
Answers

- 1 (a) (i) The contract gratuity is clearly a gratuity paid to Yip for his services rendered to Good Prospect Ltd in pursuance of the terms of employment agreed between them. A mere label given by Yip to the payment will not change the nature of the payment being made.

(ii)

Yip

Salaries Tax Computation – Year of Assessment 2002/03
 No relating back of gratuity

| | \$ | \$ |
|--|----------------------|----------------|
| Salary (\$30,000 x 12) | | 360,000 |
| Prize money | | <u>40,000</u> |
| Assessable Income | | 400,000 |
| Less: | | |
| Outgoings and expenses | 2,100 | |
| Elderly residential care expenses (\$4,000 x 12) | 48,000 | |
| Personal allowance | 108,000 | |
| Single parent allowance | 108,000 | |
| Child allowance | <u>30,000</u> | <u>296,100</u> |
| Net Chargeable Income | | <u>103,900</u> |
| | | |
| | Tax Payable thereon: | |
| | \$35,000 at 2% | 700 |
| | \$35,000 at 7% | 2,450 |
| | \$33,900 at 12% | <u>4,068</u> |
| | | <u>7,218</u> |

Yip

Salaries Tax Computation – Year of Assessment 2003/04
 No relating back of gratuity

| | \$ | \$ |
|---|----------------------|----------------|
| Salary (\$30,000 x 6 + \$35,000 x 6) | | 390,000 |
| Less: Exemption on PRC income (\$35,000 x 5) | | <u>175,000</u> |
| | | 215,000 |
| Contract gratuity | | <u>180,000</u> |
| | | 395,000 |
| Add: | | |
| Value of quarters | | 3,650 |
| (\$30,000 x 5 – \$2,400 x 5/12) x 10% – (\$30,000 x 5 x 7.5%) | | |
| Share option gain | | 42,300 |
| (\$6 – \$1.8) x 10,000 shares + \$500 – \$200 | | |
| Assessable Income | | <u>440,950</u> |
| Less: | | |
| Outgoings and expenses | 2,400 | |
| Charitable donations | 1,000 | |
| Elderly residential care expenses (\$4,000 x 12) | 48,000 | |
| Personal allowance | 104,000 | |
| Single parent allowance | 104,000 | |
| Child allowance | <u>30,000</u> | <u>289,400</u> |
| Net Chargeable Income | | <u>151,550</u> |
| | | |
| | Tax Payable thereon: | |
| | \$32,500 at 2% | 650 |
| | \$32,500 at 7.5% | 2,437 |
| | \$32,500 at 13% | 4,225 |
| | \$54,050 at 18.5% | <u>9,999</u> |
| | | <u>17,311</u> |

Total salaries tax payable for the years of assessment 2002/03 and 2003/04
 = \$7,218 + \$17,311
 = \$24,529

(iii)

Yip

Salaries Tax Computation – Year of Assessment 2002/03
Relating back of gratuity

| | |
|---|--------------------------------|
| | \$ |
| Net Chargeable Income previously calculated | 103,900 |
| Add: Contract gratuity (\$180,000 x 12/18) | <u>120,000</u> |
| Net Chargeable Income | <u>223,900</u> |
| | Tax Payable thereon: |
| | \$35,000 at 2% 700 |
| | \$35,000 at 7% 2,450 |
| | \$35,000 at 12% 4,200 |
| | \$118,900 at 17% <u>20,213</u> |
| | <u>27,563</u> |

Yip

Salaries Tax Computation – Year of Assessment 2003/04
Relating back of gratuity

| | |
|---|---------------------------|
| | \$ |
| Net Chargeable Income previously calculated | 151,550 |
| Less: Contract gratuity | <u>120,000</u> |
| Net Chargeable Income | <u>31,550</u> |
| | Tax Payable thereon: |
| | \$31,550 at 2% <u>631</u> |

Total salaries tax payable for the years of assessment 2002/03 and 2003/04
= \$27,563 + \$631
= \$28,194

Hence, it is not advantageous for Yip to apply for relating back the gratuity of \$180,000.

