

UNIVERSITY OF BOLTON

**SCHOOL OF BUSINESS AND CREATIVE
TECHNOLOGIES**

**BA (HONS) ACCOUNTANCY BY DISTANCE
LEARNING**

HONG KONG – CED (INTAKES 38 & 40)

SEMESTER 2 EXAMINATIONS 2010/2011

ADVANCED TAXATION

MODULE NO: ACC3008

Date: 26th March 2011

Time: 3 hours

INSTRUCTIONS TO CANDIDATES:

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

Answer **ANY FOUR** questions.

All questions carry equal marks.

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

School of Business and Creative Technologies
 BA (Hons) Accountancy by Distance Learning
 Hong Kong – CED (Intakes 38 & 40)
 Semester 2 Examinations 2010/2011
 Advanced Taxation
 Module No. ACC3008

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 onwards</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 onwards</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 onwards</u>
15.5%	16%	15%

Profits tax rate for corporations

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

PLEASE TURN THE PAGE...

School of Business and Creative Technologies
BA (Hons) Accountancy by Distance Learning
Hong Kong – CED (Intakes 38 & 40)
Semester 2 Examinations 2010/2011
Advanced Taxation
Module No. ACC3008

Answer ANY FOUR questions

Question 1

Mr Van used to work for an investment bank in Hong Kong. He recently attended an interview with HKCO Limited (HKCO) in Hong Kong and the employer was happy to employ him. Mr Van will be stationed in Hong Kong and is in charge of all financial matters for the Hong Kong operations. HKCO is very eager to employ Mr Van and is happy to structure the remuneration package in accordance with Mr Van's wish, so long as it is reasonable.

Initially, HKCO offers Mr Van with the following all cash remuneration package:

Basic salary	\$2,400,000 p.a.
Bonus	\$1,200,000 p.a.
Housing allowance	\$50,000 p.m.
Car allowance	\$12,000 p.m.
Education allowance for his children	\$200,000 (one off payment)
Other allowance	\$40,000 p.a.

Additional information:

1. Mr Van sold his flat immediately before his interview and would need to buy another flat or rent a place. He has not decided what to do yet. He prefers to live in luxurious flat which are normally rented at the rate of \$100,000 p.m.
2. Mr Van does not own a car but he will need one for his private purpose. HKCO is willing to provide a car for Mr Van's private use if needed.
3. HKCO is willing to provide a gratuity to Mr Van at the completion of a few years' service provided the salary will be reduced by the same amount.
4. HKCO is willing to pay for the school fees of Mr Van's children, provided the related allowances would be reduced accordingly.

Required:

Critically appraise Mr Van's current Hong Kong Salaries Tax position, and formulate a remuneration package based on his requirements for the consideration of HKCO. Support your suggestions with appropriate comparison of Mr Van's tax liability before and after the tax planning. Note that the proposed remuneration should be about the same as HKCO's initial budget.

TOTAL 25 marks

PLEASE TURN THE PAGE...

School of Business and Creative Technologies
BA (Hons) Accountancy by Distance Learning
Hong Kong – CED (Intakes 38 & 40)
Semester 2 Examinations 2010/2011
Advanced Taxation
Module No. ACC3008

Question 2

Mr Johnson is a resident in Hong Kong. He was the Finance Director of Fir Limited for 15 years until March 2010, when his employment was terminated. If Fir Limited wants to terminate the contract, a notice of 3 months would be required. Or alternatively a payment in lieu of notice of \$600,000 needs to be made. Since Fir Limited already had a replacement, Fir Limited is considering an additional termination payment of \$1,000,000 in excess of *Employment Ordinance* requirement, in order to induce Mr Johnson to leave his employment immediately.

In April 2010, Mr. Johnson accepted a job offer which requires him to relocate to Singapore. After accepting the job offer in Singapore in April 2010, Mr. Johnson is planning to move the whole family to Singapore. He had made numerous business trips when he previously worked with Fir Limited in Hong Kong. He did not report to Inland Revenue Department (IRD) for all those trips. He wondered if he really needed to bother about reporting to IRD for his impending leave to Singapore.

Mr Johnson was also of the opinion that he will fall outside the scope of Hong Kong Salaries Tax in the Year of Assessment 2009/10, since both the payment in lieu of notice and the additional termination payment he received from Fir Limited should in fact exempt from Hong Kong Salaries Tax.

