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# Examination Techniques Seminar on QP Module Examinations

## Module D (December 2016 Session)

**Date: 8 November 2016**





# Agenda

- 1 • Introduction
- 2 • Common Weaknesses
- 3 • Sharing with Markers
- 4 • Preparation for Examinations
- 5 • Q & A Session



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# Part 1: Introduction





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



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# HKICPA QP Module Examinations

## Examination Format:

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



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# Part 2: Common Weaknesses





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# Major causes to examination failure





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## **Aspect 1:** **Questions**

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



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## **Aspect 2:**

### **Answers**

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



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## **Aspect 3:**

# **Candidates**

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

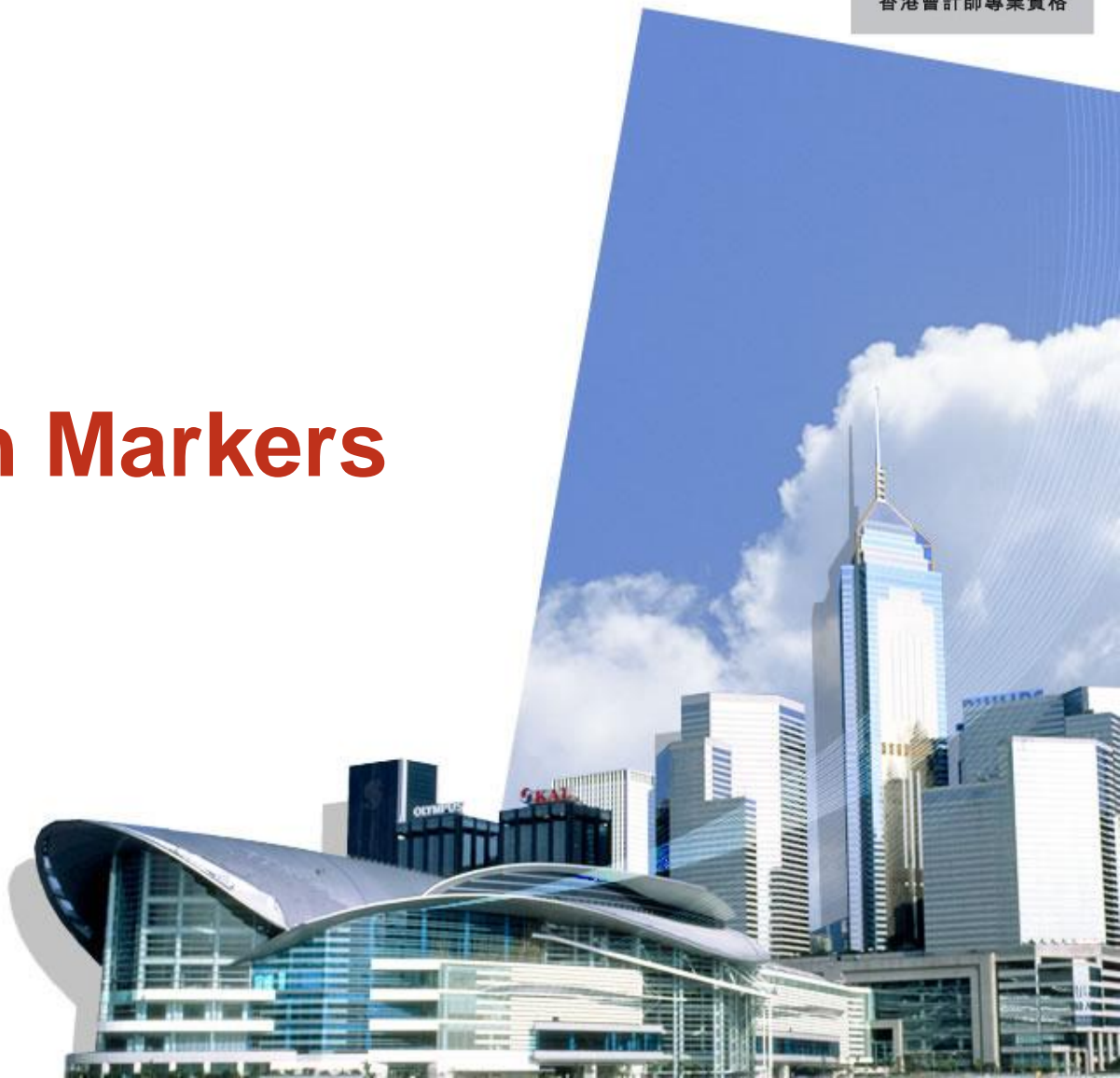


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# Part 3: Sharing with Markers





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## Key points recapped

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



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# Section A – Case Questions



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## Case background

Jubilee Or & Sons Limited ("JOS") is a consulting firm established in Hong Kong which has been carrying on tax advisory services for decades. Recently, JOS has been approached by a potential client namely Anomalistic Limited ("Co. A") requesting the following tax services:

➤ Q5



## Case background

### A. Preparation of profits tax computation for Co. A

Co. A is a Hong Kong company which has been carrying on a financial advisory business in Hong Kong for years. For the accounting year ended 30 June 2015, Co. A showed a profit before taxation of HK\$7,239,000 after crediting and charging, inter alia, the following items of income and expenditure:

	HK\$
(i) Income:	
- Compensation for early termination of a business contract by a customer	152,500
- Share of profits from an associated company	350,000
- Exchange gain from daily business related payable balance	28,300
- Interest income from loans advanced to employees	8,100
- Interest income from unpledged deposit placed with a local	1,300
- Interest income from long outstanding business related receivable balance due from overseas customers	6,800
- General bad debt provision written back	191,200
- Deposit forfeited by customers due to cancellation of service engagement	100,000

➤ Q1





## Case background

	HK\$
(ii) Expenditure:	
- Interest expense on overdue account payable to an unrelated overseas hardware supplier regarding the purchase of a computer system in prior year	2,600
- Interest expense on a bank loan from HSBC guaranteed by Co. A's director personally (the loan was exclusively used for Co. A's daily business activities)	88,000
- Interest expense on an unsecured bank loan from Standard Chartered Bank (the loan was exclusively used for the acquisition of certain listed shares for long term investment purposes)	79,500
- Special contribution to Co. A's recognised occupational retirement scheme covering previous investment loss	185,000
- Annual contribution to Co. A's recognised occupational retirement scheme (17% of each employee's annual remunerations)	680,000
- Refurbishment expense for a residential property currently used by Co. A's director as quarters	280,000
- Refurbishment expense for a commercial property currently used by Co. A as office premises	700,000
- Tax payment (salaries tax of Co. A's director)	275,000
- Accounting depreciation	163,500

