
Answers

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1 Report to the directors of Acquirer-HK

To: The directors, Acquirer-HK
From: Tax adviser
Date: Dec 2020
Subject: Share Acquisition from Vendor Group

I refer to our earlier meeting during which we discussed the proposed acquisition of HK-Holding from Vendor Group. Following is an analysis of the Hong Kong tax implications to the issues raised by the directors.

(a) Waiver of inter-company balances due to O/S-Sub

It was revealed from the due diligence report that inter-company loans were extended from O/S-Sub to HK-Holding and HK-Sub at interest. The unpaid balances of loan principal and interest remained as payables in the books of HK-Holding and HK-Sub, and as receivables in the books of O/S-Sub. Upon the acquisition of HK-Holding by Acquirer-HK, there is an intention to waive all the inter-company balances.

The loans and interest arose from O/S-Sub's assistance in financing the under-performing businesses of HK-Holding and HK-Sub, according to the facts. Hence the loans and interest arose from the carrying on of businesses by HK-Holding and HK-Sub. The businesses of HK-Holding and HK-Sub were carried on in Hong Kong when the loans were extended to them.

From the perspective of HK-Holding and HK-Sub, the waiver represents a discharge of their obligations to pay the unsettled balances, thereby triggering a credit entry in their books. Such credit entries constitute revenue to the respective companies and are chargeable to profits tax under s.14 of the Inland Revenue Ordinance unless it can be proved that:

- (i) The Loans are derived outside of Hong Kong, or
- (ii) The Loans upon waivers are capital gains by having been obtained for capital purposes (strictly the law applies to gains from sale of capital assets but in practice the exemption applies to all capital gains).

Loan principal waiver

As far as the loan principal is concerned, the waived amount is likely non-taxable if the above conditions are satisfied. There is not sufficient information available to conclude this point but we shall be glad to explore this point with you at your convenience.

It is also possible that the waived amounts would arguably be regarded as a 'grant, subsidy or similar financial assistance' to the respective debtor companies which is thereby deemed to be assessable profits of the debtor company for the year of assessment during the basis period of which the waiver takes effect, according to s.15(1)(c).

Loan interest waiver

With respect to the portion of interest expenses to be waived, pursuant to s.15(2), if a debt has previously been allowed as a deduction in computing the assessable profits but subsequently released, wholly or partly, the released portion should be brought to taxation in the year in which the debt was discharged. In the case of the inter-company balances waived, s.15(2) would be applicable such that the waived amount attributable to the unsettled interest expense would become assessable to HK-Holding and HK-Sub on the basis that tax deductions have been claimed on the interest expenses in previous years.

(b) Tax deduction to HK-Holding of inter-company loan interest payable to O/S Sub

From the perspective of HK-Holding, interest expense is incurred on the inter-company loan payable to O/S-Sub. In terms of the eligibility to profits tax deduction for the interest expense, it depends on whether the conditions under s.16(1), s.16(1)(a) and s.16(2) are satisfied. Under s.16(1), an expense is allowed to the extent that it is incurred in the production of profits chargeable to profits tax. In the case of loan interest, it is also specifically provided under s.16(1)(a) that the loan money is required to be used for the production of assessable profits. In the case of HK-Holding, it was given that the inter-company loan was obtained to finance its underperforming business and all income from its business had been returned as assessable profits in Hong Kong. Therefore, *prima facie*, the conditions under ss.16(1) and (1)(a) would be satisfied (even though the company is currently loss making, s.19D).

In addition, for a deduction to be allowed, at least one of the conditions under s.16(2) must be satisfied. In this case, due consideration should be given to the provisions of s.16(2)(c) and s.16(2)(e) as the other conditions under s.16(2) are not relevant. Section 16(2)(c) requires that the loan interest in the hands of the recipient (the lender) is taxable in Hong Kong. In this case, the interest is receivable by O/S-Sub which is a tax resident in Country X and subject to corporate tax there. In the absence of information that O/S-Sub is also assessable to profits tax in Hong Kong in respect of the interest accrued on the loan, it is reasonable to conclude that s.16(2)(c) is not applicable to justify the tax deduction to HK-Holding.

