

## **SECTION A – CASE QUESTIONS** (Total: 50 marks)

### **Answer 1(a)**

Under s.8(1)(a) of the Inland Revenue Ordinance (“IRO”), salaries tax shall be charged for each year of assessment on every person in respect of his income arising in or derived from Hong Kong from any office or employment of profit. S.9(1)(a) of the IRO defines income from any office or employment to include salary. There is nothing in ss.8 or 9 of the IRO which limit taxable payments to remuneration for services rendered or to be rendered (D19/92, IRBRD, vol 7, 156; D88/00, IRBRD, vol 15, 175).

Given that the salary was derived from Ms Chan’s employment which subsisted right up to 31 March 2017 and that the sum came squarely within the ambit of s.9(1)(a) of the IRO, it should be regarded as income from employment assessable to salaries tax. The payment is assessable to salaries tax in the year of assessment 2016/17 because post-cessation payments should be deemed to have accrued on the last date of employment under s.11D(b)(ii) of the IRO (i.e. 31 March 2017).

### **Answer 1(b)**

It is a contractual payment made in accordance with the employment contract and thus should be regarded as an income from employment and chargeable to salaries tax. (*Fuchs v Commissioner of Inland Revenue [2011] 2 HKC 422*). The payment is assessable to salaries tax in the year of assessment 2016/17 because post-cessation payments should be deemed to have accrued on the last date of employment under s.11D(b)(ii) of the IRO (i.e. 31 March 2017).

### **Answer 1(c)**

To ascertain whether a sum is assessable to salaries tax, it is required to find out its exact nature and the circumstances under which it is paid. The label of the payment given by the taxpayer or employer is not conclusive. In the present case, the compensation payment is not a severance payment or long service payment provided for under the Employment Ordinance. It is neither a contractual payment nor a payment made for services rendered or to be rendered or for acting as an employee. Besides, it is paid due to redundancy and not due to retirement or resignation. On the whole, it can be accepted as a compensation payment made by RAB for loss of employment due to restructuring and therefore not chargeable to salaries tax.

## **Answer 2**

Under s.12(1)(e) of the IRO, any self-education expenses paid in the year of assessment not exceeding the prescribed amount shall be deducted from the assessable income. S.12(6)(b) of the IRO defines self-education expenses to mean expenses paid by the taxpayer as tuition and examination fees in connection with a prescribed course of education undertaken by the taxpayer. A prescribed course of education is defined under s.12(6)(c) of the IRO as a course undertaken to gain or maintain qualifications for use in any employment and being a course of education provided by an education provider, which includes a university according to s.12(6)(d) of the IRO.

As the course fee paid by Ms Chan is in relation to an MBA course paid to a university and likely for use in her employment, it satisfies s.12(1)(e) of IRO and so the amount paid during the year ended 31 March 2017 can be allowed for deduction in the year of assessment 2016/17.

Both the period of the course and the due date for payments are irrelevant. Therefore, the amount eligible for deduction as self-education expenses for the year of assessment 2016/17 is HK\$100,000, but the amount that can be allowed for deduction is limited to the prescribed amount for the year, i.e. HK\$80,000. On the other hand, the amount allowable for deduction for the year of assessment 2017/18 is nil.

## **Answer 3**

S.26D(1) of the IRO provides that, where a person or his / her spouse, pays during any year of assessment any residential care expenses in respect of a parent or grandparent who meets the specified age requirement, a deduction shall be allowed to that person for that year of assessment. S.26D(5) defines residential care expenses to mean any expenses payable in respect of the residential care received at a residential care home and paid to that residential care home. S.26D(4) specifies that only one person can claim elderly residential care expenses ("ERCE") in respect of the same dependent parent. Therefore, only the person with legal responsibility for the payment (i.e. the one named in the invoice) can claim deduction for the total amount paid (para.19, DIPN No.36 issued in January 2000).

As Mr Wong only shared the fee by paying Ms Wong and was not the person who paid the residential care home, he is not entitled to claim a deduction for any ERCE for the year of assessment 2016/17.

