Answers

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

The suggested answers are in the nature of general comment only. They are not offered as advice on any particular matter and should not be taken as such. No reader should rely on the suggested answers as the basis for any decision. The examiners expressly disclaim all liability to any person in respect of any direct, indirect, incidental, consequential or any other damages relating to the use of the suggested answers.

1 Report to Mr Liu

To: Mr Liu
From: Tax advisor
Date: 1 March 2013
Subject: Strategies for properties held by Fortune Ltd (the Company)

We refer to our earlier discussions with you on the proposed alternatives available for the Company to deal with the vacant properties and the related Hong Kong tax implications. As requested, we provide below our comments on the respective issues.

(a) Option to sell the properties for a small gain

(i) Adjustments to the accounting profit/(loss) for tax purposes and an estimate of the adjusted tax losses to be carried forward

Based on the Company's draft statement of profit or loss, the Company incurred an operating loss of $849,900. Since this figure was derived based on generally accepted accounting principles, the figure may have to be adjusted as required by the Inland Revenue Ordinance (IRO). In general, any profits or receipts which are capital in nature, as well as income which is specifically exempted by law or any statutory order, would be excluded from the assessable profits. Items which are not included in the accounting profits but deemed as taxable income by the IRO would then be added back to the profits. As regards the expenditure, items which do not qualify for tax deductions under the IRO would need to be added back to the profits, and specific deductions granted by the IRO but not reflected in the accounting profit would need to be subtracted from/added to the profit/loss. Based on DIPN 40 and the *Secan* case, the Inland Revenue Department (IRD) adopts the view that tax deductions must follow the treatment of the items in the accounts prepared in accordance with normal commercial principles, unless the IRO provides otherwise.

As the Company has commenced business and the properties have been accounted for as fixed assets subject to accounting depreciation calculated on the same basis as the tax depreciation allowance, the Company's adjusted tax loss is estimated as follows:

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Operating loss per draft accounts	(849,900)
Add: Interest expense on shareholder's loan	40,000
Less: Interest income from bank deposits	(100)
Adjusted loss for tax purposes, to be carried forward	(810,000)

For an interest expense to be deductible, both s.16(1) and s.16(2) of the IRO have to be satisfied. Section 16(1) requires that the interest expense must be incurred in the production of assessable profits. In the Company's case, it requires that the loan money has been used to acquire the properties which would generate assessable profits to the Company. This would depend on how the properties are to be put into use. If the properties are used by the Company for its operation, used for generating taxable lease income, or to be sold at a profit which is taxable, s.16(1) would be satisfied. However, if the properties are sold at a profit which is capital in nature and not taxable, or the properties are not put into income-generating use, s.16(1) would not be satisfied and the interest would not be deductible. On the other hand, even if s.16(1) is satisfied, an interest deduction would not be granted unless any one of the conditions under s.16(2) is satisfied. In respect of a loan obtained from a non-financial institution, such as a shareholder's loan as in the Company's case, the interest income received by the shareholder must be taxable in Hong Kong before the borrower is allowed an interest deduction under s.16(2)(c). Given that Hong Kong does not tax interest income earned by individuals who do not earn that interest income in the course of carrying on a business, trade or profession, the interest income earned by you as shareholder is not taxable. Therefore, the Company would not be able to deduct the interest expense on your shareholder's loan and the expense must be added back.

Interest income earned from bank deposits is excluded as exempt income pursuant to the Exemption Order issued in 1998, which exempts from tax all interest income earned from deposits placed with financial institutions in Hong Kong, unless the deposits have been used as security for a loan. This exemption applies to the Company and thus the interest income is excluded from tax and so increases the tax loss.

(ii) Whether the sale of the properties constitutes a 'trade' and the profits arising are taxable

Under s.14 of the IRO, where profits arise from a trade, profession or business carried on in Hong Kong and the profits so derived are sourced in Hong Kong, profits tax will be imposed, unless the profits arise from the sale of capital assets. However, whether the profits from the sale of properties by the Company can be regarded as capital in nature and thus excluded from tax would depend on whether or not the sale would constitute a 'trade' or an 'adventure in the nature of trade'. This issue is contentious and subject to the merits of each case. The IRD usually examines the case by reference to the so-called 'badges of trade', as follows:

(1) Motive – Any motive to make a profit from a resale would constitute a 'trading' purpose. The Company appears to have such a profit-making from resale motive at the outset when the properties were placed for sale right after their acquisitions and good prices were being looked for. This fact is decisive. Therefore, regardless of the accounting treatment as capital assets, the properties would be regarded by the IRD as trading stock and the profits derived from sales thereon would be chargeable to profits tax.

For completeness, we would also note below the other factors which may be relevant in deciding if a property is trading stock or a capital asset where the motive of obtaining and disposing of a property cannot be easily established.

(2) Subject matter of the transaction – the subject matter in this case is property in Hong Kong. Property may be used for personal enjoyment (e.g. for self-occupation), for long-term income-generating purposes (e.g. for leasing), or for short-term speculation (e.g. for trading). It is generally considered that a property which does not yield an income or personal enjoyment for its owner is more likely to be held for trading purposes.

(3) The length of ownership period – the shorter the period of ownership, the more likely that the transaction is trading. In this case, the properties were acquired during 2012 and were immediately placed for sale. Assuming a sale is effected in 2013, the period of ownership would be too short to support the argument for capital investment.

(4) The frequency of similar transactions – the higher the frequency, the more likely that the transaction is trading. While the Company did not have any transactions before 2012, the similar treatment and sale arrangements of the two properties on hand would be taken into consideration.

(5) Supplementary work done – if additional work has been performed in enabling the properties to be sold at a better profit, a trading intention would be implied. The Company has renovated the properties before their placement for sale, which could be an indication of trading intention.

(6) Circumstances leading to the sale – in terms of timing, the Company might argue that the decision to sell the properties was driven by the desire to gain cash inflow to lessen the Company's interest burden, rather than by the appreciation in property value. However, this would have to be considered alongside all the other factors.

In addition to the above six badges, the IRD would normally look at other factors such as the funding of the acquisition cost and the utilisation of the sale proceeds. The Company financed the acquisitions almost entirely with loans obtained, at 50% from a shareholder and 50% from a bank, which is the usual practice for property traders in Hong Kong unless the loans were bridging loans (i.e. very short-term loans to be replaced with substantial capital of the Company).

