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# Answers

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1 Mr Chow

(a) Mr Chow's salaries tax assessments – 2005/06 and 2006/07

	2005/06	2006/07
	\$	\$
Salary and commission	1,100,000	1,200,000
Discretionary bonuses	0	56,000
School fees paid	20,000	30,000
Travelling allowance (\$1,000 per month)	11,000	12,000
Gain on exercise of share option	0	0
Second hand value of computer	10,000	–
Holiday passage	25,000	0
Reimbursement of removal expenses	–	12,000
Employee compensation received	–	0
Reimbursement of medical expenses	–	15,000
Principal amount of staff housing loan	–	0
Interest foregone by employer on staff housing loan	–	0
Salaries tax paid	0	177,788
	<u>1,166,000</u>	<u>1,502,788</u>
<i>Less:</i> Souvenir for secretary	–	0
Removal expenses	–	0
Medical expenses for injury	–	0
Purchase of tuxedo	0	–
Allowable travelling expenses	(5,500)	(6,000)
Allowable depreciation allowances	(5,000)	(4,000)
	<u>1,155,500</u>	<u>1,492,788</u>
<i>Add:</i> Value of quarters (\$1,155,500 x 8%) – \$15,000)	77,440	–
	<u>1,232,940</u>	<u>1,492,788</u>
<i>Less:</i> Charitable donations	(10,000)	(10,000)
Married person's allowance	(200,000)	(200,000)
Child allowance	(80,000)	(80,000)
	<u>942,940</u>	<u>1,202,788</u>
Net chargeable income		
Tax payable thereon:		
\$30,000 at 2%/2%	600	600
\$30,000 at 8%/7%	2,400	2,100
\$30,000 at 14%/13%	4,200	3,900
Remainder at 20%/19%	170,588	211,429
	<u>177,788</u>	<u>218,029</u>

(b) According to DIPN No. 10, the three determining factors are:

- the place where the contract of employment is negotiated, entered into and enforceable;
- the place where the employer is resident; and
- the place where the remuneration is paid to the employee.

**2 Mr Kwong**

**(a) Mr Kwong's property tax assessments – 2005/06 and 2006/07**

	2005/06	2006/07
	\$	\$
Consideration received (\$10,000 per month)	90,000	120,000
Premium (Note 1)	45,000	60,000
Recovery of bad debts	–	36,000
	<u>135,000</u>	<u>216,000</u>
<i>Less: Irrecoverable rent</i>	<i>(72,000)</i>	<i>–</i>
Assessable value	63,000	216,000
<i>Less: Rates paid (Note 2)</i>	<i>(2,250)</i>	<i>(4,000)</i>
	<u>60,750</u>	<u>212,000</u>
<i>Less: Notional allowances for repairs (20%)</i>	<i>(12,150)</i>	<i>(42,400)</i>
Net assessable value	<u>48,600</u>	<u>169,600</u>
Property tax at 16%	<u>7,776</u>	<u>27,136</u>

Note 1

Premium for 2005/06: \$180,000 x 9/36 = \$45,000

Premium for 2006/07: \$180,000 x 12/36 = \$60,000

Note 2

Allowable rates for 2005/06: \$3,000 x 9/12 = \$2,250

**(b) (i)** An individual who is of or above the age of 18 years, or under that age if both his parents are dead; and who or whose spouse is either a permanent or temporary resident may elect for personal assessment. The election shall be made within two years after the end of the relevant year of assessment or one month after an assessment for the year of assessment has become final and conclusive, whichever is the later.

**(ii)** A notice of appeal to the Board of Review must:

- (1) be made in writing to the Clerk to the Board of Review within one month of the transmission of the Commissioner's determination, or within such further period as the Board of Review (hereinafter referred to as the Board) may allow if satisfied that the appellant was prevented by illness, absence from Hong Kong or other reasonable cause from giving the notice within one month;
- (2) be accompanied by a copy of the Commissioner's determination together with a copy of the reasons therefor and of the statement of facts; and
- (3) contain a statement of the grounds of appeal.

