



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



Examination Technique Seminar (Case)
for
Module D on Taxation

Speaker
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EXECUTIVE TRAINING COMPANY (INTERNATIONAL) LTD



About the Lecturer



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*PhD, ACA(UK), FCCA, FAIA,
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- ❖ Practising partner of a medium size firm
- ❖ Practical experience in auditing, tax, corporate governance and risk management
- ❖ Passed QP exams and other exams ie ACCA, AIA, PC all in one go
- ❖ Professional training 10 years ago and commenced teaching MC & MD for many years
- ❖ Taught over 5000 students

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Examination Technique Seminar on Section A (Case)

- December 2012 and June 2013

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Past Paper Review

DECEMBER 2012 SECTION A

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MD – December 2012 (Case)



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]**

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MD – December 2012 (Case)



(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 ?**]

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MD – December 2012 (Case)



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.

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MD – December 2012 (Case)



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)

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MD – December 2012 (Case)



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 whether and, if so, how the following instruments are chargeable **with special stamp duty**:

- 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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MD – December 2012 (Case)



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)

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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)

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MD Taxation



DECEMBER 2012 SECTION A

Q1 ANSWER

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MD – December 2012 (Case) – ANSWER



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



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.

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MD – December 2012 (Case) – ANSWER



Question 1(b)

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

- 1) 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



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.

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DECEMBER 2012 SECTION A

Q2 ANSWER

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MD – December 2012 (Case) – ANSWER



Question 2(a)

The medical expenses are **not deductible** because of the following:

- 1) They were incurred by Dr. A for the benefit of his health. Plainly, they are of a **private nature** and are prohibited from deduction under s.17(1)(a) of the IRO.
- 2) Although the expenses could also enable Dr. A to continue to carry on his business, there is no sensible way of **apportioning them between private and business purposes**.

Relevant authority: *Fahy v CIR* (1992) 3 HKTC 695

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MD – December 2012 (Case) – ANSWER



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



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.

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MD – December 2012 (Case) – ANSWER



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 $\text{HK\$}300,000 \times 1/5 = \text{HK\$}60,000$.

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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MD – December 2012 (Case) – ANSWER



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: $\text{HK\$}500,000 \times 4\% = \text{HK\$}20,000$

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DECEMBER 2012 SECTION A

Q3 ANSWER

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MD – December 2012 (Case) – ANSWER



Question 3

Home loan interest deduction is allowable to a person who has paid interest on a mortgage loan obtained to purchase a residential property if, among others,

- 1) the person who claims the deduction is the **owner of the property; and**
- 2) the property is used by the person as **his place of residence.**

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MD – December 2012 (Case) – ANSWER



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. **HK\$10,000 x 5 months x 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.

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MD – December 2012 (Case) – ANSWER



Question 3 (Cont'd)

To sum up, the amount of home loan interest deduction to which Dr. A is entitled should be computed as follows:

His **share of deduction (HK\$25,000)** + The share of deduction nominated by Mrs. A (HK\$25,000) = HK\$50,000

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MD Taxation



DECEMBER 2012 SECTION A

Q4 ANSWER

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MD – December 2012 (Case) – ANSWER



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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MD – December 2012 (Case) – ANSWER



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.

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DECEMBER 2012 SECTION A

Q5 ANSWER

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MD – December 2012 (Case) – ANSWER



Question 5(a)

Dr. A can be granted child allowance in respect of his son because:

- 1) **the son is under the age of 18; and**
- 2) he has **maintained the son** by supporting his living expenses in the US.

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MD – December 2012 (Case) – ANSWER



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. ...

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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:

- 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.**

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MD – December 2012 (Case) – ANSWER



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.

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MD Taxation



Past Paper Review

JUNE 2013 SECTION A

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MD – June 2013 (Case)



Rhonda (HK) Limited (“Rhonda HK”) was established in Hong Kong in early 2009 and has been engaged in investment holding and securities trading business. It is a wholly owned subsidiary of Rhonda (Canada) Limited (“Rhonda CA”), a private investment holding and timber trading company incorporated in Canada with subsidiaries across different continents.

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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.

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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.

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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)



Question 1 (15 marks – approximately 27 minutes)

- 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)

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MD – June 2013 (Case)



Question 2 (6 marks – approximately 11 minutes)

Discuss the applicability of the **penalty provisions** under the Inland Revenue Ordinance to Mr. Smart with respect to his failure to inform the IRD of his chargeability to salaries tax.

(6 marks)

[S80(1), S80(2), S82A]

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MD – June 2013 (Case)



Question 3 (15 marks – approximately 27 minutes)

a) Based on the information provided, determine whether the gain from the proposed disposal of ASG Corp. shares is capital or revenue in nature.

(9 marks)

[Trade – Badges of Trade]

b) What **additional documents or information** should be obtained to further evaluate whether the **proposed disposal** of ASG Corp. shares is capital or revenue in nature?

(5 marks)

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MD – June 2013 (Case)



Question 4 (10 marks – approximately 18 minutes)

a) Elaborate how Rhonda HK can obtain the **advance ruling** from the IRD in order to ascertain the tax implications with respect to the contemplated regional timber distribution business?

(5 marks)

b) Under what circumstances in which Rhonda HK will **not** be able to rely on the advance ruling made by the IRD?

(5 marks)

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MD – June 2013 (Case)



Question 5 (4 marks – approximately 7 minutes)

From an **ethical perspective**, what steps should Robert Tang & Co. take, as the tax advisor, in assisting Rhonda HK in the advance ruling application.

