
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.

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1 Report to the Directors of Tee-fashion Ltd

To: The Directors, Tee-fashion Ltd (T-fashion)
From: Tax advisor
Date: 1 June 2014
Subject: Proposed investment structure in the PRC

We refer to the proposed structure for T-fashion's investment in the PRC via HK-Co Ltd (HK-Co) and PRC-Co Ltd (PRC-Co), and provide our advice on the respective issues as follows:

(a) (i) Subsidy income from T-fashion to HK-Co – Hong Kong tax implications

As HK-Co is set up as a regional support centre for T-fashion, HK-Co is effectively run as a cost centre. To finance its operation, HK-Co receives subsidy income from T-fashion on the basis of 110% of the total operating costs before interest and royalty. The 10% mark-up is intended to be the remuneration for HK-Co's services in Hong Kong.

Based on the broad guiding principle in Departmental Interpretation and Practice Note (DIPN) 21 and the *Hang Seng Bank* case, in determining the source of income, one looks to see what the taxpayer has done to earn the profit, and where he has done it. In respect of profits earned from the rendering of services, the source would generally be the place where the services are rendered. If, however, part of the subsidy income is identified as offshore sourced and non-taxable, the related operating costs attributable to the earning of the offshore income would not be tax deductible. As HK-Co is carrying on business in Hong Kong, and the subsidy income is the reward for its services rendered in Hong Kong, the subsidy income would be taxable in Hong Kong under s.14(1) of the Inland Revenue Ordinance (IRO). If HK-Co renders part of its services outside Hong Kong, such as the PRC, it may possibly be able to claim that part of its remuneration is sourced outside Hong Kong and is therefore not taxable.

(ii) Subsidy income – cost plus 10% mark up basis

The subsidy income is to be determined based on 110% of the total amount of HK-Co's operating cost before interest and royalty. It is obvious that the premium of 10% is the value to recognise for the Hong Kong services. As T-fashion is the parent company of HK-Co, the subsidy income would be regarded as arising from a transaction or business between associated enterprises. Based on DIPN 46, in determining the reasonable charge for the supply of goods or services between associated enterprises, the arm's length principle must be observed. The principle basically requires that the price for an uncontrolled transaction between independent enterprises be used as a benchmark to determine the price for a transaction between associated enterprises. In the case of a fee charged for intra-group services, the Inland Revenue Department (IRD) would accept the principles defined by the OECD Transfer Pricing Guidelines to first determine whether the intra-group services have been rendered, and then to determine the arm's length charge. HK-Co, the service providing entity, will therefore need to identify the services to be rendered for direct charging, prove that the charge has been made at an arm's length price, and ensure that adequate documentation be retained for substantiation purposes.

If, when the actual price for the transaction (i.e. the 10% mark-up in this case) is compared with that adopted by truly independent enterprises, it is found that the 10% premium falls below the normal profit margin which would have been expected in an uncontrolled situation, the IRD may seek to impose tax on HK-Co based on a higher subsidy income level. It is difficult at this stage to comment as to whether the 10% mark-up is an arm's length basis acceptable by the IRD. The case would be analysed by the IRD from various perspectives including the role of HK-Co and its functions, the extent of any risks taken by HK-Co, etc. Despite this, DIPN 46 acknowledges that the traditional transaction methods provided under the OECD Transfer Pricing Guidelines, which include the cost plus method, would be accepted or preferred. In the extreme, if the IRD has reasons to believe that the arrangement involves a tax avoidance scheme which aims at gaining a tax benefit, the IRD may challenge the arrangement under s.61A and in this case as a non-resident business is involved, s.20. However, if the set-up of HK-Co and the determination of the 10% mark-up are justified in terms of commercial purpose, the chance of the IRD taking the tax anti-avoidance stance successfully should not be high.

(b) (i) Loan interest income received by HK-Co from PRC-Co

If HK-Co extends an interest-bearing loan to PRC-Co and earns interest income, such interest income would be deemed by s.15(1)(f) to be assessable profits subject to profits tax, if the interest is derived from a source in Hong Kong. Based on DIPN 13, the IRD used to adopt the 'provision of credit' test to ascertain the source of interest income, i.e. the place where the credit is first made available to the borrower. In this case, if the loan to PRC-Co is first made available to

PRC-Co at a place outside Hong Kong, such as remitting the loan money to PRC-Co's bank account in the PRC, the loan interest may be regarded as sourced outside Hong Kong and not taxable to HK-Co. However, the IRD has expressed the view that the 'provision of credit' test is restricted to situations where the loan is extended from idle surplus cash and the interest earned is in the nature of passive income. Based on the *Orion Caribbean* case, the IRD may possibly apply the 'operations test' to determine the source of interest income if the IRD considers that the lending of money is in fact of the nature of a money-lending transaction.

In the case of HK-Co, the loan to PRC-Co is financed by the loan from T-fashion, and the interest charge is arranged to enable HK-Co to earn a small spread. It is therefore likely that the loan made to PRC-Co would be challenged by the IRD as a money-lending transaction. In which case, the source of the interest income will be determined by the place where the loan is negotiated, concluded and effected (the 'contract-effected' test). If the loan arrangement between HK-Co and PRC-Co is negotiated, concluded and effected in Hong Kong, then the loan interest income from PRC-Co will be sourced in Hong Kong and taxable to HK-Co.

(ii) Loan interest payment from HK-Co to T-fashion

To finance its own operations as well as the loan to PRC-Co, HK-Co will obtain a loan from T-fashion at interest. The tax deductibility of the interest payment to T-fashion will depend on:

- (1) whether the loan interest expense is incurred in the production of assessable profits [s.16(1)]; and
- (2) whether the interest on the borrowing, being a loan from a person other than a financial institution, is taxable in Hong Kong in the hands of the recipient, T-fashion [s.16(2)(c)].

In this case, assuming that the loan interest from PRC-Co is treated as sourced in Hong Kong and taxable in the hands of HK-Co, condition (1) is satisfied. However, condition (2) would not be fulfilled for the reason that T-fashion would not be taxable in Hong Kong in respect of the loan interest paid by HK-Co, assuming the loan money is not made available to HK-Co in Hong Kong in the first instance. As such, the interest payment from HK-Co to T-fashion would not be tax deductible for Hong Kong tax purposes. This remains the case regardless of whether the loan interest income from PRC-Co is taxable or not.

