THE TAXATION INSTITUTE OF HONG KONG

CTA QUALIFYING EXAMINATION PILOT PAPER

PAPER 2 – HONG KONG TAX

NOTE

This Pilot Paper intends to let candidates have an idea of the depth and breadth of the topics to be examined. The length of computational questions in the public examination should likely be confined to 2 printed pages for a 16-mark question and 4 printed pages for a 36-mark question. The answers provided are very detailed and are meant to help candidates have a better understanding of the answers. Candidates are not expected to produce such detailed answers in a three-hour examination.

TAX RATES AND ALLOWANCES

Personal Allowances for 2008/09 (Salaries Tax and Personal Assessment)

	HK$	
Basic allowance	$108,000	
Married person's allowance	$216,000	
Child allowance: First – ninth child	$50,000	EACH
Child allowance – additional (for child born during the year)	$50,000	EACH
Dependent parent/grandparent allowance (aged 60 or above OR is eligible to claim an allowance under the Government's Disability Allowance Scheme)	$30,000	EACH
Dependent parent/grandparent allowance (aged 55 or above but below 60)	$15,000	EACH
Additional dependent parent/grandparent allowance (aged 60 or above OR is eligible to claim an allowance under the Government's Disability Allowance Scheme)	$30,000	EACH
Additional dependent parent/grandparent allowance (aged 55 or above but below 60)	$15,000	EACH
Single parent allowance	$108,000	
Disabled dependant allowance	$60,000	EACH
Dependent brother or dependent sister allowance	$30,000	EACH

Personal Allowances for 2007/08 (Salaries Tax and Personal Assessment)

	HK$	
Basic allowance	$100,000	
Married person's allowance	$200,000	
Child allowance: First – ninth child	$50,000	EACH
Child allowance – additional (for child born during the year)	$50,000	EACH
Dependent parent/grandparent allowance (aged 60 or above OR is eligible to claim an allowance under the Government's Disability Allowance Scheme)	$30,000	EACH
Dependent parent/grandparent allowance (aged 55 or above but below 60)	$15,000	EACH
Additional dependent parent/grandparent allowance (aged 60 or above OR is eligible to claim an allowance under the Government's Disability Allowance Scheme)	$30,000	EACH
Additional dependent parent/grandparent allowance (aged 55 or above but below 60)	$15,000	EACH
Single parent allowance	$100,000	
Disabled dependant allowance	$60,000	EACH
Dependent brother or dependent sister allowance	$30,000	EACH

Personal Allowances for 2006/07 and 2005/06 (Salaries Tax and Personal Assessment)

	HK$	
Basic allowance	$100,000	
Married person's allowance	$200,000	
Child allowance: First – ninth child	$40,000	EACH
Dependent parent/grandparent allowance (aged 60 or above OR is eligible to claim an allowance under the Government's Disability Allowance Scheme)	$30,000	EACH
Dependent parent/grandparent allowance (aged 55 or above but below 60)	$15,000	EACH
Additional dependent parent/grandparent allowance (aged 60 or above OR is eligible to claim an allowance under the Government's Disability Allowance Scheme)	$30,000	EACH
Additional dependent parent/grandparent allowance (aged 55 or above but below 60)	$15,000	EACH
Single parent allowance	$100,000	
Disabled dependant allowance	$60,000	EACH
Dependent brother or dependent sister allowance	$30,000	EACH

Tax rates (2008/09)

Standard Rate (Property Tax, Salaries Tax and Personal Assessment) 15%

Progressive Rates (Salaries Tax and Personal Assessment)

First $40,000	2%
Next $40,000	7%
Next $40,000	12%
Remainder	17%

Tax rates (2007/08)

Standard Rate (Property Tax, Salaries Tax and Personal Assessment) 16%

Progressive Rates (Salaries Tax and Personal Assessment)

First $35,000	2%
Next $35,000	7%
Next $35,000	12%
Remainder	17%

Tax rates (2006/07)

Standard Rate (Property Tax, Salaries Tax and Personal Assessment) 16%

Progressive Rates (Salaries Tax and Personal Assessment)

First $30,000	2%
Next $30,000	7%
Next $30,000	13%
Remainder	19%

Tax rates (2005/06)

Standard Rate (Property Tax, Salaries Tax and Personal Assessment) 16%

Progressive Rates (Salaries Tax and Personal Assessment)

First $30,000	2%
Next $30,000	8%
Next $30,000	14%
Remainder	20%

Deductions (Maximum) (Salaries Tax and Personal Assessment) (2008/09):

	HK$
Self education expenses	60,000
Home loan interest	100,000
Elderly residential care expenses	60,000
Contribution to MPF/MPF-exempted retirement scheme	12,000
Approved charitable donations = maximum of 35% of (assessable income LESS allowable expenses LESS depreciation allowances)	

Deductions (Maximum) (Salaries Tax and Personal Assessment) (2007/08):

	HK$
Self education expenses	60,000
Home loan interest	100,000
Elderly residential care expenses	60,000
Contribution to MPF/MPF-exempted retirement scheme	12,000
Approved charitable donations = maximum of 25% of (assessable income LESS allowable expenses LESS depreciation allowances)	

Deductions (Maximum) (Salaries Tax and Personal Assessment) (2005/06 and 2006/07):

	HK$
Self education expenses	40,000
Home loan interest	100,000
Elderly residential care expenses	60,000
Contribution to MPF/MPF-exempted retirement scheme	12,000
Approved charitable donations = maximum of 25% of (assessable income LESS allowable expenses LESS depreciation allowances)	

100% of salaries tax or tax under personal assessment for the year of assessment **2008/09** will be waived, subject to the maximum of **$8,000**

75% of property tax, profits tax, salaries tax or tax under personal assessment for the year of assessment **2007/08** will be waived, subject to the maximum of **$25,000**

50% of salaries tax or tax under personal assessment for the year of assessment **2006/07** will be waived, subject to the maximum of **$15,000**

Profits Tax Rates (2008/09)

Corporation	16.5%
Unincorporated Business	15.0%

Profits Tax Rates (2007/08, 2006/07 and 2005/06)

Corporation	17.5%
Unincorporated Business	16.0%

Depreciation allowance rates (from 1998/99):

Initial allowance:	
- Industrial building (unused)	20%
- Plant and machinery	60%

Annual allowance:

Industrial/Commercial building (unused)	4%
Plant and machinery:	
- Furniture, office machine	20%
- Motor car, van	30%

Stamp Duty Rates

Head 1

Head 1(1) and Head 1(1A) (11 am, 28 February 2007 to 31 March 2010)

Value of consideration	Rate of stamp duty
$1-$2,000,000	$100
$2,000,001 - 2,351,760	$100 + 10% x (C - $2,000,000)
$2,351,761 - 3,000,000	1.5%
$3,000,001 - 3,290,320	$45,000 + 10% x (C - $3,000,000)
$3,290,321 - 4,000,000	2.25%
$4,000,001 - 4,428,570	$90,000 + 10% x (C - $4,000,000)
$4,428,571 - 6,000,000	3%
$6,000,001 - 6,720,000	$180,000 + 10% x (C - $6,000,000)
More than $6,720,000	3.75%

Note: C = Consideration

Head 1(1) and Head 1(1A) (1 April 2001 – 27 February 2007)

Value of consideration	Rate of stamp duty
$1-$1,000,000	$100
$1,000,001 - 1,080,000	$100 + 10% x (C - $1,000,000)
$1,080,001 - 2,000,000	0.75%
$2,000,001 - 2,176,470	$15,000 + 10% x (C - $2,000,000)
$2,176,471 - 3,000,000	1.5%
$3,000,001 - 3,290,320	$45,000 + 10% x (C - $3,000,000)
$3,290,321 - 4,000,000	2.25%
$4,000,001 - 4,428,570	$90,000 + 10% x (C - $4,000,000)
$4,428,571 - 6,000,000	3%
$6,000,001 - 6,720,000	$180,000 + 10% x (C - $6,000,000)
More than $6,720,000	3.75%

Note: C = Consideration

Head 1(2) (1 April 2001 – Present)

Premium	same as under Head 1(1)
Rent: lease with uncertain term	0.25% of annual rent
lease with term of less than 1 year	0.25% of total rent
lease with term of 1 year to 3 years	0.5% of annual rent
lease with term of more than 3 years	1% of annual rent

Head 2 (1 April 2001 – present)

Head 2(1)	0.1% of the consideration
Head 2(2)	$5
Head 2(3)	$5 + 0.2% of the consideration
Head 2(4)	$5

Head 3 (1 April 2001 – present)

Head 3(1)	3% of market value
Head 3(2)	$5

Head 4 (1 April 2001 – present) $5

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QUESTIONS

The examination paper has 2 parts.

