

UNIVERSITY OF BOLTON

BUSINESS & CREATIVE TECHNOLOGIES

ACCOUNTANCY PATHWAY BY DISTANCE
LEARNING

HONG KONG – CED (INTAKES 33 & 35)

SEMESTER ONE EXAMINATION 2009/2010

ADVANCED TAXATION

MODULE NO: ACC3008

Date: Saturday 19th December 2009

Time: 3 Hours Morning

INSTRUCTIONS TO CANDIDATES:

There are **FIVE** questions on this paper.

Answer **FOUR** questions in total.

All questions carry equal marks.

The recommended textbook may be referred to in the examination

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Where relevant, the following tax rates are to be used in answering the questions on this paper:

Personal allowances		<u>2004/2005</u>	<u>2005/2006 and 2006/2007</u>	<u>2007/2008</u>	<u>2008/2009</u>
		\$	\$	\$	\$
Basic allowance		100,000	100,000	100,000	108,000
Married person allowance		200,000	200,000	200,000	216,000
Child allowance:	first	30,000	40,000	50,000	50,000
	second	30,000	40,000	50,000	50,000
Allowance for parent / grandparent aged 55 or above but below 60		-----	15,000	15,000	15,000
Dependent parent / grandparent allowance		30,000	30,000	30,000	30,000
Additional dependent parent / grandparent allowance		30,000	30,000	30,000	30,000
Additional allowance for parent / grandparent aged 55 or above but below 60		-----	15,000	15,000	15,000
Dependent brother and sister allowance		30,000	30,000	30,000	30,000
Single parent allowance		100,000	100,000	100,000	108,000
Disable dependent allowance		60,000	60,000	60,000	60,000

Depreciation allowances

	Initial	Annual
Plant and machinery	60%	10%/20%/30%
Industrial building	20%	4%
Commercial building		4%

Salaries tax and personal assessment tax rates

<u>2006/07</u>		<u>2007/2008</u>		<u>2008/2009</u>	
First \$30,000	2%	First \$35,000	2%	First \$40,000	2%
Next \$30,000	7%	Next \$35,000	7%	Second \$40,000	7%
Next \$30,000	13%	Next \$35,000	12%	Next \$40,000	12%
Remainder	19%	Remainder	17%	Remainder	17%

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Standard rate

<u>2003/2004</u>	<u>2004/2005 to 2007/2008</u>	<u>2008/2009</u>
15.5%	16%	15%

Profits tax rate for corporations

<u>2003/04</u>	<u>2004/05 to 2007/2008</u>	<u>2008/09</u>
17.5%	17.5%	16.5%

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Question 1

Mr. Shing was employed by Ace Consultant Ltd [“ACL”] as a Research Analyst. ACL filed an Employer’s Return in respect of Mr. Shing for the period 6 June 2008 to 31 March 2009, which showed the following income particulars:

	\$
Salary	752,500
Payment made to Bose Consultant Ltd [“BCL”] (Note 1)	65,000
Others [Note 2]	<u>210,378</u>
	<u>1,027,878</u>

Note 1

Mr. Shing was previously employed by BCL before joining ACL. It was provided in the employment contract between Mr. Shing and BCL that either party may terminate the employment by giving one month notice or payment in lieu of notice to the other party.

To get Mr. Shing earlier, ACL agreed to make the payment in lieu of notice for Mr. Shing given that he accepted the employment with it. The sum of \$65,000 represented the payment in lieu of notice paid by ACL directly to BCL. Mr. Shing considers that this amount should not be subject to tax, as the payment was made directly by ACL to BCL and he did not receive this amount from ACL.

Note 2

This represented the expenses paid by ACL in respect of Mr. Shing’s quarters in Shatin. ACL leased the property from the landlord and provided it rent free to Mr. Shing as his place of residence. The sum of \$210,378 was comprised of the following:

	\$
Rent (\$15,000 x 12)	180,000
Electricity, water and gas	8,730
Residents’ club expenses	<u>21,648</u>
	<u>210,378</u>

- (a) The electricity, water and gas were billed in the name of the landlord of the property. ACL made the payment directly to the landlord.
- (b) The residents’ club expenses were billed in the name of Mr. Shing. Mr. Shing paid the expenses first and was later reimbursed by ACL.

