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# Answers

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1 (a) Mr Chan's salaries tax assessment – 2004/05

	\$	\$
Salary ( $\$730,000 \times 120/365$ )		240,000
Add: Value of quarters ( $\$240,000 \times 4\%$ )		9,600
Assessable income		249,600
Less: Basic allowance		100,000
Net chargeable income		149,600
Tax payable thereon:		
\$30,000	at 2%	600
\$30,000	at 8%	2,400
\$30,000	at 14%	4,200
\$59,600	at 20%	11,920
		19,120

Mr Chan's salaries tax assessment – 2005/06

	\$	\$
Salary		912,500
Less: Income attributable to tax paid in China ( $\$912,500 \times 100/365$ )		250,000
		662,500
Add: Value of quarters [ $\$662,500 \times 10\% - (\$24,000 - 20,000) \times 12$ ]		18,250
		680,750
Add: Mrs Chan's (one month) salary		12,000
		692,750
Less: Married person's allowance		200,000
Child allowance		40,000
Net chargeable income		452,750
Tax payable thereon:		
\$30,000	at 2%	600
\$30,000	at 8%	2,400
\$30,000	at 14%	4,200
\$362,750	at 20%	72,550
		79,750

(b) An allowance in respect of a child shall be granted to an individual who has been living with and maintaining during the year of assessment an unmarried child who was:

- (i) under the age of 18 years or;
- (ii) over the age of 18 years but under the age of 25 years and was receiving full time education at a university, college, school or other similar educational establishment; or
- (iii) over the age of 18 years and was by reason of physical or mental disability, incapacitated for work,

For this purpose, a child means:

- (i) a child of the claimant whether or not born in wedlock;
- (ii) a child of the claimant's spouse or former spouse whether or not born in wedlock;
- (iii) a legally adopted child; or
- (iv) a step child.

- (c) A non-resident who carries on a trade, profession or business in Hong Kong is chargeable to profits tax in respect of profits arising in or derived from Hong Kong from such trade, profession or business. In addition, a non-resident person who does not carry on business in Hong Kong and who may have no physical presence in Hong Kong is liable to profits tax if he receives sums in the form of royalties or licence fees for the use of or right to use in Hong Kong certain industrial or intellectual property. A non-resident is also chargeable to profits tax on sums received in respect of the performance in Hong Kong by a non-resident entertainer or sportsman of an activity as an entertainer or sportsman or in connection with a commercial occasion or event, including appearance in any promotional activity or participation in any sound recording, films, videos, radio, television, etc.
- (d) A non-resident may be assessed directly or in the name of his agent in respect of his profits arising in or derived from Hong Kong from any trade, profession or business carried on in Hong Kong. The tax so charged shall be recoverable from the assets of the non-resident or his agent. In cases where a person in Hong Kong who is not an agent deals with a non-resident who is in receipt of royalties and licence fees from Hong Kong and of non-resident entertainers and sportsmen who perform in Hong Kong, the non-resident person is chargeable to tax in the name of the Hong Kong person who paid or credited sums to him or any other non-residents. The tax so charged is recoverable by all means provided in the Inland Revenue Ordinance from the Hong Kong person.
- 2 (a) A payment made to an employee as a result of or in connection with his employment is, of itself, not enough to render him liable to tax. To be a profit arising from the employment the payment must be made in reference to the services of the employee by virtue of his employment. It must be something in the nature of a reward for services past, present or future. As the cash coupon here is a personal gift and not a reward for services, it is not assessable to salaries tax.
- (b) So far as the payment was a reward for services, the fact that it was not stipulated in the employment contract would not affect its assessability. Furthermore, as the gold coin had a cash equivalent of \$2,000, it is this figure that should be assessed.
- (c) As the employee was the one who entered into the contract with the gas company, he had a liability to pay the gas bill. By paying the bill, the employer had in fact discharged the obligation of the employee. This is clearly money's worth and is assessable to salaries tax.
- (d) The nature of such payment is, in essence, compensation for damages resulting from the employer's failure to give the requisite notice. Hence, this item is not assessable in the hands of the employee because it is not a reward for services.
- (e) The payment is not a reward for services rendered by virtue of the employee's employment. It is made to compensate the employee for giving up the right to compete and thus, is not assessable.
- (f) It is not only payments which come to an employee from his employer which are within the scope of salaries tax, the principle of reward for services extends to a reward coming from any person so long as it is in return for the services which the employee is required by his employer to perform. Hence, the tips in question are clearly assessable. In any event, the law defines income from employment to specifically include income from an office or employment derived from an employer and from others.
- (g) Employees are liable to salaries tax on the accrued benefits attributable to their employer's contributions to a recognised occupational retirement scheme when the sums are withdrawn other than upon termination of service, retirement, death or incapacity.
- (h) There is no provision in the Inland Revenue Ordinance to exempt long service payments from the charge to salaries tax. However, it has long been accepted by the Inland Revenue Department that a long service payment that is required to be paid under the Employment Ordinance is not assessable to salaries tax as it is not payment for services rendered but for termination of the employment.