Part A contains ONE compulsory question carrying 36 marks.

Part B has five questions, each carrying 16 marks and candidates are expected to answer any FOUR of these five questions. Maximum score for Part B is 64 marks.

Part A – ONE compulsory question

Question 1 (36 marks)

Platinum Limited is engaged in the retailing of computer equipment. It closes its accounts annually on 30 April. Extracted below are the accounting data of the company during the year ended 30 April 2008:

Income	Note	HK$	HK$
Gross profit from sales		4,950,000	
Income from leasing computers		50,000	
Interest income	1	250,000	
Rental income	2	360,000	5,610,000
Expenditure			
Salaries and wages		840,000	
Rent and rates		490,000	
Retirement fund	3	150,000	
Depreciation charge		450,000	
Bank interests	4	180,000	
Bad debts provisions	5	10,000	
Legal and professional fee	6	90,000	
Repairs and maintenance		40,000	
Miscellaneous expenses	7	150,000	
Donations	8	15,000	
			2,415,000
Net profit for the year			3,195,000

Explanatory Notes:

1.

	HK$
Interest on HK$ savings account with Hang Seng Bank's branch in Wanchai	238,000
Interest on HK$ savings account with Bank of China, Shenzhen Branch	2,000
Interest paid by a US customer on its overdue accounts balance with the company	10,000
Total per accounts	250,000

2. Rental income received in respect of two properties located in:

	HK$
Hong Kong	240,000
Shenzhen	120,000
Total per accounts	360,000

3.

	HK$
Ordinary annual contribution to recognized scheme (10% of individual staff's salaries)	80,000
Payment for special contribution to recognized scheme	70,000
Total per accounts	150,000

4.

	HK$
Interest on bank overdraft for daily operation of the company, secured by the personal guarantee of a director	40,000
Interest on loan for the company's operations, due to a corporate shareholder carrying on business in Hong Kong	50,000
Interests on mortgage loans from Bank of China for acquiring the rental properties in:	
Hong Kong	60,000
Shenzhen	30,000
Total per accounts	180,000

5.

	HK$
Provision b/f - 3% on total debtors' balance	(8,000)
- on identified debtors	(30,000)
Bad debts written off (trade debts)	10,000
Staff loan written off	15,000
Bad debts recovered (trade debts written off in prior years)	(5,000)
Provision c/f - 2% on total debtors' balance	8,000
- on identified debtors	20,000
Total per accounts	10,000

6.

	HK$
Legal fee for collection of trade debts	20,000
Legal fee for renewal of tenancy agreement of the rental property in Hong Kong	3,000
Professional fee for auditing and taxation services	50,000
Professional fee for profits tax appeal	30,000
Legal fee for collection of staff loan	5,000
Total per accounts	90,000

7.

	HK$
Annual dinner for staff on Chinese New Year's Eve	17,000
Tax penalty for late filing of profits tax return	3,000
Hong Kong salaries tax paid for a director	40,000
Other allowable revenue expenditure	90,000
Total per accounts	150,000

8. Donations to the Hong Kong Community Chest 15,000

9. Platinum Limited incurred the following capital expenditure for fixed assets in the accounting year ended 30 April 2008:
   - Purchase of a computer for a director's use (30% pool)($25,000) (this computer is used 65% for business purposes and 35% for private purpose)
   - Purchase of computers which were leased to customers for rental income (30% pool) ($290,000).
   - Purchase of delivery vehicles (30% pool)($160,000)
   - Purchase of a private car (30% pool) on hire-purchase (cost = $200,000, *down payment of $20,000 on 1 January 2008, monthly payments for 10 months from February 2008, $20,000 each month (interest portion = $2,000 each month)*)
   - Purchase of one set of network computer system (30% pool)($500,000)
   - Purchase of office furniture (20% pool)($80,000)
   - Purchase of room air-conditioners (20% pool)($70,000)

Depreciation charges for the above items were computed using straight-line method with the following useful life:

- 3 years for computers
- 5 years for office furniture/room air-conditioners
- 10 years for delivery vehicles/private cars

Tax written down values (WDV) of plant and machinery brought forward from the year of assessment 2007/08 are as follows:
WDV b/f (20% pool) = $500,000
WDV b/f (30% pool) = $600,000

Required:

a) Compute the depreciation allowances for Platinum Limited for the year of assessment 2008/2009. (10 marks)

b) Compute the Hong Kong profits tax liability for Platinum Limited for the year of assessment 2008/2009, taking into account of any applicable one-off tax reduction. Ignore provisional profits tax in your computation. (20 marks)

c) Give explanations to the tax treatment that you have applied to the following items:
Explanatory Note 1 - Interest income
Explanatory Note 4 - Bank Interests
Explanatory Note 8 - Donations. (6 marks)

(Total 36 marks)

Part B

There are FIVE questions in this Part. Please answer any FOUR questions in this Part.

2. Funny Ltd commenced its property investment business in Hong Kong with the purchase of a shop in Admiralty on 1 November 2006 at a price of $42,000,000. The purchase of the property was financed by a mortgage loan from Universe Bank in Hong Kong. The company prepares its accounts to 30 September each year. Its first set of accounts covers 11 months to 30 September 2007. The shop was let to Monkey Ltd on 1 December 2006 for a period of five years on the following terms:

(a) monthly rent: $200,000 (with rent-free period for 2 months (December 2006 and January 2007))

(b) premium: $720,000

Funny Ltd's first set of profit and loss account to 30 September 2007 (for 11 months) is as follows:

	$	$
Rental income ($200,000 x 8)		1,600,000
Premium (10/48 of $720,000 recognized according to Hong Kong Accounting Standard 17)		150,000
		1,750,000
Less: Auditors' fee	(30,000)	
Building management fee (for 11 months)	(38,500)	
Government rent (for 11 months)	(11,000)	
Rates (for 11 months)	(49,500)	
Mortgage loan interest (for 11 months)	(880,000)	(1,009,000)
Net profit		741,000

The Assessor of the Inland Revenue Department agreed that one-third of the purchase price related to the cost of construction and the remaining two-third was the land price. Funny Ltd did not apply for exemption from property tax for the year of assessment 2007/08 and the monthly rates would remain the same throughout the five-year lease.

Required:

NOTE: Take into account any applicable one-off tax reduction in this question.

(a) What is the basis period for property tax assessment of Funny Ltd for the years of assessment 2006/07 and 2007/08? What are the respective basis periods for profits tax assessment of Funny Ltd for the years of assessment 2007/08 and 2008/09?

