



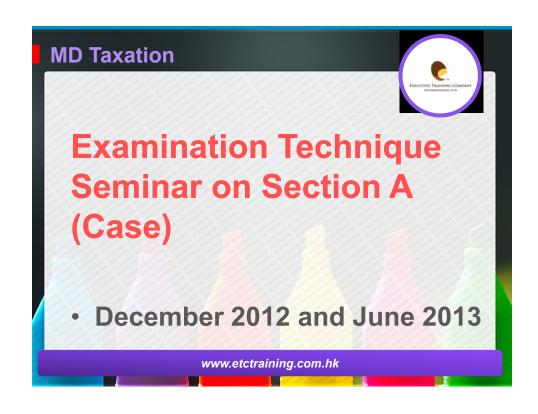
Examination Technique Seminar (Case) for Module D on Taxation

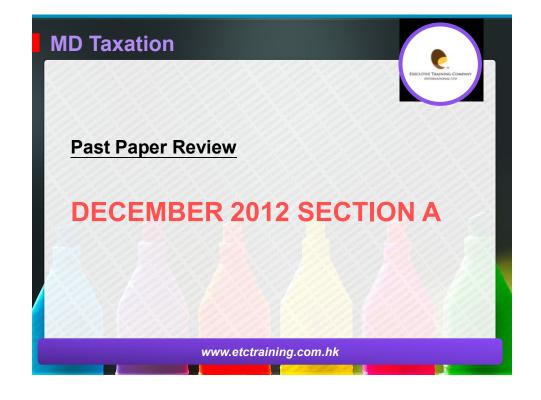
Speaker Dr. Fiona Lam

12 November 2013











Dr. A operates a medical practice in his own name in Hong Kong. Apart from treating patients from the general public, he was also contracted by Company B to provide medical services to its employees. With the implementation of the Mainland and Hong Kong Closer Economic Partnership Arrangement, Dr. A has also been engaged as a visiting doctor at a Mainland hospital. [Both onshore and offshore]

In the accounts for the year ended 31 December 2011, Dr. A recorded, among others, the following income and expenses for his medical practice:

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MD - December 2012 (Case)

(1) Income



- (a) Consultation fees of RMB100,000 from the Mainland hospital ("the Consultation Fees"). To earn the Consultation Fees, Dr. A provided medical treatment to a patient in the Mainland. At the patient's request, he also prepared in Hong Kong a medical report for the purpose of an insurance claim. [Income onshore or offshore any apportionment?]
- (b) Compensation payment of HK\$1 million for the termination of Dr. A's service contract with Company B ("the Compensation Payment"). The Compensation Payment was determined with reference to the consultation fees that Dr. A would have derived during the remaining period of the contract. According to past records, the service fees derived from this service contract would account for about 10% of Dr. A's annual income. [Capital or revenue in nature]

(2) Expenses



- (a) Medical expenses of HK\$250,000 in relation to Dr. A's injuries in a traffic accident; [Private expenses]
- (b) Additional tax of HK\$5,000 imposed under s.82A of the Inland Revenue Ordinance ("IRO") due to late submission of tax return; and [incurred in the production of profits?]
- (c) Expenditures of HK\$300,000 on the renovation of the existing clinic and HK\$500,000 on the initial decoration of a new branch clinic. Both clinics are located in office buildings in prime locations. [CBA or S16F?]

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MD - December 2012 (Case)



Dr. A entered into an agreement to purchase Flat C as the sole owner on 1 February 2011. Under the agreement, Dr. A was required to settle the consideration within one year, and was permitted to live in the flat during that year. On 1 March 2011, Dr. A obtained an equitable mortgage loan to pay part of the consideration. He commenced to repay the loan (with interest of HK\$10,000 per month) on 1 April 2011, and moved into Flat C with his family on 1 June 2011. On 1 November 2011, Dr. A settled the balance of the consideration, and nominated his wife, Mrs. A, to take up the assignment of Flat C and the related mortgage loan with him as joint tenants. The relevant assignment and mortgage deed were also executed on that day. [Individual – home loan interest?]



Dr. A also entered into an agreement to purchase another residential flat, Flat D, as the sole owner on 1 March 2011. He nominated Company E to take up the assignment of Flat D on 1 October 2011. Company E is a corporation of which Dr. A and Mrs. A are the only shareholders and directors. It incurred a significant loss from share dealing in 1997, and has been left dormant since then.

[SSD + How about BSD ? - any thoughts?]

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MD - December 2012 (Case)



Dr. A and Mrs. A have a son of 7 years old. The son has been residing in the US with Mrs. A's parents, who are aged 65 and emigrated there more than 20 years ago. During the year ended 31 March 2012, the son and Mrs. A's parents did not visit Hong Kong, whilst Dr. A contributed US\$5,000 per month to support their living expenses in the US. Mrs. A did not have any income chargeable to tax, and it is advantageous for her and Dr. A to elect for personal assessment. [Personal Allowance + PA?]

Dr. A is considering to carry on his medical practice through Company E. He consults his accountant as whether it is a good idea from a tax perspective.

Question 1 (6 marks – approximately 11 minutes)



Discuss the following issues in respect of the Consultation Fees and the Compensation Payment:

a) whether the Consultation Fees from the Mainland hospital were sourced in Hong Kong. [Scope of income]

(3 marks)

b) whether the Compensation Payment from Company B was capital or revenue in nature. [Deduction Rule]

(3 marks)

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MD - December 2012 (Case)

Question 2 (14 marks – approximately 25 minutes)



Analyse whether the following items are deductible under profits tax. For items (a) and (b), cite the relevant case law to support your analysis. [Deduction rules]

a) Dr. A's medical expenses;

(3 marks)

- b) Additional tax due to late submission of tax return; and (4 marks)
- c) Expenditures on the renovation of the existing clinic and the initial decoration of the new clinic. (Note: If deductible, compute the maximum amounts of deductions allowable under the IRO for the year of assessment 2011/12.) (7 marks)

Question 3 (8 marks – approximately 14 minutes)

Determine whether and, if so, how Dr. A should be allowed deduction of home loan interest in respect of Flat C for the year of assessment 2011/12. (8 marks)

Question 4 (6 marks – approximately 11 minutes)

