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# **EXECUTIVE TRAINING COMPANY (INTERNATIONAL) LTD**

# About the Lecturer



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- ❖ Practising partner of a medium size firm
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## Module Preparation Seminar – Agenda

- Ascertainment of property tax liability (Ch 6)
- Distinction between capital receipts/ expenditure and revenue receipts/ expenditure under profits tax (Ch 3)
- Common profits tax deduction items (Ch 3)
- Objection and appeal mechanism (Ch 2)
- Anti-avoidance provisions under the IRO (Ch 9)



## Ascertainment of property tax liability (Ch 6)

# Ascertainment of property tax liability

## Scope of property tax charge [DIPN14 (Revised)]



The charging **section (s.5)** provides that property tax shall be charged for each year of assessment on the **owner of land or buildings and land and buildings** wherever situated in Hong Kong, and shall be computed at the standard rate on the net assessable value of such land or buildings.

**“Owner”** is defined in **s.2** to include beneficial owner, a life tenant, a mortgagor, a mortgagee in possession, and a person who **holds land or buildings subject to a ground rent or other annual charge**. “Land or buildings or land and buildings” is defined in s.7A to include piers, wharves and other structure.

The definition of “owner” under section 2 of the Inland Revenue Ordinance (“the Ordinance”) has been clarified to include an owners’ corporation and expanded to cover a person who receives rental income on **any common parts of land or/and buildings**.

P.5

# Ascertainment of property tax liability



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

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.

# Ascertainment of property tax liability



## Property tax computation format

Taxpayer's name

Year of assessment 2017/2018

Basis period: Year ended 31 March 2018

Rent

\$

A

Premium

B

Bad debt recovered

C

Less: Bad debts (irrecoverable rent)

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D

(E)

Assessable value

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F

Less: Rates (paid by owner)

(G)

Less: Statutory deduction 20% of H

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H

(I)

Net assessable value

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J

Property tax thereon @ 15%

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K

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Notes: F – if negative, relate back – s.7C(3); D, F, H, – if negative, no property tax;

I – no other deduction eg management fees and repairs

(exception re mortgage interest under PA).



# Ascertainment of property tax liability



**Consideration'** includes any consideration payable in respect of the provision of any services or benefits connected with or related to the right of use (e.g. management or service fees payable to the owner).

A deposit with the landlord which is refundable upon the termination of a lease is not a consideration chargeable to property tax.

Any consideration previously deducted as irrecoverable and recovered during any year of assessment (i.e. bad debt recovery) shall be treated as consideration payable in that year of assessment (**i.e. taxable in the year of recovery**).



# Ascertainment of property tax liability



Under s.5B(4), the **'premium'** shall be deemed to be payable in equal monthly instalments, either:

- during the period of the right of use, or
- during a period of three years commencing at the start of the period of the right of use to which the consideration relates, whichever is the shorter.

## Allowable deductions under property tax

Allowable deduction	Conditions
Rates	If the owner agrees to pay the rates in respect of the 'land or buildings' or 'land and buildings', the rates paid by him/her are deductible from the assessable value.
Bad debts	Any consideration proved to the satisfaction of an Assessor to have become irrecoverable during the year of assessment is deductible in ascertaining the assessable value.  If there is no or insufficient assessable value for the deduction of the bad debts, the amount of unrelieved bad debts in that year can be carried backward and deducted from the assessable value in the latest year of assessment.
Statutory outgoings	There is a notional deduction for repairs and outgoings of 20% of the assessable value after deduction of any rates agreed to be borne and paid by an owner. Actual expenses incurred on repairs and maintenance are ignored for property tax purposes.

# Ascertainment of property tax liability

## Past Paper Analysis MD – Jun 2018 – Qu 8b,c



Mr Chan is a Hong Kong permanent resident (“HKPR”). He is married and his spouse, Ms Wong, is a Mainland resident. For investment purposes, Mr Chan purchased a residential property in Hong Kong (“Property A”) on 1 March 2016 at a consideration of HK\$25,000,000 in joint names with Ms Wong. At the time of acquisition of Property A, Mr Chan owned an industrial property in Hong Kong while Ms Wong did not own any property in Hong Kong.

Soon after the acquisition of Property A, Ms Wong, in her sole name, purchased a serviced apartment in Hong Kong (“Property B”) on 1 September 2016 at a consideration of HK\$10,000,000.

# Ascertainment of property tax liability

## Past Paper Analysis MD – Jun 2018 – Qu 8b,c (Cont'd)



Both Property A and Property B have been let out for rental income since their acquisitions. Property A was let out for a term of two years from 1 March 2016 to 28 February 2018 at a monthly rent of HK\$50,000, payable on the first day of each month while Property B was let out for a term of one year from 1 September 2016 to 31 August 2017 and the rent was HK\$360,000 for the whole term, payable in advance on the first day of the lease term. The rates, being HK\$7,500 per quarter and HK\$4,500 per quarter for Property A and Property B respectively, were all payable by the landlord.

As Ms Wong seldom visited Hong Kong, all the lease agreements of Property A and Property B were entered into in the sole name of Mr Chan. As all the rental income was received by Mr Chan, he reported all the rental income derived from Property A and Property B in his tax return – individuals.

# Ascertainment of property tax liability

Past Paper Analysis MD – Jun 2018 – Qu 8b,c (Cont'd)



## Required:

b) Compute the amount of property tax payable in respect of Property A and Property B for the year of assessment 2016/17.

(4 marks)

c) Evaluate and compute the liability of Mr Chan and Ms Wong to property tax in respect of the letting of Property A and Property B.