Judging from the facts of the case, by reference to the above factors it is likely that the Company would be regarded as carrying on a trade in properties. As a consequence, any profits arising from the property sales would likely be taxable, but any such profit could be reduced by any adjusted tax loss brought forward.

One further point to note is that the amount of tax loss estimated above may be further adjusted by the IRD to disallow the depreciation allowance on the properties, in order to reflect the position that the properties were effectively held by the Company as trading stock, instead of as capital assets. If this is the case, the estimated tax loss available for offset would be reduced to $410,000 ($810,000 –- $400,000).

(**Note to marker:** *Candidates may not be able to address the further adjustment to the tax loss by disallowing the depreciation allowance, but may proceed to discuss the taxable balancing charge. Although this concept is not strictly correct, marks will still be given for an appreciation of the knowledge of the impact of property disposal.*)

(iii) Potential stamp duty liabilities from property sales

Under Head 1 (1A) of the Stamp Duty Ordinance (SDO), the agreement for the sale and purchase of a residential property is liable to *ad valorem* duty at rates ranging from $100 (for a value not exceeding $2,000,000) to 4·25% (for a value exceeding $20,000,000). The dutiable value is usually based on the transaction price or consideration, but in the case where the consideration is below market price, the property market value will be used for stamping purposes. The subsequent formal assignment of the property executed in conformity with the stamped agreement will be liable to a fixed duty of $100. The law stipulates that both parties to the transaction are jointly and severally liable to pay the stamp duty, but in market practice, the purchaser is normally the person who pays.

In addition, special stamp duty is payable if the property was acquired during the period from 20 November 2010 to 26 October 2012 and resold within 24 months; or acquired on or after 27 October 2012 and resold within 36 months (*see tutorial note*). In the case of the Company, the two properties were acquired during the year ended 30 September 2012. Thus, the applicable rates of special stamp duty are those in respect of property acquired between 20 November 2010 and 26 October 2012, which depending on the holding period will be as follows:

– 15% for property held for six months or less;
– 10% for property held between six to 12 months; and
– 5% for property held between 12 to 24 months.

The special stamp duty is chargeable regardless of whether the sale of the property gives rise to a profit to the seller or not. If special stamp duty is payable, both parties to the transaction are jointly and severally liable.

Tutorial note: *The law on the special stamp duty rates applicable to properties acquired on or after 27 October 2012 was only gazetted on 28 December 2012, which is beyond the cut-off date for this examination diet. Therefore, candidates were not expected to give details of these provisions in their answers, but they are included below for completeness:*

In respect of property acquired on or after 27 October 2012, special stamp duty is payable at the following rates:

– *20% for property held for six months or less;*
– *15% for property held between six to 12 months; and*
– *10% for property held between 12 to 36 months.*

(b) Option to lease the properties

In the event that the properties are let out for rental under short-term leases, the Company's tax position would be:

Profits tax

Under s.14(1), profits tax is imposed on any person who carries on a trade, profession or business in Hong Kong and derives assessable profits arising in or derived from Hong Kong. 'Business' is defined in s.2 to include the letting or sub-letting of property by a corporation. Therefore, if the Company earns rental income from letting the properties, the rental income would be business income. Moreover, given that the properties are located in Hong Kong, the rental income is sourced in Hong Kong. As a result, the rental income would be subject to profits tax at 16·5%. Related expenses incurred in the production of assessable rental profits including rates, repairs and management fees would be deductible under s.16(1). In respect of loan interest payable to the bank, a tax deduction would also be granted for the reason that the loan money was used by the Company to finance the acquisition of properties which generate assessable rental profits (s.16(1)), and the interest was paid to the bank (s.16(2)(d)) on a loan not secured by any deposit or loan which derives non-taxable interest income (s.16(2A)), nor under any arrangement whereby the interest expense would flow back to the Company as non-taxable income (s.16(2B)). Moreover, tax depreciation allowances would be granted in respect of plant and machinery used by the Company. Other capital expenditure incurred on plant and machinery such as air conditioners could be eligible for an initial allowance at 60% in the year the expenditure was incurred and an annual allowance of 10%/20%/30% on the reducing value, depending on the nature of the asset.

If the properties could be regarded as capital assets at the outset, the portion of acquisition cost attributable to the building, as well as structures, as included in the renovation costs would be eligible for a commercial building allowance at 4% per annum. However, as noted above, it is very likely that the properties are regarded by the IRD as trading stock and thus no building allowance would be allowed. Further, the letting, if completed, would be as an interim measure pending better prices for sale; as such the leasing would not convert the properties from trading stock into capital assets.

Property tax

Under s.5(1), property tax is levied on any owner of land or a building, or of land and a building, situated in Hong Kong at the standard rate of 15% based on the property's net assessable value. 'Net assessable value' includes any consideration payable in money or money's worth in respect of the right to use the land/building, subject to the following deductions:

(i) government rates agreed and paid by the owner (subject to the rates concession, if any); and
(ii) a one-off statutory allowance of 20% of the assessable value after deducting rates if applicable. The statutory allowance is deemed to cover all related expenses incurred by the owner on the property, and thus, all other actual expenses including repairs, management fees and loan interest would not be deductible under property tax.

In the Company's case, the rental income earned by the Company from property letting would also be subject to property tax on the basis that the Company is the owner. This would be the case even though the same rental income is subject to profits tax as explained above. This gives rise to double taxation. To release the double taxation burden, the Company should make an application for exemption from property tax (s.5(2)(a)) on the basis that the same rental income has been included in the Company's assessable profits subject to profits tax. If the exemption is granted, the Company would not be required to file a property tax return nor pay the property tax. Only profits tax will be payable on the rental income.

In the event that the exemption is not granted (which should be rare) or the exemption is not granted before the property tax is due and payable, the Company is still required to pay the property tax but is then able to set off the property tax against the Company's profits tax payable if the rental income has been included in the assessable profits subject to profits tax (s.25). If there is an excess of property tax paid over any profits tax payable, the excess could be refunded to the Company.

Stamp duty

In terms of stamp duty, an agreement for the lease of immovable property in Hong Kong is dutiable under Head 1(2) of the SDO. For a lease term which does not exceed one year, the stamp duty rate is only 0·25% on the average yearly rent. Stamp duty is payable regardless of the fact that the properties are to be leased to an associated company owned by yourself. The group relief from stamp duty under s.45 for the transfer of properties or shares between associated corporations does not

apply to leases. However, as stamp duty is chargeable on instruments, no stamp duty would arise if no lease is entered into. Special stamp duty does not apply to leases.

