

SECTION A – CASE QUESTIONS (Total: 50 marks)

Answer ALL of the following compulsory questions. Marks will be awarded for logical argumentation and appropriate presentation of the answers.

CASE

Synergy Santa Limited (“Synergy”) is a company established in Hong Kong engaging in the investment holding business. The following incomes and expenditures have been credited and charged respectively to its financial statements for the year ended 31 March 2013.

A1. Interest Income

Bank interest income of HK\$35,000 has been derived from a Hong Kong dollar fixed deposit placed with a local bank. The deposit was pledged to guarantee an overdraft banking facility provided by the same bank to Synergy. During the year, Synergy did not utilise any of the facility and only incurred a HK\$500 bank charge as an overdraft facility renewal expense.

A2. Waiver of loan borrowed from a shareholder

A loan of HK\$2,000,000 has been borrowed by Synergy from one of its shareholders in the year 2006. The loan was utilised by Synergy as working capital for its daily business operations, and has been stated in the balance sheet of Synergy in relevant years as a long-term liability. In a recent meeting amongst the shareholders of Synergy, the respective shareholder agreed to waive Synergy from the requirement to repay the loan.

A3. Contributions to Mandatory Provident Fund (“MPF”)

Synergy made an ordinary annual contribution of HK\$630,000. The amount was calculated based on 18% of each employee’s remuneration in line with the company’s policy. In addition, Synergy also made a special contribution of HK\$390,000 to its MPF scheme on top of the ordinary annual contribution.

In April 2012, Synergy employed Mr. David Fong (“Mr. Fong”), a Hong Kong resident, as General Manager responsible for the company’s daily business operations. Information available indicated that Mr. Fong had the following remuneration package for the year ended 31 March 2013.

B1. Annual salary HK\$1,500,000

Mr. Fong also paid HK\$45,000 in MPF contributions during the year.

B2. Holiday travel warrant HK\$85,000

Mr. Fong received a round-trip air ticket with hotel accommodation to Europe in the abovesaid value as recognition of his work performance for the year 2012. Synergy directly purchased the holiday warrant from a travel agency and settled the amount in its company account maintained with the travel agent. The package tour cannot be transferred from Mr. Fong to any other persons.

B3. Bonus of HK\$100,000

The bonus was given by one of the shareholders of Synergy personally. The amount was given in recognition of Mr. Fong's exceptional performance in his position.

B4. Gain from disposal of shares HK\$400,000

Mr. Fong disposed of 50,000 shares of a listed company on 31 January 2013 and derived a gain of HK\$400,000. The share was exercised by Mr. Fong on 1 September 2012 through a share option scheme granted by his former employer with respect to his former employment in Hong Kong. The exercise price of the share was HK\$2 for each share. The market price of the share on 1 September 2012 and 31 January 2013 was HK\$7 and HK\$10 respectively. Mr. Fong resigned on 31 March 2012 from his former employment immediately prior to joining Synergy.

B5. Provision of quarters

Synergy utilised one of its long term investment properties as staff quarters for Mr. Fong during the whole year. The market rental value of the respective property was HK\$288,000 per annum. In accordance with the company's policy, Mr. Fong was required to pay 5% of his basic salary as rental to Synergy.

B6. Cash Coupon of HK\$10,000 from annual dinner lucky draw

Mr. Fong received a department store cash coupon of HK\$10,000 in Synergy's annual dinner lucky draw.

Mr. Fong occasionally travels to the PRC for either business or vacation purposes. A summary of PRC traveling records for Mr. Fong for the years 2012 and 2013 (up to 31 March) is as follows:

Periods	Number of days staying in the PRC	Purpose
From 1 January 2012 to 30 June 2012	Nil	N/A
From 1 July 2012 to 31 December 2012	130	Partly for business and partly for vacation
From 1 January 2013 to 31 March 2013	40	Wholly for business

In early April 2013, Mr. Fong noticed that he would not be required to travel to the PRC for business purposes until 30 June 2013. He therefore planned to have a vacation trip to the PRC in June 2013 for two to three weeks.

Recently Synergy received a letter from the Inland Revenue Department ("IRD") stating that the company has been selected for a field audit exercise for reviewing its tax position. The directors of Synergy are worried about the exposure resulting from the field audit exercise and therefore appointed a tax consulting firm namely Wilson Lee & Co. as its tax representative for the field audit exercise.

Question 1 (10 marks – approximately 18 minutes)

Discuss the taxability of the following incomes of Synergy for the year. Put forward your analysis from the views of Synergy and the IRD where applicable.

