

Table A: Personal allowances and deductions

Year of assessment	2018/19	2019/20
Personal allowances	HK\$	HK\$
Basic	132,000	132,000
Married person's	264,000	264,000
Single parent	132,000	132,000
Child		
1 st to 9 th child (each)	120,000	120,000
Additional allowance in the year of birth (each)	120,000	120,000
Dependent parent/ grandparent (aged 60 or above or is eligible to claim an allowance under the Government's Disability Allowance Scheme)		
Basic	50,000	50,000
Additional (for dependant residing with taxpayer continuously throughout the whole year)	50,000	50,000
Dependent parent/ grandparent (aged 55 – 59)		
Basic	25,000	25,000
Additional (for dependant residing with taxpayer continuously throughout the whole year)	25,000	25,000
Dependent brother/ sister	37,500	37,500
Personal disability	75,000	75,000
Disabled dependant	75,000	75,000
Deductions/ Concessionary deductions	HK\$	HK\$
Self-education expenses	100,000	100,000
Home loan interest	100,000	100,000
Elderly residential care expenses	100,000	100,000
Contributions to recognised retirement schemes	18,000	18,000
Qualifying premiums paid under voluntary health insurance scheme policy	-	8,000
Qualifying annuity premiums & Tax deductible MPF voluntary contributions ("TVC")	-	60,000
Approved charitable donations	35%	35%
Depreciation allowances (For all years of assessment in this paper)		
Plant and machinery:	Initial allowance ("I.A.") Annual allowance ("A.A.")	60% Given in question
Industrial building:	I.A. A.A.	20% 4%
Commercial building:	A.A.	4%

Table B: Tax rates

Year of assessment		
	2018/19*	2019/20*
Tax rates	%	%
Standard	15.0	15.0
Progressive		
HK\$1 – HK\$50,000	2.0	2.0
HK\$50,001 – HK\$100,000	6.0	6.0
HK\$100,001 – HK\$150,000	10.0	10.0
HK\$150,001 – HK\$200,000	14.0	14.0
Above HK\$200,000	17.0	17.0
Corporation profits tax	16.5	16.5
Two-tiered profits tax rates		
First HK\$2 million assessable profits		
Unincorporated businesses	7.5	7.5
Corporations	8.25	8.25
Over HK\$2 million assessable profits		
Unincorporated businesses	15.0	15.0
Corporations	16.5	16.5

*100% of the final tax payable under profits tax, salaries tax and tax under personal assessment would be waived, subject to a ceiling of HK\$20,000 per case.

Table C: Stamp duty rates

Conveyance and Agreement for sale		
Ad Valorem Duty (marginal reliefs ignored)		
	Scale 1	Scale 2
Not exceeding HK\$2,000,000	1.5%	HK\$100
HK\$2,000,001 to HK\$3,000,000	3%	1.5%
HK\$3,000,001 to HK\$4,000,000	4.5%	2.25%
HK\$4,000,001 to HK\$6,000,000	6%	3%
HK\$6,000,001 to HK\$20,000,000	7.5%	3.75%
Exceeding HK\$20,000,000	8.5%	4.25%
For residential property	From 5 November 2016 15%	(unless specifically exempted or provided otherwise)
Special Stamp Duty		
Holding period		
Not exceeding 6 months		20%
More than 6 months but 12 months or less		15%
More than 12 months but 36 months or less		10%
Buyer's Stamp Duty		15%
Lease		
Rent only:		
Not exceeding 1 year		0.25%
Not exceeding 3 years		0.5%
Exceeding 3 years		1%
Premium and rent:		
Premium part		4.25%
Rent part		same as rent only lease
Hong Kong Stock Transfer		
Contract notes		0.2%
Instrument of transfer		HK\$5

Table D: Abbreviation

DIPN	Departmental Interpretation and Practice Notes
IRD	Inland Revenue Department
IRO	Inland Revenue Ordinance

SECTION B – WRITTEN QUESTIONS (Total: 80 marks)

Answer **ALL** questions in this section. Marks are indicated at the end of each question. Together they are worth 80% of the total marks for this examination. **For computational questions, show all your workings.**

Question 1 (26 marks – approximately 48 minutes)

Square Limited ("the Company") was incorporated and is carrying on business in Hong Kong. Ken is the director of the Company. The Company has no connected entity. The Company prepares its accounts to 31 December each year. The detailed income statement for the year ended 31 December 2019 is as follows:

