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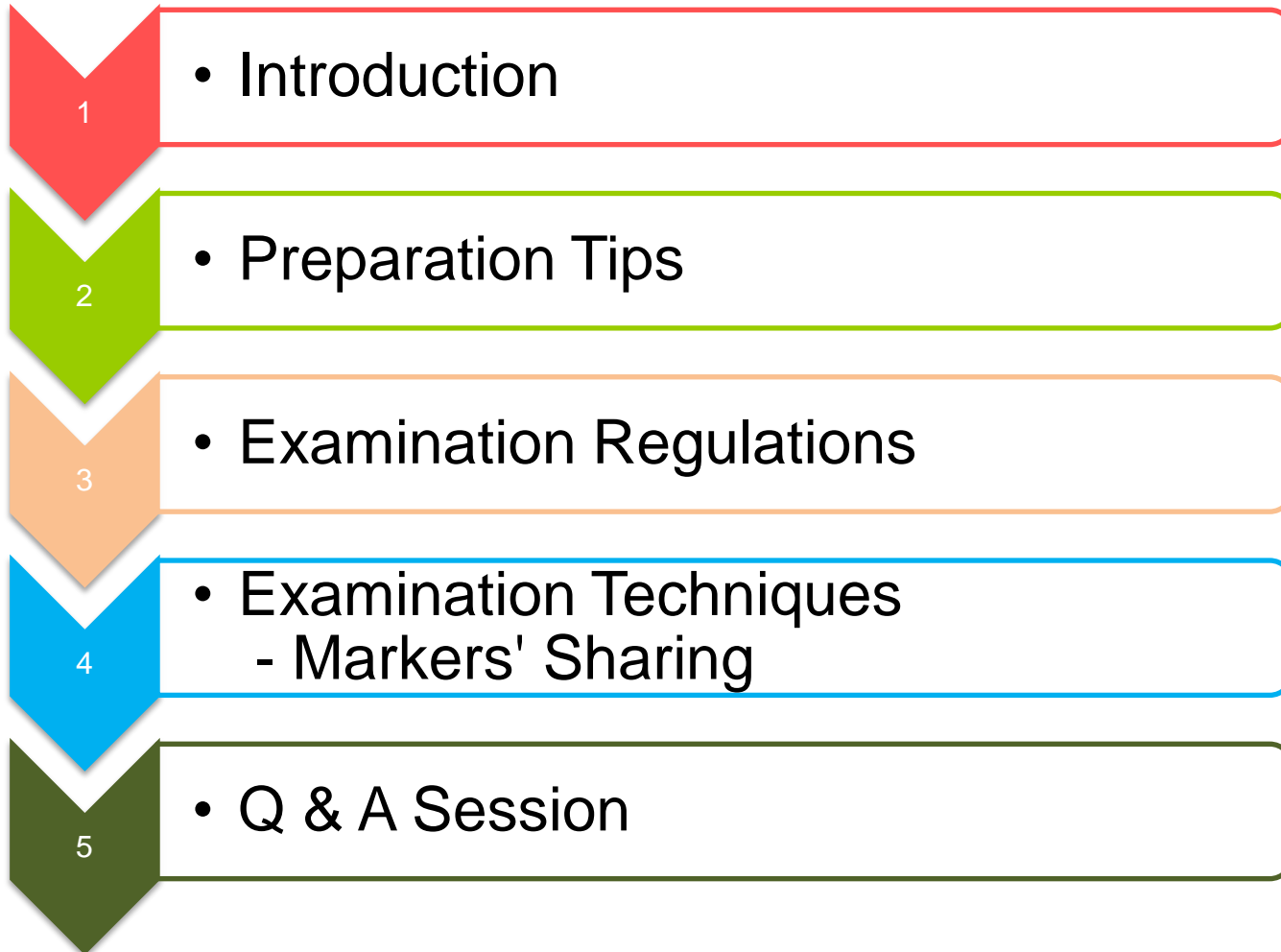
Examination Techniques Seminar on QP Module Examinations

Module D (December 2018 Session)

Date: 8 November 2018



Agenda





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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 Module
- All compulsory questions



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Part 2: Preparation Tips



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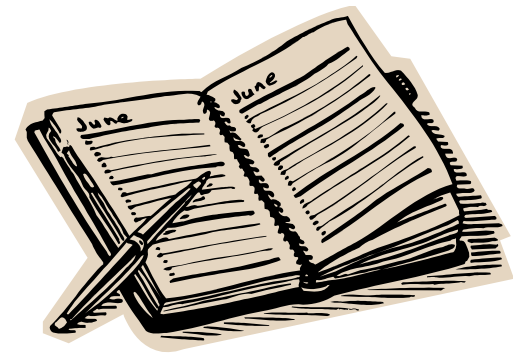


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Commit to your Study Plan

Advantages:

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





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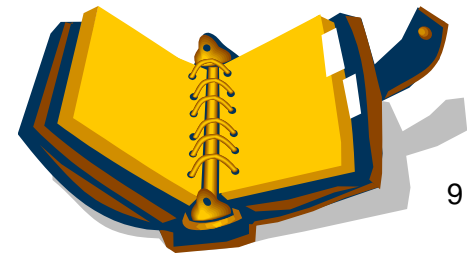
Prepare Critical File

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:

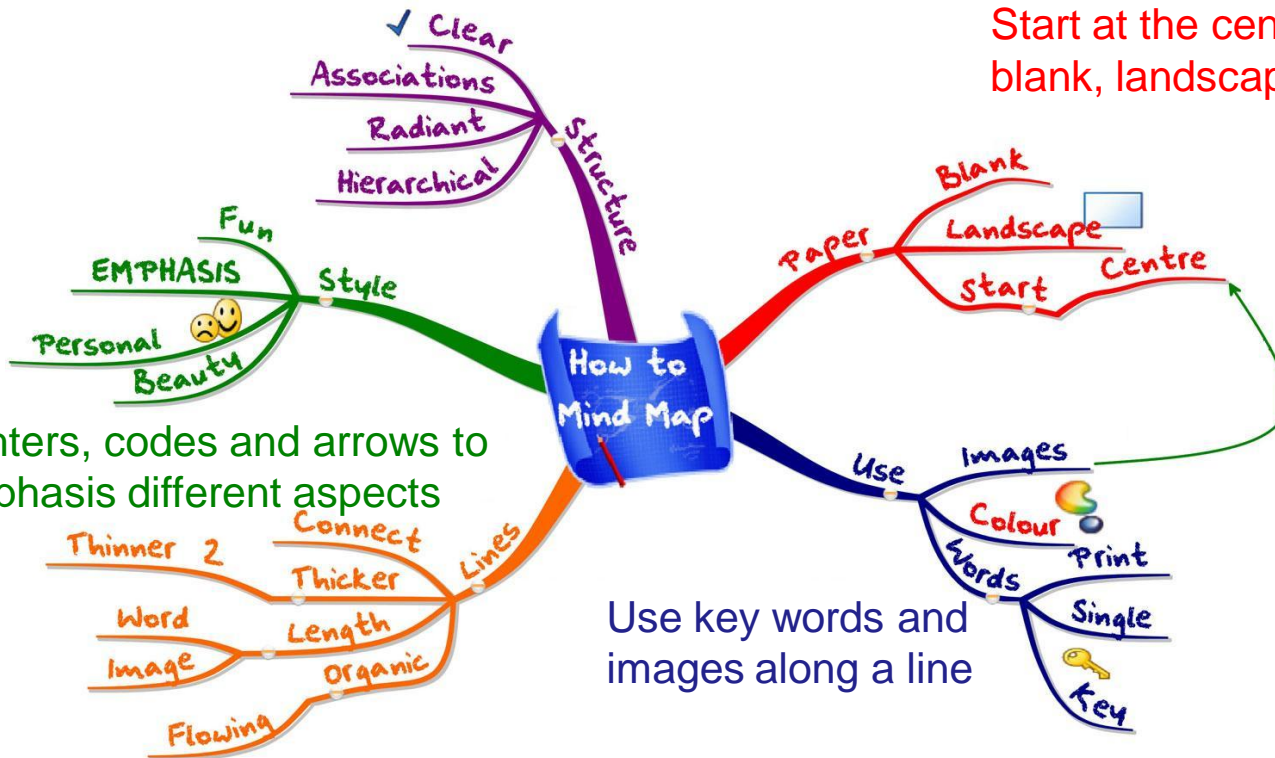
- Colour coding for standards / topics allows easy identification (same file used in examination – time saving!)
- Build up long term memories
- Avoid indexing without understanding



