

Certified Accounting Technician Examination
Advanced Level

Preparing Taxation Computations (Hong Kong)

Tuesday 10 June 2008

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 (HKKG)

The ACCA logo consists of the letters 'ACCA' in a bold, white, sans-serif font, centered within a solid black square.

**This is a blank page.
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 and prevailing practice require otherwise.
3. All workings should be shown.

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

	2005/06 and 2006/07	2007/08
Allowances	\$	\$
Basic allowance	100,000	100,000
Married person's allowance	200,000	200,000
Single parent allowance	100,000	100,000
Dependent parent/grandparent allowance – basic	15,000/30,000	15,000/30,000
additional	15,000/30,000	15,000/30,000
Child allowance – 1st to 9th (each)	40,000	50,000
Additional child allowance for each new born child during the year	–	50,000

Tax rates

Salaries tax rates:	2005/06		2006/07*		2007/08	
On the first	\$30,000	2%	\$30,000	2%	\$35,000	2%
On the next	\$30,000	8%	\$30,000	7%	\$35,000	7%
On the next	\$30,000	14%	\$30,000	13%	\$35,000	12%
Remainder		20%		19%		17%
Standard rate		16%		16%		16%
Corporation rate		17.5%		17.5%		17.5%

* 50% of the salaries tax would be waived, subject to a maximum of \$15,000 per each case

Depreciation allowance rates

Initial allowance (IA):	Plant and machinery	60%
	Industrial building	20%
Annual allowance (AA):	Furniture	20%
	Air-conditioning units	20%
	Yacht	20%
	Computers	30%
	Machines (all types)	30%
	Motor vehicles	30%
	Industrial buildings	4%
	Commercial buildings	4%

ALL FOUR questions are compulsory and MUST be attempted

- 1** Mr Smith was until 31 March 2007, the Far East sales representative of a Canadian company, earning a monthly salary of \$68,000.

For the purpose of performing his duties Mr Smith travelled throughout the Far East region. During the year ended 31 March 2006 he visited Hong Kong for 150 days.

On 1 April 2006 Mr Smith rented a residential flat in Wanchai because he planned to spend more time in Hong Kong. The monthly rent of the flat was \$21,000. His employer contributed \$18,000 per month towards his rental expenditure. During the year ended 31 March 2007, Mr Smith spent 300 days in Hong Kong.

On 1 April 2007 Mr Smith resigned from the Canadian company and joined a Hong Kong company, A Ltd, as its sales manager at a monthly salary of \$80,000. He was also appointed as a director of B Ltd, which is a wholly owned subsidiary of A Ltd. His annual director's fee from B Ltd is \$40,000, payable on 31 March. B Ltd also paid the full rent for his flat in Wanchai with effect from 1 April 2007.

On 1 May 2007 Mr Smith married Miss Grady. She is an American teacher employed by the Hong Kong Polytechnic University on a two-year contract commencing from 1 July 2005. The contract provided for a monthly salary of \$25,000 plus a contract-end gratuity equal to 25% of the total salary earned during the contract period. Mrs Smith did not renew her contract so that she could have more time to take care of their baby, who was born in June 2007.

During the year ended 31 March 2008 Mr Smith, in performing his duties, incurred travelling expenses of \$8,000 for visiting A Ltd's customers. In February 2008 he donated \$16,000 to the Hong Kong Community Chest.

Mr and Mrs Smith have elected for joint assessment, if applicable, and Mrs Smith has elected for relating back her gratuity over the two-year employment period with the Hong Kong Polytechnic University.

Required:

- (a) Compute Mr Smith's salaries tax liability for each of the years of assessment 2005/06, 2006/07 and 2007/08, under the assumption that his employment was offshore for the years of assessment 2005/06 and 2006/07.**

Note: you should ignore provisional tax. (16 marks)

- (b) State the conditions under which an individual may be granted a child allowance for salaries tax and personal assessment purposes.** (5 marks)

- (c) State the action that may be taken by the Commissioner of Inland Revenue if there is more than one claimant for the child allowance in respect of the same child for the same year of assessment.** (3 marks)

(24 marks)

- 2 (a)** Mr Lai is a musician in a band. During the two years ended 31 March 2008, he worked for three restaurants operated by the same group of companies. The relevant facts concerning his work are as follows:
- (1) instruments were supplied by the restaurants for his use;
 - (2) other members of the band were paid by the restaurants;
 - (3) Mr Lai himself received a fixed hourly sum;
 - (4) he needed permission from the restaurant operator to absent himself, but could hire substitutes at his own expense;
 - (5) he played an agreed number of hours per month;
 - (6) he practised at home, using his own piano;
 - (7) there was no fixed period for any engagement, nor was there any notice period for the termination of an engagement;
 - (8) he was not entitled to sick leave, casual leave, severance pay or holiday pay; and
 - (9) he did not register a business pursuant to the Business Registration Ordinance.

In a letter to the assessor, Mr Lai claimed that he was a self-employed person in relation to the work he did for the restaurants as he was in business on his own account.

