Preparing Taxation Computations
(Hong Kong)

ACCA CERTIFIED ACCOUNTING TECHNICIAN EXAMINATION

ADVANCED LEVEL

TUESDAY 12 JUNE 2007

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(HKG)

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The question paper begins on page 3.

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

Allowances

	2004/05 $	2005/06 and 2006/07 $
Basic allowance	100,000	100,000
Married person's allowance	200,000	200,000
Child allowance – first child	30,000	40,000
– second child	30,000	40,000
Dependent parent allowance (for each dependant aged 60 or above)		
– Basic	30,000	30,000
– Additional	30,000	30,000

Tax rates

Salaries tax rates:	2004/05 and 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%

Capital allowance rates

Initial allowance:	
Plant and machinery	60%
Industrial building	20%
Annual allowance:	
Air-conditioner	20%
Electric cooker	30%
Motor car	30%
Industrial building	4%
Commercial buildings	4%

All calculations are to be rounded to the nearest $.

ALL FOUR questions are compulsory and MUST be attempted

1 Dr Kwok, a medical doctor, graduated from the University of Birmingham, and returned to Hong Kong to join the Hospital Authority (the Authority) on 1 January 2003, as a medical officer, on a contract basis, at a salary of $25,000 per month. On 31 July 2003 he married a nurse who had been earning $10,000 per month since 1 April 2003. On 1 February 2004 the Authority promoted Dr Kwok to the position of Senior Medical Officer at a salary of $32,000 per month and provided him with staff quarters, the rateable value of which was $27,600, and for which Dr Kwok paid a monthly rent of $1,600 to the Authority.

After resigning from her post as a nurse with the Authority on 31 December 2003, Mrs Kwok bought shop premises, with a rateable value of $28,000, and used them as a boutique from 1 January 2004. The assessable profits of the boutique were:

Year ended 31 December 2004	$98,000
Year ended 31 December 2005	$168,800

Dr Kwok has held a fixed deposit with the Midland Bank in Birmingham since the year 2000, which yields interest of £520 annually (£1 = HK$13).

Dr Kwok has a widowed mother, the lawful concubine of his late father, who was aged 63 in 2003, and has lived with Dr Kwok since 1 December 2003. Dr Kwok contributed $3,000 per month to maintain his mother. He also donated cash of $10,000 to the Hong Kong Red Cross at Christmas in the years 2003, 2004 and 2005.

Dr and Mrs Kwok's first child was born on 1 January 2005. In the months of July and August 2005, Dr Kwok took his paid leave and went with his wife and child to Singapore. His quarters were occupied by another doctor of the Authority during his absence. On returning to Hong Kong on 1 September 2005, the Authority could not find him staff quarters and the whole family of Dr Kwok stayed in a hotel suite with two rooms, the rent of which was paid for by the Authority. Dr Kwok continued to pay $1,600 per month to the Authority for accommodation. Dr Kwok's mother left for Singapore permanently on 31 December 2005.

Dr Kwok went to Singapore when his contract in Hong Kong expired on 30 April 2006. He received a gratuity of $330,120. On the same day, Mrs Kwok sold the shop premises making a gain of $95,540 and closed the boutique, with an assessable profit of $28,100 for the last four months of trading.

Required:

(a) For each of the years of assessment from 2003/04 to 2006/07 inclusive:

(i) compute the net chargeable income of Dr Kwok under salaries tax if he has not claimed to relate back his gratuity; and (21 marks)

(ii) compute the total assessable income of Dr Kwok under salaries tax if he has claimed to relate back his gratuity under section 11D(b) of the Inland Revenue Ordinance.

Note: You may assume that both Dr and Mrs Kwok have elected for joint assessment if applicable and that the allowances in 2003/04 were the same as in 2004/05. Show all workings. You are not required to calculate the tax payable in this part. (6 marks)

(b) Compute the profits tax payable by Mrs Kwok for each of the years of assessment from 2004/05 to 2006/07 inclusive under the assumption that no personal assessment has been elected by Dr and Mrs Kwok. Ignore provisional tax. Show all workings. (3 marks)

(c) State the conditions under which an individual may be granted dependent parent allowances for salaries tax and personal assessment purposes. (5 marks)

(d) If there is more than one claimant for the same dependent parent allowance in respect of the same parent for the same year of assessment, explain the actions that may be taken by the Commissioner of Inland Revenue. (5 marks)

(40 marks)

2 True Colour Jewellery Ltd commenced its business four years ago. On 1 April 2006 it appointed Mr Choi as its sales director. Before joining the company, Mr Choi worked for another jewellery company.

On 31 July 2006 the company dismissed its chief accountant, Mr Tong, from employment because he was suspected of committing some malpractices. Mr Tong was asked to leave the company immediately without giving the requisite three-month notice of termination.

On 1 January 2007 the company's shop manageress, Madam Yuen, submitted a letter of resignation stating that she would be emigrating to Australia within one month.

