



Hong Kong Institute of
Accredited Accounting Technicians
香港財務會計協會

Accredited Accounting Technician Examination

Pilot Examination Paper

Paper 5 Principles of Taxation

Questions & Answers Booklet

The Suggested Answers given in this booklet are purposely made to give more details for educational purpose.

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Paper 5 Principles of Taxation

Time allowed – 3 hours

Section A: Multiple-choice Questions – Attempt all 15 Questions

Section B: Compulsory Question – Attempt the Question

Section C: Optional Questions – Attempt any 2 out of 3 Questions

**DO NOT OPEN THIS QUESTION PAPER UNTIL
INSTRUCTED TO DO SO BY THE SUPERVISOR**

Table A: Personal allowances and deductions

| | Year of assessment | |
|--|--------------------|---------|
| | 2006/07 | 2007/08 |
| | \$ | \$ |
| Personal allowances | | |
| Basic | 100,000 | 100,000 |
| Married person's | 200,000 | 200,000 |
| Single parent | 100,000 | 100,000 |
| <u>Child</u> | | |
| 1 st to 9 th child (each) | 40,000 | 50,000 |
| Additional allowance in the year of birth (each) | 0 | 50,000 |
| <u>Dependent parent/grandparent</u> | | |
| Basic | 30,000 | 30,000 |
| Additional (for dependant residing with taxpayer) | 30,000 | 30,000 |
| <u>Dependent parent/grandparent (aged 55-59)</u> | | |
| Basic | 15,000 | 15,000 |
| Additional (for dependant residing with taxpayer) | 15,000 | 15,000 |
| <u>Dependent brother/sister</u> | | |
| | 30,000 | 30,000 |
| <u>Disabled dependant</u> | | |
| | 60,000 | 60,000 |
| Deductions | | |
| Self-education expenses | 40,000 | 60,000 |
| Home loan interest | 100,000 | 100,000 |
| Elderly residential care expenses | 60,000 | 60,000 |
| Contribution to recognised retirement scheme | 12,000 | 12,000 |
| Approved charitable donations | 25% | 25% |
| Depreciation allowance | | |
| Plant and machinery: IA | 60% | 60% |
| AA | Given in question | |
| Industrial building: IA | 20% | 20% |
| AA | 4% | 4% |
| Commercial building: AA (also apply to 2003/04 to 2005/06) | 4% | 4% |

Table B: Tax rates

| Year of assessment | | | |
|----------------------------|------|----------------------|------|
| 2006/07* | | 2007/08** | |
| | % | | % |
| Salaries tax | | Salaries tax | |
| <u>Standard</u> | 16.0 | <u>Standard</u> | 16.0 |
| <u>Progressive</u> | | <u>Progressive</u> | |
| \$1 - \$30,000 | 2.0 | \$1 - \$35,000 | 2.0 |
| \$30,001 - \$60,000 | 7.0 | \$35,001 - \$70,000 | 7.0 |
| \$60,001 - \$90,000 | 13.0 | \$70,001 - \$105,000 | 12.0 |
| above \$90,000 | 19.0 | above \$105,000 | 17.0 |
| Corporation profits | 17.5 | | 17.5 |

* 50% of salaries tax or tax under personal assessment will be waived, subject to a maximum of \$15,000.

**75% of salaries tax, profits tax, property tax or tax under personal assessment will be waived, subject to a maximum of \$25,000.

SECTION A (MULTIPLE-CHOICE QUESTIONS) (20 marks)

Answer **ALL** questions in this section. Choose the best answer for each question.
Marks will not be deducted for incorrect answers.

(Questions A1 to A10 carry 1 mark each. Total: 10 marks)

A1. Which of the following is **NOT** a direct tax?

- A Salaries tax.
- B Property tax.
- C Air Passenger Departure Tax.
- D Profits tax.

A2. On 1 May 2007, Mrs Chu gave birth to two children (twin brothers). Mr Chu is employed and Mrs Chu is a housewife. They have no other dependants. What is the total amount of allowance that will be granted to Mr Chu in respect of the two new born children for the year of assessment 2007/08?

- A \$50,000.
- B \$100,000.
- C \$150,000.
- D \$200,000.

A3. Which of the following is **NOT** a characteristic of the Hong Kong tax system?

- A Low tax rates.
- B Mandatory total income tax.
- C Territorial source concept.
- D No capital gains tax.

A4. Which of the following is **NOT** a requirement for a valid appeal against the Commissioner of Inland Revenue's determination?

- A The notice of appeal must be addressed to the clerk to the Board of Review.
- B The tax demanded in the notice of assessment must be settled.
- C The appeal must be made within one month of the date of the Commissioner's determination.
- D A statement of the grounds of appeal must be attached with the notice of appeal.

A5. The chairman of the Board of Inland Revenue is:

- A The Financial Secretary.
- B The Commissioner of Inland Revenue.
- C The Chief Executive.
- D The Secretary for Justice.

