

Preparing Taxation Computations (Hong Kong)

ACCA CERTIFIED ACCOUNTING TECHNICIAN EXAMINATION

ADVANCED LEVEL

TUESDAY 14 JUNE 2005

QUESTION PAPER

Time allowed **3 hours**

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

Tax rates and allowances are on page 2

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)



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
Dependent parent allowance	30,000
Additional dependent parent allowance	30,000

Deduction	
Approved charitable donations (maximum)	25%

Tax rates	
Salaries tax rates:	
First \$30,000	2%
Next \$30,000	8%
Next \$30,000	14%
Remainder	20%
Standard rate	16%
Corporation rate	17.5%

Capital allowance rates	
	2001/02–2004/05
Initial allowance:	
Industrial building	20%
Plant and machinery	60%
Annual allowance:	
Industrial building	4%

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

ALL FOUR questions are compulsory and MUST be attempted

- 1 (a) Peter and his wife, Susan have lived in Hong Kong for many years. In October 2004 they emigrated to Singapore. Particulars of their income in Hong Kong for the year ended 31 March 2005 are as follows:

	Peter	Susan
	\$	\$
Salary	720,000	70,000
Business profit (loss)	150,000	(70,000)
Rent (1.4.2004 to 31.12.2004)		90,000

The property was owned solely by Susan. It was left vacant after 31 December 2004 because the tenant did not renew the lease. The rates paid by Susan for the whole year amounted to \$4,800.

Peter donated \$220,000 to an approved charity in June 2004. He claimed a deduction in respect of the donation against his employment income only.

Throughout the year ended 31 March 2005 Peter remitted \$8,000 monthly to Australia for his sons and parents because his two sons (aged 19 and 24) were studying at a college there and his parents also lived there.

Before leaving Hong Kong for Singapore Peter and Susan paid all the salaries tax, profits tax and property tax due for the year of assessment 2004/05. Peter and Susan now wish to jointly elect for personal assessment for that year.

Required:

- (i) State the reasons why Peter and Susan are eligible to elect for personal assessment for the year of assessment 2004/05 while they are living in Singapore. (3 marks)
 - (ii) State the time limit for Peter and Susan to make an election for personal assessment for the year of assessment 2004/05. (2 marks)
 - (iii) Calculate the amount of tax (if any) refundable to Peter and Susan if they elect for personal assessment for the year of assessment 2004/05. Your answer should include a calculation of the salaries tax, profits tax and property tax already paid by Peter and Susan, before the election was made. Ignore provisional tax. Show all workings. (16 marks)
- (b) Under the Inland Revenue Ordinance a taxpayer may be required to do a certain act or thing e.g. filing a tax return or furnishing information to the Inland Revenue Department.

Required:

Name those persons who shall be answerable on behalf of the following taxpayers for doing all such acts and things as would be required to be done under the Inland Revenue Ordinance:

- (i) an incapacitated person;
- (ii) a non-resident person;
- (iii) a partnership;
- (iv) a corporation; and
- (v) a body of persons. (5 marks)

(26 marks)

- 2 (a) Jennifer is the sales manager of iNet Inc, a company incorporated and managed in the United States. Her contract was negotiated in the United States and she is paid by direct deposit to her bank account in the United States. Her job requires her to make frequent visits to Hong Kong. During the three years of assessment 2002/03 to 2004/05, she spent 55 days, 61 days (inclusive of 2 days' sick leave) and 120 days respectively in Hong Kong. Her annual salary for each of those three years of assessment is \$730,000.

Required:

- (i) State the THREE factors which according to the Departmental Interpretation and Practice Notes No. 10 determine the locality of employment in the majority of cases. (3 marks)
- (ii) State the exemptions from salaries tax that are available to a person who derives income from a Hong Kong employment. (5 marks)
- (iii) Calculate the amount of Jennifer's salary that would have been subject to salaries tax for each of the years of assessment 2002/03 to 2004/05 inclusive under the assumptions that her employment was:
- (1) a Hong Kong employment; and
(2) a non-Hong Kong employment.

Show all workings. (6 marks)

- (b) Due to an oversight, Jennifer did not file her tax return with the Inland Revenue Department within the stipulated time period. In the absence of a return, the assessor raised an estimated assessment on Jennifer, as if she held a Hong Kong employment with iNet Inc. Jennifer does not agree with the assessment.

Required:

- (i) State the requirements of a valid objection against an assessment issued in the absence of a tax return. (5 marks)
- (ii) State the powers conferred on the Commissioner to enable him to dispose of an objection. (5 marks)

(24 marks)

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Question 3 begins on page 6.**

- 3 (a) You are the tax adviser to the Eric Engineering Company, an engineering business carried on by Eric in Hong Kong. The following is the company's profit and loss account for the year ended 31 March 2005:

	Note	\$	\$
Income:			
Service fee income			8,700,000
Interest income	1		600,000
Other income	2		250,000
			<u>9,550,000</u>
Operating expenses:			
Advertising		20,000	
Agency fee	3	10,000	
Bank charges		2,000	
Building management fee		24,000	
Cleaning and sanitary expenses		2,000	
Computer hardware and software	4	500,000	
Contribution to mandatory provident fund	5	200,000	
Depreciation		200,000	
Donation	6	100,000	
Entertainment		36,000	
Exchange loss	7	23,000	
Insurance		120,000	
Interest expense	8	200,000	
Legal and professional fees	9	400,000	
Newspapers and periodicals		6,000	
Printing and stationery		20,000	
Provision for bad and doubtful debts	10	200,000	
Rent and rates		360,000	
Repairs and maintenance	11	150,000	
Salaries and allowances	12	4,500,000	
Staff welfare expenses		300,000	
Sundry expenses	13	200,000	
Telephone and telex		30,000	
			<u>7,603,000</u>
Net profits			<u><u>1,947,000</u></u>