➤ Q1



## Case background

HK\$

(iii) Co. A also provided information on fixed assets movement and other tax information as follows:

- Addition of office furniture	99,500
- Addition of computer equipment	88,800
- Addition of a motor vehicle	238,800
- Tax written down value for 20% pool brought forward	89,300
- Tax written down value for 30% pool brought forward	111,700
- Qualifying expenditure claiming for commercial building allowance brought forward (all expenditure referred to office premises and director's quarters' decoration incurred in prior years. Such properties were all demolished during the year due to refurbishment as per item (ii) above)	400,000
- Tax written down value brought forward attributable to qualifying expenditure claiming for commercial building allowance as per above	304,000

➤ Q1



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## Case background

### **B. Advice on profits tax implications of new business activities**

For the utilisation of excess funds generated from its existing operations and for the exploration of new overseas customers, Co. A has envisaged the development of two potential business activities:

#### **(i) Money lending activities**

Excess funds generated by Co. A from its existing operations would be loaned to selective borrowers. Specifically, Co. A prefers lending its funds to overseas borrowers as it is understood that interest income derived from loans advanced to overseas borrowers is not subject to profits tax.

➤ Q2

#### **(ii) Listing advisory services to overseas customers**

Co. A would regularly assign its executives to travel overseas to meet with potential customers interested in listing their shares in the Hong Kong stock market. In this connection, staff of Co. A with listing knowledge and experience would conduct a due diligence review on the spot with respect to the overseas customers, and would prepare a comprehensive feasibility study report on the eligibility of the target customers for listing their shares in the Hong Kong stock market. Co. A expects that the abovesaid due diligence work performed by their staff shall be substantially conducted outside Hong Kong.



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## Case background

### C. Salaries tax planning in providing fringe benefits to senior executives

In a recent senior executives performance evaluation and remuneration review exercise, Co. A has been requested to revise and upgrade its remuneration package for senior executives by providing additional tax free benefits-in-kind on top of the existing rental reimbursement arrangement. Specifically, some senior executives suggested that if the additional benefits-in-kind available to them are directly provided by Co. A and cannot be converted into cash, the senior executives receiving such benefits-in-kind would not be subject to salaries tax.

➤ Q3



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## Case background

### D. Stamp duty exposure evaluation on assets realignment exercise

Mr Thomas Ng ("Mr Ng") is the sole shareholder and director of Co. A. In addition to the financial advisory business currently conducted through Co. A, Mr Ng has also invested in immovable properties in Hong Kong. Presently, Mr Ng is also the sole shareholder and director of a Hong Kong company namely Cognitive Limited ("Co. C"). Co. C has held two immovable properties ("Property X" and "Property Y") in Hong Kong for more than a decade. Property X (market value of HK\$35 million as at today) is a commercial property and has been constantly used by Co. A as office premises free of charge. Property Y (market value of HK\$10 million as at today) is a residential property currently being leased out for generating rental income. In addition, Mr Ng also personally acquired a residential property ("Property Z", with market value of HK\$16 million as at today) in year 2009 as a dwelling with his wife and children.

➤ Q4



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## Case background

Recently, Mr Ng considered to conduct an assets realignment exercise by implementing the following transfers:

- (i) Property X will be conveyed from Co. C to Co. A at the current market value.
- (ii) Upon completion of transaction (i) above, Co. C will be put into liquidation by distribution in specie in transferring Property Y to Mr Ng.
- (iii) Property Z will be transferred from Mr Ng to both his wife (a Hong Kong permanent resident) and his mother (a non-Hong Kong permanent resident) by way of a gift.

➤ Q4



## **June 2016 Session – Sect A - Q1** **(15 marks – approximately 27 minutes)**

**With respect to Co. A for the year of assessment 2015/16, compute:**

- (a) The total amounts of taxable and non-taxable income respectively as per Part A(i) of the case. (4 marks)
- (b) The total amounts of deductible and non-deductible expenses respectively as per Part A(ii) of the case. (6 marks)
- (c) The total amount of allowances for deduction under Part 6 of the Inland Revenue Ordinance ("the IRO") as per Part A(iii) of the case. (3 marks)
- (d) The profits tax liabilities as per Part A of the case.  
*Note: Ignore provisional profits tax and reduction of tax, if any, for the year.* (2 marks)



## Case background

### A. Preparation of profits tax computation for Co. A

Co. A is a Hong Kong company which has been carrying on a financial advisory business in Hong Kong for years. For the accounting year ended 30 June 2015, Co. A showed a profit before taxation of HK\$7,239,000 after crediting and charging, inter alia, the following items of income and expenditure:

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(i) Income:	
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- Interest income from loans advanced to employees	8,100
- Interest income from unpledged deposit placed with a local	1,300
- Interest income from long outstanding business related receivable balance due from overseas customers	6,800
- General bad debt provision written back	191,200
- Deposit forfeited by customers due to cancellation of service engagement	100,000

➤ Q1





## Case background

	HK\$
(ii) Expenditure:	
- Interest expense on overdue account payable to an unrelated overseas hardware supplier regarding the purchase of a computer system in prior year	2,600
- Interest expense on a bank loan from HSBC guaranteed by Co. A's director personally (the loan was exclusively used for Co. A's daily business activities)	88,000
- Interest expense on an unsecured bank loan from Standard Chartered Bank (the loan was exclusively used for the acquisition of certain listed shares for long term investment purposes)	79,500
- Special contribution to Co. A's recognised occupational retirement scheme covering previous investment loss	185,000
- Annual contribution to Co. A's recognised occupational retirement scheme (17% of each employee's annual remunerations)	680,000
- Refurbishment expense for a residential property currently used by Co. A's director as quarters	280,000
- Refurbishment expense for a commercial property currently used by Co. A as office premises	700,000
- Tax payment (salaries tax of Co. A's director)	275,000
- Accounting depreciation	163,500

➤ Q1



## Case background

HK\$

(iii) Co. A also provided information on fixed assets movement and other tax information as follows:

- Addition of office furniture	99,500
- Addition of computer equipment	88,800
- Addition of a motor vehicle	238,800
- Tax written down value for 20% pool brought forward	89,300
- Tax written down value for 30% pool brought forward	111,700
- Qualifying expenditure claiming for commercial building allowance brought forward (all expenditure referred to office premises and director's quarters' decoration incurred in prior years. Such properties were all demolished during the year due to refurbishment as per item (ii) above)	400,000
- Tax written down value brought forward attributable to qualifying expenditure claiming for commercial building allowance as per above	304,000

➤ Q1



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## Question 1a



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## Problem

- Provide a pure qualitative analysis.  
(No computation, explanation only)
- Unable to handle tax treatment of interest income.