Tutorial note: *Any lease for more than three years has to be reduced in writing, but this is not the case for shorter leases, as contemplated in this case.*

(c) Option to occupy the property yourself

You are also considering occupying one of the vacant properties yourself in the capacity of either the Company's shareholder or the Company's director.

From the perspectives of the Company, the relevant issue of concern is whether the property related expenses including the interest expense incurred on the bank loan to finance the properties would be eligible for a tax deduction. As explained above (in (a)(i)), interest expense (including all other related expenses) would be deductible if both s.16(1) and s.16(2) are satisfied.

Section 16(1) requires that the expense must be incurred in the production of assessable profits. In the event that the Company allows you to occupy the property in the capacity of a shareholder, the property would be regarded as not being put to an income-producing purpose. Therefore, all related expenses, including the bank loan interest, would not be tax deductible by the Company for profits tax purposes. A tax depreciation allowance would also not be granted, even if the property could be regarded as a capital asset to the Company.

The above restrictions would, however, not apply if the property is occupied by you in your capacity as the Company's director. In this situation, the accommodation benefit is regarded as offered to reward your services. Therefore, the related expenses including the bank loan interest would be incurred in the production of the Company's assessable profits and deductible for tax purposes. Clearly, it would be more desirable for you to occupy the property in the capacity as the Company's director.

We trust that the above addresses all the Hong Kong profits tax implications arising from the proposed options. Should there be any questions, please let us know.

End of Report

2 Mr and Mrs Ng

(a) Moving into Mrs Ng's property

After retirement, the couple plan to move into the property owned by Mrs Ng. The property is currently leased for rental and property tax has been paid by Mrs Ng. After the couple take up the property as their place of residence, the property lease will be terminated. No rental income will be earned and no property tax will be payable. Mrs Ng will have to notify the IRD of the cessation of property income one month after the cessation.

Once the property is occupied by the couple as their principal place of residence, if interest continues to be paid on the mortgage loan used to acquire the property, Mrs Ng will be eligible to claim a home loan interest deduction against her assessable income. The maximum amount of deduction for each year is $100,000, and will be granted to Mrs Ng or the couple (as the case may be) for a maximum of 15 years of assessment. The 15 years of claim are not necessarily consecutive. Since Mrs Ng, herself, will not be earning sufficient assessable income to offset the home loan interest deduction, it is suggested that the couple elect for personal assessment. If this is the case, all the income earned by the couple will be aggregated and the home loan interest deduction can be set off against their aggregated assessable income. In the case of a married couple not living apart, such as Mr and Mrs Ng, both spouses must elect for personal assessment, since both of them have income included in the assessment.

(b) Mrs Ng's father moving to an elderly home in Hong Kong or to Mainland China

In the current circumstances, Mr Ng is eligible to claim the dependent parent allowance, both basic and additional, in respect of Mrs Ng's father on the grounds that he is maintaining and living with his father-in-law. After retirement, it is proposed that Mrs Ng's father will move either into an elderly home in Hong Kong or back to Mainland China.

If Mrs Ng's father moves into an elderly home, and the costs are paid by Mr Ng, Mr Ng will be eligible for a deduction of the costs as 'Elderly Residential Care Expense', subject to a maximum deduction of $76,000 per annum. However, the deduction will only be granted if the elderly home is licensed or registered under the Hong Kong relevant legislation or operated by the Hong Kong government. Where the 'Elderly Residential Care Expense' deduction is claimed, Mr Ng or the couple will not be eligible to also claim the dependent parent allowance in respect of Mrs Ng's father. In the event that Mrs Ng's father moves back to live in Mainland China, no deduction would be granted even if elderly home costs were paid; nor would dependent parent allowance be granted for the reason that Mrs Ng's father is no longer ordinarily resident in Hong Kong.

(c) Exercise of share option

Mr Ng is entitled to exercise the share option for the remaining 500 shares. Upon exercising the option, a deemed gain will be calculated and taxable based on the market value of the shares on the date of exercise. If the exercise is effected during 2013/14, the deemed gain will be aggregated with his other employment income and retirement sum, and assessed in 2013/14. However, if the exercise is effected after 1 April 2014, the deemed gain from exercising the share option will be brought into assessment for the year of assessment in which the exercise takes place, i.e. in 2014/15 or after. Section 11D,

which deems post-employment receipts as accruing on the last day of employment, does not apply to share option gains. In the circumstances, it would be more tax effective for Mr Ng to exercise the share option in the year following the retirement year, as the deemed share option gain would likely be absorbed to a larger extent by the concessionary deductions, e.g. for home loan interest, and/or Part V allowances.

(d) Consultancy fees received after retirement

After his retirement, Mr Ng will sign a consultancy agreement with his existing employer and act as their consultant on a fee basis. *Prima facie*, this appointment is assumed to be self-employment such that Mr Ng will be subject to profits tax instead of salaries tax in respect of the fees received. Under s.14(1), profits arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong would be subject to profits tax. Any expenses incurred in the production of such assessable profits would be deductible against the assessable profits (s.16(1)). The net assessable profits after deduction would be subject to standard tax at the rate of 15%.

Under the profits tax regime, Mr Ng is not entitled to any personal allowance or concessionary deductions. Therefore, it is advisable for Mr Ng, in conjunction with Mrs Ng, to elect for personal assessment, so that Mr Ng's consultancy fees and Mrs Ng's salary would be aggregated together in the computation, and, where appropriate, full year concessionary deductions, as well as Part V allowances can be deducted. In addition, the couple would be able to claim their approved charitable donations in full, subject to the maximum deduction.

(e) Deficiencies in prior year's tax computations/positions

Based on the computations provided, Mr and Mrs Ng's tax positions for 2012/13 were not effective in the following areas:

(i) Mrs Ng's total assessable income was not sufficient to absorb her personal allowance in full.
(ii) Mrs Ng was not able to deduct her eligible approved charitable donations in full.
(iii) Mrs Ng was subject to property tax on the rental income and so mortgage loan interest was not deductible.

The deficiency in (ii) above could be remedied by Mr Ng deducting the unclaimed portion of approved charitable donations. Section 26C(1) provides that a deduction may be granted for donations made by a person 'or their spouse'. Therefore, Mr Ng is able to claim the eligible donations provided that there was no double deduction.