Notes:

- The interest income of \$600,000 consists of:

	\$
Interest from a deposit at Hang Seng Bank – Hong Kong	350,000
Interest on Exchange Fund debt instruments	100,000
Interest on qualifying debt instruments pursuant to s.14A of the Inland Revenue Ordinance	150,000
- Other income of \$250,000 represents the forfeiture of a deposit from a customer who decided to suspend an engineering project.
- Due to business expansion, the company moved office in June 2004. The agency fee of \$10,000 was paid to a property agent for introducing the new office.
- Computer hardware and software of \$500,000 represent the payment made for 20 new computers with preinstalled software.
- Eric has made contributions to a mandatory provident fund scheme. The contributions for Eric for the year ended 31 March 2005 amounted to \$60,000 (\$100,000 x 12 x 5%). The contributions for the staff of the company were also based on 5% of the staff's remuneration.

6. The donation of \$100,000 represents the cost of Christmas gifts provided to the children of Po Cheung Kuk (an approved charitable institution).
7. The exchange loss of \$23,000 consists of:
- | | |
|--|--------|
| | \$ |
| Settlement of trade debts in Japanese Yen | 20,000 |
| Purchase of office equipment (see Note 14 below) | 3,000 |
8. The interest expense of \$200,000 consists of:
- | | |
|---|---------|
| | \$ |
| Bank overdraft interest to Hong Kong Bank | 100,000 |
| Interest on capital to Eric | 100,000 |
- The overdraft was used for business operations. It was secured by the fixed deposit of the company at Hang Seng Bank – Hong Kong.
9. The legal and professional expenses include a legal fee of \$2,000 for the new tenancy agreement; and \$200,000 for registration of the company's trademark. The remaining amounts were all for general business advice.
10. The provision for bad and doubtful debts represents a specific provision made for an advance to a customer who has applied for bankruptcy.
11. Repairs and maintenance include a provision of \$50,000 for replacing the carpets in the office.
12. Salaries and allowances include Eric's salary of \$1,200,000 (\$100,000 per month x 12).
13. Sundry expenses include removal expenses of \$20,000.
14. Other than the 20 new computers (note 4 above), the company had acquired a piece of office equipment (20% pool) for a consideration of £2,000 (equivalent to HK\$26,000). Due to the appreciation of the pound sterling, an exchange loss of \$3,000 was incurred on settlement with the supplier.
15. The tax written down values of the company's plant and machinery brought forward from 2003/04 are as follows:
- | | |
|----------|---------|
| | \$ |
| 10% pool | 100,000 |
| 20% pool | 100,000 |

Required:

Compute the assessable profits of Eric Engineering Company for the year of assessment 2004/05 and the profits tax payable (if any), assuming that Eric did not elect for personal assessment for the year of assessment 2004/05 and that there is no loss brought forward from the year of assessment 2003/04.

Your computation should start with the figure for net profit and include reference to each of the items referred to in the notes to the question, indicating by the use of 'nil' any item for which there is no adjustment in the tax computation. Show all workings. (26 marks)

- (b) In recording the service fee income in the accounts for the year ended 31 March 2004, the accountant of Eric Engineering Company wrongly stated the amount as \$8,200,000 instead of \$8,000,000 and the profits for the year were therefore overstated. The error was discovered when Eric started preparing his tax return for the year of assessment 2004/05 in June 2005.

Required:

Advise Eric of the remedy open to him under the Inland Revenue Ordinance to have an erroneous assessment corrected. (4 marks)

(30 marks)

- 4 (a) Success Limited is the sole owner of a share dealing business and a 50% partner in a garment manufacturing and retailing business. The operating results of these two businesses in the four years ended 31 March 2005 are as follows:

Year of Assessment	Share dealing business (100%) Success Limited	Garment manufacturing and retailing business (50%) Success Limited		Total Profit/(loss)
	Profit/(loss)	Profit/(loss)	Prosperous Limited Profit/(loss)	
	\$	\$	\$	\$
2001/02	100,000	(250,000)	(250,000)	(500,000)
2002/03	100,000	100,000	100,000	200,000
2003/04	(300,000)	150,000	150,000	300,000
2004/05	50,000	200,000	200,000	400,000

Required:

Compute the amount of profits chargeable to tax for each of the four years of assessment in respect of:

(i) Success Limited, and

(ii) the partnership.

(12 marks)

Show all workings.

- (b) The following building costs were incurred by Linda Limited on the construction of a new building:

Period	Building Costs
1 January 2001 to 31 December 2001	\$300,000
1 January 2002 to 31 October 2002	\$500,000

The building was used by Linda Limited as a factory with effect from 1 December 2002.

On 1 November 2004 Linda Limited sold the building to Erica Limited for \$600,000 (excluding the value of the land). Erica Limited let out the building to a toy manufacturer with effect from 1 March 2005.

Both Linda Limited and Erica Limited are long-established companies. Their respective accounting dates are 31 December and 31 March.

Required:

Calculate the depreciation allowances and balancing allowance or charge applicable to Linda Limited and Erica Limited for all relevant years of assessment up to and including the year of assessment 2004/05. Show all workings.

(8 marks)

(20 marks)

End of Question Paper