

Preparing Taxation Computations (Hong Kong)

ACCA CERTIFIED ACCOUNTING TECHNICIAN EXAMINATION

ADVANCED LEVEL

TUESDAY 13 DECEMBER 2005

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(HKKG)



**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:

	2004/05
	\$
Allowances	
Basic allowance	100,000
Married person's allowance	200,000
Child allowance – first child	30,000
second child	30,000

Tax rates	
Salaries tax rates:	
First \$30,000	2%
Next \$30,000	8%
Next \$30,000	14%
Remainder	20%

	2003/04	2004/05
Standard rate	15·5%	16%
Corporation rate	17·5%	17·5%

Capital allowance rates	
Initial allowance:	
Industrial building	20%
Motor car	60%
Annual allowance:	
Industrial building	4%
Motor car	30%

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

ALL FOUR questions are compulsory and MUST be attempted

- 1 (a)** Mr Lau provides you with the following information relevant to his salaries tax liability for the year of assessment 2004/05:
- (1) He has been in the employ of Summer Company Ltd as a sales manager since 1990. His annual salary for the year ended 31 March 2005 was \$400,000. Summer Company Ltd is a Hong Kong company carrying on its motor car trading business in Hong Kong.
 - (2) He received commission totalling \$150,000 based on his sales volume in Hong Kong.
 - (3) His elder son attended a secondary school in the United Kingdom. The school fees were charged to and paid by Summer Company Ltd directly. The amount of the school fees paid by Summer Company Ltd during the year were \$63,000.
 - (4) He received a housing allowance from Summer Company Ltd totalling \$132,000 for the year, which was wholly paid out for the rent of a residential flat occupied by Mr Lau and his family, throughout the year. The housing allowance was paid under his employment contract.
 - (5) During the year he attended a taxation seminar, the cost for which was charged to and paid by Summer Company Ltd to the organiser of the seminar. The amount paid was \$3,000.
 - (6) He incurred the following expenses during the year:
 - (i) membership fee for a sports club amounting to \$10,000;
 - (ii) membership fee for a marketing professional body amounting to \$1,000;
 - (iii) purchase of a motor car for \$200,000 (30% of its usage was for employment purposes as agreed by the Inland Revenue Department).
 - (7) He obtained an interest-free loan from Summer Company Ltd in the amount of \$200,000 for the purpose of buying the motor car in note (6). If the same amount of loan had been borrowed from a commercial bank, it would have cost him interest estimated at \$17,000.
 - (8) Throughout the year Mr Lau was married and maintained two children aged 14 and 12 respectively.
 - (9) Mrs Lau was in employment until this was terminated by her employer on 28 February 2005. She earned a total amount of salary of \$220,000 during the year. On top of that she also received a housing allowance totalling \$36,000 which was not used as payment of rent. Upon termination, she received \$20,000 from her employer as payment in lieu of notice.

Required:

Compute Mr and Mrs Lau's salaries tax liabilities for the year of assessment 2004/05 assuming that Mr Lau is to claim the child allowance for both his children. Ignore provisional salaries tax. Show all workings.

(16 marks)

- (b) On 1 June 2002 Mr Hui graduated from university and commenced employment with the Hong Kong Government as a trainee engineer at a monthly salary of \$15,000. On 1 December 2002 he resigned from the civil service and joined a Hong Kong-based shipping company working on board one of its ships as a marine engineer. His starting salary was \$17,000 per month. One year later, he was promoted and his salary was increased to \$20,000 per month.

The ship on which Mr Hui worked returned to Hong Kong during the following periods:

1 January 2003 to 12 February 2003	43 days
1 September 2003 to 19 November 2003	80 days
1 December 2004 to 29 January 2005	60 days

With the exception of a period of 20 days in October 2003 during which he went to Japan for a holiday, Mr Hui stayed in Hong Kong throughout the above periods on stand-by duty.

Required:

Compute the amount of Mr Hui's salary that would have been subject to salaries tax for each of the years of assessment 2002/03 to 2004/05 inclusive. In each case give a detailed explanation of the basis of your computation. Show all workings. (8 marks)

(24 marks)

2 (a) You are given the following particulars of Mr Wong's properties:

(i) **Property A**

This property was let on 1 June 2001 for a term of four years at a monthly rent of \$12,000. The tenant paid an initial premium of \$36,000. The rates of \$1,200 per quarter, were paid by Mr Wong.

