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Examination Techniques Seminar on QP Module Examinations

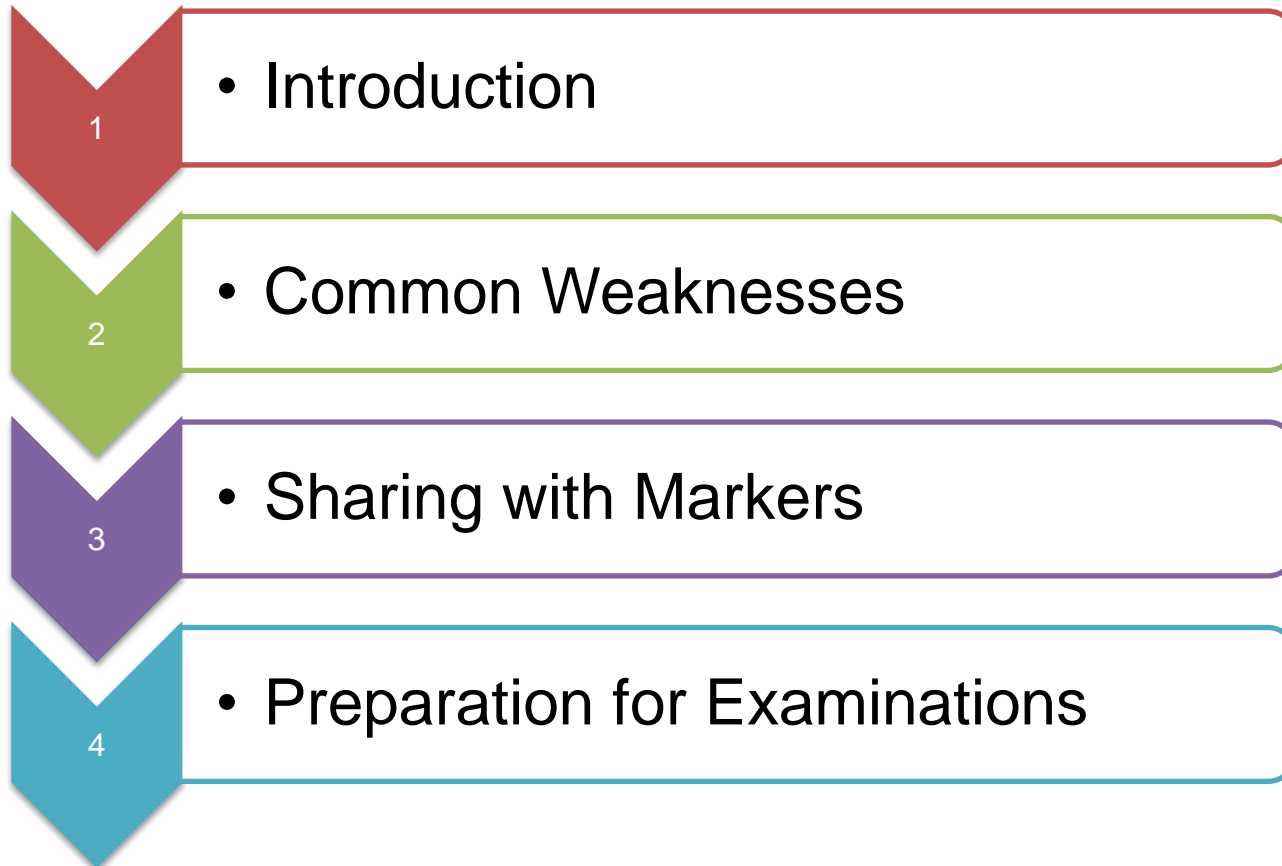
Module D (Dec 2015 Session)

Date: 10 November 2015





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 Paper
- All compulsory questions



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Part 2: Common Weaknesses





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Major causes to examination failure by aspect



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Aspect 1: **Questions**

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



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Aspect 2:

Answers

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



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Aspect 3:

Candidates

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



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Part 3: Sharing with Markers





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Key points recapped

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



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Section A – Case Questions



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Case background

- 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.



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Case background

- 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”).



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Case background

- 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:-



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Case background

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.



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Case background

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.



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Case background

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.



Case background

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:-

Date of arrival to Hong Kong	Date of departure from Hong Kong
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



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- **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.
- **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.
- **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).



➤ **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).

➤ **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.



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➤ **Question 6 (5 marks – approximately 9 minutes)**

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

➤ **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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Case background

- 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”).



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Case background

- 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:-



Case background

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. ➤ Q1
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. ➤ Q2
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. ➤ Q3



Case background

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.

➤ Q4

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.

➤ Q5

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.



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Case background

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.

➤ Q6



Case background

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:

➤ Q7

Date of arrival to Hong Kong	Date of departure from Hong Kong
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



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June 2015 Session – Sect A - Q1 (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)



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Question 1



Wrong answers

- Copy irrelevant points
- Not cover important points
- Source of profit



Answer 1

DIPN

- Issued by the IRD, DIPN **clarifies the IRD's viewpoints on particular tax provisions and/or the practice of the IRD in certain given situations**. It also outlines the IRD's respective procedures in administering relevant provisions of the IRO. Notwithstanding that DIPN has **no binding force in law** (BOR D54/06, para. 25), the IRD would follow, in general, what has been laid down in the DIPNs, both interpretation of tax provisions and assessing practices.

