

Preparing Taxation Computations

(Hong Kong)

ACCA CERTIFIED ACCOUNTING TECHNICIAN EXAMINATION

ADVANCED LEVEL

TUESDAY 15 JUNE 2004

QUESTION PAPER

Time allowed **3 hours**

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

Tax rates and allowances are on page 3

Paper T9(HKGG)

The Association of Chartered Certified Accountants



**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:

	2002/03		2003/04
	\$		\$
Allowances:			
Basic allowance	108,000		104,000
Married person's allowance	216,000		208,000
Child allowance – first child	30,000		30,000
Single parent allowance	108,000		104,000
Dependent parent allowance	30,000		30,000
Deductions:			
Elderly residential care expenses (maximum)	60,000		60,000
Home loan interest (maximum)	150,000		100,000
Tax rates:			
Salaries tax rates:			
First \$35,000	2%	First \$32,500	2%
Next \$35,000	7%	Next \$32,500	7.5%
Next \$35,000	12%	Next \$32,500	13%
Remainder	17%	Remainder	18.5%
Standard rate	15%		15.5%
Corporation rate	16%		17.5%
Capital allowance rates:			
Initial allowance:			
Plant and machinery	60%		60%
Annual allowance:			
Commercial building	4%		4%
Plant and machinery:			
– Furniture and fixtures	20%		20%

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

ALL FOUR questions are compulsory and MUST be attempted

- 1 (a) Yip joined Good Prospect Ltd, a listed company in Hong Kong, as an assistant accountant on the following terms of employment:

Period of employment: 1 April 2002 to 30 September 2003

Basic salary: \$30,000 per month payable on the last day of each month

Gratuity: \$180,000 payable on 1 April 2004

Housing: Yip can choose to live in a flat provided by Good Prospect Ltd on the condition that Yip has to pay 7.5% of his basic salary to Good Prospect Ltd as rent

On 1 May 2002, Yip acquired the right to purchase 20,000 shares in Good Prospect Ltd for \$200 when the market price was \$2 per share. On 1 May 2003, Yip sold the right to acquire 10,000 of the 20,000 shares in Good Prospect Ltd to a colleague for \$500 when the market price was \$5 per share. On 1 August 2003, Yip exercised the remaining right to acquire 10,000 shares in Good Prospect Ltd at \$1.80 each when the market value was \$6 each.

On 1 September 2002, Yip received prize money amounting to \$40,000 from Good Prospect Ltd for winning a competition organised by the company. The competition, which was open to all employees of the company, was designed to invite suggestions for streamlining the operations of the company.

After leaving Good Prospect Ltd on 30 September 2003, Yip joined Well Done Ltd, another listed company in Hong Kong, as an accountant on 1 October 2003 at a monthly salary of \$35,000. He was posted to work in the People's Republic of China (PRC) from 1 November 2003 to 31 March 2004 and he paid tax of \$5,000 on his income for that period to the PRC tax authority.

Yip occupied a flat provided by Good Prospect Ltd for the period from 1 May 2003 to 30 September 2003. On 1 November 2003, Yip acquired a property in Shenzhen, PRC, at a consideration of \$800,000 for use as his residence from that date. To finance the acquisition of the PRC property, Yip pledged the property to Well Done Ltd as security for a low interest rate loan offered by the company. Interest amounting to \$20,000 was deducted from Yip's salary for the payment of interest by Well Done Ltd for the period from 1 November 2003 to 31 March 2004.

Yip duly received the gratuity of \$180,000 from Good Prospect Ltd on 1 April 2004. He lodged a claim in his tax return for the non-taxability of the gratuity for the reason that 'the amount of the gratuity was made in full and final settlement of any claims by me against Good Prospect Ltd arising out of the termination of the employment'.

Yip's wife died in a traffic accident in 2000. She left behind her father, who was aged 60 in 2001 and has been staying in a registered nursing home in Hong Kong since Yip's wife passed away. Yip paid the nursing home expenses of \$4,000 per month. Throughout the years ended 31 March 2003 and 31 March 2004, Yip maintained his son who was born in 1992.