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Question 1 cont'd...

Note 3

On 20 May 2008, he was granted a share option to subscribe for 30,000 shares in the company at \$10 each. He paid \$3,000 for the option. On 1 June 2008, he exercised the option to buy 20,000 shares, of which 10,000 shares were subsequently disposed in the market on 14 July 2008. He assigned the remaining option right to his colleague for \$30,000 on 3 August 2008. The fair market value per share on respective dates was as follows:

20 May 2008	\$14
1 June 2008	\$15
14 July 2008	\$18
3 August 2008	\$16

Required:

- (a) Discuss whether the payment in lieu of notice made by ACL to BCL is part of Mr. Shing's income chargeable to Hong Kong salaries tax.
- (6 marks)**
- (b) If the payment in lieu of notice was made by Mr. Shing himself rather than ACL, advise whether the payment made by Mr. Shing is deductible in computing his salaries tax liabilities.
- (4 marks)**
- (c) For the item "Others - \$210,378" reported in the employer's return by ACL, discuss whether the rent; electricity, water and gas; residents' club expenses and share option benefits are chargeable to Hong Kong salaries tax.

(15 marks)

Total 25 marks

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Question 2

Mr. Chan is the sole proprietor of a grocery business called “Chan Kee”. In August 2008, Mr Chan has purchased a Causeway Bay apartment in the name of Chan Kee. The apartment was let to a Japanese tenant at a monthly rent of \$40,000 inclusive of management fee and rates.

For years, the profits of Chan Kee as reported in Mr. Chan’s tax returns were below his entitled personal allowances. In a recent field audit, the officers from the Inland Revenue Department (‘IRD’) found that Mr. Chan has not included one category of Chan Kee’s sales in his returns submitted to the IRD. The omission was found for the years of assessment 2006/07 to 2008/09. The omitted sales were in excess of \$1 million for each year and represented about one-fifth of Chan Kee’s total sales.

Mr. Chan told the IRD officers that he was illiterate and relied on his bookkeeper for all the accounting and tax matters. He claimed to have no knowledge of the omission and volunteered to pay tax on the omitted sales. His bookkeeper explained that the omission was an oversight.

Subsequent to the field visit, the IRD officers found by their own efforts that all the sales proceeds in respect of that omitted category of sales were deposited into the personal savings bank account, which was held in the name of the bookkeeper in trust for Mr. Chan.

Required:

- (a) Discuss the circumstances under which a corporation is liable to pay both profits tax and property tax, as well as the exemption and relief provided by the Inland Revenue Department to avoid double taxation. **(8 marks)**
- (b) Evaluate Mr. Chan’s exposure to the penal actions provided under the *Inland Revenue Ordinance* in connection with this investigation case. **(10 marks)**
- (c) Discuss the possible methods of quantification that might be used by the IRD. **(7 marks)**
- Total 25 marks**

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Question 3

Mr. Ng owns three residential properties in Hong Kong. The properties were let out for rental income under the following terms during the year ended 31 March 2009:

	Rose Court	Prima Villa	Sky Garden
Monthly rent	\$12,000	\$15,000	\$18,000
Rates per quarter (note)	\$3,000	\$3,200	\$3,500
Government rent per quarter (note)	\$1,200	\$1,280	\$1,400
Monthly management fee (payable by tenants)	\$800	\$1,000	\$1,100

Note:

- Rates and government rent were paid by the tenant for Rose Court.
- Rates and government rent were paid by Mr. Ng for Prima Villa and Sky Garden.

Due to financial difficulties, the tenant of Rose Court was only able to pay \$8,000 per month start from 1 January 2009. The tenant finally paid the outstanding rent on 1 May 2009.

In relation to the outstanding rent of \$39,000 owed by the previous tenant of Prima Villa for the period from 1 June 2006 to 31 August 2006, the Assessor agreed that such rent was irrecoverable on 1 July 2008 when the tenant declared bankruptcy.

In relation to the above properties, Mr. Ng paid for the following expenses:

	Rose Court	Prima Villa	Sky Garden
Repairs and maintenance	\$182,000	\$15,000	\$208,000
Mortgage loan for the purchase of properties	\$180,000	\$100,000	\$50,000

You have been supplied with the following information regarding the income and expenses of Mr. and Mrs. Ng:

Income - Mr. Ng:

- Employment income: \$600,000
- Assessable profit from his own business: \$100,000 (no deduction of any approved charitable donation)
- Share of partnership loss: \$300,000

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Question 3 cont'd...