BOR Decisions

- The BOR is an independent statutory body to **determine tax appeals**. Decisions made by the BOR are **final** with regard to the facts of a particular case. In addition, BOR's decisions are **not binding on other BOR cases**. With **reference** to the BOR's decisions, taxpayers can identify **how the relevant provisions** in the IRO are **interpreted** and applied in the circumstances.



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Answer 1 (cont'd)

Local Court Cases for tax

- In the appeals to the Hong Kong Courts, the **judges** are required to decide the cases by **expressing their opinion** in respect of questions of law. If **taxpayers or the IRD cannot agree on the interpretation of a provision** in the IRO, both parties can use the appeal procedures laid down in the IRO to seek a ruling on a question of law from the Courts. In addition, the **decisions of a higher court** (e.g. Court of Final Appeal) **bind all lower courts** and the BOR, i.e. the doctrine of judicial precedent.



**June 2015 Session – Sect A – Q2
(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)



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Interpretation of the requirements and identification of relevant provisions

➤ s.4

➤ s.49(5)

➤ DIPN No.47



Question 2



Wrong answers

- Copy irrelevant paragraphs from DIPN 47
- Copy only, no discussion
- No conclusion



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Answer 2

Under **s.4** of the IRO, officers of the IRD shall preserve secrecy with regard to all matters relating to the affairs of any person coming to his knowledge, except in the performance of his duties under the IRO. However, **s.49(5)** of the IRO provides that where any arrangements have effect by virtue of that section, the obligation as to secrecy under s.4 of the IRO shall not prevent the disclosure to any authorised officer of the government with which the arrangements are made of such information as is required to be disclosed under the arrangements. **Therefore there is no contravention by the IRD in this regard (para. 10 of DIPN No. 47, Revised January 2014).**



**June 2015 Session – Sect A – Q3
(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)



Case background - Extract

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.



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Interpretation of the requirements and identification of relevant provisions

- s.14
- s.15(1)(b)
- s.20B
- s.21A



Question 3



Wrong answers

- Discussion of irrelevant provisions, such as s.15(1)(a), s.15(1)(ba)
- Only discussion of relevant provisions without application [e.g. only copy details of s.15(1)(b)]



Answer 3

- As **Zeus** is a **non-resident** from a Hong Kong tax perspective, its royalty income should **not be subject** to profits tax under **s.14(1)** of the IRO.
- Income is deemed as a **taxable** trading receipt under **s.15(1)(b)** of the IRO as the amount was received from the use of a trademark in Hong Kong.
- Zeus is therefore **chargeable** to tax as a non-resident and under the name of **Abas** who paid these sums under the licensing agreement in accordance with **s.20B(1)(a) & (2)** of the IRO.
- Under **s.21A(1)** of the IRO, the assessable profits of the deemed trading receipts attributable to Zeus would be either (i) **100%** of the sum derived by Zeus as an associate of Abas, unless no person carrying on business in Hong Kong has at any time wholly or partly owned the respective trademark, or (ii) **30%** of the sum derived thereon in any other case.



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Answer 3 (cont'd)

- Subject to the application of s.21A(1) of the IRD, the respective profits tax liability is either **HK\$165,000** ($\text{HK\$1,000,000} \times 16.5\%$) or **HK\$49,500** ($\text{HK\$1,000,000} \times 30\% \times 16.5\%$). Abas is required to **withhold** the respective amount on behalf of Zeus for tax payment purposes under s.20B(2) of the IRO.



June 2015 Session – Sect A – Q4 (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)



Case background - Extract

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.



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Interpretation of the requirements and identification of relevant provisions

➤ s.20B

➤ s.21



Answer 4

- As the entertainment performance of Ms Metis Minos is exclusively conducted in Hong Kong, income received by her in connection to the singing concerts is derived in Hong Kong and should be chargeable to profits tax as a non-resident under s.20B(1)(b) of the IRO. Under s.20B(2) of the IRO, Ms Metis Minos would be chargeable to tax as a non-resident person in the name of Abas as the sum paid or credited to her is from Abas in accordance to the concert arrangement.
- In ascertaining the assessable profits of Ms Minos as a non-resident with respect to the entertainment performance in Hong Kong, s.21 of the IRO does not specify any percentage of the income to be computed accordingly. In this regard, the IRD usually adopts 2/3 of the gross income as the assessable profits chargeable to profits tax (para. 14, DIPN No.17, Revised January 2005). Accordingly, the profits tax payable of Ms Minos is HK\$600,000 ($\$6,000,000 \times 2/3 \times 15\%$). Abas is required to withhold the amount on behalf of Ms Minos for tax payment purposes under s.20B(2) of the IRO.



June 2015 Session – Sect A – Q5 (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)



Case background – Extract

- 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.



Question 5



Wrong answers

- Incorrect formula / computation
- Incorrect tax rate
- Only explanation without computation
- Unable to address the amount of tax credit is limited to the tax payable computed in accordance with IRO
- Lengthy elaboration which was not required
- Arithmetical error



Answer 5

(Either method A)

Step 1:

The amount of tax credit limit for tax paid in the PRC by Abas:

	HK\$	HK\$
PRC tax paid (\$300,000 x 25%)		75,000
Credit limit of tax paid in the PRC		
Net profit from the PRC grossed up at (\$300,000 - \$75,000) x $\frac{1}{(1 - 16.5\%)}$	269,461	
Less: Net profit from the PRC after deduction of tax (\$300,000 - \$75,000)	<u>225,000</u>	
Tax credit limit for tax paid in the PRC	<u>44,461</u>	△ <u>(44,461)</u>
Amount not allowed as tax credit (To be allowed as Deduction)		# <u>30,539</u>