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 emphasis different aspects

Use key words and images along a line

Make the lines associate as clear as possible



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Other Preparation Tips

- Cover beyond LP
- Form Study Group with fellow students
- Visit QP Learning Centre
 - Past papers and Examiners' reports;
 - Special topics and/or Important notice; and
 - Module preparation seminar archives



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Part 3: Examination Regulations



Examination Regulations (highlights)


- Bring HKID card and Examination Attendance Docket ("EAD")
- Be aware of the **examination regulations** printed on the EAD which will be posted to students two weeks before the examination
- Arrive 45 minutes before the examination start
- Turn off your mobile phone or other electronic communication devices
- Don't write on the script booklet during the reading time (FE only)
- Don't write your name or personal information on anywhere of your script booklets
- Use blue or black ink pen
- Use appropriate script booklet to answer each section
- Stop writing immediately once the end of examination is announced

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

Noticeboard
Module A
Module B
Module C
Module D
Final Examination
Examination Support
Technical Articles
Webcasted Video
Audio Archives
Download





Examination guidelines

This [video](#)  provides guidance on preparing for your upcoming examinations. Make sure you are familiar with these guidelines.

If you are unable to open the video by Internet Explorer, try opening it in a different browser (e.g. Chrome).

Examination assistance

Here are some study tips to help QP students to get through their examinations (please click [here](#) ).

To help QP students prepare for the four module examinations, the Institute organizes a series of examination assistance functions for each examination session. For more details, please click [here](#) .

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Part 4:

Examination Techniques

- Markers' Sharing



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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



Case background

Case

PC Limited (“PCL”), a Hong Kong company, is engaged in the businesses of trading and investment holding in overseas subsidiaries. Recently Mr Fung has been employed by PCL as Finance Manager and, upon commencement of employment, the following tax issues were tabled on his desk for his further action:

A. Appeal made to the Board of Review (“BOR”)

The BOR recently made a decision in favour of the Commissioner of Inland Revenue with respect to a tax appeal lodged by PCL, and PCL now would apply for an appeal to the Court of First Instance. However, it is noted that there are some legislative amendments in the Inland Revenue Ordinance (“IRO”) in 2015 regarding the tax appeal mechanism, and the management of PCL has no idea whether the changes would affect their upcoming appeal to the Court of First Instance.

➤ Q1



Case background

B. Preparation of 2016/17 Profits Tax Computation (“PTC”)

PCL’s 2016/17 PTC is being prepared and, inter alia, the following items have not yet been accounted for by PCL’s accounting staff:

(i)	<u>Interest income</u>	HK\$
•	Interest income on overdue trade debts from PCL’s overseas customers	195,730
•	Local bank interest income from Bank A (respective deposit was used to secure a bank loan borrowed by a Hong Kong fellow subsidiary of PCL, and the respective loan interest has been claimed as a deduction by the fellow subsidiary)	87,500
•	Overseas bank interest income from Bank B	120,300
•	Loan interest income from PCL’s overseas subsidiaries (the loans were advanced to the overseas subsidiaries’ bank accounts in Hong Kong)	3,500,000
		<u>3,903,530</u>

➤ Q2



Case background (cont'd)

(ii)	<u>Investment income / (loss)</u>	
	• Dividend income from listed shares held by PCL for trading purposes	886,200
	• Revaluation gain on certain Hong Kong listed shares (Share X) held for trading purposes	3,733,000
	• Revaluation loss on other Hong Kong listed shares (Share Y) held for trading purposes	(198,600)
		<u>4,420,600</u>
(iii)	<u>Exchange gain / (loss)</u>	
	• Gain derived from translation of year end bank accounts balance	295,000
	• Loss derived from translation of year end trade balance payables and receivables	(195,600)
		<u>99,400</u>

➤ Q2



Case background (cont'd)

(iv)	<u>Compensation income</u>	HK\$
	<ul style="list-style-type: none">• Compensation from a former director of PCL in breaching the non-competing clause of joining a rival competitor upon resignation. The relevant clause has been specified in the respective director's appointment letter.	<u>880,000</u>
(v)	<u>Interest expenses</u>	
	<ul style="list-style-type: none">• Loan interest paid to a subsidiary of PCL established in Thailand (The loan was exclusively used for facilitating PCL's trading business deriving taxable sales income)	380,950
	<ul style="list-style-type: none">• Loan interest to Bank C (the loan was secured by listed shares held by PCL for trading purposes)	184,560
	<ul style="list-style-type: none">• Loan interest to Bank D (the loan was unsecured and was exclusively used for investment in PCL's newly established subsidiary in Vietnam)	150,780
		<u>716,290</u>

➤ Q2



Case background (cont'd)

(vi) Bad debts

- | | |
|---|------------------|
| • Bad debts written off regarding an interest free loan advanced to a former staff member | 950,000 |
| • Provision of bad debts based on 50% of outstanding trade debts due for more than one year as at year end date | 1,758,320 |
| | <u>2,708,320</u> |

➤ Q2

C. Corporate treasury activities

In view of the increasing trend for the demand of intra group financing and treasury services from its overseas subsidiaries, and with the profits tax concession granted under the relevant provisions of the IRO for these activities in recent years, the management of PCL plans to establish an entity in Hong Kong specifically and exclusively conducting corporate treasury activities for its overseas subsidiaries, on the basis that the entity can enjoy the profits tax concession.

➤ Q3



Case background (cont'd)

D. A Mainland Chinese employee temporarily working in Hong Kong

A Mainland subsidiary of PCL namely PC (China) Limited (“PCN”) recently employed a Mainland Chinese resident Mr Zhang as a staff member, and would like to schedule him to work in Hong Kong for four months for a research project on garment production efficiency matters. According to the plan of PCN, Mr Zhang would receive a monthly salary of RMB8,800 and a monthly allowance of RMB5,000. In addition, Mr Zhang will perform his research work in the office of PCL during his stay in Hong Kong notwithstanding that his work has no connection to the business of PCL, and PCL will not reimburse or pay any amount to PCN or Mr Zhang with respect to his services to be performed in Hong Kong.

➤ Q4



Case background (cont'd)

D. A Mainland Chinese employee temporarily working in Hong Kong

The management of PCL would like to know the respective Individual Income Tax liabilities in the Mainland and, if any, the Hong Kong salaries tax exposure of Mr Zhang during his four months' stay in Hong Kong.

➤ Q4

Mr Fung, after reviewing the abovesaid matters, would advise the management of PCL to appoint a reputable tax consulting firm namely Aplus & Co. to provide tax advisory services for item (C) as he does not have the relevant tax knowledge to deal with the matter.