Based on the above analysis, the proposed funding arrangements may not be tax effective, as no tax deduction would be allowed for the loan interest payment to T-fashion but the loan interest income from PRC-Co may be taxable, unless the IRD is satisfied that the loan arrangement between HK Co and PRC-Co is negotiated, concluded and effected outside Hong Kong and thus the related interest income is not taxable.

(c) Royalty income received by Media-fashion Ltd (Media-fashion)

Pursuant to the licence agreement signed with Media-fashion, HK-Co will pay a royalty of \$50,000 to Media-fashion in return for the right to use or exhibit the fashion show videos/films in the PRC. As Media-fashion does not carry on business in Hong Kong, s.14 will not operate to assess its royalty income. However, Media-fashion may still be assessable to profits tax in Hong Kong under the deeming provisions of s.15. Under s.15(1)(a), any payments received for the exhibition or use of, or right to use, in Hong Kong any cinema or television film or any tape or sound recording or any advertising material connected with these would be deemed as sourced in Hong Kong from a business carried on in Hong Kong, and thus assessable to profits tax in Hong Kong. The quantum of deemed assessable income is only 30% of the gross royalty payment, unless the payment is made to an associated party and the related intellectual property has been owned by any person carrying on a trade, profession or business in Hong Kong before, in which case 100% will be deemed as assessable income. As Media-fashion is a corporation, the corporate tax rate of 16.5% will be applied to the deemed assessable income to arrive at the profits tax payable.

Nevertheless, s.15(1)(a) only applies when the right to use or use of the related intellectual property is in Hong Kong. In the case of Media-fashion, the videos/films are intended to be used in the PRC. In these circumstances, s.15(1)(a) would not be applicable. For intellectual property used outside Hong Kong, s.15(1)(ba) extends the deeming scope to assess similar payments made for the use of, or the right to use, 'any patent, design, trade mark, copyright material, secret process or formula or other property of a similar nature' outside Hong Kong where such payments are deductible for Hong Kong profits tax purposes. In the case of the right in the television programme, the licence fee was paid for the use of, or right to use, the copyright materials which subsisted in the relevant television programmes. As a result, s.15(1)(ba) would apply as long as the royalty payment was claimed for a tax deduction in Hong Kong. In the case of Media-fashion, if HK-Co claims the royalty payment as tax deductible for Hong Kong tax purposes, such royalty would be deemed as assessable profit, under s.15(1)(ba) and Hong Kong profits tax would be payable by Media-fashion. Whether or not HK-Co is able to claim the royalty payment as tax deductible would then depend on whether the royalty payment is an expense or outgoing incurred by HK-Co in the production of HK-Co's assessable profits. Based on the information given, HK-Co is not engaged in the business of broadcasting the videos/films nor does it earn any income from broadcasting the videos/films in the PRC. Therefore, it is unlikely that HK-Co would be able to claim a tax deduction for the royalty payment. In this situation, Media-fashion is likely not to be taxable on the royalty received from HK-Co.

(Tutorial note: *By reference to the recent case Turner Entertainment Networks Asia, Inc for Muse Communication Co Ltd v CIR, the Court of First Instance opined that in ordinary meaning, a person who has the right to use an intellectual property right is a person who can exploit that right or that intellectual property. Although the case of Turner is under appeal, s.15(1)(ba) is existing legislation and thus is examinable. Candidates will still get the marks even without citing the reference to the case. The name of the court case is not required to earn marks, but candidates are expected to demonstrate an understanding of tax law development.*)

(d) Treatment of specific items for profits tax

Before the tax is estimated, the tax treatments of the following items are elaborated:

(i) Depreciation of \$30,000 on computer system (cost \$100,000)

Capital expenditure incurred on the acquisition of fixed assets would normally not be allowed as an expense for tax purposes, but would generally qualify for depreciation allowance if it represents qualifying expenditure for machinery and plant, industrial buildings or commercial buildings. The IRO contains specific provisions governing the rates and methods of calculation of depreciation allowance. Some capital expenditure also qualifies for an outright deduction such as expenditure for the provision of a 'prescribed fixed asset' under s.16G, provided the relevant asset is used in the production of assessable profits. A 'prescribed fixed asset' is specifically defined, and includes computer hardware (other than hardware as an integral part of any machinery and plant), software and systems but does not include assets under a lease or hire purchase. In the case of HK-Co, assuming that the computer system has not been acquired under a lease or hire purchase, the full cost of the computer system of \$100,000 should qualify for a 100% outright tax deduction and no tax depreciation allowance will be claimed.

(ii) Incorporation fee of \$50,000

Section 17(1)(c) provides that a tax deduction would be denied for expenditure which is of a capital nature. In determining the nature of an expenditure item, various tests have been developed over time, including but not limited to the 'once-and-for-all test', 'enduring benefit test', 'fixed capital v circulating capital test', etc. Caution is required in applying the different tests and each case has to be examined on its own facts. In the case of an incorporation fee, the item was obviously incurred 'once and for all' and is not of a recurring nature. Moreover, by incurring the fee, it brings into existence the company which by itself constitutes an advantage for the enduring benefit of the business. The incorporation fee was also incurred to 'establish' the capital structure of the taxpayer's business, rather than to 'preserve' its capital. As a result, the incorporation fee is capital expenditure and not tax deductible.

(iii) Mandatory provident fund (MPF) contribution of \$30,000

Regular contributions to the MPF, whether actually paid or accrued as an accounting provision, are regarded as part of employee costs and are tax deductible if the employee costs are incurred in the production of assessable profits under s.16(1). However, the deduction is subject to a maximum limit of 15% of each employee's remuneration as provided under s.17(1)(h) or s.17(1)(i). Contributions other than regular contributions, if actually paid, are only allowed for tax deduction over five years in equal annual instalments, commencing from the year the contributions are made [s.16A]. Accrual for such non-regular contributions would not be allowed for tax deduction.

In the case of HK-Co, it will be necessary to find out whether the \$30,000 is a regular contribution and if it is, whether it exceeds 15% of any employee's remuneration. If it is a non-regular contribution, it will be necessary to ensure that the amount has actually been paid before a 20% tax deduction can be claimed for this year.

