



Hong Kong Institute of
Certified Public Accountants
香港會計師公會



Examination Technique Seminar (Essay)
for
Module D on Taxation

Speaker
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HKICPA Module Preparation Seminar

Module D - Taxation

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Exam Techniques Seminar on Section B (Essay/Short question)

- December 2012 and June 2013

Agenda

1. Exam Techniques

2. Review Past papers and Examiner's comment

- Part A: Tax system and Tax administration
- Part B: Profits tax
- Part C: Salaries tax, Property tax and Personal assessment
- Part D: Stamp duty
- Part G: China tax



1. Exam Techniques

Before the exam

1. Understand the important and new topics (e.g. new IRO & DIPN)
2. Practise past papers
3. Read the examination panelists' reports
4. Index your notes for examination by topics

Part A: Tax system and Tax administration

Part B: Profits tax

Part C: Salaries tax

- Computation format
- Tax rate and allowance table

In the exam

1. Read the requirement carefully
 - ✓ ‘*Tax exposure*’ of certain activities:
Any person is liable to Property/Salaries/Profits tax/Stamp duty
 - ✓ ‘*Tax implication*’ of certain transactions:
Any item is taxable/deductible or subject to Stamp duty
2. Draw diagram or timeline to assist your understanding of the question and the relationship between different parties
3. Plan your answer
 - i) Law and practice (IRO/SDO, Principle, Tax case, DIPN/SOIPN)
 - ii) Analyze the facts
 - iii) Draw conclusion
 - iv) Alternatives or Recommendation (make reasonable assumption)
4. New page for new question (or part)

In the exam

5. Time management

- Leave question unanswered
- Spend too much time on finding reference
- Spend too much time on copying the material

6. Only compute what is asked

E.g. Assessable income, Net assessable income, Net chargeable income or Tax liability?

7. State the applicable tax rate

8. Use correct format required

E.g. Letter, memo or report



2. Review Past papers and Examination panelist's report



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➤ **Part A:**
**Tax system and
Tax administration**



Dec 2012 Q8a

Comment on the circumstances below from the Hong Kong tax or PRC turnover tax perspectives and, where appropriate, provide your recommendations. Support your answers with relevant provisions of the IRO or the PRC rules and regulations:

Dec 2012 Q8a

Required:

- (a) Mr. Chan recently received a 2011/12 assessment notice for his sole proprietorship business. After cross-checking the relevant details, he noticed that a trading receipt of \$100,000 originally derived in the year of assessment 2010/11 had been erroneously recorded in his 2011/12 books of accounts, and thereby assessed to profits tax in the 2011/12 assessment notice.

Mr. Chan decided not to do anything to rectify the tax position for both years of assessment 2010/11 and 2011/12, and intended to settle the tax demanded for the year of assessment 2011/12 as his aggregate tax position for both years would be correctly reported after the tax settlement for the year of assessment 2011/12.

(6 marks)

Examiner's comment for Dec 2012 Q8a

Performance: Fair

Common mistakes

- Could not distinguish clearly the correct treatment for the relevant years of assessment.
- Wrongly focused their discussion on anti-avoidance provisions.
- Not able to elaborate that profits tax is charged for each year of assessment under s.14(1) of the IRO.

Answer to Dec 2012 Q8a

1. S.14(1) Charge of profits tax

Profits tax is charged for each year of assessment. Therefore, the taxpayer cannot claim that the tax reporting is correct if the overall tax liabilities for two years were computed as a single assessment.

2. S.60(1) Additional assessment

As there is an underpayment of tax for the year of assessment 2010/11, Mr. Chan should immediately inform IRD about the error and request a revision of his tax position for 2010/11 by issuing an additional assessment.

3. S.82A Additional tax

IRD may seek to impose a penalty in the form of additional tax for the undercharge of tax for 2010/11 if there is no reasonable excuse for making an incorrect return leading to the undercharge of tax.

Answer to Dec 2012 Q8a

4. S.64(1) Objection

Mr. Chan should lodge an objection against the 2011/12 assessment notice if the one month objection period has not yet lapsed.

5. S.70A Power of assessor to correct error

Mr. Chan should lodge a claim against the assessment based on the grounds that there is an error found in the respective tax return and statement submitted thereof.

6. If the taxpayer voluntarily provides full disclosure on the income received, the IRD may in practice or on a discretionary basis accept the taxpayer's tax position as reported or may revise the tax assessments for the relevant years.

Dec 2012 Q8b

- (b) Mr. Wong received his salaries tax assessment notice (2010/11 Final and 2011/12 Provisional) in the middle of October 2011.

He simply set it aside without making any reminder of his own tax payment due dates. On 3 January 2012, Mr. Wong accidentally noted from the assessment notice that the first tax payment of his salaries tax liabilities was due on that day (3 January 2012), whilst the second tax payment was due on 2 April 2012.

