
Answers

Cases are given in the answers for educational purposes. Unless specifically requested, candidates were not required to quote specific case names to obtain the marks, only to provide the general principles involved.

		<i>Marks</i>																																																																																																								
1 (a)	Under s.8, salaries tax is charged on income from an employment, office and pension arising in or derived from Hong Kong. The phrase ‘arising in or derived from Hong Kong’ is not defined in the Inland Revenue Ordinance (IRO), but s.8(1A) provides that income from employment includes income derived from services rendered in Hong Kong and excludes income derived from services rendered outside Hong Kong. Apart from this, no guidance is given in the IRO and the phrase ‘arising in or derived from Hong Kong’ is to be interpreted according to case law and Board of Review decisions.	1-5																																																																																																								
	In accordance with the principle in the <i>Goepfert</i> case, George’s employment has its source in Hong Kong as his employer is a Hong Kong company resident in Hong Kong. His income will be fully chargeable to salaries tax unless he has rendered all his services outside Hong Kong. For this purpose, services rendered in Hong Kong during visits not exceeding 60 days are ignored. As George has performed services in Hong Kong during visits of more than 60 days to Hong Kong, he cannot claim the exemption under s.8(1A)(b) as qualified by s.8(1B). However, as he has paid tax in China, he qualifies for the exemption under s.8(1A)(c), which excludes income from services rendered outside Hong Kong, if the taxpayer is chargeable to tax in the country in which the services are rendered and tax of substantially the same nature as salaries tax in Hong Kong has been paid in respect of the income attributable to the services rendered in that country. It does not matter that the tax was paid or reimbursed by the employer.	3-5																																																																																																								
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(b) (i)	George Young Salaries tax assessment Year of assessment 2011/12																																																																																																									
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(ii) Explanations:																																																																																																										
	Note 4. No rental value is applicable to the hotel accommodation provided in Hong Kong because strictly it is not a ‘place of residence’ under s.9, since it is only a place provided during the business trips.	0-5																																																																																																								
	Note 5. The provision of the car and driver are a non-taxable benefit in kind as they are not convertible into cash.	0-5																																																																																																								

Marks

The reimbursement of the proportion of petrol costs relating to business use (80%) is an allowable expenditure and so not taxable. Reimbursement of the portion for private use is, however, taxable.	0.5
Note 6. The payment by the trustee to George's child is not chargeable: see <i>BR 6/70</i> and <i>Barclays Bank v Naylor</i> referred to in DIPN 16.	0.5
Note 8. The cost of the note book is a capital expense. It is therefore precluded from deduction under s.12(1)(a).	0.5
The note book does not qualify for depreciation allowance under s.12(1)(b), as although it is an item of plant, its use is not essential to the production of assessable income.	0.5
Note 9. The self-education expense (half of the tuition fee) is deductible as the course is offered by a university and is an approved course under s.12(6).	0.5
The reimbursement of a deductible expense (half of the tuition fee) is not taxable.	0.5
	<u>4</u>

(c) The transfer of George's employment to the BVI subsidiary needs to be properly documented, in respect of the termination of the original employment contract, the writing of a new contract with new terms and notifying the Inland Revenue Department (IRD) of the cessation of the original employment. Otherwise, it is likely that the IRD will treat the transfer as resulting in no change in employment and thus George's salaries tax position will also be unchanged.	2
However, even if the transfer is regarded as a genuine change in employment, it is likely that George's salaries tax position will still remain the same, as the BVI subsidiary company, although incorporated outside Hong Kong, is still considered as resident in Hong Kong as its place of business is in Hong Kong. So the whole of George's income from the employment will still be taxable in Hong Kong unless George performs no services in Hong Kong or the services are performed in Hong Kong during visits of not more than 60 days (see <i>BR 106/02</i>).	<u>2</u>
	<u>4</u>
	<u>25</u>

