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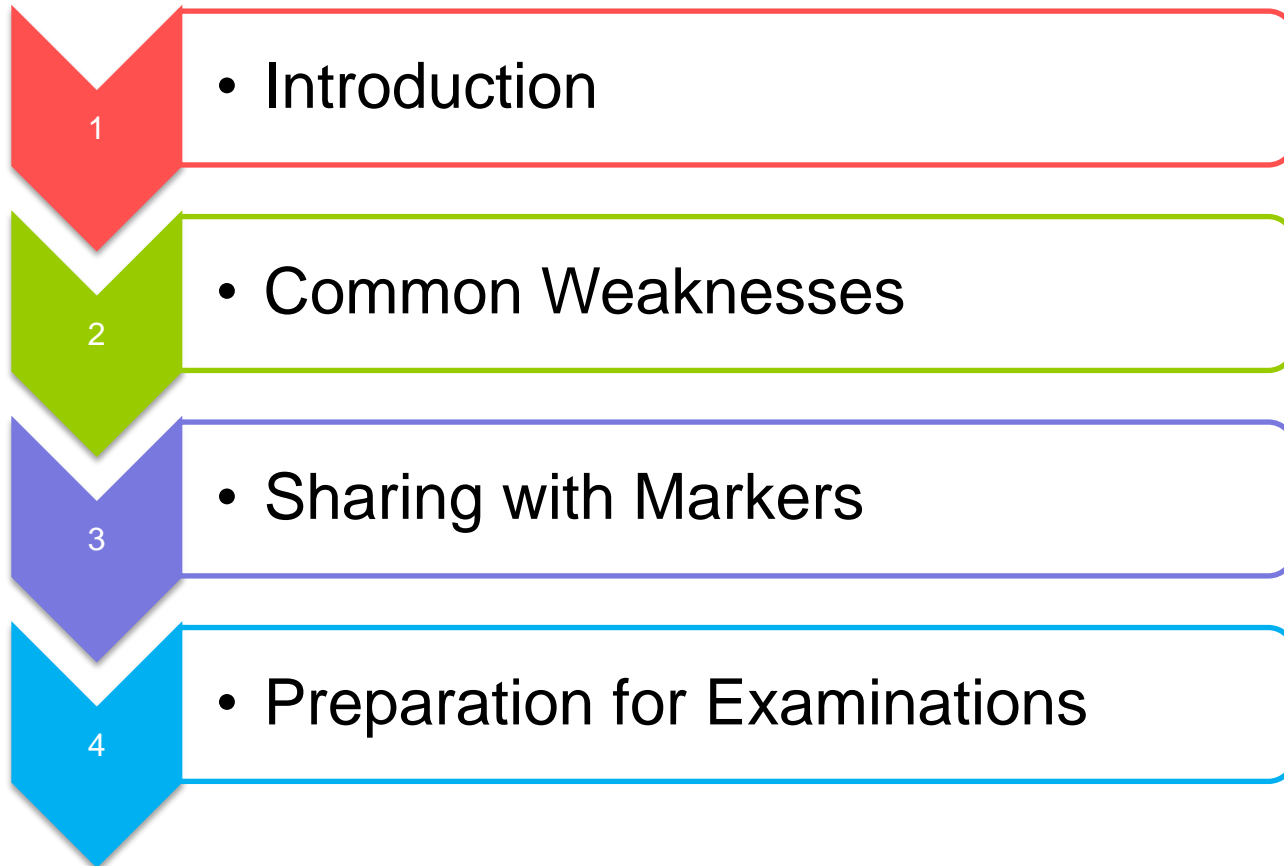
# Examination Techniques Seminar on QP Module Examinations

**Module D**  
**(June 2017 Session)**





# Agenda





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# Part 1: Introduction





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**Today's objective:**  
***Finding ways to pass the  
Module Examination!***



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# HKICPA QP Module Examinations

## Examination Format:

- Section A – Case Questions (50%)
- Section B – Essay / Short Questions (50%)
- 3 hours duration for each Paper
- All compulsory questions



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# Part 2: Common Weaknesses







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# Major causes to examination failure





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## **Aspect 1: Questions**

- Difficulty in identifying the specific question requirements
- Misinterpretation of the question requirements



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## **Aspect 2:** **Answers**

- Approach or structure of answers are disorganized
- Answers are either too long or too short
- Answers are wrong, irrelevant, or lack of practical consideration
- Answers are not linked to the case facts
- Answers are straight copy from LP or reference materials
- Did not attempt all questions



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## **Aspect 3:**

# **Candidates**

- Inadequate or ineffective preparation
- Other commitments affecting examination preparation
- Not in a good form to perform on examination day
- Felt panicking or got nervous in the examination centre
- Poor time management

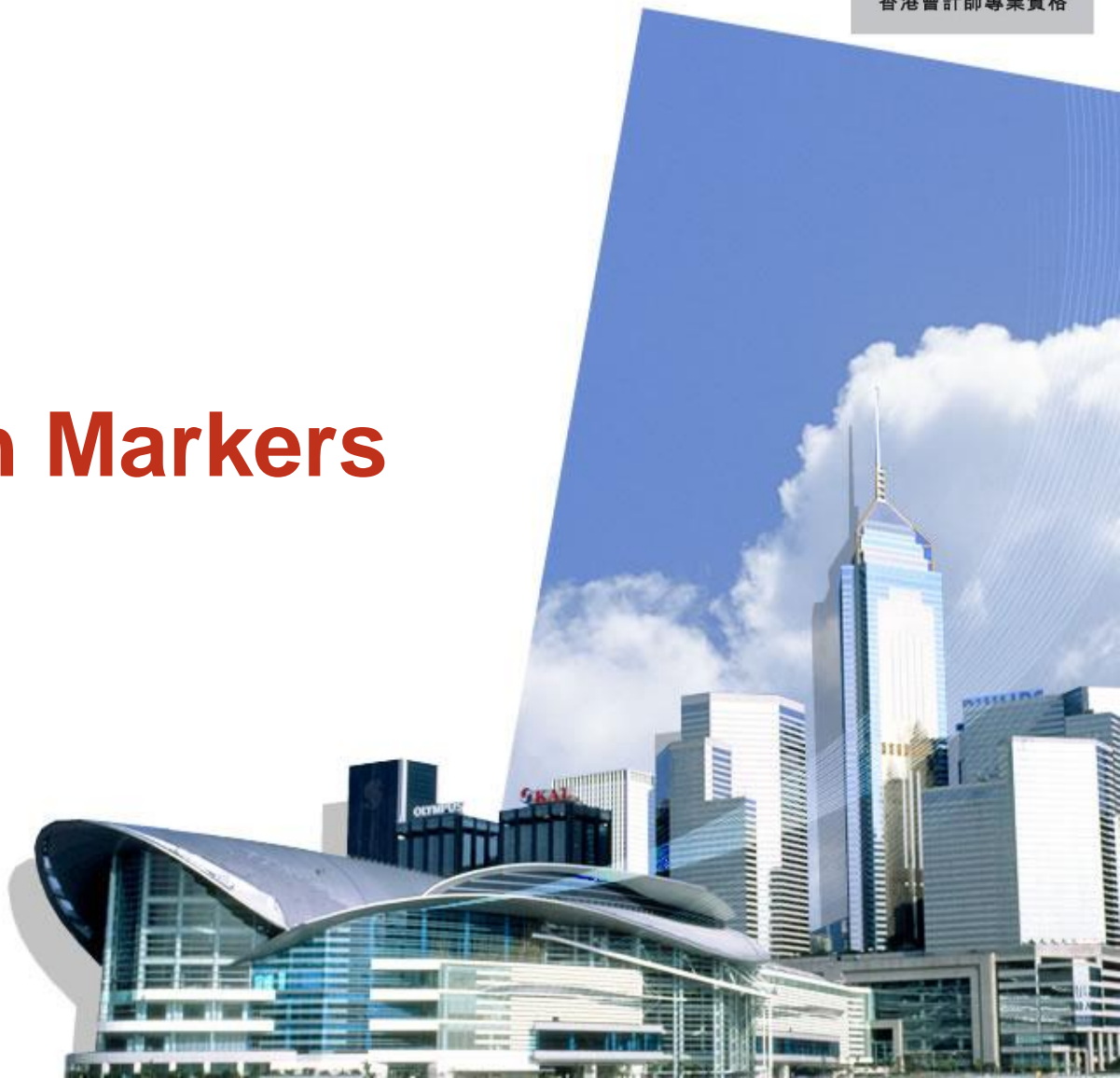


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# Part 3: Sharing with Markers





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## Key points recapped

- Interpretation of the requirements
- Understanding and application of knowledge
- Structure of the answer
- Time management



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# Section A – Case Questions



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## Case background

### 1. Case

Fantastic Hong Kong Limited (“Fantastic HK”) carries on a business in Hong Kong. It is wholly owned by Fantastic Holdings Limited (“Fantastic Holdings”) the shares of which are listed on the Hong Kong Stock Exchange. In the year 2013, Fantastic Holdings set up two wholly owned subsidiaries, Fantastic Manufacturing Limited (“Fantastic Manufacturing”) and Fantastic Procurement Limited (“Fantastic Procurement”). Fantastic Manufacturing and Fantastic Procurement were incorporated in mainland China and Country X respectively. The above companies are collectively known as the Fantastic group.





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## Case background

### 2. Production

Fantastic HK was a manufacturer of toys. Its finished goods used to be produced by its contract processing factory (“the Factory”) in mainland China. In the year 2013, Fantastic Manufacturing took the place of the Factory. Fantastic HK has since then provided the moulds (“the Moulds”) previously used by the Factory to Fantastic Manufacturing free of charge for its use in mainland China. The Moulds have been used specifically for producing finished goods for Fantastic HK. They remain under the ownership of Fantastic HK. Fantastic Manufacturing sells finished goods to Fantastic HK at an arm’s length price for the latter’s onward sales to ultimate customers.



