

Certified Accounting Technician Examination
Advanced Level

Preparing Taxation Computations (Hong Kong)

Tuesday 11 December 2007

Time allowed

Reading and planning: 15 minutes

Writing: 3 hours

ALL FOUR questions are compulsory and MUST be attempted.

Tax rates and allowances are on page 3.

Do NOT open this paper until instructed by the supervisor.

During reading and planning time only the question paper may be annotated. You must NOT write in your answer booklet until instructed by the supervisor.

This question paper must not be removed from the examination hall.

The Association of Chartered Certified Accountants



Paper T9 (HKG)

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The question paper begins on page 3.**

Supplementary Instructions

1. Calculations and workings should be rounded down to the nearest HK\$.
2. Apportionments need only be made to the nearest month, unless the law requires otherwise.
3. All workings should be shown.

Tax Rates and Allowances

The following tax rates and allowances are to be used in answering the questions.

	2005/06 and 2006/07	
Allowances		
Basic allowance	100,000	
Married person's allowance	200,000	
Child allowance – first child	40,000	
– second child	40,000	
Tax rates		
Salaries tax rates:	2005/06	2006/07
First \$30,000	2%	2%
Next \$30,000	8%	7%
Next \$30,000	14%	13%
Remainder	20%	19%
Standard rate	16%	16%
Corporation rate	17.5%	17.5%
Depreciation allowance rates		
Initial allowance:		
Furniture and fittings		60%
Industrial building		20%
Annual allowance:		
Furniture and fittings		20%
Industrial building		4%
Commercial building		4%

ALL FOUR questions are compulsory and MUST be attempted

1 Mr Chow, a Canadian, immediately after obtaining a work permit from the Immigration Department, was employed by a computer manufacturer in Hong Kong as its chief sales executive for the period from 1 May 2005 to 30 April 2007. The following information was disclosed by Mr Chow in his tax returns and in his correspondence with the assessor:

	2005/06	2006/07
(i) Salary and commission	\$1,100,000	\$1,200,000

(ii) Discretionary bonuses

Declared by his employer and credited to Mr Chow's account on	Amount	For the period
	\$	
15 May 2006	56,000	1 May 2005 to 31 March 2006
18 May 2007	67,000	1 April 2006 to 31 March 2007

(iii) Accommodation

1 May 2005 (date of arrival) to 31 March 2006	Mr Chow stayed in a two-room suite in the Hong Kong Shangri-la Hotel. The rent was paid by his employer direct to the hotel although Mr Chow had to contribute \$15,000 for that period. In addition, Mr Chow also paid \$7,000 directly to the hotel as a service charge.
1 April 2006 to 31 March 2007	Mr Chow resided in a flat in Discovery Bay which he had purchased with a loan of \$4,000,000 granted to him under an interest-free staff housing loan scheme of his employer (see notes (ix) and (xii) below).

(iv) Education allowance

On 1 May 2005 Mr Chow placed Eva, his ten-year old daughter, into the International School of Hong Kong. The tuition fees were directly borne by his employer for which it paid \$20,000 and \$30,000 for the years of assessment 2005/06 and 2006/07 respectively.

(v) Travelling allowances

Mr Chow had incurred travelling expenses of \$1,000 each month which were reimbursed in full by his employer. It was agreed between Mr Chow and the assessor that half of these expenses were for journeys between Mr Chow's home and his office, whereas the remainder was for journeys between Mr Chow's office and the offices of potential customers.

(vi) Share option

On 10 December 2005, Mr Chow, in pursuance of the terms of his employment contract, paid \$2,000 for an option to acquire 2,000 shares in the company that employed him at \$20 each. Mr Chow did not exercise the option despite the share price reaching a record high at \$40 each as at 31 March 2007.

(vii) Gift from employer

On 24 December 2005, Mr Chow's employer gave him a personal computer which it had produced at a cost of \$20,000. The computer was in recognition of Mr Chow's outstanding sales record and it had a second-hand market value of \$10,000.

(viii) Holiday passage allowance

Mr Chow was granted an allowance of \$25,000 in March 2006 for the purchase of a holiday passage; of which he spent \$23,000 when he was on vacation leave in May 2006 and the remaining \$2,000 on the purchase of a souvenir for his secretary during the trip.

(ix) Removal expenses

Removal expenses of \$12,000 which Mr Chow incurred on 1 April 2006 were refunded to him by his employer in full.