- A6.** Which of the following factor(s) is/are to be considered in determining the locality of employment under salaries tax as stated in DIPN 10?
- (1) the place where the contract of employment is negotiated, entered into and enforceable
 - (2) the places where the services are rendered
 - (3) the place of the employer's residence
 - (4) the place where the remuneration is paid to the employee
- A (1) only.
B (1) and (2).
C (1), (2) and (3).
D (1), (3) and (4).
- A7.** Which of the following paid by the landlord MAY be deducted from the assessable value under property tax?
- A Rates.
B Mortgage loan interest.
C Repairs.
D Agency's commission.
- A8.** Which of the following is **NOT** included as a consideration for property tax purpose?
- A Rent.
B Non-refundable deposit.
C Service charges paid to the owner.
D Rates agreed to be paid by the tenant.
- A9.** Which of the following is **NOT** included in the meaning of "business" for the purposes of the Inland Revenue Ordinance?
- A Poultry and pig rearing.
B Letting of premises by a corporation.
C Letting of premises by an individual.
D Agricultural undertaking.
- A10.** In determining the source of interest income of a non-financial institution chargeable to profits tax, which of the following is adopted?
- A Provision of credit test.
B Contract effected test.
C Place of business conducted by the recipient.
D Place of business conducted by the payer.

(Questions A11 to A15 carry 2 marks each. Total: 10 marks)

A11. Mr Sin owns a property in Wanchai and he lets it to Mr Lee at a monthly rent of \$20,000. Both parties agreed that Mr Sin is responsible for the payment of rates. During the year ended 31 March 2008, Mr Sin paid rates of \$3,000. Starting from 1 February 2008, Mr Lee was unable to pay the rent and he paid the outstanding rent on 15 May 2008. The net assessable value of Mr Sin's property for the year of assessment 2007/08 is:

- A \$192,000.
- B \$189,600.
- C \$160,000.
- D \$157,600.

A12. Mr Au retired on 31 December 2007 after working in a Hong Kong company for 25 years. He received a gratuity of \$120,000 from his employer on 31 January 2008. Mr Au applied to have the gratuity related back. The amount of gratuity to be included in the year of assessment 2007/08 is:

- A \$30,000.
- B \$33,333.
- C \$40,000.
- D \$90,000.

A13. Mr Kim is employed by a company in Korea. It is accepted that the locality of his employment is outside Hong Kong. During the year ended 31 March 2008, he visited Hong Kong for 95 days, which included 58 days of rendering services. During the year ended 31 March 2008, he received total emoluments of \$1,281,000 from his employer. The amount of income assessable to Hong Kong salaries tax for the year of assessment 2007/08 is:

- A \$0.
- B \$332,500.
- C \$333,410.
- D \$640,500.

A14. Mr Wong carries on a business in Hong Kong. During the year ended 31 March 2008, he purchased the following assets (AA:30%) for his business use:

Motor car: \$160,000
Computer: \$50,000

There is no balance brought forward in the 30% pool from the previous year of assessment. The total amount of deduction available to Mr Wong in respect of the above two assets for the year of assessment 2007/08 is:

- A \$115,200.
- B \$151,200.
- C \$165,200.
- D \$210,000.

A15. Over Ltd commenced business on 1 June 2007 and prepared its first set of accounts to 30 November 2008. Its adjusted profits for the 18 months from 1 June 2007 to 30 November 2008 are \$450,000. The assessable profit of Over Ltd for the year of assessment 2007/08 is:

- A \$450,000.
- B \$300,000.
- C \$250,000.
- D \$150,000.

(Total: 20 marks)

[END OF SECTION A]

SECTION B (COMPULSORY QUESTION) (30 marks)

Answer **THE** question in this section. Marks are indicated at the end of the question.

- B1.** AB Ltd is incorporated and has been carrying on the trading of metals in Hong Kong for many years. It has two directors – Mr and Mrs Wong. It closes its accounts to 31 December each year. Its profit and loss account for the year ended 31 December 2007 is as follows:

| | \$ | \$ |
|---|----------------|-----------------------|
| Gross profit | | 9,360,000 |
| Profit on sale of motor car (Note 1) | | 30,000 |
| Compensation received (Note 2) | | 150,000 |
| Interest received (Note 3) | | <u>100,000</u> |
| | | 9,640,000 |
| Less: Salaries and allowances (Note 4) | 3,820,000 | |
| Director's quarters expenses (Note 5) | 373,000 | |
| Rent and rates (Note 6) | 420,000 | |
| Bad debts (Note 7) | 147,000 | |
| Interest paid (Note 8) | 382,000 | |
| Advertising | 610,000 | |
| Water & electricity | 19,200 | |
| Tax paid (Note 9) | 550,000 | |
| Telephone charges | 81,000 | |
| Freight charges | 196,000 | |
| Contributions to recognised retirement scheme (Note 10) | 466,000 | |
| Printing & stationery | 171,000 | |
| Motor vehicles expenses (Note 11) | 123,000 | |
| Donations (Note 12) | 570,000 | |
| Depreciation | 325,000 | |
| Sundry expenses (Note 13) | <u>800,000</u> | <u>9,053,200</u> |
| Net profit | | <u><u>586,800</u></u> |

| Notes: | | \$ |
|--------------------------------|--|----------------|
| (1) Cost of motor car | | 120,000 |
| Less: Accumulated depreciation | | <u>100,000</u> |
| | | 20,000 |
| Less: Sale proceeds | | <u>50,000</u> |
| | | <u>30,000</u> |

| | | |
|---|--|----------------|
| (2) Compensation for the cancellation of a purchase order from a supplier | | 50,000 |
| Compensation for the cancellation of contract by a property vendor | | <u>100,000</u> |
| | | <u>150,000</u> |