He would then like to apply for a complete holdover of the 2011/12 provisional salaries tax demanded in this notice as he retired on 1 April 2011 and did not have any income chargeable to salaries tax after his retirement.

(5 marks)

Examiner's comment for Dec 2012 Q8b

Performance: Satisfactory

Common mistakes

- No further discussion on the holdover for the second instalment and the surcharge on late payment. The elaborations on these two aspects were integral parts of the whole discussion for this question

Answer to Dec 2012 Q8b

1. S.63E(2)(b) or (c) Ground for holdover

Mr. Wong is eligible to apply for the holdover of 2011/12 provisional tax as he has retired since 1 April 2011, and the net chargeable income during the year of assessment assessed to provisional salaries tax is likely to be less than 90% of the net chargeable income for the year preceding the year of assessment or he has ceased to derive income chargeable to salaries tax.

2. S.63E(1)(a) Time limit for a holdover application

The deadline for Mr. Wong to lodge the holdover of the tax due on 3 January 2012 has lapsed as the holdover application had to be lodged 28 days before the payment due date of 3 January 2012.

Answer to Dec 2012 Q8b

3. Holdover of 1st installment

The CIR has no discretionary power to extend the time limit for a holdover application. Therefore, Mr. Wong can no longer make a valid application for holding over the provisional salaries tax due on 3 January 2012 after the application deadline.

4. Holdover of 2nd installment

On the basis that Mr. Wong settled the tax liability due on 3 January 2012, he can apply to hold over the second tax payment due on 2 April 2012 by lodging the application 28 days before the due date i.e. to be lodged on or before 5 March 2012.

5. Surcharge on late payment

If Mr. Wong does not settle the tax liability due on 3 January 2012, the full amount of tax (both in the first and second installments) becomes due and payable immediately.



➤ **Part B:
Profits tax**

Jun 2013 Q6

A Limited is a toy trading company in Hong Kong. It commenced business in 2000 and closed its accounts annually on 30 June. In early 2011, A Limited took over B Limited, a company incorporated in the Mainland of China (“the Mainland”). After that, A Limited and B Limited reviewed their business processes, under which it was resolved that B Limited would grant A Limited a 10-year licence (“the Licence”) to use B Limited's trademark (“the Trademark”) for selling toys in Hong Kong at a licence fee of RMB 10 million per year (“the Licence Fee”) on 1 July 2011.

B Limited did not have any business presence in Hong Kong. The negotiation for and the decision to grant the Licence to A Limited were made by the directors of B Limited in the Mainland. On 1 December 2011, B Limited sold the Trademark with its right under the Licence at RMB 20 million to C Limited, a Mainland corporation which is wholly-owned by A Limited.

Jun 2013 Q6a

On 1 January 2013, C Limited terminated the Licence and sold the Trademark to A Limited at RMB 50 million with an option for C Limited to purchase back the Trademark after 5 years. The market value of the Trademark as at 1 January 2012 and 1 January 2013 were RMB 100 million and RMB 150 million respectively.

Required:

- (a) Discuss whether and, if so, how B Limited is chargeable to profits tax in respect of the Licence Fee.

(4 marks)

Examiner's comment for Jun 2013 Q6a

Performance:

- able to identify that B Limited did not carry on business in Hong Kong and sections 15(1)(b), 20B and 21A of the IRO were applicable.

Common mistakes:

- wasted time discussing some irrelevant provisions such as sections 15(1)(a) and (ba) of the IRO.
- mistakenly considered that 100% of the licence fees should be chargeable to profits tax by virtue of section 21A(1)(a)

Answer to Jun 2013 Q6a

1. Whilst B Limited did not carry on any business in Hong Kong, it received the Licence Fee from A Limited in respect of the Trademark used for selling toys in Hong Kong. By virtue of s.15(1)(b) of the IRO, the Licence Fee is deemed to arise in or be derived from Hong Kong from a trade, profession or business carried on by B Limited in Hong Kong.
2. As it appears that the Trademark had not been previously owned by any person carrying on a trade, profession or business in Hong Kong, the assessable profits deemed to be derived from Hong Kong in respect of the Licence Fee should be computed as 30% of the Licence Fee pursuant to s.21A(1)(b)(ii) of the IRO.
3. Since B Limited is a non-resident, A Limited is chargeable to profits tax on behalf of B Limited in respect of the Licence Fee (s.20B(2) of the IRO).

Jun 2013 Q6b

Required:

(b) Advise whether your answer to item (a) will be different if after the take-over, A Limited and B Limited shared the same group of directors who held all the board meetings in Hong Kong, and negotiated and concluded the agreement for the grant of the Licence in Hong Kong. Cite the relevant case law to support your answer.

