

JUNE 2012 SUPPLEMENT

Qualification Programme

# Module D

# Taxation



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

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# Changes at a glance

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## Introduction

This Supplement has been produced for those candidates preparing for the June 2012 examination session of the HKICPA Qualification Programme.

It is designed to be used in conjunction with the 2011 edition of the Learning Pack, and it will bring you fully up to date for developments that have occurred in the period since publication of the Learning Pack.

The supplement contains two sections:

**Part A** contains a list of any notified errors in the material in the current edition of the Learning Pack. These are identified in chapter order, therefore as you start a new chapter in the Learning Pack you are advised to refer to the list to see whether there is anything relevant.

**Part B** comprises a technical update on developments that will be examinable in June 2012 that are not currently covered in the Learning Pack. The topics covered are listed on the contents page, and again are covered in chapter order.

In each case the text in the Supplement explains how the Learning Pack is affected by the change, for example whether the new material should be read in addition to the current material in the Learning Pack, or whether the new material should be regarded as a replacement.

Careful study of both the Learning Pack and this Supplement should ensure that you are fully prepared for the June 2012 examination session.

Good luck with your studies!

## Part A: Identified Errata

### Chapter 1

Section 1.3  
Page 5      In the fourth paragraph of section 1.3, replace "3 May 2011" with "**13 May 2011**".

Section 7.3  
Page 24      In the first paragraph of section 7.3, replace "Inland Revenue (Amendment) (No. 3) Ordinance 2011" with "**Inland Revenue (Amendment) (No. 2) Ordinance 2011**".

### Chapter 3

Section 2.3  
Page 93      Insert the following after the last paragraph of section 2.3:

"In *Lo Tim-fat v. CIR 6 HKTC 725*, it was held that upfront payments such as initial signing fees", "goodwill payments", and "sign-on bonus" are paid because the agent agrees to the appointment and to remain as the company's agent. Once the upfront payment is received, the insurance agent holds the sum beneficially and is entitled to use it for whatever purposes he likes, including for his trade and business. In any event, the upfront payment is clearly a trading receipt chargeable to profits tax."

Section 8.5.6  
Page 148      In the fourth paragraph of section 8.5.6, replace the last sentence with the following:

"**The sales proceeds, including** any capital gain, from the disposal of patent rights or know-how rights previously allowed for a deduction will therefore be chargeable to tax, notwithstanding the exclusion provision in s.14".

Section 9.4.1  
Page 172      Insert the following after the fifth paragraph:

"In the *Scottish & Newcastle Breweries* case, it was held that a hotel business involved not only the provision of accommodation but also the provision of the right ambience (atmosphere) to make the interior attractive to customers. The light fittings, tapestries, sculptures and murals were therefore held as 'plant' as they were specifically chosen to create the atmosphere of the hotel and therefore fulfilled an important function as apparatus in that particular trade."

## Part B: Technical Update

### Chapter 1

An agreement between the Government of the Hong Kong Special Administrative Region of the People's Republic of China and the Government of **Malta** for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income was signed on 8 November 2011.

(Relevant to section 1.3 on page 5, section 7.5 on page 25)

**DIPN No. 25 (Revised)** was issued in November 2011.

**DIPN No. 31 (Revised)** was issued in November 2011.

**DIPN No. 32 (Revised)** was issued in October 2011.

**SOIPN No. 5 (Revised)** was issued in October 2011.

(Relevant to section 4.5 on pages 16 to 17)

### **Inland Revenue (Amendment) (No.3) Ordinance 2011**

*Apply from any year of assessment commencing on or after 1 April 2011*

This amendment to the IRO was enacted on 16 December 2011 to expand the scope for deduction under s.16E by introducing s.16EA to allow deduction for capital expenditure incurred on the purchase of copyrights, registered designs and registered trademarks. The following conditions must be fulfilled:

- The registered designs or registered trademarks must have been registered on the date of acquisition, either in Hong Kong or overseas
- The taxpayer must have legal and economic ownership of the intellectual property rights
- The relevant intellectual property rights are used for the production of chargeable profits

The deduction is spread over five succeeding years on a straight-line basis. However, if the intellectual property right reaches the end of its maximum period of protection in less than five years, the deduction will be spread in equal amounts over the number of years of protection.

Where the intellectual property right is subsequently sold, the sales proceeds will be treated as trading receipts and chargeable to profits tax. However, the amount is capped at the amount which was previously allowed for deduction.

