



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



Qualification Programme

Module 14 Taxation

Pilot Examination Paper

Time Allowed	3 hours
Examination Assessment Allocation	
Section A – Case Questions	50 Marks All FIVE questions are compulsory
Section B – Essay / Short Questions	50 Marks All FIVE questions are compulsory

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Module 14 – Taxation

This examination is divided into TWO sections.

- Section A (50%). This consists of FIVE compulsory case questions. You should allocate approximately 1 hour and 30 minutes in total for Section A.
- Section B (50%). This consists of FIVE compulsory essay / short questions. You should allocate approximately 1 hour and 30 minutes in total for Section B.

Suggested time allocation (by marks):

Marks	Approximate time in minutes
1	2
2	3
3	5
4	7
5	9
6	11
7	12
8	14
9	16
10	18
11	20
12	21
13	23
14	25
15	27
16	29
17	32
18	33
19	34
20	36

SECTION A – CASE QUESTIONS (Total: 50 marks)

Answer **ALL** of the following questions. Marks will be awarded for logical argumentation/ calculation and appropriate presentation of the answers.

CASE

Moon Entertainment (Hong Kong) Limited ("Moon-HK") is a Hong Kong incorporated company carrying on the business of equipment leasing and provision of technical services to outdoor event organisers who organise concerts, trade shows, media/ press conference, etc. All of the outdoor events are organised by customers and Moon-HK has no participation in such events except as an independent equipment and service provider in return for arm's length income.

Moon-HK is owned by two Hong Kong resident individuals, namely Mr Chan and Ms Wang. Mr Chan is a Hong Kong permanent resident holding an HKID card and a HKSAR passport whilst Ms Wang is a Singaporean. Ms Wang and Mr Chan got married in 2017 and Ms Wang only came to Hong Kong to take up residence in early 2019. Both Mr Chan and Ms Wang normally reside in Hong Kong. They are also the directors of Moon-HK responsible for the day-to-day operation and all key business decisions. Their normal place of work is Moon-HK's showroom located at Kowloon Bay ("Kowloon Bay Showroom"). The directors' meetings are all held at the Kowloon Bay Showroom.

The following is a description of Moon-HK's typical operation modes:

Equipment leasing

Moon-HK owns portable power generators and air-conditioning systems which are purchased from third party suppliers. The equipment is stored in the warehouse located in Yuen Long ("Yuen Long Warehouse") rented by Moon-HK. A customer who is interested in leasing the equipment will visit the Kowloon Bay Showroom to discuss the lease terms and sign the lease contract. The customer is responsible for collecting and returning the equipment at the Yuen Long Warehouse. Moon-HK has a sales team and maintenance team totaling six people based at the Kowloon Bay Showroom and the Yuen Long Warehouse respectively to perform the equipment leasing and maintenance activities. Under the standard terms of the lease contract, Moon-HK is only responsible for the normal functioning of the equipment at the time of its delivery to the customer, and the customer should bear all other expenses associated with the use of the equipment.

Provision of technical services

Sometimes a customer may not have the ability to properly set up and control the equipment to realise its full potential. Moon-HK will offer technical services to the customer in resolving the problem for a fee of HK\$5,000 per day. The technical team comprises eight people who are all employees of Moon-HK based at the Yuen Long Warehouse. The field works are performed at the site designated by the customer.

The following are the statement of profit or loss and the statement of financial position of Moon-HK for the year ended 31 December 2019:

Statement of profit or loss

	Notes	Equipment <u>Leasing</u> HK\$'000	Technical <u>Service</u> HK\$'000	<u>Total</u> HK\$'000
Rental income	1	9,000	-	9,000
Service fee income	2	-	6,000	6,000
Other income		<u>200</u>	<u>-</u>	<u>200</u>
Gross income		9,200	6,000	15,200
Less: Expense				
Depreciation		1,000	-	1,000
Office and warehouse rental		600	200	800
Director's fee		600	600	1,200
Salaries		2,500	4,500	7,000
Repair and maintenance		800	-	800
Interest expense	3	50	-	50
Other operating expenses	4	<u>250</u>	<u>100</u>	<u>350</u>
		(5,800)	(5,400)	(11,200)
Profit before tax		3,400	600	4,000
Less: Taxation				<u>(660)</u>
Profit after tax				<u>3,340</u>

Statement of financial position

Fixed asset	5			HK\$'000
Trade receivable				8,000
Cash and bank balance				2,000
				<u>500</u>
				10,500
Trade and other payable				3,500
Short-term bank borrowing				<u>1,000</u>
				4,500
Net asset				<u>6,000</u>
Share capital				100
Retained earnings				<u>5,900</u>
				<u>6,000</u>

Notes:

1. Rental income was derived from the leasing of equipment to third party corporate customers. According to the knowledge of Moon-HK, a customer, KK (Shenzhen) Limited ("KK-SZ"), had sent its representative to Hong Kong to sign the lease contract and collect the equipment at the Yuen Long Warehouse. The equipment was imported into the Mainland for use in a trade show in Shenzhen. The import and export of the equipment into and out of the Mainland were arranged by KK-SZ. The related rental income for this trade show in Shenzhen was HK\$1,000,000. KK-SZ was subsequently found to be a company incorporated and carrying on a business in the Mainland.
2. Service fee income was derived from the provision of technical services to customers. For the Shenzhen event mentioned in Note 1, KK-SZ initially required a technician of Moon-HK to support the set up and disassembly of the equipment. Subsequently, KK-SZ needed one more technician from Moon-HK to control the equipment throughout the same event. The following are the itineraries of the two technicians, Peter and Mary:

<u>Purpose of stay in the Mainland</u>	<u>Date of arrival in the Mainland</u>	<u>Date of departure from the Mainland</u>
Peter – Set up of the equipment	5 March 2019	12 March 2019
Mary – Control of the equipment	13 March 2019	30 June 2019
Peter – Disassembly of the equipment	1 July 2019	15 July 2019

The technical service fees for the set up and disassembly as well as the control of the equipment are HK\$115,000 and HK\$550,000 respectively. These fees are governed under two separate technical service contracts between Moon-HK and KK-SZ dated 1 March 2019 and 10 March 2019 respectively.