Explain <u>whether</u> and, if so, <u>how</u> the following instruments are chargeable <u>with special stamp duty</u>:

- a) the agreement dated 1 November 2011 under which Dr. A nominated Mrs. A to take up the assignment of Flat C with him as joint tenants. (2 marks)
- b) the agreement dated 1 October 2011 under which Dr. A nominated Company E to take up the assignment of Flat D. (4 marks)

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Question 5 (5 marks - approximately 9 minutes)



Evaluate whether Dr. A can be granted the following allowances under personal assessment:

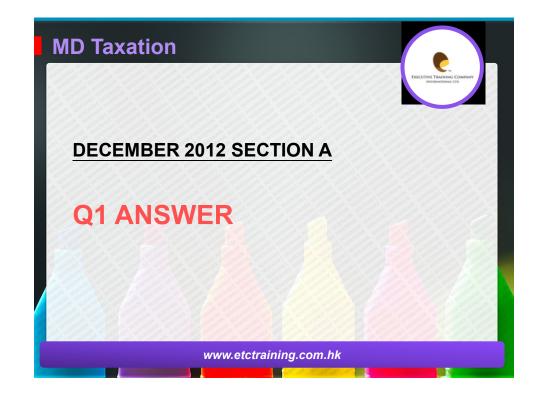
a) Child allowance in respect of his son; and

(2 marks)

b) Dependent parent allowances in respect of Mrs. A's parents.

(3 marks)

MD - December 2012 (Case) Question 6 (11 marks - approximately 20 minutes) Discuss the following issues in relation to Dr. A's idea of carrying on his medical practice through Company E: a) whether and, if so, how the change in mode of carrying on the medical practice can help Dr. A reduce his tax liabilities; (6 marks) b) what ethical considerations should the accountant be aware of in advising Dr. A on such a tax planning idea? [Code of Ethics] (5 marks)



Question 1(a)



The broad guiding principle for determining the source of profits, as laid down by Lord Bridge in Commissioner of Inland Revenue v Hang Seng Bank Ltd. [1991] 1 AC 306 and expanded by Lord Jauncey in Commissioner of Inland Revenue v HK-TVB International Ltd. [1992] 2 AC 397, is "one looks to see what the taxpayer has done to earn the profit in question and where he has done it". [S14(1) + Operation Test]

In the present case, Dr. A earned the Consultation Fees by providing medical treatment to a patient in the Mainland. Applying the above broad guiding principle, the Consultation Fees did not arise in or were not derived from Hong Kong. [Service Fee rendered]

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MD - December 2012 (Case) - ANSWER

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Question 1(a) (Cont'd)

The fact that Dr. A prepared the medical report for the patient in Hong Kong was merely an antecedent or incidental matter which did not determine the source of the consultancy income: see *Kwong Mile Services Limited v. Commissioner of Inland Revenue* [2004] 3 HKLRD 168. Indeed, there is no evidence suggesting that part of the Consultation Fees arose from the preparation of the medical report and had a locality separate from the part attributable to the provision of medical treatment.

Question 1(b)



The Compensation Payment should be revenue in nature because of the following:

- Dr. A entered into the service contract with Company B in the ordinary course of his medical practice. Being a sum to compensate for the termination of such a contract, the Compensation Payment should be regarded as a normal trading receipt.
- 2) The service contract with Company B only contributed to 10% of Dr. A's annual income. It is unlikely that the termination of the service contract would affect the entire framework of Dr. A's business. [Tree and Fruit analogy]

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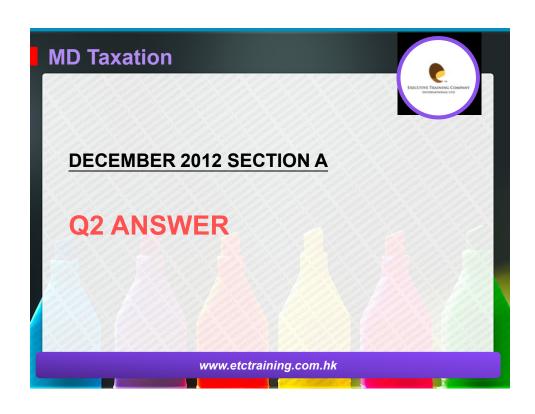
MD - December 2012 (Case) - ANSWER

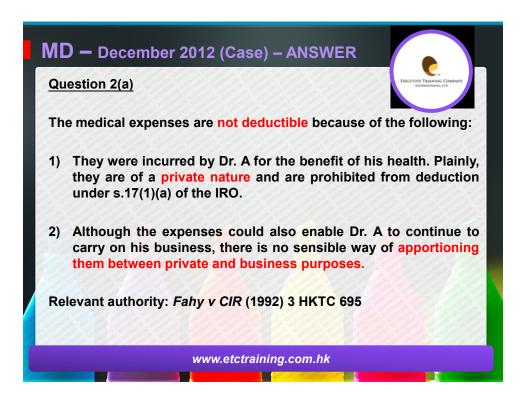
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Question 1(b) (Cont'd)

The Compensation Payment should be revenue in nature because of the following:

3) The Compensation Payment was computed with reference to the consultation fees that Dr. A would have earned from the contract. It was more akin to compensation for the loss of profits rather than the loss of capital assets.





Question 2(b)



The additional tax is not deductible because of the following:

- 1) Additional tax is a kind of fine or penalty. It was imposed due to a wrongdoing on the part of Dr. A, i.e. late submission of his tax return. It was not incurred for the purpose of earning profits from his medical practice and was thus not allowable for deduction by virtue of s.17(1)(b) of the IRO.
- 2) Moreover, the purpose of a fine or penalty is to punish the wrongdoer, and the legislative policy would be diluted if the wrongdoer is allowed to share the burden with the rest of the community.

Relevant authority: CIR v Chu Fung Chee 6 HKTC 743

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MD - December 2012 (Case) - ANSWER

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Question 2(c)

The expenditure on renovation of the existing clinic is deductible under s.16F of the IRO because of the following:

- 1) The relevant unit of building has not been used as a domestic building or structure; and
- 2) The expenditure was incurred in production of chargeable profit.

The renovation expenditure is allowed for deduction by five equal instalments, the first of which is allowed in the basis period during which the expenditure was incurred and the remaining four instalments in the basis periods of the next four succeeding years of assessment.