## Answer 1a

### Analysis of income

### Taxable

### Non-taxable

HK\$

HK\$

Compensation for early termination of a business contract	152,500	-
Share of profits from an associated company	-	350,000
Exchange gain	28,300	-
Interest income from loans advanced to employees	8,100	-
Interest income from unpledged deposit placed with a local bank	-	1,300
Interest income from long outstanding business related receivable balance	6,800	-
General bad debt provision written back	-	191,200
Deposit forfeited by customers	100,000	-
<b>Total</b>	<u>295,700</u>	<u>542,500</u>



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## Question 1b



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## Problem

- Provide a pure qualitative analysis.  
(No computation, explanation only)
  
- Unable to handle tax treatment of:
  - annual and special contribution
  - refurbishment expense
  - interest expense



## Answer 1b

### Analysis of expenses

	<u>Deductible</u> HK\$	<u>Non-deductible</u> HK\$
Interest expense on overdue account payable	2,600	-
Interest expense on a bank loan from HSBC	88,000	-
Interest expense on a bank loan from Standard Chartered Bank	-	79,500
Recognised occupational retirement scheme special contribution (\$185,000 x 1/5 as deductible)	37,000	148,000
Recognised occupational retirement scheme annual contribution (\$680,000 ÷ 17% x 15% as deductible)	600,000	80,000
Refurbishment expense for the residential property (expenses to be claimed for commercial building allowance)	-	280,000
Refurbishment expense for the commercial property (\$700,000 x 1/5 as deductible)	140,000	560,000
Tax payment	275,000	-
Accounting depreciation	-	163,500
<b>Total</b>	<u>1,142,600</u>	<u>1,311,000</u>



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## Question 1c



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## Problem

- Wrongly included addition of computer into 30% pool.
- Wrongly calculated the initial allowance on the sub-total instead of the capital expenditure incurred.
- Unable to workout CBA and balancing allowance.



## Answer 1c

### Depreciation allowance

	<u>20% pool</u> HK\$	<u>30% pool</u> HK\$	<u>Total allowances</u> HK\$
T.W.D.V. b/fwd	89,300	111,700	
Additions-office furniture/motor vehicle	<u>99,500</u>	<u>238,800</u>	
	188,800	350,500	
Less: I.A. @60% on additions	<u>(59,700)</u>	<u>(143,280)</u>	202,980
	129,100	207,220	
Less: A.A	<u>(25,820)</u>	<u>(62,166)</u>	87,986
T.W.D.V. c/fwd	<u>103,280</u>	<u>145,054</u>	
			<u>290,966</u>





## Answer 1c (cont'd)

### Commercial building allowance

	HK\$	
Ranking cost b/fwd	400,000	
Less: Disposal	(400,000)	
Add: Addition (refurbishment of residential property)	<u>280,000</u>	
Ranking cost c/fwd	<u>280,000</u>	
		<b><u>Total</u></b>
	<b>HK\$</b>	<b>allowances</b>
T.W.D.V. b/fwd	304,000	
Less: Disposal (balancing allowance)	(304,000)	304,000
Add: Addition (per above)	280,000	
Less: A.A. (@4% on ranking cost c/fwd)	<u>(11,200)</u>	11,200
T.W.D.V. c/fwd	<u>268,800</u>	
		<u>315,200</u>



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## Question 1d



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## Problem

- Not familiar with the profits tax computation template.
- Unable to compute the tax liability based on the computations in prior parts of Q1.
- Unable to identify the deduction of prescribed fixed assets.



## Answer 1d

### Anomalistic Limited Profits Tax Computation – 2015/16

HK\$

Profit before taxation	7,239,000
Add: Non-deductible expenses (per Answer 1(b))	<u>1,311,000</u>
	8,550,000
Less: Non-taxable income (per Answer 1(a))	<u>(542,500)</u>
	8,007,500
Less: Allowances under Part 6 of the IRO (per Answer 1(c))	
- Depreciation allowances	(290,966)
- Commercial building allowance	<u>(315,200)</u>
	7,401,334
Deduction under S.16G of the IRO (computer equipment)	<u>(88,800)</u>
	7,312,534
Assessable profits	<u>7,312,534</u>
Tax thereon @16.5%	<u>1,206,568</u>



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## **June 2016 Session – Sect A – Q2** **(10 marks – approximately 18 minutes)**

**Analyse, with reference to the principles and practice established by the Inland Revenue Department, the taxability of the following income to be derived by Co. A from the potential new business activities identified in Part B of the case from the source of income perspective:**

(a) Interest income from money lending activities.

(4 marks)

(b) Service income from listing advisory services provided to overseas customers.

(6 marks)



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## Case background

### **B. Advice on profits tax implications of new business activities**

For the utilisation of excess funds generated from its existing operations and for the exploration of new overseas customers, Co. A has envisaged the development of two potential business activities:

#### **(i) Money lending activities**

Excess funds generated by Co. A from its existing operations would be loaned to selective borrowers. Specifically, Co. A prefers lending its funds to overseas borrowers as it is understood that interest income derived from loans advanced to overseas borrowers is not subject to profits tax.

➤ Q2

#### **(ii) Listing advisory services to overseas customers**

Co. A would regularly assign its executives to travel overseas to meet with potential customers interested in listing their shares in the Hong Kong stock market. In this connection, staff of Co. A with listing knowledge and experience would conduct a due diligence review on the spot with respect to the overseas customers, and would prepare a comprehensive feasibility study report on the eligibility of the target customers for listing their shares in the Hong Kong stock market. Co. A expects that the abovesaid due diligence work performed by their staff shall be substantially conducted outside Hong Kong.



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## Question 2a



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## Irrelevant answers

- Six badges of trade.
- Interest income exemption order.