(iv) Estimated profits tax liability

Based on the projected management accounts, the potential tax payable by HK-Co is estimated as follows:

	\$	\$
Estimated profit before tax		206,000
Add: Royalty payment	50,000	
Interest to parent	60,000	
Incorporation fee	50,000	
Depreciation	<u>30,000</u>	<u>190,000</u>
		396,000
Less: Prescribed fixed asset		(100,000)
Estimated assessable profits		<u>296,000</u>
Estimated profits tax payable at 16.5%		<u><u>48,840</u></u>

Assumptions made:

- There is no other fixed asset acquired except for the computer system.
- The MPF contribution is a regular contribution not exceeding the statutory limit of 15%.
- The loan made to PRC-Co was negotiated and effected in Hong Kong and thus onshore.
- All the other operating costs are revenue in nature and incurred in the production of assessable profits.

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

End of Report

2 Mr Lee

(a) Stamp duty on conveyance(s) of the property and car parking space

Conveyances on the sale or transfer of immovable property in Hong Kong are subject to Hong Kong stamp duty under Head 1 of the Stamp Duty Ordinance (SDO). The chargeable document is the agreement for sale and purchase, and it 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, unless the consideration is below the market price, in which case the property market value would be used for stamping purposes. Where the sale and purchase agreement is stamped, the subsequent formal assignment or conveyance 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 to pay.

In ascertaining the stampable value of the transaction, it has been proposed to Mr Lee that he could enter into separate transactions for the property and car parking space respectively. The larger transaction represents the property itself, valued at \$19.5 million, which is subject to stamp duty at 3.75%. The smaller transaction represents the car parking space valued at \$1.5 million, which is subject to stamp duty at \$100. Therefore, the total stamp duty cost for both transactions would be \$731,350. However, if only one single transaction is effected at a value of \$21 million, the maximum rate of 4.25% would apply, and the duty would amount to \$892,500. The stamp duty saving from the separate transactions is therefore \$161,150.

However, before the use of two transactions is proceeded with, Mr Lee and the seller are required to submit a s.29 certificate declaring that the smaller transaction does not form part of a larger transaction or series of transactions. This is to counteract a tax avoidance act whereby one single transaction is divided into a series of transactions in order to enjoy the benefit from lower duty rates. In the absence of such a certificate, stamping would be based on the aggregated value as if there was a single transaction. Further, even with the s.29 certificate, the transaction would still be scrutinised by the Stamp Office, by, for example, examining the deed of mutual covenant, to justify that the car parking space is eligible to be legally saleable separately from the property and factually sold separately and distinctly from the property.

Effective from 20 November 2010, special stamp duty is payable in addition to the *ad valorem* stamp duty if the residential property was acquired by the vendor on or after 20 November 2010 and is now resold by that vendor within 24 months. The applicable rates of special stamp duty depend on the holding period, the longer the holding period the lower the rate of duty. If the property was acquired by the seller prior to 20 November 2010, no special stamp duty is payable.

Special stamp duty is applicable even if the seller is an incorporated company, and is jointly and severally payable by both the purchaser (Mr Lee) and the seller company. In Mr Lee's case, it is unclear when the property was acquired by the seller company. Mr Lee is therefore advised to obtain more information from the seller, in order to ascertain whether the property will fall within the special stamp duty regime. If so, he should seek to negotiate and agree with the seller as to the party who will pay and bear the duty, and have this specified in the agreement.

(b) Bank mortgage loan interest

Under proposal (1), Mr Lee will incur interest on a mortgage loan obtained from a bank to finance the acquisition of the property which will be occupied by himself and his wife after their marriage. Provided that the property is occupied by Mr Lee (or the couple) exclusively as their principal place of residence, and the bank loan is charged over any property in Hong Kong, the interest is eligible for a deduction as home loan interest against Mr Lee's assessable income in Hong Kong. However, the maximum amount of deduction for each year is only \$100,000, despite the actual interest cost being \$400,000. A deduction may be granted for a maximum of 15 years of assessment, but these years do not necessarily need to be consecutive.

Assuming that Mr Lee is the sole owner of the property, he will be eligible to claim the home loan interest based on the total interest paid on the home loan, subject to the \$100,000 maximum. However, if the property is jointly owned by the couple, each of the couple is treated as having paid a proportionate share of the total interest, i.e. 50% of the interest expense; and the maximum entitlement of each will also be proportionately reduced to \$50,000. If both spouses have assessable income, a home loan interest deduction may be claimed separately by each spouse. However, if only one spouse has assessable income, the couple will need to elect for personal assessment so that the total home loan interest deduction of \$100,000 can be set off against their aggregated assessable income in one single assessment. Alternatively, the spouse without any income may nominate the other income-earning spouse to claim the home loan interest deduction.

(c) Exercise of share option and sale of shares

Under proposal (2), Mr Lee intends to obtain funding by selling all of the 300,000 shares in his employer company on the market. This includes 100,000 shares which were directly awarded by his employer company in 2010/11, and 200,000 shares acquired upon exercising the share option granted to him in 2012/13. Under s.9 of the IRO, income from employment subject to Hong Kong salaries tax includes perquisites which include any benefits which are convertible into cash by the employee. Section 9(1)(d) also specifically deems as assessable employment income any gain realised upon the exercise, release or assignment of a share option granted to an employee due to an employment.

Since the 100,000 shares were awarded to Mr Lee as part of a performance bonus, and the shares are cash-convertible, the shares constitute assessable employment income to Mr Lee. The timing of the assessment will depend on when the benefits

have been 'accrued' to Mr Lee. Based on s.11D(b), an income accrues to a person when he becomes entitled to claim payment thereof. In the case of a share award, the IRD clarified in DIPN 38 that this refers to the time when the person is entitled to ownership of the shares. In Mr Lee's case, since the shares were registered in his name when they were awarded to him, the ownership of the shares is considered to have already passed to him in 2010/11 (the so-called 'upfront' approach). In this scenario, the value of the benefits (i.e. the shares) would be deemed to have accrued to Mr Lee at the time of grant, and therefore would be assessable to tax in the year of assessment 2010/11. As Mr Lee will already have been assessed to tax on this award in an earlier year of assessment, the subsequent actual sale of the shares by Mr Lee in the current year would not be taxed again.

In respect of the share option, the granting of the option would not have triggered any tax liability to Mr Lee in 2012/13. A taxable deemed gain will only arise upon the exercise, release or assignment of the option. When Mr Lee exercises the option in the current year 2013/14, the deemed gain will be assessed in the year of assessment 2013/14 based on the difference between the market value of the shares on the date of exercise and any related costs including the cost of the option and the cost of exercising the option. The date and actual value at which the shares are subsequently sold are irrelevant for salaries tax assessment purposes. Any gain arising from the sale of the shares will not be chargeable to salaries tax as it is regarded as income from personal investment, provided the seller is not a person engaged in, or related to, a share dealing business.