Note: The Commissioner of Inland Revenue must at the same time be served with a copy of the notice of appeal and of the statement of the grounds of appeal.

**(iii)** The appellant or the Commissioner of Inland Revenue must first make an application in writing to the Clerk to the Board of Review requiring the Board to state a case for the opinion of the Court of First Instance. Such application must be made within one month of the date on which the Board's determination is notified and be accompanied by a fee of \$770. Secondly, within 14 days of receiving the stated case, the person requiring the case to be heard must transmit it to the Court of First Instance and send a copy to the other party at or before the time of transmitting it to the Court of First Instance. He is also required to notify the other party that the stated case was obtained upon his application.

### 3 Pearl Ltd

#### (a) Pearl Ltd

##### Profits tax computation – Years of assessment 2005/06 and 2006/07

	2005/06	2006/07
Profit/(loss) per accounts	440,000	(65,200)
<i>Add:</i> Depreciation	39,000	22,000
Staff loans written off	25,000	–
Charitable donations	30,000	–
Legal and professional fees (\$5,000 + \$21,000)	–	26,000
Repair expenses (\$40,000 + \$150,000 + \$170,000)	–	360,000
Balancing charge (Note 1)	27,600	–
	<u>561,600</u>	<u>342,800</u>
<i>Less:</i> Interest income	–	(54,900)
Insurance compensation incorrectly recorded (\$63,000 + \$170,000)	–	(233,000)
Profit on the sale of surplus business premises	(470,000)	–
Commercial building allowance (Note 2)	(15,904)	(22,104)
Depreciation allowance (Note 3)	(26,000)	(117,000)
	<u>49,696</u>	<u>(84,204)</u>
<i>Less:</i> Charitable donations (restricted to 25%)	(12,424)	–
Assessable profits	<u>37,272</u>	<u>–</u>
Adjusted loss carried forward		<u>(84,204)</u>
Profits tax payable thereon at 17.5%	<u>6,522</u>	<u>NIL</u>

#### Note 1

	\$
Residue before sale	202,400
<i>Less:</i> Sale price (\$1,200,000 x 60%)	<u>(720,000)</u>
Excess	517,600
Balancing charge (restricted to allowances previously granted (\$230,000 – \$202,400 = \$27,600))	<u>27,600</u>

#### Note 2

	\$
Qualifying expenditure as at 1 January 2005	600,000
<i>Less:</i> Residue before sale of business premises disposed of	<u>(202,400)</u>
Qualifying expenditure	397,600
Annual allowance (A.A.) for 2005/06 (4%)	<u>15,904</u>
Qualifying expenditure as at 1 January 2006	397,600
<i>Add:</i> Construction cost of fire escape (\$150,000 + \$5,000)	155,000
Qualifying expenditure	<u>552,600</u>
A.A. for 2006/07 (4%)	<u>22,104</u>

#### Note 3

##### Depreciation allowance schedule

	\$	\$	\$
Year of assessment 2005/06			
Balance brought forward		130,000	
<i>Less:</i> Annual allowance (A.A.) (20%)		<u>(26,000)</u>	26,000
Balance carried forward		104,000	
Year of assessment 2006/07			
Additions	160,000		
<i>Less:</i> Initial allowance (I.A.) (60%)	<u>96,000</u>	64,000	96,000
		<u>168,000</u>	
<i>Less:</i> Insurance proceeds		(63,000)	
		<u>105,000</u>	
<i>Less:</i> A.A. (20%)		<u>(21,000)</u>	21,000
Balance carried forward		<u>84,000</u>	<u>117,000</u>

- (b) The loss arising from a trade, profession or business carried on by a corporation shall firstly be set off against the corporation's assessable profits for the same year of assessment. These profits include the share of the assessable profits of any partnership of which the corporation is a partner. If the loss cannot be wholly set off in this way, the balance is to be carried forward and set off against the corporation's assessable profits (including its share of the assessable profits of any partnership) for the following year and so on until fully absorbed.