	HK\$	HK\$
Gross trading profit		19,436,000
Compensation received (Note 1)		500,000
Interest received (Note 2)		200,000
Rental income (Note 3)		900,000
		<u>21,036,000</u>
Less: Audit fees	80,000	
Director's remuneration	1,200,000	
Salaries & allowances (Note 4)	6,210,000	
Contributions to MPF scheme (Note 5)	715,500	
Loss on sale of fixed assets	120,000	
Rent & rates (Note 6)	647,000	
Interest (Note 7)	600,000	
Commission (Note 8)	900,000	
Bad debts (Note 9)	450,000	
Research & development expenditure (Note 10)	3,000,000	
Legal & professional fees (Note 11)	200,000	
Motor vehicles expenses (Note 12)	380,000	
Donations (Note 13)	100,000	
Depreciation	270,000	
Sundry expenses (all allowable)	<u>520,000</u>	<u>(15,392,500)</u>
		<u>5,643,500</u>

Notes:

	HK\$
(1) Compensation from a supplier for cancellation of a trading contract	200,000
Compensation for cancellation of sale and purchase contract of a property for its business use	<u>300,000</u>
	<u>500,000</u>

(2)	Interest received on US dollar fixed deposit placed with a bank in Hong Kong	120,000
	Interest from a customer in Italy on its overdue trade receivable balance	80,000
		<u>200,000</u>
		HK\$
(3)	Property A in Macau	300,000
	Property B in Hong Kong	600,000
		<u>900,000</u>
	Property B is an office unit and it is let to an unrelated party.	
(4)	This included compensation of HK\$1,500,000 paid to its former staff for not competing with the Company's business for four years.	
(5)	Special contributions to MPF scheme	250,000
	Annual contributions in respect of Ken (20% on remuneration)	240,000
	Other employees (5% on remuneration)	225,500
		<u>715,500</u>
(6)	Office rent	600,000
	Rates for office	28,000
	Rates for Property B	19,000
		<u>647,000</u>
(7)	Bank overdraft interest to Bank H in Hong Kong. The overdraft facility was used for the Company's daily operation and was secured by the personal guarantee of Ken.	
(8)	Commission to salesmen in Hong Kong	300,000
	Commission to overseas agents	450,000
	Commission to unidentified recipients	135,000
	Commission to property agent for handling Property A	15,000
		<u>900,000</u>
(9)	Trade debts written off	400,000
	Loan to a customer written off	120,000
	Bad debt recovered (this was a loan to a supplier previously written off and not allowed)	(70,000)
		<u>450,000</u>
(10)	A research and development expenditure was incurred for its business. It was accepted that the expenditure is classified as Type B expenditure being a qualifying expenditure for its in-house qualifying research and development activities.	
(11)	Secretarial and tax filing services fees	70,000
	Legal fee for purchasing office property as mentioned in Note 1	30,000
	Professional fee for tax appeal	100,000
		<u>200,000</u>

(12)	Fines	12,000
	Car-parking charges	350,000
	Repairs	18,000
		<u>380,000</u>

- (13) Cash donations to approved charitable organizations.

Other information:

- (14) The Company incurred a refurbishment expenditure of HK\$300,000 on Property B in the year of assessment 2017/18.

- (15) For commercial building allowance purpose, the Company had incurred the following qualifying expenditure (construction costs):

	HK\$
Property B	4,000,000
Office premises	800,000
	<u>4,800,000</u>

During the year, the Company constructed a new cockloft in its office premises for HK\$600,000. The new cockloft was put into use in November 2019.

- (16) The Company was entitled to depreciation allowance for plant & machinery of HK\$420,000 for the year of assessment 2019/20.

Required:

- (a) **Compute the amount of commercial building allowance available to Square Limited for the year of assessment 2019/20.**

(3 marks)

- (b) **Compute Square Limited's Hong Kong profits tax liability for the year of assessment 2019/20. Ignore provisional profits tax.**

(17 marks)

- (c) **Explain the profits tax treatment in respect of the following items:**

- (i) **Interest received on US dollar fixed deposit placed with a bank in Hong Kong (Note 2), and**

(4 marks)

- (ii) **Compensation paid to retired former staff (Note 4).**

(2 marks)

Question 2 (18 marks – approximately 32 minutes)

Steve is employed by AA Limited as general manager in Hong Kong. AA Limited is incorporated and carried on business in Hong Kong. You have been supplied with the following information regarding Steve's employment for the year ended 31 March 2020:

- (1) Salary: HK\$1,200,000
- (2) Bonus: HK\$200,000
- (3) During the period from 1 April 2019 to 30 September 2019, Steve rented a flat as his residence at a monthly rent of HK\$40,000. AA Limited refunded the whole amount of rent to him.