(4 marks)

[Code of Ethics Section 430 of COE]

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JUNE 2013 SECTION A

Q1 ANSWER

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MD – June 2013 (Case) – ANSWER



Question 1(a)

Salaries tax is imposed under s.8(1)(a) of the Inland Revenue Ordinance (“IRO”) on a person’s income arising in or derived from Hong Kong from any office or employment of profit, or under s.8(1A)(a) on income derived from services rendered in Hong Kong including leave pay attributable to such services. S.8(1)(a) of the IRO is the basic charge of salaries tax for Hong Kong employment whilst s.8(1A)(a) of the IRO is the extended charge covering income derived from services rendered in Hong Kong from a non-Hong Kong employment. **[S8(1) Scope of Charge + S8(1A)(a) Extended Charge]**

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MD – June 2013 (Case) – ANSWER



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 Goepfert 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]

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MD – June 2013 (Case) – ANSWER



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



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]

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MD – June 2013 (Case) – ANSWER



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.

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MD Taxation



JUNE 2013 SECTION A

Q2 ANSWER

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MD – June 2013 (Case) – ANSWER



Question 2

Under s.80(2)(e) of the IRO, Mr. Smart could be liable on conviction by court to a fine **at level 3 (\$10,000) and a further fine of treble** the amount of tax that has been undercharged with respect to his failure to inform his chargeability to salaries tax under s.51(2) of the IRO without reasonable excuse. Alternatively under s.80(5) of the IRO, the Commissioner of Inland Revenue ("CIR") may compound any offence under s.80(2) of the IRO in this case.

Consider : any tax undercharged and any tax evasion ?

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MD – June 2013 (Case) – ANSWER



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

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JUNE 2013 SECTION A

Q3 ANSWER

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MD – June 2013 (Case) – ANSWER



Question 3(a)

Under **s.14(1)** of the IRO, profits tax shall be charged on every person carrying on a trade, profession or business in Hong Kong. In order to evaluate whether the acquisition and proposed disposal of the shares of ASG Corp. by Rhonda HK constituted a trade, analysis could be made in line with the so-called six badges of trade as follows:-

[Consider the charging section + use six badges of trade [*Marson v. Morton* case]

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MD – June 2013 (Case) – ANSWER



Question 3(a) (Cont'd)

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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MD – June 2013 (Case) – ANSWER



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?]

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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.

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MD – June 2013 (Case) – ANSWER



Question 3(a) (Cont'd)

4) Frequency of similar transactions

Rhonda HK has been proactively involved in the **trading of listed shares as its business**. These frequent transactions on similar items would also likely be considered by the IRD as an indication of trade with respect to the shares of ASG Corp.

5) Supplementary work done

There could **not be any form of supplementary work done for listed shares** available to Rhonda HK for enhancing their market value. In this connection, this badge of trade is irrelevant to the analysis.

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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

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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

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MD – June 2013 (Case) – ANSWER



Question 3(b) (Cont'd)

Financing

- Information on the **funding of the acquisition** of ASG Corp. shares, whether it was from short-term funds or long-term funds from equity or loans

Others

- Any other relevant information / documents facilitating the evaluation ie **share transaction statement**

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MD Taxation



JUNE 2013 SECTION A

Q4 ANSWER

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MD – June 2013 (Case) – ANSWER



Question 4(a)

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.

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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).

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JUNE 2013 SECTION A

Q5 ANSWER

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MD – June 2013 (Case) – ANSWER



Question 5

From an ethical perspective, Robert Tang & Co should **firstly issue a tax engagement letter** to Rhonda HK specifying clearly **the scope of the tax services** regarding the advance ruling application in order to avoid any misunderstanding of either party. In the course of providing the tax services, Robert Tang & Co. should put forward the **best position in favour of Rhonda HK** under the IRO, provided that it does not in any way impair the standard of integrity and objectivity under **s. 430 “Ethics in Tax Practice” in the Code** of Ethics for Professional Accountants (Revised June 2010) issued by Hong Kong Institute of Certified Public Accountants.

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MD – June 2013 (Case) – ANSWER



Question 5 (Cont'd)

Robert Tang & Co. should also **ensure that relevant information requested by the IRD for the ruling is included in the application**. In addition, Robert Tang & Co. **must not associate** itself with any information or communication to the IRD for which there is a reason to believe that the information or statements are obscure, false, misleading, incomplete, etc. Robert Tang & Co. should also elaborate clearly to Rhonda HK about the applicability and limitations of the advance ruling to be applied for.

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Other Hot Topics in MD

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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 – S16(2)(c), S16(2)(f), S16(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

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Overall view of Hot Topics in MD



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

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Overall view of Hot Topics in MD



Tax Administration

- Reporting obligations S51 and S52
- Holdover of provisional tax
- Objection and S70A Error and omission claim
- Basis Period
- DIPN 45-48 (only briefly)

Stamp Duty

- Scope of Charge – Head 1 and 2
- Group Relief – S45
- S27(4) and S27(5)
- SSD + BSD

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Exam Techniques for MD

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Specific Techniques to pass MD



A. What kinds of taxes involved ?

Profits Tax	50%
Salaries Tax	30%
Others (Property tax, Tax admin, Stamp Duty, China Tax)	20%

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Specific Techniques to pass MD



B. Income or expenses?

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



C. Give whole set of answer

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

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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



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)

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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

Revision Course: 9 Sessions

→ 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

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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

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