2 (a) The sale of Property B gives rise to a profit of \$4,000,000. The property was purchased in 2010 and sold in 2011. Whether or not the profit is taxable under s.14 depends on the nature of the profit. If the profit is capital in nature, it would be excluded from the profits tax charge. However, if the profit arises from a trade or adventure in the nature of trade, the profit would be regarded as revenue in nature and taxable.	1
In determining whether a sale is a trade or adventure in the nature of trade, it is common to apply the so-called 'badges of trade' which take into account the following factors:	
1. Subject matter – in this case, property is a subject matter which is considered as common for trading purposes.	
2. Length of ownership/holding – in this case, the holding period is about 19 months, which is too short to demonstrate a long-term intention to hold the property.	
3. Frequency or number of similar transactions in the past – information is absent from the question.	
4. Any supplementary work on the property – information is absent from the question.	
5. Circumstances responsible for the sale – the fact that the property was not able to be put into its original intended use due to an external and unforeseeable prohibition could be a valid reason to explain the disposal.	
6. Motive for disposal – the case could be stronger if it can be demonstrated that the sale was not driven by the uprising property market.	3
Other factors such as financing could also be considered by the IRD in ascertaining whether a trade or adventure in the nature of trade has actually been carried out.	
In this case, since the period of ownership/holding is about 19 months, there is a high possibility for the capital claim to be challenged by the IRD. However, in support of the good reason to dispose of the property, Bookie should be able to provide the necessary proper documentary proof to show that the genuine purpose of buying and selling the property has been driven by reasons other than profit making.	<u>1</u>
	<u>5</u>

(b)	Bookie Ltd		Marks
	Profits tax computation for the year of assessment 2011/12		0·5
	Basis period: year ended 31 December 2011		0·5
	\$	\$	
Profit for the year per accounts		2,439,625	0·5
<i>Add:</i> Depreciation	1,060,000		0·5
Goodwill impairment	200,000		0·5
Loss on asset disposal	20,000		0·5
Interest on loan from associate	15,000		0·5
Legal fees for tax appeal	5,000		0·5
Legal fees for property sale	6,000		0·5
Compensation payment	150,000		0·5
Rebate commissions	50,000		0·5
Property tax	144,000		0·5
Stamp duty	1,094,375		0·5
Donations	400,000	3,144,375	0·5
		<u>5,584,000</u>	
<i>Less:</i> Depreciation allowance for machinery and plant	251,000		0·5
Commercial building allowance	200,000		0·5
Profit from disposal of property	4,000,000		0·5
Interest income	10,000	(4,461,000)	0·5
		<u>1,123,000</u>	
<i>Less:</i> Donation (Red Cross)		(320,000)	1
		<u>803,000</u>	
<i>Less:</i> Tax loss brought forward		(330,000)	0·5
Net assessable profit		<u><u>473,000</u></u>	
Profits tax payable at 16·5%		78,045	0·5
<i>Less:</i> Property tax set-off (s.25)		(144,000)	1
Tax refundable		<u><u>(65,955)</u></u>	0·5

Correct treatment of items that require no adjustment (candidates are NOT required to prepare the following table in their answers). Marks will be awarded if they are not adjusted in the tax computation.

Taxable/non-deductible items	\$	Deductible/non-taxable items	\$
Property rental income	1,200,000	Rental for senior manager	450,000
Compensation income	200,000	Severance payment	100,000
Exchange gain	9,000	Legal fee – audit and tax filing	60,000
		Legal fee for compensation claim	8,000
		Hire purchase finance charge	2,000
		Interest on bank loan	70,000
		Interest on bank overdraft	2,000
		Exchange loss	10,000

0·5 mark each maximum 5

	Depreciation allowance schedule				Marks
	20%	30%	HP – 20%	Total allowance	
	\$	\$	\$	\$	
Written down value (WDV) brought forward	200,000	460,000			0.5
Additions					
Motor vehicle		20,000			0.5
Scanner			40,000		0.5
		<u>480,000</u>			
Initial allowance (IA) 60%		(12,000)		12,000	0.5
IA – HP (5,000 + 5,000*2)*60%			(9,000)	9,000	1
Disposals	(5,000)	(12,000)	–		1
	<u>195,000</u>	<u>456,000</u>	<u>31,000</u>		
Annual allowance	(39,000)	(136,800)	(6,200)	182,000	1.5
WDV carried forward	<u>156,000</u>	<u>319,200</u>	<u>24,800</u>		
Printing machine:					
Addition		80,000			0.5
Initial allowance 60%		(48,000)		48,000	0.5
		<u>32,000</u>			
				<u>251,000</u>	
Commercial building allowance for Property A					
Qualifying expenditure				5,000,000	0.5
Commercial building allowance at 4%				<u>200,000</u>	0.5
					25
					<u>30</u>