AB Ltd intended to purchase office premises for its own use.
 After placing the deposit, the vendor declined to sell the property and paid the compensation.

| | | |
|--|--|----------------|
| (3) Interest on deposits placed with a bank in New York | | 60,000 |
| Interest on fixed deposits placed with a bank in Hong Kong | | <u>40,000</u> |
| | | <u>100,000</u> |

| | | | |
|------|---|----------------|--|
| (4) | Director's emoluments | | 1,000,000 |
| | Staff salaries | | <u>2,820,000</u> |
| | | | <u>3,820,000</u> |
| | Only Mr Wong drew director's emoluments. | | |
| (5) | Rent for directors' quarters | | 360,000 |
| | Rates | | <u>13,000</u> |
| | | | <u>373,000</u> |
| | The rent is paid to the company's subsidiary in Hong Kong. | | |
| (6) | Rent for office premises | | 396,000 |
| | Rates for office premises | | <u>24,000</u> |
| | | | <u>420,000</u> |
| (7) | Bad debts | | |
| | | \$ | \$ |
| | Trade debts written off | 110,000 | Loan to shareholder recovered 43,000 |
| | Loan to staff written off | <u>80,000</u> | Profit and loss account <u>147,000</u> |
| | | <u>190,000</u> | <u>190,000</u> |
| (8) | Bank overdraft Interest to Bank A in Hong Kong | | 300,000 |
| | Interest on Loan B from Bank B in Hong Kong | | <u>82,000</u> |
| | | | <u>382,000</u> |
| | The bank overdraft facility was secured by Mr Wong's property. Loan B was secured by Mr Wong's fixed deposit placed with Bank B. Mr Wong received tax-free interest of \$35,000 on the deposit. | | |
| (9) | Director's salaries tax | | 290,000 |
| | Company's profits tax | | <u>260,000</u> |
| | | | <u>550,000</u> |
| (10) | Special contribution to the retirement scheme | | 150,000 |
| | Annual contributions – director (\$1,000,000 x 18%) | | 180,000 |
| | Annual contributions – other staff (not exceeding 10% of remuneration) | | <u>136,000</u> |
| | | | <u>466,000</u> |
| (11) | Rent for carpark | | 30,000 |
| | Repairs and licence | | 18,000 |
| | Petroleum | | 70,000 |
| | Fines | | <u>5,000</u> |
| | | | <u>123,000</u> |
| (12) | Cash donations to approved charitable organisations. | | |
| (13) | Renovation of office premises | | 180,000 |
| | Others (all allowable for profits tax purposes) | | <u>620,000</u> |
| | | | <u>800,000</u> |

(14) The tax written down values of plant and machinery brought forward from the year of assessment 2006/07 are as follows:

| | |
|-----------|----------|
| 20% pool: | \$35,000 |
| 30% pool: | \$49,000 |

During the year ended 31 December 2007, the company purchased the following assets:

| | |
|----------------------|-----------|
| Furniture (AA: 20%): | \$200,000 |
| Motor car (AA: 30%): | \$180,000 |
| Computer (AA: 30%): | \$100,000 |

There is no disposal of assets other than the one mentioned in note (1).

REQUIRED:

(a) **Based on the above information, compute the profits tax payable by AB Ltd for the year of assessment 2007/08. Ignore provisional profits tax. All workings must be shown.**

(21 marks)

(b) **Briefly explain the tax treatment of the following items in your profits tax computation:**

- (i) **Compensation received (Note 2)**
- (ii) **Interest paid (Note 8)**

(9 marks)

(Total: 30 marks)

[END OF SECTION B]

SECTION C (OPTIONAL QUESTIONS) (50 marks)

Answer any **TWO** questions only in this section. Each question carries 25 marks.

C1. Mr Fong is employed as an accounting manager of EF Ltd, a company incorporated and carrying on business in Hong Kong. You have been supplied with the following information regarding the year of assessment 2007/08:

- (1) Annual Salary: \$1,500,000
- (2) Bonus: \$300,000
- (3) Mr Fong took a 12-day business trip to Germany and Mrs Fong travelled with him. EF Ltd paid the following expenses in connection with the trip:

| | Mr Fong | Mrs Fong |
|------------------|----------|---------------|
| Air tickets | \$12,000 | \$12,000 |
| Accommodation | \$22,000 | No extra cost |
| Meals | \$25,000 | \$25,000 |
| Sightseeing tour | Nil | \$3,000 |

