Strategic Professional – Options

Advanced Taxation – Hong Kong (ATX – HKG)

Tuesday 8 December 2020

ATX HKG ACCA EN

Time allowed: 3 hours 15 minutes

This question paper is divided into two sections:

Section A – BOTH questions are compulsory and MUST be attempted

Section B – BOTH questions are compulsory and MUST be attempted

Tax rates and allowances are on pages 2 and 3

Do NOT open this question paper until instructed by the supervisor.

This question paper must not be removed from the examination hall.

Please note that you are not expected to make any reference to Covid 19 or the global economic crisis as a result of this pandemic in your exams. None of the temporary financial or legislative measures implemented as a result of Covid are examinable.

ATX – HKG

Think Ahead ACCA

The Association of Chartered Certified Accountants

SUPPLEMENTARY INSTRUCTIONS

1. You should assume that the tax rates and allowances shown below will continue to apply for the foreseeable future.
2. Calculations and workings should be rounded down to the nearest HK$.
3. Apportionments need only be made to the nearest month, unless the law and prevailing practice require otherwise.
4. All workings should be shown.
5. Ignore provisional tax and statutory tax reductions, unless specified otherwise.

TAX RATES AND ALLOWANCES

The following 2019/20 tax rates and allowances are to be used in answering the questions.

Profits tax rates

Assessable profits	Companies	Unincorporated business
First $2 million	8·25%	7·5%
Over $2 million	16·5%	15%

Salaries tax rates

First $50,000	2%
Next $50,000	6%
Next $50,000	10%
Next $50,000	14%
Remainder	17%
Standard rate	15%

Allowances

	$
Basic allowance	132,000
Married person's allowance	264,000
Single parent allowance	132,000
Child allowance – 1st to 9th child (each)	120,000
– additional allowance in the year of birth (each)	120,000
Dependent parent/grandparent allowance – basic	25,000/50,000
– additional	25,000/50,000
Dependent brother/sister allowance	37,500
Disabled dependant allowance	75,000
Personal disability allowance	75,000

Deductions

	$
Self-education expenses (maximum)	100,000
Home loan interest (maximum)	100,000
Elderly residential care expenses (maximum)	100,000
Contributions to recognised retirement schemes (maximum)	18,000
Qualifying health insurance premiums (maximum)	8,000
Qualifying annuity premiums and tax deductible mandatory provident fund voluntary contributions (maximum)	60,000

Depreciation allowance rates

Initial allowance:	
Plant and machinery	60%
Industrial buildings	20%
Annual allowance:	
Electronic data processing equipment	30%
Motor cars	30%
Aircraft	30%
Furniture and fixtures	20%
Machines	10–30%
Industrial buildings	4% or formula
Commercial buildings	4% or formula

Stamp duty rates

Stock 0·2% + $5

Immovable property

Conveyance on sale and agreement for sale (ignoring marginal reliefs)

	Scale 1 (Part 1)	Scale 1 (Part 2)	Scale 2
Up to $2,000,000	15%	1·5%	$100
$2,000,001 to $3,000,000	15%	3·0%	1·50%
$3,000,001 to $4,000,000	15%	4·5%	2·25%
$4,000,001 to $6,000,000	15%	6·0%	3·00%
$6,000,001 to $20,000,000	15%	7·5%	3·75%
$20,000,000 and above	15%	8·5%	4·25%

Conveyance on sale and agreement for sale chargeable with special stamp duty

Holding period	
Not exceeding six months	20%
Between six and 12 months	15%
Between 12 and 36 months	10%

Conveyance on sale and agreement for sale chargeable with buyer's stamp duty 15%

Lease

(a) Key money, construction fee etc only — As for conveyances at Scale 2 (above)

(b) Key money, construction fee etc and rent

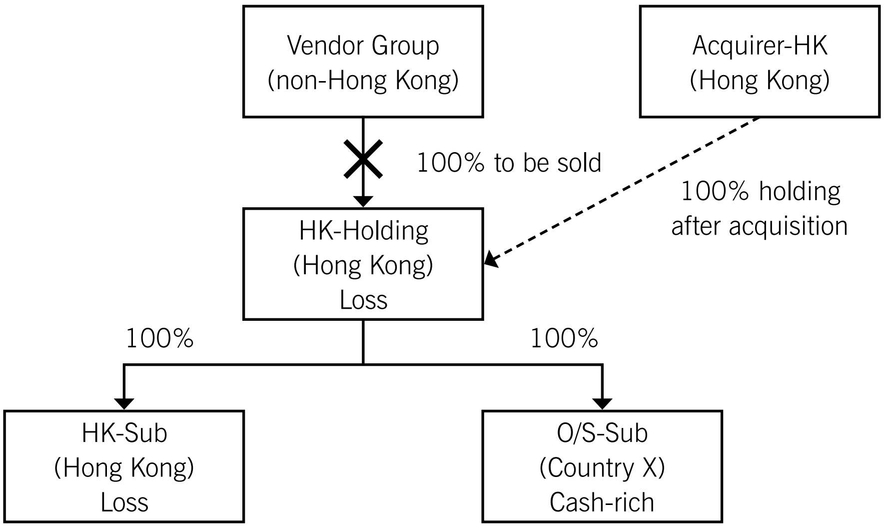
Key money, construction fee etc	4·25% of the consideration
Rent	As for rent-only lease (below)