As regards s.16(2)(e), the provision requires that the loan money is being used to purchase plant and machinery or trading stock, and the lender is not an associate of the borrower. In the case of HK-Holding, despite that information is not clear about the usage of the loan money, the fact that O/S-Sub (the lender) and HK-Holding (the borrower) are associates would render this condition inapplicable to justify the interest deduction.

In conclusion, it is likely that the interest incurred on the inter-company loan should be non-deductible for profits tax purposes by HK-Holding.

Based on the due diligence report, it was given that tax deductions had been claimed by HK-Holding on the inter-company loan interest, and no query has been raised by the Inland Revenue Department (IRD). However, based on the above analysis, there is an absence of legal authority for the interest deduction claimed. Therefore, for the purpose of due diligence, there is a potential risk to Acquirer-HK that an additional tax burden may occur post-acquisition in the event that the interest deduction is challenged by the IRD. In order to protect Acquirer-HK, this risk may be quantified and reflected in the acquisition price, or alternatively a tax indemnity be executed by the Vendor Group, to the effect that any future tax costs arising from additional assessments due to disallowance of interest deduction would be indemnified to Acquirer-HK.

(c) HK-Sub as Intra-group Financing Centre

HK-Sub will be restructured into an intra-group financing centre for the group. Funds are to be borrowed from O/S-Sub in Country X and lent onwards to HK-Holding in Hong Kong. The interest rates are to be structured such that a spread of 5% will be earned by HK-Sub from the intra-group financing transactions.

Interest Income from HK-Holding to HK-Sub

HK-Sub will earn interest amounts from the loan extended to HK-Holding. Interest amounts derived by a company carrying on business in Hong Kong is generally deemed by s.15(1)(f) (if not charged by s.14(1)) to be assessable profits chargeable to profits tax, provided that the interest is derived from a source in Hong Kong. In determining the source of interest amount, the most common test is based on the location where the loan credit is first made available to the borrower (i.e. the 'provision of credit' test). However, in the case of an interest amount earned from a money-lending business or intra-group financing transaction, the IRD may apply the operations test instead. This approach is specified under s.15(1)(ia) and (la) whereby interest amounts received by a corporation, other than a financial institution, which arises through or from the carrying on of an intra-group financing business in Hong Kong will have a Hong Kong source regardless of whether the money concerned is made available outside Hong Kong. In the case of HK-Sub which earns an interest spread from carrying on of an intra-group financing business in Hong Kong, the interest amount earned by HK-Sub is likely considered as sourced in Hong Kong and chargeable to profits tax.

Given the nature of business being intra-group financing activities, HK-Sub may possibly qualify as a 'Qualifying Corporate Treasury Centre' (QCTC) which is subject to a concessionary tax rate of 8·25% under s.14C to s.14F. To qualify as a QCTC (s.14(D)(2)), HK-Sub must be a standalone corporate entity carrying on business as a 'corporate treasury centre' and engaging solely in corporate treasury activities (subject to the safe harbor rules or the Commissioner's determination). HK-Sub must also be centrally managed and controlled in Hong Kong and carry out the corporate treasury activities in Hong Kong. 'Corporate treasury activity' includes an intra-group financing business, corporate treasury service, or any corporate treasury transaction (s.14C(1)). *Prima facie*, the proposed business which is to be performed by HK-Sub should qualify as carrying out the corporate treasury activities. Based on Departmental Interpretation and Practice Note No. 52, there are other factors to be considered by the IRD before recognising the QCTC status, including the frequency and size of transactions, the number of associates dealt with, the arm's length principle interest rate, the system of laying out and recovering the amount, and the regularity and frequency of payment. However, the IRD also emphasised that failing to reach these benchmarks would not necessarily lead to a failure to be accepted as an 'intra-group financing business'. In conclusion, the HK-Sub business should have sufficient merit to seek to be taxed at the concessionary tax rate of 8·25% based on the QCTC status, subject to the consent from the IRD.