(d) Borrowing funds from his parents

Under proposal (3), Mr Lee will borrow funds from his parents. A monthly payment of \$10,000 will be given to his parents but it is unclear whether this \$10,000 is intended to be interest or a contribution towards his parents' maintenance. If the payment is intended to be interest for the use of the idle funds, Mr Lee will not be able to claim a home loan interest deduction as the interest is not paid to a qualifying lender (government, financial institution, credit union, licensed money lender, Hong Kong Housing Society, or employer), and the loan is not subject to a mortgage or charge over a Hong Kong property. However, if Mr Lee is able to prove that the monthly payment is a contribution for maintaining his parents, this would enable him to continue to claim the dependent parent allowance even after he ceases to reside with them after his marriage.

Dependent parent allowance is granted to a taxpayer who maintains a parent, and a parent is 'maintained' if he/she resides with the taxpayer (or his/her spouse) for at least a continuous period of six months in the year of assessment without full consideration, or if he/she receives a contribution of at least \$12,000 in money from the taxpayer (or his/her spouse) towards his/her maintenance in the year of assessment. Mr Lee is currently living with his parents. Assuming that no full consideration is given by the parents currently as Mr Lee lives with them for more than six months during a year of assessment, he is entitled to claim a dependent parent allowance for both parents of \$76,000 (\$38,000 x 2). If he has lived with his parents continuously throughout the whole year, an additional allowance of another \$38,000 each will be granted, resulting in a total allowance of \$152,000 (\$76,000 x 2). However, if Mr Lee moves out before the six-month period in the current year, for example, before 30 September 2014, and does not contribute towards his parents' maintenance at all, he will not be granted any dependent parent allowance for the year of assessment 2014/15 or in any future year.

(e) Low-interest loan from his employer

Under proposal (4), Mr Lee will obtain a low-interest loan from his employer and pay monthly interest by way of a salary deduction. The interest rate is preferential over the market rate, and thus he will benefit from a saving in interest payments, of an estimated amount of \$80,000 per annum.

In respect of the loan interest payment, Mr Lee may be able to claim a home loan interest deduction provided that the arrangement involves the loan being secured by a mortgage or charge over a property in Hong Kong, and that the loan money is fully applied to finance the acquisition of the property used by Mr Lee as his primary place of residence. If not all of these conditions are fulfilled, no deduction will be allowed for the interest payment.

In respect of the monthly salary income, the fact that the take-home amount is reduced by the monthly interest payment will not affect Mr Lee's tax position. Gross salary represents his income from employment and thus will need to be reported and assessed. This remains true regardless of whether the interest payment is eligible for a deduction or not.

As regards the benefit of the interest saving, representing the interest differential between the market rate and the rate charged by the employer, the IRD clarified in DIPN 16 that the benefits would not be assessable if it is the sole liability of the employer and is not of itself convertible into money. Therefore, it would be advisable that Mr Lee's employer finance the loan without any guarantee provided by Mr Lee, and restrict Mr Lee from extending the loan money to others in return for higher interest income.

3 AB Co and Paul

(a) Deduction of remuneration by AB Co

The remuneration paid by AB Co to Paul as its employee would be tax deductible against AB Co's assessable profits under s.16(1), provided that the remuneration is incurred in the production of the company's profits. This refers to the situation where Paul's services are rendered for the benefit of AB Co. Without the assignment, it would be reasonable to assume that Paul's services are all rendered in Hong Kong and for the production of AB Co's profits in Hong Kong; however, this will not necessarily be the case during Paul's four-month assignment.

Section 16(1) only allows deductions for expenses 'to the extent' that they are incurred in the production of assessable profits. Where expenses are partly incurred for purposes other than in the production of assessable profits, only that portion of the expenses are allowed. In carrying out the assignment in Malaysia, Paul's services may be regarded as rendered for the benefit of the Malaysian subsidiary, given that Paul's assignment is to monitor and oversee the implementation of the new financial reporting system in the subsidiary. In these circumstances, it is possible that the IRD would challenge that at least part of Paul's remuneration attributable to his services in Malaysia is not incurred in the production of AB Co's profits and, thus, not tax deductible. If this portion of the remuneration is borne by AB Co, i.e. there is no recharge to the subsidiary, AB Co may suffer a tax disallowance of the total portion of the related remuneration. If, however, a recharge to the subsidiary is made, then the disallowed portion will be reduced accordingly by the amount recharged or recovered.

It may be argued that Paul's services rendered in Malaysia is for the benefit of AB Co in Hong Kong, on the basis that the new system is a reporting system which enables the subsidiary to provide a better report of its financials to its parent company in Hong Kong. But, unless it can be proved that Paul's services in Malaysia will help AB Co in its production of assessable profits under the Inland Revenue Ordinance, Paul's remuneration and related expenses will be disallowed in computing the assessable profits of AB Co for the year.

(b) Paul's liability to salaries tax

Based on the facts given, Paul's employment with AB Co should be a Hong Kong employment. Moreover, Paul does not appear to be a visitor to Hong Kong but is a resident in Hong Kong. In the circumstances, all of his employment income would be liable to Hong Kong salaries tax unless s.8(1A)(c) applies. Under s.8(1A)(c), a portion of Paul's remuneration would be exempt from Hong Kong salaries tax if (i) it was derived by Paul from services rendered in Malaysia; (ii) it is chargeable to Malaysian personal income tax which is substantially of the same nature as Hong Kong salaries tax; and (iii) the Commissioner is satisfied that Paul has, by deduction or otherwise, paid the tax in Malaysia. Provided that all the conditions are satisfied, Paul may rely on this section to exclude the four-month period's remuneration from the total assessable income for Hong Kong salaries tax purposes. Although for s.8(1A)(c) to apply, Malaysian personal income tax must be paid in Malaysia, it does not matter who actually pays this tax. Thus, it is irrelevant as to whether AB Co pays the tax directly to the Malaysian tax authorities or reimburses Paul for the Malaysian tax paid by him.

In respect of the travel and hotel accommodation costs paid by AB Co, the issue of whether they constitute taxable income to Paul depends on various factors. In general, if an employer makes payments to a third party which discharges the liability of the employee, the payments would be taxable income to the employee. However, there is case law saying that when an employee is on business trips, all reasonable expenses paid by him for the employer's business and then reimbursed by the employer are not assessable income to the employee. Therefore, the travel and hotel accommodation costs paid by AB Co would likely not constitute taxable income to Paul.