## Answer 4

Ms Chan  
Salaries Tax Computation – Year of assessment 2016/17

	HK\$
Income	
Salary (HK\$40,000 x 12)	480,000
Payment in lieu of notice	<u>40,000</u>
	520,000
<u>Less:</u> Self-education expense [s.12(1)(e)]	<u>(80,000)</u>
Net assessable income	440,000
<u>Less:</u> <u>Concessionary deductions</u>	
Charitable donations [s.26C]	(7,000)
Retirement scheme contributions [s.26G and schedule 3B]	<u>(18,000)</u>
Net income	415,000
<u>Less:</u> Married person's allowance	<u>(264,000)</u>
Net chargeable income	<u>151,000</u>
Tax payable thereon at standard rate (HK\$415,000 x 15%)	<u>62,250</u>
Tax payable thereon at progressive rates	
First    HK\$40,000 x 2%	800
Next    HK\$40,000 x 7%	2,800
Next    HK\$40,000 x 12%	4,800
Balance  HK\$31,000 x 17%	<u>5,270</u>
	<u>13,670</u>

The salaries tax liability of Ms Chan for the year of assessment 2016/17 is HK\$13,670.

## Answer 5

Mr Wong  
Property Tax Computation – Year of assessment 2016/17

<u>Property A</u>	HK\$
Rent (HK\$10,000 x 12) [s.5B(2)]	120,000
<u>Less:</u> Rates (HK\$1,000 x 4) [s.5(1A)(b)(i)]	<u>(4,000)</u>
	116,000
<u>Less:</u> 20% statutory outgoings [s.5(1A)(b)(ii)]	<u>(23,200)</u>
Net assessable value	<u>92,800</u>
<b>Property tax payable thereon at 15%</b>	<b><u>13,920</u></b>
<u>Property B</u>	
Rent (HK\$15,000 x 3) [s.5B(2)]	45,000
<u>Less:</u> Rates (HK\$2,000 x 1) [s.5(1A)(b)(i)]	<u>(2,000)</u>
	43,000
<u>Less:</u> 20% statutory outgoings [s.5(1A)(b)(ii)]	<u>(8,600)</u>
Net assessable value	34,400
	<u>x 50%</u>
Mr Wong's share of net assessable value	<u>17,200</u>
<b>Mr Wong's share of property tax payable at 15%</b>	<b><u>2,580</u></b>

The total property tax liability of Mr Wong for the year of assessment 2016/17 is HK\$16,500 (HK\$13,920 + HK\$2,580).

## Answer 6

	<u>Ms Chan</u> HK\$	<u>Mr Wong</u> HK\$	<u>Total</u> HK\$
Net assessable value [s.42(1)(a)]			
- Property A		92,800	
- Property B		<u>17,200</u>	
		110,000	110,000
Assessable income	520,000		
<u>Less:</u> Self-education expenses	<u>(80,000)</u>		
Net assessable income [s.42(1)(b)]	440,000		440,000
Net assessable profits [s.42(1)(c)]	<u>-</u>	<u>-</u>	<u>-</u>
	440,000	110,000	550,000
<u>Less:</u> Mortgage interest [s.42(1) proviso] (HK\$60,000 + HK\$17,200)	<u>-</u>	<u>(77,200)</u>	<u>(77,200)</u>
Total income [s.42(1)]	440,000	32,800	472,800
<u>Less:</u> <u>Concessionary deductions</u>			
Charitable donations	(7,000)	-	(7,000)
Retirement scheme contributions	<u>(18,000)</u>	<u>-</u>	<u>(18,000)</u>
Reduced total income [s.42(2)]	415,000	32,800	447,800
<u>Less:</u> Married person's allowance			<u>(264,000)</u>
Net chargeable income			<u>183,800</u>
Tax payable thereon at standard rate (HK\$447,800 x 15%)			<u>67,170</u>
Tax payable thereon at progressive rates			
First HK\$40,000 x 2%			800
Next HK\$40,000 x 7%			2,800
Next HK\$40,000 x 12%			4,800
Balance HK\$63,800 x 17%			<u>10,846</u>
			<u>19,246</u>
[s.43(2B)]			
Ms Chan's share of tax liability: HK\$19,246 x (HK\$415,000 / HK\$447,800)			17,836
Mr Wong's share of tax liability: HK\$19,246 x (HK\$32,800 / HK\$447,800)			<u>1,410</u>
<b>Total tax payable if personal assessment is elected</b>			<b><u>19,246</u></b>
If no personal assessment, tax payable under:			
- Salaries tax	13,670	-	13,670
- Property tax	-	16,500	16,500
- Profits tax	<u>-</u>	<u>-</u>	<u>-</u>
<b>Total tax payable if no personal assessment is elected</b>			<b><u>30,170</u></b>

It is more tax advantageous for the couple to elect for personal assessment for the year of assessment 2016/17.