The deficiencies in (i) and (iii) above could be remedied if the couple were to elect for personal assessment, under which all of their income from different sources would be aggregated, and concessionary deductions and Part V allowances granted against the aggregated income. In addition, if the total aggregated income includes rental income, the related loan interest incurred to produce the rental income would be allowed as a deduction, whereas such an interest deduction is not allowed under property tax.

In the circumstances, if the couple elected for personal assessment in 2012/13, their revised overall tax position would become:

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Mr Ng's salary and share option gain	1,233,000
Mrs Ng's salary	10,000
Mrs Ng's property's net assessable value (NAV)	96,000
Mortgage loan interest ($150,000 restricted to NAV)	(96,000)
Approved charitable donations	(12,000)
MPF contributions	(14,500)
Married person's allowance	(240,000)
Child allowance	(63,000)
Dependent parent allowance – Mrs Ng's father living together	(76,000)
Net chargeable income	837,500
Tax payable	130,375

Therefore, the total tax saved under personal assessment for 2012/13 is $35,140 ($151,115 + $14,400 – $130,375).

Under s.41(3), an election for personal assessment must be made in writing and received by the IRD not later than the later of:

(i) two years after the end of the year of assessment in respect of which the election is to be made; or
(ii) one month (or such further period as the Commissioner may allow) after any notice of assessment on any income which will fall into the total income election has become final and conclusive.

In respect of the year of assessment 2012/13, the due date for making an election would be 31 March 2015 (condition (i) above) or two months after the date of issuance of the 2012/13 assessment assuming no objection will be raised thereto, whichever is the later. Therefore, Mr and Mrs Ng should still be able to make the election in respect of the 2012/13 assessment should they wish to do so.

3 VIP Inc

(a) Under s.14(1) of the IRO, profits tax is imposed on any person who 'carries on a trade, profession or business in Hong Kong and derives profits that are arising in or derived from Hong Kong'. Amongst the conditions, the first and fundamental one is that the person chargeable to profits tax must carry on a trade, profession or business in Hong Kong. In this respect, the place of incorporation is irrelevant. Companies incorporated in foreign jurisdictions may still be regarded as carrying on business in Hong Kong if business activities are carried on in Hong Kong either through or not through a permanent establishment (PE).

Inland Revenue Rule No. 5 (IRR 5) defines a PE to mean a branch, management or other place of business, but not to include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of his principal or has a stock of merchandise from which he regularly fills orders on behalf of the principal. Although IRR 5 is for quantifying assessable profits, the definition provided is generally consistent with cases decided in other common law jurisdictions and is generally adopted in the tax treaties Hong Kong has entered into with other jurisdictions.

Therefore, in the case of VIP Inc, as for any other person, whether it would be regarded as carrying on business in Hong Kong depends on the mode in which its business is to be conducted in Hong Kong.

(b) (i) Via a subsidiary

Under this channel, VIP Inc is not carrying on business in Hong Kong itself. By setting up a subsidiary in Hong Kong, the Hong Kong operation would be carried on by the subsidiary as a separate legal entity from VIP Inc. Goods will be bought by the subsidiary from VIP Inc and sales effected in Hong Kong will be recorded as sales income by the subsidiary and the profits earned from the buying and selling of the goods accounted for by the subsidiary. The subsidiary will be considered as carrying on business in Hong Kong by virtue of its sales activities carried out in Hong Kong. The trading profits will arise in or be derived from Hong Kong through the retail outlets in Hong Kong, and the profits will be subject to profits tax in Hong Kong.

As regards VIP Inc, the sale of goods to the subsidiary will be regarded as business carried on 'with' Hong Kong, and thus the profits arising therefrom will not be taxable in Hong Kong. In the future when the subsidiary makes profits and distributes dividends to VIP Inc, the dividends will also be exempt from Hong Kong tax under s.26(1).

One point of caution is the pricing strategy for the goods sold from VIP Inc to the subsidiary. Since the sales will be regarded as transactions effected between associated entities, the issue of transfer pricing arises. VIP Inc and the subsidiary are associated on the basis that VIP Inc 'participates directly or indirectly in the management, control or capital of the subsidiary'. In determining the reasonable price for the supply of goods, the arm's length principle must be observed, making reference to the DIPN 46 on the related transfer pricing rules adopted by the IRD. Under the arm's length principle, transactions of independent enterprises should be used as a benchmark to determine the transfer price including the allocation of profits and expenses between associated entities. Therefore, the price charged by VIP Inc for goods supplied to the subsidiary should be comparable to that charged by VIP Inc for the goods supplied to an independent buyer. If it is found that the sales price of the goods supplied to the subsidiary is overstated so that any tax deduction claimed for the cost of goods sold is excessive, the IRD may seek to adjust the deduction to bring any shortfall of assessable profits into assessment. Alternatively, the IRD may deem that VIP Inc is itself carrying on business in Hong Kong in such a manner that the subsidiary makes a profit which is less than the ordinary level, and seek to tax VIP Inc on that profit (s.20).

Tutorial note: *Given that the USA tax rate is higher than the Hong Kong tax rate, from a tax perspective, it would be unusual for VIP Inc to overstate the sales price of the goods to the subsidiary*.

(ii) Via an exclusive agent

Under this channel, VIP Inc is likely to be considered as carrying on business in Hong Kong through a PE in Hong Kong. Based on IRR 5, an agent who is given the full or general authority to negotiate and conclude contracts on behalf of its principal will be deemed as a PE of the principal. If VIP Inc appoints an exclusive agent who is given the full authority to handle the sales activity including negotiating and concluding sales with the customers on behalf of VIP Inc, the IRD will likely deem the Hong Kong agent as the PE of VIP Inc. As a result, all profits arising from the sales made in Hong Kong via the exclusive agent would be deemed as profits made by VIP Inc. Although IRR 5 is technically not a charging provision, it supports the general view that VIP Inc could be subject to profits tax in Hong Kong as a result of the activities carried on by the agent in Hong Kong. The fact that the goods are shipped directly to the customers from the USA is irrelevant.