➤ Q5



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June 2018 Session – Sect A – Q1 **(4 marks – approximately 7 minutes)**

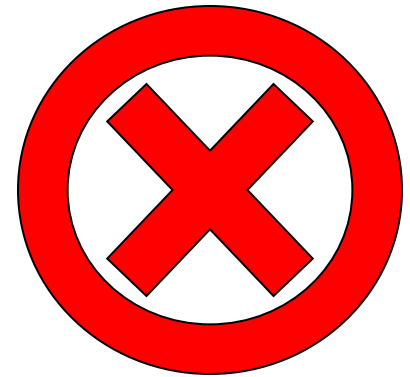
In the contexts of the relevant IRO amendments made in year 2015, advise as to the respective changes in the tax appeal mechanism and their possible effects on PCL's appeal to the Court of First Instance.

(4 marks)



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Question 1



Wrong answers

- Wrongly discussed objection and appeal procedures



Answer 1

- Prior to the Inland Revenue (Amendment) (No.3) Ordinance 2015 (“the Amendment”) enacted in November 2015, the appellant was required to make a written application requesting the Board of Review to state a case on a question of law for the opinion of the Court of First Instance under s.69(1) of the Inland Revenue Ordinance (“IRO”), and deliver it to the Clerk to the Board of Review within the stipulated timeframe and under guidance specified in s.69 of the IRO. After the Amendment which became effective from April 2016, the above case state procedure was abolished and the appellant may apply directly to the Court of First Instance for leave to appeal against the Board of Review decision on a ground involving only a question of law (Departmental Interpretation and Practice Notes (“DIPN”) No. 6 (Revised), paras. 59 to 61, and 63)
- Pursuant to the Amendment, PCL’s appeal to the Court of First Instance should proceed in a more cost efficient and less time-consuming manner.



June 2018 Session – Sect A – Q2 **(20 marks – approximately 36 minutes)**

(a) Based on the information provided in Part B of the case, compute for PCL:

- (i) The total amounts of taxable and non-taxable income respectively.
- (ii) The total amounts of deductible and non-deductible expenses respectively.

(10 marks)

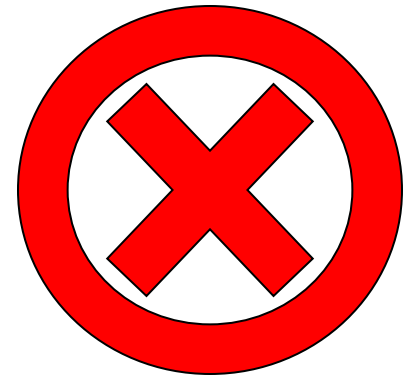


Sample answer 2(a) – Wrong

2a)		PCL
Profits Tax Computation for the Year of assessment		
2016/17		
Basis period : 1 Apr 2016 to 31 Mar 2017		
		\$
Net Profit :		
Add :		
Interest expense	380,950	
Interest expense	184,560	
Interest expense	150,780	
Bad debt	950,000	
Bad bebt	1,758,320	
Less :		
Compensation income	(880,000)	
Exchange gain	(295,000)	
Interest income	(120,300)	



Question 2(a)



Problem

- Treat specific income as both taxable and non-taxable
- Treat expenses as both deductible and non-deductible
- Prepare profits tax computation which was not required



Answer 2(a)(i) & (ii)

	Taxable HK\$	Non- taxable HK\$	Deductible HK\$	Non- deductible HK\$
Interest income on overdue trade debts	195,730			
Interest income from Bank A	87,500			
Interest income from Bank B		120,300		
Interest income from overseas subsidiaries	3,500,000			
Dividend income		886,200		
Revaluation gain from listed shares (Share X)		3,733,000		
Revaluation loss from listed shares (Share Y)			198,600	
Exchange gain		295,000		
Exchange loss			195,600	
Compensation income		880,000		
Interest expenses to an overseas subsidiary				380,950
Interest expenses to Bank C			184,560	
Interest expenses to Bank D				150,780
Staff loan written off				950,000
Trade debts provision				1,758,320
	<hr/> 3,783,230	<hr/> 5,914,500	<hr/> 578,760	<hr/> 3,240,050



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June 2018 Session – Sect A – Q2 (Cont'd) **(20 marks – approximately 36 minutes)**

(b) Explain your non-taxable and non-deductible treatments of the items identified in your above computations.

(10 marks)



Sample answer 2(b) – Wrong

- 2b) (i1) is taxable as it is revenue in nature
- (i2) is taxable as it is used to secure the loan of its subsidy
- (i3) is not taxable as it is off-shore (s.14(1))
- (i4) is taxable as it is used to secure the loan of its subsidy
- (i5) is not taxable as it is capital in nature
- (i6) is not taxable as there is no actual gain
- (i7) is not taxable as there is no tax as dividend (s.26(a))
- (i8) is not taxable as it is capital in nature

- (ii1) is not deductible as there is no actual loss
- (ii2) is deductible as it is revenue in nature
- (ii3) is deductible as under S.16(2)(g)
- (ii4) is deductible as the loan is secured
- (ii5) is not deductible as the loan is not secured
- (ii6) is not deductible as it is capital in nature
- (ii7) is deductible as it is revenue in nature



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Question 2(b)



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Problem

- Spent too much time explaining certain items exclusively
- Explained the tax treatment of taxable income and deductible expenses which were not required
- Answers were too brief



Answer 2(b)

- Interest income from Bank B is offshore in nature under the provision of credit test, and therefore should be non-taxable under s.14(1) of the IRO. Dividend income is howsoever non-taxable either under s.26(a) of the IRO if it is derived from a corporation chargeable to profits tax, or under s.14(1) of the IRO as offshore in nature if it is derived from a corporation which carried on business outside Hong Kong. Notional gain on revaluation of listed shares held for trading purposes is not taxable under s.14(1) of the IRO pursuant to the Nice Cheer case [FACV 23/2012]. Exchange gain on bank accounts balance is capital in nature and therefore non-taxable in accordance with the Li & Fung Limited case [1980] HKT 1193. Compensation from the former director for the breaching of a non-competing clause in the employment contract is capital in nature and not derived from the normal course of PCL's business, and therefore should be non-taxable under s.14(1) of the IRO.



Answer 2(b) (cont'd)

- Loan interest expenses paid to an overseas subsidiary is non-deductible as the amount did not satisfy any of the conditions stipulated under s.16(2) of the IRO. Loan interest expenses to Bank D is non-deductible as the amount was not incurred in the production of chargeable profits and therefore did not satisfy s.16(1) of the IRO. Staff loan written off is non-deductible as well as the amount was not incurred in the production of chargeable profits and therefore did not satisfy s.16(1) of the IRO. Bad debts of HK\$1,758,320 is a general provision and not essentially incurred in the production of chargeable profits, and therefore is non-deductible under s.16(1) and s.16(1)(d) of the IRO.



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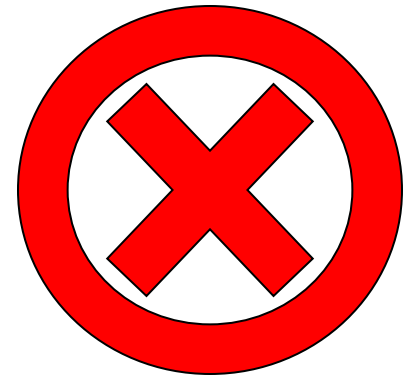


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June 2018 Session – Sect A – Q3 **(12 marks – approximately 22 minutes)**

In the contexts of the relevant IRO provisions, advise as to the regulatory requirements for the proposed Hong Kong entity exclusively and specifically established for the purpose of conducting corporate treasury activities in order to enjoy the favourable tax treatments.