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## Case background

### 3. Procurement

Fantastic HK used to purchase raw materials from various suppliers (“the Suppliers”) for the production by the Factory. Since the year 2013, the procurement work is said to have been taken up by Fantastic Procurement in place of Fantastic HK. Fantastic Procurement asserts that it has neither a place of business nor permanent establishment in any part of the world, including Hong Kong. Its correspondence address is at the business premises of Fantastic HK. Fantastic Procurement has two nominee directors overseas (“the Directors”) but employs no employees. Raw materials are said to be purchased from the Suppliers through the Directors by Fantastic Procurement which in turn sells to Fantastic HK at a mark up of 30% (“the Mark Up”). Fantastic HK then sells the raw materials to Fantastic Manufacturing without mark up for the latter’s onward production.



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## Case background

### 4. Mr McDonald

Mr McDonald was the Development Manager of the Fantastic group's competitor. He commenced his Hong Kong employment by entering into an agreement with Fantastic HK on 1 August 2014 which provided that, apart from his monthly salary of HK\$100,000, he is entitled to receive from Fantastic HK a sum of HK\$800,000 ("the Sum") upon his taking up employment with the company on 1 December 2014. He, however, has to repay the Sum to Fantastic HK if he resigns on or before 30 November 2016. Mr McDonald took up the position of Innovative Director of Fantastic HK with effect from 1 December 2014. Fantastic HK paid him the Sum on 31 December 2014 along with his salary for December 2014. To date, Mr McDonald remains under the employment of Fantastic HK.



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## Case background

### 4. Mr McDonald (Con't)

Mr McDonald is an expatriate. He has not reported to the Inland Revenue Department (“the IRD”) the income which he derived from his employment with Fantastic HK for the period from 1 December 2014 to 31 March 2015. The first Individual Tax Return issued to him was the one for the year of assessment 2015/16. He reported in that tax return the income which he derived from Fantastic HK for the year ended 31 March 2016.



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## Case background

### 5. Shares participation plan

On 3 January 2011, the Fantastic group launched a shares participation plan (“the Plan”) to allot shares in Fantastic Holdings to chosen employees who have been working with the group for more than 20 years.



## Case background

### 5. Shares participation plan (Con't)

The market price of and the dividend paid by Fantastic Holdings were as follows:

	<u>Market price per ordinary share</u>
3 January 2011	HK\$100
1 June 2011	HK\$120
31 May 2013	HK\$105
30 May 2014	HK\$110
31 March 2016	HK\$90

<u>Dividend paid on</u>	<u>Dividend paid per ordinary share</u>
3 May 2011	HK\$1.6
18 May 2012	HK\$1.5
22 May 2013	HK\$1.1
15 May 2014	HK\$1.2



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## Case background

### 6. Mr Richmond

Mr Richmond was allotted 5,000 ordinary shares (“Shares A”) on 1 June 2011 by virtue of the Plan. Shares A would be vested in Mr Richmond on 30 May 2014 if he remained an employee of Fantastic HK on that date. On 30 May 2014, Shares A were vested in and awarded to Mr Richmond by allotment. In addition, an additional award equivalent to the value of dividends as declared by Fantastic Holdings during the vesting period was accumulated and paid to Mr Richmond on 30 May 2014. On 31 March 2016, Mr Richmond transferred 4,000 ordinary shares out of Shares A to his family trust (“the Trust”) at a consideration of HK\$40,000. Mr Richmond’s children are the sole beneficiaries of the Trust.





## Case background

### 6. Mr Richmond (Con't)

The number of days for which Mr Richmond was in Hong Kong and outside Hong Kong are as follows:

<u>Year ended</u>	<u>No. of days in Hong Kong</u>	<u>No. of days outside Hong Kong</u>
31 March 2011	290	75
31 March 2012	286	80
31 March 2013	310	55
31 March 2014	312	53
31 March 2015	296	69



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## Case background

### 7. Ms Taylor

Ms Taylor was allotted 3,000 ordinary shares (“Shares B”) on 1 June 2011 by virtue of the Plan. The rights attached to Shares B are the same as other ordinary shares in Fantastic Holdings except that Ms Taylor cannot sell Shares B until 31 May 2013. She has the right to vote and is entitled to dividend as other ordinary shareholders with regard to Shares B. Ms Taylor was registered as a shareholder of Fantastic Holdings on 1 June 2011.



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## **December 2016 Session – Sect A – Q1** **(6 marks – approximately 11 minutes)**

Analyse, with reference to the relevant legal principles, whether Fantastic HK is entitled to any deduction under s.16G and capital allowance under s.39E of the Inland Revenue Ordinance (“the IRO”) in respect of the cost of the Moulds during the period the production is taken up by Fantastic Manufacturing.

(6 marks)



## Case background

### 2. Production

Fantastic HK was a manufacturer of toys. Its finished goods used to be produced by its contract processing factory (“the Factory”) in mainland China. In the year 2013, Fantastic Manufacturing took the place of the Factory. Fantastic HK has since then provided the moulds (“the Moulds”) previously used by the Factory to Fantastic Manufacturing free of charge for its use in mainland China. The Moulds have been used specifically for producing finished goods for Fantastic HK. They remain under the ownership of Fantastic HK. Fantastic Manufacturing sells finished goods to Fantastic HK at an arm’s length price for the latter’s onward sales to ultimate customers.

➤ Q1



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## Question 1



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## Irrelevant answers

- Discuss contract processing arrangement V. import processing arrangement.
- Discuss sale and lease back S39E(1)(a).



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## Question 1



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## Problem

- No application, only explanation of prescribed fixed assets S16G.
- Did not aware that the Moulds are excluded fixed assets if any person holds right as a lessee under a lease. (S16G(6))
- No application, only explain S39E.



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## Answer 1

Fantastic HK is not entitled to the deduction for prescribed fixed assets under s.16G(1) of the Inland Revenue Ordinance (“the IRO”) in respect of the Moulds as the Moulds are excluded fixed assets under s.16G(6). S.16G(6) of the IRO provides that an excluded fixed asset means a fixed asset in which any person holds rights as a lessee under a lease.

On the authority of *Braitrim (Far East) Limited v Commissioner of Inland Revenue* [2013] 4 HKLRD329, the word “lease” in s.16G(6) bears the meaning as defined in s.2(1) of the IRO. In s.2(1), it provides that “lease”, in relation to plant and machinery, includes any arrangement under which a right to use the plant and machinery is granted by the owner to another person.





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## Answer 1 (cont'd)

In the present case, though the Moulds are plant or machinery specified in item 26 of the First Part of the Table annexed to rule 2 of the Inland Revenue Rules (“the IRR”) and they are used directly for the manufacturing process, they are excluded fixed assets as their right to use has been granted by Fantastic HK to Fantastic Manufacturing. Such being the case, the cost of the Moulds is not specified capital expenditure allowable for deduction under s.16G(1) of the IRO.



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## Answer 1 (cont'd)

In the present case, the Moulds are used by Fantastic Manufacturing outside Hong Kong under a lease. So, Fantastic HK is not entitled to a depreciation allowance in respect of the Moulds under s.39E(1)(b)(i) of the IRO either. S.39E(1)(b)(i) provides that a depreciation allowance shall be denied if at the time when the machinery or plant is owned by a taxpayer, a person holds rights as lessee under a lease and that while the lease is in force, the machinery or plant is used wholly or principally outside Hong Kong by a person other than the taxpayer. The Court of Appeal has reaffirmed in *Braitrim* that the extended definition of “lease” in s.2 is applicable to s.39E.



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## December 2016 Session – Sect A – Q2 (9 marks – approximately 17 minutes)

The Assessor takes the view that Fantastic Procurement does not carry on business in Hong Kong and that the raw materials are actually procured by Fantastic HK both prior to and after the year 2013 because Fantastic Procurement virtually had done nothing at all to procure the raw materials. He opines that the arrangement between Fantastic HK and Fantastic Procurement was entered into for the purposes of shifting the profits from the former to the latter.

### Required:

Analyse, with reference to the relevant legal principles, how the profits so shifted are to be brought back into charge in the context of the relevant provisions of the IRO.

(9 marks)



## Case background

### 3. Procurement

Fantastic HK used to purchase raw materials from various suppliers (“the Suppliers”) for the production by the Factory. Since the year 2013, the procurement work is said to have been taken up by Fantastic Procurement in place of Fantastic HK. Fantastic Procurement asserts that it has neither a place of business nor permanent establishment in any part of the world, including Hong Kong. Its correspondence address is at the business premises of Fantastic HK. Fantastic Procurement has two nominee directors overseas (“the Directors”) but employs no employees. Raw materials are said to be purchased from the Suppliers through the Directors by Fantastic Procurement which in turn sells to Fantastic HK at a mark up of 30% (“the Mark Up”). Fantastic HK then sells the raw materials to Fantastic Manufacturing without mark up for the latter’s onward production.

➤ Q2



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## Question 2



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## Wrong answers

- Discuss source of profit by referring to S14, contract effected test.
- Quote irrelevant cases. (such as Magna Hang Seng Bank)



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## Question 2



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## Irrelevant answers

- Discuss S9A, royalty income and S45 stamp duty relief.



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## Question 2



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## Problem

- Could identify S.20 (2) and S.61A but unable to refer to the facts in the case to provide appropriate explanation.
- Could not identify S16(1) and S17(1)(b) are relevant.



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## Answer 2

S.20(2) of the IRO provides that where a non-resident person carries on business with a closely connected resident person in a way such that it produces to the resident person either no profits or less than the ordinary profits which might be expected to arise in or derive from Hong Kong, the business done by the non-resident person in pursuance of its connection with the resident person shall be deemed to be carried on in Hong Kong and such non-resident person shall be chargeable to tax in respect of those profits in the name of the resident person as if the resident person was the non resident's agent.





## Answer 2 (cont'd)

Both Fantastic Procurement and Fantastic HK are wholly owned subsidiaries of Fantastic Holdings. They are closely connected persons by virtue of s.20(1)(a) of the IRO. On the other hand, Fantastic Procurement is said to have no place of business or permanent establishment in any part of the world, including Hong Kong. As such, it is a non-resident person in Hong Kong.