(4 marks)

Examiner's comment for Jun 2013 Q6b

Performance:

- could point out that section 14 of the IRO would apply in the given scenario and the entire licence fees had to be brought into the profits tax charge.

Common mistakes:

- overlooked the additional information given in the question
- wrongly concluded that the licence fees would be fully chargeable by virtue of section 21A.

Answer to Jun 2013 Q6b

1. If the directors of B Limited held all the board meetings in Hong Kong, it is likely that B Limited will be regarded as carrying on a business in Hong Kong: see *De Beers Consolidated Mines Ltd v Howe* (1906) 5 TC 198.
2. Moreover, as B Limited negotiated and concluded the agreement for the grant of the Licence in Hong Kong, the Licence Fee will also be regarded as having a source in Hong Kong: see *Commissioner of Inland Revenue v HK-TVB International Limited* 3 HKTC 468 and *Lam Soon Trademark Limited v Commissioner of Inland Revenue* 6 HKTC 768.
3. In the circumstances, B Limited will be chargeable to profits tax in respect of the Licence Fee under s.14 instead of s.15(1)(b) of the IRO.

Jun 2013 Q6d

Required:

(d) Determine whether A Limited is entitled to the deduction of the purchase cost of the Trademark for profits tax purposes.

(7 marks)

Examiner's comment for Jun 2013 Q6d

Performance:

- indicate their awareness of the new deduction for intellectual property rights under section 16EA of the IRO
- able to point out the anti-avoidance provisions
- could account for the disallowance because of the association between A Limited and C Limited

Common mistakes:

- failed to recognize that the deduction was not applicable because of section 16EC of the IRO.
- did not mentioned the possible challenge on the reasonableness of the transaction because of the premature termination of the previous licence and the consideration below market value.

Answer to Jun 2013 Q6d

1. S.16EA of the IRO allows the deduction of expenditures incurred in the purchase of intellectual property even though they are capital in nature and should have been disallowed by virtue of s.17(1)(c) of the IRO.
2. However, A Limited is not entitled to any deduction under s.16EA of the IRO because the relevant purchase cost is prohibited from deduction by virtue of s.16EC(1) and (2) of the IRO, having regard to the following circumstances:

Answer to Jun 2013 Q6d

- (1) The Trademark had been used by A Limited under the Licence of which the expiry date falls after 16 December 2011. Further, the Licence was terminated before its expiry and the Trademark was purchased by A Limited at a consideration below market value with an option for licensor, C Limited, to purchase back the Trademark after 5 years. In such circumstances, it is likely that the CIR will consider that the consideration for the purchase of the Trademark is not reasonable.
- (2) The Trademark was purchased by A Limited from its subsidiary, C Limited.

Dec 2012 Q7

An investor in the US would like to participate in the securities market in Hong Kong by establishing a fund in the form of a limited company (Newco) with the objective of enjoying the profits tax exemption for an offshore fund as stipulated in the IRO. Newco will be incorporated in Bermuda and will have two individuals as directors.

Required:

- (a) Elaborate on how Newco should be structured and participate in Hong Kong securities market so that it can enjoy the profits tax exemption for an offshore fund.

(11 marks)

Examiner's comment for Dec 2012 Q7a

Performance: Diverged

Common mistakes:

- elaborated their answers in the wrong direction by discussing the source of profits, permanent establishment or the badges of trade.
- did not attempt this question.
- not familiar with this topic.

Answer to Dec 2012 Q7a

1. Under s.20AC of the IRO, profits derived by Newco are exempt from being chargeable to profits tax if it is structured and participates in Hong Kong securities market in the following manner:
 - (a) Newco is a non-resident person; and
 - (b) Newco does not carry on any trade, profession or business in Hong Kong involving transactions other than
 - (i) the Specified Transactions carried out through or arranged by a Specified Person; and
 - (ii) Transactions incidental to the carrying out of the Specified Transactions and the trading receipts from the Incidental Transactions do not exceed 5% of the total trading receipts from both the Specified Transactions and the Incidental Transactions.

Answer to Dec 2012 Q7a

2. In determining residency status, a corporation is considered to be a resident person if the central management and control of the corporation is exercised in Hong Kong (s.20AB(2)(b) of the IRO).
3. The location of central management and control is wholly a question of fact. In general, if the central management and control of a company is exercised by the directors in board meetings, the relevant locality of central management and control is where those directors' board meetings are held. (Para 15 of DIPN 43 (Revised February 2010)).
4. Specified Transactions are specified in Schedule 16 of the IRO as transactions in (i) securities, (ii) future contracts; (iii) foreign exchange contracts; (iv) consisting in the making of deposit other than by way of a money lending business, (v) foreign currencies and₄₁ (vi) exchange-trade commodities.