(12 marks)



Wrong answers

- Wrongly discussed safe labour rule and other unrelated IRO provisions (such as deemed provisions (s.15(ia) and (la))



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Question 3



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Problem

- Just copied from LP/IRO without elaboration



Answer 3

- Pursuant to s.14D(1) of the IRO, the assessable profits of a corporation regarded as a qualifying corporate treasury centre (“QCTC”) for the year of assessment are chargeable to the concessionary half rate of profits tax, i.e. 8.25%, to the extent to which the respective profits are derived from a qualifying (i) intra-group financing business, (ii) corporate treasury service, or (iii) corporate treasury transaction. The corporation must make an irrevocable application to apply for the concessionary tax rate under s.14D(5)(b) and s.14D(6) of the IRO.
- As the envisaged entity to be established by the management of PCL will provide intra-group financing and treasury services to its overseas subsidiaries, the corporation could be considered as a QCTC under s.14D(2)(a) and s.14D(3) of the IRO on the basis that it has carried out in Hong Kong one or more corporate treasury activities, and has not carried out in Hong Kong any activity other than a corporate treasury activity.



Answer 3 (cont'd)

- Under s.14C(1) of the IRO, intra-group financing business, in relation to a corporation, means the business of the borrowing of money from and lending of money to its associated corporations. Under s.14C(3) and s.1(1) of Schedule 17B of the IRO, corporate treasury service means the provision of managing the cash and liquidity position, processing payments to the vendors or suppliers, etc. to a non-Hong Kong associated corporation. Under s.14C(4) and s.2(1) of Schedule 17B of the IRO, corporate treasury transaction means the specific transactions entered into by the corporation on its own accounts and related to the business of a non-Hong Kong associated corporation, e.g. providing guarantees, investing funds, contracts for hedging, and a factoring or forfaiting transaction.



Answer 3 (cont'd)

- In addition to the above regulatory requirements, s.14D(5)(a) of the IRO also stipulates that the central management and control of the QCTC should be exercised in Hong Kong, and that the activities that produce the assessable profits chargeable to the concessionary half rate of profits tax are carried out or arranged to be carried out in Hong Kong by the QCTC.
- In order to facilitate the interest expense deduction claim on the intra-group financing business, s.16(2)(g) of the IRO is introduced simultaneously to provide interest expense deduction in respect of interest payable by the QCTC on money borrowed from its non-Hong Kong associated corporation if the following conditions are satisfied:



Answer 3 (cont'd)

- (i) the deduction claimed is in respect of interest payable on money borrowed from a non-Hong Kong associated corporation in the ordinary course of an intra-group financing business;
- (ii) the interest income received by the non-Hong Kong associated corporation must be subject to a similar tax in a tax jurisdiction outside Hong Kong at a rate not lower than the concessionary tax rate applicable to the QCTC; and
- (iii) the non-Hong Kong associated corporation is the beneficial owner of the respective interest income.



Answer 3 (cont'd)

- In addition to the abovesaid regulatory requirements, the management of PCL should also pay attention to the DIPN No. 52 – Taxation of Corporate Treasury Activity with respect to the view and practice of the Inland Revenue Department (“IRD”) on the tax treatments in relation to the interest income and expenses for intra-group financing business as well as the profits tax concession granted to QCTCs. Particularly, the acceptable requirements on carrying on intra-group financing business (DIPN No. 52, para. 10), the possibility of transfer pricing adjustment with reference to the arm’s length principle when fixing the interest rate for intra-group financing transactions (DIPN No. 52, para. 24), and the essential ingredients of central management and control requirement (DIPN No. 52, paras. 50 to 54) should be observed.



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June 2018 Session – Sect A – Q4 **(9 marks – approximately 16 minutes)**

- (a) Compute Mr Zhang's Individual Income Tax liabilities in the Mainland during his four months' stay in Hong Kong.

(5 marks)



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Question 4(a)



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Problem

- Careless mistakes (e.g. not calculate 4 months; not include the monthly allowance)



Answer 4(a)

- Mr Zhang is a Mainland Chinese national and tax resident. He is subject to Individual Income Tax in the Mainland on a worldwide basis regardless of his place of employment and residency of his employer pursuant to Article 1 of Individual Income Tax Law. His total Individual Income Tax liabilities for the four months period are as follows:
- Monthly Individual Income Tax taxable employment income =
RMB(8,800 + 5,000) = RMB13,800
- Total Individual Income Tax = RMB[(13,800 - \$3,500(monthly standard deduction)) x 25%(applicable tax rate) - 1,005(quick calculation deduction)] x 4

= RMB6,280



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June 2018 Session – Sect A – Q4 (9 marks – approximately 16 minutes)

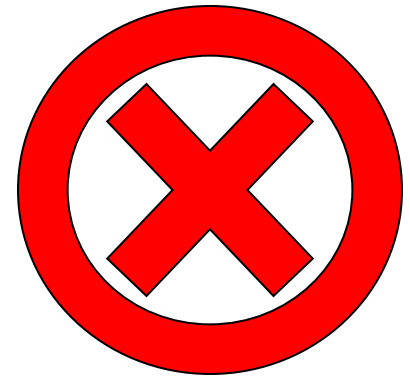
- (b) Advise, from the China-Hong Kong Double Taxation Treaty perspective, the Hong Kong salaries tax implications for Mr Zhang during his four months' stay in Hong Kong.

Note: Computation of Hong Kong salaries tax liabilities, if any, is not required.

(4 marks)



Question 4(b)



Irrelevant answers

- Source of employment income
- Time basis appointment
- 60 day rule



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Question 4(b)



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Problem

- Just copies from DIPN/LP without elaboration and application
- Unable to apply the details of the treaty to the case and draw proper conclusion



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Answer 4(b)

Pursuant to Article 14 of China-Hong Kong Double Taxation Treaty, the income derived by Mr Zhang should not be chargeable to Hong Kong salaries tax on the following basis:

- Mr Zhang would stay in Hong Kong for less than 183 days in any 12-month period commencing or ending in the taxable period concerned
- the remuneration to Mr Zhang is exclusively paid by PCN or other entities in the Mainland; and
- the remuneration paid to Mr Zhang is not borne by PCL or any other entities in Hong Kong.



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June 2018 Session – Sect A – Q5 **(5 marks – approximately 9 minutes)**

Explain the ethical considerations of Aplus & Co. during the provision of the ad hoc tax consultancy service to PCL.

(5 marks)



Answer 5

- During the provision of the tax consultancy services to PCL, Aplus & Co. should strictly observe professional ethics by putting forward the best position in favour of PCL, provided that the services can be rendered with professional competence, and do not in any way impair the standards of integrity and objectivity. In addition, Aplus & Co. should not hold out to PCL that its tax advice is beyond challenge, whilst Aplus & Co. should ensure that PCL is aware of the limitation attaching to its advice and services. The respective tax advice should also be recorded either in the form of a letter to PCL or in a memorandum for the files. Aplus & Co. should not associate itself with any communication or information which it has reason to believe that a false or misleading statement has been included therein.



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Section B – Essay/Short Questions



June 2018 Session – Sect B – Q6 (22 marks – approximately 39 minutes)

On 14 August 2015, Ms Chan was offered a position by Lee & Lee (“L&L”) as a Trainee Solicitor commencing after her passing the Postgraduate Certificate in Laws (“PCLL”) examinations in 2017. To attract Ms Chan to join the company, the offer letter contained, among others, the following terms and conditions:

- (i) The offer was conditional upon Ms Chan’s satisfactory completion and her passing the PCLL examinations at her first attempt.
- (ii) L&L would reimburse Ms Chan or pay directly the cost of her full-time PCLL programme for 2016 – 17 at a specified university in Hong Kong.
- (iii) L&L would pay Ms Chan a maintenance grant of HK\$5,000 per month for the duration of her PCLL course, which was ten months in total.