Answer 5 (cont'd)

Step 2:

The Hong Kong profits tax payable for Abas with the tax credit:

	HK\$
Assessable profits	5,000,000
Less: amount not allowed as tax credit	# <u>(30,539)</u>
	<u>4,969,461</u>
Tax thereon @16.5%	819,961
Less: Tax credit	△ <u>(44,461)</u>
Hong Kong profits tax payable for year of assessment 2013/14 after allowance of tax credit	<u>775,500</u>



Answer 5 (cont'd)

(Or method B)

Tax credit = taxable profits in the PRC x $\frac{\text{Tax payable in Hong Kong (before tax credit)}}{\text{assessable profits}}$

$$= \frac{\$300,000}{\$5,000,000} \times (\$5,000,000 \times 16.5\%)$$

$$= \$49,500$$

Tax credit limit is the lesser of the above or tax paid in the PRC of \$75,000

Tax credit limit is therefore \$49,500

Hong Kong profits tax payable for year of assessment 2013/14 after allowance of tax credit:

	HK\$
Assessable profits	<u>5,000,000</u>
Tax thereon @16.5%	825,000
Less: Tax credit as per above	<u>49,500</u>
Tax payable after tax credit	<u>775,500</u>



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June 2015 Session – Sect A – Q6
(5 marks – approximately 9 minutes)

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

(5 marks)



Case background – Extract

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.



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Interpretation of the requirements and identification of relevant provisions

➤ VAT

➤ Business Tax



Answer 6

- Under the Provisional Regulations of the People's Republic of China on Value Added Tax ("VAT"), the sale of goods, provision of processing, repair and replacement services and the importation of goods in mainland China are subject to VAT. As Abas did not carry on any of the abovesaid business activities in the PRC during the year, VAT is not applicable to Abas accordingly.
- Under the Provisional Regulations of the People's Republic of China on Business Tax income derived from (i) prescribed taxable services (e.g. transportation industry, construction industry, etc.), (ii) the transfer of intangible assets or (iii) the sale of immovable properties within the territory of the PRC are subject to Business Tax. Specifically, the service provider (i.e. income recipient) would be subject to Business Tax either if the service recipient or the service provider is located in the PRC. In this regard, the inspection income derived by Abas should be subject to Business Tax as the service recipient (i.e. Poseidon) was a PRC company located in Mainland China. The amount of Business Tax is calculated at the standard rate of 5% with respect to the taxable income.



June 2015 Session – Sect A – Q7 (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)



Case background – Extract

- 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:-

Date of arrival to Hong Kong	Date of departure from Hong Kong
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



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Interpretation of the requirements and identification of relevant provisions

- Location of employment
→ HK V. Foreign (3 factors)
- HK employment → fully taxable
- Foreign employment → time appointment



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Interpretation of the requirements and identification of relevant provisions

- Any exemptions?
- 60 days rule s.8(1B)



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Application of technical knowledge – Mr. Hercules

- HK V Foreign
- Fulfil 60 days rule ?
 - ↘ taxing right
- Not granted → taxing liability



Question 7



Wrong answers

- Incorrectly calculated time apportionment
- Incorrect personal allowances
- Incorrectly calculated salaries tax payable at standard rate by using NCI



Answer 7 (a)

Based on the available information, the contract of employment for Mr Panoptes Hercules was negotiated, concluded and enforceable with Zeus outside Hong Kong. In addition, his employer Zeus is a company managed and controlled in Greece (i.e. residency of the employer of Zeus is outside of Hong Kong). Further, the remuneration of Mr Hercules has also been paid outside Hong Kong during the year. Under the principles established in the Goepfert decision and as elaborated in paragraphs 7 to 25 of the DIPN No. 10 (Revised June 2007), the employment of Mr Hercules should be offshore in nature and only the income derived from services rendered in Hong Kong should be subject to salaries tax under s.8(1A)(a) of the IRO (i.e. time apportionment basis).



Answer 7 (a) (cont'd)

In accordance with the basis established in the Board of Review Decision D29/89, IRBRD vol. 4, 340 (para. 48, DIPN No. 38, Revised March 2008) that “any part of a day counts as a day”, the number of days Mr Hercules visited Hong Kong for the year ended 31 March 2014 are counted as follows:

June 2013	(1 – 15) 15 days
September 2013	(10 – 24) 15 days
December 2013	(5 – 14) 10 days
January 2014	(17 – 29) 13 days
February 2014	(17 – 18) 2 days
March 2014	(19 – 24) 6 days
Total 61 days	



Answer 7 (a) (cont'd)

- As Mr Hercules visited Hong Kong for more than 60 days for the year, exemption of salaries tax under s.8(1B) of the IRO is not applicable to him.
- For the purpose of counting the number of days in Hong Kong in computing Mr Hercules' salaries tax liabilities under s.8(1A)(a) of the IRO, the IRD adopted the "midnight rule" as per paragraph 46 of DIPN No. 38 (Revised March 2008).