(iv) The conditions which must be satisfied for there to be a deduction of home loan interest are as follows:

- (1) The person is the owner of dwelling (i.e. sole owner, joint tenant or tenant in common);
- (2) The dwelling is situated in Hong Kong and is used exclusively or partly for residential purposes;
- (3) Home loan interest is paid by the person on a loan applied wholly or partly for acquisition of the dwelling;
- (4) The loan is secured by a mortgage or charge over the dwelling or over any other property in Hong Kong; and
- (5) The lender is the government, a financial institution, a registered credit union, a licensed money lender, the Hong Kong Housing Society, the person's employer, or any organisation or association approved by the Commissioner of Inland Revenue.

(b) A taxpayer may apply in writing for a partial or complete holdover of provisional salaries tax, provisional property tax and provisional profits tax as follows:

| Salaries tax | Property tax | Profits tax |
|---|---|---|
| Entitlement to further allowances | N/A | N/A |
| Net chargeable income for the year is likely to be less than 90% of the provisional amount assessed. | Assessable value of the property for the year is likely to be less than 90% of the provisional amount assessed. | Assessable profits for the year is likely to be less than 90% of the provisional amount assessed. |
| N/A | N/A | A loss brought forward has been omitted or is incorrect |
| Cessation of income from employment | Cessation of income from property | Cessation of trade, profession or business. |
| N/A | Election for personal assessment has been made which is likely to reduce the tax liability. | Election for personal assessment has been made which is likely to reduce the tax liability. |
| An objection has been lodged against the final assessment upon which the provisional assessment is based. | An objection has been lodged against the final assessment upon which the provisional assessment is based. | An objection has been lodged against the final assessment upon which the provisional assessment is based. |

2 (a) (i)

Lee

Property Tax Computation – Year of Assessment 2002/03

| | \$ |
|--|----------------|
| Rent received or receivable (\$8,000 x 12) | 96,000 |
| Premium (\$36,000 x 12/24) | 18,000 |
| Rent recovered | 10,000 |
| | <u>124,000</u> |
| Rates paid by Lee (\$1,200 x 3) | 3,600 |
| | <u>120,400</u> |
| Statutory deduction (20%) | 24,080 |
| Net Assessable Value | <u>96,320</u> |
| Taxed at 15% | <u>14,448</u> |

(ii)

Lee

Property Tax Computation – Year of Assessment 2003/04

| | \$ | \$ |
|--|----|--------------|
| Rent received or receivable | | 0 |
| Premium (\$36,000 x 6/24) | | 9,000 |
| Less: Irrecoverable rent (\$8,000 x 2) | | 16,000 |
| Irrecoverable rent to be carried back | | <u>7,000</u> |
| Net Assessable Value | | <u>NIL</u> |
| Property tax payable | | <u>NIL</u> |

Lee

Property Tax Computation – Year of Assessment 2002/03

| | \$ | \$ |
|--|----|----------------|
| Rent received or receivable (\$8,000 x 12) | | 96,000 |
| Premium (\$36,000 x 12/24) | | 18,000 |
| Rent recovered | | 10,000 |
| | | <u>124,000</u> |
| Less: Irrecoverable rent | | <u>7,000</u> |
| | | 117,000 |
| Rates paid by Lee (\$1,200 x 4) | | 4,800 |
| | | <u>112,200</u> |
| Statutory deduction (20%) | | 22,440 |
| Net Assessable Value | | <u>89,760</u> |
| Property tax payable at 15% | | <u>13,464</u> |

(b) An owner of property should:

- submit a tax return within the time specified by the assessor;
- notify his chargeability to tax within four months after the end of the year of assessment;
- keep sufficient rental records for a period of not less than seven years after the completion of the transactions;
- notify his cessation of ownership of a property within one month after the cessation;
- notify his change of address within one month after the change;
- in the case of a corporate owner, notify the change in exemption status in writing within 30 days of any change in the ownership or use of the property.

