

SECTION A – CASE QUESTIONS (Total: 50 marks)

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

CASE

Zeus Corporation (“Zeus”) is a company established in Greece engaging in the entertainment business exclusively in the local Greek market, and has various subsidiaries incorporated worldwide engaging in similar entertainment businesses. In Hong Kong, Zeus set up a wholly-owned subsidiary in the prior year, namely Abas Entertainment Company Limited (“Abas”), carrying on concert production, publication and media businesses for the Hong Kong local market. To facilitate the promotion of its business for customers from the Mainland, Abas also established a representative office (“Abas RO”) in Guangzhou of the People’s Republic of China (“PRC”) for providing marketing and liaison services.

In early 2013, Zeus employed a senior executive Mr Panoptes Hercules in Greece as its Chief Tax Officer for the Asia Pacific region. According to the employment contract entered into between Zeus and Mr Hercules, he is required to travel to various Asia Pacific countries to review the business of Zeus’s subsidiaries, particularly from a tax perspective, and then report directly to the Board of Directors of Zeus in Greece (“the Board”).

During the year ended 31 March 2014, Mr Hercules spent a considerable period of time in Hong Kong to review the business of Abas from a tax perspective. Specifically Mr Hercules has identified the following matters to report to the Board which are either relevant to the tax regime in Hong Kong, or may have cross-border tax implications with respect to the specific business activities carried on by Abas:-

1. Other than complying with the provisions under the Inland Revenue Ordinance (“IRO”), Abas should also take into account local court cases on tax matters, Board of Review (“BOR”) decisions and Departmental Interpretation and Practice Notes (“DIPN”) issued by the Inland Revenue Department (“IRD”) in fulfilling its tax obligations.
2. There may have been the possibility of contravention by officers of the IRD to maintain the confidentiality of the information provided by Abas on the one hand, and to fulfill the obligation in the exchange of information to tax authorities of other jurisdictions under the Double Taxation Agreements entered into with other countries on the other hand.
3. According to a licensing agreement entered into between Zeus and Abas, a royalty fee in the amount of 5% on the annual turnover of Abas is required to be paid by Abas to Zeus in connection to the use by Abas in Hong Kong of a trademark owned by Zeus. During the year ended 31 March 2014, Zeus received HK\$1,000,000 in royalty income from Abas in this regard.

4. Abas planned to organise concerts in Hong Kong performed by a renowned Greek vocalist Ms Metis Minos. Based on the preliminary discussions between Ms Minos and Abas, Ms Minos will be present in Hong Kong for a week to perform four concerts. As the concert organiser, Abas will pay HK\$6,000,000 in total to Ms Minos for her performances in Hong Kong.
5. Abas RO has been established exclusively for promotion and liaison purposes and did not perform any income generating activities in the PRC. In respect of the 12 months ended 31 March 2014, the relevant PRC tax bureau has deemed the total taxable profits of Abas RO as equivalent to HK\$300,000 and respective total PRC Corporate Income Tax ("CIT") equivalent to HK\$75,000 (at the rate of 25%), which has also been paid accordingly.

Without taking into account any of the abovesaid PRC deemed profits and tax payments, the assessable profits of Abas for the year ended 31 March 2014 (i.e. year of assessment 2013/14) have been computed by Abas in the amount of HK\$5,000,000.

6. During the year ended 31 March 2014, Abas was incidentally appointed by a PRC local company established in Shanghai namely Poseidon (Shanghai) Limited ("Poseidon") to conduct an inspection service in Hong Kong. According to the respective service contract, Abas conducted a comprehensive site inspection for a singing contest stage constructed in the Hong Kong Coliseum in Hung Hom, Kowloon by a third party contractor. All of the services conducted by Abas for this contract were performed in Hong Kong. Under the terms of the contract, Poseidon paid a service fee of HK\$500,000 to Abas through a bank remittance upon completion of the inspection work. The relevant PRC tax bureau assessed that this transaction was outside the coverage of Value Added Tax reform, as of the assessment date.

Mr Hercules is a Greek residing in Athens. During the year ended 31 March 2014, he visited Hong Kong to discharge his duties on the following dates:-

<u>Date of arrival to Hong Kong</u>	<u>Date of departure from Hong Kong</u>
1 June 2013	15 June 2013
10 September 2013	24 September 2013
5 December 2013	14 December 2013
17 January 2014	29 January 2014
17 February 2014	18 February 2014
19 March 2014	24 March 2014

During his visit to Hong Kong, Mr Hercules stayed in a hotel's standard room at the expense of Zeus. He is single, and ordinarily resides in Athens with his parents, both aged 70. His total employment income received from Zeus for the year ended 31 March 2014 is equivalent to HK\$1,800,000 and has been credited to his bank account in Athens by Zeus.

Question 1 (7 marks – approximately 13 minutes)

Discuss the importance of local court cases on tax matters, BOR decisions and DIPN in the tax regime of Hong Kong.