Question 2(c) (Cont'd)



Therefore, the deduction of expenditure on renovation of the existing clinic for the year of assessment 2011/12 should be computed as HK300,000 \times 1/5 = HK$60,000$.

By virtue of s.16F(3) of the IRO, Dr. A is not entitled to Commercial Building Allowance ("CBA") in respect of the expenditure which has been allowed under s.16F.

As for the expenditure for the initial decoration of the new branch clinic, it was incurred to enable the unit of building to be first used by Dr. A for the production of profits, so does not qualify for deduction under s.16F.

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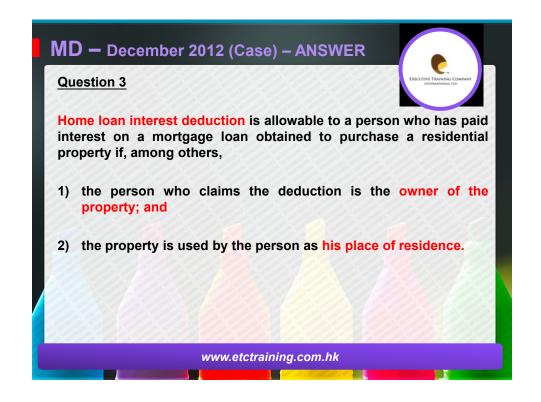
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Question 2(c) (Cont'd)

However, CBA can be granted in respect of such initial decoration expenditure under s.33A of the IRO for the year of assessment 2011/12 as follows:

Annual Allowance: HK\$500,000 x 4% = HK\$20,000





Question 3 (Cont'd)



In D108/02, 18 IRBRD 45, D70/05, (2006-07) 21 IRBRD 1, D80/05, (2006-07) 21 IRBRD 93 and D3/10, (2010-11) 25 IRBRD 162, the Board of Review held that no one can claim deduction of home loan interest unless he is a legal or registered owner of the property, not just a beneficial owner of an interest in the property.

Although Dr. A commenced to pay mortgage interest in respect of Flat C from April 2011, he had not used the flat as his place of residence until 1 June 2011. Furthermore, he only became a legal owner of the flat on 1 November 2011. In the circumstances, Dr. A is not entitled to any home loan interest deduction for the period from April 2011 to October 2011.

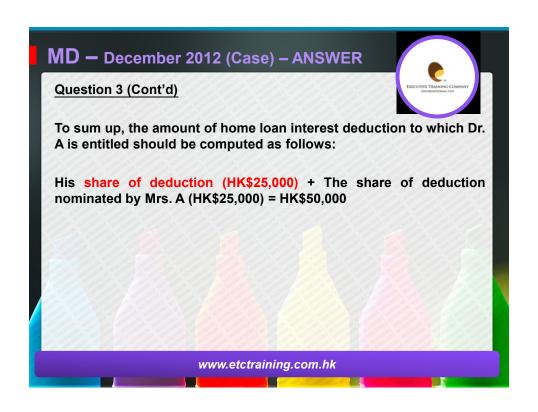
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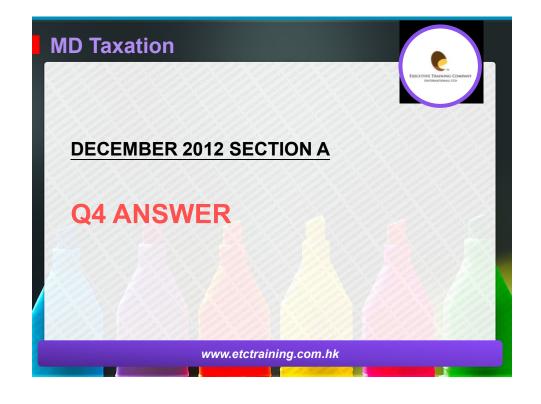
MD - December 2012 (Case) - ANSWER

Question 3 (Cont'd)

For the period from November 2011 to March 2012, Flat C was held by Dr. A and Mrs. A as joint tenants. By virtue of s.26E(2)(b)(i) of the IRO, Dr. A and Mrs. A should each be allowed deduction of home loan interest in proportion to the number of joint tenants, i.e. HK10,000 \times 5 \text{ months } \times 1/2 = HK$25,000.$

Since Mrs. A did not have any income chargeable to tax for the year of assessment 2011/12, she can nominate Dr. A to claim deduction of her share of home loan interest deduction pursuant to s.26F of the IRO.





Question 4(a)



Under this nomination agreement, the nominee (i.e. Mrs. A) is the wife of the nominator (i.e. Dr. A).

By virtue of s.29CA(10) of the Stamp Duty Ordinance ("SDO"), the nomination agreement is exempted from special stamp duty.

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Question 4(b)

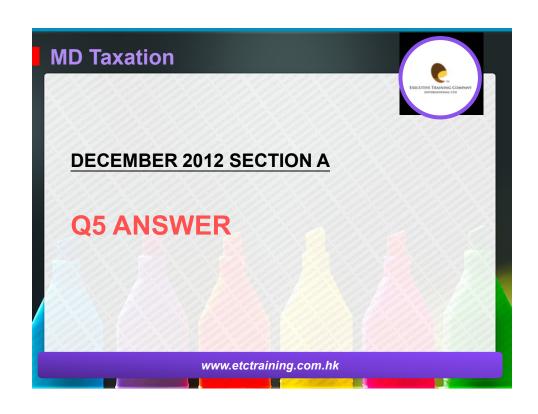


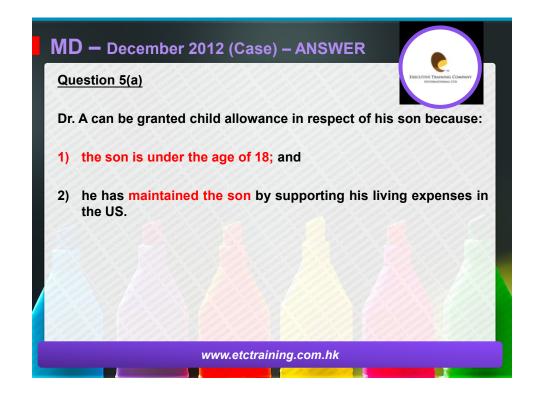
Dr. A entered into an agreement to purchase Flat D on 1 March 2011.