As such, Mr. Johnson decides to leave without completing the tax clearance. He considers that it is not important to do the tax clearance. He thinks that he needs not pay the Hong Kong taxes until the IRD assesses him afterwards and sends him the notice of assessment. He also thinks that it is not unreasonable for him to notify the IRD later, probably two or three months later, since he is required to report duty to Singapore in a hurry and is kept extremely busy in his relocation.

He lived with his parents (both aged 60), and his parents in law were living in an elderly home in Canada. The parents in law were both aged 62 and have the Hong Kong Identity Cards and the right of abode in Hong Kong. Mr. Johnson supported both parents in law wholly.

Required:

(a) Analyse what may be the consequences for Mr Johnson's decision. Cite the relevant provisions in your explanation.

(13 marks)

(b) Analyse what may be the tax consequences if Mr Johnson has claimed the dependent parent allowance in respect of his parents in law.

(12 marks)

TOTAL 25 MARKS

PLEASE TURN THE PAGE...

School of Business and Creative Technologies
 BA (Hons) Accountancy by Distance Learning
 Hong Kong – CED (Intakes 38 & 40)
 Semester 2 Examinations 2010/2011
 Advanced Taxation
 Module No. ACC3008

Question 3

John and Mary are husband and wife. During the year of assessment 2009/10, they derived the following profit and income:

Profit from partnership business

John and Mary have been carrying on a partnership business for 5 years in the name of 'Lucky Boutique' in Mongkok as a retailer of dresses and ornaments. The partnership closes its accounts on 31 March each year.

During the year ended 31 March 2010, John drew monthly salary of \$5,000 and Mary drew monthly salary of \$4,000 respectively. Their mandatory contributions to an MPF scheme as a self-employed person were also paid by the partnership. They share profits/losses equally.

The profit and loss account of the partnership for the year ended 31 March 2010 showed the following net profit:

	\$	\$
Sales		5,000,000
Less: Cost of goods sold		<u>4,000,000</u>
Gross profit		1,000,000
Less: Partner's salaries:		
John	60,000	
Mary	48,000	
Mandatory contributions to MPF scheme:		
John	3,000	
Mary	2,400	
Rent paid to John	240,000	
Other expenses (all deductible)	<u>346,600</u>	<u>700,000</u>
Net profit		<u>300,000</u>

Rental income

John is the sole owner of the business premises of Lucky Boutique in Mongkok. The property was let to the partnership for 2 years since 1 April 2009 at a monthly rent of \$20,000.

**Question 3 continued over
PLEASE TURN THE PAGE...**

School of Business and Creative Technologies
BA (Hons) Accountancy by Distance Learning
Hong Kong – CED (Intakes 38 & 40)
Semester 2 Examinations 2010/2011
Advanced Taxation
Module No. ACC3008

Question 3 continued

John was personally liable to pay rates of \$10,000 a year to the Government and management fees of \$1,500 a month to the management company. In addition, John financed the purchase of the property by a mortgage loan on which he paid total interest of \$100,000 during the year ended 31 March 2010.

Other information

1. During the year, John maintained an unmarried child, aged 20, who was undertaking part-time study in a technical institute in Hong Kong.
2. John, Mary and their child are living in a dwelling which was purchased in 2006 by Mary as the sole owner. She financed the acquisition of the dwelling by a home loan borrowed from the bank. During the year ended 31 March 2010, total home loan interest of \$80,000 was paid by Mary.
3. John and Mary elected personal assessment for the year of assessment 2009/10. They had not paid any profits tax or property tax previously for this year.
4. John and Mary intend to expand their boutique business to Macau. The business will be carried on in a shop in Macau. The shop will be staffed by local employees selling dresses and ornaments to local residents.

Required:

Based on an evaluation of the above scenario:

- (a) **Prepare a profits tax computation on the partnership Lucky Boutique for the year of assessment 2009/10. Show the allocation of the assessable profits between the partners. Ignore provisional tax. Show all workings.**
(7 marks)
- (b) **Prepare John's property tax computation for the year of assessment 2009/10. Ignore provisional tax. Ignore provisional tax. Show all workings.**
(4 marks)
- (c) **Prepare John and Mary's personal assessment computation for the year of assessment 2009/10, assuming that they wish to claim all the deductions, concessionary deductions and personal allowances for which they are eligible. Calculate the tax payable by John and Mary respectively under personal assessment. Ignore provisional tax. Show all workings.**
(10 marks)
- (d) **Advise John and Mary whether the profits derived from the Macau business, if any, would be subject to Hong Kong profits tax.**
(4 marks)

TOTAL 25 MARKS

PLEASE TURN THE PAGE...