(7 marks)

Question 2 (3 marks – approximately 5 minutes)

Discuss whether there is any possible contravention by the IRD in maintaining the confidentiality of the information provided by Abas on the one hand, and the request for exchange of information made by tax authorities of other jurisdictions under the Double Taxation Agreements entered into by the Hong Kong SAR with other countries on the other hand.

(3 marks)

Question 3 (7 marks – approximately 13 minutes)

Discuss the Hong Kong tax implications and treatment of the income earned by Zeus under the licensing arrangement between Zeus and Abas and, where appropriate, compute the associated Hong Kong tax liability (ignore provisional tax and tax reduction for the year, if any).

(7 marks)

Question 4 (5 marks – approximately 9 minutes)

Discuss the Hong Kong tax implications and treatment of the income payable to Ms Metis Minos with respect to the proposed concerts organised by Abas and, where appropriate, compute the associated Hong Kong tax liability (ignore provisional tax and tax reduction for the year, if any).

(5 marks)

Question 5 (9 marks – approximately 16 minutes)

With reference to the methods for the elimination of double taxation as specified in the *“Arrangement between the Mainland of China and the Hong Kong SAR for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income”*, compute (i) the tax credit for CIT paid by Abas RO and (ii) the associated profits tax payable by Abas for the year ended 31 March 2014 after taking into account the tax credit available to Abas (i.e. year of assessment 2013/14). Ignore provisional tax and tax reduction for the year, if any, in your computation.

(9 marks)

Question 6 (5 marks – approximately 9 minutes)

Discuss whether the payment received by Abas from Poseidon is subject to any PRC Turnover Tax.

(5 marks)

Question 7 (14 marks – approximately 25 minutes)

(a) Discuss the taxability of the employment income derived by Mr Panoptes Hercules for the year ended 31 March 2014 under the Hong Kong tax regime.

(6 marks)

(b) Compute the salaries tax liability of Mr Panoptes Hercules for the year of assessment 2013/14 based on your discussion as per Question 7(a) above (ignore provisional tax and tax reduction for the year, if any).

(8 marks)

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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 and appropriate presentation of the answers.

Question 8 (6 marks – approximately 11 minutes)

Mr Smith is single and now retired. He was the financial controller of an international company located in Tsimshatsui. His residence was also in Tsimshatsui (“the Residence”). He paid a monthly rent of HK\$15,000 in respect of the Residence whereas his monthly salary was HK\$60,000. He had no other income apart from that employment income. Mr Smith did not run any business or own any property either. In July 2012, he acquired a property in Shatin (“the Property”) from the developer with plan at a cost of HK\$5,700,000. The Property was situated next to an old hospital. To finance the acquisition, he took out an equitable mortgage of HK\$5,000,000 which he had to repay at a monthly instalment of HK\$40,000. As to the down payment as well as the other relevant expenses such as legal fee and stamp duty, Mr Smith pooled all his savings to meet those cost or expenses.

Mr Smith retired in November 2012. He received HK\$200,000 from the provident fund upon his retirement. He was not entitled to a monthly pension according to the terms of the provident fund scheme to which he contributed. The purchase of the Property was completed in December 2013. Mr Smith sold the Property in February 2014 and derived profits of \$1,500,000 from the disposal. He never moved into the Property but remained residing at the Residence. It is Mr Smith’s case that (a) he purchased the Property as his residence; (b) he felt uncomfortable with that hospital and he was unaware of it when he acquired the Property. Both Mr Smith and the Assessor agree that there was no change of intention throughout.

Required:

- (a) **Cite and elaborate two court cases which are relevant in the present case with regard to the intention of Mr Smith in ascertaining whether the Property was of capital or revenue in nature.** (2 marks)
- (b) **Discuss whether Mr Smith is chargeable to profits tax in respect of the profits which he derived from the disposal of the Property.** (4 marks)

Question 9 (22 marks – approximately 39 minutes)

Mrs Chan has been a housewife since getting married to Mr Chan. As she had no property, Mr Chan specifically set out in his will that a residential property was to be passed to her after his death. Mrs Chan inherited that property upon the passing away of Mr Chan in September 2012. She subdivided that residential property into three cubicle rooms. Through the introduction of the neighbours, Mrs Chan knew Adrian, Benjamin and Clive and licensed the cubicle rooms to them on the following terms:

	Adrian ("Licence A")	Benjamin ("Licence B")	Clive ("Licence C")
Dates of the written licence	1/12/2012	1/4/2013	The terms of the licence were verbally agreed on 1/4/2013
Terms of the licence	Two years from 1/12/2012 to 30/11/2014	Six months from 1/4/2013 to 30/9/2013	Six months from 1/4/2013 to 30/9/2013
Monthly licence fees	HK\$5,000	HK\$4,000	HK\$3,000
Rates, Government rent and management fees	To be paid by Mrs Chan		
Deposit	Equivalent to one month's licence fee to be paid by Adrian, Benjamin and Clive on the commencement of their respective licences. The deposits were to be held by Mrs Chan over the tenure of the licences. The licensees agreed that the deposits would be forfeited to set off their outstanding licence fees and the cost of repair if there was damage to the cubicle rooms.		
Usage	To be possessed exclusively by the respective licensees. As it is a residential property, the cubicle rooms can only be used for residential purposes.		
Provision of furniture by Mrs Chan	Nil		

On its expiry, Licence B was renewed for a further two months to 30 November 2013 ("Licence B1") at the same monthly licence fee. No written licence was entered into in respect of Licence B1. Benjamin did not pay the licence fee for the month of November 2013. He asked Mrs Chan to use the deposit to offset the licence fee of that month.