3. The interest expense was related to a borrowing from the mother of Ms Wang who is a Singapore resident, the fund of which was used to finance Moon-HK's working capital. The borrowing was arranged by the finance manager with the approval from the general manager in Hong Kong.
4. Other operating expenses include, among others, the cost of a mobile phone of HK\$5,000 for use by a salesman.
5. Moon-HK purchased a new power generator for HK\$200,000 during the year. There was no disposal of fixed assets during the year.

The tax written down values b/f from the year of assessment 2018/19 are as follows:

- 20% Pool: HK\$1,500,000
- 30% Pool: HK\$500,000

Without much knowledge on Hong Kong taxation, Moon-HK's finance manager is preparing to file Moon-HK's profits tax return for the year of assessment 2019/20 reporting all the income as subject to Hong Kong profits tax.

Question 1 (18 marks – approximately 33 minutes)

- (a) In the contexts of the Inland Revenue Ordinance ("IRO") and established court case principles, analyse the source of Moon-HK's business income (both from equipment leasing and provision of technical services) earned from KK-SZ from a Hong Kong profits tax perspective. (7 marks)
- (b) Identify the tax adjustments required in calculating Moon-HK's profits tax liability if the business income from KK-SZ is claimed as offshore by Moon-HK, with two examples relevant to this case (no computation is required). (3 marks)
- (c) Compute Moon-HK's profits tax liability for the year of assessment 2019/20 assuming all the income is treated as onshore-sourced and subject to Hong Kong profits tax.

Note: Ignore two-tiered tax rate, provisional profits tax and reduction of tax, if any, for the year. (8 marks)

Question 2 (9 marks – approximately 16 minutes)

Analyse the taxability of the following income received by Moon-HK from KK-SZ in the contexts of the Mainland Corporate Income Tax Law and the Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income ("China-HK DTA") taking into account the contractual arrangement between the parties (i.e. China indirect tax implications are not required to be considered):

- (a) Equipment rental of HK\$1,000,000. (4 marks)
- (b) Technical service fees of HK\$665,000. (5 marks)

Question 3 (10 marks – approximately 18 minutes)

- (a) Illustrate the possible benefits available to Moon-HK under the China-HK DTA in terms of taxation of Moon-HK's income derived from the Mainland. (4 marks)
- (b) If for whatever reason Moon-HK's technical service fees from KK-SZ are regarded by the Mainland tax authority as subject to corporate income tax in the Mainland, explain whether and how Moon-HK can claim a relief for the corporate income tax paid in the Mainland under the China-HK DTA (assuming no offshore claim is lodged by Moon-HK), in light of the provisions in the IRO and the China-HK DTA. (6 marks)

Question 4 (8 marks – approximately 14 minutes)

(a) Describe, in the context of the China-HK DTA, the IRO and the IRD's practice, how the Mainland tax authority can obtain the details of Moon-HK's business activities in the Mainland.

(4 marks)

(b) List the typical documentation that is relevant to defend Moon-HK's position that its technical service fees from KK-SZ should not be subject to corporate income tax in the Mainland.

(4 marks)

Question 5 (5 marks – approximately 9 minutes)

Mr Mak is the sole proprietor of Mak & Co, a small scale audit firm providing audit and company secretariat services for small and medium enterprises. He has just been asked by Moon-HK, its existing audit client, for tax advisory services in respect of Moon-HK's tax exposure in the Mainland.

Required:

Advise if Mak & Co is eligible to provide the tax advisory services, and the considerations to be taken into account by Mr Mak before accepting the engagement.

(5 marks)

* * * END OF SECTION A * * *

SECTION B – ESSAY / SHORT QUESTIONS (Total: 50 marks)

Answer **ALL** of the following questions. Marks will be awarded for logical argumentation/ calculation and appropriate presentation of the answers.

Question 6 (12 marks – approximately 21 minutes)

Mr Chan has been employed by ABC Limited ("ABC"), a company incorporated and carrying on business in Hong Kong, as Finance Manager since the year 2014. He was seconded to DEF Limited, a subsidiary of ABC in Singapore, for two years with effect from 1 January 2019. During the period of assignment, he remained as an employee of ABC but worked full-time in Singapore and the income earned was subject to tax in Singapore. The amount of tax payable in Singapore for the period from 1 January 2019 to 31 March 2019 was nil after granting various deductions and allowances while the amount of tax paid for the period from 1 April 2019 to 31 March 2020 was SGD100,000.

During the period of assignment, Mr Chan worked in Singapore. He came back to Hong Kong on Christmas day and Easter holiday. He also took summer vacation in Hong Kong. He spent almost 2.5 months in Hong Kong during the period from 1 April 2019 to 31 March 2020. When he returned to Hong Kong, he brought with him documents for approval by his supervisor and reported to his supervisor in Hong Kong the work progress in Singapore.