### **Answer 7(a)**

Under s.14(1) of the IRO, profits tax shall be charged on each person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business. To determine the source of profits, the broad guiding principle is that one looks to see what the taxpayer has done to earn the profits in question and where he has done it (*CIR v Hang Seng Bank Limited* [1991] 1 AC 306 or *HK-TVB International Limited v CIR* [1992] 2 AC 397).

Brick is a trading company and derives trading profits. To determine the source of trading profits, the location where the purchase and sale transactions took place are important. However, the following factors should also be taken into account:

- How were the goods procured or stored?
- How were the sales solicited?
- How were the orders processed?
- How were the goods shipped?
- How was the financing arranged?
- How was the payment effected?

Regarding e-commerce, the Inland Revenue Department (“IRD”) would apply the provisions of the IRO to electronic commerce on the same basis as those applied to conventional forms of business (para.2, DIPN No.39 issued in July 2001). The mere presence of a server (even if an intelligent one) outside Hong Kong would not turn onshore profits to being offshore sourced if all the physical business operations of Brick remain to be carried out in Hong Kong (para.9, DIPN No.39 issued in July 2001). Therefore, it is not feasible to make an offshore claim on the profits derived from online sales simply by maintaining a server outside Hong Kong.

### **Answer 7(b)**

Brick was chosen for a field audit possibly because it is a business involving cash sales. It is a small scale business where internal control would likely be insufficient. Persistent losses were recorded over the past years. Lastly, Brick might simply be selected by the IRD on a random basis.

The field auditor might interview Mr Wong and visit Brick’s shop so as to gain a thorough understanding of the business operations of Brick and to understand and examine the internal control procedures. He might request books and records (usually general ledgers, accounting vouchers and bank statements) for checking and examination. For example, he may look for unusual transactions and entries in books, particularly periodic or large payments made to private personal accounts. He may also look for unusual transactions and entries in bank statements, particularly periodic or large receipts without proper accounting vouchers and entries to support them. Moreover, he might ask Mr Wong to explain the source of funding, e.g. how he can maintain the business of Brick despite the fact that Brick has been operating at a loss for years.

\* \* \* END OF SECTION A \* \* \*

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

### **Answer 8(a)**

Stamp duty is levied on instruments or documents instead of on transactions under the Stamp Duty Ordinance (“SDO”). As no written lease contract or any other documents would be entered between A Limited and B Limited with respect to the tenancy arrangement, no stamp duty is chargeable with respect to the lease. The shareholding relationship between A Limited and B Limited is irrelevant to the analysis.

### **Answer 8(b)**

The relevant instruments effecting the transfer of the Property are subject to stamp duty in accordance with Head 1 of the SDO. Essentially, the transaction would be subject to Ad Valorem Duty (“AVD”) and a fixed duty of HK\$100.

As the Property is a residential property and the purchaser (i.e. D Limited) is not a Hong Kong permanent resident, the relevant instrument would be subject to AVD at a flat rate of 15% with respect to the stated consideration or market value, whichever is the higher. The amount of AVD is therefore HK\$2.55 million (HK\$17 million x 15%). Both Mr C as the seller and D Limited as the buyer are jointly and severally liable to pay the AVD.

As Mr C has held the Property for more than 36 months, the transfer of the Property would not be subject to Special Stamp Duty (“SSD”). However, as D Limited is not a Hong Kong permanent resident and the Property is a residential property, the transfer would be subject to Buyer’s Stamp Duty (“BSD”) under Heads 1 (1AAB) and 1(1C) of the SDO at a rate of 15% on the stated consideration or market value, whichever is the higher. D Limited is liable to pay the BSD and the amount is HK\$2.55 million (HK\$17 million x 15%).

