yeung and his wife are joint tenants of a flat, which they use as their residence. The flat has since been pledged to Mr Yeung's employer, a company that has no business presence in Hong Kong, for a mortgage loan of \$2,500,000. Mr Yeung paid mortgage interest of \$90,000 to his employer during the year ended 31 March 2004.
 - (iv) Mr Yung resides with his parents in a flat presently owned by them. On 1 June 2003, Mr Yung purchased a small house in Lantau Island resort for a consideration of \$300,000. He financed the purchase by a mortgage loan arranged with Bank C. During the year ended 31 March 2004, Mr Yung paid mortgage interest of \$15,000 to Bank C.

Required:

Compute the home loan interest that can be allowable as a deduction for the year of assessment 2003/04 in respect of each of the above clients. In the case of any client for which no deduction is available, clearly indicate the amount of the deduction as 'nil' and state why the interest is not allowable. Show all your workings. (8 marks)

(17 marks)

- 3 (a) Fingo Ltd was incorporated in Hong Kong on 1 January 1995 and carries on a business of garment trading. It closes its accounts annually on 31 March. Its profit and loss account for the year ended 31 March 2004 showed a net profit of \$1,435,000, after crediting and charging the following items of income and expenditure:

Income

	Note	\$
Dividends from quoted shares		350,000
Rental income	1	150,000
Profit on sale of patent right	2	650,000
Interest	3	75,000
Debt waived by a trade creditor		5,000
Compensation	4	27,000

Expenditure

Revaluation of closing stock	5	37,500
Taxes paid	6	64,000
Provision for bad debts	7	43,500
Travelling and entertainment	8	56,000
Contribution to a mandatory provident fund scheme	9	120,000
Depreciation		42,000
Donations	10	40,000
Loss on disposal of fixed assets		12,000
Renovations	11	450,000
Computer hardware and software	12	500,000
Legal and professional fees	13	211,000
Exchange loss	14	12,700

Notes:

- (1) During the year, the company received rental income from the following properties:
- | | |
|---------------------------------|-----------|
| Located in Kwun Tong, Hong Kong | \$100,000 |
| Located in Guangzhou, PRC | 50,000 |
| | \$150,000 |
- (2) In 1996, the company had developed a new garment product and registered its patent. The patent was recognised as a capital asset in the company's accounts at a total development cost of \$1,050,000, which had been fully amortised two years ago. In December 2003, the company sold the patent to its unrelated customer in Taiwan for an amount of \$1,000,000. In January 2004, the company acquired another new patent right from its holding company in the United States at a cost of \$350,000. The new patent was intended to be used for manufacturing purposes by the company in Hong Kong.
- (3) Details of interest income received are as follows:
- | | |
|---|----------|
| Interest on a debenture issued by a Hong Kong company in Hong Kong | \$15,000 |
| Interest on loans to an associated company (loans made available in the UK) | 35,000 |
| Interest on US dollar deposits with a bank in Hong Kong | 25,000 |
| | \$75,000 |
- (4) Compensation received comprises:
- | | |
|---|----------|
| Compensation for loss of trading stock | \$7,000 |
| Compensation for damages to office equipment | 12,000 |
| Compensation for loss of household contents of the Guangzhou property | 8,000 |
| | \$27,000 |
- (5) At the recommendation of the company's auditor, a post-audit adjustment was made to restate the company's closing stock at a valuation of \$245,000 based on the last-in first-out method, contrasting to the previous valuation of \$282,500 based on the first-in first-out method.