In the tax returns – individuals for the years of assessment 2018/19 and 2019/20, Mr Chan reported the full income derived from ABC and claimed exemption on the income derived during the period from 1 January 2019 to 31 March 2020 on the grounds that he had not rendered any services in Hong Kong and had paid tax in Singapore in respect of the said period.

Required:

Mr Chan has engaged you as his tax advisor. Prepare a memo to Mr Chan to advise, with reference to the relevant legal principles, his salaries tax liability for each of the years of assessment 2018/19 and 2019/20.

Note: A maximum of 2 marks for communication skill and 2 marks for analytical skill will be awarded.
(12 marks)

Question 7 (8 marks – approximately 14 minutes)

- (a) Ms Wong was born in Canada and has been studying and living there since birth. On 1 March 2019, she inherited a residential property ("Property X") in Hong Kong, which has been used by her parents for years, from the estate of her late mother. Property X continues to be used by Mr Wong, Ms Wong's father, after the death of his wife. At the time of transfer, the market value of Property X was HK\$4,000,000.

Ms Wong plans to get married and intends to return to Hong Kong. On 1 December 2019, she purchased another residential property ("Property Y") in Hong Kong at a consideration of HK\$6,200,000 as her matrimonial home after marriage.

Mr Wong then moved to live with Ms Wong. On 3 February 2020, Ms Wong disposed of Property X at a consideration of HK\$5,000,000.

- (b) On 1 October 2019, Mr Lo, a Hong Kong permanent resident ("HKPR"), entered into an agreement for sale and purchase to acquire a residential property in Hong Kong ("Property Z") at a consideration of HK\$12,000,000 jointly with his girl-friend, Ms Mo, who is a non-HKPR. At the time of acquisition, Mr Lo did not own any residential property in Hong Kong while Ms Mo has already owned a residential property in Hong Kong.

Soon afterwards, they got married on 1 November 2019 and Property Z was assigned to them on 1 December 2019.

Required:

Analyse the liability to stamp duty in respect of the conveyance of each of Property X, Property Y and Property Z, and compute the amount of stamp duty payable (if any).

(8 marks)

Question 8 (4 marks – approximately 7 minutes)

GHI Limited ("GHI-HK"), a company incorporated and carrying on business in Hong Kong, paid licence fees to GHI Taiwan Limited ("GHI-TW"), a subsidiary of GHI-HK carrying on business in Taiwan, for the right to exhibit series of television programmes in Taiwan. The licence fees paid were charged as a deduction in computing the assessable profits of GHI-HK.

In reply to the Assessor's enquiries, GHI-HK, on behalf of GHI-TW, claimed that the licence fees received by GHI-TW should not be chargeable to profits tax in Hong Kong.

Required:

Analyse, with reference to the relevant provision(s) of the IRO, whether the licence fees received by GHI-TW should be subject to profits tax in Hong Kong.

(4 marks)

Question 9 (9 marks – approximately 16 minutes)

JKL Limited ("JKL") was incorporated as a private company in Hong Kong on 1 January 2013 and it closed its annual accounts on 31 December. It received the first profits tax return for the year of assessment 2014/15, in which it declared that it had not yet commenced business. JKL then received a letter from the IRD informing it that profits tax return would not be sent to it annually. No profits tax returns were issued by the IRD for the years of assessment 2015/16 to 2017/18.

For review purposes, a profits tax return for the year of assessment 2018/19 was issued to JKL on 1 April 2019 and the due date for filing of the tax return was 15 August 2019. JKL did not file the tax return for the year of assessment 2018/19 within the stipulated time limit. On 1 November 2019, JKL received an estimated profits tax assessment for the year of assessment 2018/19 and the estimated assessable profits were HK\$5 million. No objection was received by the IRD from JKL within the one-month objection period.

JKL finally filed its profits tax return for the year of assessment 2018/19 on 31 December 2019, in which it declared assessable profits of HK\$3 million. At the same time, it lodged an objection to the estimated profits tax assessment on the ground that it was excessive. In the notice of objection, JKL claimed that it failed to lodge an objection in time as it had moved office and it did not receive the notice of assessment.

Required:

- (a) Analyse with reference to the relevant provisions of the IRO, whether the reason for lodging the objection out of time would be accepted by the Assessor or not. (3 marks)
- (b) Analyse with reference to the relevant provisions, the offence that JKL would likely have committed and the possible penal actions that the IRD would take. (6 marks)

Question 10 (17 marks – approximately 32 minutes)

Mr Cheung is a Mainland resident. He intended to purchase a landed property in Hong Kong for investment purposes. As advised by his friend who is an accountant, Mr Cheung acquired a company, MNO Limited ("MNO"), incorporated in the British Virgin Islands, and purchased a property in Hong Kong, with an existing tenancy, in the name of MNO. The property was assigned to MNO on 1 May 2018.

The terms of the existing tenancy are as follows:

- | | |
|---------------------|---|
| (i) Term: | 1 January 2018 to 31 December 2019 |
| (ii) Rent: | HK\$50,000 per month |
| (iii) Deposit: | HK\$100,000 |
| (iv) Rates: | HK\$7,500 per quarter (payable by landlord) |
| (v) Management fee: | HK\$3,000 per month (payable by landlord) |

The tenant did not pay rent from 1 November 2018 onwards. Despite the fact that MNO had contacted the tenant many times and issued a recovery notice to it, it had no response and finally vacated the property on 15 February 2019. No new tenant could be located prior to 31 March 2019.