- (4) On 1 May 2007, he was granted an option to subscribe for 200,000 of EF Ltd's shares at \$3 each within 2 years. He paid \$10,000 for the option on 15 May 2007. He exercised part of the option to purchase 100,000 shares on 1 December 2007. The market values per share were as follows:

| | |
|-----------------|--------|
| 1 May 2007 | \$5 |
| 15 May 2007 | \$6.50 |
| 1 December 2007 | \$8 |
| 31 March 2008 | \$7 |

- (5) Mr Fong rented a flat for his residence at a monthly rent of \$22,000. His employer refunded \$18,000 to him upon production of tenancy agreement and rental receipts. The rateable value of the flat for the year was \$240,000.
- (6) Mr Fong obtained a loan of \$450,000 from his employer to purchase a car for his own use. During the year, he paid interest of \$6,000 to his employer. If he had obtained the loan from a bank, he would have been required to pay interest of \$30,000.
- (7) At the annual dinner held by the employer on 31 December 2007, he won a cash coupon of \$3,000 in the lucky draw.

- (8) Mr and Mrs Fong had paid the following expenses during the year:

| | Mr Fong | Mrs Fong |
|--|---------|----------|
| | \$ | \$ |
| (a) Membership subscriptions to HKICPA | 2,350 | 2,350 |
| (b) Cash donations to approved charitable organisations | 15,000 | 5,000 |
| (c) School fees for a Master's degree programme at The University of Hong Kong | 40,000 | 0 |
| (d) Fees paid to a residential care home for Mr Fong's father who is aged 70 | 70,000 | 0 |

- (9) Mrs Fong is a housewife. The couple have a child aged 12. They are living with Mrs Fong's father and mother who are aged 65 and 58 respectively.

REQUIRED:

- (a) Advise Mr Fong about the conditions under which an individual is entitled to a married person's allowance and if he is entitled to such an allowance.
(5 marks)
- (b) Compute the salaries tax payable by Mr Fong for the year of assessment 2007/08. Ignore provisional salaries tax. All workings must be shown.
(14 marks)
- (c) Briefly explain the tax treatment of the following items under salaries tax:
- (i) Trip expenses paid by the company (item 3)
 - (ii) Loan from employer (item 6)
 - (iii) Cash coupon (item 7)

(6 marks)

(Total: 25 marks)

- C2. (a)** On 15 July 2003, GH Ltd purchased a commercial building from a developer for use as its office in Hong Kong at a cost of \$3,500,000 (40% of the cost was attributable to land costs). GH Ltd incurred decoration expenses of \$300,000 before the premises were put into use. On 1 November 2007, the building was sold to JB Ltd at a price of \$5,000,000 (including land). JB Ltd incurred renovation expenditure of \$500,000 and then used the building as its office.

Both GH Ltd and JB Ltd prepare their accounts to 31 March annually.

REQUIRED:

In respect of the above commercial building, compute the respective commercial building allowances that can be granted to GH Ltd and JB Ltd for the year of assessment 2007/08.

(9 marks)

- (b)** Mr and Mrs Chan are residents of Hong Kong. You have been supplied with the following information for the year ended 31 March 2008:

- (1) Mr and Mrs Chan jointly own a property in Tai Po. The property was let to a tenant at a monthly rent of \$6,000. Rates and management fees were paid by the tenant. The purchase of the property was financed by a mortgage loan with a bank in Hong Kong and Mr and Mrs Chan had paid mortgage loan interest of \$40,000 to the bank.

- (2) Mr Chan is the director and shareholder of a company in Hong Kong and he received the following income from the company:
- | | |
|----------------|-------------|
| Director's fee | \$1,200,000 |
| Dividend | \$480,000 |

- (3) Mrs Chan is a teacher and received total remuneration of \$360,000.

- (4) Mr Chan carries on two businesses in Hong Kong. One is a sole-proprietorship business and the other is a partnership business with the following results:

| | Assessable profit (loss) |
|------------------------------|--------------------------|
| Sole-proprietorship business | \$300,000 |
| Share of partnership loss | (\$550,000) |

- (5) Mrs Chan has a loss of \$190,000 brought forward from the previous year under personal assessment.

- (6) They also had the following expenses during the year:

| | Mr Chan | Mrs Chan |
|---|---------|----------|
| | \$ | \$ |
| (a) Mandatory contributions to MPF scheme | 18,000 | 12,000 |
| (b) Cash donations to approved charitable organisations | 220,000 | 120,000 |

Both Mr and Mrs Chan claimed the donation deduction under salaries tax.

| | Mr Chan | Mrs Chan |
|--|---------|----------|
| (c) Home loan interest for their dwelling. The property is owned by Mrs Chan | | 160,000 |
| (d) Cash given to Mr Chan's mother aged 65 | 40,000 | |
| (e) Fees paid to a residential care home in respect of Mrs Chan's grandfather aged 72 | 66,000 | |
| (7) Mr and Mrs Chan have a child aged 24, who is studying full-time in Hong Kong. | | |

REQUIRED:

- (i) **Advise Mr Chan about the conditions for election for personal assessment as specified under the Inland Revenue Ordinance.**
(4 marks)
- (ii) **Compute the respective tax payable under personal assessment by Mr and Mrs Chan for the year of assessment 2007/08. Show all your workings.**
(12 marks)
- (Total: 25 marks)**

C3. (a) Mr Lo owns a property at North Point. The property was let to Mr Man under the following terms:

- (a) Lease period: 1 October 2005 – 30 September 2007 (24 months)
- (b) Monthly rent: \$25,000 payable in advance at the beginning of each month
- (c) Initial premium: \$120,000
- (d) Management fee: \$1,300 per month payable by the tenant
- (e) Rates: \$3,000 per quarter payable by the tenant
- (f) Government rent: \$1,800 per quarter payable by the tenant.