(ii) **Property B**

The five-year lease of this property commenced on 1 April 2002. The monthly rent was \$14,000 and the initial premium was \$54,000. The tenant paid the rates of \$1,200 per quarter. On 1 April 2004 Mr Wong, in consideration of an additional premium of \$36,000, agreed to extend the lease by two years (i.e. up to 31 March 2009) and reduced the monthly rent to \$11,000 with effect from 1 April 2004.

(iii) **Property C**

This property was let on 1 April 2002 to Mr Lee. The term of the lease was two years and the monthly rent was \$18,000. The rates of \$1,300 per quarter, were paid by Mr Wong.

From 1 January 2004 onwards Mr Lee did not pay any rent. He moved out of the property on 31 March 2004 and left Hong Kong in June 2004.

On 1 May 2004 the property was let again to Mr Ho for a term of two years at a monthly rent of \$16,000. Mr Ho also paid Mr Wong an additional monthly charge of \$500 as his share of the management fee for the property. The rates of \$1,300 per quarter, were paid by Mr Wong.

In May 2005 Mr Lee returned to Hong Kong and paid the arrears of rent to Mr Wong. A legal cost of \$1,000 was incurred by Mr Wong for the recovery of these arrears.

Required:

Compute Mr Wong's property tax liability in respect of each of the above properties for the years of assessment 2003/04 and 2004/05 respectively. Ignore provisional property tax. Show all workings.

(22 marks)

(b) State the circumstances under which a person may be liable to additional tax and the maximum amount of the additional tax as stipulated under s.82A of the Inland Revenue Ordinance.

(8 marks)

(30 marks)

3 Fota Ltd is an established garment manufacturer in Hong Kong. It sells goods to both Hong Kong and overseas customers. The company's trading and profit and loss account for the year ended 31 March 2005 contained the following items:

Income	\$	\$
Sales of garments		
– manufactured in Hong Kong		31,400,000
– manufactured partly in Hong Kong	1	5,000,000
		<u>36,400,000</u>
Dividends	2	800,000
Interest income	3	1,200,000
Rental income	4	1,000,000
Sale proceeds of trade mark	5	500,000
Gain on sale of certificate of deposit in Hong Kong		30,000
Interest on tax reserve certificate		5,000
Miscellaneous (all taxable)		70,000
		<u>40,005,000</u>
 Expenditure		
Cost of garments sold		
– manufactured in Hong Kong		16,000,000
– manufactured partly in Hong Kong	1	2,000,000
		<u>18,000,000</u>
Salaries	6	3,000,000
Bad debts	7	200,000
Rent and rates (all allowable)		1,000,000
Contribution to an occupational retirement scheme	8	477,500
Cost of trade mark	5	700,000
Donations	9	2,500,000
Legal fees	10	90,000
Amortisation of factory	11	100,000
Depreciation	12	40,000
Other expenses (all allowable)		950,000
		<u>27,057,500</u>
 Net profit		<u><u>12,947,500</u></u>

Notes:

1. The sweater panels of garments were knitted in China. These panels were then transported to Hong Kong where they were sewn together into finished garments for sale.

2. Dividends received comprised the following:

	\$
– from a subsidiary in Hong Kong	700,000
– from listed companies in Singapore	100,000
	<u>800,000</u>

3. Interest income received comprised the following:

	\$
– on credit balances held in current accounts with customers in the United States in respect of the sale of garments manufactured in Hong Kong	500,000
– on fixed US\$ deposits held with a bank in New York	250,000
– on fixed US\$ deposits held with a bank in Hong Kong	450,000
	<u>1,200,000</u>

4. Rental income comprised the following:

	\$
– from subletting a factory in Hong Kong	750,000
– from letting a shop in New York	250,000
	<u>1,000,000</u>

5. Trade mark

On 1 June 2004, the company acquired, from a famous garment manufacturer in New York, the trade mark for manufacturing some garment products in Hong Kong. The purchase price of the trade mark was \$700,000. As the sales of the manufactured garment products were poor, the trade mark was subsequently sold at a loss on 28 February 2005 for \$500,000.