Interest Expense to O/S-Sub

To finance the loan to HK-Holding, HK-Sub obtains a loan from O/S-Sub at an interest rate lower than the interest charged to HK-Holding. The tax deductibility of the interest payment to O/S-Sub will depend on whether the interest expense is incurred in the production of assessable profits (ss.16(1) and (1)(a)); and whether the interest is taxable in Hong Kong in the hands of the recipient, i.e. O/S-Sub (s.16(2)(c)); or whether the borrowing satisfies all the conditions under s.16(2)(g).

As analysed above, the loan interest amount from HK-Holding is likely to be sourced in Hong Kong and taxable in the hands of HK-Sub. Therefore, conditions under ss.16(1) and (1)(a) would be satisfied.

However, s.16(2)(c) would likely not be fulfilled for the reason that O/S-Sub is not likely to be taxable in Hong Kong in respect of the interest received (unless O/S-Sub is challenged by the IRD as carrying on business in Hong Kong with the interest regarded as HK-sourced, which is not likely in this case).

Given that HK-Sub carries on an intra-group financing business, HK-Sub could still be eligible for an interest deduction if all conditions under s.16(2)(g) are satisfied, as follows:

- (i) interest is incurred on money borrowed from a non-Hong Kong associated corporation (O/S-Sub);
- (ii) interest in the hands of the lender (O/S-Sub) has been or will be taxed overseas at a rate greater than or equal to 16·5% (or 8·25% if HK-Sub qualifies as a QCTC and is taxed at 8·25%); and
- (iii) interest is received by O/S-Sub as the beneficial owner and is not passed on to any other person under any contractual or legal obligation, unless the interest is obliged to be passed on under a genuine arrangement at arm's length (e.g. due to genuine security on the loan or sub-participation).

In the case of HK-Sub, conditions (i) and (iii) above are likely to be met but there may be risk under condition (ii) for the reason that the interest in the hands of O/S-Sub has been taxed in Country X at 3% which is lower than the usual tax rate of 16·5% (or 8·25%) in Hong Kong. Moreover, there is also a risk under the anti-avoidance provisions of ss.16(2CC) and (2CD) if the IRD considers that the restructuring of HK-Sub into intra-group financing business is solely or dominantly for the purpose of utilising its tax loss in HK-Sub.

Effectiveness of the restructuring into an intra-group financing centre

The proposed restructuring will be tax effective provided that HK-Sub is taxed on the interest income from HK-Holding and is eligible for a tax deduction for the interest paid to O/S-Sub. In the event that the interest expense to O/S-Sub would not be deductible (e.g. s.16(2)(g) being not satisfied), there would be a double taxation in HK-Sub, resulting in the restructuring not being tax effective.

(d) Eligibility to carry forward tax loss in HK-Holding and HK-Sub

Prima facie, tax losses incurred by a company carrying on business in Hong Kong will continue to be carried forward under the name of the company, regardless of any change in the shareholding of the company. Thus, any losses would continue to be available to carry forward to offset against a company's future assessable profits earned after the change in shareholding, subject to the provisions of s.61B.

By virtue of s.61B, the ability to carry forward tax losses may be denied by the Commissioner if he is satisfied that:

- (1) the change in the shareholding of the company has resulted, directly or indirectly in profits having arisen in or been accrued to the company; and
- (2) the sole or dominant purpose of the change in shareholding was to utilise the tax losses sustained in the company in order to obtain a tax benefit or to avoid a tax liability of the company or any other person.

In the case of HK-Holding, the acquisition by Acquirer-HK means the shareholding in HK-Holding will be changed, there is a risk that the tax loss could be denied under s.61B unless there is evidence that Acquirer-HK does not have the intention to take advantage of the tax losses through the acquisition. Based on the proposed restructuring after acquisition, the shipping agency business of HK-Sub is to be transferred into HK-Holding. However, the shipping agency business had been a loss-making business and the transfer was to facilitate HK-Sub to be converted into an intra-group financing centre. If there is evidence to convince the IRD that the restructuring in HK-Holding is not solely or dominantly for the purpose of utilising the tax loss in HK-Holding, s.61B challenge could be defended.

As regards HK-Sub, s.61B may prima facie not be applicable as the shareholding in HK-Sub does not change after the acquisition.

We trust the above has addressed all the related tax concerns. Should there be any questions, please let us know.