Yip also incurred the following expenses:

	2002/03	2003/04
Donations to Hong Kong Community Chest	\$50	\$1,000
Annual membership subscription to Hong Kong Society of Accountants	\$2,100	\$2,400
Annual membership subscription to Countryside Club, Hong Kong	\$2,500	\$2,500

Required:

- (i) **State, giving reasons, why the assessor is unlikely to accept Yip's claim in respect of the non-taxability of the gratuity.** (3 marks)
- (ii) **Compute Yip's salaries tax liabilities for the years of assessment 2002/03 and 2003/2004 assuming that there is no relating back of the gratuity. Ignore provisional salaries tax. Show all workings.** (12 marks)
- (iii) **Advise Yip whether or not it would be advantageous to apply for the relating back of the gratuity to the 2002/2003 tax year. Support your advice with relevant calculations.** (4 marks)
- (iv) **State the conditions which must be satisfied for the concessionary deduction of home loan interest.** (5 marks)

- (b) **Compare and contrast the grounds for applying for the holdover of provisional salaries tax, provisional property tax and provisional profits tax.** (6 marks)

(30 marks)

- 2 (a) Lee owns a property in Hong Kong (Property A) and has let it to Cheung from 1 October 2001 on the following terms:

Period of the lease: 2 years from 1 October 2001

Premium payable on 1 October 2001: \$36,000

Monthly rent: \$8,000 payable on the 1st day of each month

Rates: \$1,200 per quarter payable by Lee

Management fee: \$500 payable to the management company by Cheung on the 1st day of each month

During the year ended 31 March 2003, the following events took place in respect of Property A:

- (i) Lee received outstanding rent from a former tenant amounting to \$10,000 which had been allowed in full by the Inland Revenue Department as irrecoverable rent during the year of assessment 2000/01.
- (ii) Due to financial difficulty, Cheung failed to pay the rent and management fee for February and March 2003.
- (iii) Lee paid all the rates up to December 2002 but forgot to pay the rates for the quarter ended 31 March 2003.
- (iv) Lee incurred \$400 in repairing Property A.

During the year ended 31 March 2004, the following events took place in respect of Property A:

- (i) Cheung failed to pay any rent. He was found unable to repay all his debts due to secured creditors and was declared bankrupt by the court on 30 September 2003.
- (ii) Lee paid the rates and management fees of Property A for the period from 1 January 2003 to 30 September 2003.
- (iii) Lee's son occupied Property A rent-free as from 1 October 2003 and has been responsible for paying all the rates and management fees since 1 October 2003.

Required:

- (i) **Compute the property tax liability of Lee in respect of Property A for the year of assessment 2002/03 assuming that the assessor was not aware that Cheung had been declared bankrupt.** (5 marks)
- (ii) **Compute the property tax liability of Lee in respect of Property A for each of the years of assessment 2002/03 and 2003/04 assuming that on 1 October 2003 the assessor became aware of the fact that Cheung had been declared bankrupt and Lee had paid all the outstanding rates.** (9 marks)

Ignore provisional property tax. Show all workings.

- (b) **List the obligations of an owner of property under the Inland Revenue Ordinance.** (6 marks)

(20 marks)

- 3 Chan and Wong carried on a partnership business selling groceries called Price Cut Supermarket, sharing profit and loss equally. The following is the trading and profit and loss account of the partnership for the year ended 30 April 2003:

	\$	\$
Sales		3,342,000
<i>Less: Cost of sales</i>		
Purchases	1,100,000	
Opening stock	400,000	
	<u>1,500,000</u>	
<i>Less: Closing stock</i>	600,000	
		<u>900,000</u>
Gross Profit		2,442,000
<i>Add:</i>		
Rental income	20,000	
Dividend income	10,000	
Bank interest received	8,000	
		<u>38,000</u>
		2,480,000
<i>Less:</i>		
Wages	1,400,000	
Rent	300,000	
Bad debt	12,000	
Interest	7,000	
Embezzlement	9,000	
Mandatory Provident Fund	90,000	
Other expenses	160,000	
Depreciation	30,000	
		<u>2,008,000</u>
Net Profit		<u><u>472,000</u></u>

Notes:

- Chan had taken some stock of the business for his own consumption. The purchase price of the stock was \$3,000 and the retail sale price was \$5,000.
- The rental income was received from letting out a surplus part of the partnership's shop premises to a third party. The shop was owned by the partnership. Property tax of \$2,400 had been duly paid for such letting. The property tax has been included in other expenses in the profit and loss account.
- The bank interest received was in respect of a bank deposit of Wong, being his private fund.
- Included in wages were amounts paid to:

Chan	\$400,000
Wong's son	\$350,000

Wong's son worked as a manager in the business.
- Rent paid was in respect of a godown used for storage of trading stock. The godown was owned by Wong's wife. The assessable value of the godown for Property Tax purposes was \$250,000. Property Tax of \$28,800 has been duly paid by Wong's wife.