- (a) Interest income (5 marks)
- (b) Waiver of loan borrowed from a shareholder (5 marks)

Question 2 (4 marks – approximately 7 minutes)

Discuss the deductibility of the MPF contributions made by Synergy for the year and, where applicable, compute the amount of allowable deduction for Synergy. (4 marks)

Question 3 (16 marks – approximately 29 minutes)

Compute the salaries tax liabilities of Mr. Fong for the year of assessment 2012/13 based on the available information. (Ignore provisional salaries tax and reduction of salaries tax for the year.) (16 marks)

Question 4 (5 marks – approximately 9 minutes)

Discuss the PRC Individual Income Tax exposure of Mr. Fong for the period from 1 January 2012 to 30 June 2013. (5 marks)

Question 5 (15 marks – approximately 27 minutes)

- (a) Assuming that you are the tax manager of Wilson Lee & Co., elaborate on:
- (i) the possible upcoming field audit exercise process; and (5 marks)
- (ii) the availability of settlement methodologies to Synergy. (5 marks)
- (b) Discuss if there is any exposure to risk for Wilson Lee & Co. in the context of (i) the Inland Revenue Ordinance and (ii) ethical perspective in acting as the tax representative of Synergy for the field audit exercise. (5 marks)

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End of Section A

SECTION B – ESSAY / SHORT QUESTIONS (Total: 50 marks)

Answer ALL of the following questions. Marks will be awarded for logical argumentation and appropriate presentation of the answers.

Question 6 (13 marks – approximately 23 minutes)

A Limited is a company incorporated and listed in Hong Kong. At all relevant times, A Limited traded actively in listed shares in Hong Kong. To finance the share dealing and investment activities, A Limited placed deposits with the Hong Kong branch of Bank C as security for a back-to-back loan. The deposits were usually rolled over automatically without much management.

For the year ended 31 March 2013, the turnover of A Limited consisted of bank interest income, gains on disposal of and dividend income from the listed shares. A Limited also received dividend from B Limited, a wholly-owned subsidiary incorporated in the Mainland of China (“the Mainland”). A Limited did not have its own establishment in the Mainland.

Recently, the Mainland tax authority has carried out an investigation into the tax affairs of B Limited. In this regard, the Hong Kong Inland Revenue Department (“IRD”) has been requested by the Mainland tax authority to provide certain information in relation to the dealings between B Limited and A Limited.

Required:

- (a) **Discuss whether the placing of deposits by A Limited with Bank C constitutes a carrying on of business in Hong Kong.**
(3 marks)

- (b) **Evaluate whether and if so, how A Limited is chargeable to any tax in the Mainland in respect of the dividend income from B Limited.**
(3 marks)

- (c) **State the factors which the IRD will consider when processing the request for information lodged by the Mainland tax authority.**
(7 marks)

Question 7 (12 marks – approximately 22 minutes)

D Limited commenced business on 1 October 2010 and closed its accounts on 31 December. The first and second accounts of D Limited were closed on 31 December 2011 and 31 December 2012 respectively.

On 1 January 2011, D Limited entered into a hire purchase agreement to acquire a lorry. The total price of the lorry was HK\$640,000, including the cash price of HK\$520,000 and interest of HK\$120,000. The agreement provided that a down payment of HK\$40,000 was payable upon the execution of the agreement and the balance to be paid by 24 instalments of HK\$25,000. The first instalment was payable on 31 January 2011 and the remaining 23 instalments were payable on the last day of the following calendar month. Each instalment included capital repayment of HK\$20,000 and interest of HK\$5,000.

Required:

- (a) Determine, with explanation in support, the basis periods of D Limited for the years of assessment 2010/11, 2011/12 and 2012/13. (7 marks)
- (b) Compute the depreciation allowance in respect of the lorry for the years of assessment 2011/12 and 2012/13. (5 marks)

Question 8 (25 marks – approximately 45 minutes)

Discuss the implications of profits tax, salaries tax, property tax, personal assessment and stamp duty (including special stamp duty), where applicable, in each of the following scenarios (Note: No tax computation is required.):

- (a) On 1 February 2012, E Limited entered into an agreement to purchase a shop from F Limited. As a confirmor, E Limited entered into an agreement to sell the shop to G Limited at profits on 15 July 2012. By an assignment dated 15 October 2012, the shop was assigned by F Limited to G Limited. E Limited was incorporated on 1 January 2012 and was wholly financed by the contributions of its two shareholders. It became dormant after the completion of the above property transaction.

(7 marks)

- (b) Mr. H and his wife, Ms. I, are retirees. The couple entered into an agreement to purchase a residential flat as joint tenants on 1 January 2012. The couple arranged a mortgage loan to finance 30% of the consideration, whilst the remainder was settled by the couple's own savings. The flat was let out after the completion of the transaction. Pursuant to a Compulsory Sale Order granted by the court under the Land (Compulsory Sale for Redevelopment) Ordinance (Cap. 545), Mr. H and Ms. I entered into an agreement to sell the flat at a profit on 1 June 2013.

(11 marks)

- (c) Mr. J had a residential flat which was inherited in accordance with the will of his deceased father on 1 April 2012. He subsequently entered into an agreement to sell the flat to Mr. K on 31 December 2012. Upon assignment on 1 April 2013, Mr. K admitted his nephew, Mr. L, as a joint tenant of the flat. Mr. K and Mr. L are both salary earners. They arranged a mortgage loan to finance the acquisition of the flat and used the flat as their residence.

(7 marks)

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