Where a corporation is trading in partnership and the partnership sustains a loss, the corporation may set off its share of the partnership loss against its assessable profits for the same year of assessment. To the extent the loss is not so used it is to be carried forward and, for subsequent years of assessment, to be set off firstly against the corporation's share of assessable profits of the partnership and then against its other assessable profits until fully absorbed.

#### 4 Mr Sum

##### (a) Computation of industrial building allowance for Mr Sum

	\$	\$
<b>Year of assessment 2003/04</b>		
Expenditure on foundation and drainage of the new building		300,000
Commitment and legal fees for the building loan		20,000
Interest on the building loan paid up to 31 December 2003 (\$120,000 x 8/12)		80,000
Construction cost for superstructure incurred up to 31 December 2003		500,000
		<u>900,000</u>
Initial allowance (I.A.) (\$900,000 x 20%)	180,000	
Annual allowance (A.A.)	<u>Nil</u>	<u>(180,000)</u>
		720,000
<b>Year of assessment 2004/05</b>		
Interest on the building loan paid up to 30 April 2004		40,000
Construction cost for superstructure incurred in the basis period		700,000
		<u>1,460,000</u>
I.A. (\$740,000 x 20%)	148,000	
A.A. (\$900,000 + \$740,000) x 4%	<u>65,600</u>	<u>(213,600)</u>
		1,246,400
<b>Year of assessment 2005/06</b>		
A.A. (\$900,000 + \$740,000) x 4%		<u>(65,600)</u>
Residue before sale		1,180,800
<b>Year of assessment 2006/07</b>		
Sales proceeds		<u>2,500,000</u>
Excess		<u>(1,319,200)</u>
Balancing charge restricted to allowances previously granted (\$180,000 + \$213,600 + \$65,600)		<u>459,200</u>

##### (b) Computation of industrial building allowance for Mr Kwan

	\$
Residue before sale	1,180,800
Add: Balancing charge	<u>459,200</u>
Residue after sale	1,640,000
Year of first use (i.e. 1 May 2004)	2004/05
25th year after year of first use	2029/30
First year of allowance to Mr Kwan	2006/07
Number of years between 2006/07 and 2029/30 inclusive	24
Annual allowance (A.A.) (i.e. \$1,640,000 ÷ 24)	<u>\$68,333</u>

		<i>Marks</i>
<b>1</b>	<b>(a) Mr Chow's salaries tax assessment – 2005/06</b>	
	Salary and commission	0.5
	Discretionary bonuses	1
	School fees paid	0.5
	Travelling allowance	0.5
	Gain on exercise of share option	0.5
	Computer at second hand value	0.5
	Holiday passage	1
	Salaries tax paid	0.5
	Purchase of tuxedo	0.5
	Travelling expenses	0.5
	Allowable depreciation allowances	0.5
	Value of quarters	2
	Charitable donations	0.5
	Married person's allowance	0.5
	Child allowance	0.5
	Tax payable	0.5
	<b>Mr Chow's salaries tax assessment – 2006/07</b>	
	Salary and commission	0.5
	Discretionary bonuses	1
	School fees paid	0.5
	Travelling allowance	0.5
	Gain on exercise of share option	0.5
	Holiday passage	1
	Reimbursement of removal expenses	0.5
	Employee compensation	0.5
	Reimbursement of medical expenses	0.5
	Principal amount of staff housing loan	0.5
	Interest foregone by employer	0.5
	Salaries tax paid	0.5
	Souvenir for secretary	0.5
	Removal expenses incurred	0.5
	Medial expenses for injury	0.5
	Travelling expenses	0.5
	Allowable depreciation allowances	0.5
	Charitable donations	0.5
	Married person's allowance	0.5
	Child allowance	0.5
	Tax payable	0.5
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		22
	<b>(b) The determining factors</b>	
	1 mark for each factor	3
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		<b>25</b>