End of Report

2 Steven

(a) Liability to Hong Kong salaries tax

If Steven has an employment located in Hong Kong, all income from that employment is liable to salaries tax unless (1) no services are rendered in Hong Kong during a year of assessment; or (2) services are rendered in Hong Kong during a year of assessment but his visits to Hong Kong during a year do not exceed 60 days (if his visits to Hong Kong during a year exceeds 60 days and during any of his visits, even just in one day, he renders any services, this exemption will not apply: *Jack So's case*); or (3) tax similar to salaries tax is paid outside Hong Kong on any income attributable to services performed in a territory which has no double tax agreement with Hong Kong.

If, on the other hand, Steven has an employment located outside Hong Kong, only the income derived from services rendered in Hong Kong, including the leave pay attributable to such services, are subject to salaries tax. This is usually determined on a time-apportionment basis, i.e. Steven's employment income will be apportioned according to the number of days that he is present in Hong Kong during the year of assessment.

On the basis of the *Goefert's case*, the location of an employment is generally regarded by the Inland Revenue Department (IRD) as outside Hong Kong where the following three factors are present:

- (1) the contract of employment was negotiated, entered into and enforceable outside Hong Kong;
- (2) the employer is resident outside Hong Kong, in this case, if Gold Ltd (Gold) is centrally managed and controlled outside Hong Kong; and
- (3) the employee's remuneration is paid outside Hong Kong.

If all of the above factors are not outside Hong Kong, the first two factors become more important. However, when the employer (in this case, Gold) is resident in Hong Kong (the second factor), the IRD tends to regard the employment as a Hong Kong employment.

In Steven's case, factor 3 could easily be satisfied. Factors 1 and 2 would seem to be less easily satisfied because Gold is a local company carrying on business in Hong Kong. Thus, it is likely that Steven's employment with Gold would be regarded by the IRD as located in Hong Kong and therefore liable to salaries tax in Hong Kong.

The exemption for services rendered outside Hong Kong (under s.8(1A)(b)) is likely not available to Steven because he renders services in Hong Kong, and his presence in Hong Kong will be that of either a 'non-visitor' or more than 60 days. No time-apportionment is applicable to a Hong Kong employment.

It is very unlikely that Steven's employment would be deemed to be located outside Hong Kong; but if it were only the income derived from services rendered in Hong Kong, including the leave pay attributable to such services, would be assessed to salaries tax. This is usually determined on a time-apportionment basis, i.e. Steven's employment income would be apportioned according to the number of days that he is present in Hong Kong during the year of assessment, s.8(1A).

(b) Relief for double taxation

If Steven is employed by Gold under a Hong Kong employment, in calculating the assessable income for Hong Kong salaries tax purposes, if:

- (1) Steven is chargeable to tax in the US in respect of income from services rendered there, and
- (2) the tax is of substantially the same nature as salaries tax in Hong Kong, and
- (3) the tax has been paid (these three facts are collectively referred to as 'double taxation'),

then Steven may exclude that part of his income on which US tax has been paid (s.8(1A)(c)).

Although unlikely, if Steven is under an offshore employment with income assessed on a time-basis for Hong Kong salaries tax purposes, s.8(1A)(c) cannot be relied upon to claim relief from double taxation. Moreover, there is no DTA between Hong Kong and the US. As a result, Hong Kong salaries tax must be payable. In this event, it would therefore be advisable for Steven to seek foreign tax relief under the US domestic tax law.

(c) Structuring of remuneration package to minimise salaries tax

Within limits, fringe benefits planning is commonly done by many employers in Hong Kong, and is generally accepted by the IRD. However, to be effective, there are various technical requirements that must be complied with, and these inevitably give rise to administrative complexities to the employer. The IRD can be expected to scrutinise fringe benefits planning arrangements carefully to ensure that these technical requirements are being complied with. If the necessary procedures are not followed, the authorities will likely treat these benefits as being taxable at their full value.

The relevant statutory provisions contained in the Inland Revenue Ordinance ('IRO'), as well as the relevant practice adopted by the IRD, have been considered and applied to the five areas representing Steven's major expenditures, namely, rent, transport, utilities, club membership fee and medical expenses.