Answer 7 (b)

	HK\$
Salary	1,800,000
Add: Rental value (HK\$1,800,000 x 4%)	<u>72,000</u>
	<u>1,872,000</u>
Assessable income attributable to services rendered in Hong Kong (HK\$1,872,000 x $\frac{55}{365}$ ^{Note})	282,082
Less: Personal allowance	<u>120,000</u>
Net chargeable income	<u>162,082</u>
Salaries tax payable (at progressive rate)	
\$40,000 @ 2%	800
\$40,000 @ 7%	2,800
\$40,000 @ 12%	4,800
\$42,082 @ 17%	<u>7,153</u>
	<u>15,553</u>
Salaries tax payable (at standard rate)	
\$282,082 x 15%	<u>42,312</u>
Tax payable, at lower one	<u>15,553</u>



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Answer 7 (b) (cont'd)

Note:

Number of days in Hong Kong according to “midnight rule”:

June 2013	14
September 2013	14
December 2013	9
January 2014	12
February 2014	1
March 2014	<u>5</u>
Total	<u>55</u> days



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Section B – Essay/Short Questions



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June 2015 Session – Sect B – Q8 (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.



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June 2015 Session – Sect B – Q8 (cont'd)

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.



June 2015 Session – Sect B – Q8 (cont'd)

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)



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Question 8a



Wrong answers

- Cases dealing with the territorial source principle
- Only cite the name of the case with no elaboration



Answer 8(a)

On the authority of *Lionel Simmon Properties Ltd (in liquidation) and Others v Commissioner of Inland Revenue (1980) 53 TC 461*, it is a well established tax principle that in determining whether a property is a capital asset or trading asset, the intention of the purchaser at the time of acquisition is crucial. In addition, following the decision in *All Best Wishes Limited v CIR* (3 HKTC 750), a self-serving statement put forward by a person is of limited value – it has to be tested by the objective facts of the case.



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Question 8b



Wrong answers

- Detailed explanation of each badge
- No application



Answer 8(b)

- On the facts now available, the gain on the disposal of the Property should be chargeable to profits tax for the following reasons:
- If it were the **intention** of Mr Smith to acquire the Property as his residence, he should have a **thorough review** on the surrounding environment beforehand. It is inconceivable that he was **unaware** of the hospital as it **was not newly built**.
 - Mr Smith had **never moved** into the Property. This objective fact does **not** support his stated intention. (Relevant authority: *All Best Wishes Limited v CIR (3 HKTC 750)*)
 - Mr Smith **sold** the Property **within 3 months** after completing his acquisition. The **quick sale** is a **strong indicator** pointing towards the **trading intention** of Mr Smith. (Relevant authority: Board of Review Decision No. *D47/04 (19 IRBRD 384)*)



Answer 8(b) (cont'd)

- d) Mr Smith's financial position does not support his assertion that the Property was acquired as his residence. During the time prior to his retirement, his monthly salary was HK\$60,000 out of which he paid rent of HK\$15,000. His disposable income was less than HK\$45,000 (HK\$60,000 – HK\$15,000) as he had to reserve funds to meet, at least, the payment of his salaries tax. Yet he had to repay the mortgage loan by monthly instalments of HK\$40,000. As to the period after his retirement, Mr Smith received no monthly pension. The sum of HK\$200,000 which he received could finance his mortgage repayments at most for five instalments even if he needed not meet his living expenses. There is no evidence that he managed to finance the repayment of the mortgage loan after his retirement either.



June 2015 Session – Sect B – Q9 (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:



June 2015 Session – Sect B – Q9 (cont'd)

	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		



June 2015 Session – Sect B – Q9 (cont'd)

- 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



June 2015 Session – Sect B – Q9 (cont'd)

- 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)



June 2015 Session – Sect B – Q9 (cont'd)

- 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 9a



Wrong answers

- Computed 6 months for licence C. (two months from Oct to Nov should also be included)
- Wrong treatment of the deposit (set off the outstanding licence fees)
- Only explanation, no computation
- Compute the property tax liability of each cubicle separately



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Answer 9(a)

Mrs Chan was the **owner** of the property as defined in **s.2** of the IRO. The licence fees were the consideration for the use of the property. Unless there was substantial evidence that Mrs Chan carried on a letting business, Mrs Chan should be **chargeable to property tax.**

Her property tax liability in respect of the licence fees income is computed as follows:



Answer 9(a)

Year of assessment 2013/14

	HK\$
Licence fee income from	
Adrian (HK\$5,000 x 12 months)	60,000
Benjamin (HK\$4,000 x 8 months)	32,000
Clive (HK\$3,000 x 8 months)	<u>24,000</u>
	116,000
<u>Less:</u>	
Irrecoverable rent (HK\$3,000 x 5 months)	<u>15,000</u>
Assessable value	101,000
<u>Less:</u>	
Rates	<u>3,500</u>
	97,500
20% statutory deduction	<u>19,500</u>
Net assessable value	<u><u>78,000</u></u>
Tax at	15%
Property tax payable	<u><u>HK\$11,700</u></u>



Question 9b



Wrong answers

- Answers too short, only point out that taxpayer as a properties owner was chargeable to property tax
- As a head tenant, was chargeable to profits tax
- Did not discuss the tax treatment of every expenses mentioned in the question



Answer 9(b)

- Although Mrs Chan entered into “licences” with Adrian, Benjamin and Clive, Mrs Chan was in effect letting or sub-letting, as the case may be, the three cubicle rooms to them. In the event that Mrs Chan was a **head tenant**, she was chargeable to **profits tax under s.14** of the IRO as the definition of “business” in s.2 of the IRO includes the sub-letting by any other person of any premises or portion of any premises under a lease or tenancy other than from the Government.
- As to the expenses, if Mrs Chan was the **owner** of the property, she would be allowed a deduction of **irrecoverable rent** (s.7C of the IRO), **rates** (s.5(1A)(b)(i) of the IRO) and **20% statutory allowance** (s.5(1A)(b)(ii) of the IRO). In the event that Mrs Chan was the **head tenant**, apart from **irrecoverable rent** (s.16(1)(d) of the IRO) and **rates** (s.16(1) of the IRO), she would also be allowed deductions of the **rental expense** incurred on the head lease, **Government rent, management fee** (s.16(1) of the IRO) as well as **commercial building allowance** (s.33A of the IRO) on the renovation costs which she incurred. Nevertheless, **no 20% statutory deduction** would be allowed to Mrs Chan as that in the case of an owner.



