

Preparing Taxation Computations

(Hong Kong)

ACCA CERTIFIED ACCOUNTING TECHNICIAN EXAMINATION

ADVANCED LEVEL

TUESDAY 12 DECEMBER 2006

QUESTION PAPER

Time allowed **3 hours**

ALL FOUR questions are compulsory and **MUST** be answered

Tax rates and allowances are on page 3

Do not open this paper until instructed by the supervisor

This question paper must not be removed from the examination hall

The Association of Chartered Certified Accountants

Paper T9(HKGG)



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The question paper begins on page 3.**

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

2004/05 and 2005/06

\$

Allowances

Basic allowance	100,000
Married person's allowance	200,000

Tax rates

Salaries tax rates:

First \$30,000	2%
Next \$30,000	8%
Next \$30,000	14%
Remainder	20%
Standard rate	16%
Corporation rate	17.5%

Capital allowance rates

Initial allowance:

Industrial building	20%
Bulldozers	60%
Motor cars	60%
Office furniture and fixtures	60%

Annual allowance:

Industrial building	4%
Commercial buildings	4%
Bulldozers	30%
Motor cars	30%
Office furniture and fixtures	20%

All calculations are to be rounded to the nearest \$.

ALL FOUR questions are compulsory and MUST be attempted

1 Throughout the year ended 31 March 2006, Mr Yim lived separately from his wife.

Both Mr and Mrs Yim own businesses independently in Hong Kong. They also had other sources of income arising in or derived from Hong Kong and incurred their own expenses individually.

Mr and Mrs Yim's income and expenses for the year ended 31 March 2006 are as follows:

	Mr Yim \$	Mrs Yim \$
Income		
Salary income from part-time jobs	50,000	30,000
Trading profit (loss) from sole-proprietor business (as assessed)	540,000	(85,000)
Share of partnership business loss (as assessed)	(38,000)	–
Excess of proceeds over cost of certificates of deposits (private fund)	15,000	–
Property rental income (after payment of rates)	56,000	54,000
Interest income from personal loans	–	10,000
Expenses		
Repairs to let property	8,700	–
Mortgage interest to finance the purchase of the let property	34,000	68,000
Mortgage interest to finance the purchase of own residence	23,400	–
Donations to approved charities	24,600	5,900

Required:

- (a) **State who can elect for personal assessment and the time limit for making such an election.** (6 marks)
- (b) **Under what circumstances will a husband and wife be deemed to be 'living apart' for the purposes of the Inland Revenue Ordinance?** (3 marks)
- (c) **Compute the tax payable by Mr and Mrs Yim if they elect for personal assessment for the year of assessment 2005/06 under each of the following assumptions:**
 - (i) **Mr Yim did not support Mrs Yim for the year ended 31 March 2006 and that they were treated as living apart.** (11 marks)
 - (ii) **Mr Yim supported Mrs Yim for the year ended 31 March 2006 and that they were not treated as living apart.** (7 marks)

You are not required to apportion the tax liability between husband and wife. Show all workings.

(27 marks)

- 2 (a) Provisional property tax is payable by every person who is chargeable to property tax. A claim, however, may be made for a holdover of the whole or part of the provisional property tax.

Required:

State the timing and grounds under which a taxpayer can apply for the holdover of provisional property tax.
(6 marks)

- (b) Mr Wong owns a flat in Mongkok which was listed for rent since 1 April 2004. On 1 July 2004, Mr Wong successfully entered into a 3-year lease with Mr Yeung at a monthly rent of \$7,000 payable at the beginning of each month. According to the lease, a premium of \$136,800 was payable to Mr Wong at the commencement of the lease. Rates which amounted to \$6,800 for each of the years ended 31 March 2005 and 31 March 2006 were however to be paid by Mr Wong. In addition, Mr Wong paid \$7,300 for repairs to the flat during the year ended 31 March 2006.

Required:

Compute the property tax payable by Mr Wong for each of the years of assessment 2004/05 and 2005/06. Ignore provisional tax. Show all workings.
(8 marks)

- (c) Assuming the same facts as in (b) above except that the flat was owned by a corporation, Wong's Ltd, which prepares its accounts to 31 March annually.

Required:

Compute the profits tax payable by Wong's Ltd in respect of the above flat for each of the years of assessment 2004/05 and 2005/06. Ignore provisional tax. Show all workings.
(9 marks)

(23 marks)

- 3 Prosperity Ltd commenced a watch manufacturing business on 1 February 2005. The watch factory is located in Tai Po Industrial Estate, but its general office is in Wanchai. Both the factory and the office are the company's own properties.

The company's first profit and loss account for the period from 1 February 2005 to 31 December 2005 shows a net profit of \$726,900.