June 2018 Session – Sect B – Q6 (cont'd) (22 marks – approximately 39 minutes)

(iv) If Ms Chan did not successfully complete and pass the PCLL examinations or she decided not to take up the employment, L&L would require from Ms Chan repayment in full of the sums in items (ii) & (iii) above.

Ms Chan accepted the offer on 18 August 2015. She then undertook a full-time PCLL course at the University of Hong Kong (“HKU”) for the academic year 2016 – 17. The course fee of HK\$100,000 was paid by L&L to HKU directly on 15 February 2017. L&L also paid the maintenance grant of HK\$5,000 to Ms Chan during each of the months from September 2016 to June 2017. Ms Chan took up the employment with L&L on 5 September 2017.



June 2018 Session – Sect B – Q6 (cont'd) (22 marks – approximately 39 minutes)

Required:

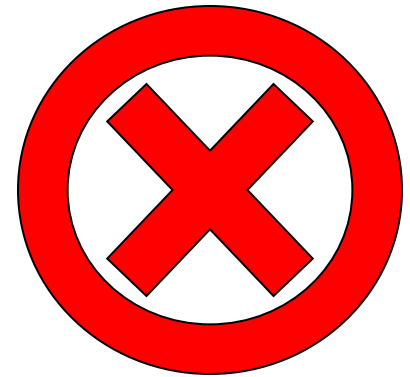
- (a) Analyse, with reference to the relevant provisions of the IRO and the legal principles, whether each of the following payments made by L&L has to be assessed to salaries tax, and if yes, the year of assessment in which the payment should be assessed.
- (i) PCLL course fee
 - (ii) Maintenance grant

(14 marks)



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Question 6(a)



Irrelevant answers

- Source of employment
- S9A



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Question 6(a)



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Problem

- Unable to conclude that the sums should be assessed when the taxpayer took up the employment instead of when the sum was paid
- Failed to apply S11B and 11D(b)
- Misunderstood that the course fee was the employer's liability



Answer 6(a)

Whether the payments are assessable income

- S.9(1)(a) of the IRO provides that income from any office or employment includes any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite, or allowance.
- In the Privy Council case David Hardy Glynn v CIR [1990] 1 HKLR 604, it was held that a perquisite not only meant the payment of money, it also included money which could be obtained from property which was capable of being converted into money and money which was paid in discharge of a debt of the employee.



Answer 6(a) (cont'd)

- In the Court of Final Appeal case Fuchs v CIR [2011] 14 HKCFAR 74, it was held that as the relevant sums were contractual payments made pursuant to the terms of the contract of employment, they were income from employment and should be chargeable to salaries tax. It was also held that income chargeable under s.8(1) of the IRO was not confined to income earned in the course of employment but embraced payments made “in return for acting as an employee” or “as a reward for past services or as an inducement to enter into employment and provide future services”.



Answer 6(a) (cont'd)

- In this case, as it was Ms Chan who undertook the PCLL course, she was personally liable to pay the course fee. Accordingly, the direct payment of the course fee by L&L to HKU represented a discharge of the debt of Ms Chan and amounted to a perquisite which was specifically included as an income from employment under s.9(1)(a) of the IRO. As regards the maintenance grant, it is clearly a cash allowance paid to Ms Chan to support her living before the employment commenced. As such, it is also an income from employment as defined under s.9(1)(a) of the IRO.



Answer 6(a) (cont'd)

- Moreover, the two sums were paid to Ms Chan or on her behalf pursuant to the terms of the offer letter and by accepting the employment offer of L&L, Ms Chan agreed to be employed as a trainee solicitor upon passing the PCLL examinations. Hence, both sums were contractual payments and were paid as an inducement for Ms Chan to enter into employment with L&L. On the authority of the *Fuchs case*, *both sums should be regarded as income chargeable to salaries tax*.



Answer 6(a) (cont'd)

In which year of assessment the sums should be assessed

- S.8(1)(a) of the IRO is the charging section of salaries tax, which would bring into charge income arising in or derived from Hong Kong from any office or employment of profit. Regarding the timing of assessment, s.11B of the IRO provides that the assessable income of a person in any year of assessment shall be the aggregate amount of income accruing to him from all sources in that year of assessment and for the purpose of this section, s.11D(b) defines that income accrues to a person when he becomes entitled to claim payment thereof.



Answer 6(a) (cont'd)

- An income would only be brought into charge if it is an income from employment. In this case, the sums were paid by L&L during the period from September 2016 to June 2017 while Ms Chan only confirmed to take up the employment with L&L on 5 September 2017. When L&L paid the sums, they were not yet an income from employment. The sums only became an income from employment on 5 September 2017 when Ms Chan took up the employment. Accordingly, the sums accrued to Ms Chan as income from employment on 5 September 2017 and should be regarded as her assessable income for the year of assessment 2017/18.



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June 2018 Session – Sect B – Q6 (cont'd) (22 marks – approximately 39 minutes)

Required:

- (b) Advise whether Ms Chan is entitled to claim a deduction with respect to the PCLL course fee paid by L&L pursuant to s.12(1)(a) and / or s.12(1)(e) of the IRO. If yes, advise in which year of assessment the deduction should be claimed and the amount deductible.

(8 marks)



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Question 6(b)



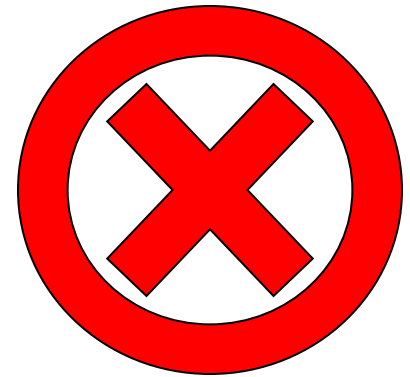
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Problem

- Just go straight to make conclusion without discussing the legal principles



Question 6(b)



Wrong answers

- Wrongly stated that the deduction should be allowed in the year of payment
- Misunderstood that the expenses should be apportioned over the course period



Answer 6(b)

- S.12(1)(a) of the IRO allows deduction of all outgoings and expenses, other than expenses of a domestic or private nature and capital expenditure, wholly, exclusively and necessarily incurred in the production of the assessable income. The requirements under s.12(1)(a) are notoriously stringent. It has been well established that only expenses which are incurred in the performance of the duties of the employment can be regarded as being “incurred in the production of the assessable income”. See *CIR v Humphrey* [1970] HKLR 447. As the PCLL course fee was Ms Chan’s private expenses and not incurred in the performance of her duties, it does not satisfy the requirements of s.12(1)(a) and cannot be allowed for deduction in any year of assessment.



Answer 6(b) (cont'd)

- S.12(1)(e) of the IRO allows deduction of the amount of the expenses of self-education (“SEE”) paid in the year of assessment not exceeding the prescribed amount. As the PCLL course fee of HK\$100,000 was paid on 15 February 2017, Ms Chan is entitled to claim deduction of the whole of the SEE in the year of assessment 2016/17 and no deduction is allowable for the year of assessment 2017/18. The maximum amount allowable for deduction in the year of assessment 2016/17 is restricted to HK\$80,000, which is the prescribed limit for the year. However, Ms Chan may not be able to benefit from the deduction as she probably did not have assessable income for the year of assessment 2016/17 during which she was studying on a full-time PCLL course.



June 2018 Session – Sect B – Q7 **(12 marks – approximately 22 minutes)**

Fun and Fun Hong Kong Limited (“Company HK”) is a company carrying on a toy trading business in Hong Kong. It closes its accounts on 31 March annually. During the year ended 31 March 2017, Company HK purchased two trade marks, which were used by two contractors to produce goods as follows:

(a) Trade Mark A

Trade Mark A was registered in Hong Kong. It was purchased from X Ltd at a cost of HK\$500,000 and there is no relationship between Company HK and X Ltd.