By entering into the nomination agreement on 1 October 2011, Dr. A is regarded as having sold the flat to Company E on that date.

The period between 1 March 2011 and 1 October 2011 is 7 months and 1 day.

Since the holding period is more than 6 months but less than 12 months, the nomination agreement will be chargeable with special stamp duty at 10% of the consideration stated therein (if any) or the market value of Flat D on 1 October 2011, whichever is the higher, under head 1(1B)(b) in the First Schedule to the SDO.





Question 5(b)



Mrs. A's parents emigrated to the US more than 20 years ago and have not visited Hong Kong during the year of assessment 2011/12.

As Mrs. A's parents were not ordinarily resident in Hong Kong during the relevant year, Dr. A cannot be granted the related dependent parent allowances.

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MD - December 2012 (Case) - ANSWER

Question 6(a)



By carrying on his medical practice through Company E, Dr. A may reduce his tax liabilities as follows:

1) As Company E becomes the person carrying on the medical practice, Dr. A will no longer be liable to profits tax in respect of the profits of the clinics. Instead, he, being the director of Company E, will provide medical services at the clinics in return for his director's remuneration. His remuneration package can be arranged to include a lot of fully or partially non-taxable fringe benefits (e.g. provision of quarters, domestic helper employed by Company E, etc.), whereas Company E will be able to claim deduction of those benefits as business expenses. ...

Question 6(a) (Cont'd)



By carrying on his medical practice through Company E, Dr. A may reduce his tax liabilities as follows:

1) ... By such arrangement, although the profits tax rate for a corporation (16.5%) is higher than the standard tax rate for individual (15%), the overall tax liabilities of both Dr. A and Company E can be reduced.

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MD - December 2012 (Case) - ANSWER

Question 6(a) (Cont'd)



By carrying on his medical practice through Company E, Dr. A may reduce his tax liabilities as follows:

2) The substantial loss sustained by Company E from share dealing has not yet been utilised due to its dormancy since 1997. In the circumstances, by injecting the medical practice into Company E, the aforesaid loss can be utilised to set off against the profits of the clinics.

Question 6(b)



In advising Dr. A on his tax planning idea, the accountant should be aware of the following:

- 1) Tax is a major source of the government's income. To preserve the welfare of the community, the accountant should act honestly in advising Dr. A on his tax planning idea.
- 2) The accountant is entitled to put forward tax advice as to the best position for Dr. A, provided that he does so within his professional competence and it does not in any way impair his standard of integrity and objectivity, and is in his opinion consistent with the law.

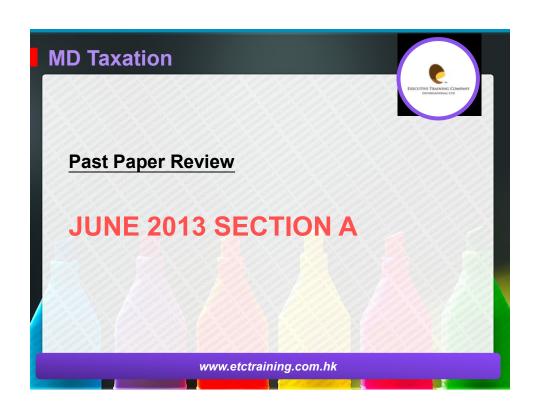
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MD - December 2012 (Case) - ANSWER

Question 6(b) (Cont'd)

In advising Dr. A on his tax planning idea, the accountant should be aware of the following:

3) The accountant should not hold out to Dr. A the assurance that the tax advice he offers is beyond challenge. Instead, the accountant should ensure that Dr. A is aware of the limitations attaching to the advice (such as the possibility that the Commissioner may invoke ss.61 and 61A of the IRO to deny any tax benefit obtained from the tax plan), so that he does not misinterpret an expression of opinion as an assertion of fact. Moreover, the accountant should remind Dr. A of his exposure to penalty provided under the IRO if the tax plan fails eventually.





MD - June 2013 (Case)



As the business of Rhonda HK was in its infancy stage, Rhonda CA has assigned its Chief Operating Officer, Mr. Stephen Smart, to monitor the business of Rhonda HK since April 2009. Mr. Smart is a Canadian and has been employed by Rhonda CA for more than two decades. During the three years ended 31 March 2010, 2011 and 2012, Mr. Smart spent 55, 118 and 196 days respectively in Hong Kong to discharge his duties. Under the instruction and arrangement of Rhonda CA, Mr. Smart is required to report on his duties directly and exclusively to the board of directors of Rhonda CA. His remuneration would continue to be paid by Rhonda CA into his personal bank account in Toronto. There would not be any new employment contract entered into between Mr. Smart and Rhonda HK. In addition, none of the salary costs of Mr. Smart would be recharged to Rhonda HK by Rhonda CA.

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MD - June 2013 (Case)



Mr. Smart has been married to Rachel, a madam professor of the University of Toronto in Canada, for more than 10 years. Their child was born in 2008. Smart's family, including his mother who is aged 70, is living in Toronto. Mr. Smart has not fully informed the Inland Revenue Department ("IRD") about his services performed in Hong Kong, and he has not received any tax return for himself from the IRD hitherto.

MD - June 2013 (Case)



In a recent investment portfolio review exercise, Mr. Smart noted that the majority of the business activities of Rhonda HK was short-term trading of varieties of locally listed shares for profit, except that a substantial quantum of ASG Corp. shares was specifically acquired and held by the company for long-term investment purpose. Shares of ASG Corp. are also listed on the Hong Kong Stock Exchange. Rhonda HK has held the shares of ASG Corp. for more than one year, and has separately classified the shares as long-term investment assets in its latest audited financial statements unlike other shares held for short-term trading purpose. It was also noted that the market price of ASG Corp. shares has increased by more than 60% since the acquisition by Rhonda HK.

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MD - June 2013 (Case)



Based on a suggestion made by Mr. Smart, Rhonda CA asked Rhonda HK to consider disposing of the shares of ASG Corp. in order to realise the gain attributable to the appreciation of the share price. Rhonda CA also suggested Rhonda HK to develop regional timber distribution business by sourcing timber from Rhonda CA for selling to customers in Asia-pacific countries directly. Rhonda CA specifically requested Rhonda HK to formulate the distribution business strategically in the way that the respective profits derived by Rhonda HK will be offshore in nature and will not be subject to Hong Kong profits tax.