(c) Rent only (as a percentage of the average yearly rent)

Undefined term	0·25%
Not exceeding one year	0·25%
More than one year but not exceeding three years	0·50%
Exceeding three years	1·00%

Section A – BOTH questions are compulsory and MUST be attempted

1 Acquirer-HK, a company incorporated and carrying on business in Hong Kong, is negotiating a deal with Vendor Group to acquire its shareholding in HK-Holding, a company incorporated in Hong Kong, together with its two subsidiaries, HK-Sub incorporated and carrying on business in Hong Kong and O/S-Sub incorporated and carrying on business in Country X. O/S-Sub is a cash-rich and profitable business but both HK-Holding and HK-Sub are loss-making businesses. The current structure of Vendor Group is illustrated below, with the dotted lines indicating the proposed acquisition by Acquirer-HK:



Based on the due diligence report, the following transactions were revealed, calling for special attention from the directors of Acquirer-HK:

(1) Substantial interest-bearing inter-company loans have been extended by O/S-Sub to HK-Holding and HK-Sub to help finance their under-performing businesses. According to the books of HK-Holding, the inter-company balance payable to O/S-Sub comprises of the loan principal and outstanding interest, which has been unpaid for several years. A similar inter-company balance, with outstanding loan principal and interest, was also found payable by HK-Sub to O/S-Sub. All inter-company loans are unsecured.

(2) O/S-Sub is tax resident in Country X. It has been reporting the interest income receivable on the inter-company loans for local tax purposes and is assessed at an effective tax rate of 3%.

(3) HK-Holding and HK-Sub have been returning all their assessable revenues and claiming tax deductions on all operating expenses, including their inter-company loan interest payable, for Hong Kong tax purposes. No queries have been received from the Inland Revenue Department in the past five years.

(4) HK-Holding actively trades in recycled products. HK-Sub is engaged in providing shipping agency services which have not been performing well due to severe competition in the industry.

In a recent directors' meeting, Acquirer-HK discussed the following post-acquisition restructuring ideas and wishes to seek tax clearance on their Hong Kong tax implications:

A. All inter-company balances (principal and interest) due by HK-Holding and HK-Sub to O/S-Sub are to be waived; and

B. HK-Sub is to transfer the shipping agency business to HK-Holding. After the transfer, HK-Sub is to be converted into an intra-group financing centre of the Acquirer-HK group. Surplus cash in O/S-Sub will be lent to HK-Sub and then lent onwards to HK-Holding for use in its operation. The interest payable by HK-Holding will be equivalent to 105% of the interest payable by HK-Sub to O/S-Sub, allowing a 5% gross margin to be earned by HK-Sub from the inter-company financing transactions.

Required:

As the tax adviser engaged by the board of Acquirer-HK, prepare a report addressing each of the following issues from a Hong Kong tax perspective:

(a) **Making reference to the Inland Revenue Ordinance, evaluate the tax implications to HK-Holding and HK-Sub arising from the waiver of their inter-company loans due to O/S-Sub. You should separately evaluate the loan principal and loan interest.** (4 marks)

(b) **Discuss the eligibility of profits tax deductions, already claimed, to HK-Holding in respect of the interest incurred on the inter-company loan payable to O/S-Sub. From the due diligence perspective, suggest a possible action that may be taken to protect Acquirer-HK from any potential post-acquisition tax risks in the event that the interest deduction is challenged by the Inland Revenue Department after the acquisition.** (7 marks)

(c) **Discuss the profits tax implications to HK-Sub in its future capacity as the intra-group financial centre of the group, as described in the post-acquisition restructuring idea B, and critically comment on the overall tax effectiveness of the idea. You should separately address the tax effect on interest income and interest expense.**

    Note: You are NOT required to address the transfer pricing issue and overseas tax. (15 marks)

(d) **Making reference to a specific anti-avoidance rule in Hong Kong, evaluate the eligibility to carry forward the tax loss, if any, in HK-Holding and HK-Sub after the acquisition by Acquirer-HK.**

    Note: You are NOT required to make reference to general anti-avoidance rules. (5 marks)

Professional marks will be awarded for the appropriateness of the format and presentation of the report and the effectiveness with which the advice is communicated. (4 marks)

(35 marks)

2 Diamond Inc (Diamond) is a United States (US) corporation which manufactures sportswear in the US. Diamond wants to market the sportswear throughout Hong Kong and South-East Asia generally. To do this, a subsidiary company called Gold Ltd (Gold) will be established in Hong Kong, which will act as the local and South-East Asian distributor of the sportswear.

Steven, a US resident for tax purposes, is offered the position of regional director of Gold to oversee the South-East Asian region. Steven's annual remuneration package will be $1,200,000. Although stationed in Hong Kong, Steven will travel extensively back to the US and throughout the South-East Asian region. Steven plans to rent a furnished apartment near his workplace in Hong Kong. He estimates his main expenses during the year will be as follows:

(1) Rent: $300,000;
(2) Car and private transport: $180,000;
(3) Club membership fee: $30,000
(4) Utilities $40,000; and
(5) Medical expenses: $15,000.