(2 marks)

(b) Compute the property tax payable by Funny Ltd for the years of assessment 2006/07 and 2007/08. Ignore provisional property tax. Assume that the Inland Revenue Department allows by concession the deduction of the rates for November 2006 before the shop was let out. (2 marks)

(c) Compute the amount of commercial building allowance available to Funny Ltd for the year of assessment 2007/08. (2 marks)

(d) Compute the net profits tax payable by or refundable to Funny Ltd for the year of assessment 2007/08 if the property tax for the year of assessment has been paid by Funny Ltd. (4 marks)

(e) Advise Funny Ltd the obligations under the Inland Revenue Ordinance regarding the keeping of records of rental income in its capacity as an owner of property.

(3 marks)

(f) Advise Funny Ltd on the conditions for an application for exemption from property tax. (3 marks)

(Total: 16 marks)

Question 3 (16 marks)

In May 2006, Mr Pang, an Australian Chinese having lived in Hong Kong for many years, was recruited by Asia Telecom as its marketing manager. He received an annual salary of $580,000 during the 2008/2009 year of assessment. He is married with two children. Asia Telecom was incorporated in the HKSAR but conducts its business throughout the Asia-Pacfic region. During the above year of assessment, he only spent eight months in the HKSAR as he has to travel extensively throughout Asia. His salary is deposited into his

HSBC bank account in Sydney, Australia. He regularly withdraws money from his account through electronic teller machines.

Mr Pang was also appointed a director of Japan Telecom, which is a subsidiary company of Asia Telecom, incorporated in Japan. In the 2008/2009 year of assessment, he received a director's fee of $30,000 for attending five meetings in Tokyo, Japan. Japan Telecom also provided him with a rent-free flat in Clear Water Bay, Kowloon, Hong Kong. However, the employer (i.e. Asia Telecom) required 7.5% of Mr Pang's monthly salary be deducted as "notional" rent for this accommodation provided by the subsidiary, Japan Telecom. Mr Pang moved out of the Clear Water Bay flat and lived in a flat located in Deep Water Bay, Hong Kong on 1 October 2008. The flat was purchased by Mr Pang on 1 October 2008. Mr Pang paid mortgage interest of $150,000 to Heung Gong Bank Ltd in respect of his residence in Deep Water Bay for 6-month period from 1 October 2008 to 31 March 2009.

Asia Telecom made the following payments to Mr Pang during the period April 2008 to March 2009:

(i) allowance of $18,000 for utilities (e.g. electricity, gas, water, etc.)

(ii) holiday allowance of $30,000 ($48,000 was actually spent by Mr Pang for a family trip to Japan in July 2008); and

(iii) laundry expenses of $5,000.

Asia Telecom allowed Mr Pang to choose to receive a monthly allowance of $5,000 or to use the company car at no cost. Mr Pang chose to use the company car and the car was used wholly for travelling to and from work.

Asia Telecom gave a new mobile phone to Mr Pang as a gift for his good performance. The cost of the mobile phone to Asia Telecom was $5,000. Its value in the second-hand market is about 80% of the cost.

Mr Pang was granted an option by Asia Telecom on 1 May 2008 to acquire 1,000 shares of Japan Telecom at the equivalent of $30 per share. He bought the shares on 1 September 2008 and paid a handling fee of $1,000 to his employer. The market value of the shares was at the equivalent of $80 per share when he took up the shares. He eventually sold the shares at a profit for the equivalent of $120 per share on 31 March 2009. In August 2008, Mr Pang spent $14,000 to purchase a portable personal computer for his business trips. It was used wholly and exclusively for his job as he never used this computer at home and for non-business matters.

Mr Pang served as a juror for 12 days in September 2008 and the juror's fee was $280 per day.

Mr Pang joined the mandatory provident fund scheme administered by his employer. He and his employer each contributed 5% of his salaries to the scheme.

During the year, Mr Pang enrolled in the Doctor of Business Administration programme offered by the Hong Kong Polytechnic University and incurred tuition fee of $115,000.

Mr Pang's father, aged 61 in the year of assessment 2008/2009, stayed in an elderly residential care home in Hong Kong and a monthly fee of $8,500 was borne by Mr Pang. Mr Pang donated $5,000 in cash to the Hong Kong Community Chest during the year ended 31 March 2009. Mr Pang's mother, aged 58 in the year of assessment 2008/2009, was living with Mr Pang's family.

Apart from his day-time employment, Mr Pang operated an information technology consultancy firm on a part-time basis. The business suffered an agreed loss of $30,000 in 2007/08 but its operational results improved in 2008/09 with an assessable profit of $50,000.

Mr Pang's wife, Judy, is a part-time music teacher of the Hong Kong Music Academy with a monthly salary of $20,000. She paid an annual subscription fee of $2,000 for membership of the Music Institute of Hong Kong. This professional membership is a pre-requisite for her employment. She donated $ 84,000 in cash to Tung Wah Group of Hospitals for the year ended 31 March 2009. She took a refresher course in music theory in May 2008 and paid a tuition fee of $8,000 herself but claimed back $6,000 in January 2009 from the Continuing Education Fund.

The elder daughter of the couple, aged 20, was studying full-time in the Hong Kong University of Science and Technology. Mr Pang is eligible for receiving education allowance for his second child (who was aged 11 and studying in a primary school) from his employer and the employer paid the annual tuition fee ($56,000) for his second child directly to the school on 1 September 2008. Under an agreement between Asia Telecom and the school, Mr Pang was not legally liable to pay the tuition fee of the primary school. On 31 March 2009, Mrs Pang gave birth to one boy and one girl who are twins.

During the year ended 31 March 2009, Mrs Pang maintained her mother, aged 57, by giving her $3,000 as living expenses each month. Mrs Pang also had to be solely responsible for maintaining her 15-year old younger sister who was living in Hong Kong.

On 31 March 2009, due the re-organization of companies within the group, Mr Pang was made redundant and he was paid a redundancy payment of $500,000 in accordance with the

Hong Kong Employment Ordinance.

Required:

Compute Mr Pang's tax liability for the year of assessment of 2008/2009, taking into account any applicable one-off tax reduction. (16 marks)

(Ignore provisional taxes)

(Note: you need to decide whether there is property/profits tax payable by Mr Pang and whether Mr Pang should elect for separate taxation or joint assessment under salaries tax.)

Question 4

(A) Mr Tsang wishes to purchase a flat as a long-term investment which would produce a steady rental income for his living expenses after his retirement. Somebody tells him that he can minimise his tax liability by incorporating a limited company and purchasing the flat through the company.

Required:

Draft a letter to Mr Tsang explaining to him whether it is more beneficial to purchase the property in his own name or via a limited company wholly owned by him. (10 marks)

(Your answer should include a discussion of the treatment of lump-sum premium received and deduction of expenses, and cover other non-tax issues.)

(B) Mr Wang, an Australian Chinese having lived in Hong Kong for many years, was recruited by Company A as its marketing manager. Company A was incorporated in the HKSAR but conducts its business throughout the Asia-Pacific region. Mr Wang's salary is deposited into his HSBC bank account in Sydney, Australia. He regularly withdraws money from his account through electronic teller machines.

Assume that Mr Wang had to travel to China to perform his duties and stayed in Hong Kong for 50 days only (and needed to work on some days among those 50 days) during the year of assessment 2009/10.