(3 marks)

# Ascertainment of property tax liability

## Past Paper Analysis MD – Jun 2018 – Qu 8b,c (Cont'd)



### Answer (b)

#### Property A

	HK\$
Rent (HK\$50,000 x 12) [s.5B(2)]	600,000
<u>Less: Rates (HK\$7,500 x 4) [s.5(1A)(b)(i)]</u>	<u>(30,000)</u>
	570,000
<u>Less: 20% statutory outgoings [s.5(1A)(b)(ii)]</u>	<u>(114,000)</u>
Net assessable value	<u>456,000</u>
Property tax payable thereon at 15%	<u>68,400</u>

#### Property B

Rent (HK\$360,000 / 12 x 7) [ss.5B(2) and 5B(4)]	210,000
<u>Less: Rates (HK\$4,500 / 3 x 7) [s.5(1A)(b)(i)]</u>	<u>(10,500)</u>
	199,500
<u>Less: 20% statutory outgoings [s.5(1A)(b)(ii)]</u>	<u>(39,900)</u>
Net assessable value	<u>159,600</u>
Property tax payable thereon at 15%	<u>23,940</u>

# Ascertainment of property tax liability

## Past Paper Analysis MD – Jun 2018 – Qu 8b,c (Cont'd)



### Answer (c)

Under s.5(1) of the IRO, property tax shall be charged on every person being an owner of any land or buildings in respect of the rental income derived from letting of the land or buildings. As both Mr Chan and Ms Wong are owners of Property A, they should be jointly and severally liable to property tax in respect of the rental income derived from the letting of Property A. On the other hand, Ms Wong should be solely liable to property tax in respect of the rental income derived from the letting of Property B, despite the fact that all the rental income was received by Mr Chan.

Accordingly, the amount of property tax payable by Mr Chan is HK\$34,200 (HK\$68,400 / 2) and the amount of property tax payable by Ms Wong is HK\$58,140 (HK\$34,200 + HK\$23,940).



## Distinction between capital receipts/ expenditure and revenue receipts/ expenditure under profits tax (Ch 3)



# Distinction between capital and revenue receipts under profits tax



## Capital receipts and revenue receipts

Whether a receipt is capital or revenue in nature, the general test is to distinguish between **fixed capital and circulating capital**.

Receipts are **capital in nature** if connected with **fixed capital (fixed assets)** of the business but **revenue in nature** if connected with **circulating capital (current assets)** of the business.

# Distinction between capital and revenue receipts under profits tax



## Revenue or trading receipts include:

- (a) Receipts from disposal of **trading stock or services** in the course of business; and
- (b) Receipts arising incidentally to the business, e.g. forfeiture of deposits from customers who failed to collect goods ordered

## Capital receipts include:

Capital receipts are those relating to **the structure of the business**, e.g. proceeds from sale of office premises.

# Distinction between capital and revenue receipts under profits tax



## Principles established in case law help to illustrate the distinction between capital or revenue receipts:

- Any sum received for **permanent loss or destruction of a fixed asset** is a capital receipt [*Case: Glenboig Union Fireclay Co Ltd*]
- Any sum received for **temporary loss of use of a fixed asset**, or payment for loss of profits is a revenue receipt [*Case: London and Thames Haven Oil Wharves Ltd v Attwool*]
- Any sum received for **repairable damage** to a fixed asset is a capital receipt. [*Case: London and Thames Haven Oil Wharves Ltd v Attwool*]

# Distinction between capital and revenue receipts under profits tax



## Principles established in case law help to illustrate the distinction between capital or revenue receipts:

- Any sum received for **the loss of trading stock** is a trading receipt while any sum received for the loss of capital asset is a capital receipt
- Any sum received for the **cancellation of a trading contract** is a revenue receipt
- Any sum received for the **cancellation** of one of a number of agency contracts is a revenue receipt
- Any compensation received for the **cancellation of the major or only contract** which led to the cancellation of a **material part or the whole of the company's business** is a capital receipt

# Distinction between capital and revenue receipts under profits tax



## Compensation

- Compensation received **in lieu of trading receipts** is taxable as trading income
- Compensation for **loss or damage to the profit making structure** of the business
- Compensation received in relation to the sterilisation of business assets, **closure of business or entering into a restrictive covenant** for not performing certain acts

If a lump sum is received without making any distinction between compensation for the loss of capital and compensation for the loss of revenue assets or income, the whole sum may be regarded as a capital receipt .

# Distinction between capital and revenue receipts under profits tax



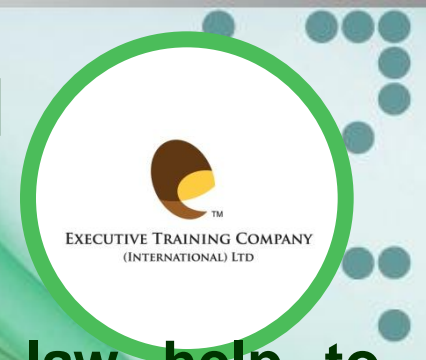
## Capital expenditure and revenue expenditure

The analysis made by the judge in **Ammonia Soda Co Ltd v Chamberlain** on fixed and circulating capital is useful in distinguishing the nature of an expenditure. A summary of the analysis is on 'Capital receipts and revenue receipts':

The following is a general comparison of capital expenditures and revenue expenditures:

Capital expenditures	Revenue expenditures
Once and for all	Often recur
Usually of large amount	Usually of small amount
Provide an enduring benefit to the business	Provide short-term benefits or temporary influence to the business
Influence the profit yielding structure of the business	No or limited effect on the profit yielding structure of the business
May be fixed within the business in the form of an asset (e.g. machinery or plant)	May circulate within or depart from the business (e.g. trading stock)
Shown in the statement of financial position as assets	Charged to the statement of profit or loss as expenses

# Distinction between capital and revenue receipts under profits tax



The following principles established in case law help to **distinguish between capital and revenue expenditure:**

- The cost of **acquiring raw materials** in their natural state, is a capital expenditure.
- The cost of **taking over a business** is a capital expenditure.
- The cost of acquiring or **disposing of an agreement or a lease** which is part of the fixed assets of a trade is a capital expenditure.
- The cost of removing and replacing part of an entire asset is a revenue expenditure.
- Expenses incurred in erecting a new structure 'in its entirety' or the cost of replacing an entire asset so that a new capital asset is created is a capital expenditure

# Distinction between capital and revenue receipts under profits tax



The following principles established in case law help to **distinguish between capital and revenue expenditure:**

If instead of repairing an asset, an alternative or **improved part** is constructed, the expenditure is a **capital expenditure** and no allowance is due for the hypothetical repairs which might have been carried out .