(c) Effect of the double tax agreement

Pursuant to Article 16 of the Double Tax Agreement (DTA) between Hong Kong and Malaysia, Paul's remuneration relating to his services rendered in Malaysia would be exempt from Malaysian personal income tax if all of the three conditions are fulfilled. For the purposes of the application of the DTA, in Paul's case, the term 'Contracting Party' refers to Hong Kong, and the term 'the Other Contracting Party' refers to Malaysia.

The first condition is that the aggregate number of days that Paul stays in Malaysia in a taxable year does not exceed 183 days. It is not clear from the DTA how a day is counted, but in the case of Paul where his intention is to stay in Malaysia for only four months, it is unlikely that this threshold would be exceeded.

The second condition is that the payment of Paul's remuneration is made by an employer who is not a resident of Malaysia. As it is intended that Paul's remuneration would continue to be paid by AB Co in Hong Kong and AB Co is not resident in Malaysia, this condition is fulfilled.

The third condition is that the payment of Paul's remuneration is not to be borne by any permanent establishment or fixed base in Malaysia. In the event that AB Co bears the whole of Paul's remuneration and does not recharge any of it to the Malaysian subsidiary, this condition will be fulfilled. However, if there is a recharge, this condition may be subject to challenge as to whether the Malaysian subsidiary would, for the purpose of applying the double taxation arrangement, be regarded as a permanent establishment or a fixed base of AB Co. If the answer is in the affirmative, i.e. the Malaysian subsidiary is treated as a permanent establishment or a fixed base of AB Co and part of Paul's remuneration is recharged to, i.e. borne by the Malaysian subsidiary, the third condition would not be fulfilled and Paul's remuneration would not be eligible for the treaty exemption.

4 Red Ltd

(a) Entitlement to depreciation allowances

Red Ltd, which holds the relevant interest in the building, can claim industrial building allowance (IBA) if the usage of the individual floor qualifies as an industrial building as defined in s.40(1); and the building is used in the production of profits chargeable to profits tax.

Under s.40(1), industrial building or structure means, among other things, any building or structure used for the purposes of a trade which consists of the manufacture of goods or materials or the subjection of goods or materials to any process.

In addition, any building or structure used for the purposes of a trade which consists of the storage of goods or materials is also treated as an industrial building or structure. However, the trade itself must be one of storage, the storage of a person's own goods does not qualify.

For the ground floor which is used as a factory, Red Ltd is entitled to IBA as goods were manufactured in the premises.

For the first floor which is used as a warehouse, Red Ltd is not entitled to IBA as its trade is not one of storage. The storage of goods is only incidental to its trade. However, commercial building allowance (CBA) is available for any building or structure which is not an industrial building [s.40(1)], and is used in a trade or business in the production of profits chargeable to profits tax. So Red Ltd will be entitled to CBA for the first floor.

Since the building was purchased from a property development company, the amount of qualifying expenditure for IBA attributable to the ground floor is the net price (excluding the price of the land) paid on the sale [s.35B(b)(i)], calculated as follows:

$$\$3,600,000 \times 2,000,000 / 3,000,000 \times 1/2 = \$1,200,000$$

For the first floor which qualifies for CBA, the amount of qualifying expenditure equals the capital expenditure incurred on the construction of the building [s.33A(1)], calculated as follows:

$$\$2,000,000 \times 1/2 = \$1,000,000$$

Therefore, the depreciation allowance to which Red Ltd is entitled for all relevant years of assessment is calculated as follows:

IBA

	\$
Cost	1,200,000
Initial allowance (20% in 2005/06)	(240,000)
AA (4% for 9 years from 2005/06 to 2013/14)	(432,000)
Residue of expenditure	<u>528,000</u>

CBA

	\$
Cost	1,000,000
AA (4% for 9 years from 2005/06 to 2013/14)	(360,000)
Residue of expenditure	<u>640,000</u>

(b) Proposals for the disposal of the building

(i) Sell the building for its market value

Profit or loss on sale

According to the Inland Revenue Ordinance, profits arising from the sale of capital assets are excluded from assessment [s.14]. The building has been occupied by Red Ltd for its own use of manufacturing since purchase. It is clear that the building is Red Ltd's capital asset. It follows that any profit from its sale will not be chargeable to profits tax. As a corollary, any loss from its sale will not be tax deductible.

Balancing adjustments

In the year of assessment during which the building is sold, a balancing adjustment known as a balancing charge or balancing allowance, as the case may be, has to be made on Red Ltd. Red Ltd's assessable profit will be increased by a balancing charge (i.e. the excess of the sale price over the residue of expenditure, up to the aggregate of allowances granted to Red Ltd); or reduced by a balancing allowance (i.e. the excess of the residue of expenditure over the sale price). The residue of expenditure means the capital expenditure as reduced by the allowances granted. This adjustment applies to both the ground floor which qualifies for IBA, and the first floor which qualifies for CBA.

For the purpose of ascertaining the sale price attributable to the building element when computing the balancing adjustment, the sale price of the building has to be apportioned between the land and the building elements. The IRD usually accepts a basis of apportionment which follows that adopted when allocating the price paid to purchase the building between the land and the construction cost of the building. If Red Ltd wishes to adopt a different basis of apportionment, it should provide more concrete evidence to justify that its proposed basis is more appropriate in the circumstance of the case. Red Ltd may attempt to agree with the purchaser separate prices for the land and the building; or failing that, a professional valuation of the land at the time of sale will be of assistance.

(ii) Demolish the building and redevelop the site

Balancing adjustments

When the building is demolished, a balancing charge or allowance arises [s.35(1)]. As Red Ltd is going to demolish the building for redevelopment, no insurance, salvage or compensation monies are receivable and hence no balancing charge will be assessed on it.

However, Red Ltd is not entitled to any balancing allowance. This is because the IRO provides that, for both industrial and commercial buildings, no balancing allowance shall be made to any person where the building is demolished for

purposes unconnected with or not in the ordinary course of the conduct of the trade or business for the purposes of which the building was used in circumstances qualifying for IBA or CBA. Red Ltd is a furniture manufacturer, the redevelopment of the building for sale or rental is clearly unconnected with and not in the ordinary course of the conduct of its business.

Interest deduction

Prior to completion of the redevelopment, the interest incurred by Red Ltd on the bank loan obtained to finance the redevelopment is not deductible in the years in which they are incurred. Instead, the interest will be included as part of the capital cost of the redevelopment.