Required:

Discuss whether Mr Wang is liable to Hong Kong salaries tax in the year of assessment 2009/10. (6 marks)

(Total 16 marks)

Question 5

(A)

Mr Wu and his wife's income and expenses for the year of assessment 2008/09 are as follows:

<u>Mr Wu's income</u>

(a) Salary from employment : $110,000

(b) Profits from sole-proprietorship business before deduction of any approved charitable donation (Basis period: 1/7/2007 to 30/6/2008) : $50,000

(c) Share of profits of a partnership business (Basis period: 1/4/2008 to 31/3/2009) : $40,000

(d) Rental received from a flat in North Point (Rates of $1,000 per quarter were paid by the tenant) : $96,000

(e) Rental received from a flat in Tsimshatsui (Rates of $1,000 per quarter were paid by the tenant) : $84,000

(f) Interest received from a fixed deposit with a bank in Hong Kong : $40,000

<u>Mr Wu's expenses/business loss</u>

(a) Mortgage loan interest paid for the flat in North Point : $110,000

(b) Costs of repairs on the property in North Point : $5,000

(c) Loss from property dealing business : $5,500

(d) Donations to approved charitable institutions : $560,000, including $ 20,000 donated by the sole proprietorship business

(e) Contribution to grand-mother : $12,000

(f) Tuition fee for studying a Ph.D. degree at Kowloon University, a public university in the HKSAR : $120,000

<u>Mrs Wu' s income</u>

(a) Director's fee received from a trading company which is managed and controlled in Hong Kong : $800,000

(b) Profits from a boutique business (Basis period: 1/10/2007 to 30/9/2008) : $540,000

(c) Rental received from a shop in Tai Po : $140,000

(d) Interest from loans to friends : $10,000

<u>Mrs Wu's expenses</u>

(a) Rates paid for the shop in Tai Po : $8,000

(b) Mortgage loan interest paid for the shop in Tai Po : $110,000

(c) Contribution to father-in-law : $5,000

(d) Contribution to her grand-father : $10,000

Other information

(1) During the year ending 31 March 2009, Mr Wu lived with his wife, his father and his children. His father was aged 70. His first son, aged 24, was a full time student. His second son, aged 16, was married on 1 October 2007 and employed as an office assistant earning $5,000 per month. Mr and Mrs Wu got a newly-born baby on 31 March 2009.

(2) Mr Wu and his wife jointly elected for personal assessment for the year of assessment 2008/09.

(3) Mrs Wu has to solely take care of the living of her disabled younger sister who was aged 22 and incapacitated for work since the year of assessment 2007/08.

Required:

Calculate the tax payable by Mr Wu and his wife under personal assessment for the year of assessment 2008/09. (12 marks)

(B) Explain how stamp duty is charged on a temporary sale and purchase agreement, a formal sale and purchase agreement, and an assignment for the purchase of (i) a residential property and (ii) a non-residential property. (4 marks)

(Total 16 marks)

Question 6

(A) Winky Corporation Limited is a Hong Kong company formed in July 2007 and intends to close its first set of accounts on 31 March 2008. The main business of the company is to import food from the United States and sell it in Hong Kong. The company appointed Johnny Kinky, an American citizen, as its managing director at a monthly remuneration of HK$150,000. Mr Kinky arrived in Hong Kong in June 2007 (he had never been to Hong Kong before then). The company plans to start the import business in September 2007 after they have recruited adequate supporting staff in Hong Kong. Mr Kinky will have to travel to the United States on a regular basis to negotiate business (and to visit his family). As Mr Kinky has no knowledge about the Hong Kong tax regulations, he comes to you, an expert, for advice.

Required:

Please advise Mr Kinky on the following:

(i) **the obligations of a business under the Hong Kong Inland Revenue Ordinance in respect of its own business activities and in respect of the tax affairs of its employees;** (5 marks)

and

(ii) **the consequences of failing to fulfil those obligations.** (3 marks)

(B) Fiona Fong has been working as the Chief Accountant of a Hong Kong listed company, Friendly Limited, since 2000. Three years ago Fiona set up a British Virgin Islands company called Final Limited and used the company to buy a flat on the Peak. This property has been used as her place of residence since its purchase. The original cost of the flat was $7 million and its current market value is $7.5 million.

Recently Fiona planned to set up another new company in Hong Kong, Flame Limited. There is an employment contract between Flame Limited and Fiona. Under the contract, Fiona will be appointed as an employee of Flame Limited and will receive an annual salary of $500,000. Fiona will also be entitled to rent-free accommodation provided by Flame Limited.

A lease agreement will be entered into between Flame Limited and Final Limited on 1 December 2009, under which Flame Limited will rent the flat on the Peak from Final Limited for a three-year period. Consideration for the lease agreement comprises a premium of $300,000 payable on the commencement date of the lease and a fixed monthly rent of $8,000.

Fiona's uncle has indicated immense interest in Fiona's flat on the Peak. Her uncle owned a property in the Clear Water Bay which he acquired at an original cost of $4.5 million. Its current market value is $6 million. He proposes to exchange his Clear Water Bay property for the flat on the Peak owned by Final Limited. He will make up the difference in value by means of a transfer of 10,000 shares in a Hong Kong listed company to Final Limited. The estimated market value is $150 per share at the proposed date of the execution (1 December 2009) of the deed of exchange for the two properties in question.

Required:

(i) **Can Flame Limited and Final Limited get any stamp duty relief for the lease agreement entered into between the two companies. Compute the amount of stamp duty payable, if any, on the lease agreement;** (4 marks);

and

(ii) **What are the relevant chargeable instruments in connection with the exchange of properties and compute the stamp duty payable for each such instrument under the Stamp Duty Ordinance?** (4 marks)

(Total parts (a) and (b) 16 marks)

– END OF QUESTION PAPER –

SUGGESTED ANSWERS

(MARKING SCHEME WILL BE DEVELOPED AFTER COMMENTS/FEEDBACK HAVE BEEN RECEIVED.)

Question 1

(a)

Platinum Limited
Depreciation Allowance Schedule
Year of Assessment 2008/09

(A) Pooled items

	20% pool		30% pool		Allowance
	$	$	$	$	$
WDV b/f		500,000		600,000	
Additions	150,000		450,000		
Less: IA 60%	*(90,000)*	60,000	*(270,000)*	180,000	*360,000*
		560,000		780,000	
Less: AA	20%x560,000	*(112,000)*	30%x780,000	*(234,000)*	*346,000*
WDV c/f		448,000		546,000	
Total					*706,000*

(B) Hire-purchase item

Capital expenditure incurred for accounting year ended 30 April 2008

= down payment $20,000 + 3 monthly payments (Feb – Apr 08) $18,000 x 3

= $74,000

Cost	$200,000
Initial Allowance	
(60% x $74,000)	(44,400)
	155,600
Annual Allowance	
(30% x $155,600)	(46,680)
	108,920

Depreciation allowance for hire-purchase item = $44,400 + 46,680 = *$91,080*

(C) Item not 100% for business use

Cost	$25,000
Initial Allowance	
(60% x 25,000)	(15,000)
	10,000

Annual Allowance	
(30% x 10,000)	(3,000)
	7,000

Total IA + AA = $15,000 + $3,000 = $18,000
Depreciation allowance claimable = $18,000 x 65% = $11,700

Total depreciation allowance = $706,000 + $91,080 + $11,700 = $808,780

Full deduction of cost of prescribed fixed asset = $500,000 (network computer system)

Note: (20%-pool additions = office furniture $80,000 + room air-conditioners $70,000 = $150,000, 30% additions = computers for lease $290,000 + vehicles $160,000 = $450,000)

1. Computers purchased for private use are not entitled to depreciation allowance.
2. Computers leased to customers are not to be treated as “prescribed fixed assets”.
3. Network computer system is entitled to full deduction as “prescribed fixed asset” against assessable profit under section 16G of Inland Revenue Ordinance.