Answer 9(c)

- Stamp duty is a tax on an instrument. It is not a tax on a transaction. As long as the instruments are chargeable to stamp duty under the Stamp Duty Ordinance (“the SDO”), stamp duty has to be levied irrespective of the label given to them. With regard to a lease, if it provides the tenant an exclusive right of possession of the property, it is chargeable to stamp duty under the SDO even if it is labeled as a licence.
- In the present case, no matter whether Mrs Chan is the owner or the head tenant, Licence A and Licence B are chargeable instruments under Head 1(2) specified in the First Schedule of the SDO. The stamp duty to be levied on Licence A is 0.5% on the average yearly rent whereas that of Licence B is 0.25% of the total rent payable over the term of the lease.
- As to Licence B1 and Licence C, they are not chargeable to stamp duty under the SDO as no written instrument was entered into.



Answer 9(d)

The consequences of not stamping an instrument that is chargeable to stamp duty are as follows:

- (a) S.15(1) of the SDO provides that, with limited exceptions, no unstamped instrument can be accepted as evidence in any proceedings other than in criminal proceedings or in civil proceedings instituted by the Collector of Stamp to recover stamp duty and / or penalty.
- (b) S.15(2) of the SDO provides that all public officers and bodies corporate cannot act upon, file or register any instrument unless it is duly stamped. It follows that, for example, the Land Registrar cannot register an unstamped assignment on the sale and purchase of an immovable property, the Lands Tribunal cannot handle a case on the irrecoverable rent arising from an unstamped tenancy agreement, the share registrar of a Hong Kong company cannot register the change in shareholders upon the presentation of an unstamped contract note.
- (c) S.19(3) of the SDO provides that no broker or agent can legally claim any charge for brokerage or commission for the sale or purchase of Hong Kong stock if he fails to comply with s.19 of the same ordinance, which includes causing the contract notes to be stamped (S.19(1)(b) of the SDO).
- (d) S.21 of the SDO provides that an unregistered shareholder is not entitled to any dividend or interest in respect of the relevant shares.



June 2015 Session – Sect B – Q10 (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.



June 2015 Session – Sect B – Q10 (cont'd)

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)



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Question 10a



Wrong answers

- Only copy s.12(1)(a) with no explanation



Answer 10(a)

- S.12(1)(a) of the Inland Revenue Ordinance (“the IRO”) provides that in ascertaining the net assessable income of a person, there shall be deducted from the assessable income of that person 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 meaning of incurred “in the production of the assessable income” had been discussed in *Commissioner of Inland Revenue v. Humphrey (1970) 1 HKTC 451*. Expenses are not incurred “in the production of assessable income” if they are incurred only to enable the duties to be performed.
- In the present case, the travelling expenses which David incurs in travelling between his home and the tennis courts are not incurred “in the production of assessable income”. Rather, they are incurred for the production of assessable income. Hence, those travelling expenses are not allowable for deduction. In contrast, the travelling expenses which David incurs in travelling between various tennis courts are incurred in the production of assessable income. The latter expenses are allowable for deduction.



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Question 10b



Wrong answers

- Just copy the details of s.12(1)(a)
- No explanation
- No application



Answer 10(b)

- The deduction criteria of s.12(1)(a) is stringent and rigid. Following the decision in *Brown v. Bullock* 40 TC1, the test is not whether the employer imposes the expenses but whether the duties do. Also, on the authority of *Hillyer v Leeke* (1976) STC 490, if an individual is wearing clothing for his own purposes of cover as well as wearing it in order to have the appearance which the job requires, it cannot be said that the expense of his clothing is wholly or exclusively incurred in the performance of duties.



Answer 10(b)

- In the present case, first, the invoices which Eric furnished were dated 1 March 2013. It is patently clear that the expenses were not incurred in the year of assessment 2013/14. Even if the expenses were incurred in the year of assessment 2013/14, they were not allowable for deduction either. Although Eric's employer requires him to dress properly, it does not necessarily follow that his clothing expenses are allowable for deduction. It is clear that the suits and shoes are ordinary civilian clothing which serve the dual purposes of cover and comfort as well as giving the appearance required by the job. Hence, the expenses were not wholly and exclusively incurred in the production of his assessable income.



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Question 10c



Wrong answers

- Just copy the details of s.12(1)(b)
- No explanation
- No application



Answer 10(c)

- S.12(1)(b) of the IRO provides that in ascertaining the net assessable income of a person, there shall be deducted from the assessable income of that person depreciation allowances calculated in accordance with Part 6 in respect of capital expenditure on machinery or plant the use of which is essential to the production of assessable income. In the *Board of Review Decision No. D61/06 (2006-07) 21 IRBRD 1137*, the Board held that the meaning of the word “essential” in s.12(1)(b) of the IRO is consistent with “necessarily” in s.12(1)(a).