The cost of initial repairs **to improve a newly acquired asset** to put it into a usable condition is a capital expenditure.

The cost of initial **repairs to remedy normal wear** and tear of a newly acquired asset which is in working condition is a revenue expenditure.

A lump sum payment to **dispense with a continuing revenue expense** does not create any new intangible asset and is therefore a revenue expenditure.



# Distinction between capital and revenue receipts under profits tax



A payment to **get rid of an unsatisfactory director** is a normal revenue expense which is regarded as part of the cost of engaging and dismissing servants.

A payment to retiring directors for agreeing **not to compete** with the company would increase the company's goodwill by buying off potential competitors and is therefore a capital expenditure.

# Distinction between capital and revenue receipts under profits tax



## Past Paper Practice – Dec 2016 Qu 10

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 utilised deposits amounted to HK\$2 million.

# Distinction between capital and revenue receipts under profits tax



## Past Paper Practice – Dec 2016 Qu10 (Cont'd)

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)

# Distinction between capital and revenue receipts under profits tax



## Past Paper Practice – Dec 2016 Qu10

### Answer

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.

# Distinction between capital and revenue receipts under profits tax



## Past Paper Practice – Dec 2016 Qu10

### Answer (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.



## Common profits tax deduction items (Ch 3)

# Common profits tax deduction items

## MD – General Deduction Rule



s.16(1)	<b>General Deduction Rule</b>	All outgoings and expenses to the extent to which they are incurred by the taxpayer during the basis period of the year of assessment in the production of chargeable profits shall be deducted.
s.17		The expenses must: <ul style="list-style-type: none"><li>• not be of domestic or private nature [s.17(1)(a)],</li><li>• not being money expended for the purpose of producing non-chargeable profits [s.17(1)(b)],</li><li>• not of capital nature or loss or withdrawal of capital [s.17(1)(c)], and</li><li>• not of cost of any improvements [s.17(1)(d)].</li></ul>
[Lo & Lo case].	<b>incurred</b>	Expense must be paid.
IRR 2A	<b>Apportionment</b>	Basis of apportionment of general expenses
IRR 2B	<b>Apportionment</b>	Basis of apportionment on interest on money borrowed for dual basis in share investment and share dealing.
IRR 2C	<b>Apportionment</b>	Adjustment to expenses of supervision and management attributable to substantial investment portfolio.

# Common profits tax deduction items



## Profits Tax – Interest expenses

Borrowing expenses include interest expenses, legal fees and bank charges in connection with the borrowing. **Sections 16(1)(a) & 16(2)** require all claims for deductions in respect of these borrowing expenses payable on moneys borrowed for the **purpose of producing chargeable profits** to be supported by sufficient details together with documentary evidence if required to satisfy at least one of the six conditions under s.16(2).



# Common profits tax deduction items

## Profits Tax – Interest expenses

### 6 Conditions of Section 16(2)

- s. 16(2)(a) – borrowed by a financial institution
- s. 16(2)(b) – borrowed by a public utility company
- **s. 16(2)(c) – borrowed not from a financial institution**
- **s. 16(2)(d) – borrowed from a financial institution**
- **s. 16(2)(e) – borrowed for purchase of machinery or trading stock and not borrowed from associated parties**
- s. 16(2)(f) – money is raised by through issue of listed debentures or marketable instruments



# Common profits tax deduction items



## Profits Tax – Deductions

**s.16(2)(c)** – The money has been borrowed from a **person other than a financial institution ("F.I.")** or an overseas financial institution and the sums payable by way of interest are chargeable to tax under the IRO.

In effect, the IRD wishes to make sure while the borrower claims interest deduction, **the interest recipient** (i.e. the general lender in this case) **shall be subject to tax in Hong Kong.**

**s. 16(2)(d)** – The money has been borrowed from a **F.I. or an overseas F.I., and** the loan is **not secured or guaranteed by any deposits** the income of which there from is not subject to tax under the IRO. For example, if the loan is used for producing chargeable profits (s.16 (1)(a) satisfied) and the loan is secured by a deposit that **earns taxable income** (hence not secured by deposits that earn non-taxable income), the interest on the loan **is then deductible.**

In effect, the IRD wishes to make sure that the borrower will not claim deduction for interest on a loan that is secured by a deposit while the deposit (may be available due to the provision of the loan) is used to earn non-taxable interest income.

# Common profits tax deduction items



## Profits Tax – Deductions

**s. 16(2)(e)** – The money has been borrowed **wholly and exclusively** for capital expenditure on **plant and machinery or for purchase of trading stock** while the lender is not a connected person like relative, partner, director and associated corporation of the borrower

### **s.16(2A): “Secured Loan Test”**

Tests in Section 16(2A) and Section 16(2B) are also required to be examined before deduction can be allowed. The interest will not be deductible if the loan is secured by a deposit or loan by an associate person of the taxpayer and the interest on **which is not subject to tax** in Hong Kong (Section 16(2A)).

### **s.16(2B): “Interest flow back test”**

The interest will also not be deductible if the interest on the principal of the loan will be paid **directly or indirectly to an associate person** of the taxpayer and the interests are not subject to tax in Hong Kong.

# Profits Tax - Deductions



<b>s.16(2)(f)</b>	<b>Qualified Debenture</b>	Interest relates to corporate borrowings by way of certain <b>qualified debentures or other marketable debentures</b> . In case the borrowing is from associated corporation and the moneys of the subject loan arise entirely from the proceeds of the qualified debentures or marketable instruments, the interest deduction would be restricted to the amount of interest paid by the associated corporation to the holders of the debentures or instruments.
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<b>s.16 (2C)</b>	<b>Qualified Debenture</b>	Section 16(2C) provides that if arrangements are in place whether between the borrower and the holders of the listed debentures or marketable instruments concerned or otherwise, whereby any sum payable by way of interest on the debentures or instruments concerned or on any interest in the debentures or instruments concerned is payable, whether directly or through any interposed person, to the borrower or to a person who is connected with the borrower, the amount of interest deduction shall be reduced by an amount
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# Common profits tax deduction items



## Deductible interest under ss.16(2)(g), 16(2CA) and 16(2CC)

When an **'in-house bank'** in a group borrowed money from a non-Hong Kong associated corporation and on-lent the money to another associated corporation in Hong Kong, the in-house bank might be taxed on the interest income under s.15(1)(f), but might not be allowed a tax deduction for the interest expense due to the failure to satisfy any of the conditions in ss.16(2)(c) –(f).