To guard against possible tax avoidance, deduction under ss.16E or 16EA will not be allowed in the following situations:

- The relevant intellectual property rights were purchased wholly or partly from an associated party
- If a taxpayer cancels a licence (that existed prior to 2011/12) to intellectual property rights before its expiry and purchases the relevant intellectual property rights at an unreasonable consideration
- The relevant intellectual property rights were under sale and leaseback or leveraged licensing arrangements
- The relevant intellectual property rights were used wholly or principally outside Hong Kong by a person other than the taxpayer

(Relevant to section 7.3 on page 24)

PRC Individual Income Tax rates starting from 1 September 2011:

(a) *Progressive tax rates on taxable income from wages and salary*

Monthly taxable amount (RMB)	Tax rate
1,500 or less	3%
Income in excess of 1,500 to 4,500	10%
Income in excess of 4,500 to 9,000	20%
Income in excess of 9,000 to 35,000	25%
Income in excess of 35,000 to 55,000	30%
Income in excess of 55,000 to 80,000	35%
Income in excess of 80,000	45%

Note: The statutory monthly deduction for PRC tax residents and non-PRC tax residents is RMB3,500 and RMB4,800 respectively starting from 1 September 2011

(b) *Progressive tax rates on taxable income of sole traders from production and business, contracting for, or leasing of business operations of enterprises*

Annual taxable income (RMB)	Tax rate
15,000 or less	5%
Income in excess of 15,000 to 30,000	10%
Income in excess of 30,000 to 60,000	20%
Income in excess of 60,000 to 100,000	30%
Income in excess of 100,000	35%

(Relevant to Appendix 1 on page 29)

## Chapter 2

### ***CIR v. Choon Nang Electrical Appliance Manufactory Limited (2011) DCTC 2456***

The taxpayer made various defences for not paying the profits tax when they fall due, including that the amount was excessive or incorrect as the matter was under objection. However, it was held that the taxpayer did not have a reasonable defence, which was struck out accordingly.

### ***Kong Tai Shoes Manufacturing Company Limited v. CIR [2011] HCAL 34***

The CIR did not issue a determination on the taxpayer's objections for up to six and a half years. The court, although it refused the taxpayer's application to quash the assessments, ordered that the CIR issue a determination within two to six months.

The taxpayer filed a notice of appeal to the Court of Appeal. The appeal is scheduled to be heard on 20 July 2012.

### ***Nam Tai Group Management Limited v. CIR (2011) DCTC 458***

The CIR claimed against the taxpayer for profits tax due and payable under s.75 of the IRO. The taxpayer's defence was that the CIR should have exercised his discretion properly when deciding whether to hold over the tax pending objection, and since he did not, the tax should not be payable.

It was held that the taxpayer did not have a reasonable defence, which was struck out accordingly.

***Tungtex Trading Company Limited v. CIR [2009] HCIA 7***

The taxpayer sought to have the case stated remitted back to the Board of Review for amendment. The court considered the proposed amendments and decided that it was not justified.

***Moulin Global Eyecare Trading Limited (In Liquidation) v. CIR [2011] CACV 64***

The CIR's appeal to the Court of Appeal was heard on 2 and 3 February 2012. Pending judgement.

(Relevant to the Appendix on page 76)

**Chapter 3**

***C G Lighting Limited v. CIR [2011] FAMV 23***

The taxpayer's application to the Court of Final Appeal for leave to appeal was heard and dismissed on 24 August 2011.

(Relevant to Appendix 5 on page 237)

***Aviation Fuel Supply Company v. CIR [2009] HCIA 6***

The taxpayer designed and constructed an aviation fuel supply facility for the Airport Authority. Under the agreement, the taxpayer had a right to receive part of the income from the operation of the facility for 20 years. However, as provided in the agreement, the Airport Authority paid the taxpayer a lump sum to buy out the taxpayer's right to receive the income.

It was held that the taxpayer carried on a business of designing and constructing the facility to earn the income over the 20 years. It did not carry on a business of constructing and selling the facility for a lump sum and therefore was not chargeable to profits tax under s.14 of the IRO. It was also held that the selling of the right for the lump sum was not a transfer of a right and therefore not chargeable to profits tax under s.15(1)(m) and s.15A of the IRO.

The CIR filed a notice of appeal to the Court of Appeal. The appeal is scheduled to be heard on 13 to 15 November 2012.

(Relevant to Appendix 2 on page 229)

**Chapter 4**

Under "Topic highlights" on page 314, replace with the following:

"As of December 2011, Hong Kong has signed 22 comprehensive double taxation agreements and arrangements."

In the fourth paragraph on page 314, replace with the following:

"As of December 2011, Hong Kong has concluded comprehensive double taxation agreements with 22 jurisdictions including Belgium, Thailand, the Mainland of China, Luxembourg, Vietnam, Brunei, the Netherlands, Indonesia, Hungary, Kuwait, Austria, the United Kingdom, Ireland, Liechtenstein, France, Japan, New Zealand, Switzerland, Portugal, Spain, the Czech Republic and Malta."

Under "Topic recap" on page 314, replace with the following:

"Hong Kong has signed 22 comprehensive double taxation agreements."