Further, the interposition of Fantastic Procurement between the Suppliers and Fantastic HK has certainly reduced the profits of Fantastic HK as part of its profits has been shifted to Fantastic Procurement to the extent of the Mark Up. That being so, the profits so shifted, i.e., the Mark Up, are chargeable to profits tax in the name of Fantastic HK as the agent of Fantastic Procurement by virtue of s.20(2) of the IRO.



## Answer 2 (cont'd)

Alternatively, the Assessor may disallow the deduction of the Mark Up under ss.16(1) and 17(1)(b) of the IRO. S.16(1) provides that there shall be deducted all outgoings and expenses to the extent to which they are incurred in the production of assessable profits. S.17(1)(b) provides that expenses not incurred in the production of assessable profits are not allowable for deduction.

It was held in ***So Kai Tong Stanley trading as Stanley So & Co v CIR*** [2004] 2 HKLRD 416 that s.16(1) entitles the Commissioner of Inland Revenue (“the Commissioner”) to ascertain the extent to which the outgoings or expenses are incurred in the production of assessable profits, which are considered to be most reasonable and appropriate in the circumstances of the case.



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## Answer 2 (cont'd)

In the present case, although Fantastic HK did purchase certain raw materials, the purchase cost incurred by Fantastic HK was excessive to the extent of the Mark Up as Fantastic Procurement had done nothing at all to procure the purchases. The Mark Up was not incurred in the production of its assessable profits. Hence, the Assessor may disallow the deduction of the Mark Up claimed by Fantastic HK and consequently increase the assessable profits of Fantastic HK by virtue of ss.16(1) and 17(1)(b) of the IRO.

Alternatively, the purchase of raw materials by Fantastic HK from the associated enterprise Fantastic Procurement may be regarded under s.61A of the IRO, as not having been conducted under the arm's length principle but to avoid liability for tax and the assistant commissioner may then assess the liability to tax of Fantastic HK.



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## **December 2016 Session – Sect A – Q3** **(8 marks – approximately 14 minutes)**

Analyse, with reference to the relevant legal principles, whether the Sum is chargeable to salaries tax; and if so, the year of assessment in which it is chargeable.

(8 marks)



## Case background

### 4. Mr McDonald

Mr McDonald was the Development Manager of the Fantastic group's competitor. He commenced his Hong Kong employment by entering into an agreement with Fantastic HK on 1 August 2014 which provided that, apart from his monthly salary of HK\$100,000, he is entitled to receive from Fantastic HK a sum of HK\$800,000 ("the Sum") upon his taking up employment with the company on 1 December 2014. He, however, has to repay the Sum to Fantastic HK if he resigns on or before 30 November 2016. Mr McDonald took up the position of Innovative Director of Fantastic HK with effect from 1 December 2014. Fantastic HK paid him the Sum on 31 December 2014 along with his salary for December 2014. To date, Mr McDonald remains under the employment of Fantastic HK.

➤ Q3



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## Question 3



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## Problem

- Analyse S.8 which is not required.
- Unable to identify S11B and S11D(b).



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## Answer 3

S.9(1)(a) of the IRO provides that income from any office or employment includes any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite or allowance, whether derived from the employers or others. S.11B of the IRO provides that the assessable income of a person in any year of assessment shall be the aggregate of income accruing to him from all sources in that year of assessment. S.11D(b) of the IRO further provides that income accrues to a person when he becomes entitled to claim payment thereof.

On the authority of *Hochstrassers v Mayers* (1959) 38 TC 673, to be liable to salaries tax, the relevant payment must arise from employment, be attributable to the taxpayer's services because of his employment and be in return for the taxpayer's services past, present or future. Besides, following the decision in *Shilton v Wilmshurst (Inspector of Taxes)* (1991) STC 88, an emolument from employment means an emolument from being or becoming an employee.



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## Answer 3 (cont'd)

In the present case, the Sum was paid to Mr McDonald as an emolument for becoming an employee of Fantastic HK. It was an inducement for Mr McDonald to take up the employment. Accordingly, the Sum is chargeable to salaries tax by virtue of s.9(1)(a) of the IRO. Though Mr McDonald has a contingent liability to repay the Sum to Fantastic HK if he resigns on or before 30 November 2016, it is crystal clear that he was entitled to the Sum when he took up the employment on 1 December 2014. Fantastic HK did pay Mr McDonald the Sum according to the employment agreement. The Sum was accrued to Mr McDonald in the year of assessment 2014/15 when he took up the employment with Fantastic HK.





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## **December 2016 Session – Sect A – Q4** **(7 marks – approximately 12 minutes)**

Explain the offence which Mr McDonald has committed; and explain the relevant penalty provisions in Part 14 of the IRO which are applicable to Mr McDonald as a taxpayer.

(7 marks)



## Case background

### 4. Mr McDonald (Con't)

Mr McDonald is an expatriate. He has not reported to the Inland Revenue Department (“the IRD”) the income which he derived from his employment with Fantastic HK for the period from 1 December 2014 to 31 March 2015. The first Individual Tax Return issued to him was the one for the year of assessment 2015/16. He reported in that tax return the income which he derived from Fantastic HK for the year ended 31 March 2016.

➤ Q4



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## Question 4



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## Wrong answers

- Misapplied S82(1).



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## Answer 4

Under s.51(2) of the IRO, every person chargeable to tax for any year of assessment shall inform the Commissioner in writing that he is so chargeable not later than 4 months after the end of the basis period for that year of assessment unless he has already been required to furnish a tax return.

In the present case, Mr McDonald failed to comply with s.51(2) of the IRO in reporting his chargeability to salaries tax for the year of assessment 2014/15.

As such, the penalty provisions under ss.80(2)(e) and 82A(1)(e) of the IRO are applicable to him.



## Answer 4 (cont'd)

S.80(2)(e) of the IRO provides that any person who without reasonable excuse fails to comply with s.51(2) of the IRO commits an offence and is liable on conviction to a fine at level 3 and a further fine of treble the amount of tax which has been undercharged in consequence of that failure. S.80(5) of the IRO further provides that the Commissioner may compound any offence under s.80.

As to s.82A(1)(e) of the IRO, it provides that any person who without reasonable excuse fails to comply with s.51(2) of the IRO shall be liable to be assessed under s.82A additional tax of an amount not exceeding treble the amount of tax which has been undercharged in consequence of that failure.



## December 2016 Session – Sect A – Q5 (12 marks – approximately 22 minutes)

(a) Recommend an assessment approach as prescribed in the Departmental Interpretation and Practice Notes No. 38 (Revised) (“DIPN No. 38”) which is applicable to Mr Richmond’s case; state the year of assessment in which the assessable income in relation to Shares A is chargeable to tax and calculate the amount of assessable income, if any, on the basis that Mr Richmond’s employment with Fantastic HK throughout is (i) a Hong Kong employment; and (ii) a non-Hong Kong employment. Explain your analysis.

( 6 marks)

(b) Recommend an assessment approach as prescribed in the DIPN No. 38 which is applicable to Ms Taylor’s case; state the year of assessment in which the assessable income in relation to Shares B is chargeable to tax and calculate the amount of assessable income. Explain your analysis.

( 6 marks) 51



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## Case background

### 5. Shares participation plan

On 3 January 2011, the Fantastic group launched a shares participation plan (“the Plan”) to allot shares in Fantastic Holdings to chosen employees who have been working with the group for more than 20 years.

➤ Q5



## Case background

### 5. Shares participation plan (Con't)

The market price of and the dividend paid by Fantastic Holdings were as follows:

➤ Q5

	<u>Market price per ordinary share</u>
3 January 2011	HK\$100
1 June 2011	HK\$120
31 May 2013	HK\$105
30 May 2014	HK\$110
31 March 2016	HK\$90

<u>Dividend paid on</u>	<u>Dividend paid per ordinary share</u>
3 May 2011	HK\$1.6
18 May 2012	HK\$1.5
22 May 2013	HK\$1.1
15 May 2014	HK\$1.2





## Case background

### 6. Mr Richmond

Mr Richmond was allotted 5,000 ordinary shares (“Shares A”) on 1 June 2011 by virtue of the Plan. Shares A would be vested in Mr Richmond on 30 May 2014 if he remained an employee of Fantastic HK on that date. On 30 May 2014, Shares A were vested in and awarded to Mr Richmond by allotment. In addition, an additional award equivalent to the value of dividends as declared by Fantastic Holdings during the vesting period was accumulated and paid to Mr Richmond on 30 May 2014. On 31 March 2016, Mr Richmond transferred 4,000 ordinary shares out of Shares A to his family trust (“the Trust”) at a consideration of HK\$40,000. Mr Richmond’s children are the sole beneficiaries of the Trust.

➤ Q5a



## Case background

### 6. Mr Richmond (Con't)

The number of days for which Mr Richmond was in Hong Kong and outside Hong Kong are as follows:

➤ Q5a

<u>Year ended</u>	<u>No. of days in Hong Kong</u>	<u>No. of days outside Hong Kong</u>
31 March 2011	290	75
31 March 2012	286	80
31 March 2013	310	55
31 March 2014	312	53
31 March 2015	296	69



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## Question 5(a)



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## Problem

- Did not calculate the value of dividend during the vesting period.
- Mistakenly answered that the value of dividends during the vesting period were not chargeable.
- Wrongly considered the share awards as share options.



## Answer 5(a)

Vesting of shares was involved in Mr Richmond's case. As such, the back end approach is to be adopted in the computation of the relevant assessable income. Irrespective of whether Mr Richmond's employment with Fantastic HK is a Hong Kong employment or a non-Hong Kong employment, the assessable income in relation to Shares A is chargeable to salaries tax in the year of assessment 2014/15 because Shares A were vested in him on 30 May 2014.

