

Workshop Outline and Learning Methodologies

| Session | Methodologies | Chapters covered | Guidance Notes |
|----------------------------|-------------------------------------------------------------------------------------------|------------------------------|----------------|
| Workshop 1 | | | |
| 1. Introduction | <ul style="list-style-type: none">• Presentation• Group discussion | | |
| 2. Profits tax | <ul style="list-style-type: none">• Group exercise | Ch. 3, 8 & 11 | Pg. 1 to 4 |
| 3. Negotiation | <ul style="list-style-type: none">• Role play• Group exercise | | |
| 4. Tax for individuals | <ul style="list-style-type: none">• Case study• Group discussion | Ch.5 & 11 | Pg. 5 to 7 |
| Workshop 2 | | | |
| 5. Reboot | <ul style="list-style-type: none">• Presentation• Group discussion | | |
| 6. Tax-avoidance | <ul style="list-style-type: none">• Group discussion | Ch. 3, 4, 8, 9 & 11 | Pg. 1 to 2 |
| 7. Cross border tax issues | <ul style="list-style-type: none">• Group discussion | Ch. 3, 4, 12 & 13 | Pg. 3 to 4 |
| 8. Tax planning | <ul style="list-style-type: none">• Case study• Group reflection | Ch.3, 4, 5, 6, 7, 9, 11 & 12 | Pg. 5 to 6 |
| 9. Conclusion | <ul style="list-style-type: none">• Presentation• Group discussion | | |

Preamble

The focus of the workshops under the Enhanced Qualification Programme is on formative development of skills, i.e. to train candidates to become future CPAs.

As such, many of the cases and issues discussed during the workshops were designed to encourage different points of view which may result in different conclusions being drawn by the candidates during the workshops.

These guidance notes will point out some of the main observation points from these discussions to facilitate a better understanding of those cases or issues. These guidance notes are not intended to be 'model answers' and should not be used for any purpose other than for a better understanding of the key points discussed during the workshops.

Workshop Two – Tax Avoidance Cases

(Group Discussion Exercise)

Reason for activity

CPAs need to be familiar with anti-avoidance provisions in order to identify and manage the risk of possible challenges by the IRD on current or proposed arrangements.

Issue 1: Management service company

Details were provided of a management service company which provided management services to the law practice of a barrister. During the year, the management service company incurred significant entertainment expenses and received a management fee from the barrister's law practice which was calculated at a 12.5% mark-up on the total expenditure of the management service company. The IRD has not issued an enquiry letter to the management service company on its entertainment expenses.

Main observation points

Candidates were required to discuss whether the arrangement would infringe upon s.61 or s.61B of the IRO and whether the expenditures incurred were deductible under s.16(1) and not disallowed under s.17 of the IRO.

Most candidates correctly referred to DIPN 24 (Revised) Profits tax - Service company "Type II" arrangements which explains the circumstances under which service company claims will be challenged by the IRD.

should analyse the facts of the case to see if the arrangements can be justified and therefore not in contravention of the anti-avoidance provisions. For example, if the acquisition of the company or the reduced selling price can be justified by commercial reasons, then it may not contravene the anti-avoidance provisions.

Issue 2: Acquisition of a company

Details were provided on BL, a Hong Kong distributor, which acquired SL, another distributor in Hong Kong, to expand its market to other countries in Asia. BL initially sold goods to SL at the same price as it would sell to its local customers. However, at year end, a bulk discount was offered to SL on all the sales during the year as a year-end adjustment.

Main observation points

Most students correctly identified that the acquisition of SL may be challenged under s.61B if the sole or dominant purpose was to utilise the tax loss of SL. Some students also recognised the risk of the year-end price adjustment to the intra-group transactions which may be challenged under s.61A as per the *Ngai Lik* case.

Issue 3: Stamp duty

Details were provided on property transactions between group companies involving two houses, one of which was ultimately sold to an unrelated party, and a retail shop which was leased at a lease premium and a monthly rent. All the relevant agreements have not been stamped.

Main observation points

Many students recognised that the sale and purchase agreement may be exempt from stamp duty and special stamp duty (SSD) if the relevant conditions are met. However, the sale to the unrelated party would be subject to stamp duty and also SSD since no exemption applies (refer to SOIPN 5 (revised) – paragraph 32) and the property was acquired after 30 November 2011 and resold within 6 months. Some students recognised that lease agreements are outside the scope of the exemption and for those agreements which are eligible for exemption, they must be adjudicated.

Issue 4: Deduction claims

Details were provided on RL which provided machines to its subsidiaries for production, acquired assets from an unrelated company and revalued upwards to claim deductions under s.16E and s.16G, as well as entered into sale and leaseback arrangements with its subsidiary.