(b)

Platinum Limited
Computation of Hong Kong Profits Tax Liability
for the year of assessment 2008/2009
Basis Period: Year ended 30 April 2008

		HK$	HK$
Profits before tax per account			3,195,000
Add: Retirement fund – special contribution (70,000 x 4 / 5)		56,000	
Depreciation charge		450,000	
Bank interest – mortgage loan for the Shenzhen property		30,000	
Bad debt provision – staff loan write-off		15,000	
Legal and professional fee (30,000 tax appeal +5,000 staff loan)		35,000	
Tax penalty		3,000	
Donations		15,000	604,000
			3,799,000
Less: Decrease in general provision for bad debt	(10,000)		
Interest income – (238,000+2,000)	(240,000)		
Rental income – Shenzhen property	(120,000)		(370,000)
			3,429,000

Less: Depreciation allowance	(748,780)
Less: Cost of prescribed fixed asset	(500,000)
	2,180,220
Less: Donation	(15,000)
Assessable profit	2,165,220

Profits tax liability @16.5% $357,261 (ignore cents)

Can include brief explanations/notes.

(c)

Interest income

Under S15(1)(f) of the Inland Revenue Ordinance (IRO), sums received by or accrued to a corporation carrying on a trade, profession or business in Hong Kong by way of interest are deemed to be taxable receipts if the interest arises in or is derived from Hong Kong. In determining the source of interest income, the provision of credit test is relevant, i.e. one looks at the place where the credit was first made available to the borrower.

Applying the provision of credit test, the HK$ deposits placed with the Hang Seng Bank's Wanchai Branch are prima facie sourced in Hong Kong and the related interest income is taxable. Nevertheless, with effect from 22.6.1998, interest income from deposits placed with financial institutions in Hong Kong is exempt from payment of profits tax under the *Exemption from Profits Tax (Interest Income) Order*, provided that the deposits are not used to secure bank borrowing on which the interest expense is deductible under S16(2)(d). The deposits have not been used to guarantee any borrowing and accordingly, interest income of $238,000 from the Hang Seng Bank would be exempt.

Regarding the interest income received from the Shenzhen Branch of Bank of China, the provision of credit was outside Hong Kong and therefore such interest income ($2,000) is not caught by S15(1)(f). The currency of the deposits is irrelevant.

The taxability of interest income derived from trade debts is determined by reference to the related trading transactions, as the financing arrangement for the sale of goods on credit is part and parcel of the trading transaction. On the basis that the trading profits derived from the sale of goods to all customers are of a Hong Kong source and therefore taxable, the interest income ($10,000) derived from the overdue trade debts is taxable.

Bank interest payment

Interest payable on money borrowed for the purpose of producing chargeable profits is deductible under S16(l)(a) provided that any one condition set out in S16(2) is satisfied, subject to the limitations under S16(2A), (2B) and (2C). On the facts given, it seems that S16(1)(a) was satisfied for various interest payment except for the interest on the mortgage loan for the Shenzhen property which was a non-Hong Kong expense. Therefore, the said interest for the mortgage loan relating to the Shenzhen property ($30,000) cannot be deducted.

For the other loans, the question remains is whether or not any one condition in S16(2) is also fulfilled, subject to the limitations under S16(2A), (2B) and (2C).

In the case of a borrowing from a financial institution, S16(2)(d) is relevant. For the interest to be deductible, the borrowing should not be secured by any deposit placed by the taxpayer and/or its connected persons where the interest income from that deposit is not taxable in Hong Kong, subject to the limitations under S16(2A), (2B) and (2C).

The first bank interest ($40,000) is for a loan secured by a director personally, not by any deposit. S16(2)(d) is satisfied and limitations under S16(2A), (2B) and (2C) are not applicable. Therefore, the loan interest can be deducted.

The second bank interest ($50,000) is for a loan due to a corporate shareholder. For the interest payable to a person other than financial institution, S16(2)(c) is relevant. As the lender carries on a business in Hong Kong and the provision of credit was in Hong Kong, the interest received by the lender would be taxable under S15(l)(f) and the limitations under S16(2A), (2B) and (2C) are not applicable. Accordingly, Platinum Limited could get a deduction for the interest payment.

The mortgage loan relating to the rental property in Hong Kong was secured by the property, not by any deposit. Therefore, S16(2)(d) is satisfied and other limitations under S16(2A), (2B) and (2C) are not applicable. Therefore, the loan interest can be deducted.

Donations

Donations are deductible if:

1. they are pure donation, i.e. with no consideration in return
2. they are paid in money or money’s form and not in-kind
3. they are not less than $100 in aggregate
4. they are paid to approved charitable institutions
5. they are not more than 35% of the assessable profit before donation
6. they are not otherwise deductible under other provisions

In this case, the donations paid to Hong Kong Community Chest are deductible as they fulfilled the above criteria.

Question 2

(a)

Property Tax

basis period for the year of assessment 2006/07 = 1 December 2006 to 31 March 2007 (4 months)

basis period for the year of assessment 2007/08 = 1 April 2007 to 31 March 2008 (12 months)

Profits Tax

basis period for the year of assessment 2007/08 = 1 November 2006 to 30 September 2007 (11 months)

basis period for the year of assessment 2008/09 = 1 October 2007 to 30 September 2008 (12 months)

(b)

Funny Ltd

Property Tax Computation

Year of Assessment 2006/07

(basis period = 1 Dec 06 – 31 Mar 07)

	$
Rent ($200,000 x 2) (note: rent-free (Dec 06 – Jan 07))	400,000
Premium ($720,000 x 4 / 36)	80,000
Assessable value	480,000
Less: Rates paid by owner ($49,500/11x5)	(22,500)
	457,500
Less: Statutory deduction 20%	(91,500)
	366,000
Property tax @16%	58,560
(Government rent is NOT deductible)	

Funny Ltd

Property Tax Computation

Year of Assessment 2007/08

(basis period = 1 Apr 07 – 31 Mar 08)

	$
Rent ($200,000 x 12)	2,400,000
Premium ($720,000 x 12 / 36)	240,000

Assessable value	2,640,000
Less: Rates ($49,500/11 x 12)	(54,000)
	2,586,000
Less: Statutory deduction 20%	(517,200)
Net Assessable Value	2,068,800
Property tax @16%	331,008

When 2007/08 tax reduction is taken into account,

property tax = $331,008 - $331,008 x 75% (subject to maximum of $25,000)

= $331,008 - $25,000

= $306,008

(c)

Funny Ltd

Computation of commercial building allowance

Year of assessment 2007/08

Cost of construction ($42,000,000 x 1 / 3) = $14,000,000

Annual allowance = 4% on $14,000,000 = $560,000

(d)

Funny Ltd

Profits tax computation

Year of assessment 2007/08

(basis period: 11 months to 30 September 2007)

		$
Profit per accounts		741,000
Less: commercial building allowance		(560,000)
Assessable profit		181,000
Profits tax @17.5%	$31,675	
Less: section 25 property tax set-off	(331,008)	
Balance of tax refundable	$299,333 **(REFUND)**	

When 2007/08 tax reduction is taken into account

Profits tax @17.5%	$31,675	
Less: 75% of $31,675	(23,757)	rounded up from $23,756.25
	7,918	
Less: section 25 property tax set-off	(306,008)	
Balance of tax refundable	$298,090 **(REFUND)**	

(e)

Section 51D(1) of the Inland Revenue Ordinance provides that any person who is the owner of land, building or land and building situated in Hong Kong is required :

(i) to keep sufficient records in English or Chinese of the rental income to enable the net assessable value of that land, building or land and building to be readily ascertained, and
(ii) 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.

The preservation of the above records is not required if:

- the Commissioner of Inland Revenue has specified that such rental records need not be preserved, or
- the corporation that was the owner of the property has been dissolved.