Income - Mrs. Ng:

- Employment income: \$150,000
- Loss brought forward under personal assessment: \$400,000

Expenses:

	Mr. Ng	Mrs. Ng
Contributions to MPF scheme	\$12,000	\$6,000
Approved charitable donations	\$40,000	\$45,000

Mr. and Mrs. Ng have elected for personal assessment for the year of assessment 2008/09. They are living with their child aged 10.

Required:

- (a) Advise Mr and Mrs Ng regarding their eligibility to elect for personal assessment in accordance with the *Inland Revenue Ordinance*. **(2 marks)**
- (b) Compute the net assessable value of each of Mr. Ng's properties for the year of assessment 2008/09. **(9 marks)**
- (c) Compute the tax payable under personal assessment by Mr. and Mrs. Ng for the year of assessment 2008/09. Show all your workings. **(14 marks)**

Total 25 marks

Question 4

Jody Ltd carries on the business of trading in garments. It sources products from factories in the PRC, and sells exclusively to customers in the USA and Europe. Currently, it pays profits tax on all of its profits.

David, who is a director of the company, approaches you to seek advice as to how the company could reduce its tax liability. He has observed that some of his competitors own companies incorporated offshore in the BVI which are not subject to tax in the BVI, and he wonders whether using a BVI company would help to reduce taxes overall.

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Question 4 cont'd...

Required:

- (a) Advise David whether utilising a BVI company would help to reduce taxes.
(4 marks)
- (b) Suppose that the BVI company is used to provide management services to the Hong Kong business, advise David of any tax implications (including the tax anti-avoidance provisions) relating to this arrangement.
(7 marks)
- (c) Suppose that the BVI company is used to act as a re-invoicer (i.e, it could buy goods from the Hong Kong business at a relatively low-price, and re-sell the goods to the customers in the USA and Europe at the agreed-upon prices), advise David any tax implications (including the tax anti-avoidance provisions) relating to this arrangement.
(7 marks)
- (d) Alternatively, if the BVI company is used to actually buy the goods directly from the factories and to re-sell them to the customers in the USA and Europe, and the Hong Kong company simply earns a commission for providing buying agency services, advise David any tax implications relating to this arrangement.
(7 marks)
- Total 25 marks**

Question 5

The Prime Estates Group (the Group) was founded in the early sixties and the ultimate holding company in the Group, Prime Estates (Holding) Limited, a company incorporated in Bermuda, has been listed on the Hong Kong Stock Exchange since 1980.

As at 31 December 2008, its principal holdings included Excel Place, a Grade-A commercial office complex located in Central. Excel Place has 1.6 million square feet of office space. It was constructed by Prime Estates (HK) Limited. The construction of Excel Place was completed in 2002 and it was first let out in August 2002. The land cost was HK\$5 billion and the cost of construction was HK\$6 billion. As at 31 December 2008, it had a market value of HK\$23 billion (including land value).

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Question 5 cont'd...

The Group underwent corporate restructuring for the purpose of listing the property, Excel Place, under an investment trust in May 2009. The restructuring exercise involved the following transactions:

- (1) formation of an SPV (special purpose vehicle) in BVI, Excel Place (BVI) Limited, with share capital of HK\$24 billion.
- (2) allotment of all the shares in Excel Place (BVI) Limited to Prime Estates (Holding) Limited.
- (3) the transfer by Prime Estates (HK) Limited of Excel Place to Excel Place (BVI) Limited. The transfer was at market value of HK\$24 billion.

The Group engaged a tax advisor to advise on the Hong Kong Profits Tax and Hong Kong Stamp Duty implications of the transactions in the corporate restructuring.

Required:

- (e) Advise the Group as to any potential Profits tax implications arising from the restructuring exercise.
(8 marks)
- (f) Advise the Group as to any relevant depreciation allowance issues arising and show any necessary computations.
(7 marks)
- (g) Advise the Group as to any potential stamp duty issues arising from the restructuring exercise.
(10 marks)

Total 25 marks

END OF QUESTIONS