Starting from 1 October 2019, Steve moved into his own flat purchased by him in September 2019. The cost of the flat was HK\$12,500,000, which was financed with the mortgage loans granted by AA Limited (HK\$4,000,000) and Bank A in Hong Kong (HK\$5,000,000). AA Limited also gave a monthly allowance of HK\$40,000 to Steve for the repayment of mortgage loans. During the period from 1 October 2019 to 31 March 2020, Steve paid the followings in respect of the two mortgage loans:

Recipient	AA Limited	Bank A
	HK\$	HK\$
Principal	0	120,000
Interest	30,000	90,000

- (4) In April 2019, Steve took a nine days business trip to Germany, followed by a seven days' vacation leave there. His wife, Mary, joined him during the vacation leave. AA Limited paid HK\$90,000 to a travel agency for Steve's air-ticket, accommodation and catering. Steve paid HK\$54,000 to the travel agency for Mary's air-ticket and catering. No additional cost was required for accommodation. The cost of the air-ticket was HK\$40,000 each.
- (5) On 1 June 2019, Steve was granted an unconditional option to purchase 100,000 shares of AA Limited at HK\$2 each within two years. Steve paid HK\$10,000 for the option. On 10 July 2019, he exercised the option. On 30 November 2019, he received dividends of HK\$80,000 from AA Limited. The market values per share were as follows:

1 June 2019	HK\$3.80
10 July 2019	HK\$5.00
30 November 2019	HK\$4.50

- (6) Steve's elder son, Ronald, is studying full-time in an international school in Hong Kong. AA Limited signed a contract with the school so that the school fees of Ronald were payable by AA Limited. During the year, AA Limited paid total school fees of HK\$140,000 to the school.

- (7) Steve is the director of AB Limited. AB Limited is a wholly owned subsidiary of AA Limited, carrying on business in Hong Kong. During the year, he received director's fees of HK\$150,000 from AB Limited.

Other information:

- (8) Mary is a housewife. They have two sons, Ronald and George. George was born on 2 March 2020. Steve's father who is aged 68 is living with them.

- (9) During the year, Steve paid the following:

	HK\$
(a) Subscription to professional association related to his employment	2,150
(b) Cash donations for AA Limited's lucky draw at its annual dinner	3,000
(c) Cash donations to approved charitable organizations	90,000
(d) Self-education expenses for an MBA course	60,000
(e) Mandatory contribution to MPF scheme	18,000
(f) Qualifying annuity premiums	60,000

Required:

- (a) Compute the amount of share option gain chargeable to salaries tax for the year of assessment 2019/20.

(2 marks)

- (b) Compute Steve's salaries tax liability for the year of assessment 2019/20. Ignore provisional salaries tax.

(12 marks)

- (c) Analyse the tax treatment in respect of the following items:

- (i) Dividend of HK\$80,000 from AA Limited (Note 5), and

(2 marks)

- (ii) Cash donations for AA Limited's lucky draw at its annual dinner (Note 9(b)).

(2 marks)

Question 3 (9 marks – approximately 16 minutes)

Joe purchased a residential flat for his own use in August 2013. 70% of the purchase price was financed by a mortgage loan obtained from a bank in Hong Kong with repayment terms of 25 years, and the balance was made from his past savings. Joe had no history of purchase and sale of property. In March 2020, he sold the residential flat and obtained huge gain. He used the proceeds to purchase a new residential property as his residence.

He approached you for advice and wondered whether he was required to pay tax on the disposal. You told Joe that only gain from a transaction constituted an adventure in the nature of trade will be taxable.