(1) Accommodation

Where Gold reimburses rent paid by Steven to his landlord, or alternatively pays the rent to his landlord directly, then the amount so paid can be excluded from Steven's taxable income. Instead, Steven would be treated as having received a taxable benefit equal to the 'rental value' of the premises concerned, and this is normally calculated as 10% of his other taxable emoluments (excluding lump sum payment or gratuity paid or granted upon the retirement or termination of employment and share option gains). For this purpose, the rental payment can include not only rent, but also management fees and rates with respect to the premises which Steven is obliged to pay under his lease.

However, the IRD will stringently monitor the situation to ensure that Gold's obligation to make such rental payments or reimbursements is clearly set out in Steven's contract of employment, and that he does, in fact, incur the rental expenses so provided. If Steven is not required to use such payments to pay rent, then the whole of the payment will be taxable as an ordinary salary payment.

Other benefits can be paid for by Gold and provided to Steven on a tax-free basis, provided that in doing so Gold does not discharge any legal obligation that Steven has to make such payment, and further provided that he cannot convert such benefit into cash.

(2) Car and private transport

Gold can make the use of a car available to Steven. Provided that Steven is not personally liable to make any lease or purchase payments to the supplier of the car, this benefit will be tax-free. Again Steven should not have the right to require cash to be paid to him instead. Rather, his employment contract must specify that he is entitled to receive the use of a company car. Alternatively, the contract of employment could be silent on this point, and Gold could simply make the car available to Steven to use.

(3) Club membership fee

Gold could acquire corporate membership of the club and allow Steven to use it. It is accepted that no chargeable benefit arises in respect of the cost of acquisition of corporate membership of a club. The IRD recognises that as entitlement to corporate membership benefits may be transferred from one employee to another it is not possible to attribute such expenditure to a particular employee. On the other hand, where an employer makes a payment in respect of an individual membership fee or other club expense for which an employee is personally liable, the payment will constitute chargeable income of the employee.

(4) Utilities

It would be possible for Gold to pay the utilities bills with respect to his premises, without Steven being taxed thereon. This would cover payments for telephone, gas, water and electricity. However, as noted above, it is necessary that Steven

must not have the legal obligation to make these payments to the utility companies concerned. Therefore, it is essential that Gold enters into the contracts with the utility companies for the supply of the various services. This means of course Gold will be legally liable to pay these amounts. Furthermore, Steven must not have the 'option' to be able to take cash in lieu of having his utility bills paid by Gold. If he is entitled to simply take cash from Gold directly, then the amount that he could have received from Gold would be taxed on him. It is therefore essential that the employment contract specifies that Gold will make such payments and Steven will not be entitled to payment in cash.

(5) Medical expenditure

Medical and dental insurance policies are common fringe benefits. Gold could maintain an insurance policy to cover Steven for his medical needs. Payments made by the insurance company to Steven will be tax-free. Alternatively, if Gold wishes to make such payments directly without maintaining insurance, Gold could enter into an arrangement with specified doctors that, should Steven consult with such doctor, the doctor agrees that he/she will not look to Steven for the payment of fees, but will charge Gold only. Through this technique, Steven will avoid entering into a legal obligation to pay the doctor's fee and the amount paid by Gold to the doctor will be tax-free.

3 Simon

(a) (i) HK tax and stamp duty implications if the property is acquired

Tax implications

If Simon acquires the property in his personal name or joint names with his wife, the rental income will be chargeable to property tax rather than profits tax. Under s.5(1) of the Inland Revenue Ordinance (IRO), property tax is levied on any owner of land or buildings or land and buildings situated in Hong Kong, at the standard rate (15%) on the net assessable value of the property.

'Net assessable value' as defined under s.5B includes any consideration payable in money or money's worth in respect of the right to use the land and/or buildings, as reduced by two types of deductions:

- (1) government rates paid by the owner if it has been so agreed between the owner and the tenant; and
- (2) a 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. Therefore, all other actual expenses incurred by Simon, including the management fee, rates and interest, will not be deductible for property tax purposes.