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June 2018 Session – Sect B – Q7 (cont'd) **(12 marks – approximately 22 minutes)**

During the year ended 31 March 2017, Company M, a manufacturer located in Vietnam, produced 1,000,000 toy items bearing the Trade Mark A for Company HK. The finished goods were sold by Company HK to customers in Hong Kong and Taiwan in the respective quantities of 600,000 and 400,000. Company HK maintained a sales office in Taiwan and it had been accepted by the Inland Revenue Department (“IRD”) that the trading profits generated by the Taiwan sales office were offshore in nature.



June 2018 Session – Sect B – Q7 (cont'd) (12 marks – approximately 22 minutes)

(b) Trade Mark B

Trade Mark B was registered in Hong Kong. Trade Mark B was purchased from Z Ltd at a cost of HK\$1,000,000. Company HK and Z Ltd are under the common control of Mr C. The price of Trade Mark B had been valued by an independent firm before the acquisition. After the acquisition, Company HK registered the same trade mark in the Philippines. The cost for registration in the Philippines was HK\$400,000.

During the year ended 31 March 2017, Company P, a manufacturer located in the Philippines, produced 1,000,000 toy items bearing the Trade Mark B for Company HK. The finished goods were sold by Company HK to customers in Hong Kong and the Philippines in the respective amounts of 500,000 and 500,000. The profits derived by Company HK were all chargeable to tax in Hong Kong.



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June 2018 Session – Sect B – Q7 (cont'd) **(12 marks – approximately 22 minutes)**

Required:

- (a) Advise, with reference to the relevant legal principles and provisions of the IRO, the deductibility of the purchase cost of a trade mark.

(5 marks)



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Question 7(a)



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Problem

- Unable to identify S16EC(4)(b) can apply to deny deduction if the relevant right is used wholly outside HK by a person other than the taxpayer



Answer 7(a)

- An expense must satisfy s.16(1) and not be excluded by s.17 of the IRO before it can be allowed for deduction. Any expenditure of a capital nature is not allowed for deduction under s.17(1)(c) of the IRO. There are, however, specific provisions under the IRO which allow tax relief in respect of certain kinds of capital expenditure.
- In most circumstances, the purchase cost of a trade mark is of a capital nature as it is made with a view of bringing into existence an asset or advantage for the enduring benefit of a trade or business. Accordingly, it should be denied for deduction under s.17(1)(c) of the IRO. However, s.16EA specifically allows deduction of capital expenditure incurred on purchase of specific intellectual property rights, which includes a trade mark registered under s.47 of the Trade Marks Ordinance (Cap. 559) or under the law of any place outside Hong Kong.



Answer 7(a) (cont'd)

- Therefore, if a trade mark is a registered one, the purchase cost of which can be allowed for deduction pursuant to s.16EA of the IRO while that of an unregistered trade mark is not deductible under s.17(1)(c) of the IRO. Deduction under s.16EA is to be allowed in five years of assessment commencing in the year of assessment during the basis period for which the capital expenditure was incurred.
- However, s.16EC of the IRO restricts that there are certain circumstances under which deduction under s.16EA is not allowable. For example, s.16EC(2) specifies that no deduction is allowable in respect of any relevant right purchased by a person wholly or partly from an associate. Besides, s.16EC(4)(b) of the IRO specifically denies the deduction of an intellectual property right if at the time when the relevant right is owned by the taxpayer, a person holds rights as a licensee under a license of the relevant right, and the relevant right is, while the license is in force, used wholly or principally outside Hong Kong by a person other than the taxpayer.



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June 2018 Session – Sect B – Q7 (cont'd) **(12 marks – approximately 22 minutes)**

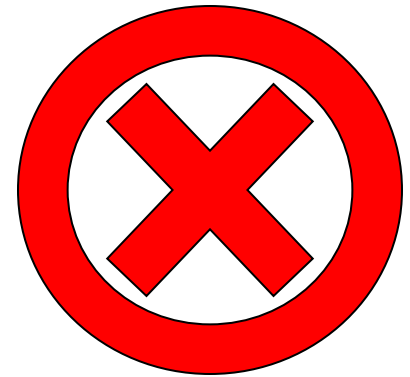
Required:

- (b) In respect of each of Trade Mark A and Trade Mark B, analyse, by applying the relevant legal principles, whether the purchase cost and registration cost are tax deductible. If yes, compute the amount deductible for the year ended 31 March 2017.

(7 marks)



Question 7(b)



Wrong answers

- Trademark A
 - Unable to calculate the correct deductible amount by taking into account the quantities of finished goods sold to customers in HK and Taiwan



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Question 7(b)



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Problem

- Trademark B
 - Unable to distinguish the tax treatment between purchase cost and registration cost. They are governed by different tax provisions



Answer 7(b)

Trade Mark A

- Trade Mark A is a registered trade mark. Accordingly, its purchase cost can be allowed for deduction under s.16EA of the IRO. Despite the fact that Company M, being a company other than Company HK, was using Trade Mark A in Vietnam to manufacture the toys, Trade Mark A was not a registered trade mark in Vietnam and Company M was actually using an unregistered trade mark in Vietnam. Therefore, s.16EC(4)(b) is not applicable.
- However, as Company HK was only subject to profits tax in respect of 60% ($600,000 / 1,000,000 \times 100\%$) of its profits, the same portion of the purchase cost of Trade Mark A, i.e. HK\$300,000 (60% of HK\$500,000) can be allowed for deduction. Accordingly, the amount deductible for the year of assessment 2016/17 is HK\$60,000 ($HK\$300,000 \times 1/5$).



Answer 7(b) (cont'd)

Trade Mark B

- By virtue of s.16EC(2) of the IRO, no deduction is allowable for the purchase cost of Trade Mark B as it was purchased from an associate, irrespective of whether the price is at arms-length.
- Regarding the registration cost of Trade Mark B in the Philippines, it can be allowed for deduction under s.16(1)(g) of the IRO as long as Trade Mark B was used by Company HK for producing chargeable profits in Hong Kong.



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June 2018 Session – Sect B – Q8 **(12 marks – approximately 22 minutes)**

Mr Chan is a Hong Kong permanent resident (“HKPR”). He is married and his spouse, Ms Wong, is a Mainland resident. For investment purposes, Mr Chan purchased a residential property in Hong Kong (“Property A”) on 1 March 2016 at a consideration of HK\$25,000,000 in joint names with Ms Wong. At the time of acquisition of Property A, Mr Chan owned an industrial property in Hong Kong while Ms Wong did not own any property in Hong Kong.

Soon after the acquisition of Property A, Ms Wong, in her sole name, purchased a serviced apartment in Hong Kong (“Property B”) on 1 September 2016 at a consideration of HK\$10,000,000.



June 2018 Session – Sect B – Q8 (cont'd) **(12 marks – approximately 22 minutes)**

Both Property A and Property B have been let out for rental income since their acquisitions. Property A was let out for a term of two years from 1 March 2016 to 28 February 2018 at a monthly rent of HK\$50,000, payable on the first day of each month while Property B was let out for a term of one year from 1 September 2016 to 31 August 2017 and the rent was HK\$360,000 for the whole term, payable in advance on the first day of the lease term. The rates, being HK\$7,500 per quarter and HK\$4,500 per quarter for Property A and Property B respectively, were all payable by the landlord.

As Ms Wong seldom visited Hong Kong, all the lease agreements of Property A and Property B were entered into in the sole name of Mr Chan. As all the rental income was received by Mr Chan, he reported all the rental income derived from Property A and Property B in his tax return – individuals.