Income and expense items taken into account in arriving at this net profit included the following which (if appropriate) need to be considered for tax adjustments:

	Note	\$
Income Items		
Profit from the sale of one half of the Wanchai office	1	130,000
Interest from foreign deposits with a bank in Hong Kong		19,000
Rental income	2	60,000
Expense Items		
Interest expenses	3	126,000
Charitable donations	4	180,000
Loss on exchange	5	7,600
Bad debts and provision	6	94,500
Contributions to approved retirement fund	7	335,000
Depreciation	8	77,000

Note

1. The company purchased one unit of office in Wanchai for \$2,340,000, intended to be wholly used by the company. In the second half of the year, part of the office moved to the factory in Tai Po. One half of the office became surplus to the needs of the company and was sold for \$1,300,000.

It was agreed between the company and the Inland Revenue Department that 40% of the purchase price related to land cost.

2. On 1 August 2005, the company purchased a new industrial building in Tai Po from View Profits Ltd for \$4,000,000. As agreed with the Inland Revenue Department, half of the purchase price related to the land cost. One-third of the area of the building was immediately rented out to a toy manufacturer who used it entirely for production purposes. The remaining area has been used by the company as its office and manufacturing plant in equal shares. Particulars of the industrial building are as follows:

	\$
Cost of construction by developer	1,200,000
Net price paid by View Profits Ltd to the developer (land cost excluded)	1,500,000

The industrial building had not been put to use prior to 1 August 2005.

3. Interest expenses comprised the following:

	\$
Overdraft interest charged by a bank in Hong Kong in respect of an overdraft facility granted as part of the working capital	27,000
Interest on a loan from a creditor in a tax haven country where the loan was made available to the company	99,000
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	126,000
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4. Donations comprised the following:

	\$
Donations to approved charities	80,000
Payments to an approved research institute for scientific research related to the company's trade	100,000
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	180,000
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5. The loss on exchange was incurred when the company repaid a foreign currency loan used to finance the purchase of plant and machinery.

6. Bad debts comprised the following:

	\$
General provision	44,000
Specific provision	36,000
Trade debts written off	23,000
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	103,000
Less: Bad debts recovered	15,000
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	88,000
Add: Legal fee for collecting trade debts	6,500
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	94,500
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7. Contributions to an approved retirement fund comprised the following:

	\$
Initial contribution	250,000
Annual contributions (15% of participating staff salaries)	85,000
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	335,000
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8. The depreciation charged in the accounts was calculated by the straight line method for all depreciable assets. It was agreed by the Assessor that the total amount of statutory depreciation allowances in respect of the company's plant and machinery for the year of assessment 2005/06 was \$231,000.

Required:

(a) **Compute the assessable profits and the amount of profits tax payable in respect of Prosperity Ltd for the year of assessment 2005/06. Ignore provisional tax. Show all workings.** (15 marks)

(b) **Define the term 'approved research institute' and list the kinds of payments or expenditures incurred on research and development that are qualified for deduction for the purposes of s.16B of the Inland Revenue Ordinance.** (7 marks)

(22 marks)

4 (a) You are the accounting manager of a manufacturing company. An accounting officer, who is responsible to you, has prepared a schedule of capital expenditure for the year ended 31 March 2006 as follows:

	\$
(i) Replacement of implements and utensils	23,500
(ii) A newly acquired patent used in manufacturing including a registration fee of \$5,000	91,000
(iii) Office ceiling lighting points	3,700
(iv) Extension to the company's showroom	147,000
(v) Furniture and fixtures for staff club	26,000
(vi) Construction of an industrial building (completed on 1 June 2006):	
– cost of land	587,000
– cost of drainage	210,000
– cost of materials	643,000
– construction workers' wages	457,000
– other construction expenses	161,000
(vii) A bulldozer	93,000
(viii) Transfer of a motor vehicle from the Macau subsidiary of the company (its original cost was \$85,400 and it was purchased and first used in the year of assessment 2003/04)	30,000
(ix) A second hand industrial building, which had been constructed at a cost of \$2,530,000 and first used in the year 2002/03. (Both amounts are stated excluding the cost of land)	1,158,000
(x) Building of a fire escape in the acquired second hand industrial building [see (ix) above]	39,000

Unless otherwise stated, all the above assets were in use during the year to 31 March 2006.

On 1 April 2005, the tax written down values of the plant and machinery and the qualifying cost eligible for commercial building allowance of the company were as follows:

	\$
20% pool	246,700
30% pool	276,700
Qualifying cost eligible for commercial building allowance	549,680

Required:

- (i) In the case of each of the items of expenditure listed, state whether or not it is deductible or qualified for capital allowances in the computation of the company's assessable profits. (6 marks)
- (ii) Calculate the depreciation allowances available to the company for the year of assessment 2005/06. Show all workings. (13 marks)

(b) The Commissioner of Inland Revenue is authorised to raise an assessment to additional tax under s.82A.

Required:

- (i) Describe the formal procedures which the Commissioner must follow before making such an assessment to additional tax. (5 marks)
- (ii) State the requirements of a valid appeal to the Board of Review against an assessment to additional tax. (4 marks)

(28 marks)

End of Question Paper