After completion of the redevelopment, the interest incurred by Red Ltd on the bank loan is deductible under ss.16(1) and 16(2)(d), provided that the loan is not secured by any deposits or loans which derive non-taxable income in Hong Kong [ss.16(2)(d) and 16(2A)], and there is no arrangement in place such that the interest payment ultimately flows back to Red Ltd or any connected person [s.16(2B)].

Rental income and other related expenses

Rental income received from the new building will be chargeable to property tax under s.5(1). Under this section, property tax is levied on any owner of land or building or land and buildings situated in Hong Kong, at the standard rate (15%) on the net assessable value of the property. 'Net assessable value' is defined under s.5B to include any consideration payable in money or money's worth in respect of the right to use the land and/or buildings, as reduced by government rates agreed and paid by the owner, and a one-off statutory allowance of 20% of the assessable value after deducting the rates (if applicable). All other actual expenses incurred, such as repairs and management fees, are not deductible for property tax purposes.

Rental income derived from the new building is also chargeable to profits tax. According to s.2, 'business' is defined to include letting or sub-letting of property by a corporation. The double taxation of Red Ltd which is subject to both property tax and profits tax can be eliminated by the application of s.5(2)(a). Under this section, any corporation which is subject to profits tax in respect of rental profits can apply for an exemption from property tax in relation to the same rental profits. It will be advisable for Red Ltd to claim exemption under s.5(2)(a) so that the rental profits are only subject to profits tax under s.14. If no exemption is applied for and granted, any property tax paid can be off set against profits tax chargeable on Red Ltd for the same rent receivable under s.25, and any excess thereof will be refunded.

Profits tax under s.14 is imposed on assessable profits which take into account all the relevant expenses and outgoings incurred in the production of those assessable profits [s.16(1)] to the extent that the expenses and outgoings are not disallowed by s.17. It is therefore possible to deduct related expenses such as loan interest, agency fees for soliciting tenants, management fees, rates, repairs and maintenance. Commercial building allowances will be available on the qualifying costs of construction of the building (i.e. excluding the land value) and deductible against the rental profits. If total deductible expenditure exceeds total rental revenue, then the excess loss for the year can be carried forward for deduction against any assessable profits for subsequent years of assessment.

5 Derek Chan

(a) Taxability of the termination payment

Under s.8, salaries tax is imposed on any income arising in or derived from Hong Kong from an office, employment or pension. It is clear that the salary and accrued vacation pay are taxable on the basis that they are income from Derek's employment by Joyce Ltd (JL). The fact that some leave days are brought forward from the previous year is not relevant since the amount is not received by Derek until 2014/15, and thus the payment will be assessed in the year 2014/15.

'Income' is further defined under s.9 to include leave pay and gratuities. In the case of Derek, as long as the lump sum gratuity is made as a result of his employment by JL for his past services rendered to JL in Hong Kong, then the payment will be subject to Hong Kong salaries tax.

An issue arises as to whether the whole of the payment can be converted into a tax-free payment simply by the parties agreeing that the payment is being made as a 'release' of all claims which the employee has against the employer. The letter to be issued by JL appears to have been designed to suggest that this is a capital payment. However, case-law indicates that the IRD is entitled to look beyond this letter, which appears to be merely window-dressing to disguise the true arrangements which have been agreed. Therefore, the payment would not be non-taxable simply because of the letter.

The suggestion that the termination payment is to be made to him after the date of cessation of his employment of 30 June 2014 is not relevant for salaries tax purposes. Under s.11D(b)(ii), any payments made to a taxpayer after they have ceased to derive income are deemed to have accrued on the last day of employment. This is to prevent any post-cessation payments from escaping tax assessment. Derek's termination payment would be deemed to accrue on 30 June 2014 and as a result, the payment would have to be included in the final year's tax returns to be reported by JL and by Derek, for the year of assessment 2014/15.

One possible way to minimise Derek's salaries tax liability is to explore whether any element of the gratuity payment is, as a matter of fact, attributable to Derek's loss of office and to his agreeing not to join any competitor within two years, or other facts other than having been employed by JL. It is given that Derek is asked to leave as a result of the change in product line. It is, however, not clear whether the role of the product director is actually being made redundant. If Derek has the legal right

of being or reasonable expectation in law to be employed beyond 30 June 2014, but this right is now being terminated due to the extinction of the position as a result of the change in product line, there is a strong case to argue that part of the termination payment serves as a compensation for Derek's loss of office. This compensation is not a reward for his past services and thus may be excluded from salaries tax. On the other hand, Derek has agreed not to join any competitor within two years. Regardless of whether Derek has been asked to sign any documents or covenant to this effect, Derek may ask for a consideration in return for his agreement. In this case the consideration would be a payment for deprivation of rights, not a reward for his past services or from his employment, and thus would not be taxable.

However, there have been cases in recent years illustrating that if a compensation type of payment has been made in accordance with the terms of an employment, it is, in reality, deferred remuneration from that employment. Therefore, despite its nature being described as compensation and its actual payment being post-termination, the compensation may be treated as taxable to the extent that it can be proved to have been paid in accordance with the terms of the employment, or for past services. In Derek's case, it is uncertain whether the compensation for this restrictive agreement is included as part of his employment contract. If it is already part of his employment terms, it will be taxable.

(b) Joyce Ltd's compliance obligations

As Derek Chan's employer, JL has the following compliance obligations under the IRO in respect of his termination:

- (1) To notify the IRD of the cessation of Derek's employment no later than one month before the date of cessation, i.e. by 31 May 2014, or such shorter period as might be reasonable [s.52(5)].
- (2) To notify the IRD of Derek's intention to leave Hong Kong no later than one month before the date of intended departure, i.e. 15 June 2014 [s.52(6)].
- (3) To withhold all payments due to Derek for one month from the date of notification of his intended departure [s.52(7)]. The purpose of this is to enable the IRD to 'garnish' any payments due, by requiring the employer to make such payment to the IRD in satisfaction of the employee's tax liability. The termination payments should therefore not be released to Derek within the said month unless JL receives notification from the IRD to release such payment before the expiry of the said month. The obligation to withhold expires after the said month.