The relevant shares award is not to be assessed in the year of assessment in which the Plan was launched (i.e., 2010/11) or the year of assessment in which Shares A were granted to Mr Richmond (i.e., 2011/12). This is because Mr Richmond was not entitled to Shares A in those two years of assessment. By the same token, as Shares A had not been vested in Mr Richmond in the years of assessment 2012/13 and 2013/14, the relevant shares award is not to be assessed in those years of assessment either.



## Answer 5(a) (cont'd)

If Mr Richmond's employment with Fantastic HK is a Hong Kong employment, the relevant assessable income in respect of Shares A is as follows:

$$(5,000 \text{ shares} \times \text{HK\$}110 \text{ note } 1) + [5,000 \text{ shares} \times (\text{HK\$}1.5 + \text{HK\$}1.1 + \text{HK\$}1.2)] \text{ note } 2 = \text{HK\$}569,000$$

If Mr Richmond's employment with Fantastic HK is a non-Hong Kong employment, the relevant assessable income in respect of Shares A is as follows:

$$\text{HK\$}569,000(\text{as above}) \times \frac{296}{365} \text{ note } 3 = \text{HK\$}461,435$$



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## Case background

### 7. Ms Taylor

Ms Taylor was allotted 3,000 ordinary shares (“Shares B”) on 1 June 2011 by virtue of the Plan. The rights attached to Shares B are the same as other ordinary shares in Fantastic Holdings except that Ms Taylor cannot sell Shares B until 31 May 2013. She has the right to vote and is entitled to dividend as other ordinary shareholders with regard to Shares B. Ms Taylor was registered as a shareholder of Fantastic Holdings on 1 June 2011.

➤ Q5b



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## Question 5(b)



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## Wrong answers

- To assess the award in the Y/A 2013/14  
(Mix up the concepts of "restricted period" with "vesting period")



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## Answer 5(b)

As Ms Taylor was granted Shares B in the year of assessment 2011/12, the assessable income in relation thereto will be assessed in that year of assessment. Though restriction to sell was imposed on Shares B, it did not undermine Ms Taylor's rights to those shares. Indeed, she was registered as a shareholder of Fantastic Holdings on 1 June 2011. The upfront approach is to be adopted in the present case. Having said that, the Inland Revenue Department ("the IRD") will generally allow a 5% discount for each year of sale restriction (Para. 61, in DIPN No. 38 (Revised) issued in March 2008). Such being the case, the relevant assessable income in respect of Shares B is as follows:





## Answer 5(b) (cont'd)

$$3,000 \text{ shares} \times \text{HK\$}120^{\text{note 4}} \times (1 - 5\% \times 2^{\text{note 5}}) = \text{HK\$}324,000$$

Note 1: Being the market value of Shares A on the vesting date.

Note 2: Being the additional award equivalent to the value of dividends as declared by Fantastic Holdings during the vesting period.

Note 3: The value of the shares awarded is to be assessed on a time apportionment basis in the year of vesting, i.e., year of assessment 2014/15.

Note 4: Being the market value of Shares B on the date of grant.

Note 5: Being the 2-year restriction period.



## **December 2016 Session – Sect A – Q6**

**(8 marks – approximately 14 minutes)**

- (a) Explain and calculate the stamp duty payable, if any, with reference to the relevant provisions or heads, on the vesting of Shares A.
- ( 2 marks)
- (b) (i) Explain and calculate the stamp duty payable, if any, with reference to the relevant provisions or heads, on the transfer of 4,000 ordinary shares from Mr Richmond to the Trust.
- (4 marks)
- (ii) What if Mr Richmond is the sole beneficiary of the Trust? Explain the stamp duty or fee payable, if any, with reference to the relevant provisions or heads, on the transfer of 4,000 ordinary shares by Mr Richmond to the Trust.

Note: Computation is not required.

(2 marks)



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## Question 6(a)



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## Problem

- Did not read the question carefully and not realise that the shares were allotted.
- Unable to distinguish allotment of shares from transfer of shares.



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## Answer 6(a)

S.19(16) of Stamp Duty Ordinance (“the SDO”) provides that sale or purchase includes any disposal or acquisition other than an allotment. As Mr Richmond was awarded Shares A by allotment, no stamp duty is payable in this regard.



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## Question 6b(i)



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## Wrong answers

- Not subject to stamp duty under S.27(5) or S.45 of SDO.



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## Answer 6(b)(i)

On 31 March 2016, the market value of the ordinary shares in Fantastic Holdings was HK\$90 per share. The consideration of HK\$40,000 for the transfer of 4,000 ordinary shares from Mr Richmond to the Trust was obviously below the market value. The transfer will be deemed to be a conveyance or transfer operating as a voluntary disposition inter vivos and is chargeable to stamp duty on the basis of the market value of the shares (s.27(4) of the SDO). The stamp duty payable pursuant to Head 2(3) is as follows:

$$4,000 \text{ shares} \times \text{HK\$}90 \times \underline{0.2\%} + \underline{\text{HK\$}5} = \text{HK\$}725$$



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## Question 6b(ii)



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## Wrong answers

- Wrongly applied S.45.



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## Answer 6(b)(ii)

If Mr Richmond is the sole beneficiary of the Trust, it is a voluntary disposition without a change of beneficial ownership. As such, no stamp duty is payable under s.27(5) of the SDO. However, Mr Richmond may adjudicate the relevant transfer documents (ss.13(1) and 13(3)(b) of the SDO) with an adjudication fee of HK\$50.





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# Section B – Essay/Short Questions



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## **December 2016 Session – Sect B – Q7** **(18 marks – approximately 32 minutes)**

Global Holdings Limited (“Global”) is a company established in Hong Kong engaging in the garment trading business. During the financial year ended 31 March 2015, Global acquired a used commercial property (“the Property”) as its office premises at a consideration of HK\$96,000,000. In preparing the profits tax return and computation for the year of assessment 2014/15, the accountant of Global used 1/3 of the purchase consideration as the qualifying expenditure, and claimed 4% thereon as the commercial building allowance (“CBA”). The return and other supporting documents were subsequently filed to the IRD.



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## **December 2016 Session – Sect B – Q7** **(18 marks – approximately 32 minutes)**

Recently, Global received a letter from the IRD pointing out that CBA should be computed with reference to the capital expenditure incurred on the construction cost of a commercial building or structure, and if the relevant interest is sold, with reference to the residue of expenditure as stipulated in the IRO. Specifically, in case the cost of construction is not available, the first assignment price should be used as a reference. It was further provided that the Property was acquired by Global from the first hand owner, and the first assignment price paid by the first hand owner to the Property's developer was HK\$8,400,000. In addition, the first hand owner commenced to claim rebuilding allowance in the year of assessment 1984/85.



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## **December 2016 Session – Sect B – Q7** **(18 marks – approximately 32 minutes)**

Based on this information, the IRD requested Global to re-compute the CBA by using 1/3 of the first assignment price as the cost of construction of the Property in computing the residue of expenditure, and to quantify the over/under-claimed CBA made by Global correspondingly.

The accountant of Global did not have the relevant tax knowledge to recompute the CBA as requested by the IRD, and therefore Global appointed Messrs. Kenneth Chu & Chu as the tax representative to handle the matter.



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## **December 2016 Session – Sect B – Q7** **(18 marks – approximately 32 minutes)**

### **Required:**

(a) Describe the ethical considerations Messrs. Kenneth Chu & Chu should be aware of (i) prior to and (ii) upon the acceptance of the appointment from Global.

(5 marks)

(b) Based on the information available, compute the CBA Global is entitled to in accordance with the IRD's request, and compute the over/under-claimed CBA in Global's original profits tax computation.

(10 marks)



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## **December 2016 Session – Sect B – Q7** **(18 marks – approximately 32 minutes)**

### **Required:**

(c) Assuming that you are the tax manager of Messrs. Kenneth Chu & Chu, advise Global with justification as to how to maximise the CBA claim under the IRD's proposed method in using the first assignment price as a reference for quantifying the cost of construction of the Property.

(3 marks)



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## Question 7(a)



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## Irrelevant answers

- Discussed ethical considerations after commencing the tax services.  
(e.g. confidentiality)



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## Answer 7(a)

Prior to the appointment as tax representative, Messrs. Kenneth Chu & Chu should ensure the objectivity of its firm to Global by confirming that conflict of interest does not exist with respect to the appointment. In this regard, Global should not impose any influence on Messrs. Kenneth Chu & Chu alerting its tax practice on the engagement. In addition, Messrs. Kenneth Chu & Chu should gear up with competent professional knowledge to accomplish the engagement.

In addition to the above and particularly upon the acceptance of the engagement, Messrs. Kenneth Chu & Chu should issue a comprehensive engagement letter to Global specifying clearly the scope of tax services to be provided, and requesting Global to sign off the engagement letter before commencing the works.





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## Question 7(b)



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## Problem

- Not familiar with the computation of CBA in respect of an used building.
- Did not calculate the over / under claimed CBA.
- Unable to calculate the notional rebuilding allowance / notional CBA.



## Answer 7(b)

The CBA of the Property Global is entitled to (For the year of assessment 2014/15):

	HK\$
Deemed cost of construction (1/3 of HK\$8,400,000)	2,800,000
Less: Notional rebuilding allowance	
(1984/85 to 1989/90, 6 years @ 0.75%)	(126,000)
(1990/91 to 1997/98, 8 years @ 2%)	<u>(448,000)</u>
	2,226,000
Less: Notional CBA	
(1998/99 to 2013/14, 16 years x HK\$2,226,000 x 4%)	<u>(1,424,640)</u>
Residue of expenditure before sale	801,360
Less: Sales proceeds (1/3 of HK\$96,000,000)	<u>32,000,000</u>
Excess	<u><u>31,198,640</u></u>
Residue of expenditure before sale	801,360
Add: Balancing charge	
(Restricted to CBA previously claimed)	<u>1,424,640</u>
Residue of expenditure after sale <b>(A)</b>	<u><u>2,226,000</u></u>
Year of first use (Deemed under s.33A(4)(b))	1998/99
25 <sup>th</sup> year from the year of first use	2023/24
Number of years from 2014/15 to 2023/24 <b>(B)</b>	10
CBA thereon <b>((A) x 1/(B))</b>	222,600
Original CBA claimed by Global	
(@ 4% x 1/3 x HK\$96,000,000)	<u>1,280,000</u>
CBA over-claimed by Global	<u><u>(1,057,400)</u></u>



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## Question 7(c)



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## Irrelevant answers

- Suggest to acquire another property with higher cost.
- Suggest to incur more decoration cost.