School of Business and Creative Technologies
BA (Hons) Accountancy by Distance Learning
Hong Kong – CED (Intakes 38 & 40)
Semester 2 Examinations 2010/2011
Advanced Taxation
Module No. ACC3008

Question 4

Until January 2008 Samuel & Co closed its factory situated in Yuen Long and moved its manufacturing operation into the Mainland. In June 2008, Samuel & Co signed a subcontracting agreement with a manufacturing company in the Mainland, the China Production Company (CPC).

Accordingly to the subcontracting agreement with Samuel & Co, CPC would purchase raw material from Samuel & Co, processes the furniture in the Mainland and sells finished furniture back to Samuel & Co. CPC also sold to other clients abroad on its own account. Samuel & Co concluded ordinary trading contracts with CPC.

Mr. Samuel noted some arguments in a recent court case concerning the possibility of claiming apportionment in a processing case. Mr. Samuel thought that Samuel & Co had some chance of arguing for apportionment. He drafted Samuel & Co's case following similar lines of arguments of the case:

“Evidence showed that the purchases and sales were not made at arm's length prices. Facts were also established that the purchase invoices and sales invoices were all made only to fulfil the requirements of Mainland tax authorities. Samuel & Co in fact supplied some of the raw materials at cost to CPC. In fact, there were also instances when Samuel & Co supplied the raw materials even below cost.

Samuel & Co also had an agency agreement with CPC. CPC has an authority to handle all goods consumed by Samuel & Co to CPC. Samuel & Co also provided board minutes that authorised this agency agreement. In the circumstances, Samuel & Co's profits were derived from the manufacturing activities in the Mainland China itself and CPC on its behalf. Alternatively, Samuel & Co contended that it came within the concession of 50:50 profit apportionment.”

IRD inspected the minutes authorizing the agency agreement, and questioned whether that meeting was properly convened and conducted.

In addition to the supply of raw materials, Samuel & Co would also provide production machines to CPC free of charge according to the subcontracting agreement. Samuel & Co purchased two production machines at a cost of \$3,000,000 in July 2008. All machines were then installed and used at CPC's factory.

On the other hand, Samuel & Co also incurred a total of \$600,000 on the refurbishment of staff quarters in December 2008. Mr. Samuel thinks that the IRD should allow a deduction for these expenditures.

**Question 4 continued over
PLEASE TURN THE PAGE...**

School of Business and Creative Technologies
BA (Hons) Accountancy by Distance Learning
Hong Kong – CED (Intakes 38 & 40)
Semester 2 Examinations 2010/2011
Advanced Taxation
Module No. ACC3008

Question 4 continued

Required:

(a) In the above circumstances, evaluate whether apportionment is available in this case and state the tax effects of your case.

(15 marks)

(b) Suggest whether depreciation allowance and *Section 16F* should be available in respect of the machines and the refurbishment of staff quarters in the Mainland. Argue both for and against the allowance being available.

(10 marks)

TOTAL 25 MARKS

PLEASE TURN THE PAGE...

School of Business and Creative Technologies
BA (Hons) Accountancy by Distance Learning
Hong Kong – CED (Intakes 38 & 40)
Semester 2 Examinations 2010/2011
Advanced Taxation
Module No. ACC3008

Question 5

Sunny Ltd (SL) was incorporated in Hong Kong in 1981, its directors being Mr Jackson and his wife. SL's principal business was the design, manufacture and trading of garment.

Mr Jackson's father owns another company, Lolo Limited (LL), which is engaging in technology business. LL has been suffering losses for many years. The agreed losses for recent years were as follows:

Year of assessment	Agreed losses (\$)
2005/06	(2,285,425)
2006/07	(8,772,359)
2007/08	(4,258,200)
2008/09	(8,543,088)
2009/10	(10,699,500)

Due to the sustained losses, LL is in financial difficulty. Mr Jackson's father wanted Mr Jackson to help LL out. Mr Jackson is pondering on acquiring LL through SL and transferring the garment trading business to that entity.

Mr Jackson has also set up a new company, MCO Limited (MCO), in Mauritius. Under the master supply agreement, MCO would buy the garment from the suppliers and then sell them to SL at a 40% mark up. Through such arrangement, the gross profit margin of SL would be reduced by 10%.

Required:

Analyse the potential risks in relation to the above tax planning structures, and suggest to Mr Jackson what he should do to mitigate such risks.

TOTAL 25 MARKS

END OF QUESTIONS