To rectify the asymmetrical tax treatment of interest income and interest expense for **genuine intra-group borrowing and lending transactions**, **s.16(2)(g)** was introduced.

**Effective from 1 April 2016**, interest incurred on money borrowed by a corporation in the ordinary course of its intra-group financing business carried on in Hong Kong is deductible if the following conditions are all satisfied:

# Common profits tax deduction items



## Deductible interest under ss.16(2)(g), 16(2CA) and 16(2CC)

- (a) Interest is payable on money borrowed from a **non-Hong Kong associated corporation** (s.16(2)(g)(i));
- (b) The lender is subject to tax on the interest in a territory outside Hong Kong which is similar to profits tax at a rate that is not lower than the reference rate (16.5% or 8.25% for a QCTC) – **the 'subject to tax' condition** in s.16(2)(g)(ii); and
- (c) The lender's right to use and enjoy that interest is not constrained by a contractual or legal obligation to pass that interest to any other person, unless the obligation arises as a result of a transaction between the lender and a person other than the borrower at arm's length – **the 'beneficial ownership' test in s.16(2)(g)(iii).**

The term 'carrying on an intra-group financing business in Hong Kong' has the same meaning as that for a CTC.

# Common profits tax deduction items



## Deductible interest under ss.16(2)(g), 16(2CA) and 16(2CC)

A **non-Hong Kong associated corporation** means a corporation not carrying on a trade or business in Hong Kong (s.14C(1)). An **associated corporation** which merely maintains a bank account in Hong Kong without any other business operation would generally not be regarded as carrying on a trade or business in Hong Kong (DIPN 52, para 8).

Interest must be paid to a corporation. Interest paid to a non-corporate associate (e.g. partnerships, trust) will not be allowed for tax deduction.

## Interest paid in the ordinary course of an intra-group financing business

Interest must be payable by a corporation **on money borrowed from a non-Hong Kong associated corporation** in the ordinary course of its intra-group financing business. Interest payable on money borrowed for purposes other than on-lending the same to other associated corporations is not money borrowed in the ordinary course of an intra-group financing business and the relevant interest will not be allowed for tax deduction.

# Profits Tax – Other Deductions



<b>s.16B</b>	<b>Research and development</b>	<p>General expenditure/ expenditure on plant and machinery fully deductible in the year of assessment it is incurred.</p> <p>Expenditure on buildings/ structure qualifies for IBA</p> <p>Proceeds from sale of rights in relation to research and development to the extent not yet subject to profits tax and not exceeding the amount previously allowed for the research and development would be treated as trading receipts at time of completion of sale</p>
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# Profits Tax – Other Deductions

s.16E	Purchased patents	Purchase of patent rights or know-how rights for use in Hong Kong in the production of chargeable profits. The purchase shall <b>not be made from associate</b> . The subsequent sale of such rights is nevertheless taxable.
s.16EA(11), s.16E(4) [Refer to DIPN 49]	IPRs	<p>Intellectual property rights (“IPRs”), viz. patents, rights to any know-how, copyrights, registered designs and registered trade marks that qualify for the above tax deduction</p> <ul style="list-style-type: none"> <li>• Only allowable for “<b>registered designs</b>” or “<b>registered trade marks</b>”.</li> <li>• Taxpayer must have proprietary interest and uses in the production of chargeable profits.</li> <li>• Apportionment available.</li> <li>• Spread over five succeeding years on a straight-line basis starting from the year of purchase ie <b>20% each year</b>.</li> <li>• Where a relevant IPR is <b>subsequently sold</b>, the sale proceeds to be treated as trading receipts are capped at the amount of the deduction as previously allowed.</li> <li>• Apportionment available.</li> <li>• Spread over five succeeding years on a straight-line basis starting from the year of purchase ie 20% each year.</li> <li>• Where a relevant IPR is subsequently sold, the sale proceeds to be treated as trading receipts are capped at the amount of the deduction as previously allowed.</li> </ul>

# Profits Tax – Other Deductions



s.16F	Building refurbishment	<p>Allows deduction of capital expenditure on the renovation and refurbishment of non-domestic building.</p> <ul style="list-style-type: none"><li>• <b>20% each year</b></li></ul> <p><b>No deduction for:</b></p> <ul style="list-style-type: none"><li>• The subject building or structure is a <b>domestic</b> building or structure.</li><li>• The non-domestic building or structure is <b>first used</b> substantially by the taxpayer.</li><li>• The non-domestic building or structure is to be used for a <b>purpose different</b> from that for which it was used immediately before the capital expenditure was incurred [s.16F(4)].</li></ul>
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# Profits Tax – Other Deductions



## Scope of tax deductions for capital expenditure incurred for purchase of intellectual property rights expanded

IRD has expanded the scope of profits tax deductions for capital expenditure incurred by enterprises for the purchase of intellectual property (IP) rights from five types to eight with effect from the year of tax assessment 2018/19.

The additional three types of IP rights involved are **rights in layout design (topography) of integrated circuits**(受保護的布圖設計(拓樸圖)權利), **plant varieties** (受保護植物品種權利) and **performances economic rights** (表演者的經濟權利)..

This also expands the scope of tax deductions originally provided for the **registration expenses** for trade marks, designs and patents, to cover plant variety rights as well.