Steven is concerned about the salaries tax liability that he will have to pay in Hong Kong.

Required:

(a) Advise Steven whether, and if so to what extent, the income he will receive from Gold Ltd will be liable to salaries tax in Hong Kong. (7 marks)

(b) Explain whether Steven is eligible for any relief from double taxation in the event he is taxable in the United States (US) as well as in Hong Kong on the income he will receive from Gold Ltd.

Note: You may assume there is no double taxation treaty between Hong Kong and the US. (3 marks)

(c) Explain how Steven's remuneration package could be structured so as to minimise the amount of salaries tax he will have to pay in Hong Kong. (15 marks)

(25 marks)

Section B – BOTH questions are compulsory and MUST be attempted

3 Simon and his wife, both Hong Kong permanent residents, are planning to emigrate to Taiwan in three months' time. Simon ceased his employment on 15 November 2020 and is currently negotiating to purchase a residential property in Hong Kong for investment purposes. The seller of the residential property is a Hong Kong incorporated company, whose only asset is the property which is currently being let out. Simon is considering the following options to purchase the property:

Option 1: To buy the property for $18,000,000, either in: (i) his personal name or (ii) joint names with his wife. Simon does not own any residential property in Hong Kong whilst his wife already holds one residential property in Hong Kong.

Option 2: To buy all the shares in the company from its only shareholder, Peter, for $11,000,000. In addition, Simon will pay Peter $7,000,000 for an assignment of a shareholder's loan which Peter has made to the company. Two separate documents will be prepared to give effect to the transfer of the shares and the assignment of the shareholder's loan respectively.

In either case, Simon will borrow $10,000,000 from a bank to finance the acquisition of the property. Simon will continue to hold the property for rental.

Simon is concerned about the Hong Kong tax implications of the above options to purchase the property investment and has approached you for advice.

Required:

(a) Advise Simon on the Hong Kong tax and stamp duty implications, if:

(i) he acquires the property in his personal name or joint names with his wife (Option 1); or (10 marks)

(ii) he acquires all the shares in the company, together with the shareholder's loan (Option 2). (8 marks)

(b) State the statutory reporting obligations with which Simon should comply before he leaves for Taiwan. (2 marks)

(20 marks)

4 Uni Global Group (the Group) is engaged in multinational investment activities. The Group's ultimate holding company is listed in the United States (US). Uni (HK) Ltd (Uni-HK), the Group's subsidiary in Hong Kong, is carrying on business in Hong Kong as the Group's headquarters in Asia Pacific. Uni-HK is currently recruiting a senior executive to fill the position of Vice President for Asia-Pacific. After a series of interviews, Mr Moore has been shortlisted and the Human Resources (HR) director has initiated negotiations with Mr Moore on his employment terms.

Mr Moore has made a specific request for the following terms:

(1) Share option – upon signing the employment contract, Uni-HK would grant him a share option to acquire at least 100,000 shares in the Group's ultimate holding company at an exercise price equivalent to 30% of the share market price at the date of signing the employment contract.

(2) Non-home country tax subsidies – Mr Moore is a US citizen and will be subject to US tax in respect of his income from employment with Uni-HK. Mr Moore is however concerned about any other non-US tax such as HK salaries tax that may also be chargeable due to his employment services rendered in different places. He therefore requests that other than the US tax, any other tax, such as HK salaries tax arising from his employment, would be paid and borne by Uni-HK.

In considering the request for the share option, the HR director of Uni-HK intends to insert a vesting period of two years to ensure that any benefit would only accrue to Mr Moore two years after he started to serve the Group. In addition, the Group's ultimate holding company would recharge Uni-HK for the related costs incurred when the share option is granted and exercised.

As regard to Mr Moore's request for non-home country tax subsidies, it has been confirmed with the Group's management that Mr Moore is expected to spend most of his time working in Hong Kong, such that any exposure to overseas taxes would be avoided.

Before concluding the terms, the HR director is obliged to explore both the Hong Kong salaries tax position arising from the above staff benefits to Mr Moore and the Hong Kong profits tax deductions available to Uni-HK in respect of the above staff costs.

Required:

(a) Regarding the grant and exercise of the share option and subsequent share disposal by Mr Moore, discuss:

(i) the Hong Kong salaries tax position for Mr Moore; and
(ii) the Hong Kong profits tax position of Uni-HK in terms of the related costs incurred. (14 marks)

(b) Assuming that Uni-HK agrees with the 'non-home country tax subsidies' as proposed by Mr Moore, as a result of which Uni-HK would pay, on behalf of Mr Moore, his Hong Kong salaries tax arising from his employment with Uni-HK, discuss:

(i) whether the tax paid and borne by Uni-HK would become assessable income to Mr Moore in arriving at his assessable income for Hong Kong salaries tax purposes; and
(ii) whether Uni-HK is eligible for a profits tax deduction on the salaries tax paid. (6 marks)

(20 marks)

End of Question Paper