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June 2018 Session – Sect B – Q8 (cont'd) **(12 marks – approximately 22 minutes)**

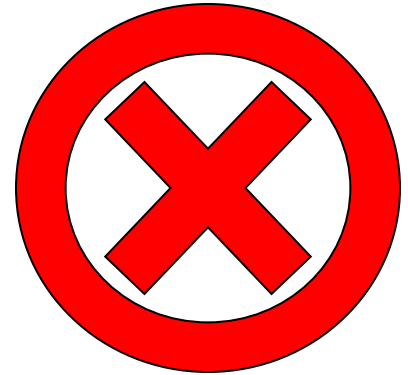
Required:

- (a) Evaluate the liability of Mr Chan and Ms Wong to stamp duty regarding the purchase of Property A and Property B, and compute the amount of stamp duty payable.

(5 marks)



Question 8(a)



Wrong answers

- Incorrect stamp duty rates was used to calculate AVD
- Wrongly treated Property B (serviced apartment) was a non-residential property



Answer 8(a)

Property A

- Mr Chan and Ms Wong are liable to pay Ad Valorem Stamp Duty (“AVD”) in respect of the purchase of Property A. As Property A was a residential property acquired by Mr Chan, who is a Hong Kong permanent resident (“HKPR”), jointly with Ms Wong who, though not a HKPR, is a close relative of Mr Chan, and each of them did not own any other residential property in Hong Kong at the time of acquisition, the purchase transaction would be subject to AVD at Scale 2 rates. The amount of AVD payable is HK\$1,062,500 (HK\$25,000,000 x 4.25%).
- Acquisition of residential property by a HKPR jointly with his close relative, including a spouse, is not chargeable with Buyer’s Stamp Duty (“BSD”). Therefore, Mr Chan and Ms Wong are not required to pay BSD for the transaction.



Answer 8(a) (cont'd)

Property B

- Ms Wong, a non-HKPR, is liable to pay AVD for the purchase of Property B at Scale 1 rates. The amount of AVD payable is HK\$750,000 (HK\$10,000,000 x 7.5%).
- For stamp duty purposes, the classification of premises in terms of “residential property” or “non-residential property” is by reference to the permitted use rather than the actual use of the property, or the label or description given to the property. Unless there is documentary evidence such as occupation permit showing that the property cannot be used for residential purposes, the instrument signed by a non-HKPR as buyer for the acquisition of the property will be chargeable with BSD. Accordingly, Ms Wong is liable to pay BSD regarding the acquisition of Property B. The amount of BSD payable is HK\$1,500,000 (HK\$10,000,000 x 15%).



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June 2018 Session – Sect B – Q8 (cont'd) **(12 marks – approximately 22 minutes)**

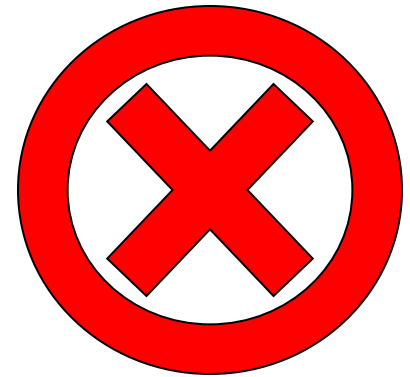
Required:

- (b) Compute the amount of property tax payable in respect of Property A and Property B for the year of assessment 2016/17.

(4 marks)



Question 8(b)



Wrong answers

- Wrong tax rate (e.g. corporation tax rate) was used
- Wrongly combined the acquisition of property A and B together



Answer 8(b)

Property A

	HK\$
Rent (HK\$50,000 x 12) [s.5B(2)]	600,000
<u>Less: Rates (HK\$7,500 x 4) [s.5(1A)(b)(i)]</u>	<u>(30,000)</u>
	570,000
<u>Less: 20% statutory outgoings [s.5(1A)(b)(ii)]</u>	<u>(114,000)</u>
Net assessable value	<u>456,000</u>
Property tax payable thereon at 15%	<u>68,400</u>

Property B

Rent (HK\$360,000 / 12 x 7) [ss.5B(2) and 5B(4)]	210,000
<u>Less: Rates (HK\$4,500 / 3 x 7) [s.5(1A)(b)(i)]</u>	<u>(10,500)</u>
	199,500
<u>Less: 20% statutory outgoings [s.5(1A)(b)(ii)]</u>	<u>(39,900)</u>
Net assessable value	<u>159,600</u>
Property tax payable thereon at 15%	<u>23,940</u>



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June 2018 Session – Sect B – Q8 (cont'd) **(12 marks – approximately 22 minutes)**

Required:

- (c) Evaluate and compute the liability of Mr Chan and Ms Wong to property tax in respect of the letting of Property A and Property B.

(3 marks)



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Question 8(c)



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Problem

- Only evaluation/explanation was provided, without computing the property tax liabilities of the couple



Answer 8(c)

- Under s.5(1) of the IRO, property tax shall be charged on every person being an owner of any land or buildings in respect of the rental income derived from letting of the land or buildings. As both Mr Chan and Ms Wong are owners of Property A, they should be jointly and severally liable to property tax in respect of the rental income derived from the letting of Property A. On the other hand, Ms Wong should be solely liable to property tax in respect of the rental income derived from the letting of Property B, despite the fact that all the rental income was received by Mr Chan.
- Accordingly, the amount of property tax payable by Mr Chan is HK\$34,200 (HK\$68,400 / 2) and the amount of property tax payable by Ms Wong is HK\$58,140 (HK\$34,200 + HK\$23,940).



June 2018 Session – Sect B – Q9

(4 marks – approximately 7 minutes)

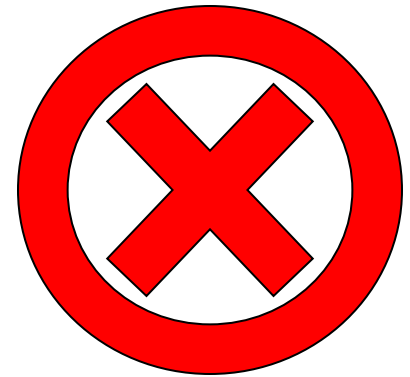
An advance ruling service has been provided by the IRD since 1998. In appropriate circumstances, the IRD will publish on its website selected rulings which are considered to be of general interest.

Required:

- (a) State whether the published rulings are binding on the IRD.

- (b) Explain the cautions that a taxpayer should exercise when he wishes to rely on the published rulings.

(4 marks)



Wrong answers

- Wrongly discussed the impact from the perspective of a taxpayer applying for an advance ruling



Answer 9

- (a) The published rulings are non-binding on the IRD and provide no protection to any persons other than the applicants.
- (b) Reference can only be made to a ruling if the facts are identical to the proposed transactions. In case of doubt as to the similarity of the proposed transactions, the taxpayer should request for a ruling. Caution should also be exercised to ensure that the relevant provisions of the IRO or the relevant case law interpretation and practice of those provisions have not changed. Similarly, a ruling may no longer be appropriate if an administrative practice outlined therein turns out to be used as a tax avoidance device.



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December 2017 Session – Sect B – Q9 **(14 marks – approximately 25 minutes)**

JAY Limited (“the Company”) is a company listed on the Stock Exchange of Hong Kong and carries on a business in Hong Kong. In February 2017, the Company appointed Mr Zhang as its Independent Non-Executive Director. Mr Zhang is a Chinese resident and did not visit Hong Kong during the year ended 31 March 2017, notwithstanding that he participated in the director’s meetings of the Company held in Hong Kong through tele-conferencing.