Required:

- (a) List out the factors for considering whether a transaction constitutes an adventure in the nature of trade.
(6 marks)
- (b) Based on the above information, analyse whether the gain on disposal of the residential flat by Joe is likely to be subject to profits tax.
(3 marks)

Question 4 (9 marks – approximately 16 minutes)

North Limited commenced business on 1 March 1970. It prepared its accounts to 31 December each year. It ceased business on 31 October 2019 and there was no successor to the business. You have been supplied with the following information:

- (1) The tax written down values of plant and machinery brought forward from the year of assessment 2018/19 are as follows:

20% pool	HK\$37,000
30% pool	HK\$25,000

During the period from 1 January 2019 to 31 October 2019, North Limited purchased new furniture (A.A.: 20%) of HK\$30,000. Upon cessation of business, all its plant and machinery were sold with the following sale proceeds (not exceeding original cost):

20% pool assets	HK\$14,000
30% pool assets	HK\$30,000

- (2) The residual value of decoration of office for the purpose of commercial building allowance brought forward from the year of assessment 2018/19 is HK\$40,000. The office was returned to the landlord when the business ceased.
- (3) Adjusted profits/ (losses) before depreciation allowances for the relevant years:

	HK\$
Period from 1 January 2019 to 31 October 2019	190,000
Year ended 31 December 2018	300,000
Year ended 31 December 1974	120,000
Year ended 31 December 1975	(4,000)

Required:

- (a) Compute the amount of depreciation allowance of plant and machinery available to North Limited for the year of assessment 2019/20. (3 marks)
- (b) Compute North Limited's assessable profits for the year of assessment 2019/20 (cessation year). You are required to specify the basis period of the year of assessment 2019/20. (6 marks)

Question 5 (9 marks – approximately 16 minutes)

Paul is a resident of Country A and is working there. When he was seconded to work with his employer's subsidiary in Hong Kong in 2017, he purchased a residential flat ("the Property") as his residence for HK\$12,000,000. Paul obtained a mortgage loan with a bank in Hong Kong to finance the purchase of the Property. He left Hong Kong in March 2018 and he appointed a property agent to let out the Property.

The Property was then let to John under the following terms:

- (1) Lease period: 1 April 2019 – 30 September 2021 (30 months)
- (2) Monthly rent: HK\$35,000 payable in advance at the beginning of each month
- (3) Rent-free period: 1 April 2019 – 30 April 2019
- (4) Premium: HK\$90,000 payable on 1 April 2019
- (5) Refundable deposit: HK\$70,000 payable on 1 April 2019
- (6) Rates: payable by Paul
- (7) Management fee: HK\$2,000 per month payable by John

During the year ended 31 March 2020, Paul paid the following expenses in respect of the Property:

- (8) Rates (after rates concession): HK\$12,000
- (9) Furniture for the Property: HK\$30,000
- (10) Mortgage loan interest: HK\$180,000
- (11) Agency fee to the property agent for handling the property: HK\$24,000

Other information:

- (12) Paul is single and his presence in Hong Kong during the following years of assessment was as follows:

2017/18	2018/19	2019/20
320 days	30 days	40 days

- (13) Paul expects that he will not visit Hong Kong in the year of assessment 2020/21.

Required:

- (a) Analyse, with reference to the relevant provisions of the IRO, whether Paul is liable to Hong Kong property tax and eligible to elect for personal assessment for the year of assessment 2019/20. (4 marks)
- (b) Assuming Paul is liable to property tax, compute Paul's property tax liability for the year of assessment 2019/20. Ignore provisional property tax. (5 marks)

Question 6 (9 marks – approximately 16 minutes)

On 1 September 2019, Simon executed an agreement for sale and purchase to purchase a residential property ("the Property") in Hong Kong for HK\$10,000,000 from Peter. Peter purchased the Property on 1 July 2017.

On 31 October 2019, Simon included his spouse Judy in the conveyance on sale as the joint owner of the Property. On the date of assignment, the value of the Property was HK\$9,000,000.

Simon is a Hong Kong permanent resident and Judy is not a Hong Kong permanent resident. Simon did not own any residential property in Hong Kong on 1 September 2019 but Judy solely owned another residential property in Hong Kong on 31 October 2019. Each person acted on his or her own behalf in the purchase of the Property. Simon and Peter are not relatives.

Required:

Analyse, with reference to the relevant provisions under the Stamp Duty Ordinance, whether ad valorem stamp duty, special stamp duty and buyer's stamp duty are payable on:

- (a) the agreement for sale and purchase, and
- (b) the conveyance on sale, respectively.

If so, compute the respective amounts payable.

(9 marks)

* * * END OF EXAMINATION PAPER * * *