MNO received a profits tax return for the year of assessment 2018/19 from the IRD. However, it refused to complete the profits tax return and requested the IRD to issue a property tax return to it for the same year of assessment on the following grounds:

- (i) MNO is the legal owner of the property and derives rental income from the letting of it. As such, it should be subject to property tax instead of profits tax.
- (ii) MNO is a foreign corporation with no business carried on in Hong Kong except for holding of an immovable property earning passive rental income. Therefore, it should not be charged to profits tax in Hong Kong.

Required:

Answer the following questions with reference to the relevant provisions of the IRO.

- (a) **Explain whether MNO is chargeable to property tax in Hong Kong. If so, advise whether MNO is entitled to any deduction under property tax for the year of assessment 2018/19 with computations showing the amount that MNO is entitled to for each type of deduction.**

(9 marks)

- (b) **Explain whether MNO is chargeable to profits tax in Hong Kong. If so, advise whether MNO is entitled to any exemption under profits tax assuming that it is also chargeable to property tax.**

(8 marks)

* * * END OF EXAMINATION PAPER * * *

Module 14

Taxation

Answers

The suggested answers are longer than what candidates are expected to give in the examination. The purpose of the suggested answers is meant to help candidates in their revision and learning. The suggested answers may not contain all the correct points and candidates should note that credit will be awarded for valid answers which may not fully covered in the suggested answers.

SECTION A – CASE QUESTIONS (Total: 50 marks)

Answer 1(a)

The rental income is derived from the leasing of movable property. In the case of *British United Shoe Machinery (SA) (Pty) Limited v CT (South Africa)* [1964] 26 SATC 163, the source of rental income was held to arise where the property is used by the lessee (in this case it is in the Mainland).

It would, however, seem to be arguable that the income should be viewed as arising where the taxpayer provides the property to the lessee i.e. the relevant business activities and respective locations. In this case this will include the solicitation of customer, negotiation, conclusion and execution of the equipment lease contracts, delivery of equipment, maintenance of equipment, general management of the business, etc., which are all conducted by Moon-HK's management team and employees in Hong Kong.

It is likely the Inland Revenue Department ("IRD") will take the latter view and challenge that the profits from the lease of equipment to KK-SZ, regardless of the location where the equipment is used, is onshore sourced and subject to Hong Kong profits tax.

In addition, the IRD may apply s.15(1)(d) of the Inland Revenue Ordinance ("IRO") to deem the income as chargeable to profits tax if the right of use of the equipment in Hong Kong had not been specifically excluded in the respective lease agreement.

On the other hand, the technical service fee income from the provision of on-site technical service to KK-SZ, to the extent that the services are rendered by Moon-HK outside of Hong Kong, is offshore sourced and not subject to Hong Kong profits tax pursuant to the decision in *CIR v Hang Sang Bank Ltd.* [1991] AC306 and Departmental Interpretation and Practice Notes ("DIPN") No. 21.

In this context, since the technicians are all employees of Moon-HK, their activities performed substantially outside of Hong Kong leading to the earning of the technical service fee from KK-SZ can be attributable to Moon-HK to support the latter's offshore claim.

Answer 1(b)

Expenses to the extent that they are not incurred in the production of a taxpayer's chargeable profits should be disallowed in computing his profits tax liability (s.16(1) of the IRO). This principle equally applies to depreciation allowances for an asset partly used for the production of a taxpayer's non-taxable income (s.39B of the IRO).

If the above disallowable expenses cannot be reliably and directly identified, the IRD typically accepts indirect apportionment based on a reasonable allocation key proposed by the taxpayer. In this regard, the taxpayer has the burden of proof.

Tax adjustments relevant in the context of this case may include:

- Depreciation allowances attributable to the equipment used for generating the offshore rental income.
- Direct and indirect operating expenses attributable to the earning of the offshore rental and technical service fee incomes.

Answer 1(c)

Moon-HK
Profits tax computation
Year of assessment 2019/20
Basis period: year ended 31 December 2019

Profit before tax	HK\$ 4,000,000
Add:	
Accounting depreciation	1,000,000
Interest expense	50,000
Capital expenditure on mobile phone	5,000
Less:	
Depreciation allowances	<u>(589,400)</u>
Assessable profits	<u>4,465,600</u>
Profits tax liability @ 16.5%	<u>736,824</u>

Computation of depreciation allowances:

	20% Pool HK\$	30% Pool HK\$	HK\$
Tax WDV b/f	1,500,000	500,000	
Addition (HK\$200,000 + HK\$5,000)	205,000	-	
Initial allowance @60%	<u>(123,000)</u>	<u>-</u>	123,000
Annual allowance	<u>(316,400)</u>	<u>(150,000)</u>	<u>466,400</u>
Tax WDV c/f	<u>1,265,600</u>	<u>350,000</u>	<u>589,400</u>

Answer 2(a)

Under the Mainland Corporate Income Tax Law, a non-resident enterprise (i.e. Moon-HK) without any establishment in the Mainland deriving income sourced in the Mainland (i.e. rental income from the use of movable property in the Mainland) shall pay corporate income tax on income sourced within the Mainland. The applicable tax rate is 10% payable by way of withholding.

In this case, since the equipment was brought into the Mainland by KK-SZ, and the customs declaration papers for importation of the equipment into the Mainland were likely handled by KK-SZ, the Mainland tax authority will chase after KK-SZ first as the importer and payer of the rental income for payment of the corporation income tax in the Mainland.