Property tax can work unfairly where a person incurs expenses greater than the deemed 20% allowance. There would be particular hardship if interest deductions could not be taken into account. The IRO gives relief by providing that, if Simon and his wife are eligible and elect for personal assessment, they will be entitled to a deduction for interest incurred to acquire the property (s.42(1)). However, the deduction is limited to the 'net assessable value' of the property, i.e. 80% of the total rental received.

To be eligible to elect for personal assessment, Simon and his wife have to be either ordinarily resident in HK or a temporary resident (s.41(1)). 'Ordinarily resident' means an individual makes a regular and substantial period of visits from year to year, or maintains a place of abode. 'Temporary resident' means an individual who stays in Hong Kong for a period or a number of periods amounting to more than 180 days during the year of assessment in respect of which the election is made or for a period or periods amounting to more than 300 days in two consecutive years of assessment, one of which is the year of assessment in respect of which the election is made (s.41(4)). Since Simon and his wife are leaving for Taiwan as emigrants, it is not likely that they will be ordinarily resident in Hong Kong. In order to be eligible, Simon and his wife have to be temporary residents.

Stamp duty implications

Conveyances on the sale or transfer of immovable property in Hong Kong are subject to stamp duty under Head 1 of the Stamp Duty Ordinance (SDO). The chargeable document is the agreement for sale and purchase (AFS), and it is liable to *ad valorem duty* (AVD) at either Scale 1 (Part 1 or Part 2) or Scale 2 rates. Where the property is a residential property (RPPT) and the purchaser or transferee (or all purchasers or transferees) is a Hong Kong permanent resident (HKPR) who buys the RPPT on his/her own behalf (i.e. the person is both the legal and beneficial owner) and does not own any other RPPT in Hong Kong at the time of acquisition, lower rates under Scale 2 ranging from \$100 (for a value not exceeding \$2 million) to 4.25% (for a value exceeding \$20 million) applies. 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.

In the case of Simon, if he acquires the property in his personal name, lower rates under Scale 2 will apply. However, if he acquires the property in joint names with his wife who already owns a RPPT in Hong Kong, the flat rate of 15% under Part 1 of Scale 1 will apply. Therefore, the stamp duty payable is \$675,000 (3.75% on \$18m) if the property is acquired in the name of Simon, or \$2.7m (15% on \$18m) if the property is acquired in the joint names of Simon and his wife. Where the AFS is stamped, the subsequent formal assignment or conveyance executed in conformity with the stamped AFS will be liable to a fixed duty of \$100. The law stipulates that parties to the transaction, the buyer and the seller, are jointly and severally liable to pay the stamp duty, but in market practice, the purchaser is normally the person to pay.

In addition, special stamp duty (SSD) will be payable if the RPPT was sold by the seller within 36 months of acquisition. The applicable rates of SSD depend on the holding period, the longer the holding period the lower the rate of duty. SSD is applicable even if the seller is an incorporated company, and is jointly and severally payable by both the purchaser (Simon) and the seller (the company). In Simon's case, it is unclear when the property was acquired by the company. Simon is therefore advised to obtain more information from the company, in order to ascertain whether the property will fall within the SSD regime. If so, he may seek to negotiate and agree with the company as to which party will pay and bear the duty, and to have this specified in the agreement.

Buyer's stamp duty (BSD) will not apply in Simon's case because he and his wife are HKPRs who are acquiring the RPPT on his/their own behalf.

(ii) HK tax and stamp duty implications if all the shares in the company together with the shareholder's loan are acquired

Tax implications

If Simon acquires all the shares in the company, the rental income will be chargeable to both property tax and profits tax. Section 5(1) is still applicable on the basis that the company will still be considered as the 'owner' of the property. Any rental income so received is subject to property tax calculated in the same manner as for an individual (as above).

However, according to s.2, 'business' is defined to include the letting or sub-letting of property by a corporation. Moreover, under s.14, any person who carries on a trade, profession or business in Hong Kong and derives assessable profits in Hong Kong will be subject to profits tax. The company is regarded as carrying on the business of property letting in Hong Kong and will be subject to profits tax.

This double taxation of the company 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 income can apply for an exemption from property tax in relation to the same rental income so that the rental income is only subject to profits tax. Alternatively, the company can rely on s.25 to claim the set off of the property tax paid against the profits tax payable.