Starting from 1 July 2007, Mr Man did not pay any rent to Mr Lo. Mr Man moved out of the property upon expiry of the lease and was untraceable. It was discovered that Mr Man also owed management fees for two months and rates and government rent for one quarter. The assessor accepted that the rent was irrecoverable from the time Mr Man moved out from the property.

The property was re-let to Mr Kam on 1 January 2008 under the following terms:

- (a) Lease period: 1 January 2008 – 31 March 2011
- (b) Rent free period: 1 January 2008 – 29 February 2008
- (c) Monthly rent: \$28,000 payable in advance at the beginning of each month
- (d) Initial premium: \$150,000
- (e) Management fee: \$1,300 per month payable by the tenant
- (f) Rates: \$3,000 per quarter payable by the landlord
- (g) Government rent: \$1,800 per quarter payable by the landlord

Mr Lo had the following expenses during the year ended 31 March 2008:

- (a) Rates (1.7.2007 – 31.3.2008): \$9,000
- (b) Government rent (1.7.2007 – 31.3.2008): \$5,400
- (c) Management fee (1.7.2007 – 31.12.2007): \$7,800
- (d) Decoration: \$100,000
- (e) Repairs: \$50,000
- (f) Mortgage loan interest for purchase of the property: \$78,000

REQUIRED:

- (i) **Compute the property tax payable by Mr Lo for the year of assessment 2007/08. Ignore provisional property tax. Show all your workings.**
(9 marks)
- (ii) **Explain to Mr Lo the deductibility of the management fees and rates paid by him during the year ended 31 March 2008.**
(3 marks)
- (iii) **Advise Mr Lo of the obligations of a property owner in Hong Kong under the Inland Revenue Ordinance regarding the keeping of rental records.**
(4 marks)

- (b) Mr Yiu is a resident of Hong Kong and is working in a trading company there. He has recently received a notice of assessment for the year 2007/08 in which the profit on his disposal of a property amounting to \$900,000 was assessed under profits tax. The property was purchased by Mr Yiu on 1 February 2007 and sold on 1 August 2007.

Mr Yiu approaches you for advice.

REQUIRED:

- (i) **List the six badges of trade for Mr Yiu that will be taken into account in considering if a transaction constitutes an adventure in the nature of trade.**
(3 marks)
- (ii) **Advise Mr Yiu the requirements of a valid objection against the assessment as specified under the Inland Revenue Ordinance.**
(6 marks)

(Total: 25 marks)

[END OF EXAMINATION PAPER]

Suggested Answers

Pilot Examination Paper

Paper 5

Principles of Taxation

SECTION A (MULTIPLE-CHOICE QUESTIONS) (20 marks)

(Questions A1 to A10 carry 1 mark each. Total: 10 marks)

- A1. C
- A2. D
- A3. B
- A4. B
- A5. A
- A6. D
- A7. A
- A8. D
- A9. C
- A10. A

(Questions A11 to A15 carry 2 marks each. Total: 10 marks)

- A11. B
- A12. A
- A13. B
- A14. C
- A15. D

(Total: 20 marks)

SECTION B (COMPULSORY QUESTION) (30 marks)

| | | | Marks |
|----------------|---|------------------|-------|
| B1. (a) | AB Ltd | | |
| | Profits tax computation | | |
| | Year of assessment 2007/08 | | |
| | Basis period: year ended 31 December 2007 | | [1] |
| | | \$ | |
| | Net profit per account | 586,800 | [0.5] |
| | Less: Profit on sale of motor car | 30,000 | [0.5] |
| | Compensation received | 100,000 | [1] |
| | Bank interest received \$(60,000 + 40,000) | 100,000 | [1] |
| | Loan to shareholder recovered | <u>43,000</u> | [0.5] |
| | | <u>273,000</u> | |
| | | 313,800 | |
| | Add: Loan to staff written-off | 80,000 | [0.5] |
| | Interest on Loan B | 35,000 | [0.5] |
| | Profits tax paid | 260,000 | [0.5] |
| | Special contributions to retirement scheme (\$150,000 x 4/5) | 120,000 | [1] |
| | Annual contributions for director (\$1,000,000 x (18 – 15)%) | 30,000 | [1] |
| | Fines | 5,000 | [0.5] |
| | Donations | 570,000 | [0.5] |
| | Renovation expenditure of office premises (\$180,000 x 4/5) | 144,000 | [1] |
| | Depreciation | <u>325,000</u> | [0.5] |
| | | 1,882,800 | |
| | Less: Depreciation allowances | 272,300 | [0.5] |
| | Prescribed fixed asset | <u>100,000</u> | [1] |
| | | 1,510,500 | |
| | Less: Approved charitable donations (\$1,510,500 x 25%) | 377,625 | [1] |
| | Assessable profit | <u>1,132,875</u> | [1] |
| | Tax payable @ 17.5% | 198,253 | [1] |
| | Less: Tax waived | <u>25,000</u> | [0.5] |
| | Profits tax payable | <u>173,253</u> | |