In the case that KK-SZ has not withheld the Mainland corporate income tax before making the payment to Moon-HK, whether KK-SZ will be able to make a claim against Moon-HK for reimbursement of the Mainland tax subsequently paid will depend on the contractual arrangement between the parties (it would seem difficult since the lease contract has specified that Moon-HK is not responsible for any expense associated with the use of the equipment by the lessee).

Under Article 12 of the China-HK DTA, the rental income is regarded as a royalty for the use of commercial equipment and the applicable withholding tax rate is at 7%.

Answer 2(b)

Under the China-HK DTA, business profit is taxable in the Mainland only if Moon-HK has a permanent establishment ("PE") in the Mainland as defined under Article 5 of the China-HK DTA and the profit is attributable to that PE.

In order to enjoy the above PE protection, Moon-HK should be a Hong Kong tax resident as defined under Article 4 of the China-HK DTA. Otherwise for a non-resident, the threshold for service PE in the Mainland is 90 days only.

In the context of this case, Moon-HK's business presence in the Mainland may constitute a PE under the following circumstances:

- A building site, a construction, assembly or installation project or supervisory activities in connection therewith, but only if such site, project or activities last more than six months.
- The furnishing of services, including consultancy services, by an enterprise of One Side directly or through employees or other personnel engaged by the enterprise for such purpose, but only if activities of that nature continue (for the same or a connected project) in the Other Side for a period or periods aggregating more than 183 days within any 12-month period.

Based on the information provided, the Shenzhen project lasted for less than six months (from March 2019 to July 2019) and the total number of days spent in the Mainland by employees of Moon-HK for the KK-SZ project is 133 days (8 + 110 + 15) which does not exceed 183 days.

Although there are two separate contracts for different types of work, they should be considered as connected to the same event. Therefore the days of staff presence in the Mainland under each contract should be aggregated for counting purposes.

It follows that Moon-HK's presence in the Mainland did not constitute a PE in the Mainland (assuming Moon-HK does not have any form of presence in the Mainland other than sending its technicians to work in the Mainland on a travelling basis). Thus the technical service fee income is not subject to the Mainland corporate income tax.

Answer 3(a)

The China-HK DTA provides the following benefits to Moon-HK in relation to its income derived from the Mainland:

- For business profit relating to technical service fee, it is taxable in the Mainland only if Moon-HK has a PE as defined under Article 5.
- The threshold a service PE in the Mainland is extended from 90 days (for non-resident in a non-treaty country) to 183 days (for Hong Kong tax resident).
- Dividend, interest and royalty derived from the Mainland can be subject to the preferential withholding tax rates of 5% or 7%.
- In the event that Moon-HK's income is also subject to corporate income tax in the Mainland under the China-HK DTA, the above tax paid in the Mainland can be creditable against the Hong Kong profits tax liability, as a relief for double taxation of income.
- The China-HK DTA provides the mutual agreement procedure to allow the two competent authorities to discuss and resolve the issue of double taxation suffered by the applicant.

In order to enjoy the above benefits, Moon-HK has to be a Hong Kong tax resident for the purpose of the China-HK DTA. This status can be substantiated by the Certificate of Residence ("CoR") issued by the IRD. In the absence of CoR, Moon-HK would not be entitled to any of the above treaty benefits.

Answer 3(b)

Based on the information given and on the assumption that Moon-HK is a Hong Kong tax resident for the purpose of the China-HK DTA, it appears that Moon-HK does not have a PE in the Mainland and hence its technical service fee income should not be subject to corporate income tax in the Mainland.

Under Article 21 of the China-HK DTA, tax paid in the Mainland only and exclusively in accordance with the provisions of this Arrangement in respect of any item of income derived by a Hong Kong tax resident will be allowed as a credit against the Hong Kong tax payable on that income by the Hong Kong tax resident.

The amount of tax credit will be computed in accordance with the provisions of the IRO. In processing an application for tax credit, the IRD will consider whether the relevant tax is imposed by the Mainland under the laws of China.

S.50 of the IRO provides for the allowance of tax credit under a DTA concluded by Hong Kong. Under s.50(1) of the IRO, foreign tax means "any tax payable in that territory which under the arrangements is to be so allowed...."

If the Mainland corporate income tax paid by Moon-HK is imposed due to whatever reason, and is not in accordance with the China-HK DTA, the China tax paid cannot be regarded as "foreign tax" as defined under s.50(1) of the IRO.

The Mainland corporate income tax paid will not be creditable against Moon-HK's profits tax liability.

In this situation, there is double taxation of profit that cannot be relieved due to the above technical interpretation of the China-HK DTA. Moon-HK may initiate the Mutual Agreement Procedure. By sharing the case information and the circumstances leading to the double taxation with the Mainland and Hong Kong tax authorities, the two tax authorities may come to a mutually agreed method to resolve this problem.

Answer 4(a)

Article 24 of the China-HK DTA provides for the protocol of exchange of information ("EoI") between the two competent authorities as is necessary, in particular information for the prevention of fiscal evasion.

S.51(4AA) of the IRO allows the IRD to collect information (in this case likely from Mary or Moon-HK) concerning Moon-HK's corporate income tax liability in the Mainland for the purpose of EoI.

S.49(5) of the IRO provides that the obligation as to secrecy imposed by s.4 of the IRO shall not prevent the disclosure to any authorised officer of the Mainland tax authority such information as is required to be disclosed under the China-HK DTA.