### **Answer 8(c)**

E Limited and F Limited are associated body corporates under s.45(2) of the SDO as F Limited is the wholly owned subsidiary of E Limited. In this connection, the transfer of the shop premises may be exempt from AVD, SSD and BSD subject to the fulfillment of the restrictions as stipulated under s.45(4) of the SDO. As the consideration of the transfer would be settled through bank borrowing and the bank is prima facie an unrelated person, the exemption is deniable pursuant to s.45(4)(a) of the SDO. However, the Collector of Stamp Revenue has issued a ruling that if the bank loan is made by a bank in the ordinary course of business and the bank does not have any interest in the shop premises other than as security, the stamp duty exemption would still be applicable.

### **Answer 9(a)**

The source of a director's remuneration should be determined by the place where the company exercises its central management and control, i.e. the location of the office of the director. As JAY Limited carries on a business in Hong Kong, it is probable that its central management and control are also exercised in Hong Kong. As such, it is likely that the director's fee derived by Mr Zhang would be wholly assessable to salaries tax under s.8(1)(a) of the IRO. The facts that Mr Zhang is not a Hong Kong resident, did not visit Hong Kong and did not render any services in Hong Kong are irrelevant to the consideration. According to ss.52(3) and (4) of the IRO, JAY Limited has the obligation to notify the IRD of the commencement of employment of Mr Zhang not later than three months after the date of commencement of the employment as he is or is likely to be chargeable to salaries tax.

In addition, JAY Limited, pursuant to s.52(2) of the IRO has to furnish an employer's return reporting details of Mr Zhang's remuneration for the year ended 31 March 2017 regardless of his chargeability to salaries tax.

### **Answer 9(b)**

If JAY Limited, without reasonable excuse, fails to (i) comply with s.52(4) of the IRO to notify the IRD of the commencement of employment of an employee chargeable to tax within three months after the date of commencement of employment; and (ii) furnish the employer's return of an employee as requested by the IRD under s.52(2) of the IRO, JAY Limited commits an offence, and is liable on conviction to a fine at level 3 (i.e. HK\$10,000) for each of the offence under s.80(1) of the IRO. The Court may also order JAY Limited to comply with the requirements as stipulated under ss.52(2) and 52(4) of the IRO within a specified timeframe. Moreover, s.80(5) of the IRO provides that the Commissioner of Inland Revenue may compound the offence and may before judgment stay or compound any proceedings thereunder.

### **Answer 9(c)**

In the course of providing tax advisory services to JAY Limited, Messrs. Ko & Ko should comply with s.430 'Ethics in tax Practice' in the Code of Ethics for Professional Accountants (Revised in June 2010) published by the Hong Kong Institute of Certified Public Accountants ("the Code"). Specifically, Messrs. Ko & Ko should:

- (i) put forward the best position in favour of JAY Limited with professional competence and not in any way impair its standard of integrity and objectivity;
- (ii) ensure that JAY Limited is aware of the limitations attaching to its tax advice;
- (iii) ensure that the tax advice is properly prepared based on the information received from JAY Limited, provided that the information appears to be reasonable;



- (iv) record the tax advice given to JAY Limited either in the form of a letter or in a memorandum for the files; and
- (v) not associate themselves with any false or misleading information.

### **Answer 10(a)**

Under s.14(1) of the IRO, profits tax shall be charged on every person carrying on a trade, profession or business in Hong Kong except profits arising from sales of capital assets. A trade is defined in s.2 of the IRO to include every adventure in the nature of trade. Whether a trade is carried on is a question of fact to be determined by looking at all the circumstances of the case. In determining whether the Gain derived by Ms Tsoi is chargeable to profits tax, it is necessary to ascertain Ms Tsoi's intention at the time of the acquisition of the Carpark. The stated intention has to be tested against objective facts. Furthermore, the Assessor of the IRD should conduct an evaluation and examination to see whether the six badges of trade are present.

(i) Subject matter of the realisation

The Carpark may be used by Ms Tsoi as a capital asset (e.g. personal use or producing rental income, etc) or for trading purposes. As the subject matter can be held either as a long-term investment or for resale purpose, further examination should be made in connection with the motive for acquiring the asset.