Main observation points

Many students correctly recognised that depreciation allowance will be denied under s.39E if the machines were leased, and the lessee used the machines wholly or principally outside Hong Kong. The same applies if the machines were financed by a non-recourse debt, or if the sale and leaseback arrangement contravened s.39E(1)(a). Only some students pointed out that the IRD may scrutinise the valuation for deduction claims under s.16E and s.16G.

Workshop 2 – Cross Border Tax Issues

(Group Discussion Exercise)

Reason for activity

CPAs should have an awareness of the tax issues arising from cross-border transactions, especially due to the increase in cross-border transactions between Hong Kong and the Mainland.

Case 1: Machine leasing

Details were provided on EL which leased a machines to a Mainland company and another machine to another Mainland company. It also received annual licence fee and service fee from another Mainland company for the right to use EL's technology and for on-site technical services.

Main observation points

Some students recognised that, if there is a transfer of title at the end of the lease, the transaction is taxed under VAT. If not, the transaction should be taxed under BT. EL would also be subject to Corporate Income Tax (CIT) on a withholding basis on the lease payment received on both machines.

Most students recognised that the licence fee should be subject to BT, and CIT on a withholding basis. For the service fee, as the provider or recipient of the taxable service were located in the Mainland, it is subject to BT. Assuming EL did not have a permanent establishing in the Mainland, the service fee should also be subject to CIT on a withholding basis if the technical service was classified as part of the technical licence arrangement.

Case 2: Production and distribution

Details were provided on a plan to setup 2 companies in the Mainland. The first company would produce and sell cigarettes to customers in the Mainland or act as an agent to solicit customers for suppliers in the Mainland. The second company would sell and deliver cigarette production machines but is unsure whether to setup a third company to provide the delivery services.

Main observation points

Candidates were required to discuss the turnover tax implications. The first company would pay VAT on the sale of the cigarettes less the input VAT paid on purchase of the tobacco and production machines. It would also be subject to consumption tax (CT) on the sale of the cigarettes less the CT paid on the purchase of the tobacco. If the first company acted as an agent instead, the commission income received would be subject to business tax (BT).

The second company would be subject to VAT less the input VAT paid. However, if a third company is established to provide the delivery services, it would be subject to BT for the provision of transportation services. Although the rate of tax is lower, the customer would not be able to claim the higher input VAT under the first alternative (delivered by the second company instead).

Note: These exercises provide candidates a chance to experience the challenges faced by CPAs in practice. Certain aspects of the question, which may be beyond the scope of this module, are retained to ensure that the scenario closely resembles the cases encountered by CPAs in real life. Candidates would not be expected to have knowledge beyond level one (awareness) for China Tax in the module examination.

Workshop 2 – Tax Planning for Individuals

(Group Discussion Exercise)

Reason for activity

CPAs should be able to apply up-to-date tax knowledge together with innovative and critical thinking to minimise the tax exposure of an individual in a legal and commercially realistic manner.

Case Study: Personal Assessment and Business Structure

Details of the income and expenses of Ms Ong's professional tutoring business for the year were provided. Candidates were required to compute Ms Ong's tax position under Personal Assessment (PA) and also to advise whether it would be more tax advantageous for her to run her business as a sole proprietorship or a limited company.

Main observation points

Most candidates correctly computed Ms Ong's tax payable for the year with PA and without PA, and concluded that the amount of tax payable would be lower under PA. Although the amount of profits tax payable under a sole proprietorship is higher than the amount of profits tax payable under a limited liability company (salaries paid to Ms. Ong would be deductible under a limited liability company), most students recognised that if Ms. Ong is eligible to elect PA, her overall tax payable (using the sole proprietorship structure) for the year would be lower than the overall tax payable using the limited liability company structure. Some students correctly pointed out that non-tax considerations should also be taken into account in determining the structure of the business.

Workshop 2 – Tax Planning for Corporations

(Group Discussion Exercise)

Reason for activity

CPAs should be able to apply up-to-date tax knowledge together with innovative and critical thinking to minimise the tax exposure of a company or a group of companies in a legal and commercially realistic manner.

Case Study: Acquisition of business and tax reporting

Details of an overseas company planning to setup a company in Hong Kong to invest in Hong Kong listed securities were provided. The company is also contemplating how to finance an acquisition of another Hong Kong company engaged in the operation of restaurants in Hong Kong.

Main observation points

Most students correctly referred to DIPN 43 (revised) which provides the details on how a non-resident can be exempt from profits tax on its profits derived from specified transactions. Some students correctly recognised that there are tax avoidance "deeming provisions" to prevent resident persons from disguising themselves as non-residents to take advantage of the exemption.

For the acquisition of the Hong Kong company, many students correctly pointed out that the interest on the loan to finance the acquisition would not be deductible as it would not be incurred in the production of the assessable income of the acquirer. Some students proposed that the acquisition of the assets and the business may be more tax advantageous since the interest on the loan is likely to be deductible. However, the students correctly pointed out that the acquirer may prefer to use a separate limited liability company to hold the business due to other non-tax considerations.