3 (a)

Partnership of Chan and Wong
 Profits Tax Computation – Year of assessment 2003/04
 Basis Period : Year ended 30 April 2003

| | \$ | \$ |
|---|--------------------------------|-----------|
| Profit per account | | 472,000 |
| <i>Add:</i> | | |
| Stock taken by Chan | 5,000 | |
| Chan's wages | 400,000 | |
| Excessive rent paid to Wong's wife (\$300,000 – \$250,000) | 50,000 | |
| General provision for bad debts | 4,000 | |
| Loan to supplier | 2,100 | |
| Loan to employee | 2,900 | |
| Interest (\$5,000 + \$2,000) | 7,000 | |
| Cash taken by Wong | 4,000 | |
| Legal fee re: godown | 5,000 | |
| Christmas gifts | 2,000 | |
| Charitable donations | 5,000 | |
| Fines | 18,000 | |
| Chan's excessive portion of contribution to MPF (\$20,000 – \$12,000) | 8,000 | |
| Property tax paid | 2,400 | |
| Depreciation | 30,000 | |
| | | 545,400 |
| | | 1,017,400 |
| <i>Less:</i> | | |
| Dividend income | 10,000 | |
| Bank interest received | 8,000 | |
| Commercial building allowance (\$1,000,000 x 4%) | 40,000 | |
| Acquisition of prescribed fixed asset | 25,000 | |
| Depreciation allowance | 57,600 | |
| | | 140,600 |
| | | 876,800 |
| <i>Less:</i> Charitable donations | | 5,000 |
| Assessable Profits to be transferred to personal assessment | | 871,800 |
| | Tax payable | NIL |
| | <i>Less:</i> Property tax paid | 2,400 |
| | | 2,400 |
| | Tax repayable | 2,400 |

Depreciation allowance schedule

| | \$ | 20% pool \$ | 30% pool \$ | Allowance \$ |
|-----------------------------|--------|----------------|----------------|-----------------|
| Balance b/f | | 50,000 | 20,000 | |
| Additions | 65,000 | | | |
| <i>Less:</i> I.A. (60%) | 39,000 | 26,000 | | 39,000 |
| | | 76,000 | | |
| <i>Less:</i> Sales proceeds | | 13,000 | | |
| | | 63,000 | | |
| A.A. | | 12,600 | 6,000 | 18,600 |
| Balance c/f | | 50,400 | 14,000 | 57,600 |

Treatment of items:

Notes

- 1 A figure representing the market value of the trading stock taken away by partners is required to be included as taxable receipts as if it had been sold in the ordinary course of business.
- 2 A taxpayer is not entitled to a deduction for any tax paid or payable by him or her. However, the partnership is entitled to have its profits tax liability reduced by the amount of property tax paid, with the excess being refunded.
- 3 Interest derived from private funds of partners is not taxable in the accounts of the partnership.
- 4 Partner's and partner's spouse's salaries are not allowable for deduction, but the restriction does not extend to cover partner's children.
- 5 Rent paid to a partner's spouse is deductible only to the extent of the assessable value of the godown.

- 6 Doubtful debts are deductible to the extent that it is estimated to the assessor's satisfaction, that they have become bad during the basis period. For this reason, a general provision is not deductible for tax purpose. Loans to a supplier and an employee are not deductible as they have not been included as trading receipts of the partnership. Nor is the partnership carrying on a money lending business.
- 7 Interest on partners' capital is not deductible. Interest paid on a loan secured by a deposit from an associate, against which the interest received in his hands is not taxable, does not qualify for deduction.
- 8 Cash stolen by an employee is regarded as expenses incurred in the ordinary course of a business. Cash taken by a partner is regarded as drawings and is not deductible.
- 9 Only the maximum amount of \$12,000 is qualified for deduction.

(b) Allocation of partnership profits:

| | Chan \$ | Wong \$ | Total \$ |
|---------------------|----------------|----------------|----------------|
| Salary | 400,000 | – | 400,000 |
| Interest | – | 2,000 | 2,000 |
| Contribution to MPF | 8,000 | – | 8,000 |
| Excessive rental | – | 50,000 | 50,000 |
| Residue (1:1) | <u>210,900</u> | <u>210,900</u> | <u>421,800</u> |
| Share | <u>618,900</u> | <u>262,900</u> | <u>881,800</u> |