Answer 10(c)

- As to the meaning of the word “necessarily”, following the decision in *Ricketts v Colquhoun* 10 TC 118, expenses which were incurred due to personal choices were not deductible. Again, on the authority of *Brown v. Bullock* (1961) 40 TC 1, the test is not whether the employer imposes the expenses but whether the duties do. One therefore has to look whether the duties cannot be performed without incurring the particular expense.
- On the facts now available, the new computer is not essential to the production of Felix’s assessable income. The purchase of the new computer is a matter of his own choice. His employer has already provided him with a computer, albeit the model is not the latest one. Hence, the conditions set out in s.12(1)(b) are not satisfied. No deduction of depreciation allowance in relation to the new computer can be allowed.



June 2015 Session – Sect B – Q11 (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)



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Question 11



Wrong answers

- Discuss the holding over of tax in dispute (conditional and unconditional hold over)



Answer 11

- S.71(2) of the IRO provides that tax shall be paid notwithstanding any objection or appeal, unless the Commissioner of Inland Revenue (“the CIR”) orders that payment of tax be held over pending the result of the objection or appeal.
- In the event of default of tax, s.71(5) provides that the CIR may order a sum not exceeding 5% of the amount in default to be added onto the tax and recover therewith. S.71(5A) further provides that on the expiry of six months of the date deemed to be in default, the CIR may order a sum not exceeding 10% of the total unpaid amount (i.e., tax in default together with the amount imposed under s.71(5)) be added onto the total unpaid amount and recovered therewith.



Answer 11

- As to the recovery of tax, the CIR may recover the tax in default and the surcharge as a civil debt through the District Court pursuant to s.75 of the IRO. S.76 of the IRO further provides that the CIR may give notice in writing to third parties (including those who owe money or are about to pay money to the taxpayer) requesting them to pay such money to the collector for the purposes of settling the tax and the surcharge in default. In addition, the CIR can also turn to s.77 of the IRO to secure the payment of the tax in default by issuing a departure prevention direction.
- If Mr Bill does not pay the tax in dispute before the payment due date, the outstanding tax will be in default. A surcharge of 5% or 10%, as the case may be, may be imposed on the total amount in default. Recovery action on the tax in default will also be taken against Mr Bill under ss.75, 76 and 77 of the IRO.



June 2015 Session – Sect B – Q12 (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)



Answer 12(a)

As Mr Mak holds dual capacity – audit partner of A & Co and tax director of A Limited, he should ensure **independence**. He should make sure that the staff of A & Co and A Limited as well as himself will **only** take up **either** the audit work or the tax work of Hiccups Limited **but not both**. Also, he should ensure **integrity** and **professional competence** in acting as the tax advisor of Hiccups Limited.



Answer 12(b)

In view that it is probable that the closing stock of Hiccups Limited had been understated, it follows that the profits as well as its assessable profits might have been understated as well. Such being the case, Mr Mak should advise Hiccups Limited to take this into account in the tax computations for the year of assessment 2013/14. Certainly, he should also put Hiccups Limited in the **best position** in computing the tax liability. Also, he should **advise** Hiccups Limited as to the relevant **penalty provisions** in the event that its **assessable** profits were understated resulting in tax being **undercharged**. With regard to future years of assessment, he should advise Hiccups Limited of the importance of filing correct tax returns, *inter alia*, the **keeping of stock records** to ensure that the **correct closing stock** value is reflected in the company's financial statements.



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December 2014 Session Examples



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Dec 2014 session – Sect A – Q1(b)

A Ltd is a wholly-owned subsidiary of B Ltd, a leading logistic service company in Hong Kong. On 1 April 2013, A Ltd obtained a loan of HK\$100 million from Bank C at 10% per annum (“the Loan”) to finance the acquisition of a new ship. The Loan was secured by a **deposit of HK\$60 million placed by B Ltd with the US branch of Bank C** at 4% per annum (“the Deposit”).

Required

Discuss whether B Ltd is chargeable to profits tax in respect of the **interest income** derived from the Deposit. **(5 marks)**



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Identification of technical knowledge

Relevant provisions?

s.14 or s.15(1)(f) of the IRO?



Question 1(b)



Wrong answer

S.14

- Person carrying on a trade, profession or business in Hong Kong
- Derived profit from that trade, profession or business(excluding profits arising from the sale of capital assets)
- Arising in or derived from Hong Kong

Note: B Ltd carried on logistic service business in Hong Kong.



Question 1(b)



Wrong answer

S.15(1)(f)

Applying Interest Income Exemption Order?

- The interest income was exempted from profits tax as the deposit was placed in financial institution



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Suggested answer

B Ltd is neither a financial institution nor a money lender, chargeable to tax under **S.15(1)(f)** of the IRO

To determine the source, apply the “**provision of credit**” test.

The place where the funds from which the interest is derived were provided to the borrower.

The Deposit was placed with the **US branch of Bank C** should be regarded as having a source **outside Hong Kong** and is thus **not** chargeable to profits tax.



Dec 2014 session – Sect A – Q2

In October 2013, B Ltd sold all its shares in A Ltd at a consideration of HK\$30 million to Mr. D, who did not carry on any business on his own account. Mr. D would advance HK\$70 million to Bank C on the condition that the repayment of principal and interest of the advance by Bank C was subject to the repayment of principal and interest of the Loan by A Ltd.

Required:

Explain the stamp duty obligations of **B Ltd** and **Mr. D** in respect of their sale and purchase of shares in A Ltd.

(Note: **Computation** of the stamp duty payable, if any, is **required**.)