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## Answer 7(c)

S.33A of the IRO does not specify any stipulated or prescribed percentage of the first assignment price as the capital expenditure for computing the respective CBA of commercial buildings and structures. In this regard, Global may submit to the IRD to take a portion higher than 1/3 of the first assignment price as the cost of construction of the Property in computing CBA with reasonable grounds (e.g. higher cost of construction ratio compared to land cost in early 1980's, etc).



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## **December 2016 Session – Sect B – Q8**

**(4 marks – approximately 7 minutes)**

Modern Amusement Limited (“Modern”) is a China company. Among the many amusement parks it operates, Modern commenced to operate a golf park in mainland China from July 2016 onward offering services for leisure golf activities including the provision of a large area of green golfing zones, trainers, caddies, etc. In July and August 2016, Modern engaged New Modern Transportation Limited (“New Modern”), also a China company, to directly transport various equipment to facilitate the golf park services. During the period from July to December 2016, Modern derived revenue of RMB18 million from operating the golf park, and Modern also paid RMB750,000 to New Modern for the abovementioned transportation services.



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## **December 2016 Session – Sect B – Q8** **(4 marks – approximately 7 minutes)**

### **Required:**

Based on the above information, analyse and calculate the maximum China turnover tax liabilities with respect to (i) the golf park revenue derived by Modern, and (ii) the transportation services revenue derived by New Modern.

(4 marks)



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## Question 8



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## Wrong answers

- Used incorrect VAT rates.
- Wrongly stated that the transactions were subject to business tax.



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## Answer 8

Under the prevailing China turnover tax regime, golf park operation activities conducted by Modern were within the scope of entertainment industry (provision of sites and services for recreational activities), and the respective income should be subject to value-added tax effective from 1 May 2016. The maximum rate of value-added tax applicable to Modern should be 6% since it is not a small-scale taxpayer. Accordingly the maximum amount of value-added tax payable by Modern would be RMB1,080,000 (RMB18 million x 6%).

The income derived from transportation activities conducted by New Modern in July and August 2016 should be subject to value added tax under the prevailing China turnover tax regime. The relevant value-added tax rate applicable to the provision of transportation services is 11%, and therefore the value-added tax liabilities with respect to the income would be RMB82,500 (RMB750,000 x 11%).





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## **December 2016 Session – Sect B – Q9** **(12 marks – approximately 22 minutes)**

Cambridge Holdings Limited (“Cambridge”) is a group holding company established in Hong Kong with subsidiaries engaging in various businesses locally. Since the year of assessment 2004/05, Cambridge has employed senior management executives and incurred substantial overheads for providing strategic management and administrative services to the subsidiaries. Yet due to adverse market sentiments and other economic factors, the operating performance of Cambridge’s subsidiaries was generally not satisfactory, and Cambridge did not charge nor derive any management fee income from the subsidiaries notwithstanding the provision of the abovementioned management services up to the year of assessment 2014/15. Cambridge did not derive any other income during the relevant years either.



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## December 2016 Session – Sect B – Q9 (12 marks – approximately 22 minutes)

In preparing the profits tax returns for the years of assessment from 2004/05 to 2014/15, Cambridge stated its principal business activity as “investment holding” and claimed tax loss for each year, which substantially resulted from the expenditure incurred in connection with the salaries of its management executives and other essential overhead expenses. However, the IRD consistently refused to allow any tax loss to Cambridge, and only issued notices with a remark “no trading, no loss agreed” as the tax position of Cambridge for the respective years.

In the year of assessment 2015/16, the subsidiaries of Cambridge experienced favorable business performances. Cambridge charged and derived management fee income from its subsidiaries, and generated a substantial amount of assessable profits for the year. Cambridge would like to utilise its tax loss brought forward from prior years to set off the assessable profits, notwithstanding that the tax loss was not agreed by the IRD as indicated above.



## December 2016 Session – Sect B – Q9 (12 marks – approximately 22 minutes)

### Required:

(a) From the perspectives of (i) Cambridge and (ii) the IRD, analyse the deductibility of the expenses incurred by Cambridge during the years of assessment from 2004/05 to 2014/15 in the contexts of the IRO.

(8 marks)

(b) On the assumption that the abovementioned expenses were essentially deductible, analyse how and when Cambridge could claim the set-off of the losses sustained against its assessable profits for the year of assessment 2015/16 pursuant to the relevant provisions stipulated in the IRO.

(4 marks)



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## Question 9(a)



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## Irrelevant answers

- Wrongly discussed the taxability of management fee income.



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## Question 9(a)



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## Problem

- Only quote the general provisions governing the deductibility of expenses.
- Unable to provide sufficient elaboration.
- Unable to identify the importance of ensuring that the income received and the expenses claimed should be commercially realistic.



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## Answer 9(a)(i)

From the perspective of Cambridge

S.16(1) of the IRO provides for a deduction of all outgoings and expenses to the extent to which they are incurred during the basis period for that year of assessment by a person in the production of assessable profits in which he is chargeable to profits tax for any period, subject to the deduction restrictions as stipulated under s.17(1) of the IRO. In this regard, it is possible in the contexts of the IRO that an expense may be deducted in the basis period in which it is incurred, and the related income may be charged to tax in prior or subsequent years of assessment. Quantum of income generated therefrom should have no relevancy to the amount of deductible expenses incurred. However, there must have been sufficient distinct and direct relationship between the expenditure incurred and actual earning of the income in specific years.



## Answer 9(a)(i) (cont'd)

With respect to Cambridge, the expenses incurred during the years of assessment 2004/05 to 2014/15 could be claimed as deductible only if the amounts were essentially incurred in a business in which income assessable to profits tax has been generated in the year of assessment 2015/16. From this perspective, Cambridge must prove to the satisfaction of the IRD that there was a distinct and direct relationship between the expenditure incurred and actual earning of the income, and that the expenses incurred were not excessive in the context of s.16(1) of the IRO, i.e. there was a direct causation between the expenses incurred in the years of assessment 2004/05 to 2014/15 and the taxable income derived In the year of assessment 2015/16 longitudinally, and that the respective services provided in the years of assessment 2004/05 to 2014/15 were accordingly not “free of charge” essentially.



## Answer 9(a)(ii)

From the perspective of IRD

However, the IRD may take the view that the provision of the management and administrative services to the subsidiaries at no charge during the years of assessment 2004/05 to 2014/15 was not an arm's length transaction. The entering into the transaction was therefore considered artificial and not commercially realistic. The relationship between the expenses incurred in prior years and the generation of income in the year of assessment 2015/16 was too remote so that the IRD, with reference to s.17(1) of the IRO, may disallow the deduction of the expenses under s.16(1) of the IRO for the reason that they were not incurred in the production of Cambridge's assessable profits. It may also invoke the general anti-avoidance provisions, i.e. under ss.61 and 61A of the IRO, to deny the deduction claim so as to counteract the tax benefit by the postponement of the liability to pay tax.





## December 2016 Session – Sect B – Q9 (12 marks – approximately 22 minutes)

### Required:

(a) From the perspectives of (i) Cambridge and (ii) the IRD, analyse the deductibility of the expenses incurred by Cambridge during the years of assessment from 2004/05 to 2014/15 in the contexts of the IRO.

(8 marks)

(b) On the assumption that the abovementioned expenses were essentially deductible, analyse how and when Cambridge could claim the set-off of the losses sustained against its assessable profits for the year of assessment 2015/16 pursuant to the relevant provisions stipulated in the IRO.

(4 marks)



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## Question 9(b)



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## Problem

- Did not understand what is a statement of loss.
- Wrongly discussed hold-over application.
- Only discuss how to lodge an objection in general, did not show how to apply to the case.



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## Answer 9(b)

A statement of loss or loss notice (“the Notice”) issued by the IRD is an administrative document and not an assessment within the meaning of the IRO. As the Notice has no statutory force, it cannot become final and conclusive under s.70 of the IRO (***Common Empire Ltd v CIR*** [2007] 1 HKLRD 679). Taxpayers in this connection can lodge a disagreement with the Notice regarding the quantum of tax loss at any time, until any loss claimed affects an assessment to tax (Para. 26, DIPN No. 8 (Revised) issued in September 2009), under which a right of objection under s.64 of the IRO arises.



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## Answer 9(b) (cont'd)

As there is no statutory time limit in lodging the disagreement with the Notices regarding the tax loss for the years of assessment 2004/05 to 2014/15, Cambridge may pursue the disagreement to revise its profits tax position for the years concerned with relevant justifications any time before the issue of the 2015/16 notice of assessment. Alternatively, Cambridge may lodge a written objection against the 2015/16 profits tax assessment claiming the set-off of the tax loss brought forward from prior years against the assessable profits within the one-month period after the date of the notice of assessment.



## December 2016 Session – Sect B – Q10 (9 marks – approximately 17 minutes)

Infinity Beauty Limited (“Infinity”) is a company established in Hong Kong engaging in the car beauty business with various car beauty outlets in different locations locally. Customers of Infinity have been required to pay a lump sum amount upfront as a deposit. Subsequent utilisation of the beauty services by the customers would be charged with a specific pre-determined service fee. The service fee would then be debited against the abovesaid pre-paid deposit accordingly.