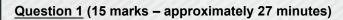
MD – June 2013 (Case)



After various discussions, a draft operational model has been formulated for implementing the regional timber distribution business. Rhonda HK has also decided to appoint Robert Tang & Co., a reputable local tax consulting firm, to prepare an advance ruling application to the IRD for the proposed timber distribution business on its Hong Kong profits tax implication.

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MD – June 2013 (Case)



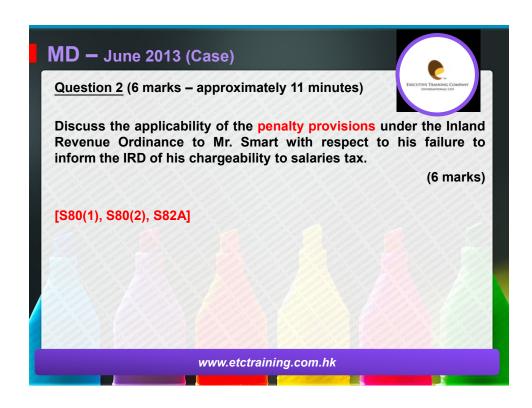


 a) Discuss the salaries tax implications for Mr. Smart with respect to his services performed in Hong Kong for the relevant years.
 [HK Salaries Tax - HK employment v. Non-HK employment -DIPN 10]

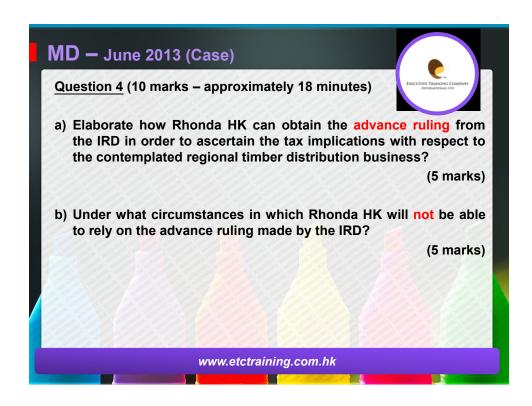
(12 marks)

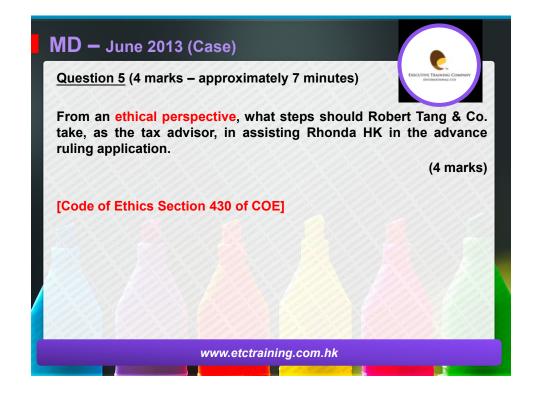
b) On the basis that the income of Mr. Smart is assessable to salaries tax, discuss if he is entitled to claim the respective personal allowances. [Consider any residency requirement]

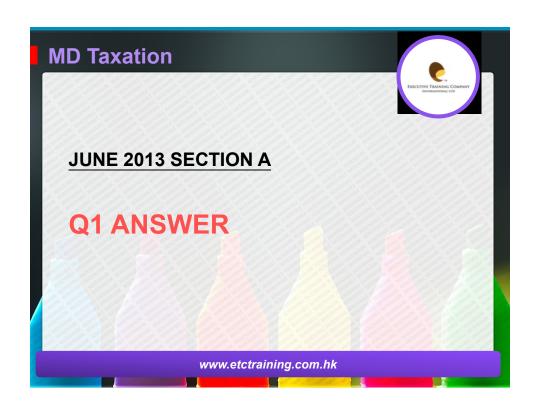
(3 marks)

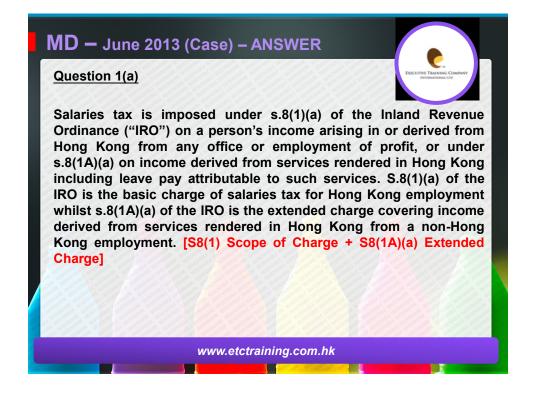












Question 1(a) (Cont'd)



In determining the situs of employment, the Inland Revenue Department ('IRD") issued the Departmental Interpretation & Practice Notes No. 10 Revised June 2007 ("DIPN 10 June 2007") elaborating that the major factors are (a) contract of employment, (b) residence of the employer, and (c) place of payment of remuneration. In this regard, the salaries tax exposures of Mr. Smart could be analysed as follows:

[Use DIPN 10 Goephert Case]

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MD - June 2013 (Case) - ANSWER

Question 1(a) (Cont'd)



a) Contract of employment

This refers to the place where the employment contract is negotiated, concluded and enforceable. Based on the information provided, Mr. Smart entered into his employment contract with Rhonda CA in Canada and has not been seconded to Rhonda HK with any new employment contract. This indicates that the employment contract of Mr. Smart was negotiated, concluded and enforceable outside Hong Kong.

[Most important : the residence of the employer]

Question 1(a) (Cont'd)



b) The residence of the employer

This refers to the place of central management and control of the employer. As Mr. Smart has been at all relevant times employed by Rhonda CA and it is a company managed and controlled in Canada, this indicates that the residency of the employer for Mr. Smart was also outside Hong Kong.

c) The place where the employee's remuneration is paid

The remuneration of Mr. Smart has been paid in Canada both before and after Mr. Smart rendered his services in Hong Kong. There has been no change of the payment arrangement.

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MD - June 2013 (Case) - ANSWER

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Question 1(a) (Cont'd)

Based on the abovesaid analysis, the employment of Mr. Smart with Rhonda CA should be offshore source in nature, and accordingly only the income derived from services rendered in Hong Kong including leave pay attributable to such services should be subject to salaries tax under s.8(1A)(a) of the IRO, subject to s.8(1B) of the IRO.