6. Bad debts comprised the following:

General provision for bad debts	\$4,000
Specific provision for bad debts	3,000
Loan to a supplier of goods	2,100
Loan to an employee	2,900
	<u>\$12,000</u>

7. Interest paid comprised the following:

Bank overdraft secured by an offshore bank deposit of Chan's father	\$5,000
Interest on capital contributed by Wong	2,000
	<u>\$7,000</u>

8. Embezzlement comprised the following:

Cash stolen by an employee	\$5,000
Cash taken by Wong	4,000
	<u>\$9,000</u>

9. Contributions to the Mandatory Provident Fund comprised the following:

Chan	\$20,000
Other employees (mandatory portion)	70,000
	<u>\$90,000</u>

10. Other expenses comprised the following:

Legal fee for drafting the initial tenancy agreement with Wong's wife (Note 5)	\$5,000
Entertainment of suppliers	70,000
Staff Christmas party	10,000
Christmas gifts to friends	2,000
Charitable donations	5,000
Subscription to industry union	3,000
Newspapers and magazines	4,000
Fines for breach of law	18,000
Property tax paid (Note 2)	2,400
Other miscellaneous allowable expenses	40,600
	<u>\$160,000</u>

11. The partnership owned the shop premises which were acquired in October 2000. It was agreed that the cost of construction of the premises was \$1,000,000.

12. The written down values of furniture and fixtures brought forward from 2002/03 were: 20% pool \$50,000, 30% pool \$20,000.

Additions during the year were:

- (a) a computer costing \$25,000
- (b) new furniture and fixtures costing \$65,000

Sales during the year were: certain assets under the 20% pool were sold for \$13,000. These assets had originally cost \$150,000.

Required:

(a) Compute the assessable profits and the amount of tax payable/repayable in respect of the partnership for the year of assessment 2003/04, giving brief explanation of your treatment of the items referred to in notes 1 to 9 above. Assume no provisional profits tax has been charged on the partnership for the year of assessment 2003/04.

(24 marks)

(b) Compute each partner's share of profit or loss for the partnership.

(6 marks)

Show all workings.

(30 marks)

4 (a) You have the following clients:

- (i) Law, a solicitor, purchased law books and law reports in the sum of \$100,000 for his newly established law firm. (2 marks)
- (ii) Live Well Ltd, a company engaged in the manufacture of biochemical products, set up a laboratory for the purpose of carrying out frontier research and the advancement of knowledge. The company expended \$5,000,000 on the purchase of laboratory equipment, and \$3,000,000 as the cost of construction for the laboratory premises. (4 marks)
- (iii) Scandal Ltd, a company now applying for a listing in the Stock Exchange, has recently dismissed an unsatisfactory director to avoid adverse publicity and has paid him \$2,000,000 as compensation for loss of office. (2 marks)
- (iv) Forceful Ltd, a company engaged in the business of property investment, has instituted legal actions against the resumption of a piece of land, which it held for development, by the government. It has received a bill of \$500,000 from the solicitor for the costs incurred to date. (2 marks)
- (v) Runaway Ltd, whose shareholders have just passed a resolution for its winding up, made severance payments in the sum of \$2,000,000 two days ago in order to lay off all its existing employees in accordance with the labour law. (2 marks)

Required:

In each case state, giving reasons, whether or not the expense(s) incurred is deductible in the computation of the assessable profits of your client.

- (b) Fong, who is single, graduated from the University in 2002 and commenced employment with a company from 1 August 2002 at a monthly salary of \$25,000. He was required to travel extensively to China for business. He ceased employment on 31 August 2003. He left Hong Kong to emigrate to Australia on 3 September 2003.

Fong did not submit a tax return before departure as he considered that he was not chargeable to any tax due to his place of work being in China. The assessor issued a tax return to Fong for completion on 4 September 2003. Having learned that Fong had already departed from Hong Kong, the assessor immediately raised an estimated assessment on Fong for the year of assessment 2003/04 on 5 September 2003 which was sent to his old address in Hong Kong. As Fong had already left Hong Kong, he was not aware of the assessment. When Fong visited Hong Kong on 1 January 2004, he discovered that the Inland Revenue Department had already issued a reminder in respect of the outstanding tax and added a 5% surcharge to the tax payable.

Required:

- (i) **State, giving reasons whether or not the Inland Revenue Department has the power to do the acts described above;** (4 marks)
- (ii) **Advise Fong what he should do now.** (4 marks)

(20 marks)

End of Question Paper