During the year ended 31 December 2015, Infinity disposed of its business entirely to an unrelated third party namely Finite Care Limited (“Finite”) by transferring its whole customer base and the physical car beauty outlets to Finite. The sale considerations consisted of (i) HK\$3 million payable by Finite to Infinity, and (ii) waiver of the transfer of the unrealised customer deposits, which had not yet been booked in the accounts of Infinity, by Infinity to Finite. As at the date of disposal of the business, the accumulated unutilised deposits amounted to HK\$2 million. 98



## December 2016 Session – Sect B – Q10 (9 marks – approximately 17 minutes)

Upon preparation of its financial statements for the year ended 31 December 2015, Infinity recognised the sales considerations of HK\$5 million (consisting of (i) and (ii) as discussed above) as income in its accounts. Subsequent to the disposal of the business, Infinity ceased its business and became inactive thereafter.

### Required:

Evaluate the taxability of the sale considerations (i) and (ii) derived by Infinity by analysing whether they are capital or revenue in nature.

(9 marks)



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## Question 10



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## Problem

- Simply discussed the business receipts were taxable or not because of either capital or revenue nature, without elaborating the relevant IRO provision.



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## Answer 10

S.14(1) of the IRO specifically excludes profits arising from the sale of capital assets from the charge to profits tax. However, the term “capital assets” has not been defined in the IRO. Based on the general commercial rules and established principles, a distinction between fixed capital (attributable to capital in nature receipts) and circulating capital (attributable to revenue in nature receipts) is essential for the differentiation. In this regard, capital receipts are those relating to the structure of the business, whilst revenue or trading receipts are from the disposal of stocks or services in the course or incidental to the business.





## Answer 10 (cont'd)

Based on the information provided, it appears that the sales consideration (i) with respect to the HK\$3 million represents the amount in connection with the disposal of Infinity's capital assets (i.e. the entire customers base and car beauty outlets), and Infinity had ceased its business thereafter. It may therefore be argued that the sales consideration (i) of HK\$3 million is capital in nature and should not be subject to profits tax. For the sales consideration (ii) attributable to the waiver of the unutilised customers' deposit of HK\$2 million payable by Infinity to Finite, the amount represents realisation of income incidentally derived from customers in the normal course of Infinity's business. The income would likely be regarded as revenue in nature and is chargeable to profits tax under s.14(1) of the IRO.



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## **December 2016 Session – Sect B – Q11** **(7 marks – approximately 12 minutes)**

Mr Xiao Yuan Zhang (“Mr Xiao”) is a Chinese resident and is engaged in property investment in mainland China. Recently, he has planned to diversify his investment by participating in the property market in Hong Kong. Specifically, Mr Xiao would purchase a few immovable landed properties in Hong Kong generating rental income for long term purposes. Yet as a foreign investor, he has no idea about the statutory obligations in holding a property to generate rental income, and whether he should hold the properties directly by himself or via a limited company incorporated in Hong Kong.



## **December 2016 Session – Sect B – Q11** **(7 marks – approximately 12 minutes)**

### **Required:**

(a) Explain the obligations of Mr Xiao holding immovable properties deriving rental income in Hong Kong from the IRO perspective, especially as a non-Hong Kong resident.

(4 marks)

(b) Explain the possible types of tax to be charged with respect to rental income generated by a Hong Kong limited company specifically used by Mr Xiao for holding immovable properties in Hong Kong.

(3 marks)



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## Question 11(a)



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## Problem

- Simply list the obligations of employee and employer.
- Did not aware that the requirement was to explain the obligation of a property owner.



## Answer 11(a)

The obligations of a non-Hong Kong resident (e.g. Mr Xiao) holding Immovable properties in Hong Kong generating rental income are substantially the same as those of a Hong Kong resident, and specifically as follows:

- He should complete the tax returns and file to the IRD within the stipulated time (S.51(1) of the IRO) and pay the respective tax liability.
- He should notify the IRD in writing the chargeability of property tax, if a return has not been received, within four months after the end of that year of assessment (S.51(2) of the IRO).
- He should notify the IRD if the respective property has been sold or transferred within one month after the sale or transfer (S.51(6) of the IRO).
- He should notify the IRD within one month, if his corresponding address has been changed (S.51(8) of the IRO).
- He should keep sufficient rental records of not less than seven years in order to enable his property tax liability to be readily ascertained (S.51D of the IRO). <sup>106</sup>



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## Answer 11(b)

As the owner of an immovable property in Hong Kong, the Hong Kong limited company is liable to property tax under Part 2 of the IRO in respect of the rental income derived thereon. Yet the definition of “business” under s.2 of the IRO includes, inter alia, letting by any corporation to any person of any premises. Hence the company is prima facie carrying on a business in Hong Kong and is chargeable to profits tax under Part 4 of the IRO in respect of the relevant rental income.

Notwithstanding that the subject rental income may be chargeable to both property tax and profits tax simultaneously, s.25 of the IRO can be applied to allow the property tax paid therefrom, if any, to be utilised for setting off the profits tax liability of the Hong Kong limited company for the same year. In addition, the company may also apply for exemption to property tax under s.5(2)(a) of the IRO if the rental income is reported as assessable to profits tax.



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## **June 2016 Session – Sect B – Q7** **(8 marks – approximately 14 minutes)**

Mr Chan resides with his mother. By an assignment dated 1 February 2009, Mr Chan and his mother purchased a property ("the Property") as joint tenants. The Property was erected by the Government of the HKSAR under the Home Ownership Scheme. The assignment imposed alienation restrictions on Mr Chan and his mother for the sale of the Property. They have to pay a premium to the Housing Authority for the removal of the alienation restrictions before they can sell the Property in the open market.

To finance the acquisition of the Property, Mr Chan obtained a bank loan ("Loan A") which was secured by a mortgage over the Property. On 1 April 2009, Mr Chan and his mother moved into the Property and have used it as their residence since then.



## June 2016 Session – Sect B – Q7 (cont'd)

On 1 April 2014, Mr Chan obtained an additional bank loan ("Loan B") by further pledging the Property. The proceeds of Loan B were applied to pay the premium for the purposes of removing the alienation restrictions in respect of the Property.

Mr Chan is employed as a designer by a fashion company. He is the sole breadwinner of his family whereas his mother is a retiree and has no income. Apart from this employment, Mr Chan has no other income. All the repayments of Loan A and Loan B were made by Mr Chan. He now would like to claim deduction of the following interest expenses, which he paid in respect of the loans:

Year of assessment	<u>2009/10</u>	<u>2014/15</u>
	HK\$	HK\$
Loan A	160,000	40,000
Loan B	_____ -	<u>50,000</u>
Total	<u>160,000</u>	<u>90,000</u>





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## June 2016 Session – Sect B – Q7 (cont'd)

### Required:

Elaborate and apply the relevant provisions in the IRO and compute the amount of interest to be allowed to Mr Chan for salaries tax deduction for each of the years of assessment 2009/10 and 2014/15.

**(8 marks)**



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## Question 7



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## Problem

- Only compute the amount of home loan interest that were allowable.
- Did not provide analysis in the conclusion.
- Did not elaborate the relevant provisions.



## Answer 7

### Year of assessment 2009/10

Insofar as is relevant, s.26E(1) of the IRO provides that home loan interest is to be granted to any person who has paid interest on a home loan obtained to purchase a residential property which is used by the person as his place of residence. S.26E(2)(a) of the IRO further provides that a deduction allowable to a person under s.26E(1) shall be the lesser of the amount of the home loan interest paid or the amount specified in Schedule 3D in relation to that year of assessment. The amount specified in Schedule 3D for the year of assessment 2009/10 is HK\$100,000. But s.26E(2)(a) of the IRO is subject to s.26E(2)(b) and (c).

S.26E(2)(b)(i) provides that where a dwelling is held by a person as joint tenant, the amount of the home loan interest shall be regarded as having been paid by the joint tenants each in proportion to the number of the joint tenants.



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## Answer 7 (cont'd)

S.26E(2)(c)(i) further provides that where a dwelling is held by a person as a joint tenant, the relevant amount specified in Schedule 3D of the IRO in relation to home loan interest should be regarded as having been reduced in proportion to the number of the joint tenants.

In the present case, the Property is Mr Chan's place of residence. He is one of the joint tenants of the Property. For the purposes of s.26E(2)(b)(i) of the IRO, the amount of home loan interest regarded as having been paid is half of HK\$160,000, i.e., HK\$80,000. For the purposes of s.26E(2)(c)(i) of the IRO, the relevant amount specified in Schedule 3D will be reduced to half of HK\$100,000, i.e., HK\$50,000. By virtue of s.26E(2)(a) and on the authority of the Board of Review Decision No. D20/01 16 IRBRD 187 and D11/06 (2006-07) 21 IRBRD 227, Mr Chan is only entitled to the deduction of home loan interest to the extent of half of HK\$100,000, i.e. HK\$50,000 for the year of assessment 2009/10.



## Answer 7 (cont'd)

Year of assessment 2014/15

With regard to Loan A, for the purposes of s.26E(2)(b)(i) of the IRO, the amount of home loan interest as having been paid is half of HK\$40,000 i.e., HK\$20,000.

As to Loan B, s.26E(9) of the IRO provides that a home loan means a loan of money which is applied for the acquisition of the dwelling. Loan B was taken out for the payment of premium to remove the alienation restriction in respect of the Property. It was not taken out for acquiring the Property. Hence, Loan B is not a home loan. On the authority of the Board of Review Decision No. D139/01 17 IRBRD 26, Mr Chan is not entitled to the deduction of home loan interest in respect of Loan B.

Hence, Mr Chan is entitled to the deduction of home loan interest in the amount of HK\$20,000 for the year of assessment 2014/15.



## **June 2016 Session – Sect B – Q8** **(12 marks – approximately 22 minutes)**

Gourmet Limited is a food processing company. It has been operating in a hired factory premises in Tai Po for years. In view of the soaring rent and in order to secure the availability of the factory premises, Gourmet Limited entered into a lease ("the Lease") with the landlord to rent the factory premises for a term of 15 years commencing from 1 April 2015 at a consideration of HK\$60 million ("the Sum"). Gourmet Limited paid the Sum to the landlord on 1 April 2015. The Sum is non-refundable even if Gourmet Limited terminates the Lease earlier. Other terms of the Lease remain the same as those of the previous leases which Gourmet Limited entered into with the landlord. It was categorically provided in the Lease that the ownership and the title of the factory premises did not transfer to Gourmet Limited.