3 (a) Mrs Lo's property tax computation for the year of assessment 2011/12

	\$	
Rental [(45,000 + 6,000)*12]	612,000	1
Premium (90,000*12/24)	<u>45,000</u>	1
Assessable value	657,000	
Less: Rates (15,000*4)	<u>(60,000)</u>	1
	597,000	
Less: 20% statutory allowance	<u>(119,400)</u>	0.5
Net assessable value	<u>477,600</u>	
Property tax payable at 15%	<u>71,640</u>	0.5
		<u>4</u>

(b) Partnership allocation for the year of assessment 2010/11

	Partnership	Mr Lo	Mr Chan	
	\$	\$	\$	
Salaries to partners	240,000	120,000	120,000	0.5
Salaries to spouse	108,000	–	108,000	0.5
Balance (1:1)	(798,000)	(399,000)	(399,000)	0.5
Allowable loss	(450,000)	(279,000)	(171,000)	
Loss lapsed upon retirement	171,000	–	171,000	1
Loss carried forward	<u>(279,000)</u>	<u>(279,000)</u>	<u>0</u>	0.5
Profits tax payable	<u>Nil</u>			0.5

Partnership allocation for the year of assessment 2011/12

	Partnership \$	Mr Lo \$	ABC Ltd \$	
Salaries to partner	120,000	120,000	–	0.5
Interest on capital	100,000	–	100,000	0.5
Balance (1:2)	450,000	150,000	300,000	0.5
Assessable profit	670,000	270,000	400,000	
Loss brought forward	(270,000)	(270,000)	–	0.5
Loss set off under s.19C(4)	(250,000)	–	(250,000)	1
Profit/loss transferred to personal assessment	–	–	–	0.5
Net assessable profit	150,000	0	150,000	
Profits tax payable at 16.5%	24,750		24,750	0.5
Loss carried forward	9,000	9,000		0.5
				8

(c) Personal assessment computation for Mr and Mrs Lo
Year of assessment 2011/12

	Mr Lo \$	Mrs Lo \$	Total \$	
Assessable profits from proprietorship business [200,000 – 70,000 (ACD limited to 35%)]	130,000			1
Salary		320,000		0.5
Net assessable value (NAV)(from part (a))	130,000	477,600		0.5
Less: Mortgage interest (restricted to NAV)		797,600		
ACD (182,000 – 70,000) [limited to 35% of (130,000 + 70,000 + 797,600 – 477,600) = 182,000]		(477,600)		1
Mandatory provident fund contributions		(112,000)		1.5
		(12,000)		0.5
Reduced total income	130,000	196,000		
Joint total income			326,000	0.5
Less: Married person's allowance			(216,000)	0.5
Net chargeable income			110,000	
Tax payable at progressive rates			7,200	0.5
Tax payable at standard rate (326,000*15%) is not applicable			48,900	0.5
Therefore, tax payable is:				
By Mr Lo: \$7,200*130,000/326,000			2,871	0.5
By Mrs Lo: \$7,200*196,000/326,000			4,329	0.5
				8
				20

- 4 (a) A club is an association formed for other than business purposes. The association should not exist for financial advantage of its members: *Kowloon Stock Exchange Ltd* (1984). Whether or not a club is subject to profits tax depends on whether it is deemed under s.24(1) to be carrying on a business in Hong Kong. 0.5

A club is deemed not to be carrying on a business if not less than half of its gross receipts on revenue account (including entrance fees and subscriptions) are received from members who are entitled to vote in general meetings. As a result, no profits tax liability arises. On the other hand, if less than half of its gross receipts are received from its voting members, then the club is deemed to be carrying on a business. As a result, the whole of its income including entrance fees (although they are capital in nature) and subscriptions will be chargeable to profits tax after adjustments for allowable deductions. 2.5

Even if the club is not deemed to carry on a business, it will still be liable to property tax in respect of rental income from non-members.