| | Depreciation allowance | | | | Total | |
|-------------------------|------------------------|----------------|----------------|-----------------|----------------|-------|
| | \$ | 20% pool \$ | \$ | 30% pool \$ | | |
| WDV b/f | | 35,000 | | 49,000 | | [1] |
| Additions | 200,000 | | 180,000 | | | [1] |
| Initial allowance – 60% | <u>120,000</u> | <u>80,000</u> | <u>108,000</u> | <u>72,000</u> | 228,000 | [1] |
| | | 115,000 | | 121,000 | | |
| Sale proceeds | | | | <u>(50,000)</u> | | [1] |
| | | | | 71,000 | | |
| Annual allowance | | <u>23,000</u> | | <u>21,300</u> | <u>44,300</u> | [1] |
| WDV c/f | | <u>92,000</u> | | <u>49,700</u> | <u>272,300</u> | [0.5] |

(21 marks)

- | | | Marks |
|------------|--|--|
| (b) | (i) <i>Compensation for the cancellation of a purchase order from a supplier</i> As the purchase order is a trading contract, the compensation received in lieu of trading receipts is revenue in nature and hence the compensation is taxable. | [1] |
| | <i>Compensation for the cancellation of a contract by a property vendor</i> The transaction involves the purchase of office premises, which is capital in nature and therefore any compensation received is also capital in nature. The compensation is not taxable. | [1] |
| | (ii) <i>Bank overdraft interest to Bank A</i> It is considered that the interest is incurred for the purpose of business and hence section 16(1)(a) is satisfied. The overdraft facility is paid to the bank and is only secured by a director's property, section 16(2)(d) is satisfied and no restriction is required by section 16(2A) or section 16(2B). Hence, the interest paid is wholly deductible. | [1] [1] [1] |
| | <i>Interest on Loan B</i> It is considered that the interest is incurred for the purpose of business and hence section 16(1)(a) is satisfied. Although the interest is paid to a bank and it satisfies section 16(2)(d), the loan is secured by a director's fixed deposit, which generates tax-free interest. Therefore, section 16(2A) applies and the interest deduction is to be reduced on a reasonable basis. Generally, the amount of non-deductible interest is restricted to the amount of tax-free interest (DIPN 13A). | [1] [1] [1] [1] |

(9 marks)

(Total: 30 marks)

SECTION C (OPTIONAL QUESTIONS) (50 marks)

- | | | Marks |
|----------------|---|-------|
| C1. (a) | A married person's allowance is granted to an individual who is, at any time during the year, married, and | [1] |
| | (i) whose spouse has no income chargeable to salaries tax in that year; | [1] |
| | or | |
| | (ii) the individual and his or her spouse have elected for joint assessment to salaries tax for that year; or | [1] |
| | (iii) who has validly elected personal assessment for that year. | [1] |

Since Mrs Fong is a housewife and has no income chargeable to salaries tax for the year of assessment 2007/08, Mr Fong is entitled to married person's allowance. [1]

(5 marks)

(b)

| Mr Fong Salaries tax Year of assessment 2007/08 | | \$ | \$ | |
|--|---------------|----|------------------|-------|
| Salary | | | 1,500,000 | [0.5] |
| Bonus | | | 300,000 | [0.5] |
| Holiday journey benefit \$(12,000 + 25,000 + 3,000) | | | 40,000 | [2] |
| Share option gain \$(8 – 3) x 100,000 – \$10,000 x 1/2 | | | <u>495,000</u> | [2] |
| | | | 2,335,000 | |
| Rental value \$(2,335,000 – 495,000 – 2,350) x 10% | 183,765 | | | [1] |
| Less: Rent suffered \$(22,000 – 18,000) x 12 | <u>48,000</u> | | <u>135,765</u> | [1] |
| | | | 2,470,765 | |
| Less: Subscription | 2,350 | | | [0.5] |
| Self-education expense | <u>40,000</u> | | <u>42,350</u> | [0.5] |
| Net assessable income | | | 2,428,415 | |
| Less: Concessionary deductions | | | | |
| Approved charitable donations | 20,000 | | | [1] |
| \$(15,000 + 5,000) | | | | |
| Elderly residential care expense | <u>60,000</u> | | <u>80,000</u> | [0.5] |
| | | | 2,348,415 | |
| Less: Married person's allowance | 200,000 | | | |
| Child allowance | 50,000 | | | |
| Dependent parent allowance | 45,000 | | | |
| \$(30,000 + 15,000) | | | | |
| Additional dependent parent allowance | <u>45,000</u> | | <u>340,000</u> | [2] |
| Net chargeable income | | | <u>2,008,415</u> | |
| Salaries tax payable at progressive tax rates: | | | | |
| \$(2,008,415 – 105,000) x 17% + \$7,350 | | | <u>330,930</u> | [1] |
| Limitation test: \$2,348,415 x 16% | | | <u>375,746</u> | [1] |
| Tax payable | | | 330,930 | |
| Less: Tax waived | | | <u>25,000</u> | [0.5] |
| Salaries tax payable | | | <u>305,930</u> | |