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## Question 2a



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## Problem

- Only explain the concept of "provision of credit" test.
- No discussion of the taxability of interest income in the context of carrying on a money lending business from perspective of operation test.



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## Answer 2a

For simple loans of money, the taxability of interest income is determined by the place where the credit is provided to the borrower, (i.e. the place where the funds from which the interest income is derived are provided to the borrower), in accordance to the "provision of credit" test (Para. 2, DIPN No. 13 (Revised) issued in December 2004). Essentially, if the relevant loan is first made available to the borrower outside of Hong Kong (e.g. through the remittance of funds to the borrower's overseas bank account), the interest income derived thereon should be offshore in nature and should not be subject to profits tax. The place of residence of the debtor is irrelevant to the taxability of the interest income.





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## Answer 2a (cont'd)

However, in line with the case of *Orion Caribbean Limited v. CIR* 4 HKTC 432, the taxability of interest income derived by a taxpayer carrying on a money lending business should be determined by the operation test (i.e. the respective activities deriving the income and the location where these activities have been done) instead of the abovesaid "provision of credit" test. In this connection, Co. A should carefully review if the envisaged money lending activities would constitute a distinctive money lending business from the profits tax perspective.



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## Question 2b



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## Problem

- Only general discussion of the broad guiding principle.
- Unable to identifying the relevant principles and elaborating them in greater detail.
- Unable to apply the principles to the case.



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## Question 2b



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## Irrelevant answers

- Analysed the income in the context of trading activities.
- Contract effected test.



## Answer 2b

The broad guiding principle in determining the source of profits (including service income and other income derived from various forms of business activities) is that one looks to see what the taxpayer has done to earn the profits in question, and where he has done it. Specifically the following principles are particularly relevant in determining the locality of service income (Para. 17, DIPN No. 21 (Revised) issued in July 2012):

- i. The relevant operations (activities) producing the service income and where those operations took place should be ascertained.
- ii. The operations in question must be the operations of the taxpayer.
- iii. The operations do not comprise the whole of the activities of the taxpayer carried out in the course of its business, but only those which produce the service income.
- iv. If services are performed both in Hong Kong and overseas, apportionment of the service income into onshore and offshore sourced portion may be appropriate, subject to the availability of an appropriate basis.
- v. The absence of an overseas permanent establishment to facilitate the provision of the services outside Hong Kong does not of itself mean that the service income must be sourced in Hong Kong. However, in the HK-TVBI Case, Lord Jauncey said that "it can only be in rare cases that a taxpayer with a principal place of business in Hong Kong can earn profits which are not chargeable to profits tax".



## Answer 2b (cont'd)

With respect to the service income to be derived by Co. A from the proposed listing advisory services and in line with the above principles, Co. A should identify all the relevant activities to be conducted both within and outside Hong Kong, and evaluate what are the most important activities and critical step(s) constituting the generation of the service income, and the respective location(s) in performing the services. In conducting the evaluation, only the activities conducted directly by Co. A should be taken into account. In addition, Co. A should evaluate whether its overseas permanent establishment, if any, can facilitate the offshore claim, or alternatively Co. A should prepare the justification of having offshore profits without any permanent establishment outside of Hong Kong. Co. A should also consider the applicability of apportioning the service income into both an onshore and offshore sourced portion where an appropriate basis is available.



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## **June 2016 Session – Sect A – Q3**

**(5 marks – approximately 9 minutes)**

**Analyse the suggestion made by the senior executives as per Part C of the case in structuring the additional new tax free benefits-in-kind provided by Co. A from the salaries tax perspective in the context of the relevant IRO provisions.**

Note: Comment on the existing rental reimbursement arrangement is not required.

**(5 marks)**



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## Case background

### C. Salaries tax planning in providing fringe benefits to senior executives

In a recent senior executives performance evaluation and remuneration review exercise, Co. A has been requested to revise and upgrade its remuneration package for senior executives by providing additional tax free benefits-in-kind on top of the existing rental reimbursement arrangement. Specifically, some senior executives suggested that if the additional benefits-in-kind available to them are directly provided by Co. A and cannot be converted into cash, the senior executives receiving such benefits-in-kind would not be subject to salaries tax.

➤ Q3



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## Question 3



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## Irrelevant answers

- Rental reimbursement.





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## Question 3



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## Problem

- Did not analyse the benefit-in-kind in the context of relevant IRO provisions.
- Did not discuss the exclusion of child education and holiday journey benefits from tax-free treatment as stipulated specifically in the IRO.



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## Answer 3

Under s.9(1)(a)(iv) and s.9(2A)(a) of the Inland Revenue Ordinance ("IRO"), income from employment assessable to salaries tax excludes any amount paid by the employer to or for the credit of a person other than the employee in discharge of a sole and primary liability of the employer to that other person, provided that the benefit is not capable of being converted into cash by the recipient. In this connection, benefits-in-kind structured and provided by Co. A to its senior executives should not be subject to salaries tax if they are structured in line with the regulatory framework as per the relevant IRO provisions.



## Answer 3 (cont'd)

However, Co. A and the senior executives should also note that the provision under s.9(1)(a)(iv) of the IRO shall not be applicable to the following benefits-in-kind, which are specifically excluded under other provisions in the IRO:

- i. Any amount paid by an employer in connection with the education of a child of an employee (s.9(2A)(b) of the IRO); and
- ii. Any amount paid by an employer in connection with a holiday journey (s.9(2A)(c) of the IRO).



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## **June 2016 Session – Sect A – Q4** **(15 marks – approximately 27 minutes)**

**Analyse the stamp duty exposure and compute, if any, the respective stamp duty liabilities in connection with the following properties under the assets realignment exercise as identified in Part D of the case:**

- (a) Property X. (5 marks)
- (b) Property Y. (3 marks)
- (c) Property Z. (7 marks)



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## Case background

### D. Stamp duty exposure evaluation on assets realignment exercise

Mr Thomas Ng ("Mr Ng") is the sole shareholder and director of Co. A. In addition to the financial advisory business currently conducted through Co. A, Mr Ng has also invested in immovable properties in Hong Kong. Presently, Mr Ng is also the sole shareholder and director of a Hong Kong company namely Cognitive Limited ("Co. C"). Co. C has held two immovable properties ("Property X" and "Property Y") in Hong Kong for more than a decade. Property X (market value of HK\$35 million as at today) is a commercial property and has been constantly used by Co. A as office premises free of charge. Property Y (market value of HK\$10 million as at today) is a residential property currently being leased out for generating rental income. In addition, Mr Ng also personally acquired a residential property ("Property Z", with market value of HK\$16 million as at today) in year 2009 as a dwelling with his wife and children.