**3 (a) Statement of assessable profits for the partnership**

Year of assessment Basis period – year ended 31 December	2003/04 2003 \$	2004/05 2004 \$	2005/06 2005 \$
Profit (loss) per accounts	(728,000)	40,000	460,000
Add: Salary to Edwin	200,000	200,000	200,000
Provision for depreciation	100,000	100,000	100,000
Profits tax paid	88,000	–	–
	<u>(340,000)</u>	<u>340,000</u>	<u>760,000</u>
Less: Depreciation allowance	50,000	50,000	50,000
Assessable profit (loss)	<u><u>(390,000)</u></u>	<u><u>290,000</u></u>	<u><u>710,000</u></u>

**Statement of allocation of profit (loss)  
Year of assessment 2003/04**

Partner	P/L	Salary \$	Balance \$	Total \$	Re- allocation \$	Share of Loss \$
Eric	1/4	–	(147,500)	(147,500)	17,500	(130,000)
Edwin	1/4	200,000	(147,500)	52,500	(52,500)	–
Reality Ltd	1/2	–	(295,000)	(295,000)	35,000	(260,000)
		<u>200,000</u>	<u>(590,000)</u>	<u>(390,000)</u>	<u>0</u>	<u>(390,000)</u>

\* Re-allocation:  $\$52,500 \times \$147,500 / (\$147,500 + 295,000) = \$17,500$   
 $\$52,500 \times \$295,000 / (\$147,500 + 295,000) = \$35,000$

**Year of assessment 2004/05**

Partner	P/L	Salary \$	Balance \$	Share of Profit \$
Eric	1/4	–	22,500	22,500
Edwin	1/4	200,000	22,500	222,500
Reality Ltd	1/2	–	45,000	45,000
		<u>200,000</u>	<u>90,000</u>	<u>290,000</u>

**Year of assessment 2005/06**

Partner	P/L	Salary \$	Balance \$	Share of Profit \$
Eric	1/4	–	127,500	127,500
Edwin	1/4	200,000	127,500	127,500
Reality Ltd	1/2	–	255,000	255,000
		<u>200,000</u>	<u>510,000</u>	<u>710,000</u>

**Computation of profits tax payable by the partnership**

Year of assessment	2003/04	2004/05	2005/06
	\$	\$	\$
Assessable profit (loss)	(390,000)	290,000	710,000
Less: Amount transferred to:			
Eric	130,000	22,500	127,500
Edwin	–	–	327,500
Reality Ltd	260,000	–	–
Balance of profits subject to tax	<u>NIL</u>	<u>267,500</u>	<u>255,000</u>
Profits at tax rate of 16%	–	222,500	–
Profits at tax rate of 17.5%	–	45,000	255,000
	<u>NIL</u>	<u>267,500</u>	<u>255,000</u>
Tax payable thereon	<u>NIL</u>	<u>43,475</u>	<u>44,625</u>

**(b) Eric – 2003/04 personal assessment**

	\$
Loss from partnership	(130,000)
Profit from freelance business	64,000
Property income (\$60,000 less 20% statutory deduction)	48,000
	<u>(18,000)</u>
Less: Interest paid (\$83,000 × 80%) (restricted)	48,000
Loss c/f	<u>(66,000)</u>