As regards the collection of tax, an assessment may be issued either directly to VIP Inc or in the name of the Hong Kong agent. In the latter case, the Hong Kong agent is required to retain out of any assets of VIP Inc (such as the sales proceeds) an amount sufficient to meet the tax liability of VIP Inc, and to pay the tax to the IRD on behalf of VIP Inc. The agent is statutorily indemnified against any claim by VIP Inc in respect of this withholding.

(iii) Via a distribution agent

Under this channel, an agent will be appointed in Hong Kong but will only be responsible for keeping an inventory of goods from VIP Inc and distributing the goods to customers in Hong Kong according to instructions. The Hong Kong agent will not have any full authority to deal with the customers. Unfortunately, the fact that the Hong Kong agent will keep an inventory of merchandise and regularly fills orders on behalf of the principal from that inventory will be

considered as having a place of business for VIP Inc and thus will constitute a PE in Hong Kong. VIP Inc will still be regarded as carrying on business in Hong Kong through having the goods handled by the Hong Kong agent.

Tutorial note: *As the goods are manufactured in the USA and the solicitation, negotiation and conclusion of the sales orders are manually accepted in the USA, it is highly arguable that the profits are derived outside Hong Kong. In this case, the tax position will be similar to that under channel (i), i.e. the profits are not taxable in Hong Kong. There is room for the IRD to argue that part of the profits should be attributed to the storage of the goods with the distribution agent for delivery to the customers; however, such argument has not been tested in a court of law in Hong Kong.*

(iv) Via direct sales with Hong Kong after-sales services

Under this channel, VIP Inc will be dealing with the customers directly via online orders. Purchase orders will be placed with VIP Inc directly and accepted by VIP Inc. Sales decisions including negotiation and conclusion are all effected between VIP Inc in the USA and customers in Hong Kong. Goods will be shipped to customers directly. In these circumstances, VIP Inc is only considered as carrying on business 'with' Hong Kong, not 'in' Hong Kong and s.14 does not apply to subject VIP Inc to profits tax. The Hong Kong agent is not a PE of VIP Inc, so long as it does not have full authority to negotiate with the customers in Hong Kong, and does not keep an inventory of goods in Hong Kong. The provision of after-sales services to customers by the Hong Kong agent does not render VIP Inc to be carrying on business in Hong Kong. The Hong Kong agent in this case is not required to file any tax return to the IRD nor to withhold any tax amount on behalf of the principal.

4 Smart Ltd

(a) General principles for determining the source of manufacturing profits

The general principles are set out in DIPN 21 'Locality of profits', paragraphs 30 to 32.

The Inland Revenue Department (IRD) considers that, where goods are manufactured in Hong Kong, the profits arising from the sale of such goods will be fully taxable because the profit-making activity is considered to be the manufacturing operation carried out in Hong Kong. Where goods are manufactured partly in Hong Kong and partly outside Hong Kong, then that part of the profit which relates to the manufacture of goods outside Hong Kong will not be regarded as arising in Hong Kong; and apportionment is generally done on a 50:50 basis, unless compelling circumstances dictate otherwise.

Where a company manufactures goods outside Hong Kong and sells them to Hong Kong customers, the manufacturing profits are not liable to profits tax. However, in the exceptional case where the sale activities in Hong Kong are so substantial as to constitute a retailing business, profits attributable to the retailing activities are fully taxable.

The IRD provides an example in the DIPN where a Hong Kong manufacturing business enters into a processing arrangement with a Mainland entity, under which the Mainland entity provides the factory premises, the land and labour while the Hong Kong manufacturing business provides the raw materials, technical know-how, management, production skills, design, skilled labour, training and supervision for the local labour and the manufacturing plant and machinery. The Mainland entity is responsible for processing the goods, for which it is paid a processing fee by the Hong Kong manufacturing business. This kind of arrangement is called 'contract processing'. In the Department's view, the Hong Kong company's operations in the Mainland complement its operations in Hong Kong. Recognising the operations of the Hong Kong company on the Mainland, an apportionment of profits on a 50:50 basis is usually accepted.

If, however, manufacturing on the Mainland has been contracted to a sub-contractor and paid for on an arm's length basis, with the minimal involvement of the Hong Kong business, this will not be a case of manufacturing profit but rather a case of trading profits. Profits of the Hong Kong business will be calculated by deducting from its sales the cost of the goods sold, including any sub-contracting charges paid to the sub-contractor on the Mainland. Taxation of such trading profits will be determined on the same basis as for a commodities or goods trading business.

In recent years, the IRD has discovered that many of the manufacturing arrangements made by Hong Kong businesses are not by way of contract processing. Instead, the Hong Kong business sells raw materials to the Mainland entity, which processes the raw materials into finished goods and then sells the finished goods back to the Hong Kong business. This kind of arrangement is called 'import processing'. In such cases, the Hong Kong business will be treated by the IRD as a trading business and no apportionment will be granted.

(b) Whether Smart Ltd's profits should be subject to, or exempt from, profits tax

To be chargeable to profits tax, s.14(1) requires various cumulative conditions to be satisfied, that is: (1) a business is carried on in Hong Kong, (2) there are profits from that business and (3) those profits arise in or are derived from Hong Kong. In Smart Ltd's (Smart) case, both conditions (1) and (2) are satisfied and condition (3) is therefore critical.

Hong Kong tax operates on a 'territorial' concept. To determine the source of profits, the broad guiding principle is that one looks to see what the taxpayer has done to earn his profits and where he has done it: the *Hang Seng Bank* case and *HK-TVB International* case. In the case of manufacturing profits, the profit-making activity is considered to be the manufacturing operation and profits are made where this is carried out.

Smart commenced business in Hong Kong as a manufacturer and exporter of plastic products. Profits arising from the sale of such goods were fully taxable because the manufacturing operation was carried out in Hong Kong. But from 2013,

manufacturing is carried out by Wise Co (Wise) on the Mainland. Smart and Wise adopt the import processing method by which the raw materials are imported into the Mainland by way of purchase and the finished goods are exported out of the Mainland by way of sale. The transactions between Smart and Wise are that Wise carries on an import processing business, the transfers of raw materials and finished products between Smart and Wise are by way of sale and purchase and the consideration for such sales and purchases is satisfied by Smart's payment of money to Wise. Smart purchases the raw materials and sells the raw materials to Wise. Subsequently, Smart purchases the finished goods from Wise and sells the finished goods to outside customers. Smart thus earns its profit from the buying and selling of finished goods. It is therefore a trading company.