		<b>Marks</b>
<b>2</b>	<b>(a) Mr Kwong's property tax assessment – 2005/06</b>	
	Consideration	1
	Premium	1
	Irrecoverable rent	0.5
	Rates	1
	Notional allowance	1
	Tax payable	0.5
	<b>Mr Kwong's property tax assessment 2006/07</b>	
	Consideration	1
	Premium	1
	Recovery of bad debts	1
	Rates	0.5
	Notional allowance	1
	Tax payable	0.5
		<u>10</u>
<b>(b)</b>	<b>(i) Personal assessment</b>	
	Individual	0.5
	Of or above 18	0.5
	Under 18 if both parents dead	1
	Permanent or temporary resident in Hong Kong	1
	Within two years after the year of assessment	1
	Within one month after assessment final and conclusive	1
		<u>5</u>
	<b>(ii) Appeal to the Board of Review</b>	
	Made in writing to the Clerk to the Board of Review	1
	Within one month of the transmission of the Commissioner's determination	1
	Or within such further period as the Board of Review may allow	1
	Be accompanied by the documentation from the Commissioner of Inland Revenue	1
	Contain a statement of the grounds of appeal	1
		<u>5</u>
	<b>(iii) Appeal to the Court of First Instance</b>	
	Application in writing to the Clerk to the Board of Review	1
	Within one month of the decision by the Board	1
	Accompanied by a fee of \$770	1
	Transmit the stated case to the Court of First Instance within 14 days	1
	Notify the other party of the stated case obtained	1
		<u>5</u>
		<u><b>25</b></u>

	<b>Marks</b>
<b>3 (a) Pearl Ltd – 2005/06 and 2006/07 profits tax</b>	
Depreciation (0.5 mark each)	1
Staff loans written off	1
Charitable donations added back	0.5
Legal and professional fees (1 mark each)	2
Repair expenses (1 mark each)	3
Balancing charge	2
Interest income	1
Insurance compensation (1 mark each)	2
Profit on the sale of surplus business premises	1
Commercial building allowance (2 marks each)	4
Depreciation allowances	
– annual allowance for 2005/06	1.5
– initial allowance for 2006/07	1
– annual allowance for 2006/07	2
Charitable donations allowed	1
Loss carried forward	0.5
Tax payable	0.5
	<u>24</u>
<b>(b) Treatment of losses in respect of a corporation</b>	
Firstly be set off against the corporation's assessable profits for the same year of assessment	1
Profits include the share of the assessable profits of any partnership of which the corporation is a partner	1
Balance of losses is to be carried forward and set off against the corporation's assessable profits for the following years until fully absorbed	1
Loss sustained by a corporation in a partnership may set off its share of loss against its assessable profits for the same year of assessment	1
Loss not so used is to be carried forward to subsequent years of assessment	1
Set off against the corporation's share of assessable profits of the partnership, then against its other assessable profits until fully absorbed	1
	<u>6</u>
	<b><u>30</u></b>
<b>4 (a) Industrial building allowance for Mr Sum</b>	
Year of assessment 2003/04:	
Demolition cost of old building – not eligible	1
Foundation and drainage	1
Commitment fees	1
Interest	1
Construction cost	1
Initial allowance	1
No annual allowance	1
Year of assessment 2004/05:	
Interest	1
Balance of construction cost	1
Initial allowance	1
Annual allowance	1
Year of assessment 2005/06:	
Annual allowance	1
Year of assessment 2006/07:	
Balancing charge	2
	<u>14</u>
<b>(b) Industrial building allowance for Mr Kwan</b>	
Residue after sale	2
Annual allowance for 2006/07	4
	<u>6</u>
	<b><u>20</u></b>