- (x) Employee compensation
On 10 May 2006, while inspecting the manufacturing plant owned by his employer in Shenzhen, China, Mr Chow was injured by a machine; for which injury he subsequently received compensation of \$30,000 from his employer's insurer. The expenses for Mr Chow's medical treatment of \$15,000 were, however, fully reimbursed by his employer.
- (xi) Charitable donations
Apart from cash donations of \$10,000 made to the Tung Wah Group of Hospitals (the Hospitals) in each December of 2005 and 2006, Mr Chow, on 28 February 2006, paid \$5,000 for a ticket for a fund-raising show organised by the Hospitals and for which Mr Chow purchased a tuxedo at a cost of \$4,000 to appear at the show.
- (xii) Staff housing loan
His employer estimated that a sum of \$110,000 would have been payable by Mr Chow for the year ended 31 March 2007, as interest for the housing loan, if it had been interest-bearing.
- (xiii) Depreciation allowance
It had been agreed between Mr Chow and the assessor that the amounts of allowable depreciation allowance for the years of assessment 2005/06 and 2006/07 were \$5,000 and \$4,000 respectively.
- (xiv) Tax liability
Mr Chow's salaries tax liabilities for the years of assessment 2005/06 and 2006/07 were paid and borne by his employer on 15 January 2007 and 16 July 2007 respectively.
- (xv) Family background
Mr Chow is married with two daughters, Eva (10 years old) and Christine (5 years old). Mrs Chow is a housewife.

Required:

- (a) Compute the salaries tax payable by Mr Chow for each of the years of assessment 2005/06 and 2006/07. Your computation should include reference to each of the items referred to in the question, indicating by the use of the figure '0' each item for which no adjustment is required to be made in the tax computation.**

Note: You should ignore provisional tax. (22 marks)

- (b) 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)

(25 marks)

- 2 (a) Mr Kwong owns a residential flat. The flat was let to a Mr Hui who failed to pay rent from October 2004 onwards. Mr Kwong regained possession of the flat on 1 April 2005. The flat was then vacant until July 2005 when Mr Kwong entered into a four-year tenancy agreement with a Mr Cheng on the following terms:
- (i) Duration of the tenancy: 1 July 2005 to 30 June 2009.
 - (ii) Lump sum premium payable on 1 July 2005: \$180,000
 - (iii) Monthly consideration: \$9,000 for rental and \$1,000 for the use of an air-conditioning unit and furniture, both of which were payable by Mr Cheng on the first day of each month.
 - (iv) Rates were payable by Mr Kwong.

All the payments due from Mr Cheng in the years 2005/06 and 2006/07 were duly made.

On 1 January 2006, the assessor wrote to Mr Kwong advising that he was satisfied that rents amounting to \$72,000 which had previously been assessed in the 2004/05 property tax assessment had now become bad. Half of this amount was, however, eventually recovered by Mr Kwong in February 2007 after having incurred a recovery fee of \$5,000.

The annual amount of rates paid by Mr Kwong for the flat were \$3,000 and \$4,000 for the years of assessment 2005/06 and 2006/07 respectively.

Required:

Compute the amounts of property tax payable by Mr Kwong for each of the years of assessment 2005/06 and 2006/07 under the assumption that personal assessment has not been elected by him.

Note: You should ignore provisional tax. (10 marks)

(b) Explain the statutory requirements for:

- (i) Lodging a valid application for personal assessment, including the time limit for making such an election.** (5 marks)
- (ii) Lodging a valid appeal to the Board of Review against a Commissioner's determination.** (5 marks)
- (iii) Lodging a valid notice of appeal to the Court of First Instance against a decision of the Board of Review.** (5 marks)

(25 marks)

3 Pearl Ltd closes its accounts annually on 31 December each year. A summary of its accounts and notes thereto for the years ended 31 December 2005 and 2006 are provided as follows:

	2005		2006	
	\$	\$	\$	\$
Trading profit		123,100		100,700
Sundry income [Note (i)]		—		63,000
		<u>123,100</u>		<u>163,700</u>
<i>Less:</i>				
Travelling expenses [Note (ii)]	7,000		8,000	
Sundry expenses [Note (iii)]	55,000		17,800	
Legal and professional expenses [Note (iv)]	4,100		26,000	
Repairs [Note (v)]	48,000		210,000	
Depreciation	39,000		22,000	
		<u>(153,100)</u>		<u>(283,800)</u>
		(30,000)		(120,100)
Profit on the sale of surplus business premises [Note (vi)]		470,000		—
Interest on bank deposits		—		54,900
		<u>440,000</u>		<u>(65,200)</u>

Notes to the accounts:

(i) A fire occurred on 30 June 2006, destroying part of the trading stock and some office furniture. The furniture destroyed was all purchased before 1 January 2005. The compensation money of \$289,000 received from the insurance company was treated in the accounts for the year ended 31 December 2006 as follows:

Items	Amount \$
Trading stock destroyed credited as sales	56,000
Furniture and fittings damaged (with nil net book value) credited as sundry income	63,000
Business premises damaged credited against repairs account	170,000
	<u>289,000</u>

(ii) Travelling expenses were allowances paid to employees for travelling between home and office.