Answer to Dec 2012 Q7a

5. Specified Person normally is a corporation licensed or an authorised financial institution registered under the Securities and Futures Ordinance for carrying on a business in any regulated activity within the meaning of the Securities and Futures Ordinance (Para 39 of DIPN 43 (Revised February 2010)).

6. Incidental Transactions refer to various modes of operation of different offshore funds, including custody of securities, and receipt of interest or dividend on securities acquired through the Specified Transactions (Para 37 of DIPN43 (Revised February 2010)).



Dec 2012 Q7b

Required:

- (b) Discuss the circumstances in which the profits derived from the abovesaid offshore fund structure and participation in accordance with the profits tax exemption provisions in the IRO for the offshore fund would still be subject to profits tax.

(3 marks)

Examiner's comment for Dec 2012 Q7b

Performance: Not satisfactory

Common mistakes:

- Not able to identify the deeming provision in the IRO.

Answer to Dec 2012 Q7b

A resident person will be deemed to have derived assessable profits in respect of profits derived by the offshore fund from both Specified and Incidental Transactions if the resident person

- (i) alone or jointly with other associates holds direct and / or indirect beneficial interest of 30% or more in a tax-exempt offshore fund; or
- (ii) holds any percentage if the offshore fund is the resident person's associate (s.20AE of the IRO).

Dec 2012 Q7c

Required:

(c) Briefly state the tax reporting obligations, if any, for the offshore fund under the IRO.

(2 marks)

Examiner's comment for Dec 2012 Q7c

Performance: Below expectations

Common mistakes:

- Not explain clearly that there was no provision in the IRO relevant to the application or registration of offshore fund exemption.
- Could not discuss the reporting requirement stipulated under the deeming provision as elaborated in the DIPN 43.

Answer to Dec 2012 Q7c

1. IRO does not have any provisions on the statutory requirements for offshore fund profits tax exempt application or registration.
2. However, a resident person with deemed assessable profits derived under s.20AE of the IRO bears the legal obligation of complying with other provisions of the IRO on reporting chargeability, lodgment of returns, providing information, payment of tax etc. (Para 67 of DIPN 43 (Revised February 2010)).



Jun 2013 Q7

C Recreation Club (“the Club”) was incorporated in Hong Kong under the Companies Ordinance as a company limited by guarantee in 2001. A summary of its income and expenditure account for the year ended 31 March 2012 is provided as follows:

<u>Income</u>	\$
Members’ subscription [Notes (1) and (2)]	600,000
The Rent [Note (3)]	300,000
The Fee [Note (4)]	40,000
Hire charges for sports facilities [Note (5)]	<u>200,000</u>
	1,140,000
Less: Administrative expenses	<u>(900,000)</u>
Surplus	<u>240,000</u>

Jun 2013 Q7

Note:

- (1) All members have voting rights at the Club's general meetings.
- (2) Members' entrance fees of \$250,000 were directly credited to the Club's Accumulated Fund and not included in the income and expenditure account.
- (3) The Club is the registered owner of Building D in Hong Kong. In May 2011, the Club entered into a lease ("the Lease") with E Limited (which is not a member of the Club) in respect of the ground floor of Building D at a monthly rent of \$30,000 ("the Rent") for the period from 1 June 2011 to 31 May 2013. E Limited operated a restaurant on the ground floor to serve both members and non-members of the Club.

Jun 2013 Q7

Note:

- (4) In January 2012, the Club entered into an agreement (“the Agreement”) with F Limited, granting it a non-exclusive right of use of the roof of Building D. Under the Agreement, F Limited was only allowed to use the roof for the installation and operation of certain mobile communication equipment. The term of the Agreement ran from 1 February 2012 to 31 January 2013, and the fee payable thereunder was \$20,000 per month (“the Fee”). To protect its rights under the Agreement, F Limited is considering to register the Agreement in the Land Registry.
- (5) Sports facilities on the first to third floors of Building D were open for use by both members and non-members with fees charged. For the year ended 31 March 2012, the hire charges received from members amounted to \$120,000.



Jun 2013 Q7a

Required:

- (a) Determine, with explanations and workings in support, whether the Club is chargeable to profits tax for the year of assessment 2011/12.
(6 marks)

Examiner's comment for Jun 2013 Q7a

Performance: Well

- correctly apply section 24(1) of the IRO
- correctly determine whether the recreation club was chargeable to profits tax by computing the percentage of gross receipts from its members on revenue account.



Answer to Jun 2013 Q7a

Under s.24(1) of the IRO, a person, who carries on a club or similar institution and receives not less than half of its gross receipts from its members on revenue account, will be deemed not to carry on a business.