The 50:50 apportionment under paragraph 34 of DIPN 21 is only available to 'contract processing' and not to 'import processing'. The IRD will therefore treat Smart not as a manufacturer but as a trader.

The profits of Smart's trading business will be calculated by deducting from its sales the cost of the goods sold, including any sub-contracting charges paid to Wise. The taxation of such trading profits will be determined on the same basis as for a trading business; and trading profits are made where the purchase contracts and sales contracts are 'effected' (the *Hang Seng Bank* case). On the basis that either the contract of purchase or sale or both are effected in Hong Kong, the IRD will assume that Smart's profits will be 100% taxable as trading profits, but may look at other factors to determine the case (DIPN 21, paragraph 23(c)).

The above approach has been adopted by the Commissioner in *CIR* v *Datatronic Ltd* and *CIR* v *CG Lighting Ltd* and endorsed by the Court of Appeal, which concluded, based on the facts found in the cases, that the activities performed by the taxpayer on the Mainland were merely antecedent or incidental to the production of profits. The Court of Appeal found that the arrangement between the taxpayer and its subsidiary on the Mainland was by way of import processing, and the taxpayer's profits were not manufacturing profits. Instead, the taxpayer's profit-making transactions consisted of the purchasing of goods from the subsidiary and then reselling them at a profit, which took place in Hong Kong. The Court of Appeal further agreed with the Commissioner that DIPN 21 had no legal effect.

(c) Deduction in respect of the cost of machinery and moulds transferred to Wise Ltd

As Smart's profits are treated as fully taxable in Hong Kong, in computing its assessable profits, Smart may therefore, potentially, be able to claim a 100% deduction for the cost of the moulds as prescribed fixed assets pursuant to s.16G; and a depreciation allowance in respect of the machinery acquired under hire purchase, under s.39B.

Prescribed fixed assets are defined to include assets used in a manufacturing process, but exclude assets in which any person holds rights as a lessee under a lease: s.16G(6). 'Lease' in relation to any machinery or plant is defined in s.2 as including 'any arrangement under which a right to use the machinery or plant is granted by the owner of the machinery or plant to another person'.

In *Braitrim (Far East) Limited* v *CIR*, the Court of Appeal held that the term 'lease' in s.16G(6) should follow the statutory definition under s.2(1). Therefore, the provision of moulds by Smart to Wise constitutes a 'lease' arrangement under which a right to use the moulds was granted by Smart to Wise; and, therefore, the moulds are 'excluded fixed assets' not qualifying for any tax deductions under s.16G.

Similarly, s.39E(1)(b)(i) stipulates that where there is a lease of machinery or plant in which the taxpayer is a lessor (including assets acquired under hire purchase) and the asset is used by a person other than the taxpayer wholly or principally outside Hong Kong, no depreciation allowance on capital expenditure on such an asset shall be granted. Therefore, if the machinery is 'leased' by Smart for use in Wise's Mainland factory, s.39E operates to deny Smart any depreciation allowance (DIPN 15).

Tutorial note: *Braitrim (Far East) Limited applied for leave to appeal to the Court of Final Appeal. The application was heard and dismissed by the Court of Appeal on 19 April 2013. The taxpayer's application to the Court of Final Appeal for leave to appeal was heard and dismissed on 19 April 2013.*

5 (a) Island Bank

A financial institution means an authorised institution within the meaning of s.2 of the Banking Ordinance: s.2(1) of the IRO. Island Bank is obviously a financial institution. Even where the credit has been provided to the borrower outside Hong Kong, interest income derived by a financial institution 'through or from the carrying on of its business' is deemed to have a Hong Kong source: s.15(1)(i). Although the scope of this subsection has been held by various Boards of Review to be very wide, the Commissioner accepts that only two factors are relevant to determining the source of interest income derived by a financial institution, namely, the place where the loan was initiated, negotiated, approved and documented; and the place where the funding was raised: see DIPN 21, para 54.

In this case, although the borrower was located outside Hong Kong and the loan was initiated, etc by Island Bank through its staff outside Hong Kong, the loan was funded by Island Bank from Hong Kong. Therefore, 100% of the interest is assessable: see DIPN21, para 54 (1)(b).

Tax relief is, however, available for the payment of withholding tax under s.16(1)(c): see DIPN 28. This relief takes the form of a deduction rather than a tax credit. Therefore, since 100% of the interest is assessable, 100% of the withholding tax (i.e. $300,000) is deductible.

Furthermore, 100% of the interest paid on the money borrowed to finance the provision of the loan will be deductible under s.16(1)(a) and s.16(2)(a).

(b) HK Co

Unlike a typical bank account balance which has been described as a capital asset, the purchase of foreign currency for a speculative purpose is trading in nature. Therefore, the issue in this case is not whether the foreign currency assumed the nature of capital when it was accumulated over time and placed on deposit to obtain interest and better exchange rates (as in *CIR* v *Li & Fung Ltd*). Rather, the issue is whether, when HK Co purchased the foreign currency, did it do so with the intention of selling it at a profit? In other words, did HK Co as a matter of objective fact purchase foreign currency with the intention of reselling it at a profit? If it did, then the profit would arise from an adventure in the nature of trade and should be taken into account in computing HK Co's assessable profits.

In the present case, the transaction giving rise to the profit was (a) wholly financed by borrowed money and (b) entered into on a short-term basis for the purpose of making a profit from the purchase and sale of foreign currency. It could thus be concluded that when HK Co purchased the Australian dollars, it was not investing in foreign currency, rather it was trading in the currency. The profits of $200,000 should, therefore, be revenue in nature and chargeable to profits tax: see *D73/97*.

As the deposit has been used as security for the loan, the interest income of $5,000, although derived from a deposit with a financial institution in Hong Kong, cannot be exempted under the 1998 Exemption Order. However, the interest expense of $10,000 incurred to earn the chargeable profit from the purchase and sale of the foreign currency is deductible under s.16(1)(a) and s.16(2)(d).

(c) Real Property Development Ltd (RPDL)

Section 16(1) allows a deduction of expenses for a year of assessment to the extent that they are incurred in the basis period for the year of assessment in the production of assessable profits. This means that the profits produced can be assessable for any year of assessment, not necessarily the year of assessment in the basis period for which the expense is incurred.

In the *Secan* case, the Court of Final Appeal held that if an expense has been properly treated in the taxpayer's accounts according to generally accepted accounting principles, and such treatment is not disallowed under the provisions of the IRO, there should be no tax adjustment for the expense.