**Eric – 2004/05 and 2005/06 personal assessment**

Year of assessment	2004/05	2005/06
	\$	\$
Profit from partnership	22,500	127,500
Property income (\$60,000 less 20% statutory deduction)	48,000	48,000
	<u>70,500</u>	<u>175,500</u>
Less: Interest paid (\$74,000 and \$60,000 at 80%) (restricted)	(48,000)	(48,000)
	<u>22,500</u>	<u>127,500</u>
Less: Loss b/f	(66,000)	(43,500)
Loss c/f	<u>(43,500)</u>	
Reduced total income		84,000
Less: Home loan interest (\$60,000 × 20%)		12,000
Basic allowance		100,000
Net chargeable income		<u>NIL</u>
Tax payable		<u>NIL</u>

**(c) Edwin – 2005/06 personal assessment**

		\$	\$
Profit from partnership			327,500
Salary income – Edwin's wife			96,000
			<u>423,500</u>
<i>Less:</i> Married person's allowance	200,000		
Child allowance	80,000		280,000
			<u>143,500</u>
Net chargeable income			<u><u>143,500</u></u>
Tax payable thereon:			
	\$30,000	at 2%	600
	\$30,000	at 8%	2,400
	\$30,000	at 14%	4,200
	\$53,500	at 20%	10,700
			<u>17,900</u>
			<u><u>17,900</u></u>

Note : The profit from the restaurant is excluded from the personal assessment because it involves more than 20 partners.

**(d) Statement of assessable profits for Reality Ltd**

Year of assessment	2003/04	2004/05	2005/06
	\$	\$	\$
Rental income	1,200,000	1,200,000	1,200,000
<i>Add:</i> Other income	550,000	550,000	550,000
	<u>1,750,000</u>	<u>1,750,000</u>	<u>1,750,000</u>
<i>Less:</i> Loss from partnership	260,000	–	–
Net assessable profits	<u>1,490,000</u>	<u>1,750,000</u>	<u>1,750,000</u>
Tax payable	<u>260,750</u>	<u>306,250</u>	<u>306,250</u>

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Prestige Ltd  
Year of Assessment 2003/04  
Basis period: year ending 31 March 2004

Industrial building allowance	\$
Qualifying expenditure:	
Site investigation	74,000
Architect fees	420,000
Foundation work	790,000
Loan interest	240,000
	1,524,000
Allowance:	
Initial allowance (20% x \$1,524,000) x 80% *	243,840
* : Percentage of qualifying use of the building	

Year of Assessment 2004/05  
Basis period: year ending 31 March 2005

Industrial building allowance	\$
Qualifying expenditure:	
Construction cost	5,400,000
Loan interest	280,000
	5,680,000
Allowances:	
Initial allowance (\$5,680,000 x 20%) x 80%	908,800
Annual allowance [(\$1,524,000 + \$5,680,000) x 4%] x 80%	230,528
	1,139,328
<b>Depreciation allowances</b>	
Additions to 10% pool (\$670,000 + \$700,000)	1,370,000
Less: Initial allowance (60%)	822,000
	548,000
Less: Annual allowance (10%)	54,800
	493,200
WDV c/f	493,200

		<b>Marks</b>
<b>1</b>	<b>(a) Mr Chan’s salaries tax assessment – 2004/05</b>	
	Salary	1.5
	Value of quarters	1.5
	Basic allowance	1
	Tax payable	0.5
	<b>Mr Chan’s salaries tax assessment – 2005/06</b>	
	Salary	1
	Income taxed in China	2
	Value of quarters	2
	Mrs Chan’s salary	1
	Married person’s allowance	1
	Child allowance	1
	Tax payable	0.5
		<u>13</u>
	<b>(b) Child allowance</b>	
	1 mark for each condition correctly mentioned	3
	1 mark for any 3 definitions of child correctly mentioned	3
		<u>6</u>
	<b>(c) Non-resident person liable for profits tax</b>	
	Profits arising in or derived from Hong Kong	1
	In the form of royalties	1
	Licence fees for the use of or right to use of intellectual property	1
	Performance in Hong Kong by non-resident entertainer or sportsman	1
	Appearance in any promotional activity or participation	1
		<u>5</u>
	<b>(d) Assessment applicable to a non-resident</b>	
	A non-resident may be assessed directly	1
	Or in the name of his agent	1
	Tax recoverable from assets of the non-resident or his agent	1
	Recipients of royalties and licence fees and entertainers and sportsmen from non-agent in Hong Kong	1
	Tax charged in the name of the Hong Kong payer	1
	Tax recoverable by all means provided in IRO	1
		<u>6</u>
		<u><b>30</b></u>