Required:

(a) State the obligations imposed on True Colour Jewellery Ltd by the Inland Revenue Ordinance in respect of Mr Choi, Mr Tong and Madam Yuen in the above circumstances. (10 marks)

(b) State the possible legal consequences for True Colour Jewellery Ltd if it fails to fulfil the obligations in (a) above. (5 marks)

(15 marks)

3 **(a)** The profit and loss account for the year ended 31 December 2006 of Lucky Company, which is a partnership between Messrs Au, Chan and Leung, is as follows:

	$		$
Office rent (Note 4)	72,000	Profit from sales of quoted shares	
Salaries (Note 5)	241,000	– local (Note 1)	160,000
Advertising expenses	85,000	– foreign	70,000
Legal expenses (Note 6)	6,700	Profits from gold bullion trading (Note 2)	260,000
Interest expenses (Note 7)	85,000	Brokerage (as real estate agents)	250,200
Bad debts (Note 8)	20,000	Dividends from quoted shares	12,500
Travelling expenses	64,000	Profit from a certificate of deposit (Note 3)	15,500
Embezzlement by staff	7,000		
Utilities charges	16,000		
Depreciation on plant and machinery	14,000		
Sundry expenses (Note 9)	3,500		
Net profit	154,000		
	768,200		768,200

Notes

1. Lucky Company is a share dealer. Some of the shares were sold to the partners on 1 July 2006 at their cost of $50,000. The market value of these shares as at that date was $150,000.
2. The gold bullion trading was transacted in the London gold market through brokers in Hong Kong.
3. The certificate of deposit (in US dollars) was purchased and sold, before the date of maturity, in Hong Kong. The purchase was financed by the funds of the business.
4. The rent was paid to the spouse of Mr Au, who was the landlord of the property occupied by the partnership business.
5. Salaries comprise:

		$
Salaries to staff		95,000
Salaries to partners:	Mr Au	110,000
	Mr Chan	30,000
	Mr Leung	6,000
		241,000

6. Legal expenses comprise:

	$
Traffic fines	2,500
Renewal of lease for the office	2,200
Civil actions against clients for unpaid brokerage	2,000
	6,700

7. Interest expenses comprise:

	$
Interest on loan from Mr Chan	40,000
Interest on bank overdraft (without any security or guarantee)	45,000
	85,000

The money borrowed was wholly used to finance the dealing in local quoted shares.

8. Bad debts comprise:

	$
Brokerage irrecoverable	15,000
Personal loan to an employee (who subsequently absconded)	5,000
	20,000

9. All the sundry expenses were deductible expenses for tax purposes.

Other information

1. The depreciation charged in the accounts was calculated by the straight line method for all depreciable assets. It was 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 2006/07 was $26,914.
2. The partners shared the profit and loss of the business equally. Mr Chan and Mr Leung elected for personal assessment for the year of assessment 2006/07, but Mr Au did not.
3. The assessor has agreed the adjustments to be made under the Inland Revenue Rules 2A and 2C as $14,000 and $7,500 respectively. He also agreed that for administrative convenience the partnership would not be required to pay profits tax in respect of the share of profits to be transferred to the partners' personal assessments.

Required:

(a) (i) Compute the profits tax payable by Lucky Company for the year of assessment 2006/07. Your answer should clearly identify the shares of profits to be transferred to personal assessment for each of the partners and show all workings.
Ignore provisional tax. (19 marks)

(ii) Briefly explain the purpose of the Inland Revenue Rules 2A and 2C. (2 marks)

(b) On 1 November 2006 a company was informed by the Inland Revenue Department that an estimated profits tax assessment had been raised on the company by the assessor in the absence of a tax return for the year of assessment 2005/06. The company had in fact suffered a loss for that year.

Required:

State the requirements for lodging a valid objection against an assessment raised on a taxpayer who has failed to file the tax return in relation to the assessment. (4 marks)

(25 marks)

4 **(a)** A Ltd commenced business before 1 April 1974. In 2007, it changed its accounting date from 30 June to 31 March. Its adjusted profits have been as follows:

	$
12 months to 30 June 2005	240,000
12 months to 30 June 2006	450,000
9 months to 31 March 2007	340,000

B Ltd commenced business before 1 April 1974. In 2006, it changed its accounting date from 30 June to 31 December. Its adjusted profits and (losses) have been as follows:

	$
12 months to 30 June 2005	200,000
12 months to 30 June 2006	800,000
6 months to 31 December 2006	(350,000)

C Ltd commenced business in 2001. In 2007, it changed its accounting date from 31 May to 31 January. Its adjusted profits have been as follows:

	$
12 months to 31 May 2005	560,000
12 months to 31 May 2006	600,000
8 months to 31 January 2007	310,000

For all the above companies, the assessor has already raised profits tax assessments for the year of assessment 2005/06 already.

Required:

Calculate the assessable profits of each of the three companies (A Ltd, B Ltd and C Ltd) for the years of assessment affected by the change of accounting dates. The assessable profits of the additional assessments, where appropriate, should also be shown.
Ignore depreciation allowances. Show all workings. (10 marks)

(b) In 2006 Mr Mak changed the annual accounting date of his business from 30 September to 30 June. Pursuant to section 18E of the Inland Revenue Ordinance the assessor decided that the profits tax basis periods for Mr Mak's business for the years of assessment 2005/06 and 2006/07 should be the twelve months ended on 30 September 2005 and the twelve months ended on 30 June 2006 respectively.

The tax written down values of Mr Mak's plant and machinery brought forward from the year of assessment 2004/05 were as follows:

20% pool	$20,000
30% pool	$40,000

On 1 July 2005 Mr Mak bought an air-conditioner for his business by means of hire-purchase. In addition to a down-payment of $1,000 he paid, starting on 1 August 2005, 10 monthly instalments of $500 each. The cash price of the air-conditioner was $5,000.

With effect from 1 September 2005 an electric cooker originally bought by Mr Mak on 1 April 2003, was used by him solely for his business. Prior to 1 September 2005 the cooker had been used by Mr Mak only at home. The original cost of the cooker was $1,600.

With effect from 1 January 2006, Mr Mak has sometimes used his business motor car for private purposes. The extent of such private use was on average 50% for the whole of the assessment 2006/07. The car was bought two years ago for $40,000. As at 1 January 2006 its market value was $15,000.

Required:

Compute the depreciation allowances of Mr Mak's business claimable for each of the years of assessment 2005/06 and 2006/07. Show all workings. (10 marks)

(20 marks)

End of Question Paper