In light of the above, if the Mainland tax authority makes a specific request to the IRD for information concerning Moon-HK's business activities in the Mainland, and the IRD agrees the information requested is foreseeably relevant to determine Moon-HK's corporate income tax liability in the Mainland under the provisions of the China-HK DTA, the IRD can share the information about Moon-HK's business activities in the Mainland with the Mainland tax authority.

Answer 4(b)

Typical documentation that can defend Moon-HK's position includes:

- CoR certifying Moon-HK is a Hong Kong tax resident for the purpose of the China-HK DTA such that it is entitled to the service PE protection (notably the 183 days threshold) for its business profit.
- Technical service contract specifying the nature of activities performed in the Mainland and the planned period of stay in the Mainland.
- Travel document (passport, immigration card, visa application, air/ train ticket, hotel voucher, etc.) of the person who actually travelled to the Mainland to perform the service.
- Log book for the project showing who is travelling, purpose of stay, date in and date out, etc.

Answer 5

Presently there is no qualification or experience requirement for a person or an entity acting as tax advisors in the contexts of IRO. Specifically, there is no registration system of tax advisors or representatives in Hong Kong. Accordingly, there is no statutory restriction regulating the eligibility of Mr Mak or Mak & Co to provide tax advisory services to his clients.

Yet, in considering the provision of tax advisory services, Mr Mak should comply with the relevant sections within s.600 "Ethics in Tax Practice" in the Code of Ethics for Professional Accountants published by the Hong Kong Institute of Certified Public Accountants. Specifically, Mr Mak should consider the objectivity of his firm by confirming that a conflict of interest does not exist in providing the tax advisory services to Moon-HK, its existing audit client. In addition, Mr Mak should ensure that Mak & Co should have competent professional knowledge to provide the tax advisory service.

* * * END OF SECTION A * * *

SECTION B – ESSAY / SHORT QUESTIONS (Total: 50 marks)

Answer 6

To: Mr Chan
From: xxxxxxxx
Date: xx/xx/xxxx
Subject: Salaries Tax liability for the years of assessment 2018/19 and 2019/20

This memo serves to advise on your salaries tax liability for each of the years of assessment 2018/19 and 2019/20, with respect to the relevant Hong Kong tax principles.

S.8(1)(a) of the IRO provides that salaries tax shall be charged for each year of assessment on every person in respect of his income arising in or derived from Hong Kong from any office or employment of profit. However, there are two exclusion provisions.

The first one is s.8(1A)(b)(ii) of the IRO, which provides that income arising in or derived from Hong Kong from any employment excludes income derived from services rendered by a person who renders outside Hong Kong all the services in connection with his employment. For the purposes of this exclusion, services rendered in Hong Kong during visits not exceeding a total of 60 days in the basis period of a year of assessment are to be ignored pursuant to s.8(1B) of the IRO.

The second one is s.8(1A)(c) of the IRO, subject to ss.8(1C) and 50AA. This provision excludes from the charge to salaries tax income derived by a person from services rendered by him outside Hong Kong in any non-DTA territory where (i) by the laws of the territory where the services are rendered, the income is chargeable to tax of substantially the same nature as salaries tax under the IRO; and (ii) the Commissioner ("CIR") is satisfied that that person has paid tax of that nature in that territory in respect of the income.

As you were employed by ABC, a company incorporated and carrying on business in Hong Kong, the income derived from your employment with ABC is chargeable to salaries tax in Hong Kong under s.8(1)(a) of the IRO.

Since Hong Kong has not entered into any double taxation arrangement with Singapore (i.e. Singapore is a non-DTA territory), we did not have to consider the application of ss.8(1C) and 50AA.

Year of assessment 2018/19

You worked in Hong Kong during the period from 1 April 2018 to 31 December 2018 and were only seconded to Singapore with effect from 1 January 2019. In other words, you did not render all your services in connection with your employment outside Hong Kong for the year of assessment 2018/19 (i.e. from 1 April 2018 to 31 March 2019). As such, you would not be entitled to the exemption under s.8(1A)(b)(ii) of the IRO. Neither could you enjoy the exemption under s.8(1B) as you were present in Hong Kong for more than 60 days in the year of assessment concerned.

On the other hand, albeit the income for the period from 1 January 2019 to 31 March 2019 has been charged to tax in Singapore, you were not entitled to the exemption provided under s.8(1A)(c) as you have not paid tax in Singapore for such part of income (DIPN No. 10 (Revised) para. 37).

Year of assessment 2019/20

It is well established that an employee would only be accepted as having rendered no service in Hong Kong if any services performed in Hong Kong was purely gratuitous, outside the scope of his employment and was done rarely (D129/98, IRBRD, vol 13, 607; D27/03, IRBRD, vol 18,448). During the year of assessment 2019/20, you have brought documents back to Hong Kong for your supervisor's approval and such services could not be regarded as purely gratuitous and unconnected with your employment. In any event, you have reported work progress to your supervisor in Hong Kong. In other words, you have rendered services in connection with your employment in Hong Kong. Accordingly, you would not be entitled to exemption under s.8(1A)(b)(ii) of the IRO. Besides, you were present in Hong Kong for more than 60 days in the year of assessment 2019/20. Neither can you enjoy the exemption under s.8(1B) of the IRO.

Since you have paid tax in Singapore in respect of the income earned from services in Singapore and on the assumption that the tax you paid in Singapore is similar to salaries tax in Hong Kong, you would be entitled to exemption under s.8(1A)(c) of the IRO in respect of that part of the income.