[Non-Hong Kong Employment – time basis]

Question 1(a) (Cont'd)



The income earned by Mr. Smart during the year ended 31 March 2010 should be exempt from the charge of salaries tax as he visited Hong Kong in that year for less than 60 days (s.8(1B) of the IRO). For the two years ended 31 March 2011 and 31 March 2012, Mr. Smart visited Hong Kong for more than 60 days each year and accordingly his income earned during those two years should be assessable to salaries tax by apportioning the total income usually on a time-in time-out basis. [Apply 60 days rule first]

This is apportioning Mr. Smart's remuneration including leave pay in a year based on the total number of days he spent in Hong Kong in that year over the total number of days of the year (DIPN 10 June 2007 paragraphs 25 & 29). [Apportionment Basis]

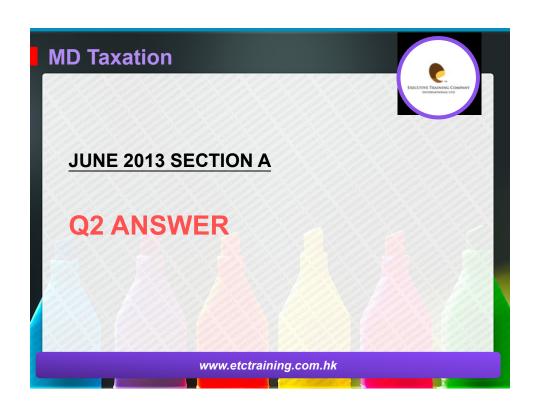
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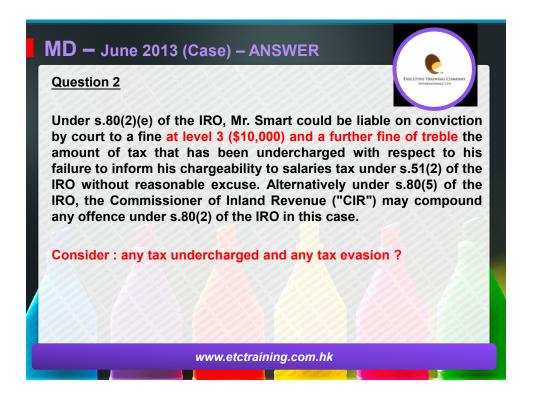
MD - June 2013 (Case) - ANSWER

Question 1(b)



Mr. Smart is entitled to claim the whole amount of married person's allowance in the relevant years under s.29 of the IRO, as he is married and his spouse did not have any assessable income. There is no residency requirement for his spouse for the purposes of claiming married person's allowance. Likewise, Mr. Smart is also entitled to claim the whole amount of child allowance for his son, as the conditions stipulated in s.31(1) of the IRO were satisfied based on the information provided, and there is also no residency requirement for his child for Mr. Smart to claim child allowance. However, Mr. Smart could not claim dependent parent allowance under s.30 of the IRO as, during the three-year period, his mother was not ordinarily resident in Hong Kong under s.30(1)(b)(i) of the IRO.





Question 2 (Cont'd)



If it appears that Mr. Smart had willfully intended to evade tax by giving false answers to any questions or requests for information asked or made leading to the failure of informing chargeability to salaries tax, he could be prosecuted in court under s.82(1)(e) of the IRO. The penalty would be a fine at level 3 (\$10,000), a further fine of three times the amount of tax undercharged and imprisonment for six months under summary conviction, or a penalty at level 5 (\$50,000), a further fine of three times the amount of tax undercharged and imprisonment for three years on indictment.

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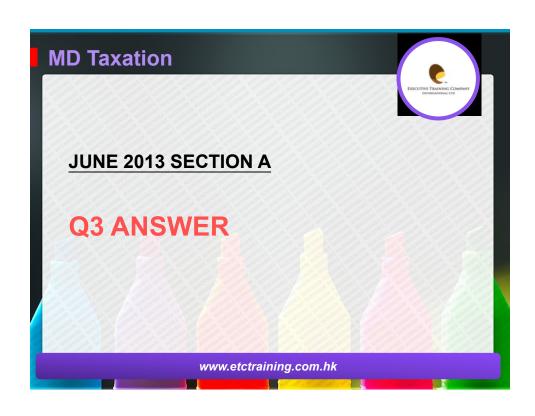
MD - June 2013 (Case) - ANSWER

Question 2 (Cont'd)

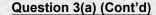


If no prosecution under s.80(2) or 82(1) of the IRO has been instituted to him, the CIR could impose a penalty under s.82A(1)(e) of the IRO on Mr. Smart by way of an additional tax of an amount not exceeding treble the amount of tax which has been or would have been undercharged in consequence of the failure to comply with s.51(2) of the IRO.

Consider the difference between s.80 Vs s. 82A









1) Subject matter of the realisation

Listed shares could be held for short-term trading purposes or for long-term investment purposes, as the shares in themselves were neutral in nature. However, it appears that Rhonda HK constantly conducted share trading business and treated those shares as trading stocks. In this regard, this would be unfavourable for Rhonda HK to argue that it held the ASG Corp. shares for long-term investment purposes.

Nature of business of the tax client

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Question 3(a) (Cont'd)

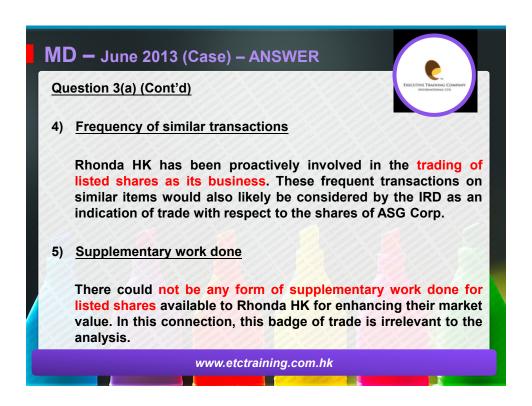


2) Motive

The motive of holding ASG Corp. shares by Rhonda HK was implicit and could not be verified by any direct evidence. However, the classification of the shares as long-term fixed assets in its financial statements and other evidence could provide a positive indication to substantiate the long-term investment intention.

[Any profit motive?]