(c) Actions available to the IRD to recover tax from Derek Chan

In the absence of instituting court proceedings, the IRD can recover tax from Derek Chan by:

- (1) Giving notice to any person to pay the outstanding tax from any money due by that person to Derek, or money held by that person on or for the account of Derek, or money to be paid by that person to Derek, or money to be paid by that person to Derek on behalf of or by authority of some other person [s.76]. This includes giving notices to:
 - (i) Derek's employer JL to pay over the outstanding tax from any money due by it to Derek (in this case, the termination payment); and
 - (ii) any bank in which Derek has a bank account to pay over the outstanding tax from the balance of such account.
- (2) Applying to a district judge for a departure prevention direction which will authorise any immigration or police officer to prevent Derek from leaving Hong Kong without paying the tax or furnishing security to the satisfaction of the Commissioner for payment of the tax [s.77].

	<i>Available</i>	<i>Maximum</i>
1 (a) (i) Subsidy income – HK tax implications		
Broad guiding principle	0.5	
Source of service income determined by place of services	0.5	
HK-Co is carrying on business in HK	0.5	
10% mark-up is remuneration for services rendered in HK	0.5	
All subsidy income is taxable in HK	0.5	
If rendered outside HK, offshore-sourced and non-taxable	0.5	
Related operating cost non-deductible	0.5	
	<hr/> 3.5	3
(ii) Subsidy income – charging basis		
Associated enterprise transaction	0.5	
Arm's length principle to be observed	0.5	
Benchmark to independent enterprises or uncontrolled transaction	0.5	
Intra-group services identified and rendered	0.5	
Arm's length charge for intra-group services	0.5	
Adequate documentation	0.5	
If 10% falls below normal, tax on higher level	0.5	
Uncertain if 10% basis is acceptable, subject to case analysis	0.5	
Cost plus method is acceptable	0.5	
In extreme case, tax avoidance challenge under ss.20 and 61A	1	
	<hr/> 5.5	5
(b) (i) Loan interest from PRC-Co to HK-Co		
Interest deemed as assessable profits if HK-sourced (s.15(1)(f))	0.5	
Provision of credit test	0.5	
The place where the credit is first made available to borrower	0.5	
If loan is made to PRC-Co outside HK, interest offshore and non-taxable	0.5	
Test only applies to idle fund or passive interest income	0.5	
Likely loan to PRC-Co will be challenged as money lending	0.5	
Operation test or contract effected test would apply	0.5	
If loan is effected in HK, interest is HK-sourced and taxable	0.5	
	<hr/> 4	3
(ii) Loan interest from HK-Co to T-fashion		
Interest is incurred in the production of assessable profits (s.16(1))	0.5	
Interest on loan from a person other than financial institution (s.16(2)(c))	0.5	
Interest is taxable on the recipient (s.16(2)(c))	0.5	
If interest from PRC-Co is taxable, first condition is met	0.5	
But T-fashion is not taxed on interest received	0.5	
Therefore, interest payment is not deductible	0.5	
Proposed funding is not tax effective unless loan interest from PRC-Co is offshore and non-taxable	1	
	<hr/> 4	3
(c) Royalty income received by Media-fashion		
Royalty for the right to use or exhibit the videos/films in HK	0.5	
Not carrying on business, so not assessable under s.14	0.5	
But deemed assessable under s.15 and subject to tax	0.5	
Deemed assessable profit is 30% of gross royalty	0.5	
Or 100% if associates and property owned by any person carrying on business in HK	1	
16.5% corporate rate to apply	0.5	
If used outside HK, s.15(1)(a) does not apply	0.5	
Royalty is still deemed assessable if use is outside HK but a tax deduction is claimed (s.15(1)(ba))	1	
No deduction for HK-Co as not income-generating	1	
Media-fashion is not likely to be taxable on royalty	0.5	
	<hr/> 6.5	5

	<i>Available</i>	<i>Maximum</i>
(d) Treatment of items		
(i) Depreciation		
Capital expenditure not tax deductible	0.5	
Qualifies for depreciation allowance	0.5	
Outright deduction for 'prescribed fixed assets' (s.16G)	0.5	
Asset is used in the production of assessable profits	0.5	
Asset is not under lease or hire purchase	0.5	
Computer hardware, software and systems	0.5	
\$100,000 cost is 100% deductible	0.5	
No tax depreciation allowance	0.5	
	<u>4</u>	3
(ii) Incorporation fee		
Capital expenditure to be disallowed	0.5	
Incurred once-and-for-all, not recurring	0.5	
Brings into existence asset of enduring benefit	0.5	
Incurred to establish the capital structure	0.5	
Fee is capital expenditure and not deductible	0.5	
	<u>2.5</u>	2
(iii) MPF contribution		
Regular contributions are employee costs and deductible	0.5	
Regardless of actually paid or accrued	0.5	
Incurred in the production of assessable profits	0.5	
Maximum limit of 15% of each employee's remuneration	0.5	
Non-regular contribution, only if paid, not accrued	0.5	
Allowed over five years, 20% per annum	0.5	
Need to find out more in this case	0.5	
	<u>3.5</u>	3
(iv) Estimated profits tax liability		
Calculation including adjustment of items:	2.5	
(Royalty payment, non-deductible loan interest to parent, incorporation fee, depreciation, and prescribed fixed asset)		
No adjustment of items supported with assumptions:		
(MPF contributions, loan interest income from PRC-Co, others)	1	
Correct tax rate applied 16.5%	0.5	
	<u>4</u>	4
Appropriate format and presentation	1	
Logical development	1	
Effectiveness of communication	2	
	<u>4</u>	<u>4</u>
		<u>35</u>