For the year of assessment 2011/12, the Club's position is as follows:

<u>Receipts from members</u>	\$	\$
Entrance fees	250,000	
Entrance fees	600,000	
Hire charges for sports facilities	<u>120,000</u>	970,000
<u>Receipts from non-members</u>		
The Rent	300,000	
The Fee	40,000	
Hire charges for sports facilities (\$200,000 - \$120,000)	<u>80,000</u>	420,000

Answer to Jun 2013 Q7a

% of members' receipts [$\$970,000 / (\$970,000 + \$420,000)$] 69.78%

As the Club received not less than half of its gross receipts from its members on revenue account for the year of assessment 2011/12, it is deemed not to carry on a business and is not chargeable to profits tax for that year.

Jun 2013 Q7b

Required:

(b) Discuss the Club's property tax exposure for the year of assessment 2011/12 from the following perspectives:

- (i) whether the Club is chargeable to property tax in respect of the Rent and the Fee; and
- (ii) whether any property tax exemption is available to the Club.

(Note: Computation of property tax, if any, is NOT required.)

(6 marks)

Examiner's comment for Jun 2013 Q7b

Performance:

- able to state that the rent and licence fees received by the club should be brought into the charge to property tax.

Common mistake:

- could not explain why the exemption under section 5(2)(a) of the IRO was not applicable.
- misread the question and included a discussion on the property tax “deduction” instead of “exemption” in their answers.

Answer to Jun 2013 Q7b

1. The Club is the registered owner of Building D. For the year of assessment 2011/12, the Club received the Rent and the Fee in consideration for the right of use of the ground floor and the roof of the building respectively. Subject to the exemption provided under s.5(2)(a) of the IRO, the Club is chargeable to property tax for the year of assessment 2011/12 in respect of the Rent and the Fee pursuant to s.5(1) and s.5B(2) of the IRO.
2. Although the Club is a corporation, it is deemed not to be carrying on a business for the year of assessment 2011/12 by virtue of s.24(1) of the IRO. As such, the Rent and the Fee are not chargeable to profits tax. It follows that the exemption provided under s.5(2)(a) does not apply to the Club.



➤ **Part C:**
**Salaries tax, Property tax and
Personal assessment**

Jun 2013 Q8

Marcus commenced his employment with G Limited on 1 April 2011. His remuneration package included, among others, (a) monthly salary of \$40,000, (b) rent refund to the maximum of \$10,000 per month, (c) an option to acquire 10,000 shares in G Limited at \$1.5 per share and (d) benefits from a Mandatory Provident Fund (“MPF”) scheme, to which both Marcus and G Limited had to make contributions. On 31 March 2012, Marcus resigned from G Limited. He left Hong Kong and emigrated to Canada at the end of April 2012.

During the year ended 31 March 2012, Marcus rented a flat for residence at a monthly rent of \$12,000 for the first 10 months. In the last two months, he moved to a hotel room and incurred rental expenses of \$16,000 in total. On his last day of employment, Marcus exercised his share option when the market price of a share in G Limited was \$2.

Jun 2013 Q8a

He also received his accrued benefits of \$80,000 under the MPF scheme (“the MPF Benefits”). Out of the MPF Benefits, \$12,000 was attributable to the mandatory contributions made by G Limited, whilst the balance arose from the mandatory and voluntary contributions made by Marcus.

In June 2011, Marcus married Diana, who did not have any income chargeable to tax. The couple are devout Christians. During the year ended 31 March 2012, they made donations of \$200,000 to a church, which is an approved charitable institution.

Required:

- (a) Compute, with necessary explanations, the Net Chargeable Income of Marcus for the year of assessment 2011/12.

(9 marks)

Examiner's comment for Jun 2013 Q8a

Performance: Good

Common mistake:

- the tax treatments for MPF benefits seemed to be a bit difficult for the candidates

Answer to Jun 2013 Q8a

	\$
Salary (\$40,000 x 12)	480,000
Share option gain [(\$2 - \$1.5) x 10,000]	5,000
Value of residence [Note (2)]	<u>23,200</u>
Assessable Income	508,200
Less: Mandatory contributions to MPF scheme [Note (3)]	(12,000)
Approved charitable donations [Note (4)]	<u>(177,870)</u>
	318,330
Less: Married person's allowance	<u>(216,000)</u>
Net Chargeable Income	<u>102,330</u>

Answer to Jun 2013 Q8a

Note:

- (1) The MPF Benefits attributable to Marcus' contributions are clearly not taxable.

As Marcus left Hong Kong and emigrated to Canada after his resignation, the MPF Benefits attributable to the mandatory contributions by G Limited are exempted from salaries tax by virtue of s.8(2)(cb) of the IRO.

- (2) Value of residence for the period from 1 April 2011 to 31 January 2012:

$$\$480,000 \times 10/12 \times 10\% - (\$12,000 - \$10,000) \times 10 = \$20,000$$

Value of residence for the period from 1 February 2012 to 31 March 2012: $\$480,000 \times 2/12 \times 4\% = \$3,200$

$$\text{Total value of residence} = \$20,000 + \$3,200 = \$23,200$$

Answer to Jun 2013 Q8a

(3) Under the MPF scheme, Marcus is required to make a mandatory contribution at 5% of his income, subject to an income ceiling of \$20,000 per month (for the year of assessment 2011/12).