➤ Q4



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## Case background

Recently, Mr Ng considered to conduct an assets realignment exercise by implementing the following transfers:

- (i) Property X will be conveyed from Co. C to Co. A at the current market value.
- (ii) Upon completion of transaction (i) above, Co. C will be put into liquidation by distribution in specie in transferring Property Y to Mr Ng.
- (iii) Property Z will be transferred from Mr Ng to both his wife (a Hong Kong permanent resident) and his mother (a non-Hong Kong permanent resident) by way of a gift.

➤ Q4



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## Question 4a



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## Problem

- Answers were brief.
- Did not discuss in greater detail the chargeable instrument and the timeframe of stamping.
- Failed to analyse AVD, SSD and BSD.



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## Question 4a



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## Wrong answers

- Co. A and Co. C were associated companies and therefore be exempted from stamp duty.





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## Answer 4a

The transfer of Property X from Co. C to Co. A is chargeable to Ad Valorem Stamp Duty ("AVD") under Head 1 in the First Schedule of the Stamp Duty Ordinance ("SDO"). The chargeable instrument with respect to the transfer is the Agreement for Sale under Head 1 (1A) or, in a case without any Agreement for Sale, the Conveyance on Sale (Deed of Assignment) under Head 1(1). The time for stamping is within 30 days after the execution of the respective instrument.

As Property X is a commercial property, the transfer is subject to Scale 1 rates under Head 1(1) or Head 1(1A). The respective AVD liability is thus HK\$2,975,000 (HK\$35,000,000 x 8.5%).



## Answer 4a (cont'd)

Notwithstanding that Co. A and Co. C are entirely owned by Mr Ng, this shareholding structure cannot be regarded as "associated companies" within the meaning under s.45(2) of the SDO. In this connection, stamp duty relief under s.45 of the SDO is not applicable accordingly.

As Property X is a commercial property, Special Stamp Duty ("SSD") under Head 1 (1AA) and 1(1B), and Buyer's Stamp Duty ("BSD") under Head 1(1AAB) and Head 1(1C) are not applicable with respect to the transfer.



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## Question 4b



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## Problem

- Unable to analyse stamp duty implication with respect to the transfer of immovable property effected through liquidation by distribution in specie.



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## Answer 4b

On the basis that Co. C would be put into liquidation by distribution in specie, the shareholder of Co. C (i.e. Mr Ng) would be regarded as becoming a beneficial owner of Property Y previously owned by Co. C upon executing the instrument to effect the distribution in specie of Property Y to Mr Ng (Para.12, SOIPN No. 8 issued in October 2014). In this regard, the transfer should not be subject to any AVD, SSD and BSD as the beneficial owner of Property Y has not been changed with respect to the transfer.



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## Question 4c



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## Problem

- Unable to analyse the relationship between and amongst at the transferor and transferee in the context of SDO.
- Unable to mention the chargeable instrument and the timeframe of stamping.
- Failed to analyse BSD and SSD.



## Answer 4c

The transfer of Property Z from Mr Ng to his wife and his mother collectively by way of a gift is chargeable to stamp duty as a voluntary disposition inter vivos under s.27 of the SDO, and the relevant instrument effecting the transfer (i.e. Conveyance or Deed of Assignment) would be chargeable to AVD under Head 1(1) in the First Schedule of the SDO. The time for stamping is within 30 days after the execution of the instrument.

In ascertaining the relevant AVD rate for the transfer, Scale 2 rates under Head 1(1) would be applicable if all the transferees are close relatives of the transferor (i.e. Mr Ng) under s.29AL(2)(a) of the SDO, and all transferees are also close relatives amongst themselves under s.29AL(2)(b) of the SDO. As the wife of Mr Ng and the mother of Mr Ng are not close relatives within the meaning of s.29AD(b) of the SDO, Scale 2 rates are not applicable. The AVD is therefore HK\$1,200,000 (HK\$16,000,000 x 7.5%) in accordance to Scale 1 rates under Head 1(1) (Para.39, SOIPN No. 8 issued in October 2014).



## Answer 4c (cont'd)

On the same basis (i.e. the transferees are not closely related under s.29AD(b) of the SDO) and the mother of Mr Ng is a non-Hong Kong permanent resident, the exemption of BSD under s.29DB(2)(b)&(c) of the SDO is not applicable and therefore the transfer is subject to BSD at HK\$2,400,000 (HK\$16,000,000 x 15%) under Head 1(1AAB), payable within 30 days after the execution of the instrument.

SSD is not applicable to the transfer as Property Z was acquired by Mr Ng in year 2009, i.e. prior to the effective date of the SSD regime on 20 November 2010.



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## **June 2016 Session – Sect A – Q5** **(5 marks – approximately 9 minutes)**

**Compare the respective ethical considerations of JOS to be undertaken (i) before accepting the tax services engagement with Co. A, and (ii) during the provision of the tax services to Co. A.**

**(5 marks)**





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## Question 5



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## Problem

- Failed to differentiate the respective ethical considerations before and after accepting the tax services agreement.
- Mere copied the fundamental principles without application.



## Answer 5

- i. Before accepting the tax services engagement, JOS should ensure its objectivity to Co. A by ascertaining that there is no conflict of interest for JOS in rendering the tax services to Co. A. In addition, JOS should also ensure that they have competent professional knowledge in providing the respective tax services to Co. A.
  
- ii. During the provision of the tax services, JOS should put forward the best position in favour of Co. A, provided that it does not impair its standard of integrity. Information provided by Co. A should be kept by JOS confidentially. The tax advice and tax computation prepared by JOS should be prepared on a fair basis. Specifically, JOS should not hold out to Co. A that they are beyond challenge.

(Any other fundamental principles from the Code of Ethics for Professional Accountants s.430 "Ethics in tax practice" relevant to the services provided to Co. A are also acceptable)



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# Section B – Essay/Short Questions



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## **June 2016 Session – Sect B – Q6** **(6 marks – approximately 11 minutes)**

Honour Estate comprises five blocks of residential buildings with 500 residential units. The deed of mutual covenants ("the DMC") of Honour Estate provides, inter alia, that the common area of the estate includes the roof of each residential building. It is common ground that the owners of those 500 residential units ("the Landlords") have undivided share in the common area of Honour Estate. The DMC also provides that each of the Landlords has the full and free right to use the common area.