	<i>Available</i>	<i>Maximum</i>
2 (a) Stamp duty implications		
Transfer of immovable property (Head 1)	0.5	
Stamping of agreement for sale and purchase	0.5	
<i>Ad valorem</i> duty rates	0.5	
Duty on 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	
Proposed split transactions, larger at 3.75%	1	
Smaller transaction at \$100	1	
If no split, total at 4.25%	1	
Stamp duty savings from split	0.5	
Tax avoidance counteract, submit a s.29 certificate	0.5	
Scrutiny by the Stamp Office	0.5	
Special stamp duty	0.5	
If property acquired on or after 20 November 2010	0.5	
Resold within 24 months	0.5	
Rate depends on the length of pre-sale ownership	0.5	
Payable in addition to normal <i>ad valorem</i> duty	0.5	
Even if the seller is a company	0.5	
Both parties jointly and severally liable	0.5	
Mr Lee to find out more and negotiate who bears the special stamp duty	1	
	<u>12.5</u>	12
(b) Mortgage loan interest		
Property exclusively used as principal place of residence	0.5	
Bank loan is charged over HK property	0.5	
Home loan interest deduction	0.5	
Maximum \$100,000	0.5	
Maximum 15 years, need not be consecutive	1	
If jointly owned, maximum is halved \$50,000	0.5	
Claimed by each spouse if both have assessable income	0.5	
If only one spouse has assessable income, should elect PA	0.5	
Or nominate income-earning spouse to claim	0.5	
	<u>5</u>	4
(c) Exercise of share option and sale of shares		
100,000 shares are convertible into cash, taxable	0.5	
At the time the benefit accrued or entitled to share ownership	0.5	
Taxable in 2010/11 as upfront shares	0.5	
Subsequent sale is not taxable	0.5	
Deemed gain on exercising share option is assessable	0.5	
When exercised in 2013/14	0.5	
Based on share market value on date of exercise	0.5	
Less related costs, option and exercising the option	0.5	
Subsequent sale is irrelevant	0.5	
	<u>4.5</u>	4
(d) Borrowing funds from parents		
Unclear if contribution or interest	0.5	
No home loan interest deduction as not qualifying lenders	1	
If contribution, dependent parent allowance (DPA)	0.5	
Definition of 'maintain'	1	
Additional allowance if residing with parents for whole year	0.5	
If moved out before six months, and no contribution, no DPA	0.5	
	<u>4</u>	3

	<i>Available</i>	<i>Maximum</i>
(e) Low-interest loan from employer		
Home loan interest deduction only if property is mortgaged for a loan	0.5	
Gross salary is still taxable	0.5	
Interest saving not taxable if it is the employer's sole liability	0.5	
And if not convertible into cash	0.5	
Mr Lee should not give guarantee and loan usage should be restricted	0.5	
	<u>2.5</u>	<u>2</u>
		<u>25</u>
3 (a) Deductibility of remuneration		
Deductible if incurred in the production of profit (s.16(1))	0.5	
Whether Paul's services rendered in Malaysia are for the benefit of AB Co	1	
Apportionment to the extent of any benefit rendered to the subsidiary	1	
If no recharge to subsidiary, fully disallowed	1	
If recharge to the subsidiary, disallowance is reduced	0.5	
Arguable that it is for the benefit of AB Co	1	
Conclusion	<u>1</u>	6
(b) Liability to salaries tax		
Salary:		
HK employment	0.5	
Not a visitor	0.5	
Fully taxable unless exempt under s.8(1A)(c)	1	
Conditions under s.8(1A)(c)	1.5	
Four-month period's remuneration excluded if conditions are satisfied	0.5	
Malaysian personal income tax must be paid	1	
But who pays is not relevant	0.5	
Travel and hotel accommodation costs:		
Taxable if a discharge of the employee's liability	1	
Reimbursement of reasonable expenses paid by employee for employer's business while on business trip not taxable	1	
Conclusion	<u>0.5</u>	
	<u>8</u>	7
(c) Effect of DTA		
Exemption under the DTA if conditions are met	1	
1st condition – not exceeding 183 days	1.5	
2nd condition – employer not resident of Malaysia	1.5	
3rd condition – remuneration not borne by a PE in HK		
– If no recharge	1.5	
– If is recharged	1.5	
	<u>1.5</u>	<u>7</u>
		<u>20</u>

	<i>Available</i>	<i>Maximum</i>
4 (a) Depreciation allowances		
IBA granted for building or structure		
– Used in a trade of manufacture of goods or materials or subjection of goods or materials to any process	1	
– Used in a trade of storage	1	
Entitled to IBA for G/F but not 1/F	1	
CBA granted for non-IB used in a trade/business	1	
Entitled to CBA for 1/F	0.5	
Ascertainment of qualifying expenditure for IBA	1	
Ascertainment of qualifying expenditure for CBA	1	
Calculation of IBA	1	
Calculation of CBA	0.5	
	<u>8</u>	7
(b) (i) Proposal to sell the building for its market value		
Profit/loss on sale capital in nature, not taxable/deductible	1	
Balancing adjustment to be made, in year of sale	0.5	
Basis of calculation of balancing charge/balancing allowance	1	
Ascertainment of sale price attributable to the building element	1	
Agree with purchaser separate prices for land and building	0.5	
Or obtain a professional valuation of the land	0.5	
	<u>4.5</u>	4
(ii) Proposal to demolish the building and redevelop		
No balancing charge as no sales proceeds	0.5	
No balancing allowance as the building is demolished for purposes unconnected with the trade	1.5	
Interest incurred prior to completion of redevelopment included as part of redevelopment cost, not deductible	1	
Interest incurred after completion of redevelopment deductible if ss.16(1), (2)(d), (2A) and (2B) are satisfied	1.5	
Rental income subject to property tax at standard rate	0.5	
Basis of calculation	1	
Rental income also subject to profits tax	0.5	
Exemption from property tax under s.5(2)(a)	0.5	
Property tax set off against profits tax under s.25	0.5	
Advantages of profits tax assessment:		
Expenses and outgoings incurred in the production of assessable profits deductible under s.16(1)	1	
CBA deductible	0.5	
Losses can be carried forward	0.5	
	<u>9.5</u>	9
		<u>20</u>

	<i>Available</i>	<i>Maximum</i>
5 (a) Taxability of termination payment		
Salary and accrued vacation pay taxable under s.8	1	
Irrelevant that some leave days are brought forward from previous year	1	
Lump sum gratuity taxable under s.9	1	
Payment cannot be made non-taxable simply by making it a 'release' of all claims	1	
Ability of the IRD to look beyond the content of the letter	1.5	
Irrelevant that the payment is made after cessation of employment	1	
Such payment is deemed to accrue on the last day of employment	1	
And assessed in 2014/15	0.5	
Possible ways to minimise the tax liabilities:		
Any payment for loss of office	2	
Any payment for agreeing not to join any competitor	2	
May be taxable if pre-arranged as part of the terms of employment	<u>2</u>	14
 (b) Joyce Ltd's compliance obligations under the IRO		
Notify cessation of employment one month before cessation	1	
Notify intention to leave HK one month before departure	1	
Withhold all payments for that month	<u>1</u>	3
 (c) Actions the IRD can take to recover tax from Derek Chan		
Give notice to any person owing money	1	
Specifically: employer (JL)	0.5	
Any bank	0.5	
Apply for a departure prevention direction	<u>1</u>	<u>3</u>
		<u>20</u>