- 4 (a)**
- (i)** The cost of books of reference acquired for use in a legal profession is to be admitted as qualifying for depreciation allowance as machinery or plant. Hence, the acquisition cost of the law books and law reports will be granted initial allowance and annual allowance in the year of acquisition and when they have used for the legal practice.
 - (ii)** Deduction is allowable for relevant payments made or expenditure incurred during the basis period. The capital expenditure incurred on the purchase of equipment is allowable for deduction whereas the expenditure on the cost of construction of the laboratory premises qualifies as an industrial building. Hence, initial allowance and annual allowance under industrial building allowance will be granted on the cost of construction of the laboratory premises in the year of incurrence and when they have been used by the business.
 - (iii)** Lump sum payments made to get rid of an unsatisfactory director is in the interest of the company and is allowable for deduction as expenses incurred for the purposes of the trade.
 - (iv)** The cost of resisting legal proceedings attacking the title to land and buildings is allowable as a revenue charge incurred in the ordinary course of maintaining the assets of the business.
 - (v)** Severance payments made according to law, including those made upon the cessation of a taxpayer's business, are regarded as having been incurred in the production of profits and are allowable deductions.

(b) (i) The Inland Revenue Department does have the authority for the following reasons:

- An assessor may raise an assessment on any taxpayer who is, in the opinion of the assessor opinion, chargeable to tax as soon as may be after the expiration of the time limit by the notice requiring the taxpayer to furnish a return.
- An assessor may assess any person at any time if he is of the opinion that such person is about to leave Hong Kong, or that for any other reason it is expedient to do so.
- Notices given by the assessor may be served on a person either personally or by post sending to his last known postal address.
- Tax is deemed to be in default if it is not paid by the due date for payment. Whenever tax is in default, the Commissioner of Inland Revenue may impose a surcharge of 5% of the amount in default.

(ii) What Fong should do:

- Give a notice of objection in writing to the Commissioner of Inland Revenue.
- State precisely the grounds of objection in the notice of objection.
- Request the Commissioner of Inland Revenue to extend the statutory 1-month objection period due to his absence from Hong Kong.
- Complete a tax return to accompany the notice of objection given to the Commissioner of Inland Revenue.

| | | Marks |
|---|--|--|
| 1 | (a) (i) Taxability of gratuity | |
| | related to services rendered | 1 |
| | in pursuance of terms of employment | 1 |
| | Mere label will not change the nature of payment | 1 |
| | | <hr style="width: 100%; border: 0.5px solid black;"/> 3 |
| | (ii) Yip – 2002/03 salaries tax | |
| | Salary | 0.5 |
| | Prize money | 0.5 |
| | Outgoings and expenses | 0.5 |
| | Elderly residential care expenses | 0.5 |
| | Personal allowance/single parent allowance | 0.5 |
| | Child allowance | 0.5 |
| | No deduction for the charitable donation | 0.5 |
| | Tax payable | 0.5 |
| | | <hr style="width: 100%; border: 0.5px solid black;"/> 4 |
| | Yip – 2003/04 salaries tax: | |
| | Salary | 0.5 |
| | Exemption on PRC income | 1 |
| | Contract gratuity | 0.5 |
| | Value of quarters | 2 |
| | Share option gain | 1 |
| | Outgoings and expenses | 0.5 |
| | Charitable donations | 0.5 |
| | Elderly residential care expenses | 0.5 |
| | Personal allowance/single parent allowance | 0.5 |
| | Child allowance | 0.5 |
| | Tax payable | 0.5 |
| | | <hr style="width: 100%; border: 0.5px solid black;"/> 8 |
| | (iii) Relate back of gratuity – 2002/03 | |
| | Contract gratuity | 1 |
| | Net chargeable income | 0.5 |
| | Tax payable | 0.5 |
| | Relate back of gratuity – 2003/04 | |
| | Net chargeable income | 0.5 |
| | Tax payable | 0.5 |
| | Not advantageous | 1 |
| | | <hr style="width: 100%; border: 0.5px solid black;"/> 4 |
| | (iv) Conditions for home loan interest: | |
| | 1 mark for each condition | 5 |
| | | <hr style="width: 100%; border: 0.5px solid black;"/> |
| | (b) Compare and contrast grounds for holdover: | |
| | 1 mark for each point | 6 |
| | | <hr style="width: 100%; border: 0.5px solid black;"/> 30 |