[Note: The assessment rubric for awarding marks for core enabling competences is attached at the end of the suggested answers.]

Answer 7

Property X

Any property inherited from a deceased person's estate under a will, the law of intestacy or the right of survivorship by a beneficiary is not chargeable with stamp duty. Therefore, no Ad Valorem Stamp Duty ("AVD") or Buyer's Stamp Duty ("BSD") is payable on inheritance of Property X.

Besides, sale or transfer of a residential property which is inherited from a deceased person's estate is exempted from Special Stamp Duty ("SSD"). Therefore, even if Property X was disposed within 36 months from the date of inheritance, its sale transaction should not be subject to SSD.

Property Y

As Ms Wong has already owned a residential property in Hong Kong, i.e. Property X, at the time of acquisition of Property Y, the agreement for the purchase of Property Y is chargeable to AVD at Part 1 of Scale 1 rate. Under what circumstances did Ms Wong become the owner of Property X is irrelevant. The amount of AVD payable is HK\$930,000 (HK\$6,200,000 x 15%).

As Ms Wong was born in Canada and has been studying and living there since birth, she is unlikely a Hong Kong permanent resident ("HKPR") at the time of acquisition of Property Y, and should therefore be liable to pay BSD. The amount of BSD payable is HK\$930,000 (HK\$6,200,000 x 15%).

Property Z

If a residential property is jointly acquired by more than one person and any one of the purchasers already owned a residential property in Hong Kong at the time of acquisition, AVD is payable at Part 1 of Scale 1 rate on the entire consideration of the property regardless of the respective share of interest of the purchasers in the property acquired. Therefore, the agreement for the purchase of Property Z is chargeable to AVD at Part 1 of Scale 1 rate. The amount of AVD payable is HK\$1,800,000 (HK\$12,000,000 x 15%).

If the residential property was acquired by a HKPR jointly with a close relative, it is not necessary to levy BSD on the agreement for purchase. However, as Ms Mo was still the girlfriend of Mr Lo, she was not considered as a close relative of Mr Lo when the agreement for sale and purchase was executed. The agreement for the purchase of Property Z should be subject to BSD. The amount of BSD payable is HK\$1,800,000 (HK\$12,000,000 x 15%).

Answer 8

Assuming that GHI-TW is not a company carrying on business in Hong Kong, the licence fees received would not be subject to profits tax under s.14(1) of the IRO. However, the licence fees received by GHI-TW might be caught by the deeming provisions under s.15(1) of the IRO.

S.15(1)(a) and s.15(1)(b) of the IRO deem sums received by or accrued to a person for the use, or right to use in Hong Kong, of any intellectual property listed in the provisions. As the television programmes were for exhibition in Taiwan, the licence fees so received by GHI-TW would not be caught by these two provisions.

However, the licence fees received by GHI-TW would be deemed as trading receipts under s.15(1)(ba) of the IRO. S.15(1)(ba) is applicable where the sums were received for the right of use of copyright material outside Hong Kong and the sums were deductible in ascertaining the assessable profits of a person in Hong Kong, i.e. GHI-HK. (*Turner Entertainment Networks Asia, Inc. for Muse Communication Co Ltd v CIR [2015] 3 HKLRD 295*).

Answer 9(a)

S.64(1) of the IRO provides that any person aggrieved by an assessment may by notice in writing to the CIR object to the assessment but such notice must be received by the CIR within one month after the date of the notice of assessment. However, s.64(1) proviso (a) of the IRO allows the CIR to extend the statutory one-month period to a reasonable time if he is satisfied that the person has been prevented from giving a notice of objection within the statutory period of one month, owing to absence from Hong Kong, sickness or other reasonable cause.

JKL claimed that it failed to lodge an objection in time as it had moved office and for this reason it did not receive the notice of assessment. S.51(8) of the IRO provides that any person chargeable to tax who changes his address should within one month inform the CIR in writing of the particulars of change. If JKL did not receive the notice of assessment due to its failure to inform the CIR of the change of address, this would unlikely be accepted as a reasonable cause for extending the statutory one-month period.

Answer 9(b)

S.51(1) failure

S.51(1) of the IRO provides that an assessor may give a return to any person and requires that person to furnish the return within reasonable time. JKL was required to submit 2018/19 Profits Tax return on or before 15 August 2019. JKL however did not submit the 2018/19 Profits Tax return until 31 December 2019. JKL undoubtedly has failed to comply with the requirement under s.51(1) of the IRO.

If JKL cannot provide a reasonable excuse for the failure to comply with s.51(1), the penal actions under the IRO include the institution of prosecution under s.80(2)(d) (on conviction subject to a fine at level 3 and a further fine of treble the undercharged amount), the compounding of the offence in lieu of prosecution under s.80(5), and the imposition of additional tax under s.82A(1)(d) as a penalty.

S.51(2) failure

S.51(2) of the IRO provides that any person chargeable to tax should inform the CIR in writing that he is so chargeable not later than 4 months after the end of that year of assessment. Given that the assessable profits of JKL for the year of assessment 2018/19 amount to HK\$3 million, it is likely that it also has assessable profits for the three previous years of assessment 2015/16 to 2017/18, in respect of which no returns have been issued by the IRD. If so, JKL has failed to comply with s.51(2) of the IRO.

If JKL cannot provide a reasonable excuse for the failure to comply with s.51(2), the penal actions, as mentioned above for s.51(1) failure, apply equally to failure under s.51(2), viz. prosecution under s.80(2)(e), compounding under s.80(5) and imposition of additional tax under s.82A(1)(e).