By virtue of s.26G and Schedule 3B of the IRO, such mandatory contributions (i.e. $\$20,000 \times 5\% \times 12 = \$12,000$) are allowable for deduction.

(4) Under s.26C(2)(a)(ii) and (2A) of the IRO, the allowable amount of approved charitable donations is restricted to 35% of Assessable Income (i.e. $\$508,200 \times 35\% = \$177,870$).



Jun 2013 Q8b

Required:

- (b) Advise whether and, if so, how the computation for item (a) will be different if the MPF Benefits include an amount of \$20,000 attributable to the voluntary contributions made by G Limited.

(3 marks)

Examiner's comment for Jun 2013 Q8b

Performance: Good

- correctly apply the proportionate benefit rule and compute the taxable amount of the benefits.

Common mistake:

- due to unsatisfactory time allocation, it was observed that some candidates did not allocate sufficient time to prepare their answers and this affected their performance in this simple question.

Answer to Jun 2013 Q8b

If the MPF Benefits also include an amount of \$20,000 attributable to the voluntary contributions made by G Limited, such amount will only be exempted from salaries tax to the extent of the proportionate benefit (s.8(2)(cc)(ii) and (4) of the IRO), which is computed as $\$20,000 \times 12 \text{ months} / 120 \text{ months} = \$2,000$ (s.8(5) of the IRO).

The balance (i.e. $\$20,000 - \$2,000 = \$18,000$) will be included as part of Assessable Income (s.9(1)(ae) of the IRO).

Dec 2012 Q9

Mr. and Mrs. Lip married on 1 October 2011. The following information is provided by them for the year ended 31 March 2012.

- A. Mr. Lip was the Finance Director of a company listed on the Hong Kong Stock Exchange. His total remuneration for the year was \$1,350,000. He made a contribution of \$12,000 to his Mandatory Provident Fund Scheme.
- B. Mr. Lip resided in a residential flat provided rent free by his employer. The flat was leased directly by his employer at a monthly rent of \$45,000.
- C. Mr. Lip had been granted an option to subscribe for 30,000 shares of his employer's shares on 1 May 2011 at the option cost of \$6,000 payable to his employer. On 1 August 2011 he assigned one third of the shares option to his colleague at the consideration of \$20,000, subsequent to the approval obtained from his employer on the assignment.

Dec 2012 Q9

He exercised another one third of the option on 1 December 2011 at the option exercise price of \$2 per share, whilst on the same day the remaining one third of the share option right was released back to his employer at the consideration of \$100,000. He sold all the shares obtained from exercising the option on 1 March 2012. The market value of the share was \$5 on 1 May 2011, \$6 on 1 August 2011, \$7 on 1 December 2011 and \$8 on 1 March 2012.

- D. Mrs. Lip did not have any full-time or part-time employment during the year. Instead, she carried on a beauty salon business with her sister in the form of a partnership with profit or loss to be shared on an equal basis. The tax loss sustained by the partnership and attributable to Mrs. Lip for the year and agreed by the IRD was \$150,000.
- E. Mrs. Lip has acquired a residential property and has leased it out to generate rental income for a number of years. A new tenancy agreement was entered into and commenced on 1 April 2011 at \$12,000 per month with one month rent free period in April 2011.

Dec 2012 Q9a

Rates of \$1,800 per quarter were paid by Mrs. Lip. During the year Mrs. Lip incurred \$165,000 mortgage loan interest for the abovesaid property.

- F. Mrs. Lip donated \$10,000 to the Community Chest during the year, and enrolled in an MBA course at a local university and paid \$65,000 in school fees for the year. Mr. Lip had been constantly living with his mother for many years. Unfortunately, his mother passed away on 1 February 2012 at the age of 75. Mr. Lip's father was 78 years old and lived in an elderly residential care home. Mr. Lip incurred \$86,000 residential care expenses for the year.

Required:

- (a) Calculate the net assessable income of Mr. Lip for the year of assessment 2011/12.

(5 marks)

Examiner's comment for Dec 2012 Q9a

Performance: Satisfactory

Common mistakes:

- made simple arithmetic errors
- wrongly included the share option gain in computing the rental value.