# Profits Tax – Other Deductions



<p><b>s.16G</b></p>	<p><b>Prescribed fixed asset</b></p>	<p>100% deduction in respect of capital expenditure incurred on “prescribed fixed asset” used for the production of chargeable profits. <b>[N/A on hire purchased assets]</b></p> <p>Sale of prescribed fixed asset are taxable to the extent of deduction already granted</p>
<p><b>s.16H-K</b></p>	<p><b>Environmental Protection Machinery / Environmental Protection Installation</b></p>	<p>Specified capital expenditure incurred in a year of assessment on the provision of <b>EPM is wholly deductible</b> in the year of assessment.</p> <p>EPM covers environment-friendly vehicles – 100% deductible</p> <p><b>Sale of proceeds of EPM</b> are taxable limited to amount of deductions already granted.</p> <p>Capital expenditure incurred on construction of an <b>environmental protection installation EPI</b> is deductible in equal instalment over 5 years of assessment. 20% per year.</p> <p><b>Sale of EPI</b> – if unallowed expenditure exceeds the proceeds, the excess is deductible; if proceeds exceed unallowed expenditure, the excess is taxable.</p>

# Profits Tax – Other Deductions

## Past Paper Practice – Jun 2018 – Qu 7



Fun and Fun Hong Kong Limited (“Company HK”) is a company carrying on a toy trading business in Hong Kong. It closes its accounts on 31 March annually. During the year ended 31 March 2017, Company HK purchased two trade marks, which were used by two contractors to produce goods as follows:

a) Trade Mark A

Trade Mark A was registered in Hong Kong. It was purchased from X Ltd at a cost of HK\$500,000 and there is no relationship between Company HK and X Ltd.

During the year ended 31 March 2017, Company M, a manufacturer located in Vietnam, produced 1,000,000 toy items bearing the Trade Mark A for Company HK. The finished goods were sold by Company HK to customers in Hong Kong and Taiwan in the respective quantities of 600,000 and 400,000. Company HK maintained a sales office in Taiwan and it had been accepted by the Inland Revenue Department (“IRD”) that the trading profits generated by the Taiwan sales office were offshore in nature.

# Profits Tax – Other Deductions

## Past Paper Practice – Jun 2018 – Qu 7 (Cont'd)



### b) Trade Mark B

Trade Mark B was registered in Hong Kong. Trade Mark B was purchased from Z Ltd at a cost of HK\$1,000,000. Company HK and Z Ltd are under the common control of Mr C. The price of Trade Mark B had been valued by an independent firm before the acquisition. After the acquisition, Company HK registered the same trade mark in the Philippines. The cost for registration in the Philippines was HK\$400,000.

During the year ended 31 March 2017, Company P, a manufacturer located in the Philippines, produced 1,000,000 toy items bearing the Trade Mark B for Company HK. The finished goods were sold by Company HK to customers in Hong Kong and the Philippines in the respective amounts of 500,000 and 500,000. The profits derived by Company HK were all chargeable to tax in Hong Kong.

# Profits Tax – Other Deductions

## Past Paper Practice – Jun 2018 – Qu 7 (Cont'd)



### Required:

- a) Advise, with reference to the relevant legal principles and provisions of the IRO, the deductibility of the purchase cost of a trade mark.

(5 marks)

- b) In respect of each of Trade Mark A and Trade Mark B, analyse, by applying the relevant legal principles, whether the purchase cost and registration cost are tax deductible. If yes, compute the amount deductible for the year ended 31 March 2017.

(7 marks)

# Profits Tax – Other Deductions

## Past Paper Practice – Jun 2018 – Qu 7 (Cont'd)



### Answer (a)

An expense must satisfy s.16(1) and not be excluded by s.17 of the IRO before it can be allowed for deduction. Any expenditure of a capital nature is not allowed for deduction under s.17(1)(c) of the IRO. There are, however, specific provisions under the IRO which allow tax relief in respect of certain kinds of capital expenditure.

In most circumstances, the purchase cost of a trade mark is of a capital nature as it is made with a view of bringing into existence an asset or advantage for the enduring benefit of a trade or business. Accordingly, it should be denied for deduction under s.17(1)(c) of the IRO. However, s.16EA specifically allows deduction of capital expenditure incurred on purchase of specific intellectual property rights, which includes a trade mark registered under s.47 of the Trade Marks Ordinance (Cap. 559) or under the law of any place outside Hong Kong.



# Profits Tax – Other Deductions



## Past Paper Practice – Jun 2018 – Qu 7 (Cont'd)

### Answer (a) (Cont'd)

Therefore, if a trade mark is a registered one, the purchase cost of which can be allowed for deduction pursuant to s.16EA of the IRO while that of an unregistered trade mark is not deductible under s.17(1)(c) of the IRO. Deduction under s.16EA is to be allowed in five years of assessment commencing in the year of assessment during the basis period for which the capital expenditure was incurred.

However, s.16EC of the IRO restricts that there are certain circumstances under which deduction under s.16EA is not allowable. For example, s.16EC(2) specifies that no deduction is allowable in respect of any relevant right purchased by a person wholly or partly from an associate. Besides, s.16EC(4)(b) of the IRO specifically denies the deduction of an intellectual property right if at the time when the relevant right is owned by the taxpayer, a person holds rights as a licensee under a license of the relevant right, and the relevant right is, while the license is in force, used wholly or principally outside Hong Kong by a person other than the taxpayer.

# Profits Tax – Other Deductions

## Past Paper Practice – Jun 2018 – Qu 7 (Cont'd)



### Answer (b)

#### Trade Mark A

Trade Mark A is a registered trade mark. Accordingly, its purchase cost can be allowed for deduction under s.16EA of the IRO. Despite the fact that Company M, being a company other than Company HK, was using Trade Mark A in Vietnam to manufacture the toys, Trade Mark A was not a registered trade mark in Vietnam and Company M was actually using an unregistered trade mark in Vietnam. Therefore, s.16EC(4)(b) is not applicable.

However, as Company HK was only subject to profits tax in respect of 60% ( $600,000 / 1,000,000 \times 100\%$ ) of its profits, the same portion of the purchase cost of Trade Mark A, i.e. HK\$300,000 (60% of HK\$500,000) can be allowed for deduction. Accordingly, the amount deductible for the year of assessment 2016/17 is HK\$60,000 ( $\text{HK\$}300,000 \times 1/5$ ).