(6) Taxes paid comprise the following:	
2003/04 provisional profits tax	\$54,000
Surcharge for late payment of tax	8,000
Salaries tax for a company's director	2,000
	<u>\$64,000</u>
(7) Bad debts charged in the accounts comprise:	
Bad debts recovered (trade debts written off in prior years)	(\$3,500)
Increase in general provision	19,000
Debts written off due to confirmed bankruptcy of debtors	15,500
Irrecoverable rent of the Guangzhou property written off	12,500
	<u>\$43,500</u>
(8) Travelling and entertainment included an amount of \$10,000, being reimbursement of transportation costs to one of the company's directors from/to home and office.	
(9) Contributions to the mandatory provident fund scheme were as follows:	
Annual contribution to the scheme	\$80,000
(representing 20% of individual staff salaries)	
Provision for special contribution to the scheme	40,000
	<u>\$120,000</u>
(10) Donations made in the year were as follows:	
Donation to the Community Chest	\$25,000
Five wheel chairs donated to an elderly home operated by the Social Welfare Department	15,000
	<u>\$40,000</u>
(11) During the year, the company made certain renovations to its show room in order to promote a new image for its products.	
(12) Computer hardware and software of \$500,000 represents the payment made for the acquisition of 20 new computers with preinstalled software.	
(13) Legal and professional fees charged in the accounts comprise:	
Legal fees for an appeal before the Board of Review	\$50,000
Legal fees for advice on overseas investments	67,500
Legal fees for renewal of the lease agreement of the Guangzhou property	12,500
Fines for breach of immigration law for the employment of illegal immigrants by the company	5,000
Registration of the company's trade marks	30,000
Audit fees	46,000
	<u>\$211,000</u>
(14) The exchange loss comprises:	
Gain arising from settlement of trade debts	\$43,700
Loss arising from the year end conversion of bank deposits	(56,400)
	<u>(\$12,700)</u>
(15) The assessor had agreed the total amount of depreciation and commercial building allowances that the company is entitled to claim (after taking into account the insurance compensation received) are \$321,500.	

Required:

Compute the profits tax payable by Fingo Ltd for the year of assessment 2003/04. Show all your workings. You may assume that there is no loss brought forward from the year of assessment 2002/03. (27 marks)

- (b) Hingo Ltd is a company carrying on a business of toy trading in Hong Kong. It borrowed \$3 million at 15% per annum from a bank to purchase a batch of specialised merchandise from a supplier in Japan for delivery to customers in Hong Kong. The loan was partly secured by a deposit of Mr Fung, the majority shareholder in Hingo Ltd. The interest income of Mr Fung is not chargeable to tax in Hong Kong.

Required:

State, giving reasons whether or not, the interest on the loan from the bank is tax deductible. (4 marks)

(31 marks)

4 (a) Lingo Ltd, a toy manufacturer which closes its accounts on 31 December annually, owns a 15-floor (1/F to 15/F) industrial building in Hong Kong. The land was acquired for \$1,800,000 in April 2000. The construction cost of the building was \$3,900,000. The building was completed and has been used by Lingo Ltd for the manufacturing of its products since December 2000.

In the past, only one floor of the building was occupied by Lingo Ltd as an office and show room. After moving certain manufacturing processes to the PRC, the usage of the building has been re-organised with effect from 1 August 2003 as follows:

Floor	Usage
1/F to 10/F	Work place for manufacturing
11/F to 13/F	General office and show room
14/F	Design office
15/F	Canteen for workers

Required:

- (i) State any two purposes of use of a building or structure which will qualify it as an 'industrial building or structure'. (2 marks)
- (ii) Briefly explain Lingo Ltd's entitlement to industrial building allowance on the building after 1 August 2003. (4 marks)
- (iii) Compute the industrial building allowance and/or commercial building allowance to which Lingo Ltd is entitled for each of the years of assessment 2002/03 and 2003/04. (3 marks)

(b) On 1 January 2003, the tax written down values of the plant and machinery of Lingo Ltd were as follows:

	\$
10% pool	1,258,000
20% pool	600,000
30% pool	400,000

The company had the following transactions in respect of plant and machinery during the year ending 31 December 2003:

Date	Particulars
(i) 1 January 2003	Purchased five pieces of concrete pipe mould at \$18,000 each.
(ii) 15 February 2003	Purchased a new lorry on the following hire-purchase terms: – Cash price: \$240,000 – Down payment: 20% of cash price – Balance settled by 24 equal monthly instalments of \$8,800 each commencing on 13 March 2003
(iii) 25 February 2003	Sold an old lorry for \$50,000. This lorry has been bought in 1997 for \$160,000.
(iv) 4 June 2003	Mr Ling, the majority shareholder in Lingo Ltd, transferred his private motor car to the company for \$50,000. The car has been bought by him on 1 October 2000 at a cost of \$180,000.
(v) 17 August 2003	Sold all the assets in the 20% pool for \$550,000. These assets were originally purchased for \$1,000,000.
(vi) 30 December 2003	Transferred all the assets in the 10% pool to Mingo Ltd, an associated company of Lingo Ltd, at no consideration. Lingo Ltd failed to determine the market value of these assets on the date of transfer.

Required:

Compute the total depreciation allowances that can be claimed by Lingo Ltd for the year of assessment 2003/04. (10 marks)

(19 marks)

End of Question Paper