Answer to Dec 2012 Q9a

Mr. Lip

Net Assessable Income – 2011/12

	HK\$
Director remuneration	1,350,000
Add: Rental value (\$1,350,000 x 10%)	<u>135,000</u>
	1,485,000
Add: Share option gain (Note)	<u>164,000</u>
Net assessable income	<u>1,649,000</u>

Note:

$$\$20,000 + (10,000 \times (\$7 - \$2)) + \$100,000 - \$6,000 = \$164,000$$



Dec 2012 Q9b

Required:

- (b) Calculate the net assessable value of the property owned by Mrs. Lip for the year of assessment 2011/12. (3 marks)

Examiner's comment for Dec 2012 Q9b

Performance: Satisfactory

- could demonstrate their ability to prepare the computation

Answer to Dec 2012 Q9b

Mrs. Lip

Net Assessable Value – 2011/12

	HK\$
Rent (\$12,000 x 11)	132,000
Less: Rates (\$1,800 x 4)	<u>(7,200)</u>
	124,800
Less: 20% statutory allowance	<u>(24,960)</u>
Net assessable value	<u>99,840</u>

Dec 2012 Q9c

Required:

- (c) Calculate the Hong Kong tax liabilities of Mr. and Mrs. Lip under personal assessment for the year of assessment 2011/12. Ignore the 2011/12 tax reduction and 2012/13 provisional tax in your calculation. (9 marks)

Examiner's comment for Dec 2012 Q9c

Performance: Satisfactory

- Familiar with the basis layout of the computation under personal assessment

Common mistakes:

- wrong deduction of education expenses
- partial deduction of statutory allowances
- omission of the comparison of tax liabilities between progressive rate and standard rate
- failure to apportion tax liabilities between husband and wife.



Answer to Dec 2012 Q9c

Mr. and Mrs. Lip

Tax liabilities under Personal Assessment

Year of assessment 2011/12

	Mr. Lip	Mrs. Lip	Total
	HK\$	HK\$	HK\$
Net assessable income (Note)	1,649,000	---	1,649,000
Net assessable value of the property	<u>---</u>	<u>99,840</u>	<u>99,840</u>
	1,649,000	99,840	1,748,840
Less: interest on mortgage loan re the property (restricted to net assessable value)	<u>---</u>	<u>(99,840)</u>	<u>(99,840)</u>
	1,649,000	---	1,649,000
Less: Concessionary deductions			
Approved Charitable Donations	(10,000)	---	(10,000)
Elderly Residential Care Expenses	(72,000)	---	(72,000)
MPF Contribution	<u>(12,000)</u>	<u>---</u>	<u>(12,000)</u>
	<u>1,555,000</u>	<u>---</u>	<u>1,555,000</u>



Answer to Dec 2012 Q9c

Less: Business loss incurred by Mrs. Lip	<u>(150,000)</u>
	1,405,000
Less: Married Person's Allowance	(216,000)
Dependent Parent Allowance	(36,000)
Additional Dependent Parent Allowance	<u>(36,000)</u>
Net chargeable income	<u><u>1,117,000</u></u>
Lower of :-	
- Tax thereon at standard rate (\$1,405,000 x 15%)	<u><u>210,750</u></u>
or	
- Tax thereon @ progressive rate (\$8,400 + ((\$1,117,000 - \$120,000) x 17%)	<u><u>177,890</u></u>
	(applicable)
Total tax payable by Mr. Lip	
\$177,890 x 1,555,000/1,555,000 =	<u><u>\$177,890</u></u>
Total tax payable by Mrs. Lip	
\$177,890 x 0/1,555,000 =	<u><u>\$0</u></u>

Answer to Dec 2012 Q9c

Note:

Self-education expenses for Mrs. Lip are deductible under salaries tax (s.12(1)(e) of the IRO) only, and the expenses cannot be allowed for deduction in computing tax liabilities under personal assessment.



➤ **Part D:
Stamp Duty**

Jun 2013 Q7c (Extract)

C Recreation Club (“the Club”) was incorporated in Hong Kong under the Companies Ordinance as a company limited by guarantee in 2001.

Note

- (3) The Club is the registered owner of Building D in Hong Kong. In May 2011, the Club entered into a lease (“the Lease”) with E Limited (which is not a member of the Club) in respect of the ground floor of Building D at a monthly rent of \$30,000 (“the Rent”) for the period from 1 June 2011 to 31 May 2013. E Limited operated a restaurant on the ground floor to serve both members and non-members of the Club.
- (4) In January 2012, the Club entered into an agreement (“the Agreement”) with F Limited, granting it a non-exclusive right of use of the roof of Building D. Under the Agreement, F Limited was only allowed to use the roof for the installation and operation of certain mobile communication equipment.

Jun 2013 Q7c (Extract)

The term of the Agreement ran from 1 February 2012 to 31 January 2013, and the fee payable thereunder was \$20,000 per month (“the Fee”). To protect its rights under the Agreement, F Limited is considering to register the Agreement in the Land Registry.

Required:

- (c) Advise the Club, E Limited and F Limited of the stamp duty implications relating to the Lease and the Agreement. (Note: Computation of stamp duty, if any, is NOT required.)