Excellent Service Company Limited ("Excellent Service") was appointed as manager of Honour Estate to manage the estate. It entered into an agreement with a telecommunication company to let out the roofs of the residential buildings for the latter's setting up of mobile base stations. The estate management accounts of Honour Estate show that its income comprises fees derived from the roofs ("the Receipts") and management fees collected from the Landlords. The above incomes are disbursed for the payment of the estate management expenses which include salaries, maintenance, refurbishment and rates.



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## Question 6 (cont'd)

### Required:

On the facts now available, analyse (a) whether the Receipts are chargeable to tax in Hong Kong, and if so, the type of tax to which the Receipts are chargeable; (b) the identity of the chargeable person; and (c) the chargeable amount and the available deductions.

(6 marks)



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## Question 6



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## Irrelevant answers

- DIPN 21.
- Six badges of trade.



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## Question 6



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## Problem

- Unaware that the question was about property tax.
- Unable to ascertain the relevant chargeable persons, chargeable amount and available deductions.
- Not familiar with the computation of property tax.
- Wrongly included management fees in the net assessable value.



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## Answer 6

- (a) The owners of those 500 residential units ("the Landlords") are the owners of the common area, which includes the roofs (hereinafter collectively referred to as "the Properties"), of Honour Estate. As s.7A of the IRO provides that buildings includes any part of a building, it follows that the roofs of the residential buildings also fall into s.5(1) of the IRO – the charging section of property tax. The Receipts are the consideration paid for the use of the Properties. Hence, they are chargeable to property tax.





## Answer 6 (cont'd)

- (b) As to the chargeable person, the Landlords are the owners of the Properties. They are the relevant chargeable persons. (Relevant authority: Board of Review Decision No. D80/02 17 IRBRD 984). Alternatively, as "owner" includes a person who, on behalf of another person, receives any consideration in respect of the right of use of any common parts (s.2 of the IRO), Excellent Service Company Limited is also the chargeable person as it receives the Receipts on behalf of the Landlords.
- (c) The net assessable value of the Properties is the Receipts less (i) rates paid by the owners in respect of the Properties (s.5(1A)(b)(i) of the IRO) and (ii) 20% statutory deduction (s.5(1A)(b)(ii) of the IRO). The disbursement of the Receipts on estate management expenses other than rates has no relevance on the computation of net assessable value of the Properties.



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

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

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



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

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

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

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



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

### Required:

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

**(8 marks)**



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## Question 7



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## Problem

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



## Answer 7

### Year of assessment 2009/10

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

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



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## Answer 7 (cont'd)

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

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



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## Answer 7 (cont'd)

Year of assessment 2014/15

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

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

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





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

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

### **Required:**

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

**Note: Computation is not required.**

**(12 marks)**



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## Question 8



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## Problem

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



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## Question 8



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## Wrong answers

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



## Answer 8

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



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## Answer 8 (cont'd)

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



## Answer 8 (cont'd)

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

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



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## Answer 8 (cont'd)

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



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

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

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





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

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

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



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

Mr Lee

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



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

Mrs Lee

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

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

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



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

### Required:

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



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## Question 9a(i)



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## Problem

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



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## Question 9a(i)



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## Irrelevant answers

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



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## Question 9a(i)



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## Wrong answers

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



## Answer 9a(i)

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

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

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

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





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## Question 9a(ii)



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## Problem

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



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## Answer 9a(ii)

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



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## Question 9b



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## Problem

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



## Answer 9b

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

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



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## Question 9c



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## Problem

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



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## Answer 9c

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



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## **June 2016 Session – Sect B –10** **(4 marks – approximately 7 minutes)**

Mary teaches chemistry in a secondary school. She attended a course on fine art provided by a university in Hong Kong. She did not receive reimbursement from her employer in respect of the course fee.

### **Required:**

Analyse, with reference to the relevant provisions in the IRO, whether the course fee is allowable for deduction from the perspective of salaries tax.

**(4 marks)**



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## Question 10



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## Problem

- Unable to point out that the course fee was not allowable under s.12(1)(a).





## Answer 10

The course fee is not allowable for deduction under s.12(1)(a) of the IRO. It is not deductible under s.12(1)(e) either.

S.12(1)(a) of the IRO provides that, other than expenses of a domestic or private nature and capital expenditure, all outgoings and expenses wholly, exclusively and necessarily incurred in the production of the assessable income are allowable for deduction. In the present case, Mary is a chemistry teacher. There is no evidence that the fine art course fee was wholly, exclusively and necessarily incurred in the production of her assessable income.



## Answer 10 (cont'd)

S.12(1)(e) of the IRO on the other hand provides that self-education expenses as defined in s.12(6) are allowable for deduction. S.12(6)(c) of the IRO provides that a prescribed course of education means a course undertaken to gain or maintain qualifications for use in any employment and being provided by an approved institution which includes an education provider (s.12(6)(d) of the IRO). In the present case, although the course was provided by a university which is an education provider as defined in s.12(6)(d) of the IRO, there is no evidence that the course was undertaken by Mary to gain or maintain qualifications for use in any employment.



## June 2016 Session – Sect B – Q11 (5 marks – approximately 9 minutes)

Amazing Limited is a Hong Kong company. John is an expatriate and has been employed as the General Manager for many years. The company set up a representative office in Shenzhen in January 2013. It appointed John as the chief representative of the representative office. John received a monthly salary of RMB11,000 in respect of his acting as the chief representative of the representative office. At that time, John had to take care of the business of both the Hong Kong office and the representative office. He spent his time in mainland China for a period of less than 90 days in a calendar year as he was heavily engaged in the business in Hong Kong.

With the expansion of the market in mainland China, the company set up a foreign investment enterprise in Shenzhen in January 2014. John was then seconded from Hong Kong to mainland China. He held the position of General Manager in the foreign investment enterprise and was remunerated at a monthly salary of RMB30,000. He has been stationed in Shenzhen since the secondment. That said, his time spent in mainland China was around 11 months in a calendar year as he had to attend meetings overseas.



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## June 2016 Session – Sect B – Q11 (cont'd)

### Required:

Analyse whether the income derived by John from the representative office and the foreign investment enterprise is chargeable to Individual Income Tax in mainland China. If so, explain the China tax reporting obligations of John and his employers in relation thereto.