(14 marks)

| | Marks |
|--|--|
| (c) | |
| (i) <i>Trip expenses paid by the company</i> The trip taken by Mr Fong is on business trip and not taxable as it is not a holiday travel. However, the trip taken by Mrs Fong is a holiday travel and so the amount spent by the company in connection with her journey is taxable. As no extra cost is incurred on the accommodation, no taxable benefit arises. | [1] [1] [1] |
| (ii) <i>Loan from employer</i> The benefit obtained from the low interest loan provided by Mr Fong's employer is not chargeable as the benefit obtained is not convertible into cash. The interest paid to his employer is not deductible as it is private in nature. | [1] [1] |
| (iii) <i>Cash coupon</i> As the cash coupon is not received by reason of Mr Fong's employment or services rendered, it is not taxable. | [1] |
| | (6 marks) |
| | (Total: 25 marks) |

| | | Marks |
|----------------|--|----------------------|
| C2. (a) | GH Ltd Year of assessment 2007/08 Commercial building allowance | |
| | \$ | |
| | Qualifying expenditure (\$3,500,000 x 60%) | 2,100,000 [1] |
| | Addition (decoration expenses) | <u>300,000</u> [0.5] |
| | | 2,400,000 |
| | Annual allowance for 2003/04 to 2006/07 (\$2,400,000 x 4% x 4) | <u>384,000</u> [1] |
| | Residue expenditure before sale | 2,016,000 |
| | Less: Sales proceeds (\$5,000,000 x 60%) | <u>3,000,000</u> [1] |
| | Balancing charge | <u>984,000</u> |
| | Restricted to allowances given | <u>384,000</u> [0.5] |
| | JB Ltd Year of assessment 2007/08 Commercial building allowance | |
| | Year of first use of commercial building | 2003/04 [0.5] |
| | 25 th year after 2003/04 | 2028/29 [0.5] |
| | Year of first use by JB Ltd | 2007/08 [0.5] |
| | No. of years from 2007/08 to 2028/29 | 22 years [0.5] |
| | Residue of expenditure before sale | 2,016,000 [0.5] |
| | Balancing charge | <u>384,000</u> [0.5] |
| | | 2,400,000 |
| | Addition | <u>500,000</u> |
| | | 2,900,000 |
| | Less: Annual allowance on original building (\$2,400,000 x 1/22) | 109,091 [1] |
| | Annual allowance on addition (\$500,000 x 4%) | <u>20,000</u> [1] |
| | WDV c/f | <u>2,770,909</u> |
| | | (9 marks) |
| (b) | (i) An election for personal assessment must be: | |
| | (a) made in writing; and | [1] |
| | (b) lodged with the Commissioner of Inland Revenue not later than: | |
| | (1) two years after the end of the year of assessment in respect of which the election is made, | [1] |
| | (2) one month after an assessment of any income or profit which forms part of the total income for such year of assessment becomes final and conclusive under section 70, or | [1] |
| | (3) such further period as the Commissioner of Inland Revenue may allow. | [1] |
| | | (4 marks) |

| | Mr and Mrs Chan | | | Marks |
|--|----------------------------|------------------|----------------|-------|
| (ii) | Personal assessment | | | |
| | Year of assessment 2007/08 | | | |
| | Mr Chan | Mrs Chan | Joint | |
| | \$ | \$ | \$ | |
| Net assessable value (\$6,000 x 12 x 0.8 x 1/2) | 28,800 | 28,800 | | [1] |
| Net assessable income | 1,200,000 | 360,000 | | [1] |
| Assessable profit | <u>300,000</u> | <u>0</u> | | [0.5] |
| | 1,528,800 | 388,800 | | |
| Less: Mortgage loan interest | <u>20,000</u> | <u>20,000</u> | | [1] |
| | 1,508,800 | 368,800 | | |
| Less: Concessionary deductions | | | | |
| Approved charitable donations (working) | 247,800 | 92,200 | | [1] |
| MPF contributions | 12,000 | 12,000 | | [1] |
| Home loan interest | 0 | 100,000 | | [0.5] |
| Elderly residential care expense | <u>60,000</u> | <u>0</u> | | [0.5] |
| | 1,189,000 | 164,600 | | |
| Less: Share of partnership loss/loss b/f | <u>(550,000)</u> | <u>(190,000)</u> | | [1] |
| | 639,000 | (25,400) | | |
| Inter-spouse loss set-off | <u>(25,400)</u> | <u>25,400</u> | | [1] |
| | <u>613,600</u> | <u>0</u> | 613,600 | |
| Less: Married person's allowance | | 200,000 | | |
| Child allowance | | 50,000 | | |
| Dependent parent allowance | | <u>30,000</u> | <u>280,000</u> | [1.5] |
| Reduced total income after personal allowances | | | <u>333,600</u> | |
| Tax payable at progressive rates: | | | | |
| \$(333,600 – 105,000) x 17% + \$7,350 | | | <u>46,212</u> | [1] |
| Limitation test: \$613,600 x 16% | | | <u>98,176</u> | [0.5] |
| Tax payable | | | 46,212 | |
| Less: Tax waived | | | <u>25,000</u> | [0.5] |
| Tax payable under personal assessment by Mr Chan | | | <u>21,212</u> | |