(f)

A corporation carrying on a trade, profession or business in Hong Kong can claim exemption from property tax by making an application in writing to the Commissioner of Inland Revenue if:

- the profits derived from the property concerned are part of the profits of the trade carried on by the corporation; or
- the property is occupied by the corporation for the purposes of producing profits chargeable to profits tax. (section 5(2) of the Inland Revenue Ordinance)

Question 3

Notes:

(1) Need to explain briefly why Mr Pang's employment has a HK source (the three tests in the HK tax case CIR v Goepfert).
(2) Need to explain why the director's fee from Japan Telecom is not assessable under HK Salaries Tax (McMillan v Guest).
(3) Asia Telecom and Japan Telecom are associated corporations. Therefore, rental value has to be computed for the quarters provided by Japan Telecom. Such computation is based on the relevant taxable income from both Asia Telecom and Japan Telecom. Since the director's fee of $30,000 from Japan Telecom is not taxable under HK Salaries Tax, the rental value should be based only on the relevant income from Asia Telecom.

(4) The use of company car is in general not assessable because it does not discharge an employee's personal liability and is not capable of being converted into cash. However, when the employer is allowed to choose between cash and the "company car" benefit, the benefit becomes convertible into cash and therefore is assessable under Hong Kong salaries tax.

(5) The value of the gift (mobile phone) that is convertible into cash (i.e. $5,000 x 80% = $4,000) is an assessable benefit since the gift is a reward for services rendered.

(6) The cost of the computer of $14,000 is capital in nature and cannot be deducted. No depreciation allowance under section 12(1)(b) can be claimed to reduce the assessable income since the computer is not 'essential' to the production of assessable income (i.e. cost was not necessarily incurred).

(7) Car allowance of $18,000 is fully taxable but no deduction of travelling expenses can be allowed (CIR v Humphrey).

(8) Education allowance of $60,000 is fully taxable according to the Inland Revenue Ordinance.

(9) Holiday allowance of $30,000 is fully taxable. The excess amount of $(48,000 – 30,000) = $18,000 is not deductible as it is private in nature.

(10) Laundry expenses of $5,000 are fully taxable.

(11) Juror's fee is NOT taxable. Serving as a juror is a public service, not an employment. The juror's fee paid is meant to cover travelling and meal expenses of a juror.

(12) Redundancy payment made in accordance with provisions in Hong Kong Employment Ordinance is not taxable under Hong Kong Salaries Tax.

Other explanations can be included.

(a) <u>Mr Pang's tax liability</u>

Mr Pang
Salaries Tax Computation
<u>Year of Assessment 2008/09</u>

		$	$
Salaries	(a)		580,000
Utility allowance	(b)		18,000
Car allowance	(c)		60,000
Mobile phone	(d)		4,000
Holiday travel allowance	(e)		30,000
Education allowance	(f)		56,000
Laundry expenses	(g)		<u>5,000</u>
			753,000

Rental value $(sum of (a) to (g) = 753,000) x 6/12 x 10%

Less: rent paid \$580,000 x 6/12 x 7.5%= 37,650 -21,750		15,900
Share option benefit \$((80-30) x 1,000 –1,000)		49,000
Assessable income		817,900
Less: Self education expense (max \$60,000)		(60,000)
Net assessable income		757,900
Less: Home loan interest (max \$100,000)	(100,000)	
Elderly residential care expenses (max \$60,000)	(60,000)	
Contribution to MPF (max \$12,000)	(12,000)	
Approved charitable donation	(5,000)	
Approved charitable donation beyond the maximum deduction claimable by wife (\$84,000-\$83,300)	(700)	
		(177,700)
Net assessable income after concessionary deductions		580,200
Less: Personal allowances:		
Basic allowance	(108,000)	
Child allowances (for 4 children)	(200,000)	
Child allowances (for the twins born in 2007/08)	(100,000)	
Dependent parent allowance (Mr Pang's mother (age 58))	(15,000)	
Additional dependent parent allowance (Mr Pang's mother (age 58))	(15,000)	
Dependent parent allowance (Mrs Pang's mother (age 57))	(15,000)	
Dependent sister (of Mrs Pang) allowance	(30,000)	(483,000)
Net chargeable income		97,200

(note: juror's allowance is not taxable under Salaries Tax)

(note: it is more tax advantageous for Mr Pang to claim the dependent sister allowance in respect of his wife's sister and other personal allowances entitled by Mrs Pang.)

Salaries tax	
Standard rate (\$580,200*15%)	87,030
	(not applicable)
Salaries tax payable by Mr Pang	

First $40,000 @ 2%	800	
Second $40,000 @ 7%	2,800	
Remainder ($97,200-$80,000) = $17,200 @ 12%	2,064	
		5,664

Tax payable = $5,664

BUT

when 2008/09 100% tax reduction is taken into consideration, tax amount, the NET salaries payable = NIL

Mr Pang's Business
Profits Tax Computation
Year of Assessment 2008/09
(for information only, not required by the question)

	$
Assessable profit	50,000
less: Tax loss b/f from 2008/09	(30,000)
Assessable profit after loss set-off	20,000
Profits tax payable (15%)	3,000

No property tax is payable by Mr Pang because the flat owned by him was occupied as his family's residence.

Judy (Mrs Pang)'s tax liability

(Not required by the question. However, candidates still need to work out the Net Assessable Income (NAI) figure of Mrs Pang to determine the approved charitable donation that is claimable by her.)

Mrs Pang (Judy)
Salaries Tax Computation
Year of assessment 2008/09

	$	$
Salary income ($20,000 x 12)		240,000
Less: Annual subscription to professional body		(2,000)
Less: Self-education expense ($8,000 - $6,000)		(2,000)
Net Assessable Income		236,000
Less: Approved charitable donation (max = $(240,000 less subscription to professional body) x 35% = $238,000 x 35%)		(83,300)
Net assessable income after concessionary deductions		152,700
Less: Personal allowances:		

Basic allowance			(108,000)
Net chargeable income			44,700
Salaries tax payable by Mrs Pang (Judy)			
First $40,000 @ 2%		800	
Remainder ($44,700-$40,000) = $4,700 @ 7%		329	
		1,129	
Tax payable =			1,129

(note: no deduction of MPF contribution as the question does not mention this)

When 2008/09 100% tax reduction is taken into consideration,
NET salaries tax payable = NIL

Total tax payable by Mr and Mrs Pang:
under salaries tax for 2008/09 = NIL

Total tax payable by Mr Pang under profits tax =3,000
(for information only, not required by the question)

It will not be advantageous for the couple to elect for joint assessment as the net chargeable income of Mrs Pang ($68,500) will be added to the net chargeable income of Mr Pang and taxed at 12% and 17% under joint assessment and not at progressive tax rates of 2% and 7% under separate taxation, resulting in a higher total salaries tax payment.

Question 4

(A)

Date: 1 November 2009

Dear Mr Tsang,

Re: Purchase of property

I refer to our meeting yesterday in respect of your purchase of a property. I would like to draw your attention to your exposure to property tax, profits tax and stamp duty. I would also explain the tax advantages and disadvantages of acquiring a property either in your own name or by a corporation owned by you.

Rental Income

If you purchase a property in your own name, you will be subject to property tax on the rental income you receive from leasing the property. The only deductible expenses under property tax are rates paid by you, bad debts and a 20% statutory deduction. The actual expenses incurred on repairs and improvement, and financial charges are not deductible under property tax. However, you may deduct interest expenses up to the net assessable value of the property if you elect personal assessment. A lump-sum premium received can be spread over the period of the lease or up to 36 months, whichever period is shorter.

If you purchase a property in the name of a limited company, income (including lump-sum premium and regular rental payments) received will all be assessable business income. You can deduct the actual repairs and interest expenses incurred in respect of the property. You are also entitled to depreciation allowances for the capital expenditure incurred for the acquisition and improvement of the property. However, you are required to pay audit fees, company secretarial fees and business registration fees for maintaining the company. Such expenses may outweigh the amount of tax you save from the payment of interest and repairs.