**(5 marks)**



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## Question 11



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## Irrelevant answers

- Provided answers on VAT.
- Discuss the exemption under DTA.



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## Question 11



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## Problem

- Unable to distinguish the treatment of RO from that of a foreign investment enterprise from the perspective of IIT.
- Unable to note that 90-day exemption not applicable to the taxpayer as he was the chief representative of a RO.



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## Answer 11

With regard to the period during which John was the chief representative of the representative office ("Period A"), although John spent less than 90 days during a calendar year in mainland China ("the Mainland"), the 90-day exemption is not applicable to him because he was the chief representative of a representative office and his remuneration was deemed to have been borne by the representative office. Such being the case, the income derived by John from his acting as the chief representative of the representative office was chargeable to Individual Income Tax ("IIT") in the Mainland. The IIT would be calculated using the time apportionment method since John acted as both the General Manager of the Hong Kong company and the chief representative at the same time.



## Answer 11 (cont'd)

As to the period during which he acts as the General Manager of the foreign investment enterprise ("Period B"), John's income is also chargeable to IIT in the Mainland. John stayed in the Mainland for a period of around 11 months during a calendar year.

Turning to tax reporting obligations. John's annual income was more than RMB120,000 in both Period A and Period B. As such, he had to report his taxable income to the local tax bureau within three months after the end of the relevant year. John's employers should also (a) furnish IIT withholding returns to the relevant tax bureau and (b) act as the withholding agent to withhold IIT from the salaries payable to John on a monthly basis within 15 days after the end of the month.





## December 2015 Session – Sect B – Q8

- Mr Koo has been employed by Ocean View Limited ("Ocean View") for 30 years and he is currently in the position of general manager responsible for the overall control and management of the company's business activities. Ocean View has a sole director namely Mr Cheung and he is also the sole shareholder of the company since its incorporation 30 years ago. Mr Koo and Mr Cheung have maintained a very good and close relationship both in business and personally.
- It has also been noted that on the recent Chinese New Year's eve, Mr Koo received a sum of money directly from Mr Cheung which was approximately five times his current basic annual salary. Mr Cheung emphasised to Mr Koo that it was a gift to him for Chinese New Year in pursuance of their decades of friendship, and that the money was exclusively and directly given by Mr Cheung instead of cash from Ocean View.



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## December 2015 Session – Sect B – Q8 (cont'd)

- Mr Koo only maintained one employment contract with Ocean View, and did not enter into any other written or verbal employment contract with Mr Cheung or any other parties. Specifically, Mr Koo stated that the money received by him was beyond his expectations.



## December 2015 Session – Sect B – Q8 (cont'd)

Required:

- (a) If you were the Assessor of the Inland Revenue Department ("IRD"), how would you argue that the money received by Mr Koo should be subject to salaries tax? (4 marks)
- (b) If you were Mr Koo, how would you argue that the above money should not be subject to salaries tax? (4 marks)
- (c) What additional information should be obtained to further evaluate the taxability of the money received by Mr Koo? (3 marks)



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## Question 8a



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## Problems

- Arguments not comprehensive.
- Wrongly discussed service companies and anti-avoidance provisions.



## Answer 8a

### Possible arguments for subject to salaries tax

- Under s.9(1)(a) of the IRO, income from employment includes wages, salary, etc, derived from the employer or others. In this regard, the income of Mr Koo derived from the employment with Ocean View Limited can be paid by others, especially from Mr Cheung as he is the sole director and shareholder of the company. The payment is possibly part and parcel of the remuneration of Mr Koo attributable to his employment with Ocean View.



## Answer 8a (cont'd)

### Possible arguments for subject to salaries tax

- There is no concrete evidence substantiating the argument that the money was a gift given because of personal friendship. The assertion of Mr Cheung is self-serving and has no objective justification.
- The amount received by Mr Koo is substantially in proportion to his annual salary and the date of receipt is also the eve of Chinese New Year. This pattern is in line with the payment of a performance-based bonus typically found in generic employment arrangements.



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## Question 8b



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## Problems

- Discussion and analysis were not comprehensive.
- Only provide general answers.



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## Answer 8b

### Possible arguments for not subject to salaries tax

- There was no implicit or explicit agreement entered into by Mr Koo with Ocean View nor Mr Cheung for any new employment contract or extension of existing employment covering the payment of the subject amount to Mr Koo. Substantially the amount is a spontaneous payment and has no connection to the present or any other employment of Mr Koo.





## Answer 8b (cont'd)

### Possible arguments for not subject to salaries tax

- The amount was substantially higher than Mr Koo's existing annual salary. The quantum was unlikely to be in line with any performance-based bonus paid principally and directly by the employer or others, and therefore should not be regarded as part of his employment income.
- The payment to Mr Koo was unexpected and was solely on a discretionary basis made by Mr Cheung personally. This is not likely to be a pattern generically found in any contractual arrangement for employment of income.



## Answer 8c

Relevant additional information for further evaluation could be obtained from the following perspectives:

- Details of similar payments, if any, paid to Mr Koo by Mr Cheung in prior years.
- Details of similar payments, if any, paid by Mr Cheung to other employees of Ocean View and / or other close contacts of Mr Cheung.
- Evidence justifying the long-term friendship between Mr Koo and Mr Cheung.



## Answer 8c (cont'd)

Relevant additional information for further evaluation could be obtained from the following perspectives:

- Financial information and business performance of Ocean View for examination if there is any co-relation between the payment and the profitability of Ocean View during the relevant financial period.
- Detailed comparison of the remuneration package of Mr Koo in current and prior years in order to evaluate if the prevailing package had been revised in line with the incorporation of the subject payment.
- Examine whether Mr Koo has reached the retirement age and if the amount received by him is substantially a retirement gratuity paid by Mr Cheung.



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## December 2015 Session – Sect B – Q9

- 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.



## December 2015 Session – Sect B – Q9 (cont'd)

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.

(a) With respect to the above said proposed arrangement, discuss the taxability of the rental income attributable to Mr Lee and Ms Wong, and identify, if any, the possible options available to them in the contexts of the IRO for reducing the tax liabilities derived thereon.