Clive did not pay his licence fee from June 2013 onwards. He moved out of the property on 30 November 2013. The Assessor of the IRD accepts that Mrs Chan is unable to recover the licence fees from July 2013 and after.

Mrs Chan handled the subdividing and the licensing matters on her own as the issues were simple and straightforward. She appointed a decoration company and incurred renovation costs of HK\$10,000 in the year of assessment 2012/13 in subdividing the property into three cubicle rooms and reconstructing the sewerage system. That aside, she paid the following expenses in the year of assessment 2013/14 in licensing the cubicle rooms:

Rates	HK\$3,500 (after rates concession)
Government rent	HK\$7,000
Management fees	HK\$12,000

Required:

- (a) Determine, with explanations in support, the type of tax which Mrs Chan was chargeable to and compute her tax liability for the year of assessment 2013/14 with respect to the licence fees income. Mrs Chan does not elect to have her income assessed under Personal Assessment (ignore provisional tax and tax reduction for the year, if any).

(6 marks)

- (b) Discuss whether, and if so, how, the tax liability of Mrs Chan will be different if she was a head tenant of the property. In this regard, she entered into a head lease with the landlord and then entered into the licences with Adrian, Benjamin and Clive on the same terms and paid the same expenses as set out above. She also incurred the rental expense on the head lease.

Note: No tax computation is required.

(8 marks)

- (c) Discuss whether, and if so, how, each of Licence A, Licence B, Licence B1 and Licence C was chargeable to stamp duty.

(4 marks)

- (d) Elaborate the consequences of not stamping an instrument, including and not limited to a lease, that is chargeable to stamp duty.

(4 marks)

Question 10 (12 marks – approximately 22 minutes)

- (a) David is a tennis coach. He teaches classes at various tennis courts and incurs travelling expenses when travelling between his home and the tennis courts. He also incurs travelling expenses when travelling between tennis courts but he receives no reimbursement from his employer.
- (b) Eric is a property agent. His employer requires him to dress properly so that he looks smart and professional when promoting properties. In his Individual Tax Return for the year of assessment 2013/14, he claimed deduction for the expenses which he incurred on the purchase of renowned brand suits and genuine leather shoes. He furnished invoices dated 1 March 2013 to support his claims in this regard.
- (c) Felix is the graphic designer of an advertising company. His employer allows him to do the design work at home when necessary so that he can look after his kids. For this purpose, his employer provides Felix with a desktop computer for his use at home. That computer, however, is not the latest model. Felix therefore purchased a new computer to do his work. He incurred the cost on the acquisition of his new computer.

Required:

Discuss, with explanations to support, whether the following expenses or costs are allowable for deduction from the perspective of salaries tax:

- (a) **The travelling expenses incurred by David when he travels (i) between his home and the tennis courts; and (ii) between tennis courts.**
(4 marks)
- (b) **The expenses incurred by Eric on the purchase of renowned brand suits and genuine leather shoes as he claimed in his Individual Tax Return for the year of assessment 2013/14.**
(4 marks)
- (c) **The cost incurred by Felix on the acquisition of his new computer.**
(4 marks)

Question 11 (6 marks – approximately 11 minutes)

Mr Bill is an expatriate. He objected to the salaries tax assessment for the year of assessment 2013/14 raised on him. The assessment is due for payment early next week. To date, he has not received a reply from the IRD on whether, and if so, how his salaries tax will be held over. Mr Bill is wondering whether he should pay the salaries tax by the due date.

Required:

Elaborate the provisions in the Inland Revenue Ordinance that are relevant to Mr Bill on the payment and the recovery of tax.

(6 marks)

Question 12 (4 marks – approximately 7 minutes)

Mr Mak is the audit partner of A & Co as well as the tax director of A Limited, an associated company of A & Co. Hiccups Limited recently appointed A & Co and A Limited as its auditor and tax advisor respectively. In the course of carrying out the audit for the year of assessment 2013/14, A & Co found that the closing stock of Hiccups Limited might have been understated. A & Co therefore qualified the company's accounts in this regard.

Required:

From an ethical perspective, answer the following questions.

(a) What consideration should Mr Mak, as the tax director of A Limited, bear in mind in taking up the appointment as the tax advisor of Hiccups Limited?

(2 marks)

(b) How should Mr Mak advise Hiccups Limited, including and not limited to the preparation of tax computations, in light of the qualified opinion expressed by A & Co?

(2 marks)

* * * END OF EXAMINATION PAPER * * *