### **Required:**

**Analyse, with reference to the relevant tax principles, whether the Sum is allowable for profits tax deduction as (a) an expense; and (b) an entitlement of capital allowance under the IRO.**

**Note: Computation is not required.**

**(12 marks)**



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## Question 8



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## Problem

- Only refer to S.16(1), not refer to S.17(1)(c), nor refer to relevant legal principles.
- Unable to note that taxpayer not entitled to capital allowance because the sum was not incurred on the construction of a building.



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## Question 8



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## Wrong answers

- Wrong explanation that taxpayer was not entitled to capital allowance as he was not the owner of the relevant property.





## Answer 8

- (a) S.16(1) of the IRO provides for the deduction of outgoings and expenses which are incurred by a taxpayer in the production of its assessable profits. S.17(1)(c), however, provides that no deduction shall be allowed in respect of any expenditure of a capital nature. On the authority of the High Court decision of ***Wharf Properties Limited v Commissioner of Inland Revenue*** 1 HKLR 347, even if an expense falls within s.16, it still has to be considered whether the deduction is to be excluded under s.17. It is only when an expense qualifies for the deduction under both s.16 and s.17 that it is allowable for deduction. It was also held in ***the Wharf case*** that in determining whether an expense was of capital or revenue in nature, one has to examine not only the status of the expenditure but also the purpose or the circumstances under which the expenditure is incurred. Following the decision in ***British Insulated and Helsby Cables Limited v Atherton*** 10 TC 155, when an expenditure is made, not only once and for all, but with a view to bringing into the existence of an asset or an advantage for the enduring benefit of a trade, the expenditure is capital in nature. As to the meaning of "enduring benefit" or "permanent", it was held in ***Henriksen v Grafton Hotel, Ltd*** 24 TC 453 that they referred to enough durability to justify its being treated as a capital asset.



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## Answer 8 (cont'd)

In the present case, the payment of the Sum enabled Gourmet Limited to obtain the right to use the factory premises for a term of 15 years. Though the Sum did not bring Gourmet Limited the title on the factory premises, the right so acquired brought into existence an advantage for the enduring benefit of the company. On the authority of *British Insulated and Helsby Cables Limited v Atherton*, the Sum was capital in nature. Such being the case, it is not allowable for deduction under s.17(1)(c) of the IRO.



## Answer 8 (cont'd)

- (b) Notwithstanding that the Sum was capital in nature, it does not follow that Gourmet Limited is entitled to the deduction of the industrial building allowance or commercial building allowance in respect thereof.

S.34 of the IRO provides that a person is entitled to the deduction of industrial building allowance when certain conditions are met. Where a person incurred capital expenditure on the construction of a building or structure which is an industrial building or structure and occupied it for the purposes of a trade, he is entitled to deduction of an initial allowance (s.34(1) of the IRO). Where a person is entitled to an interest in a building or structure which is an industrial building or structure and where that interest is the relevant interest in relation to the capital expenditure incurred on the construction of that building or structure, a person is entitled to the deduction of an annual allowance (s.34(2) of the IRO). As to commercial building allowance, a provision similar to s.34(2) is set out in s.33A(1) of the IRO.



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## Answer 8 (cont'd)

In the present case, it is patently clear that the Sum was not incurred in the construction of the factory premises. Hence, Gourmet Limited is neither entitled to the deduction of industrial building allowance nor commercial building allowance.



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## **June 2016 Session – Sect B – Q9** **(15 marks – approximately 27 minutes)**

Mr Lee is the sole proprietor of a café ("the Café"). He also has two solely owned properties, Property 1 and Property 2, which have been let out since their acquisitions. In financing the purchases of the properties, Mr Lee respectively took out two bank loans, Loan 1 and Loan 2.

Mr Lee and his wife (hereinafter collectively referred to as "the Couple") reside at Property 3 on a housing estate in Happy Valley. Mrs Lee is the sales manager of a fashion company. Their first child was born on 1 April 2014. To look after the child, Mr Lee's mother ("the Mother") has been residing at Property 4 since the birth of the child. Property 3 and Property 4 are situated in the same building though Property 4 is on an upper floor. Prior to that, the Mother resided in the New Territories from where it took her an hour to travel to Property 3. The Couple sent their child to the Mother every morning. After finishing dinner at Property 4 every evening, the Couple picked up their child and returned home.



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## June 2016 Session – Sect B – Q9 (cont'd)

The Mother was at the age of 58 in the year of assessment 2012/13. Mr Lee paid the Mother HK\$60,000 a year to support her living throughout the three years of assessment from 2012/13 to 2014/15. The Mother seldom traveled overseas. Her overseas tour lasted for, at most, ten days in each year of assessment.

The relevant income derived and expenses incurred by the Couple during the three years of assessment are as follows:



## June 2016 Session – Sect B – Q9 (cont'd)

Mr Lee

Year of assessment	<u>2012/13</u> HK\$	<u>2013/14</u> HK\$	<u>2014/15</u> HK\$
Assessable profits / (allowable loss) of the Café	<u>(150,000)</u>	<u>(50,000)</u>	<u>(250,000)</u>
Net assessable value			
Property 1	360,000	380,000	400,000
Property 2	<u>240,000</u>	<u>240,000</u>	<u>280,000</u>
Total	<u>600,000</u>	<u>620,000</u>	<u>680,000</u>
Mortgage interest			
Loan 1	150,000	130,000	120,000
Loan 2	<u>260,000</u>	<u>250,000</u>	<u>230,000</u>
Total	<u>410,000</u>	<u>380,000</u>	<u>350,000</u>



## June 2016 Session – Sect B – Q9 (cont'd)

Mrs Lee

Year of assessment	<u>2012/13</u> HK\$	<u>2013/14</u> HK\$	<u>2014/15</u> HK\$
Assessable income	<u>210,000</u>	<u>230,000</u>	<u>250,000</u>

The Couple elected to have their income assessed under personal assessment for the years of assessment 2012/13 and 2014/15. Mr Lee also claimed deduction of dependent parent allowance for the aforesaid two years of assessment and additional dependent parent allowance in respect of the Mother for the year of assessment 2014/15.

As to the year of assessment 2013/14, the Couple forgot to indicate in their Individual Tax returns their intention to have their income to be assessed under personal assessment. On 3 August 2014, the property tax assessment in respect of Property 1 and Property 2 was issued to Mr Lee and the salaries tax assessment was issued to Mrs Lee. They did not object to the assessments raised.





## June 2016 Session – Sect B – Q9 (cont'd)

### Required:

- (a) Analyse, with reference to the relevant tax principles,
- (i) the amount of mortgage interest that is allowable for deduction to Mr Lee for the year of assessment 2012/13;  
*Note: Computation is required.* (3 marks)
- (ii) whether Mr Lee is entitled to the deduction of additional dependent parent allowance in respect of the Mother for the year of assessment 2014/15. (2 marks)
- (b) Compute the net chargeable income of the Couple under s.42A(1)(b) of the IRO for each of the years of assessment 2012/13 and 2014/15. (7 marks)
- (c) The Couple now would like to have their income to be assessed under personal assessment for the year of assessment 2013/14. The Commissioner of Inland Revenue does not allow them a further period of time to make the election. Identify, with explanations in support, the last date on which they have to elect to have their income to be assessed under personal assessment. (3 marks)



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## Question 9a(i)



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## Problem

- Did not provide any analysis of the relevant tax principles
- Mixed up mortgage loan interest (S.42(1)) with home loan interest (S.26E)
- Did no computation



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## Question 9a(i)



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## Irrelevant answers

- Apply s.16(1)(a), s.16(2)(d), s.16(2A) and s.16(2B).



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## Question 9a(i)



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## Wrong answers

- Wrongly allowed the mortgage interests in full without any restriction on the deduction.



## Answer 9a(i)

Proviso to s.42(1) of the IRO provides that there shall be deducted from that part of the total income the amount of interest payable on money borrowed for the purpose of producing that part of the total income where the amount of such interest has not been allowed and deducted under Part 4. In the Board of Review Decision No. D86/99 14 IRBRD 581, the Board held that the proviso does not allow a global deduction for interest payable against total taxable income. It only allows a deduction for interest payable on money borrowed for the purpose of producing that part of the property income which has been included in the computation of total income under s.42(1)(a) of the IRO.

On the authority of the Board of Review Decision No. D86/99, the amount of mortgage interest that is allowable for deduction is as follows:

Mortgage interest allowable for deduction capped at  
net assessable value of the respective property

	HK\$
Property 1	<u>150,000</u>
Property 2	<u>240,000</u>
Total	<u>390,000</u>



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## Question 9a(ii)



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## Problem

- Unable to note that the Mother did not reside with the taxpayer.



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## Answer 9a(ii)

S.30(3)(b) of the IRO provides that an additional allowance is to be granted if the parent resided, otherwise than full valuable consideration, with the person who is eligible to claim the dependent parent allowance under s.30(1) of the IRO. In the present case, although Mr Lee is entitled to the deduction of the dependent parent allowance in respect of the Mother (s.30(1) of the IRO), no deduction of additional dependent parent allowance is to be allowed. It is because the Mother did not reside with Mr Lee continuously throughout the year of assessment 2014/15. She resided at Property 4 whereas Mr Lee resided at Property 3.



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## Question 9b



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## Problem

- No idea how to compute the net chargeable income under s.42A(1)(b).
- No idea that the income as well as allowances of the couple should be aggregated.
- Compute net chargeable income for the year of assessment 2013/14 which had not been requested in the question.