MD — June 2013 (Case) — ANSWER Question 3(a) (Cont'd) 3) Length of ownership Rhonda HK has held the ASG Corp. shares for only about more than a year. The ownership period was relatively short and could likely be challenged by the IRD as an indication of trade.



MD - June 2013 (Case) - ANSWER

Question 3(a) (Cont'd)



6) Circumstances responsible for the realisation

It appears that the proposed disposal of ASG Corp. shares was to capture the gain from the appreciation in the share value. This reason would likely be challenged by the IRD as synonymous with trading of shares for profit purposes, and thereby constituted an indication of trade.

The above analysis reveals that the proposed disposal of ASG Corp. shares by Rhonda HK could likely be challenged by the IRD as a trading transaction and thereby the IRD would seek to assess profits tax on the gain derived from the disposal.

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MD - June 2013 (Case) - ANSWER

Question 3(b)



Additional information / documents for further evaluation could be obtained under the following categories:-

Subject matter of the realisation

- Feasibility study or investment plan for holding the shares of ASG Corp. as long-term investment, if any
- Information differentiating ASG Corp. shares from other listed shares to be held for long-term investment intention, if any

MD - June 2013 (Case) - ANSWER

Question 3(b) (Cont'd)



Motive

- Memorandum & Articles of Association of Rhonda HK indicating the business strategy of holding assets
- Circumstances leading to the acquisition of ASG Corp. shares
- Board minutes of Rhonda HK for the acquisition of the ASG Corp. shares

Length of Ownership

 Information of circulation velocity of other shares held for trading purposes

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MD - June 2013 (Case) - ANSWER

Question 3(b) (Cont'd)

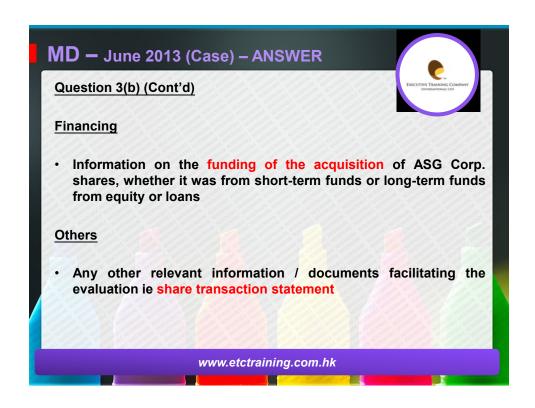


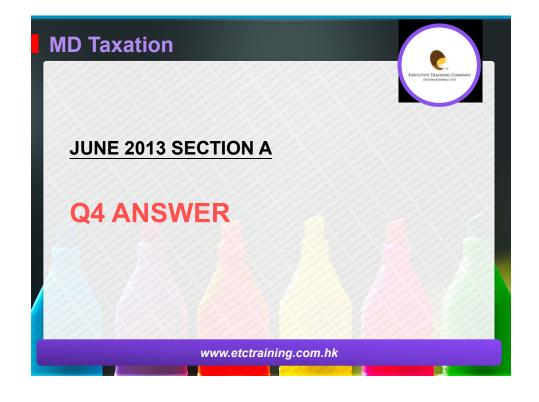
Frequency of trading transactions on ASG Corp. shares

 Information on whether Rhonda HK had previous trading transactions of ASG Corp. shares for short-term profit purposes

Circumstances leading to disposal

- Information on whether Rhonda HK would acquire other listed shares for long-term investment purposes after the disposal
- The plan on the application of sales proceeds derived from the disposal





MD - June 2013 (Case) - ANSWER Question 4(a) Under s.88A of the IRO, Rhonda HK can apply

Under s.88A of the IRO, Rhonda HK can apply for an advance ruling from the IRD on the contemplated regional timber distribution business in order to ascertain the tax exposures of the gain derived from the abovesaid distribution business.

Purpose of advance ruling

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MD - June 2013 (Case) - ANSWER

Question 4(a) (Cont'd)



Rhonda HK should submit all relevant information to the IRD about the proposed regional timber distribution business (information as per paragraphs 19 & 20 and Appendix I of Departmental Interpretation and Practice Note No. 31 Revised November 2011("DIPN 31 November 2011") issued by the IRD). On the basis that there is no decline or refusal to make a ruling by the IRD under s.2 & s.3 of Part I of Schedule 10 of the IRO, a ruling will be made by the CIR on how the relevant provision of the IRO could apply to the proposed distribution business described in the application, and the CIR shall apply the provision in accordance with the ruling provided that Rhonda HK implements the distribution business in the way stated in the ruling.

MD - June 2013 (Case) - ANSWER

Question 4(b)



The ruling is applicable to Rhonda HK only for the period stated by the IRD. In addition, s.7 of Part 1 of Schedule 10 of the IRO states that a ruling shall not apply in relation to an arrangement if (i) the arrangement is materially different from that identified in the ruling (ii) there was a material omission or misrepresentation in the ruling application, and (iii) any assumption of the CIR on a future event or other matters stated in the ruling is incorrect (paragraph 46 of DIPN 31 November 2011).

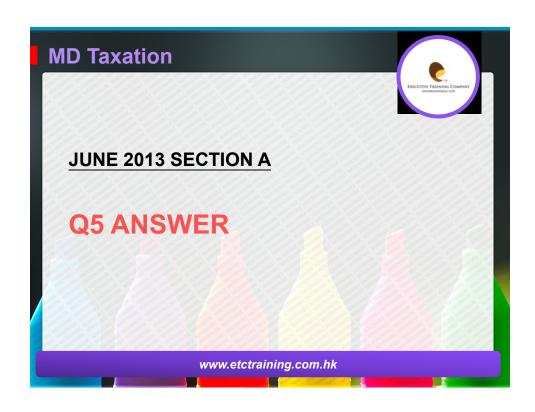
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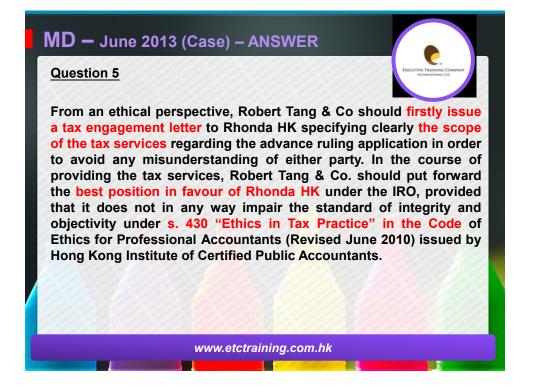
MD - June 2013 (Case) - ANSWER