Question 2



Wrong answer

S.45 relief

- transfer of Hong Kong stock between associated body corporates
- the bodies are associated if one is beneficial owner of not less than 90 per cent of the issued share capital of the other, or a third such body is beneficial owner of not less than 90 per cent of the issued share capital of each.



Question 2



Wrong answer

Only discussion of relevant provision without application

Under s.19(1)(a) and (b) of the Stamp Duty Ordinance (“SDO”), B Ltd and Mr. D are each required to (i) make and execute a contract note in respect of the sale or purchase of the shares in A Ltd, and (ii) cause it to be stamped under head 2(1) in the First Schedule of the SDO.

Under head 2(1) in the First Schedule of the SDO, the stamp duty payable on each contract note is computed at 0.1% of the consideration for the shares.



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Suggested answer

Under **s.19(1)(a) and (b)** of the Stamp Duty Ordinance (“SDO”), B Ltd and Mr. D are each required to (i) make and execute a **contract note** in respect of the sale or purchase of the shares in A Ltd, and (ii) cause it to be **stamped** under **head 2(1)** in the First Schedule of the SDO.

Under head 2(1) in the First Schedule of the SDO, the stamp duty payable on each contract note is computed at **0.1%** of the consideration for the shares.



Suggested answer (cont'd)

The **consideration** is **HK\$30 million**. However, Mr. D would enter into a **sub-participation agreement** with Bank C whereby the repayment of the Loan by A Ltd would, in effect, be secured by Mr. D to the extent of **HK\$70 million**. By virtue of **s.24(1) and (3)** of the SDO, such **part of the Loan** will be deemed to be **part of the consideration** for stamp duty purposes.

The stamp duty payable will be computed as follows:

$$\text{(HK\$30 million + HK\$70 million)} \times 0.1\% \times 2 = \text{HK\$200,000}$$

In addition to the contract notes, B Ltd and Mr. D will also execute an **instrument of transfer** to effect the transfer of legal title of the shares. Stamp duty of **\$5 under head 2(4)** in the First Schedule of the SDO.



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Dec 2014 session – Sect B – Q4(a)

FC Asia Limited (“FCA”)

- **2009/10 and 2010/11 Notices of Assessment,**
- **and 2011/12 Loss Notification**
- **Recently received 2012/13 Notice of Assessment**

It was noted that there were prior years adjustments (“PYA”). But management of FCA considered that the PYA should have no impact on its 2012/13 profits tax position and did not take into account any of the PYA in preparing the 2012/13 Profits Tax Return. The PYA were attributable to the rectification of incorrect recognition of sales income and cost of sales in prior years. Specifically, **sales income was understated in the year ended 31 March 2010, whilst cost of sales in the two years ended 31 March 2011 and 2012 were both understated respectively**

Required:

Discuss the tax implications of FCA, if any, derived from the **PYA** for the years of assessment **2009/10 to 2012/13** and, where applicable, advise the **actions** which should be taken by FCA immediately in **response** to the **PYA**.

(8 marks) ¹¹⁸



Question 4(a)



Wrong answer

S.60 Additional Assessment

- any person has not been assessed or has been assessed at less than the proper amount, the assessor may, within the year of assessment or within 6 years after the expiration thereof, assess such person



Question 4(a)



Wrong answer

S.64(1) Objection

- by notice in writing to the Commissioner, object to the assessment; but no such notice shall be valid unless it states precisely the grounds of objection to the assessment and is received by the Commissioner within 1 month after the date of the notice of assessment



Question 4(a)



Wrong answer

S.70A Correction of Error or Omission

- application made within 6 years after the end of a year of assessment or within 6 months after the date on which the relative notice of assessment was served, whichever is the later,
- by reason of an error or omission in any return or statement submitted in respect thereof, or by reason of any arithmetical error or omission in the calculation of the amount of the net assessable value



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Suggested answer

For year **2009/10**, the IRD has issued **Notice of Assessment** to FCA. This indicated that FCA should derive **assessable profits** for the year. As the PYA for this year was derived from the **understatement of sales income, taxable profits** for the year should therefore be **under-assessed**. FCA should therefore promptly notify the IRD the details of PYA for the year, the amount of assessable profits understated, and to request the issue of **Additional Assessment under s.60** of the IRO.

For year **2010/11**, the IRD has also issued **Notice of Assessment** to the company. Again, this indicated that FCA should have derived **assessable profits** for the year. As the **understatement of cost of sales** deriving the PYA for the year should **reduce the assessable profits** of the company, FCA should lodge a claim to the IRD under **s.70A** of the IRO to revise its profits tax position, and request the **refund of overpaid profits tax**.



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Suggested answer (cont'd)

For year **2011/12**, the company should have incurred a tax loss as IRD has issued **Loss Notification** to FCA. As the **understatement of cost of sales** giving rise to the PYA for the year should **increase the tax loss** of the company, FCA should lodge a **disagreement** to the IRD elaborating the details of the PYA and request a **revision to its tax loss** for the year.

For year **2012/13**, Notice of Assessment issued by the IRD indicated that FCA should have taxable profits for the year. As the amount of **tax loss brought forward** from prior year should be **increased** due to the PYA in the prior year, the **net assessable profits** of the company for the year should be correspondingly **reduced**. FCA should therefore **lodge an objection** against the Assessment under s.64(1) of the IRO **if the Assessment was issued within one month**. If the Assessment **was issued more than one month ago**, FCA may consider lodging a **claim under s.70A of the IRO** on the basis that there is an error in computing the assessable profits of the company with respect to the tax loss brought forward from the prior year.