## Answer 9b

	<u>2012/13</u> HK\$	<u>2014/15</u> HK\$
Mr Lee		
Assessable profits <sup>1</sup>	-	200,000
Net assessable value	600,000	680,000
Mrs Lee		
Assessable income	<u>210,000</u>	<u>250,000</u>
Total income	810,000	1,130,000
<u>Less:</u>		
Interest payable on Loan 1 and Loan 2	<u>-390,000</u>	<u>-350,000</u>
	420,000	780,000
<u>Less:</u>		
Loss for the year	<u>-150,000</u>	<u>-</u>
Net total income	270,000	780,000
<u>Less:</u>		
Married person's allowance	-240,000	-240,000
Child allowance	-	-140,000
Dependent parent allowance in respect of the Mother	<u>-19,000</u>	<u>-40,000</u>
Net chargeable income under s.42A(1)(b) of the IRO	<u>11,000</u>	<u>360,000</u>

Note 1: Year of assessment 2014/15: HK\$250,000 (being assessable profits for the year of assessment 2014/15) – HK\$50,000 (being loss brought forward from the year of assessment 2013/14) (s.19C(1) and s.42(1)(c) of the IRO)



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## Question 9c



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## Problem

- Unable to indentify, with explanations in support, the last date to elect personal assessment.
- Just copied the relevant provisions without any analysis.



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## Answer 9c

The property tax assessment and the salaries tax assessment were issued to the Couple on 3 August 2014. They did not object to those assessments. On 4 September 2014, the assessments became final and conclusive in terms of s.70 of the IRO. If the Couple would like to have their income assessed under personal assessment for the year of assessment 2013/14, they have to write to the Commissioner of Inland Revenue not later than (a) one month after the assessments concerned become final and conclusive i.e., 4 October 2014; or (b) two years after the end of the year of assessment in respect of which the election is made, i.e., by 31 March 2016 (s.41(3) of the IRO). Hence, they have to make their application on 31 March 2016, at the latest.



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# Part 4: Preparation for the Examinations





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香港會計師專業資格

- 1. Prepare your examination**
- 2. Prepare yourself for examination**



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# 1. Prepare your examination

## Before examination

### DO

- Commit to your **Study Plan**
- Cover beyond LP
- Form **Study Group** with fellow students
- Prepare **Critical File**
- Practise past papers
- Visit QP Learning Centre
  - Past papers and Examiners' reports;
  - Special topics and/or Important notice; and
  - Examination preparation seminar archives



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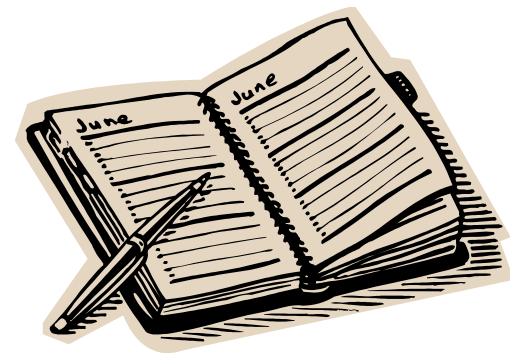


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## Commit to your Study Plan

### Advantages:

- Schedule ahead
- Build long term memories → maximize efficiency
- Avoid last minute work and minimize impact of unpredicted events...







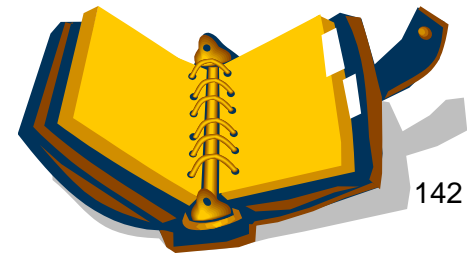
## Prepare Critical File

### How to prepare:

- Use different colour post-it for different standards / topics
- Organise materials by different standards / topics
- Understand theories behind each standards / topics
- Get familiar with this file

### Advantages:

- Colour coding for standards / topics allows easy identification (same file used in examination – time saving!)
- Build up long term memories
- Avoid indexing without understanding





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## During examination

### DO

- Identify question requirements
- Highlight key words (e.g. Calculate / Advise / Propose etc...)
- **Mind-map** or sketch the question requirements
- Outline answers or approach
- Pay attention to specific format requirement (e.g. Write a memorandum)
  - Start with an introduction and end with a conclusion
    - ➔ Get easy marks!



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# Part 4: Preparation for the Examinations





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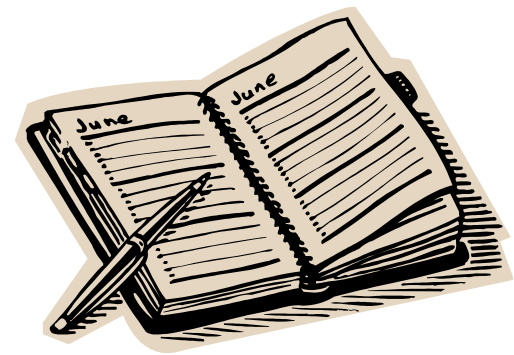


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## During examination

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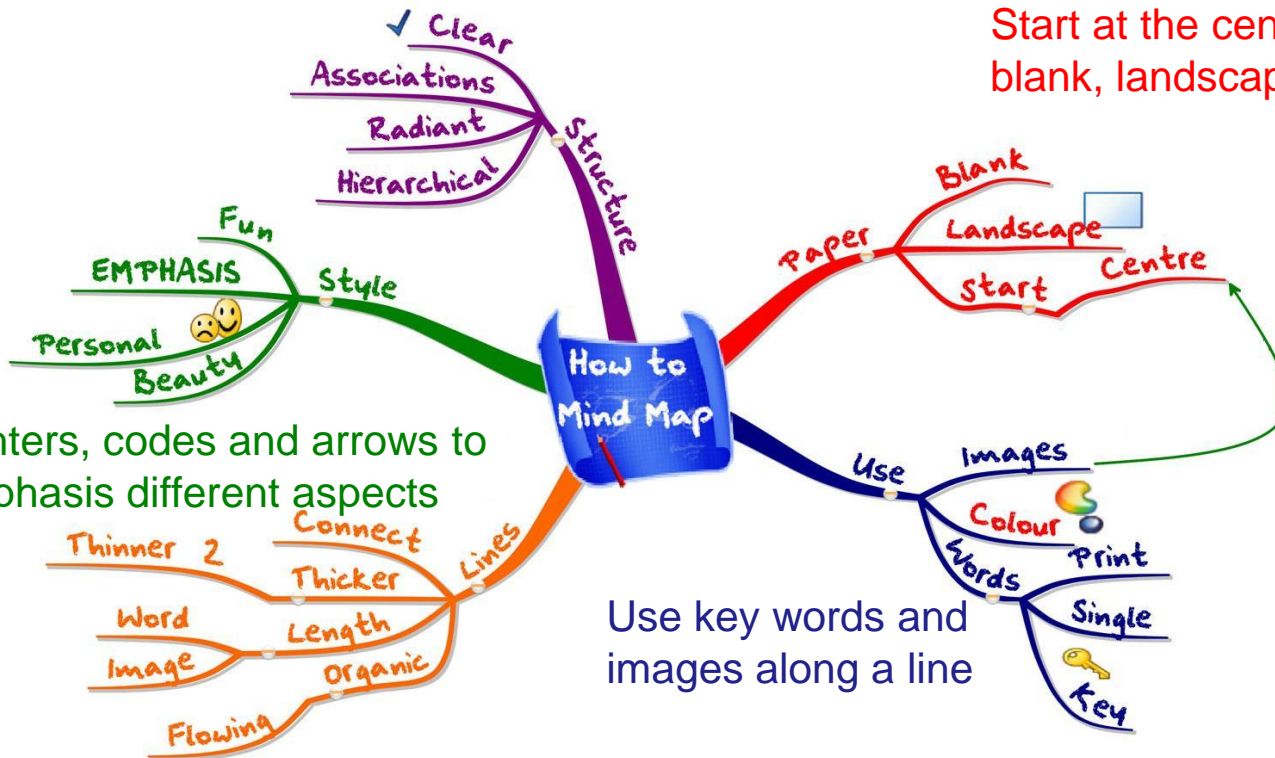


# Mind Map

Radiate the ideas out  
from the central theme  
and main branches

Start at the centre of a  
blank, landscape paper

Use highlighters, codes and arrows to  
link and emphasis different aspects



Use key words and  
images along a line

Make the lines associate  
as clear as possible



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## During examination

### DO

- Apply technical knowledge
- Do an easy question first to gain confidence
- Leave time at the end to check for careless mistakes
- **Write legibly**

### DON'T

- Don't make up any information that is not provided by the question
- Don't write more than required as indicated by marks allocation
- Don't struggle, move to another question

(Question No. 2.)

- a) Even ABC is a ~~an~~ costing method suitable for ~~the~~ requirement to apportion the cost.  
However, it cannot reflect all the cost and consideration that related to the new customer policy.
- b) ABC is a complicated ~~and~~ system, it might inability to ~~access~~ non-controllable cost to the ~~relevant~~ division.  
New policy for the firm can help it to be focus on provide better service to customer and focus on high revenue's customer.  
(To start with the new customer policy, we should use more than one analyse or costing method to make decision.)  
However, the firm may loss the low cost but high contribution's customer and loss the customer's ~~costs~~ confidence once the customer cannot meet the target.
- c) KWL can get profit under new policy (set up a "re-use system" once the customer can). The company also can set up "quality system" ~~if the customer can~~ if the customer can meet the quality control which under new policy that can be ~~re-use~~ re-use organ.



## Examples of handwriting

Example 1:

**adverse opinion**

Example 2:

**substantive matters ??**

Example 3:

**seriously misleading ?????**



## 2. Prepare yourself for examination

- Study HARD before examination
- Arrive early (examination centre opens for entry 45 minutes before start)
- Be aware of the **examination regulations** printed on the Examination Attendance Docket ("EAD")
  - The EAD will be posted to students 2 weeks before the examination

**Failure to follow any of the examination regulations may result in marks penalty or even disqualification from the entire examination!**



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- **There is no shortcut to any examinations including QP!**
- **This is your examination and not others' examination**
- **The only way to pass is to prepare properly for it!**