In the present case, the three expense items have been capitalised and included in work in progress according to generally accepted accounting principles. Therefore, only those which are attributable to the 500 units to be sold should be deductible. In the absence of other direct costing for the 500 units, 25% of the expenses (500/2,000) should be eligible for a deduction under s.16(1) upon the sale of the 500 units.

The deduction of interest is further governed by s.16(1)(a), which provides that interest on money borrowed for the purpose of producing assessable profits is deductible provided that any condition under s.16(2), as well as the requirements under ss.16(2A) and (2B), are satisfied.

In the case of RPDL, the interest is incurred to produce chargeable profits. This satisfies s.16(1)(a). The interest is paid to a bank in Hong Kong, which is a financial institution, therefore s.16(2)(d) is satisfied. Section 16(2A) requires that the loan must not be secured in whole or in part, directly or indirectly, by any deposit or loan which derives non-taxable income in Hong Kong. Section 16(2B) further requires that no arrangement has been in place whereby any interest payment is ultimately paid back to the borrower, or any connected person of the borrower. Therefore, a deduction will be available provided both ss.16(2A) and (2B) are satisfied, i.e. the loan has not been secured by any deposit or loan which derives non-taxable income, and the interest will not ultimately be paid back to RPDL, or any connected person of RPDL.

The units are trading stock of the company. Section 16(2)(e) will be satisfied if the loan on which the interest is paid is not borrowed from an associate, or a corporation controlled by the trustee of a trust where the trustee, or the corporation, or any beneficiary in the trust is an associate of RPDL. The meaning of an associate, as far as this case may be relevant, is an associated corporation of the company. The bank which received the interest is an associated corporation of the company if it is controlled by the company, or vice versa, or if both the bank and the company are controlled by a third person by means of voting rights or any powers in the articles of association of any corporation: s.16(3).

Assuming s.16(2)(d) or (e) and ss.16(2A) and (2B) are satisfied, the amounts deductible will be:

Interest paid	$26m x 500/2,000	$6·5m
Architect's fee	$3m x 500/2,000	$0·75m
Project management fee	$1m x 500/2,000	$0·25m

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Advanced Taxation (Hong Kong) **December 2013 Marking Scheme**

				Available	*Maximum*
1	(a)	(i)	**Adjustment of accounting profits**		
			Capital and exempt profit to be excluded	0·5	
			Deemed taxable income to be added back	0·5	
			Non-deductible expenses added back	0·5	
			Specific deductions to be subtracted	0·5	
			Normal commercial principles apply unless provided otherwise	0·5	
			Calculation of adjusted tax loss (3 x 0·5)	1·5	
			Interest deduction depends on usage s.16(1)	1	
			Interest received by shareholder not taxable	0·5	
			Interest on shareholder loan not deductible s.16(2)(c)	0·5	
			Interest income on deposit exempt due to 1998 Exemption Order	0·5	
				6·5	6
		(ii)	**Whether sale is 'trade'**		
			'trade' or 'adventure in the nature of trade'	0·5	
			'motive' and its specific application in this case	1·5	
			Description of remaining five badges of trade (1 mark each)	5	
			Other relevant factors: funding	1	
			Conclusion: trading	0·5	
			Tax loss further adjusted to disallow depreciation (or balancing charge)	1	
				9·5	8
		(iii)	**Stamp duty liabilities**		
			Transfer of immovable properties (Head 1)	0·5	
			Stamping of sale and purchase agreement	0·5	
			Ad valorem rates	0·5	
			Consideration or market value if higher	0·5	
			Subsequent formal assignment $100	0·5	
			Both parties jointly and severally liable	0·5	
			In practice, borne by purchaser	0·5	
			Special stamp duty if acquired after 20 November 2010	1	
			Property is resold within 24 months	1	
			Rates depending on holding period	0·5	
			Payable in addition to normal stamp duty	0·5	
			Regardless of profit or loss	1	
			Both parties jointly liable	0·5	
				8	7
	(b)		**Option to lease**		
			Profits tax payable s.14(1)	0·5	
			'business' includes letting of property by corporation	0·5	
			Related expenses incurred in production of profits s.16(1)	0·5	
			Bank loan interest deductible if not secured by non-taxable interest or interest not flow back s.16(2)(d), s.16(2A), s.16(2B)	1	
			Tax depreciation allowances	0·5	
			Commercial building allowance only if a capital asset	0·5	
			Temporary letting does not convert	1	
			Property tax is payable as owner	0·5	
			Net assessable value	0·5	
			Deduction restricted to rates and 20%	0·5	
			Double taxation	0·5	
			Exemption from property tax s.5(2)(a)	0·5	
			Property tax set off against profits tax s.25	0·5	
			Stamp duty at 0·25% as lease for less than one year	0·5	
			Section 45 not applicable	1	
			If no lease, no stamp duty	0·5	
			No special stamp duty	0·5	
				10	8

	Available	*Maximum*
(c) Option to occupy by Mr Liu		
Issue is deductibility of expenses	0·5	
If in shareholder's capacity, not income producing	0·5	
Not deductible s.16(1)	0·5	
If in director's capacity, deductible as benefit for services	0·5	
Deductible s.16(1)	0·5	
	2·5	2
Appropriate format and presentation	1	
Logical development	1	
Effectiveness of communication	2	4
		35