S.51(8) failure

S.51(8) of the IRO provides that any person chargeable to tax who changes address shall within 1 month inform the CIR in writing of the particulars of the change. JKL in its notice of objection stated that it had moved office and did not receive the notice of assessment. This suggests that JKL has failed to comply with s.51(8) of the IRO.

If JKL cannot provide a reasonable excuse for the failure to comply with s.51(8), the penal actions under the IRO include the institution of prosecution under s.80(1)(c) (on conviction subject to a fine at level 3 with court order for compliance) or the compounding of the offence in lieu of prosecution under s.80(5).

Answer 10(a)

S.5(1) of the IRO provides that property tax shall be charged for each year of assessment on every person being the owner of any land or buildings wherever situate in Hong Kong and shall be computed at the standard rate on the net assessable value of such land or buildings for each such year. As MNO is the legal owner of a landed property situated in Hong Kong, it should be subject to property tax in respect of the rental income derived by it.

MNO is entitled to three types of deductions under property tax.

S.5(1A)(b)(i) of the IRO allows for the deduction of the rates that the owner agrees to pay.

S.5(1A)(b)(ii) allows for the deduction of an allowance for repairs and outgoings which is 20% of the assessable value after deduction of the rates under s.5(1A)(b)(i).

S.7C(1) of the IRO allows for the deduction of any consideration receivable by the owner which has proved to the satisfaction of the assessor that it has become irrecoverable during that year of assessment.

In this case, the tenant failed to pay rent of 3.5 months for the period from 1 November 2018 to 15 February 2019. The outstanding rent totaling HK\$175,000 (HK\$50,000 x 3.5) can be accepted as irrecoverable on 15 February 2019 when the tenant vacated the property (i.e. year of assessment 2018/19). If MNO had used the deposit of HK\$100,000 to offset part of the irrecoverable rent, the net amount that has become irrecoverable was HK\$75,000 (i.e. HK\$175,000 - HK\$100,000). This sum can be deducted from the total rent receivable of HK\$525,000 (HK\$50,000 x 10.5 months).

Apart from the irrecoverable rent, MNO is entitled to deduction under s.5(1A)(b)(i) of the rates paid by it. The amount allowable for deduction is HK\$27,500 (HK\$7,500 / 3 x 11).

Also, MNO is entitled to deduction of 20% statutory allowance. The amount allowable for deduction is HK\$84,500 ((HK\$525,000 - HK\$75,000) - HK\$27,500] x 20%).

Answer 10(b)

S.14(1) of the IRO provides that profits tax shall be charged for each year of assessment on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business.

"Business" is defined under s.2(1) of the IRO to include letting or sub-letting of any premises by any corporation. S.2(1) also defines "corporation" to mean any company which is either incorporated or registered under any enactment or charter in force in Hong Kong or elsewhere.

There should be no dispute that MNO is a corporation within the meaning of s.2(1) and it derived rental income from the letting of property. Pursuant to s.2(1) of the IRO, the letting of property by MNO, being a corporation, already constitutes a business. Given that the property concerned was situated in Hong Kong, the business of letting must be carried on by MNO in Hong Kong. As the source of the rental income is clearly in Hong Kong, it follows that the profits of letting business of MNO should be chargeable to profits tax in Hong Kong under s.14(1) of the IRO.

S.25 provides for relief to a corporation under profits tax if that corporation is also chargeable to property tax on the same income. By the operation of s.25, the amount of profits tax payable shall be reduced by the amount of property tax paid.

In addition, a corporation which would be entitled to s.25 set-off may apply in writing with the CIR for exemption of property tax.

Assessment rubric for awarding marks for core enabling competences

	2 marks	1 mark	0 mark
Demonstration of communication skill	The candidate has presented the answer in an appropriate format. The candidate has presented well-structured content to the audience specified in the question requirement.	The candidate has presented the answer in an appropriate format, but overall the content is not well-structured and logically presented to the audience specified in the question requirement.	The candidate has not presented the answer in an appropriate format. The information presented is not relevant to the audience specified in the question requirement.
Demonstration of analytical skill	The candidate has demonstrated questioning mind for issues and is able to identify relevant facts in the case background. The candidate has made appropriate judgements / conclusions based on relevant facts.	The candidate has identified some issues and some relevant facts in the case background. Not all judgements/ conclusions are made based on analysis of relevant facts.	The candidate is not able to identify issues and relevant facts in the case background. The answer is merely restatement of information from the case background without any analysis.
Demonstration of problem solving skill	The candidate is able to understand the problem and determine the root causes based on the case background. The candidate is also able to identify the alternatives and recommend an appropriate solution with consideration of the circumstances.	The candidate understands the problem but has only partially determined the root causes based on the case background. The candidate has identified some alternatives without recommending which should be taken.	The candidate does not understand the problem and is not able to determine the root causes based on the case background. No alternatives or recommended solutions are found in the answer.
Demonstration of the five-step process in addressing ethical dilemmas	The candidate is able to apply the full five-step process to address the ethical dilemma based on the case background. The candidate is able to discover alternative solutions and recommend an appropriate solution with detailed explanation.	The candidate is able to partially apply the five-step process to address the ethical dilemma based on the case background. The candidate has discovered some alternative solutions without recommendation and explanation.	The candidate is not able to apply the five-step process to address the ethical dilemma based on the case background. No alternative solutions or recommendations are found in the answer.

* * * END OF EXAMINATION PAPER * * *