| | | Marks |
|----------|---|------------------|
| 2 | (a) (i) Lee – 2002/03 property tax | |
| | Rent | 0.5 |
| | Premium | 1 |
| | Rent recovered | 1 |
| | Rates | 1 |
| | Statutory deduction | 0.5 |
| | Net assessable value | 0.5 |
| | Tax payable | 0.5 |
| | | <u>5</u> |
| | (ii) Lee – 2003/04 property tax | |
| | Rent | 1 |
| | Premium | 1 |
| | Irrecoverable rent | 1 |
| | Irrecoverable rent carried back | 1 |
| | Net assessable value | 0.5 |
| | Tax payable | 0.5 |
| | Lee – 2002/03 property tax | |
| | Sum of rent, premium and rent recovered | 0.5 |
| | Irrecoverable rent | 1 |
| | Rates | 1 |
| | Statutory deduction | 0.5 |
| | Net assessable value | 0.5 |
| | Tax payable | 0.5 |
| | | <u>9</u> |
| | (b) Obligations: | |
| | 1 mark for each obligation | <u>6</u> |
| | | <u>20</u> |

| | Marks |
|---|------------------|
| 3 (a) Chan and Wong – 2003/04 profits tax | |
| Profit | 0.5 |
| Stock taken | 0.5 |
| Chan's wages | 0.5 |
| Excessive rent paid | 1 |
| General provision | 0.5 |
| Loan to supplier | 0.5 |
| Loan to employee | 0.5 |
| Interest | 1 |
| Cash taken by Wong | 0.5 |
| Legal fee | 0.5 |
| Christmas gifts | 0.5 |
| Charitable donations (*) | 0.5 |
| Fines | 0.5 |
| Chan's excessive contribution to MPF | 1 |
| Property tax paid | 0.5 |
| Depreciation | 0.5 |
| Dividend income | 0.5 |
| Bank interest received | 0.5 |
| Commercial building allowance | 1 |
| Prescribed fixed asset | 1 |
| Depreciation allowance | 2.5 |
| Charitable donations (*) | 0.5 |
| Assessable profits | 0.5 |
| Set-off against property tax paid | 1 |
| Tax repayable | <u>0.5</u> |
| | 17.5 |
| (*) Or 1 mark for no adjustment of charitable donation | |
| 0.5 mark each for Notes 1, 3–5 and 8–9 | 3 |
| 1 mark for Notes 2 and 7 | 2 |
| 1.5 marks for Note 6 | <u>1.5</u> |
| | <u>24</u> |
| (b) Chan and Wong – profits and loss allocation: | |
| Salary to partner | 1 |
| Interest | 1 |
| Contribution to MPF | 1 |
| Rental | 1.5 |
| Residue | <u>1.5</u> |
| | <u>6</u> |
| | <u>30</u> |

| | | Marks |
|---|--|------------------|
| 4 | (a) (i) Law books and law reports | |
| | Qualified for depreciation allowance as machinery or plant | 1 |
| | Initial allowance and annual allowance to be granted | 1 |
| | (ii) Expenditure on scientific research: | |
| | Purchase of equipment is allowable for deduction | 1 |
| | Cost of construction of laboratory premises qualified as industrial building | 2 |
| | Initial allowance and annual allowance to be granted | 1 |
| | (iii) Expenditure on get rid of unsatisfactory director | |
| | in the interest of the company | 1 |
| | incurred for purposes of the trade and allowable | 1 |
| | (iv) Expenditure on preservation of fixed asset: | |
| | allowable as revenue charge | 1 |
| | in the ordinary course of maintaining assets of the business | 1 |
| | (v) Severance payments: | |
| | made according to law | 1 |
| | incurred in the production of profits and allowable | 1 |
| | | <u>12</u> |
| | (b) (i) Authority of the IRD | |
| | 1 mark for each point | 4 |
| | (ii) What Fong should do | |
| | 1 mark for each point | 4 |
| | | <u>8</u> |
| | | <u>20</u> |