(12 marks)

Working:

Mrs Chan:

$$\$368,800 \times 25\% = 92,200$$

$$\text{Donations transferred to Mr Chan: } \$120,000 - \$92,200 = \$27,800$$

Mr Chan:

Total donations available for deduction:

$$\$220,000 + \$27,800 = \$247,800 \text{ (less than 25\% on } \$1,508,800)$$

(Total: 25 marks)

| | | Marks |
|--------------|--|-----------------------|
| C3. | Mr Lo Property tax Year of assessment 2007/08 | |
| (a) | | |
| (i) | \$ | |
| | Rent receivable: | |
| | 1.4.2007 – 30.9.2007 (\$25,000 x 6) | 150,000 [1] |
| | 1.3.2008 – 31.3.2008 (\$28,000 x 1) | 28,000 [1] |
| | Premium \$120,000 x 6/24 + \$150,000 x 3/36 | <u>42,500</u> [2] |
| | | 220,500 |
| | Less: Irrecoverable rent (\$25,000 x 3) | <u>75,000</u> [1] |
| | | 145,500 |
| | Less: Rates (\$9,000 x 1/3) | <u>3,000</u> [1] |
| | | 142,500 |
| | Less: 20% statutory deduction | <u>28,500</u> [1] |
| | Net assessable value | <u>114,000</u> [1] |
| | Tax payable @16% | 18,240 [0.5] |
| | Less: Tax waived (75% on \$18,240) | <u>13,680</u> [0.5] |
| | Property tax payable | <u>4,560</u> |
| | | (9 marks) |
| (ii) | Under property tax, only the following items can be deducted from the assessable value: | |
| | (a) irrecoverable rent; | |
| | (b) rates agreed to be paid by the landlord; and | |
| | (c) an allowance for repairs and outgoings of 20% of the assessable value after deduction of rates and irrecoverable bad debts, if any. | |
| | As such, no deduction of management fee paid by Mr Lo is available under property tax. For the payment of rates, it is only agreed with the tenant that the rates for the period from 1.1.2008 to 31.3.2008 is payable by Mr Lo. Only the rates paid by him for this period is deductible. Other rates paid by him are not deductible. | [1] [1] [1] |
| | | (3 marks) |
| (iii) | Section 51D of the Inland Revenue Ordinance provides that any person who is the owner of land and/or buildings situated in Hong Kong is required: | |
| | (a) to keep sufficient records in English or Chinese of the rental income to enable the assessable value of that land and/or buildings to be readily ascertained, and | [1] |
| | (b) to retain such records for a period of not less than seven years after the completion of the transactions, acts or operations to which they relate. | [1] |
| | The preservation of the above records is not required if: | |
| | (a) the Commissioner of Inland Revenue has specified that such rental records need not be preserved, or | [1] |
| | (b) the corporation that was the owner of the property has been dissolved. | [1] |
| | | (4 marks) |

- | | | Marks |
|------------|-------------|--|
| (b) | (i) | The six badges of trade which are considered to be relevant factors in determining whether a particular activity or a series of transactions constitutes trading are: (a) Subject matter of the realization; [0.5] (b) Length of the period of ownership; [0.5] (c) Frequency or number of similar transactions by the same person; [0.5] (d) Supplementary work on, or in connection with, the property realized; [0.5] (e) Circumstances responsible for the realization; and [0.5] (f) Profit seeking motive. [0.5] |
| | | (3 marks) |
| | (ii) | Under section 64 of the Inland Revenue Ordinance, the requirements of a valid objection are: (a) the notice of objection must be in writing; [1] (b) the notice of objection must be received by the Commissioner of Inland Revenue within one month after the date of issue of the notice of assessment; [1] (c) the notice of objection must state precisely the grounds of objection; and [1] (d) in the case of an estimated assessment raised in the absence of a return, a properly completed return must be submitted with the notice of objection or within such further period as the Commissioner of Inland Revenue may allow. [1] |
| | | However, if the person is prevented from giving the notice of objection within the one month period because: (a) he was absent from Hong Kong, [0.5] (b) he was sick, or [0.5] (c) of any other reasonable cause, [0.5] the Commissioner may extend the one month limit for lodging an objection as may be reasonable in the circumstance. [0.5] |
| | | (6 marks) |
| | | (Total: 25 marks) |

[END OF SUGGESTED ANSWERS]