			Available	*Maximum*
2	**(a)**	**Moving into Mrs Ng's property**		
		Cessation of property income	0·5	
		No property tax is payable	0·5	
		Notify IRD re cessation within one month after cessation	1	
		Occupy the property as principal place of residence	0·5	
		Home loan interest is deductible	0·5	
		Maximum deduction is $100,000 per annum	0·5	
		Maximum years of claim is 15 years	0·5	
		Not necessarily consecutive	0·5	
		Mrs Ng has insufficient income to absorb	0·5	
		Personal assessment is recommended so income can be aggregated	1	
		Married couple both with income so must elect together	0·5	
			6·5	6
	(b)	**Mrs Ng's father moving to elderly home or China**		
		Currently eligible for and claiming DPA	0·5	
		If moving into elderly home, ERCE is deductible	0·5	
		Maximum deduction is $76,000 per annum	0·5	
		Elderly home must be licensed/registered in HK	0·5	
		No dependent parent allowance is granted	0·5	
		If moving back to China, no deduction nor DPA	0·5	
		Father is no longer ordinarily resident in HK	0·5	
			3·5	3
	(c)	**Share option to be exercised**		
		Deemed gain is taxable based on MV on date of exercise	0·5	
		If exercised before retirement, gain is aggregated with other income and assessed in the year of retirement 2013/14	1	
		If exercised after 1 April 2014, gain is assessed in the year of exercise	0·5	
		Share option gain is not accrued on the last day of employment	0·5	
		More tax effective to exercise after 1 April 2014 because of the effect of full year concessionary deductions and allowances	1	
			3·5	3
	(d)	**Consultancy fees after retirement**		
		Self-employment subject to profits tax	0·5	
		Related expenses are deductible s.16(1)	0·5	
		Tax rate is 15%	0·5	
		No personal allowance or concessionary deductions under profits tax	0·5	
		Personal assessment recommended	0·5	
		Mr Ng's consultancy fee aggregated with Mrs Ng's salary	0·5	
		Full year concessionary deduction and Part V allowance deducted	0·5	
		Approved charitable donations can be claimed in full, subject to maximum	0·5	4
	(e)	**Deficiencies in prior years**		
		Mrs Ng's assessable income is insufficient to absorb the basic allowance	0·5	
		Mrs Ng was unable to claim approved charitable donations in full	0·5	
		Mrs Ng was subject to property tax without any loan interest deduction	0·5	
		Unclaimed donation could have been claimed by Mr Ng	1	
		Personal assessment should have been elected	0·5	
		Mortgage loan interest can be deducted under personal assessment	0·5	
		Calculation of revised overall tax position 2012/13	3	
		Tax saved under personal assessment	0·5	
		Election for personal assessment must be in writing	0·5	
		Not later than two years after end of the year of assessment	0·5	
		Or one month after assessment becomes final and conclusive	0·5	
		Due date for election for 2012/13 is 31 March 2015	1	
		The couple should still be able to elect personal assessment	0·5	
			10	9
				25

			Available	Maximum
3	**(a)**	**Principles**		
		Carrying on trade, profession or business in HK s.14(1)	0·5	
		Place of incorporation is irrelevant	0·5	
		Foreign companies through a PE	0·5	
		Definition of a PE as per IRR 5	1·5	3
	(b) (i)	**Subsidiary**		
		Subsidiary is separate legal entity	0·5	
		Subsidiary carries on business in HK due to management and control	0·5	
		Profits of subsidiary taxable in HK	0·5	
		VIP Inc not taxable in HK as it carries on business 'with' HK	0·5	
		Dividend from subsidiary not taxable in HK	0·5	
		Transfer pricing issue	1	
		VIP Inc and HK subsidiary are associated	0·5	
		Arm's length principle	0·5	
		Benchmarked with independent transactions	0·5	
		If price is overstated, tax deduction is over-claimed	0·5	
		IRD may adjust the deduction	0·5	
		Or deem VIP Inc to carry on business in HK (s.20)	1	7
	(ii)	**Exclusive agent**		
		VIP Inc is carrying on business in HK	0·5	
		Through the agent as PE (IRR 5)	1	
		Agent is given full authority	0·5	
		VIP Inc is taxable in HK	0·5	
		Direct shipment is irrelevant	0·5	
		Assessment issued either to VIP Inc or in the name of agent	1	
		If agent, withholding of tax is required	1	
		Agent to pay the tax on behalf of principal	0·5	
		Agent is indemnified against claims for withholding	0·5	6
	(iii)	**Distribution agent**		
		Though no authority, agent keeps inventory of stock in HK	0·5	
		Therefore, a PE of VIP Inc (IRR5)	1	
		VIP Inc is deemed as carrying on business in HK via the agent	0·5	2
	(iv)	**Direct sales**		
		Sales decisions are made by VIP Inc direct with customers	0·5	
		Carrying on business 'with' HK	0·5	
		Profits not taxable in HK	0·5	
		Agent only provides after-sales services, so not a PE	0·5	
		Agent does not need to report or withhold tax	0·5	
			2·5	2
				20

			Available	Maximum
4	**(a)**	Source of manufacturing profits, including apportionment	1	
		Taxation of substantial sales activities as a retailing business	0·5	
		Explanation and treatment of contract processing	2	
		Treatment where the involvement of the HK business is minimal (sub-contracting)	1·5	
		Treatment of import processing	1	
			6	5
	(b)	Conditions of s.14(1)	1	
		Source of manufacturing profits	1	
		Nature of transactions makes Smart a trading company	3	
		Concession does not apply	1	
		Basis of taxation of trading profits	2	
		Implications of *Datatronic* and *CG Lighting*	2	
			10	9
	(c)	Deduction for moulds as 'prescribed fixed asset' under s.16G	0·5	
		Depreciation allowance for machinery under s.39B	0·5	
		'Leased' asset is an excluded asset	1	
		Meaning of a lease	1	
		Conclusion: s.16G not applicable	1	
		Provisions of s.39E (1)(b)(i)	1	
		Conclusion s.39B not applicable	1	6
				20
5	**(a)**	Island Bank is a financial institution	0·5	
		'Provision of credit' test not applicable to financial institution	1	
		Interest is taxable under s.15(1)(i)	1	
		Interest 100% taxable	1	
		100% deduction for withholding tax	1	
		100% deduction for interest on borrowed funds	1	
			5·5	5
	(b)	Speculative purchase of foreign currency is trading	1	
		What was HK Co's intention?	1·5	
		Analysis of the case	2	
		Conclusion: profit revenue in nature and taxable	0·5	
		Exemption Order not applicable	1	
		Interest expense deductible	1	7
	(c)	General tax deduction principles [s.16(1) and s.16(1)(a)]	1	
		Implications of the *Secan* case	1	
		Three expense items capitalised	0·5	
		Only those attributable to the 500 units to be sold are deductible	0·5	
		25% of the expenses are deductible under s.16(1)	0·5	
		Deduction rule for loan obtained from a financial institution, and flow through test [s.16(2)(d), ss.16(2A) and (2B)]	1·5	
		The units are trading stock	0·5	
		Deduction rule for loan obtained for trading stock, security test and flow through test [s.16(2)(e), ss.16(2A) and (2B)]	1·5	
		Amounts deductible (3 x 0·5)	1·5	
			8·5	8
				20