(iii) Sundry expenses comprise:

	2005 \$	2006 \$
Small loans to members of staff written off as bad	25,000	—
Donations to approved charitable organisations	30,000	—
Souvenirs for retiring staff		3,000
Printing of calendars given to customers as New Year gifts	—	11,000
Fees paid for staff attending seminars on business management	—	3,800
	<u>55,000</u>	<u>17,800</u>

(iv) Legal and professional expenses comprise:

	2005 \$	2006 \$
Trade debts collection	2,500	—
Legal fees in connection with employment contracts	1,600	—
Architect fees for new fire escape	—	5,000
Legal expenses and agency fees for the sale of the business premises	—	21,000
	<u>4,100</u>	<u>26,000</u>

(v) Repair expenses for the year ended 31 December 2006 comprise a general reserve of \$40,000 for repainting the business premises, \$150,000 for the cost of construction of a new fire escape and \$190,000 for the cost of repairing the business premises after the fire.

(vi) Profit on the sale of surplus business premises comprises:

	\$
Sale price of the portion sold in 2005	1,200,000
Less: Cost of construction of the portion purchased in 2002	(230,000)
Attributable land cost of the portion	(500,000)
	470,000

It was agreed between the company and the assessor that the residue before sale of the portion of the business premises sold in 2005 was \$202,400 and that 40% of its sale price was related to land cost.

(vii) Additions to furniture and fittings for the year ended 31 December 2006 amounted to \$160,000.

(viii) The tax written down value of furniture brought forward as at 1 January 2005 comprised:

	\$
Items destroyed in the fire (original cost \$180,000)	55,000
Remainder	75,000
	130,000

(ix) The qualifying cost of the business premises eligible for commercial building allowance as at 1 January 2005 was \$600,000.

Required:

(a) Compute the profits tax payable by Pearl Ltd for each of the years of assessment 2005/06 and 2006/07.

Note: You should ignore provisional tax. (24 marks)

(b) Section 19C of the Inland Revenue Ordinance provides the rules governing the treatment of losses after 1 April 1975. Explain briefly the tax treatment of the losses of a corporation under this provision.

(6 marks)

(30 marks)

- 4 Mr Sum started a cassette tape manufacturing business in 1992 and makes up his accounts to 31 December each year. In April 2003 he acquired an old factory building in Wong Chuk Hang which he then demolished and developed the site into a new two-storey building.

Mr Sum incurred the following expenditure in respect of the development of the new building:

Date of payment	Nature of payment	Amount \$
5 April 2003	Cost of old building (including \$590,000 land cost)	850,000
15 April 2003	Demolition expenditure for old building	230,000
1 May 2003	Expenditure on foundations and drainage of new building	300,000
1 May 2003	Commitment fees for building loan	20,000
May 2003 to April 2004	Interest on building loan paid by 12 equal monthly instalments, payable on the last day of each month.	120,000
31 December 2003	Part of construction cost for the new building superstructure	500,000
30 April 2004	Balance of construction cost for the new building superstructure	700,000

The new building was completed on 1 May 2004. It was subsequently used to accommodate the cassette tape manufacturing division of Mr Sum's business.

In June 2006, Mr Sum sold the building to Mr Kwan for \$2,500,000 (land cost excluded). Mr Kwan used the building as a garment production centre. Mr Kwan's business accounts are made up to 31 March each year.

Required:

- (a) **Compute the respective amounts of initial and annual allowances, if any, that Mr Sum is entitled to claim and the balancing adjustment in respect of the building for each of the years of assessment from 2003/04 to 2006/07 inclusive.** (14 marks)
- (b) **Compute the residue of expenditure in respect of the building immediately after the sale to Mr Kwan and the amount of industrial building annual allowance, if any, that Mr Kwan was entitled to claim in respect of the building for the year of assessment 2006/07.** (6 marks)

(20 marks)

End of Question Paper