# Profits Tax – Other Deductions

## Past Paper Practice – Jun 2018 – Qu 7 (Cont'd)

### Answer (b) (Cont'd)

#### Trade Mark B

By virtue of s.16EC(2) of the IRO, no deduction is allowable for the purchase cost of Trade Mark B as it was purchased from an associate, irrespective of whether the price is at arms-length.

Regarding the registration cost of Trade Mark B in the Philippines, it can be allowed for deduction under s.16(1)(g) of the IRO as long as Trade Mark B was used by Company HK for producing chargeable profits in Hong Kong.



# Profits Tax – Other Deductions

## Past Paper Practice – Dec 2016 Qu 9a



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.

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.

# Profits Tax – Other Deductions



## Past Paper Practice – Dec 2016 Qu9a (Cont'd)

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.

### Required:

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)

# Profits Tax – Other Deductions



## Past Paper Practice – Dec 2016 Qu9a

### Answer

(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.

# Profits Tax – Other Deductions



## Past Paper Practice – Dec 2016 Qu9a

### Answer (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.

# Profits Tax – Other Deductions

## Past Paper Practice – Dec 2016 Qu 9a



### Answer (Cont'd)

(ii) From the perspective of the 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.





# Objection and appeal mechanism (Ch 2)

# Objection and appeal mechanism



## Objection s.64(1)

If a taxpayer disagrees with an assessment raised by an assessor, he/she may lodge an objection with the Commissioner.

The **notice of objection** shall:

- Be in writing;
- State precisely the grounds for the objection; and
- Be received by the Commissioner within one month after the date of the notice of assessment.

The Commissioner may accept a **late objection** if the delay is caused by:

- Sickness;
- Absence from Hong Kong; or
- Other reasonable grounds.

# Objection and appeal mechanism



## Estimated assessment

To object against an estimated assessment raised under s.59(3), a valid return has to be filed together with the notice of objection within the objection period of one month.

The onus of proof is on the taxpayer to show that the assessment is incorrect or excessive.

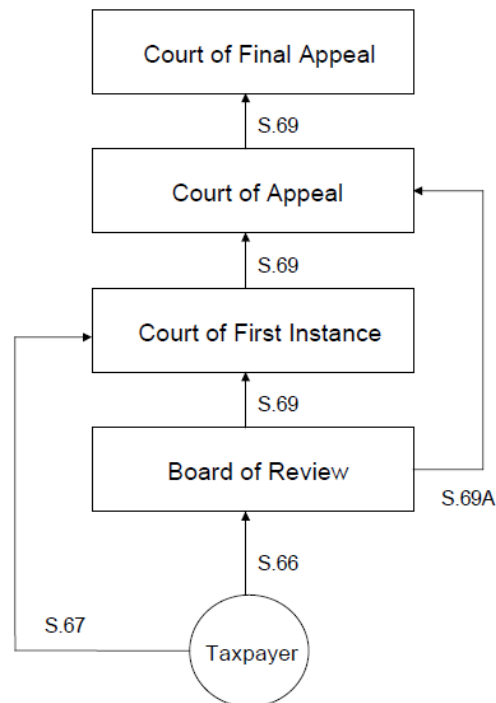
# Objection and appeal mechanism

## The tax appeal channel



A tax appeal may be made to the Board of Review, the Court of First Instance, the Court of Appeal and, finally, the Court of Final Appeal.

The tax appeal channel may be shown as follows:



# Objection and appeal mechanism



## The tax appeal channel

At the hearing of the appeal, the onus of proof is on the taxpayer to prove that the assessment is excessive or incorrect. **An appeal should be decided on the basis of balance of probabilities.**

Unless the appeal is transferred to the Court of First Instance under s.67(1) of the IRO, the Board of Review will ascertain the basic facts. After hearing the appeal, the Board is entitled to confirm, reduce, increase or annul the assessment under appeal.

The Inland Revenue (Amendment) (No. 3) Ordinance 2015 was gazetted on 13 November 2015. The objectives are to enhance the tax appeal mechanism and improve the efficiency and effectiveness of the Board of Review.

# Objection and appeal mechanism



## The tax appeal channel

It covers the following four aspects:

- (1) Allow an appeal against the decision of the Board of Review on a question of law to **go direct to the Court of First Instance** or, if applicable, the **Court of Appeal**. This abolishes the present case stated procedure under the Board of Review, which is not only **time-consuming and costly**, but also affects the capacity of the Board of Review to hear other appeals;
- (2) Empower the person presiding at the hearing of an appeal before the Board of Review to **give directions on the provision of documents and information for the hearing**. This is to address the situation of late submissions from time to time, which has affected the proceedings of the Board of Review and may also lead to rescheduling of hearings;

# Objection and appeal mechanism

## The tax appeal channel



It covers the following four aspects:

- (3) Provide **privileges and immunities** to the Chairman, Deputy Chairmen and other members of the Board of Review, and the parties to a hearing as well as other persons appearing before the Board of Review. This is in line with the arrangement of other statutory appeal boards; and
- (4) Raise the ceiling of costs to be paid by the appellant as may be ordered by the Board of Review from \$5,000 to **\$25,000**, to strengthen the deterrent effect against frivolous appeals.

The current ceiling has not been adjusted since 1993.

# Objection and appeal mechanism

## Past Paper Jun 2018 – Case Qu 1a (Extract)



### CASE

PC Limited (“PCL”), a Hong Kong company, is engaged in the businesses of trading and investment holding in overseas subsidiaries. Recently Mr Fung has been employed by PCL as Finance Manager and, upon commencement of employment, the following tax issues were tabled on his desk for his further action:

#### A. Appeal made to the Board of Review (“BOR”)

The BOR recently made a decision in favour of the Commissioner of Inland Revenue with respect to a tax appeal lodged by PCL, and PCL now would apply for an appeal to the Court of First Instance. However, it is noted that there are some legislative amendments in the Inland Revenue Ordinance (“IRO”) in 2015 regarding the tax appeal mechanism, and the management of PCL has no idea whether the changes would affect their upcoming appeal to the Court of First Instance.





# Objection and appeal mechanism

## Past Paper Jun 2018 – Case Qu 1 (Extract)

### Question 1 (4 marks – approximately 7 minutes)

In the contexts of the relevant IRO amendments made in year 2015, advise as to the respective changes in the tax appeal mechanism and their possible effects on PCL’s appeal to the Court of First Instance.