Profits tax upon sale of the property

When you sell the property at a later date, you may be liable to profits tax. This applies to whether you purchase the property in your own name or a limited company wholly owned by you. The taxability of the profit on disposal of the property depends on the badges of trade applied to each situation. Nevertheless, the claim for treating the profit as capital gains (and thus being exempt from profits tax in Hong Kong) is somewhat easier in the case of an individual than a limited company if all the circumstances and evidence available are the same.

Stamp duty

(i) On acquisition

When the property is purchased, stamp duty at the conveyance scale (maximum 3,75% from 1 April 1999 to 31 March 2010, 4.25% from 1 April 2010) is payable irrespective of whether the property is acquired by an individual or a limited company. However, the situation will be different when the property is sold.

(ii) On disposal

If the property is acquired in your own name, stamp duty at the conveyance scale is payable when the property is sold. If the property is acquired in the name of a limited company, you have the option of selling the property itself or selling the shares of the limited company holding the property to the potential buyer. When the shares are sold, the stamp duty rate payable by the seller is 0.1% (with effect from 1 September 2001) of the selling price, and another 0.1% (with effect from 1 September 2001) of stamp duty payable by the purchaser. If the company is an overseas company and does not keep its register of members in HK, the sale or transfer of shares is exempt from HK stamp duty.

If you have any question about the content of this letter, please contact me at 21234567.

Yours sincerely,
YYY

(B)
Analysis of Mr Wang's employment according to the criteria stated in Goepfert's case.
1) His employment contract was signed and executed in Hong Kong;
2) His employer is resident in Hong Kong (a Hong Kong listed company); and
3) His salaries are paid in Australia.

The employment of Mr Wang is likely to be situated in Hong Kong since the first two factors indicate a Hong Kong locality and the first two factors have a much heavier weighting than the third one.

The question of whether Mr Wang is liable to salaries tax hinges upon whether he is qualified as a "visitor" under s8(1B). If the answer is yes, since he is staying in Hong Kong for not more than 60 days in 2009/10, he will be exempt from salaries tax.

The practice of the Inland Revenue Department is to determine the work base of a taxpayer in order to conclude whether the taxpayer qualifies as a visitor. Therefore, if the taxpayer is required to be stationed outside Hong Kong, despite the fact that he and his family reside in Hong Kong, he can still qualify as paying visits to Hong Kong under s8(1B) when he returns to Hong Kong, and hence can enjoy the exemption under s8(1B).

Therefore, it is necessary to examine the work base of Mr Wang (having regard to what extent he is required to perform his services outside Hong Kong). Each case must be examined separately according to its facts to decide whether the presence of a taxpayer in Hong Kong constitutes a visit under section 8(1B) of IRO. The exact nature of the job duties of Mr Wang under the employment contract and his employer's directives may also be taken into consideration (but of much lesser importance) to determine whether he is regarded as a visitor.

For a Hong Kong based employee who travels extensively in the course of his/her employment and returns to Hong Kong which is his/her activity base, all of his/her income is liable to Hong Kong Salaries Tax as his/her trips outside Hong Kong are merely incidental to his/her duties.

If a Hong Kong employee is assigned or seconded to work and stay overseas and that place of work can be treated as his/her base of work, the Inland Revenue Department (IRD) is of the view that when he/she occasionally returns to Hong Kong, he/she may be regarded as visiting Hong Kong and the 60-day rule may be applicable.

If Mr Wang's work base during the year of assessment 2009/10 is in China and he only returns to Hong Kong for 50 days and renders services on some of the visit days, he may still, in accordance with IRD's practice, likely qualify as a "visitor" when he comes back to Hong Kong. If so, it is likely that Mr Wang will be considered a visitor by the IRD and be entitled to the 60-day exemption in the year of assessment 2009/10. However, if Mr Wang's work base is regarded as Hong Kong (and not China), he will be liable to Hong Kong Salaries Tax on his income for the **whole** year unless he can exclude part of the income for his services in China when such income arises from his work in China and has been subject to tax in China and he has paid the relevant Chinese tax charged.

Question 5

(A)

Mr and Mrs Wu's personal assessment for the year of assessment 2008/09:

		Mr Wu	Mrs Wu
	$	$	$
Net assessable value (Note 1)	76,800		
	67,200	144,000	105,600
Net assessable Income :			
Salary less self-education expenses (maximum deduction of 60,000) = $110,000 – $60,000 = $50,000		50,000	
Directors' fee			800,000
Assessable profit			
Sole-proprietor's business (Note 2)	32,500		
Partnership business	40,000	72,500	

Boutique business		540,000
Total income	266,500	1,445,600
Less : Mortgage loan interest (maximum = total NAV)	(110,000)	(105,600)
	156,500	1,340,000
Less : Approved charitable donations (Note 3)	(64,400)	(469,000)
	92,100	871,000
Less : Business loss	(5,500)	
Net total income	86,600	871,000
Joint total income		957,600
Less : Married Person's allowance	(216,000)	
Child allowance (for 2) (first son / newly-born baby)	(100,000)	
Child allowance (additional) (for newly-born baby)	(50,000)	
Dependent sister allowance (Mrs Wu's sister)	(30,000)	
Disabled dependent allowance (Mrs Wu's sister)	(60,000)	
Dependent parent allowance (Mr Wu's father)	(30,000)	
Additional dependent parent allowance (Mr Wu's father)	(30,000)	
Dependent grandparent allowance (Mr Wu's grandmother)	(30,000)	(546,000)
Net chargeable income		411,600

Tax at standard rate = $957,600 x 15% = $143,640

Tax at progressive rates = $8,400 (first $120,000) + 17% x $(411,600 – 120,000) = $57,972 (ignore cents)

Therefore, the tax payable

= $57,972 LESS one-off tax reduction of 100% (subject to maximum of $8,000)

= $57,972 - $8,000

= $49,972

Tax payable by Mr Wu = $49,972 x 86,600 / 957,600 = $4,519 (ignore cents)

Tax payable by Mrs Wu = $49,972 x 871,000 / 957,600 = $45,452 (ignore cents) – for the total, there is a rounding difference of $1

Note 1

Flat in North Point (owned by Mr Wu)

Rent	$96,000
Less: rates	--
	96,000
Less: 20% statutory deduction	(19,200)
Net Assessable Value	76,800

Flat in Tsimshatsui (owned by Mr Wu)

Rent	$84,000
Less: rates_	--
	84,000
Less: 20% statutory deduction	(16,800)
Net Assessable Value	67,200

Shop in Tai Po (owned by Mrs Wu)

Rent	$140,000
Less: rates	(8,000)
	132,000
Less: 20% statutory deduction	(26,400)
Net Assessable Value	105,600

Note 2

Mr Wu may claim deduction of charitable donations under profits tax for his sole proprietorship business as follows:

Assessable profit before donations	$50,000
Less: donation (restricted by 35%)	(17,500)
Assessable profit after donations	32,500

Note 3

Maximum donation allowed for Mr Wu is $(156,500 + 17,500 (donation allowed under profits tax) + 60,000 (self-education expense)) x 35% = $81,900

Therefore, the amount allowed under personal assessment for Mr Wu is $(81,900 - 17,500 (donation already allowed under profits tax)) = $64,400

The excessive donations made by Mr Wu of $(560,000 – 81,900) = $478,100 BUT SUBJECT TO 35% of Mrs Wu's net total income of $1,340,000 (i.e. $469,000).

Note 4

Interest income is exempt from tax. Dependent grandparent allowance for Mr Wu's grand-mother can be granted but not that for Mrs Wu's grand-father (because the contribution for the year of assessment was less than the stipulated sum of $12,000 per year).

Note 5

Child allowance is given for the first son as his age was between 18 and 25 and was receiving full time education. Child allowance cannot be given for the second son as he was married during the whole year of assessment. Child allowance is also given to the new born baby. New-born baby gets additional child allowance in the year of birth.

Note 6

Maximum self-education expenses that can be claimed was $60,000.