Profits tax under s.14 is imposed on the assessable profits which take into account all relevant expenses and outgoings which are incurred in the production of assessable profits (s.16(1)). The company is therefore able to deduct the related expenses such as rates, management fees and mortgage loan interest. In addition, commercial building allowance will be calculated and deductible against the rental income. In a situation where total deductible expenditure exceeds total income, the excess loss can be carried forward to subsequent years and is eligible for deduction against any future assessable profits. Currently, the profits tax rate applicable is 8·5% on the first \$2 million profit, and 16·5% on the remainder.

The sale of the shares from Peter to Simon is a private transaction of the shareholder. Therefore, the transfer of the shares and the assignment of the shareholder's loan have no profits tax implication for the company.

Stamp duty implications

The shares of the company, which is a Hong Kong company, are Hong Kong stock: definition in s.2(1) of the SDO. Therefore the parties effecting the sale and purchase thereof must prepare and stamp contract notes for the sale and purchase and an instrument of transfer (s.19(1) and Heads 2(1) and 2(4) respectively). Duty on the contract notes under Head 2(1) is 0·2% of the amount or value of the consideration; duty under Head 2(4) on the instrument of transfer is \$5.

Because the transfer of Hong Kong stock is subject to the payment of further money for the assignment of the shareholder's loan, this additional money is also considered to form part of the total amount on which stamp duty is to be assessed (s.24(1)). Therefore, stamp duty on the contract notes under Head 2(1) is \$36,000 (\$18m x 0·2%). Because the seller and the purchaser are each liable to pay one-half of this amount, it follows that the amount payable by Simon is \$18,000, which is much lower than the amount payable (\$1·35m or \$2·7m) if the property, not the shares, were acquired by Simon.

The final issue relates to the consequences of having prepared two separate documents in respect of the same transaction. The SDO stipulates that all the facts and circumstances affecting the liability of any instrument to stamp duty must be fully and truly set forth in the instrument (s.11). This means that the share transfer document should contain a reference to the related assignment of the shareholder's loan, because this would affect the calculation of stamp duty payable. The calculations shown take this into account.

Although not anticipated to be the case here, the party preparing the documents would have committed an offence, if, having been employed or concerned in or about the preparation of the instrument, the party has neglected or omitted fully and truly to set forth in that instrument all the relevant facts and circumstances. However, the offence is only committed if the party did so with an intent to defraud the Government, and not simply out of inadvertence of the stamp duty consequences.

(b) Statutory reporting obligations

Under the IRO, any person who ceases to own a source of income chargeable to tax in Hong Kong is obliged to inform the Commissioner of Inland Revenue (CIR) within one month of such cessation (s.51(6)). This applies to Simon, such that he should file the notice of cessation of employment within one month of cessation, i.e. on or before 15 December 2020.

Moreover, any person who is chargeable to tax in Hong Kong and who is about to leave Hong Kong for a period which will exceed one month (except for a vacation or business purpose) must inform the CIR in writing of his expected date of departure

and return, and this notice should be filed at least one month before the departure (s.51(7)). In the case of Simon, he is leaving for Taiwan as emigrants and thus is expected to leave Hong Kong for more than one month. He is therefore required to file the notice of such departure to the CIR at least one month before his departure.

4 Uni-HK Ltd (Uni-HK)

(a) Share Option

(i) Hong Kong salaries tax for Mr Moore

Under the general assessability rule, a share option is taxable to Hong Kong salaries tax if it is received as a reward for the employment located or services provided, as applicable, in Hong Kong (i.e. Hong Kong-sourced). The timing of assessment and value to be assessed, however, may be different depending on the circumstances. Pursuant to the specific rule under s.9(1)(d), an option benefit is taxed on the gain at the time when the option is exercised, assigned, or released.

At the time when the share option is exercised, the taxable gain is calculated as the difference between the share market price at the time of exercise and the share exercise price, multiplied by the number of shares acquired from option exercise, and reduced by any share option costs and deemed sales costs e.g. stamp duty. If the share option is assigned or released, the consideration or proceeds received as reduced by the option cost would be assessable. However, if the shares are subsequently sold, any gain arising therefrom is considered as a return from investment rather than employment, and thus is disregarded for Hong Kong tax purposes.