	Marks
<b>2 (a)</b> Reference to services of the employee by virtue of employment	1
Reward for services past, present or future	1
Cash coupon is a personal gift and not taxable	1
	<hr/> <b>3</b> <hr/>
<b>(b)</b> Payment was reward for services and is taxable	1
Does not matter that it is not contractual	1
Cash equivalent of \$2,000 be assessed	1
	<hr/> <b>3</b> <hr/>
<b>(c)</b> The employee had a liability to pay gas bill	1
The employer discharged the obligation of employee	1
Money's worth and assessable	1
	<hr/> <b>3</b> <hr/>
<b>(d)</b> Compensation for damages	1
Not a reward for services and not assessable	1
	<hr/> <b>2</b> <hr/>
<b>(e)</b> Compensation for giving up a right	1
Not derived by virtue of employment and not assessable	1
	<hr/> <b>2</b> <hr/>
<b>(f)</b> Not only payments come from employer	1
Assessable so long as it is in return for services	1
Tips in question are assessable	1
The law defines income includes from others	1
	<hr/> <b>4</b> <hr/>
<b>(g)</b> Liable to salaries tax	1
On accrued benefits attributable to the employer's contributions	1
Not for termination of service	0.5
Not for retirement	0.5
Not for death	0.5
Not for incapacity	0.5
	<hr/> <b>4</b> <hr/>
<b>(h)</b> No provision in IRO to exempt long service payment	1
IRD by concession accept as not taxable	1
Not payment for services rendered but for termination of employment	1
	<hr/> <b>3</b> <hr/>
	<hr/> <b>24</b> <hr/>

	Marks
<b>3 (a) Eric, Edwin and Reality Ltd partnership – profits tax</b>	
Adjusted profits (0·5 mark for each adjustment)	2
Share of loss for y/a 2003/04 (1·5 marks for each partner)	4·5
Share of profit for y/a 2004/05 (1 mark for each partner)	3
Share of profit for y/a 2005/06 (1 mark for each partner)	3
Balance of profits subject to tax (0·5 mark for each y/a)	1·5
Tax payable thereon (0·5 mark for y/a's 2003/04 and 2005/06 and 1 mark for y/a 2004/05)	2
	<u>16</u>
<b>(b) Eric – 2003/04 personal assessment</b>	
Profit from freelance business	0·5
Property income net of statutory deduction	1
Interest paid (restricted)	1
Loss c/f	0·5
<b>Eric – 2004/05 and 2005/06 personal assessment</b>	
Property income (0·5 mark for both years)	0·5
Interest paid (0·5 mark for each y/a)	1
Loss offset (0·5 mark for each y/a)	1
Reduced total income	0·5
Home loan interest	0·5
Basic allowance	0·5
	<u>7</u>
<b>(c) Edwin – 2005/06 personal assessment</b>	
Wife's salary income	0·5
Wife's partnership income excluded	1
Married person's allowance	0·5
Child allowance	0·5
No dependent parent allowance	1
Tax payable thereon	0·5
	<u>4</u>
<b>(d) Reality Ltd – profits tax</b>	
Loss transferred from partnership	1·5
Tax payable thereon (0·5 mark for each y/a)	1·5
	<u>3</u>
	<u><b>30</b></u>

	Marks
<b>4 Prestige Ltd – 2003/04 depreciation allowance</b>	
Site investigation	1
Architect fees	1
Foundation work	1
Loan interest	1.5
Initial allowance	1.5
<b>Prestige Ltd – 2004/05 depreciation allowance</b>	
Construction cost	1
Loan interest	1.5
Initial allowance	1.5
Annual allowance on total qualifying expenditure	2
Additions to 10% pool (1 mark each)	2
Initial allowance	1
Annual allowance	1
	<hr/>
	<b>16</b>
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