(B)

(i) Residential property

A fixed stamp duty of $100 or ad valorem (depending on the value of the transaction) stamp duty at a rate of 1.5% to 4.25% (from 1 April 2010) or 1.5% to 3.75% (from 11 am, 28 February 2007 to 31 March 2010) is charged on a temporary sale and purchase agreement within 30 days after the date of execution. In pursuance with the stamped temporary sale and purchase agreement, the formal temporary sale and purchase agreement, and the assignment are charged with a fixed stamp duty of $100.

If a formal sale and purchase agreement is executed within 14 days after the date of execution of a temporary sale and purchase agreement with the same terms and the same parties, the temporary sale and purchase agreement is exempt from the charge of stamp duty while the formal sale and purchase agreement is chargeable with ad valorem stamp duty. The period of stamping is within 30 days after the execution of the formal sale and purchase agreement.

With effect from 1 April 1999, the payment of stamp duty on the sale and purchase agreement may be deferred, upon application to the Collector of Stamp Revenue, to the earlier of the following two periods:

- within 3 years from the date of execution of the sale and purchase agreement, or
- within 3 years from the date of the execution of the assignment.

If there is a sub-sale of the property, the payment of stamp duty on the first purchase of the property is payable within 7 days from the execution of the sub-sale and purchase agreement. Fresh stamp duty is also payable on the sub-sale, i.e. on the change of owner. If the new owners are spouse, parents or children of the original owners, no ad valorem stamp duty is charged on the sub-sale, and only a fixed duty of $100 is chargeable.

(ii) Non-residential property

The only instrument chargeable with stamp duty is the assignment. The temporary sale and purchase agreement or the formal sale and purchase agreement is not required to be stamped. Any change of names before the execution of the assignment is not subject to any stamp duty.

Question 6

(A)

(i) Obligations of a taxpayer subject to profits tax

The profits derived by Winky Corporation Limited from selling American food in Hong Kong are subject to Hong Kong profits tax. As a taxpayer subject to Hong Kong profits tax, Winky Corporation Limited is obliged under the Inland Revenue Ordinance:

(1) To complete the profits tax return with supporting information within the time limit specified in the return. The first profits tax return will be for the year of assessment 2007/2008 and will, following normal practice, be issued in April/May 2008. Before then, a provisional profits tax return for the year of assessment 2007/2008 may be issued. (s. 51(1))

(2) To notify the Commissioner of Inland Revenue that the company is chargeable to profits tax within 4 months from the end of the year of assessment unless a profits tax return has been received before then. In this case, notification should not be later than 31 July 2008, 4 months after the first year of assessment in which the company is liable to profits tax (as first set of accounts closed on 31 March 2008). (s. 51(2))

(3) To notify the Commissioner of Inland Revenue of the cessation of business operations within one month of cessation (s. 51(6)). This is unlikely to be applicable to Kinky Corporation Limited for the time being.

(4) To notify the Commissioner of Inland Revenue of any change in business address within one month of the change. (s. 51(8))

(5) To keep proper business records for not less than 7 years. (s. 51C)

Obligations of an employer

As an employer, Winky Corporation Limited has the following obligations under Inland Revenue Ordinance in respect of its employees (note: employees include directors (s. 52(3)):

(1) To complete the employer's return of employees' remuneration and pension within the time period specified. Usually this return is issued in April each year. (s. 52(2))

(2) To supply information about any new employee who is likely to be liable to salaries tax within 3 months after the commencement of the employment. (s. 52(4))

(3) To notify the Commissioner of Inland Revenue of any employee who is about to cease employment within one month of cessation (s. 52(5)). The Commissioner is empowered to accept a shorter period of notice.

(4) To notify the Commissioner of Inland Revenue of any employee who is chargeable to Salaries Tax and is about to leave Hong Kong for more than a month other than on a business trip. The notification should be made not later than one month before the departure (s. 52(6)). The Commissioner is empowered to accept a shorter period of notice.

(5) To retain any money payable to employees in respect of whom a notification has been made under s. 52(6) for one month from the date of notice under s. 52(6). (s. 52(7))

(ii) Offences and Penalties

Failure to notify the commencement of business, change of address and cessation of business without reasonable excuse are offences under s. 80(1). The Commissioner of Inland Revenue may prosecute the taxpayer and the penalty that can be imposed by court is a fine at level 3 ($10,000) and the court may also order the employer to do the act that is required. The Commissioner may compound the offence.

Failure to keep proper business records is an offence under s. 80(1A). The maximum penalty is a fine at level 6 ($100,000) and the court may also issue a compliance order. The Commissioner of Inland Revenue may compound the offence.

The penalties for failure to submit a profits tax return and failure to notify the chargeability are higher as these will usually lead to a delay in charging tax or result in an undercharge of tax. If these offences are committed without reasonable excuse, the taxpayer may be prosecuted under s. 80(2). Penalty at level 3 ($10,000) plus treble the amount of tax that has been undercharged in consequence of such offence would be imposed. The Commissioner of Inland Revenue may compound the offence.

Alternatively, the Commissioner may take action under s. 82A whereby he/she may, by assessment, impose additional tax (a penalty tax) which is in addition to the taxpayer's actual tax liability (s. 82A(2)). The additional tax may not exceed treble the amount of tax undercharged. This provision is only applicable if no proceedings have been instituted under s. 80(2) and the taxpayer has not been prosecuted for fraud or wilful evasion. If additional tax is raised under s. 82A, the taxpayer could not be further prosecuted on the same facts for an offence under s. 80(2) or s. 82(1). For cases which are not serious, the Commissioner may take no penal action but issue a warning letter to the taxpayer. If these offences are committed with wilful intent, the taxpayer may be prosecuted under s. 82. The penalties under s. 82 are higher and include imprisonment.

Failure to observe the employer's obligations under s. 52 without reasonable excuse is an offence under s.80(1). The Commissioner of Inland Revenue may prosecute the taxpayer and the penalty that can be imposed by court is a fine at level 3 ($10,000) and the court may also order the employer to do the act that is required. The Commissioner may compound the offence.

(B)

(i)

Under section 45, there is an exemption of stamp duty for the transfer of immovable property or stock between associate bodies corporate.

However, even though Final Limited and Flame Limited are both 100% owned by Fiona, they cannot satisfy the 90% associated relationship as only the corporate shareholdings will be taken into account for the purposes of determining the section 45 exemption. Final Limited and Flame Limited are therefore not associated bodies corporate under section 45 of the Stamp Duty Ordinance.

Furthermore, section 45 exemption does not apply to leases signed between associated bodies corporate.

As the lease covered a three-year period, stamp duty is payable at 1% of the average yearly rent. The lease (taking into account both premium and monthly rent) is chargeable to stamp duty as follows:

$300,000 x 3.75% + $8,000 x 12 x 0.5% = $11,730

(ii)

Transfer of listed Hong Kong stock

Each of the bought note and the sold note is chargeable with *ad valorem* stamp duty at the rate of 0.1% on the market value of the listed Hong Kong stock at the date of execution of the deed of exchange.

The stamp duty is \$150 x 10,000 x 0.1% = \$1,500 for the bought note and the same amount (\$1,500) for the sold note.

Fixed stamp duty of \$5 is payable on each instrument of transfer.

Exchange of residential flat

If a deed of exchange is drawn up to have two immovable properties exchanged between their owners, the stamp duty is not charged on the market value of the two properties but on the equality money payable between the two parties to make up for the difference in value of these two properties.

Hence, in the situation given in the question, the equality money is equal to value of the listed shares payable on the date of the deed of exchange. The equality money is therefore computed as follows:

\$150 x 10,000 = \$1,500,000

As the consideration is below \$2,000,000, the lowest stamp duty amount of \$100 applies to the deed of exchange.

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