(4 marks)

### Answer

Prior to the Inland Revenue (Amendment) (No.3) Ordinance 2015 (“the Amendment”) enacted in November 2015, the appellant was required to make a **written application** requesting the Board of Review to state a case on a question of law for the opinion of the Court of First Instance under s.69(1) of the Inland Revenue Ordinance (“IRO”), and deliver it to the Clerk to the Board of Review within the stipulated timeframe and under guidance specified in s.69 of the IRO.

# Objection and appeal mechanism

## Past Paper Jun 2018 – Case Qu 1 (Extract)



### Answer (Cont'd)

After the Amendment which became effective from April 2016, the above case state procedure was abolished and the **appellant may apply directly to the Court of First Instance** for leave to appeal against the Board of Review decision on a ground involving only a question of law (Departmental Interpretation and Practice Notes (“DIPN”) **No. 6 (Revised)**, paras. 59 to 61, and 63)

Pursuant to the Amendment, PCL’s appeal to the Court of First Instance should proceed in a more cost efficient and less time-consuming manner.



## Anti-avoidance provisions under the IRO (Ch 9)

# Anti-avoidance provisions under the IRO



## Section 61 – Certain transactions and dispositions to be disregarded

Pursuant to s.61, where an assessor is of the opinion that:

- (a) Any transaction which reduces or would reduce the amount of tax payable by any person is **artificial or fictitious**, or that
- (b) Any disposition is not in fact given effect to; he may disregard any such transaction or disposition and the person concerned shall be assessed accordingly.

# Anti-avoidance provisions under the IRO



## Section 61 – Certain transactions and dispositions to be Disregarded

**‘Artificial’** is not defined in the IRO. In general, an artificial transaction refers to an unusual transaction that is ‘not natural or not ordinary’, or a transaction which has been carried out but is commercially unrealistic.

**‘Fictitious’** also is not defined in the IRO. A fictitious transaction refers to a transaction which is ‘not genuine or unreal’, or a transaction which the parties to it never intend to make or carry out (i.e. a ‘sham’).

A transaction which has been effectively carried out cannot be fictitious but can be artificial.

# Anti-avoidance provisions under the IRO



## Section 61A – Transactions designed to avoid liability to tax

The scope of s.61 has been considered to be **narrow** as it only applies to artificial or fictitious transactions or dispositions not in fact carried out; and that the only action that can be taken by the IRD is to disregard such transactions or dispositions.

Section 61A was enacted in 1986 to extend the scope of the anti-avoidance provisions to any transaction entered into or effected after 13 March 1986. For s.61A to apply,

- (a) There must be a transaction as defined;
- (b) The transaction has or would have had the effect of conferring a tax benefit on a person (the relevant person); and
- (c) Having regard to the following matters, it would be concluded that the sole or dominant purpose of entering into that transaction was to enable the relevant person, either alone or in conjunction with other persons, to obtain a tax benefit.

# Anti-avoidance provisions under the IRO

## Section 61A – Transactions designed to avoid liability to tax

The seven specific matters under s.61A(1) are:

- (1) The manner in which the transaction was entered into or carried out;
- (2) The form (the legal rights and obligations created) and substance (the practical end result) of the transaction;
- (3) The result in relation to the operation of the IRO that, but for s.61A, would have been achieved by the transaction;
- (4) Any change in the financial position of the relevant person that has resulted, will result, or may reasonably be expected to result, from the transaction;
- (5) Any change in the financial position of any person who has, or has had, any connection (whether of a business, family or other nature) with the relevant person, being a change that has resulted or may reasonably be expected to result from the transaction;
- (6) Whether the transaction has created rights or obligations which would not normally be created between persons dealing with each other at arm's length under a transaction of the kind in question; and
- (7) The participation in the transaction of a corporation resident or carrying on business outside Hong Kong.



# Anti-avoidance provisions under the IRO



## Section 61B – Utilisation of losses to avoid tax

Section 61B was enacted in 1986 to deter arrangements in which a profit making company purchased the shares in a company with carry-forward tax losses and then the profit making company attempted to utilise such available tax losses by diverting profits to the loss company.

Section 61B applies if:

- (a) **change in shareholding** in a corporation has been effected after 13 March 1986;
- (b) The Commissioner is satisfied that as a direct or indirect result of the change in shareholding, profits have been received by or accrued to that corporation during any year of assessment (i.e. not necessarily in the year subsequent to the change); and
- (c) Utilisation of the loss of that corporation to avoid or reduce the tax liability of that corporation or any other person is the **'sole or dominant' purpose of the change in shareholding.**



# Anti-avoidance provisions under the IRO



## s.20 - Business with closely connected resident persons

Under s.20(2), where a **non-resident person** carries on business with a resident person with whom he is **closely connected** and the course of such business is so arranged that it produces to the resident person either no profits which arise in or derive from Hong Kong, 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 his connection with the resident person shall be deemed to be carried on in Hong Kong. The non-resident person shall then be chargeable to tax in respect of his profits from such business in the name of the resident person as if the resident person were his agent, and all the provisions of the IRO shall apply accordingly.

The **controlling interest** of a company shall be deemed to be owned by the beneficial owners of its shares, whether held directly or through nominees, and shares in one company held by or on behalf of another company shall be deemed to be held by the shareholders of the last-mentioned company (s.20(1)(a)).

# Anti-avoidance provisions under the IRO



## s.20 - Business with closely connected resident persons

Section 20 is designed **to counteract the diversion of profits** from Hong Kong to a closely connected non-resident person. It is different from most of the transfer-pricing provisions in other jurisdictions, as it does not seek to substitute an arm's-length price for the transaction between related parties.

Specifically, it deems the business done by the non-resident person to be carried on in Hong Kong and the profits arising therefrom are to be taxed in the name of the resident person as if the resident person were the agent of the non-resident person.