1
4

(b) Analysis of receipts from members and non-members:

	Year ended 31 December 2010	Year ended 31 December 2011	
	\$	\$	
Receipts from members			
Members' entrance fees	100,000	50,000	0.5
Members' subscription	125,000	180,000	0.5
Car parking fees	120,000	130,000	0.5
Lounge Café receipts	160,000	180,000	0.5
Fund raising sales	45,000	55,000	0.5
	<u>550,000</u>	<u>595,000</u>	
Receipts from non-members			
Rental from property	350,000	500,000	0.5
Lounge Café receipts	80,000	90,000	0.5
Fund raising sales	45,000	55,000	0.5
Donations	–	100,000	0.5
	<u>475,000</u>	<u>745,000</u>	
Total receipts	<u>1,025,000</u>	<u>1,340,000</u>	
% of receipts from members	53.7%	44.4%	0.5

For the year ended 31 December 2010, the All Friends Club is deemed not to be carrying on a business. No profits tax is payable but property tax is payable in respect of the rental income received from leasing part of its building to non-members. Since the Club is not deemed to be carrying on a business, the loss is not allowed to be carried forward.

2

For the year ended 31 December 2011, the All Friends Club is deemed to be carrying on a business. All its receipts are subject to profits tax, including entrance fees and the donation. The profits tax payable is calculated as follows:

1

	\$	
Surplus for the year	210,000	0.5
Add: Entrance fees	50,000	0.5
Property tax	60,000	0.5
Assessable profits	<u>320,000</u>	
Profits tax at 15%	48,000	0.5
Less: Property tax set off under s.25	<u>(60,000)</u>	0.5
Profits tax refundable	<u>(12,000)</u>	0.5
		<u>11</u>
		<u>15</u>

5 As an employer, the IRO requires the following compliance reporting to be made in the case of a member of staff ceasing employment:

- (1) Under s.52(5), an employer is required to notify the CIR in writing of the cessation of employment of an employee at least one month before the cessation. A shorter period of notice may be accepted if the employer is not aware of the date of cessation at least one month before it occurs. 1.5
- (2) Under s.52(6), when an employee is about to leave Hong Kong after the cessation of employment for a period longer than one month and the employer is aware of such intended departure, the employer is required to notify the CIR in writing of the departure and the expected date of departure at least one month before the intended departure. Shorter notice may be accepted if the CIR deems it reasonable. 1.5
- (3) Under s.52(7), when an employer has given notice of the expected departure of an employee under s.52(6), the employer must not pay to or on behalf of the employee any money or money's worth, without the CIR's written consent, within one month of having given the notice. 1.5

In the case of Henry, the company is required to observe the following compliance obligations:

- (1) The cessation date is 31 May 2012. Strictly speaking, the company is obliged to file the cessation return by 30 April 2012, which is the date of resignation. In anticipation of the need for administrative work, a shorter period of notice could be acceptable. However, filing the cessation return one month after receiving the resignation notice, i.e. on 31 May 2012, which is also the last day of employment may not be accepted by the IRD, unless there is justifiable reason for the excessive delay. 2
- (2) Since the company is aware of Henry's intention of leaving Hong Kong for more than one month, it is obliged to report at least one month before the intended departure date. The fact that this is not reported may be challenged by the IRD as non-compliance and a penalty may be imposed. 1
- (3) The company is also obliged to retain any payment to be made to Henry until he has cleared all Hong Kong tax liabilities and the CIR has given consent to release the money. In complying with the withholding requirement, the company is protected from any action that may be brought by Henry against it for any non-payment. Failing to comply with these obligations would cause the company to be subject to a fine at level 3, i.e. \$10,000. 1.5
- (4) The fact that the final payment is to be paid into Henry's bank account outside Hong Kong does not alter the nature of the payment as far as its taxability is concerned. It also does not alter the compliance obligations of the company with regard to retaining payment or in reporting the payment made in the course of employment. 1

10