

UNIVERSITY OF BOLTON
BUSINESS & CREATIVE TECHNOLOGIES
ACCOUNTANCY PATHWAY BY DISTANCE
LEARNING
HONG KONG – CED (INTAKES 34 & 36)
SEMESTER ONE EXAMINATION 2009/2010
ADVANCED TAXATION
MODULE NO: ACC3008

Date: Saturday 27 March 2010

Time: 2.00 pm - 5.00 pm

Duration: 3 hours

INSTRUCTIONS TO CANDIDATES:

There are **FIVE** Questions.

Answer any **FOUR** Questions

Candidates are advised that the examiners attach importance to the legibility of writing and clarity of expression

University of Bolton
 Business & Creative Technologies
 Accountancy Pathway By Distance Learning
 Hong Kong – CED (Intakes 34 & 36)
 Semester 2 Examination 2009/2010
 Advanced Taxation
 Module No. ACC3008

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

Personal allowances	2004/2005	2005/2006 <u>and</u>	2007/2008	2008/2009
	\$	\$	\$	\$
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	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%

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%

PLEASE TURN THE PAGE

University of Bolton
Business & Creative Technologies
Accountancy Pathway By Distance Learning
Hong Kong – CED (Intakes 34 & 36)
Semester 2 Examination 2009/2010
Advanced Taxation
Module No. ACC3008

Question 1

Hong (Holding) Limited (HH) has a subsidiary in Hong Kong: Hope Time Limited (HT) which is a watch manufacturer.

HT signed a processing agreement with Precision (China) Limited (PCL), a mainland Chinese company for a term of 5 years on 1 April 2008. The processing agreement has been approved by the relevant mainland Chinese authorities. The agreement includes the following terms: HT provides PCL with raw materials, manufacturing machinery and equipment, and technical assistance at no charge. HT also takes title over the raw materials and the finished goods. PCL manufactures the finished goods which are exported to HT at no charge. HT then sold the finished goods to customers in Hong Kong and overseas.

During the year end 31 March 2009, the management accounts of HT show the following items:

- Gross profit of \$27,500,000,
- Processing fee of \$2,500,000 paid to PCL, and
- Unrealized exchange gain of \$115,000 for sales made to overseas customers.

Required:

(a) Critically assess the extent that HT's gross profit is chargeable to Hong Kong tax.

(13 marks)

(b) Assuming that the Assessor of the Inland Revenue Department agrees that HT's gross profit is apportioned on a 50:50 basis for the year of assessment 2008/09, discuss and evaluate the tax treatments of HT's processing fee and unrealised exchange gain.

(12 marks)

TOTAL 25 MARKS

PLEASE TURN THE PAGE

University of Bolton
Business & Creative Technologies
Accountancy Pathway By Distance Learning
Hong Kong – CED (Intakes 34 & 36)
Semester 2 Examination 2009/2010
Advanced Taxation
Module No. ACC3008

Question 2

Mr. Chan is a senior marketing director at Hong Prosper Limited (HP). The following information related to his personal affairs for the year ended 31 March 2009:

1. His employment contract was negotiated in the US (where he was then living) but signed by him in Hong Kong when he was investigating his proposed work environment. His remuneration (see item 6 below) was deposited into his account with the Hong Kong branch of the Bank of America. During the year he spent 120 days working outside Hong Kong. He did not take any holidays during the year.
2. He is one of the directors of a joint venture (which is managed and controlled in Shenzhen) set up by HP in Mainland China. For this post he was paid a fee of \$100,000.
3. In order to help him in his job, he subscribed for a magazine called 'Technology Today' at an annual subscription fee of \$2,000 and purchased a personal computer at \$40,000. The personal computer was used to send faxes, emails etc. This computer saved him an enormous amount of time, especially when in his hotel room whilst he was travelling overseas. He used the computer exclusively for work purposes.
4. As part of his employment package he is entitled to participate in a share option plan established by HP. He was granted 1,000 options on 1 December 2008 (market value \$30 per share). He exercised the options on 1 March 2009 (market value \$25 per share) and sold them on 31 March 2009 (market value \$28 per share). The cost of the option was nil, but under the terms of the option agreement the cost upon exercise was \$15 per share. All of his service was taken into account when the company assessed his qualification to participate in its share option scheme.

**Question 2 continued over...
PLEASE TURN THE PAGE**

University of Bolton
Business & Creative Technologies
Accountancy Pathway By Distance Learning
Hong Kong – CED (Intakes 34 & 36)
Semester 2 Examination 2009/2010
Advanced Taxation
Module No. ACC3008

Question 2 cont'd...

5. HP gave him the choice of being remunerated by a salary of \$100,000 per month plus accommodation benefit worth \$100,000 per month (this would take the form of rent-free accommodation in the company's luxurious Kowloon Tong flat) or an increased salary amounting to \$200,000 per month. He chose the second alternative and rented a flat in Central for \$80,000 per month. In its Employer's Return, HP split his remuneration into 2 parts: salary \$120,000 per month and an 'accommodation allowance' of \$80,000 per month.
6. His wife worked part time as a court reporter in Hong Kong and earned a salary of \$240,000.
7. He has two children aged 23 and 24. The eldest son, unmarried, is a full time Ph.D. student at UCLA, California. The youngest daughter, also unmarried, was a full time M.Phil. student at UCLA until she graduated in July 2008. She then took a highly paid job as a computer systems officer in California.
8. His father-in-law, aged 60, who had previously lived alone in Causeway Bay, became ill and unable to look after himself. On 1 December 2008, Mr. Chan arranged his father-in-law to live in a nursing home (registered under the Nursing Homes and Maternity Homes Registration Ordinance) in North Point. Thereafter, he paid all the nursing care and food bills amounting to \$20,000 per month.