(ii) Motive

If the Carpark was acquired as a capital asset, Ms Tsoi should demonstrate that she had personal need of the Carpark, or that the Carpark had been let out for rental income which generated a favourable rental yield. Examination of the actual usage of the Carpark should be looked into.

(iii) Length of ownership

The Carpark was owned by Ms Tsoi for less than two years. The relatively short period of ownership points towards a trading transaction unless there were specific circumstances leading to its disposal in January 2017. Examination from this perspective may be conducted for further consideration.

(iv) Circumstances responsible for the disposal

Assets disposed of for reaping profits without other concrete circumstances may indicate that the transaction constituted a trade. The circumstances leading to the sale of the Carpark should be investigated and verified against objective facts.

(v) Frequency of similar transactions

Examination of the frequency of similar transactions, if any, by Ms Tsoi is essential as it could constitute an indication of trade. The presence of property trading history lends support to the idea that a trade is being carried on.

(vi) Supplementary work done

Due to the nature of the Carpark, the examination from this perspective is irrelevant to the analysis.

(Analysis from other perspectives with proper elaborations, e.g. method of financing the acquisition and utilisation of the sales proceeds, are also acceptable.)

**Answer 10(b)**

Further information or documents to be obtained for evaluation include the following:

(i) Subject matter of the realisation/motive

- Information substantiating personal use, or investment plan demonstrating the long-term investment purpose of Ms Tsoi.
- Details of the tenancy agreement attached to the Carpark upon acquisition with a copy of such agreement.
- Effort paid for renting out the Carpark upon expiration of the tenancy period, if any, and the supporting documentation (e.g. a copy of the advertisement).

(ii) Frequency of similar transactions

- Other property transactions history of Ms Tsoi before and after the disposal of the Carpark, if any.
- Other business, if any, conducted by Ms Tsoi in the same field and the details.

(iii) Circumstances responsible for the realisation

- Reason for disposing of the Carpark by Ms Tsoi with supporting documentary evidence.
- Whether the disposal was initiated by a third party or actively pursued by Ms Tsoi.
- The usage of the sales proceeds.
- Whether the Carpark was disposed of together with the existing tenancy agreement.
- The purchase of replacement property, if any, subsequent to the sale of the Carpark.

(iv) Others

- Method of financing the acquisition of the Carpark.
- Professional knowledge and expertise of Ms Tsoi in property transactions.
- Any other relevant information/documents for evaluation.

### **Answer 10(c)**

Examination should also be made in order to ascertain whether Ms Tsoi has complied with the obligations of a property owner in the contexts of the IRO. It should include whether Ms Tsoi has informed the chargeability to property tax (s.51(2) of the IRO), completed and filed a tax return reporting the rental income derived (s.51(1) of the IRO), notified the disposal or transfer of the Carpark (s.51(6) of the IRO), informed the change of corresponding address, if any, (s.51(8) of the IRO), and kept sufficient rental records of not less than seven years (s.51D of the IRO).

### **Answer 11**

Import of the Products into mainland China from foreign jurisdictions is first subject to creditable Value-added Tax ("VAT") at 17% under the prevailing Provisional Regulations on Value-added Tax of the People's Republic of China ("the PRVAT"). The PRVAT also specifies that sales of the Products within the territory of mainland China are also subject to VAT, and the tax rate is 17% (borne by the customers).

Turnover tax in mainland China also includes, inter alia, Consumption Tax ("CT"). Under the prevailing Provisional Regulations on Consumption Tax of the People's Republic of China ("PRCT"), the import of cosmetics and signature golf balls are subject to CT at the rates of 30% and 10% respectively (per the latest Cai Shui Circular, the rate of CT is revised to 0% and 15% for low-end and high-end cosmetics respectively). However, the import of smartphones is not subject to CT. In addition, the sales of the Products within the territory of mainland China are also not subject to CT. The import and sale of the Products did not have any withholding tax implications for New Year in mainland China.

Dividends paid to a non-Chinese tax resident would normally be subject to withholding tax at the rate of 10%. Subject to relevant application procedures, the withholding tax rate could be reduced to 5% for Hong Kong residents in accordance with the Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Incomes.

There is no turnover tax exposure on the payment of dividends to non-Chinese tax residents.

\* \* \* END OF EXAMINATION PAPER \* \* \*