Required:

- (i) State the major factors under the economic reality test for deciding whether a taxpayer would be regarded as a self-employed person;** (5 marks)
 - (ii) Analyse Mr Lai's case in the light of the factors identified in (i) and conclude on his employment status.** (5 marks)
- (b) With regard to the additional tax imposed as a penalty (as prescribed in section 82A of the Inland Revenue Ordinance):**
- (i) State the circumstances under which a person may be liable to additional tax;** (6 marks)
 - (ii) State the maximum amount of the additional tax;** (2 marks)
 - (iii) State the person(s) who may assess additional tax and the procedure which should be followed before making the assessment;** (6 marks)
 - (iv) State the manner in which an additional tax assessment should be issued.** (2 marks)

(26 marks)

- 3 Fat Tat Trading Co Ltd carries on a trade in Hong Kong. Its profit and loss account for the year ended 31 March 2008 showed a net profit of \$1,045,755, after crediting and charging, *inter alia*, the following items of income and expenditure:

Income	Note	\$
Dividends from quoted shares		350,000
Interest	1	75,000
Debt waived by a trade creditor		3,000
Proceeds on the disposal of patent rights	2	45,000
Gain on the disposal of certificates of deposit	3	69,000
Expenditure		
Tax paid	4	40,000
Bad debts provision	5	43,000
Contribution to a recognised occupational retirement scheme	6	135,000
Depreciation		66,000
Cost of trade mark	7	44,000
Lease premium	8	50,000
Donation to the Community Chest		75,000
Loss on the sale of assets		3,500
Share of the loss from a partnership business carried on in Hong Kong	9	45,000

Notes

1. Interest income received comprised the following:	\$
Interest on a debenture issued by a Hong Kong company in Hong Kong	15,000
Interest on loans to an associated company (loans made available in the USA)	35,000
Interest on qualifying debt instruments pursuant to section 14A of the Inland Revenue Ordinance	25,000
	<u>75,000</u>
2. The patent rights were acquired during the year ended 31 March 2007. The cost thereof had been allowed as a deduction.	
3. Gain on the disposal of certificates of deposit comprised the following:	\$
US dollar certificates of deposit (through a stockbroker in the US)	15,000
HK dollar certificates of deposit	54,000
	<u>69,000</u>
4. Tax paid comprised the following:	\$
Salaries tax paid for a director	35,000
Property tax paid on director's quarters owned by the company for the year of assessment 2007/08	5,000
	<u>40,000</u>
5. Bad debts provision comprised the following:	\$
Trade debts written off	35,000
Increase in general provision	9,000
Increase in specific provision (untraceable debtors)	7,000
	<u>51,000</u>
Less: debts (previously written off) recovered	8,000
	<u>43,000</u>

6. Contribution to a recognised occupational retirement scheme comprised the following:	\$
Ordinary annual contribution (5% of staff salaries)	35,000
Special contribution in one lump sum	100,000
	<u>135,000</u>

7. The trade mark was purchased on 25 February 2008. The company plans to launch a new product with this trade mark in August 2008.
8. The lease was in respect of the company's office premises. The lease period is 20 years from 2006/07. A premium of \$150,000 is payable in three equal annual instalments from 2006/07.
9. The Inland Revenue Department has agreed the share of loss transferred to the company as \$45,000.

Other information

1. It has been 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 2007/08 is \$97,215.
2. Other items of income and expenditure not shown above need no adjustment for tax purposes.

Required:

(a) Compute the profits tax payable by Fat Tat Trading Co Ltd for the year of assessment 2007/08.

Note: you should ignore provisional tax. (17 marks)

(b) Explain fully, in relation to profits tax, the deductibility of:

(i) bad and doubtful debts; and (4 marks)

(ii) contributions made by an employer under a recognised retirement scheme for employees. (5 marks)

(26 marks)

4 Mrs Wan inherited a machines hiring business from her deceased father's estate on 1 April 2006 together with the following business assets:

Assets	Tax written down	Original cost	Book value
	value as at		as at
	31 March 2006		31 March 2006
	\$	\$	\$
20% pool:			
Furniture	40,000	80,000	30,000
15 air-conditioning units	20,000	50,000	30,000
30% pool:			
100 sewing machines	70,000	200,000	90,000
Other machines	250,000	600,000	350,000

During the period from 1 April 2006 to 31 March 2008, Mr Wan had the following transactions in respect of plant and machinery:

Date	Transactions
20 October 2006	Purchased a lorry under the following hire-purchase terms: Cash price \$150,000 Down payment \$50,000 Monthly instalment \$12,000 (Commencing from 1 November 2006 for ten months). The interest element for each instalment is \$2,000.
31 December 2006	Replaced loose tools for \$4,000.
18 March 2007	Paid in cash for 200 cutting machines at \$1,600 each. These machines were delivered to the business for use on 8 April 2007.
30 March 2007	Sold five air-conditioning units for \$250 in total.
10 June 2007	A computer was brought into business use by Mrs Wan who had originally purchased it for private use on 1 April 2005 for \$30,000.
1 July 2007	Purchased new furniture for \$80,000 in cash.
1 August 2007	Purchased a yacht under the following hire-purchase terms: Cash price \$250,000 Down payment \$150,000 Monthly instalment \$23,000 (Commencing from 1 September 2007 for five months). The interest element for each instalment is \$3,000. The yacht is partly used by Mrs Wan for her personal purposes. The extent of such use is 80%.
1 September 2007	Sold the 100 sewing machines inherited from her father for \$32,000
1 September 2007	Purchased for cash 200 auto-sewing machines at \$4,000 each.
31 December 2007	Replaced loose tools for \$5,000.
31 March 2008	Sold the yacht bought in August 2007 for \$200,000.

The accounts of the business are made up to 31 March annually.

Required:

Compute the depreciation allowances claimable by Mrs Wan's business for each of the years of assessment 2006/07 and 2007/08.

(24 marks)

End of Question Paper