**Chapter 8**      **SOIPN No. 5 (Revised)** issued in October 2011.  
(Relevant to section 1.1 on page 422)

**Chapter 9**      **DIPN No. 25 (Revised)** issued in November 2011.  
(Relevant to section 4.5 on page 486)

In "Example 23" on pages 523-4, add the following :

"Need to consider the SSD implications if the residential property was acquired on or after 20 November 2010, either by an individual or a company (regardless of where it is incorporated), and resold within 24 months."

In section 6.6.2 on pages 525-6, add the following:

"The profits from the sale of shares in a special purpose vehicle may be subject to profits tax – see D46/09 (decided in 2010)."

**DIPN No. 31 (Revised)** issued in November 2011.  
(Relevant to section 7 on page 530)

In section 8.6 and 8.7 on pages 154-5, add the following:

"The IRD has issued a notice on "Tax Treatment for Defined Benefit Retirement Schemes" on 18 July 2011 detailing its revised assessing practice on "Net Total" recognised in the profit and loss account or statement of comprehensive income of an entity participating in a defined benefit retirement scheme.

[www.ird.gov.hk/eng/tax/bus\\_dbs.htm](http://www.ird.gov.hk/eng/tax/bus_dbs.htm) "

**Chapter 12**      Under "Learning focus" on page 611, replace with the following:

"As of December 2011, Hong Kong has signed 22 comprehensive double taxation agreements and arrangements."

Last paragraph of section 1.1 on page 614, replace with the following:

"As of December 2011, Hong Kong has concluded comprehensive double taxation agreements with 22 jurisdictions including Belgium, Thailand, the Mainland of China, Luxembourg, Vietnam, Brunei, the Netherlands, Indonesia, Hungary, Kuwait, Austria, the United Kingdom, Ireland, Liechtenstein, France, Japan, New Zealand, Switzerland, Portugal, Spain, the Czech Republic and Malta."

The first paragraph of section 5.5 on page 634, add the following:

"The DTA between Hong Kong and the Netherlands became effective on 24 October 2011".

The first sentence of section 5.6 on page 636, add the following:

"As of December 2011, Hong Kong has signed 22 DTAs with other jurisdictions."

Last sentence of section 5.6 on page 636, replace the last sentence with the following:

"Please refer to Appendix 1 for a summary of the CDTAs that Hong Kong has signed as of December 2011."

Appendix 1 "Summary of Avoidance of Double Taxation Agreements" on page 638, add the following:

DTA with Hong Kong	Withholding tax charged by host country			Taxing right of host country		Taxing right of capital gain on disposal of shares	
	Dividend	Interest	Royalty	Shipping income	Airline income	> 50% immovable property	Others
Spain	0%/10% (xvii)	5%	5%	Exempted	Exempted	Both, except quoted shares	Home country
Czech Republic	0%/ 5% (xvii)	0%	10%	Exempted	Exempted	Both, except quoted shares	Home country
Malta	0%	0%	3%	Exempted	Exempted	Both, except quoted shares	Home country

### Chapter 13

Section 6.2 on page 658. Insert the following before paragraph (8):

"The transfer of all or part of the tangible assets of an enterprise, along with associated receivables, debt and workforce to other units in an asset restructuring transaction via a merger, division, sales or asset exchange, does not fall within the scope of business tax. The transfer of immovable property and land use rights in the course of such transactions also fall outside the scope of business tax" (Bulletin [2011] No. 51 issued by the PRC State Administration of Taxation on 26 September 2011).

Insert the following after section 13.3 on page 667 :

#### VAT Reform Pilot Program

The PRC Ministry of Finance and the State Administration of Taxation jointly issued tax notices, Caishui [2011] No. 110 and Caishui [2011] No. 111 on 16 November 2011. The reform will result in a merger of VAT and business tax.

Caishui [2011] No. 110 outlines the general principles for the VAT reform pilot program to be implemented in the Mainland in Year 2012. It stipulated that the VAT reform pilot program will be carried out in two phases. The first phase will be applicable to specific sectors in Shanghai. The second phase will be rolled out as pilot programs to other regions for specific sectors. There is no date stipulated for the full VAT reform pilot program.

Caishui [2011] No. 111 sets out the specific pilot program to be implemented in

Shanghai since 1 January 2012. Under the pilot program, service providers will be classified as “general VAT payers” and “small-scale VAT payers”. A taxpayer with annual taxable service turnover of at least RMB5 million should apply for the status of a general VAT payer.

Based on the two tax notices:

The applicable VAT rates for the general VAT payers (service providers) will be as follows:

Leasing of movable property and tangible goods	–	17%;
Provision of transportation and construction services	–	11%;
Provision of other specific “modern services”	–	6%

“Modern services” are defined in Caishui [2011] No. 111 to include research and development and technology services, information technology services, design services, intellectual property services, advertising services, meeting and exhibition services and certification services.

The VAT rate for small-scale VAT payers (service providers) will be 3%.

Taxpayers covered by the pilot program should pay VAT at the location where the enterprise is located. Business tax paid in other regions can be deducted when calculating the VAT payable.