December 2017 Session – Sect B – Q9 **(14 marks – approximately 25 minutes)**

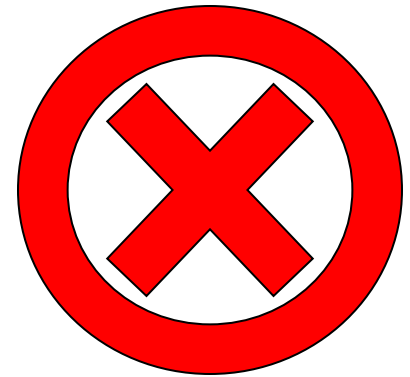
Recently, the human resources department of the Company was about to prepare the Employer's Returns for the Company for the year ended 31 March 2017, and would include the remuneration details of Mr Zhang in the Employer's Returns as he had received a director's fee of HK\$200,000. After due discussions, Mr Zhang argued that the Company should not file any Employer's Return in respect of him, as he should not be assessable to salaries tax on the basis that (i) he was not a Hong Kong resident and did not visit Hong Kong, and (ii) he did not render any services in Hong Kong during the year ended 31 March 2017. As the head of the human resources department did not have any relevant tax knowledge, the management of the Company appointed Messrs. Ko & Ko to obtain tax advice in relation to its Employer's Return filing obligations.



December 2017 Session – Sect B – Q9 **(14 marks – approximately 25 minutes)**

Required:

- (a) Analyse the arguments of Mr Zhang in the contexts of (i) his chargeability to salaries tax and (ii) whether the Company has any Employer's Return filing obligations in respect of him for the year ended 31 March 2017, and if so, specify the details.
- (5 marks)
- (b) On the assumption that the Company has filing obligations as the employer of Mr Zhang and the Company erroneously failed to do so, analyse the possible penal actions applicable to and the maximum penalties that could be imposed on the Company in the contexts of the IRO.
- (4 marks)
- (c) Describe the ethical considerations Messrs. Ko & Ko should be aware of in the course of providing the tax advisory services to the Company.
- (5 marks)



Wrong answers

- Wrongly discussed the source of income from an employment rather than an office
- Wrongly discussed 60 days rule exemption
- Wrongly discuss DTA arrangement between Mainland China and Hong Kong



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Question 9(a)



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Problem

- Overlooked the requirement to discuss the employer's return filing obligations



Answer 9 (a)

The source of a director's remuneration should be determined by the place where the company exercises its central management and control, i.e. the location of the office of the director. As JAY Limited carries on a business in Hong Kong, it is probable that its central management and control are also exercised in Hong Kong. As such, it is likely that the director's fee derived by Mr Zhang would be wholly assessable to salaries tax under s.8(1)(a) of the IRO. The facts that Mr Zhang is not a Hong Kong resident, did not visit Hong Kong and did not render any services in Hong Kong are irrelevant to the consideration. According to ss.52(3) and (4) of the IRO, JAY Limited has the obligation to notify the IRD of the commencement of employment of Mr Zhang not later than three months after the date of commencement of the employment as he is or is likely to be chargeable to salaries tax.

In addition, JAY Limited, pursuant to s.52(2) of the IRO has to furnish an employer's return reporting details of Mr Zhang's remuneration for the year ended 31 March 2017 regardless of his chargeability to salaries tax.



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Question 9(b)



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Problem

- Did not aware to discuss the compound provision
- Just stated all the penalty provisions, without referring to the facts of the case
- Discuss the penal actions for not complying with one filing obligation only, in fact, there were two filing obligations



Answer 9 (b)

If JAY Limited, without reasonable excuse, fails to (i) comply with s.52(4) of the IRO to notify the IRD of the commencement of employment of an employee chargeable to tax within three months after the date of commencement of employment; and (ii) furnish the employer's return of an employee as requested by the IRD under s.52(2) of the IRO, JAY Limited commits an offence, and is liable on conviction to a fine at level 3 (i.e. HK\$10,000) for each of the offence under s.80(1) of the IRO. The Court may also order JAY Limited to comply with the requirements as stipulated under ss.52(2) and 52(4) of the IRO within a specified timeframe. Moreover, s.80(5) of the IRO provides that the Commissioner of Inland Revenue may compound the offence and may before judgment stay or compound any proceedings thereunder.



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Question 9(c)



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Problem

- Just copied from LP or reference materials
- No analysis
- Did not address the answers to the relevant ethics in practice provisions



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Answer 9 (c)

In the course of providing tax advisory services to JAY Limited, Messrs. Ko & Ko should comply with s.430 'Ethics in tax Practice' in the Code of Ethics for Professional Accountants (Revised in June 2010) published by the Hong Kong Institute of Certified Public Accountants ("the Code"). Specifically, Messrs. Ko & Ko should:

- (i) put forward the best position in favour of JAY Limited with professional competence and not in any way impair its standard of integrity and objectivity;
- (ii) ensure that JAY Limited is aware of the limitations attaching to its tax advice;



Answer 9 (c) (cont'd)

- (iii) ensure that the tax advice is properly prepared based on the information received from JAY Limited, provided that the information appears to be reasonable;
- (iv) record the tax advice given to JAY Limited either in the form of a letter or in a memorandum for the files; and
- (v) not associate themselves with any false or misleading information.



December 2017 Session – Sect B – Q11 **(6 marks – approximately 11 minutes)**

New Year Limited (“New Year”) is a wholly foreign owned enterprise established in mainland China and engages in the import and sale of luxury goods at its retail shop in Beijing. In November 2017, New Year expanded its business by importing and selling the following products (“the Products”):

- Smartphones
- Cosmetics
- Signature golf balls

In addition, New Year would pay dividends to its shareholder. It is noted that the sole shareholder of New Year is an individual who is a Hong Kong permanent resident.

New Year is a general taxpayer of Value-added Tax.



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December 2017 Session – Sect B – Q11 **(6 marks – approximately 11 minutes)**

Required:

Analyse the China turnover tax and withholding tax implications for New Year with respect to (i) import and sale of the Products, and (ii) payment of dividends to its sole shareholder.

(6 marks)



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Question 11



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Problem

- Not familiar with PRC tax
- Just copied irrelevant materials
- Not aware that dividend would be subject to withholding tax rate
- Not aware that the withholding tax rate would be reduced to 5% for Hong Kong residents under DTA



Answer 11

Import of the Products into mainland China from foreign jurisdictions is first subject to creditable Value-added Tax ("VAT") at 17% under the prevailing Provisional Regulations on Value-added Tax of the People's Republic of China ("the PRVAT"). The PRVAT also specifies that sales of the Products within the territory of mainland China are also subject to VAT, and the tax rate is 17% (borne by the customers).

Turnover tax in mainland China also includes, inter alia, Consumption Tax ("CT"). Under the prevailing Provisional Regulations on Consumption Tax of the People's Republic of China ("PRCT"), the import of cosmetics and signature golf balls are subject to CT at the rates of 30% and 10% respectively (per the latest Cai Shui Circular, the rate of CT is revised to 0% and 15% for low-end and high-end cosmetics respectively). However, the import of smartphones is not subject to CT. In addition, the sales of the Products within the territory of mainland China are also not subject to CT. The import and sale of the Products did not have any withholding tax implications for New Year in mainland China.



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Answer 11 (cont'd)

Dividends paid to a non-Chinese tax resident would normally be subject to withholding tax at the rate of 10%. Subject to relevant application procedures, the withholding tax rate could be reduced to 5% for Hong Kong residents in accordance with 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 Incomes.

There is no turnover tax exposure on the payment of dividends to non-Chinese tax residents.



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Summary of Examination Techniques

- Don't panic
- Manage your time (1.8 mins./mark)
- Attempt all questions and review your answers at last
- Read question requirements and identify the issues carefully
 - Highlight key words (e.g. Calculate / Advise / Propose etc...)
- Pay attention to specific format requirement (e.g. Memo)
- Give relevant answers
- Write clearly and check for careless mistakes
- Apply technical knowledge and don't copy from LP



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Part 5: Q & A Session