(6 marks)

Examiner's comment for Jun 2013 Q7c

Performance: Average

- could state that the lease of the ground floor of Building D was chargeable with stamp duty.

Common mistakes:

- not able to mention that the licence of the roof of the same building was not chargeable because of the lack of exclusive possession.
- waste time on stamp duty computation which is not required.

Answer to Jun 2013 Q7c

1. The Lease is chargeable with stamp duty under head 1(2)(b) of the First Schedule of the Stamp Duty Ordinance (“SDO”). The Club and E Limited should present it for stamping within 30 days after the execution of the Lease.
2. For the Agreement, it does not give F Limited the right to exclusive possession. The rights of F Limited under the Agreement are also restricted. As such, the Agreement is more akin to a licence which is not chargeable with stamp duty.
3. F Limited is considering to register the Agreement in the Land Registry. However, s.15(2) of the SDO provides, among others, that no instrument chargeable with stamp duty shall be registered by any public officer unless such instrument is duly stamped. In order to avoid any doubt on the stamp duty chargeability of the Agreement which may prevent its registration in the Land Registry, it is advisable that F Limited should submit the Agreement for adjudication under s.13(1) of the SDO.



➤ **Part G:
China Tax**

Jun 2013 Q6c (Extract)

A Limited is a toy trading company in Hong Kong. It commenced business in 2000 and closed its accounts annually on 30 June. In early 2011, A Limited took over B Limited, a company incorporated in the Mainland of China (“the Mainland”).

B Limited did not have any business presence in Hong Kong. On 1 December 2011, B Limited sold the Trademark with its right under the Licence at RMB 20 million to C Limited, a Mainland corporation which is wholly-owned by A Limited. The market value of the Trademark as at 1 January 2012 was RMB 100 million.

Required:

- (c) Evaluate whether and, if so, when and how B Limited is chargeable to the Mainland business tax in respect of the sale of the Trademark to C Limited on 1 December 2011. (Note: Computation of business tax payable is required if chargeable.) (5 marks)

Examiner's comment for Jun 2013 Q6c

Performance:

- could identify that the transaction was a taxable activity for the purposes of Mainland business tax

Common mistakes:

- not able to state the location of the recipient as the determinant of chargeability.
- not aware that the consideration for the trademark was below its market value and that the Mainland tax authority might impose the business tax charge on the basis of the market value.

Answer to Jun 2013 Q6c

1. B Limited should be chargeable to business tax in respect of its sale of the Trademark to C Limited because C Limited, being the recipient of the Trademark, is in the Mainland.
2. The above liability to business tax arises on the date on which B Limited transferred the Trademark to C Limited, i.e. 1 December 2011.
3. Since the consideration for the Trademark (RMB 20 million) is apparently below its market value (RMB 100 million), by virtue of Article 7 of the PRBT, the Mainland Tax Authority may adopt the market value as the taxable turnover and the applicable tax rate is 5%.
4. Therefore, the business tax payable = RMB 100 million x 5% = RMB 5 million.

Dec 2012 Q8c

Comment on the circumstances below from the Hong Kong tax or PRC turnover tax perspectives and, where appropriate, provide your recommendations. Support your answers with relevant provisions of the IRO or the PRC rules and regulations:

- (c) Prince Limited is a consultancy company incorporated and centrally managed in Hong Kong. Recently, it has been engaged by a PRC client to provide business consultancy services directly in the client's office in Guangzhou, Guangdong Province of the PRC. The services were completed within two weeks, and Prince Limited received RMB100,000 and RMB1,800 as income and travelling expenses reimbursement respectively.

The accounting manager of Prince Limited has no idea whether the abovesaid amounts would have any PRC turnover tax exposure in view of the short duration of time providing the services in the PRC, and the relatively small amount of income involved.

(6 marks)

Examiner's comment for Dec 2012 Q8c

Performance: Not satisfactory

Common mistakes:

- wrongly focused on the Double Taxation Arrangement, permanent establishment in Mainland and the 183 days rule.
- underestimated the importance of PRC tax, and did not familiarise themselves with the relevant Business Tax regime in the PRC.

Answer to Dec 2012 Q8c

1. From the PRC turnover tax perspective, income derived from services received by the PRC client in the PRC are subject to PRC business tax (Article 1 of the Provisional Regulations of the People's Republic of China on Business Tax).
2. As business consultancy is in the scope of service industry, the applicable rate for business tax is 5%.
3. The business tax liability is therefore $\text{RMB}101,800 \times 5\% = \text{RMB}5,090$, as taxable income includes turnover and expenses reimbursement.
4. There is no business tax exemption provision with respect to income threshold and services duration and accordingly Prince Limited is liable to the abovesaid PRC business tax.

Practice Makes Perfect

Good luck!

End of Seminar