# Anti-avoidance provisions under the IRO



## Section 38B –

### Commissioner's power to determine the true market value of an asset on sale

**Section 38B** empowers the Commissioner to determine the value of **machinery and plant** when they are being disposed of at a price **other than the true market value** in the following circumstances:

- (a) The buyer is a person over whom the seller has control; or
- (b) The seller is a person over whom the buyer has control; or
- (c) Both the seller and the buyer are persons over both of whom some other person has control; or
- (d) The sale is between a husband and a wife, not being a wife living apart from her husband.

# Anti-avoidance provisions under the IRO



## Section 39E – Depreciation allowances for leased machinery and plant

Section 39E was enacted in 1986 to deny depreciation allowances to the lessor of machinery and plant acquired under a contract entered into after 13 March 1986 in the following circumstances:

- (a) The machinery or plant was acquired under a sale and lease back arrangement; or
- (b) The machinery or plant, other than a ship or an aircraft, is, while the lease is in force,
  - (i) Used wholly or principally outside Hong Kong by a person other than the taxpayer; or
  - (ii) The whole or a predominant part of the cost of acquisition or construction of the machinery or plant was financed directly or indirectly by a non-recourse debt; or
- (c) The machinery or plant is a ship or aircraft or any part thereof and
  - (i) The lessee is not an operator of a Hong Kong ship or aircraft; or
  - (ii) The whole or a predominant part of the cost of acquisition or construction of the ship or aircraft was financed directly or indirectly by a non-recourse debt.

# Anti-avoidance provisions under the IRO



## Practice Question - Dec 2015 Q9b

Mr Lee is a finance manager of a local trading company and lives together with his mother, Ms Wong, in Hong Kong. His income has been subject to salaries tax and he has also claimed both Dependent Parent and Additional Dependent Parent Allowances in filing his annual Individual Tax Returns towards maintaining and living with his mother in prior years. Ms Wong has retired and has not derived any income for years. Recently Mr Lee planned to personally acquire a residential flat in Hong Kong to capture possible long term appreciation of such capital asset. He envisaged that he has busy working and living schedules and may not have the spare time to arrange routine leasing matters for the acquired property in the leasing market. In this regard, Mr Lee would use a nominal value of say HK\$100 to lease out the property to his mother. Ms Wong would then lease out the flat in the property market as the sub-tenant to generate rental income.

**(b) Discuss the possible IRD's challenge to the above said arrangement from an anti-avoidance perspective in the context of the IRO.**

**(8 marks)**

# Anti-avoidance provisions under the IRO

## Practice Question - Dec 2015 Q9b



### Answer

In view of the possible overall tax benefit derived by Ms Wong from the arrangement proposed by Mr Lee, the IRD may challenge the plan and seek to apply respective anti-avoidance provisions in the IRO to counteract the tax benefit derived thereon. Specifically, the IRD may apply s.61 and / or s.61A of the IRO in the circumstances. Under s.61 of the IRO, the IRD may disregard any transaction or disposition, and the person concerned shall be assessed accordingly where an assessor of the IRD is of the opinion that:-

- (a) any transaction which reduces or would reduce the amount of tax payable by any person is artificial and fictitious, or that
- (b) any disposition is not in fact given effect.

# Anti-avoidance provisions under the IRO



## Practice Question - Dec 2015 Q9b

### Answer (Cont'd)

Alternatively under s.61A(2) of the IRO, the assistant commissioner may raise an assessment on the relevant person (i) as if the transaction or any part thereof had not been entered into or carried out, or (ii) in such manner as he considers appropriate to counteract the tax benefit which would otherwise be obtained, in the circumstances that:-

- (a) there must be a transaction as defined;
- (b) the transaction has or would have had the effect of conferring a tax benefit on a person; and
- (c) having regard to the seven specific matters under s.61A(1)(a) to (g) of the IRO, it would be concluded that the sole or dominant purpose of entering into that transaction was to enable the relevant person, either alone or in conjunction with other persons, to obtain a tax benefit

# Anti-avoidance provisions under the IRO



## Practice Question - Dec 2015 Q9b

### Answer (Cont'd)

As Mr Lee intended to use a nominal value instead of the market price for leasing the property to his mother for further leasing out to generate rental income, and in which the tax liabilities of Ms Wong could be reduced by the election of personal assessment, the IRD may use the abovesaid general anti-avoidance provisions to assess the respective tax liabilities of Mr Lee and Ms Wong on the basis that the transaction (i.e. the use of nominal value in leasing the property to Ms Wong for further leasing out in the property market) is artificial and fictitious, and / or the sole or dominant purpose of entering into that transaction was to obtain tax benefit.

In this regard, Mr Lee should review the proposed transaction and explore the genuine and commercial justification of the arrangement in order to defend their tax positions and the possible challenge from the IRD.



# Passing MD – Basic Techniques



## Expectations from Students:

- Quote correctly sections (sub-sections), DIPN and cases
- Correct application of the tax rules; do not just copy
- Reasonable conclusion given – answer the question
- Count marks for each question ie 5 marks question – at least 7 minor points
- Present your answer in a logical manner
- Use assumptions
- Give tax evidence

# Answer Plan for each question



- Step 1 –** Which kind of tax?  
Profits Tax, Salaries Tax and Property Tax?  
Involve Stamp Duty?
- Step 2 –** Is the question related to income or expense?
- Step 3 –** Consider the charging section or the general rule first?  
Then consider any DIPN & cases in support.
- Step 4 –** Apply to the question's facts
- Step 5 –** Discuss different applications under different assumptions
- Step 6 –** Suggest further evidence and give a reasonable conclusion

# MD Preparation



**Only got 2 and ½ months left – What shall you do?**

- **Do past papers with updated answers**
- **Practice writing out**
- **Write as many questions out as possible**
- **Practice using your critical file**
- **Time yourself**

# Final Advice



- **The time to look-up the textbook is limited during an open-book exam**
- **Students should:**
  - have a good understanding of the topics before going into the exam
  - read the case and questions carefully
  - answer what is being asked, not what they wanted to be asked
  - identify the core issues of the question and allocate their time accordingly
  - analyse the facts of the case and apply the tax rules or principles to arrive at the conclusion
  - not copy large passages from the textbook
  - use logical thinking to understand and respond to the questions