6. Included in the salaries was an amount of \$1,000,000 paid to a director as a director's fee. Prior to the annual general meeting of the company, the company received complaints from several shareholders who alleged that the amount of the director's fee was excessive, with reference to the ability and contribution of that director.

7. Bad debts comprised the following:

	\$
– loan to a principal shareholder	180,000
– specific provision for doubtful trade debts	20,000
	<u>200,000</u>

8. The contribution to an occupational retirement scheme comprised the following:

	\$
– additional injection of funds	300,000
– annual contribution	177,500
	<u>477,500</u>

Because of the adverse investment environment, the fund manager responsible for managing the scheme made severe losses. At the recommendation of the company's actuary, additional funds had been injected into the scheme during the year to make up the deficit.

The annual contribution is made up as follows:

	Emoluments for the year ended 31 March 2005	Annual contribution
	\$	\$
Managing director	350,000	40,000
Financial controller	300,000	40,000
General manager	200,000	40,000
Other staff	1,150,000	57,500
	<u>2,000,000</u>	<u>177,500</u>

9. Donations comprised the following:

	\$
– beds donated to Tung Wah Hospital	500,000
– cash donated to Hong Kong Community Chest	2,000,000
	<u>2,500,000</u>

10. Legal fees comprised the following:

	\$
– formation of a subsidiary in Hong Kong	20,000
– registration of trade mark (see note 5 above)	45,000
– recovery of loan from a major shareholder (see note 7 above)	25,000
	<hr/>
	90,000
	<hr/> <hr/>

11. During the year, the company incurred the following expenses (carried forward as an asset in the company's balance sheet) for the construction of a factory in the New Territories for manufacturing garments in Hong Kong from 2006:

	\$
– cost of land	63,000,000
– architect's fee	500,000
– cost of construction	6,500,000
	<hr/>
	\$70,000,000
	<hr/> <hr/>

The factory was still under construction as at 31 March 2005.

12. The depreciation charged in the accounts was in respect of the company's plant and machinery. It has been agreed by the Assessor that the total amount of statutory depreciation allowances in respect of the company's plant and machinery for the year of assessment 2004/05 would be \$340,000.

13. The company has a loss brought forward of \$200,000 from the year of assessment 2003/04.

Required:

Compute the assessable profits and the amount of tax payable by Fota Ltd for the year of assessment 2004/05. Ignore provisional profits tax. Show all workings.

(24 marks)

4 (a) You have the following clients:

(i) Red Company Ltd commenced business in 1995. In 2004 it changed its accounting date from 31 December to 30 June. Its profits for recent years as adjusted for tax purposes are shown below:

	\$
12 months to 31 December 2001	240,000
12 months to 31 December 2002	300,000
12 months to 31 December 2003	180,000
6 months to 30 June 2004	180,000

(ii) Yellow Company Ltd started business in 2000. The company changed its accounting date from 30 June to 31 March in 2005. Its profits for recent years as adjusted for tax purposes are shown below:

	\$
12 months to 30 June 2003	300,000
12 months to 30 June 2004	400,000
9 months to 31 March 2005	350,000

Required:

State the basis period and compute the assessable profits for each of the years of assessment 2003/04 and 2004/05 for each of your two clients:

(i) Red Company Ltd (5 marks)

(ii) Yellow Company Ltd (5 marks)

Show all workings.

(b) The Inland Revenue Ordinance has specified the time limit for various actions that may be taken by the taxpayer or the Assessor.

Required:

State the time limit for each of the following actions:

(i) application for relating back a gratuity paid upon the termination of employment of an employee;

(ii) revocation of a claim for the deduction of home loan interest which has already been allowed;

(iii) requiring the Board of Review to state a case on a question of law for the opinion of the Court of First Instance of the High Court;

(iv) application for correcting an assessment by reason of an error or omission in any return or statement submitted in respect thereof;

(v) lodging a claim for a refund of tax overpaid; and

(vi) application for the holding over of provisional profits tax. (12 marks)

(22 marks)

End of Question Paper