Required:

- (a) With relevant computations, evaluate whether it is advantageous for Mr. and Mrs. Chan to elect for Joint Assessment for the year of assessment 2008/09.

(13 marks)

- (b) Based on an evaluation of the above scenario advise Mr Chan of the tax treatment for items (1) to (5) above

(12 marks)

**TOTAL 25 MARKS
PLEASE TURN THE PAGE**

University of Bolton
Business & Creative Technologies
Accountancy Pathway By Distance Learning
Hong Kong – CED (Intakes 34 & 36)
Semester 2 Examination 2009/2010
Advanced Taxation
Module No. ACC3008

Question 3

Jackie Chan has started her career as a freelance writer with various major fashion magazines in Hong Kong since January 2005. She provided part-time services to those magazines in return for an authoring fee. However Jackie has never applied for a business registration certificate nor has she kept any records of her own income, and it was so arranged that the authoring fees were credited directly by the payers to the bank account of Chan & Chan.

Chan & Chan is a newspaper stand business ran by Jackie's father and mother before they retired last year. For years the profits of Chan & Chan as reported in the tax returns of were below the married personal allowance, and as a result Jackie's father and mother was not required to pay any tax for the profits made. Subsequently in March 2008 Jackie ceased to work as a freelance writer, as she was offered a full time job by one of the international magazines in Hong Kong.

In August 2009, Chan & Chan was under field audit. Following the initial interview, the field auditors from the Inland Revenue Department issued a notice under *section 51(4)(a) of the Inland Revenue Ordinance* to Chan & Chan requiring it to produce its business books and records for examination.

Subsequently the officers of Inland Revenue Department ["IRD"] found that Chan & Chan had actually ceased business for years. They also discovered that Jackie did not report the authoring fees in her own tax returns for the years of assessment from 2005/06 to 2007/08.

Required:

(a) Discuss Jackie's tax filing obligations in respect of her authoring fees under the *Inland Revenue Ordinance*. **(7 marks)**

(b) Evaluate Jackie's exposure to the penal actions provided under the Inland Revenue Ordinance. **(8 marks)**

Question 3 continued over...

PLEASE TURN THE PAGE

University of Bolton
Business & Creative Technologies
Accountancy Pathway By Distance Learning
Hong Kong – CED (Intakes 34 & 36)
Semester 2 Examination 2009/2010
Advanced Taxation
Module No. ACC3008

Question 3 cont'd...

(c) Critically discuss and the methods that might be employed by the Inland Revenue Department in quantifying the amount of understated profits in a field audit case, and analyze the approach that might be adopted by the tax representative.

(10 marks)

TOTAL 25 MARKS

Question 4

As at 1 January 2006, Loser Ltd had a licensing agreement with Winner Corporation, a US company with no business operations in Hong Kong. Under this original agreement, Loser was obliged to pay Winner a fixed annual license fee of HK\$8,000,000 at 31 December each year in return of the right of using a nano technology onto the products produced by Loser.

On 1 April 2009, Loser entered into a new agreement with Winner under which Loser would pay a lump sum payment of HK\$20,000,000 as a consideration to acquire the nano patent from Winner. At the same time when Loser entered into the new agreement with Winner, Loser also acquired a 50% equity interest in Winner at a cash consideration of HK\$80,000,000.

The nano products are manufactured in PRC production facilities owned by Loser subsidiaries under import processing agreements. The finished products are shipped back to Hong Kong for local sales.

Required:

You are currently appointed as a tax advisor for Loser and based on an evaluation of the above scenario you are required to, provide a report to Loser's finance director on the following issues:

(a) The deductibility of the payments made by Loser under the original and the new agreements for Hong Kong Profits Tax purposes; **(10 marks)**

Question 4 continued over...

PLEASE TURN THE PAGE

University of Bolton
Business & Creative Technologies
Accountancy Pathway By Distance Learning
Hong Kong – CED (Intakes 34 & 36)
Semester 2 Examination 2009/2010
Advanced Taxation
Module No. ACC3008

Question 4 cont'd...

(b) The taxability of the income received by Winner under the original and the new agreements for Hong Kong Profits Tax purposes; and **(10 marks)**

(c) Whether the income received by Winner is subject to Hong Kong Profits Tax and the possible obligations of Loser under the *Inland Revenue Ordinance*.

(5 marks)

TOTAL 25 MARKS

Question 5

Patrick Tan is a Financial Advisor and has been engaged as a Senior Advisor by a Securities Firm ["the Firm"] in Hong Kong. The appointment of Patrick Tan by the Firm was made through PT Ltd, of which Patrick and his wife are the major shareholders and directors.

By an Employment Contract, Patrick was employed by PT Ltd as its Executive Director. He was entitled to monthly remuneration of \$20,000 plus an annual vacation leave of 30 days according to this Employment Contract.

Under a separate Service Contract entered into between PT Ltd and the Firm, PT Ltd agreed to assign Patrick to work for the Firm. According to the Service Contract, PT Ltd was entitled to a monthly remuneration of \$50,000 and an annual bonus from the Firm. The Firm made the payment by monthly auto-pay to PT Ltd's bank account. In the performance of his services, Patrick always carried with him two name cards: one with the title of Executive Director issued by PT Ltd; another as Senior Advisor under the name of the Firm.

Required:

Based on an evaluation of the above scenario comment on the respective Hong Kong tax implications to the Firm, PT Ltd and Patrick Tan under the above arrangement.

TOTAL 25 MARKS

END OF QUESTIONS