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Part 4: Preparation for the Examinations





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



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1. Prepare your examination Before examination

DO

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



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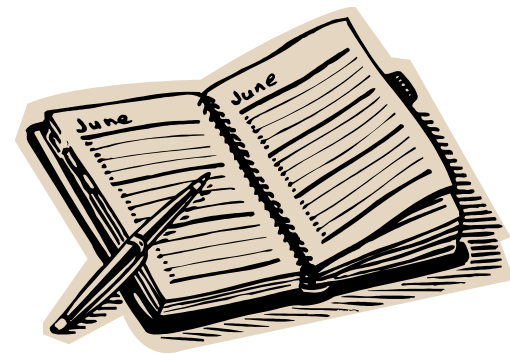


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Committed to your Study Plan

Advantages:

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





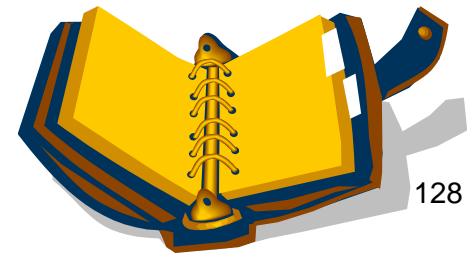
Prepare critical file

How to prepare:

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

Advantages:

- To use colour coding for standards / topics – easy identification (same file used in examination – time saving!)
- To build up long term memories
- To avoid indexing without understanding





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Before writing answers on the answer booklets

DO

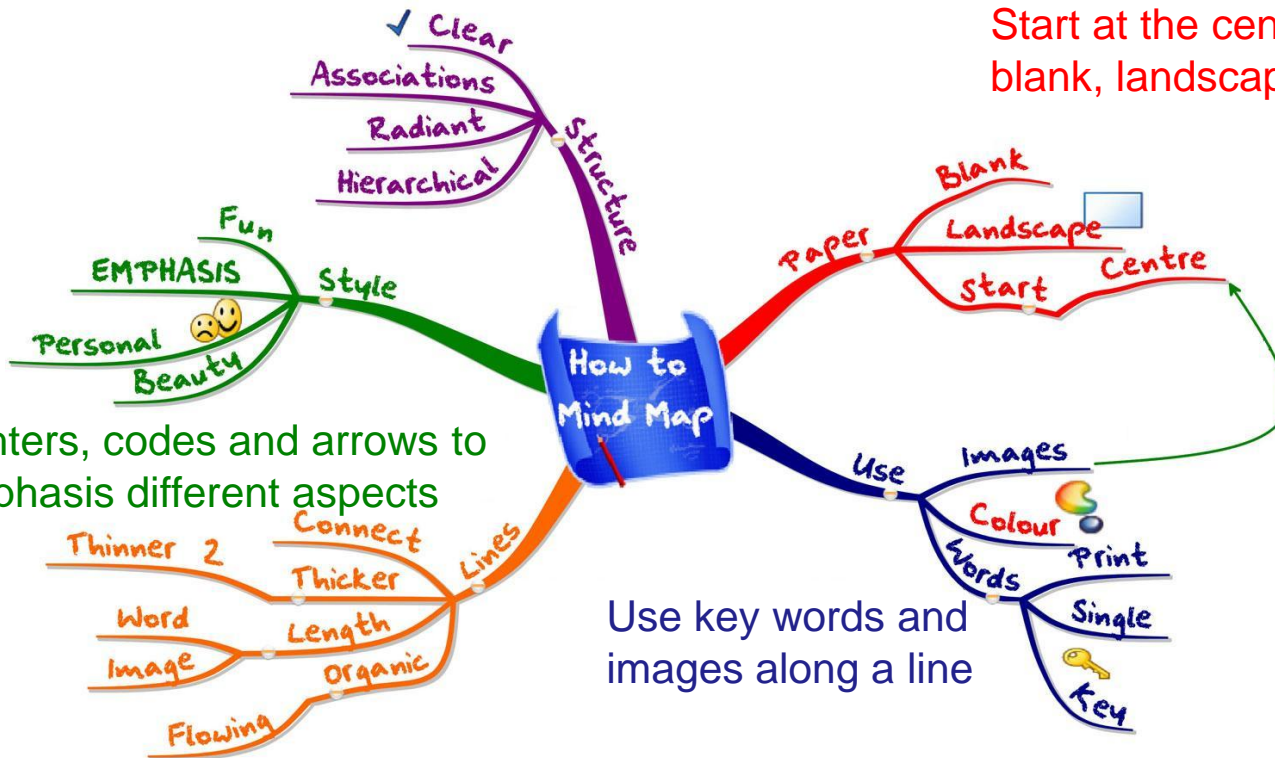
- Identify question requirements
- Highlight key words (e.g. Calculate / Advise / Discuss etc...)
- **Mind-map** or sketch the question requirement
- Outline your answers or approach
- Pay attention to specific format requirements (e.g. Write a memorandum)
 - Start with an introduction and end with a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

Mind Map

Radiate the ideas out
from the central theme
and main branches

Start at the centre of a
blank, landscape paper

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



Use key words and
images along a line

Make the lines associate
as clear as possible



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During examination

DO

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

DON'T

- Don't make up any information that was not provided by the question
- Don't write more than required
- Don't struggle, move to another question

(Question No. 2.)

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



Examples of handwriting

Example 1:

adverse opinion

adverse opinion

Example 2:

substantive matters

substantive matters ??

Example 3:

seriously misleading

seriously misleading ????



2. Prepare yourself for examination

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

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



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Closing

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



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Thank you