(6 marks)

(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)



## Answer 9a

- Under s.5(1) of the IRO, rental income derived by Mr Lee from his owned property situated in Hong Kong is subject to property tax. By way of election of personal assessment under Part 7 of the IRO, the interest expenses on money borrowed for producing the rental income can only be deducted to the extent of the nominal rental income received from Ms Wong under s.42(1) of the IRO. Excessive interest expenses, if any, incurred by Mr Lee cannot be allowed for deduction against his other taxable income under s.42(1) of the IRO.
- Under s.30(1) of the IRO and on the basis that Mr Lee continues to maintain and resides with his mother, Ms Wong, he can be entitled to claim Dependent Parent and Additional Dependent Parent Allowances continuously notwithstanding that Ms Wong has derived rental income subject to tax.



## Answer 9a (cont'd)

- In the context of Ms Wong, the rental income derived by her under the arrangement would be subject to profits tax under s.14(1) of the IRO instead of property tax on the basis that she carries on a property sub-letting business in Hong Kong.
- In order to minimise the respective tax liabilities, Ms Wong may consider applying for personal assessment and claim the Personal Allowance to deduct against the property rental income. However, Ms Wong cannot deduct the interest expenses, if any, incurred on the loan borrowed for the acquisition of the respective property under s.42(1) of the IRO as the loan, if any, is borrowed by her son Mr Lee as the owner of the property instead of by herself.



## Answer 9b

- 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.





## Answer 9b (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.



## Answer 9b (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.



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# Thank you



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# Part 4: Preparation for the Examinations





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



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# 1. Prepare your examination

## Before examination

### DO

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



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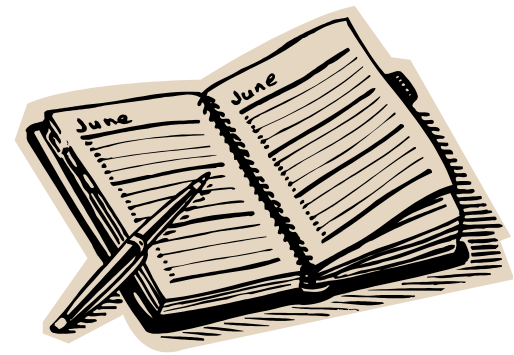


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## Commit to your Study Plan

### Advantages:

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





## Prepare Critical File

### How to prepare:

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

### Advantages:

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







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## During examination

### DO

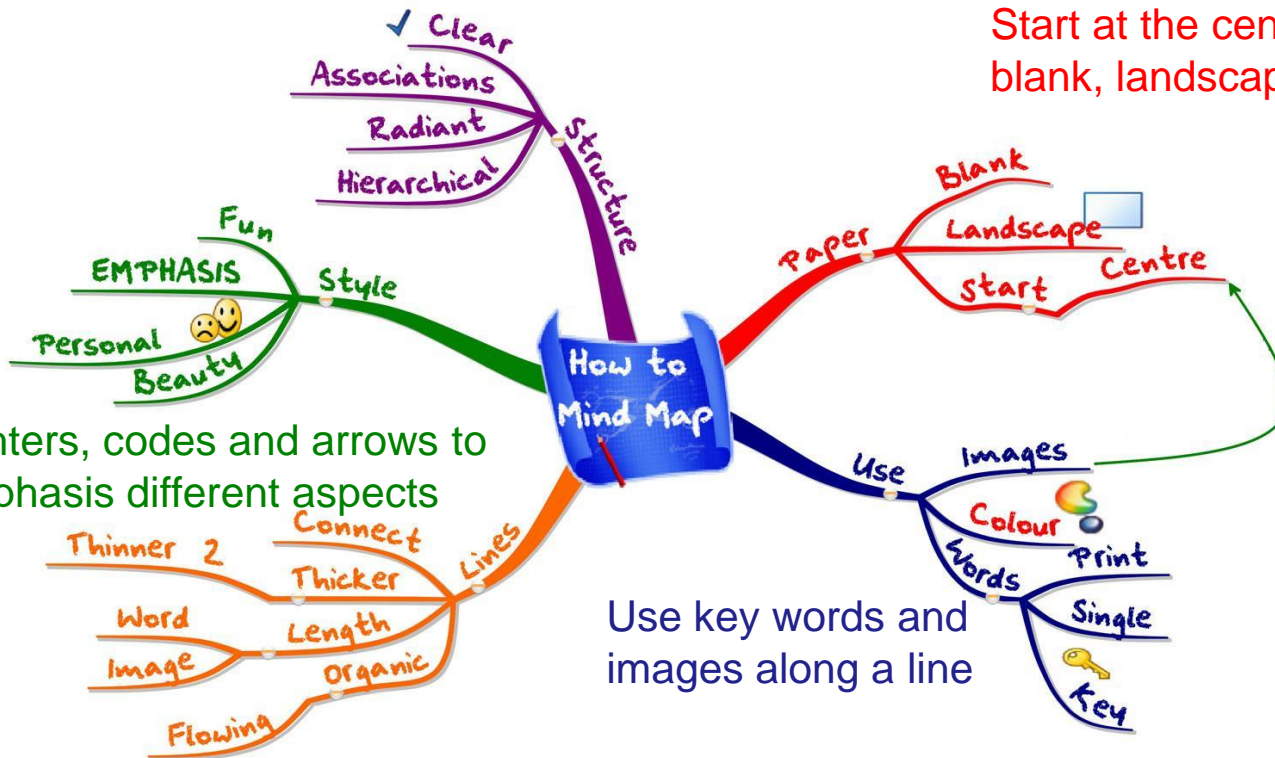
- Identify question requirements
- Highlight key words (e.g. Calculate / Advise / Propose etc...)
- **Mind-map** or sketch the question requirements
- Outline answers or approach
- Pay attention to specific format requirement (e.g. Write a memorandum)
  - Start with an introduction and end with a conclusion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

# Mind Map

Radiate the ideas out from the central theme and main branches

Start at the centre of a blank, landscape paper

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



Use key words and images along a line

Make the lines associate as clear as possible



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## During examination

### DO

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

### DON'T

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

(Question No. 2.)

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



## Examples of handwriting

Example 1:

*adverse opinion*

**adverse opinion**

Example 2:

*substantive matters*

**substantive matters ??**

Example 3:

*seriously misleading*

**seriously misleading ????**



## 2. Prepare yourself for examination

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

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



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香港會計師公會



Hong Kong's  
**CPA Qualification**  
香港會計師專業資格

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



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# Part 5: Q&A Session