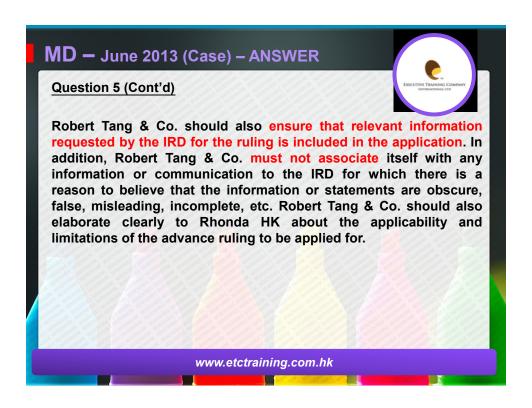
Question 4(b) (Cont'd)



Under s.13 of Part 1 of Schedule 10 of the IRO, the CIR may at anytime withdraw a ruling by notifying the respective applicant in writing with the reasons therefor. The ruling may also be affected if the relevant provision of the IRO applicable to the ruling is repealed or amended during the ruling applicable period (s.16 of Part 1 of Schedule 10 of the IRO). In addition, the ruling may also be affected if the interpretation of law, on which a ruling is based, is changed by the IRD as a result of a court decision (paragraph 52 of DIPN 31 November 2011).









Overall view of Hot Topics in MD

Profits Tax

- · S14(1) Profits tax scope of charge
- Source concept (Locality of profits) DIPN 21 (Revised)
- · Operation test Hang Seng Bank Case, TVBI Case
- Trade: Capital gain on disposal Badges of trade [Marson Vs Morton]
- Capital/revenue items S14(1)
- Doing business in Hong Kong Permanent Establishment Branch or Agent – IRR 5(1)
- Deemed trading receipts royalty S15(1)(a),(b)(ba), S21A, S20A,
 20B, Emerson Case, Lam Soon Trademark Case, DIPN 49
- Interest income DIPN 13 and DIPN 34 S15(1)(f) [Provision of credit test] and Interest Income Exemption Order
- Deductible expenses S16(1)
- Interest Expenses S16(2), S16(2A)-(2C)

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Overall view of Hot Topics in MD

Profits Tax

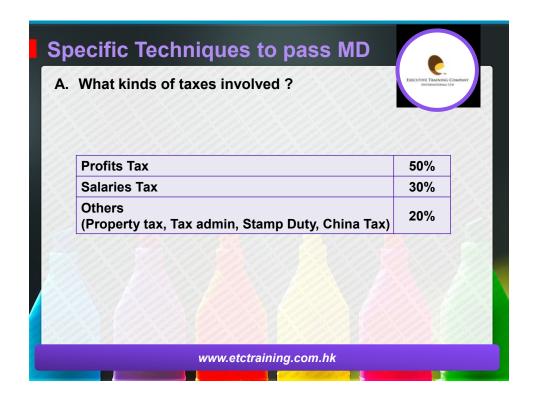
- Interest on Redevelopment Costs Wharf Properties and Secan Case
- Interest to Non-financial institution and related to debentures \$16(2)(c), \$16(2)(f), \$16(2C)
- IBA & CBA S40(1), Balancing adjustments
- Deduction of R & D expenses S16B
- Deduction of patent S16E [DIPN 49]
- Building Refurbishment Expenses S16F
- Prescribed Fixed Assets S16G
- Environment protection machinery / Installation S16H-J
- · Leased assets S39E
- Exchange differences and financial instruments DIPN 42 [Secan Case]
- Off-shore Funds DIPN 43, S20AB, S20AC, S20 AE
- S20 Transfer Pricing, S61 and S61A General anti-avoidance provisions , S61B Profits tax computation
- DTA DIPN 44 Article 5 and 14



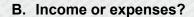
Salaries Tax Salaries Tax – scope of charge – S8(1), DIPN 10, Goepfert Case Exemption – S8(1A)(b), S8(1B), S8(1A)(c) Rental arrangements Share Options and Awards – S9(1)(d) DIPN 38 Salaries Tax computation – personal allowances, home loan interest Personal assessment ie benefits www.etctraining.com.hk







Specific Techniques to pass MD





Profits Tax income

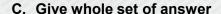
- S14(1) Charging section
- DIPN 21 (Revised)
- · Operation test [Hang Seng Bank Case, TVBI case]
- S15 (Deeming Provisions) Royalties

Profits tax expenses

 Always give General Deduction Rule S16(1) first + Specific Deduction Rules if applicable

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Specific Techniques to pass MD





For example: Royalties income

- Scope of Charge S15(1)(b) or S15(1)(ba)
- Tax adjustments S21A 30% or 100%
- Tax administration S20A or S20B
- Emerson Case
- Effect of DIPN 49

Specific Techniques to pass MD

D. Count marks



5 marks question: around 7 points

E. Tax computation

3 out of 10 for calculation 7 out of 10 for explanation

- Remember to use cross referencing
- Explanations are the most important

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Final Techniques to pass MD

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A. Consideration of commencement of business and termination of business

- B. Always consider capital or revenue capital gain S14(1) not taxable Capital expenditure S17(1)(c)
- C. Disposal of properties or shares tax implication and stamp duty implication always consider profits tax and stamp duty
 - · Profits tax: Badges of Trade
 - Stamp Duty: Heads
- D. Watch out for most updated cases (subject to 6-month rule)

Common Techniques to pass MD

- A. Prepare your critical files
- B. Only need 1 set of notes
- C. Time yourself
- D. Start practise writing
- E. Don't just copy use key words for application
- F. Demonstrate logical thinking sometimes no right or wrong
- G. No need to highlight everything in the question booklet
- H. Writing legible to read

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MD Preparation with ETC

Knowledge Course: 10 Sessions

→ Boost your knowledge



→ Practise past papers and other ETC questions

Only got 1 month left – What shall you do?

- Do past papers with updated answers
- - **Practise writing out:** Progress test + Exam Pack (2 additional tests) + Final Mock
- 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