For the purpose of assessing the gain, it is also important to ascertain the source of the option benefit. Based on Departmental Interpretation and Practice Note No. 38, the income arising from the option right would be regarded as Hong Kong-sourced if the person has a Hong Kong employment at the time of the grant of the right. The income would then be taxed upon the exercise, assignment or release of option, unless all the services during the year of grant are rendered outside Hong Kong. In the case of Mr Moore, as Uni-HK is carrying on business in Hong Kong, it is reasonable to assume that Mr Moore's employment is Hong Kong employment at the time of option grant. Moreover, Mr Moore is expected to spend most of his time working in Hong Kong, and thus it is unlikely that he would provide all services outside Hong Kong in an assessment year. Therefore, the share option granted to Mr Moore is regarded as Hong Kong-sourced and the income arising therefrom would be taxable through exercise, assignment and release.

Due to the specific assessability rule for an option right, the vesting period should in principle have no impact on the salaries tax implication, except where Mr Moore's employment is changed from Hong Kong-sourced to non-Hong Kong sourced during the vesting period, which is unlikely. In this case, with the 2-year vesting period, Mr Moore would be refrained from exercising, assigning or releasing the share option until two years after granting. If Mr Moore remains in Hong Kong-sourced employment until the time the option is fully vested, he would be taxed at the time when the option is exercised, assigned or released.

(ii) Hong Kong profits tax for Uni-HK

From the perspective of Uni-HK, whether the costs incurred on granting the share option are deductible for profits tax purposes depends on, *prima facie*, whether the general deductibility rule under s.16(1) is satisfied. Under s.16(1), expense or outgoings would be deductible to the extent incurred in the production of assessable profits. In the case of the cost of providing staff remuneration, it is generally deductible if the related employee is deployed for services rendered for the benefit of the company with a view to producing the company's profits subject to profits tax in Hong Kong.

In the case of Mr Moore's option costs incurred by Uni-HK, the deductibility issue depends on two factors: (a) whether the whole or part of the services of Mr Moore are in the production of assessable profits of Uni-HK; and (b) whether the costs recharged by the Group's ultimate holding are *de facto* 'expense or outgoings' and whether they are actually 'incurred'.

Relating to factor (a), if it can be proved that Mr Moore's services are wholly rendered for the benefit of Uni-HK in the production of Uni-HK's assessable profits, then the related staff cost for Mr Moore, including share option, would be deductible, subject to factor (b). However, in the case of Mr Moore, the deductibility would be complicated by the fact that Mr Moore is employed as vice-president (Asia Pacific) and may be, presumably, responsible for the Group's business rather than only Uni-HK. If this is the case and Uni-HK is not recharging part of Mr Moore's staff costs to other group companies receiving Mr Moore's services, it is likely that only that part of Mr Moore's staff cost, including the share option cost, that is attributable to the production of Uni-HK's assessable profits would be deductible. Uni-HK may suffer a tax disallowance of part of the staff cost incurred for Mr Moore. This position could be enhanced if Uni-HK makes a recharge to the other group companies that have received Mr Moore's services.

As regards factor (b), since the option relates to the shares in the listed ultimate holding, the associated costs relating to the option granted and exercised would be taken up by the ultimate holding company (either for its issuance of new shares or acquisition of shares from the market) which would then recharge the costs to Uni-HK. Based on the Inland Revenue Department's (IRD) prevailing practice, the costs recharged by the ultimate holding and recorded in Uni-HK's books would be tax deductible to Uni-HK only when the share option is exercised and the recharge becomes unconditionally payable by Uni-HK. The amount recharged should also be justified and not excessive. However, any recharge made before the option is exercised or during the vesting period would not be deductible on the basis that the amount represents only a contingent liability or a provision which is not an 'expense or outgoings' actually 'incurred'. Should there be any subsequent write-back due to cancellation or release, the gain from write-back would become taxable

if the initial recharge had been deductible before. To substantiate the recharge mechanism, the IRD also requests that a written recharge agreement be in place between the ultimate holding company and Uni-HK. Should the IRD suspect the mechanism is entered into for tax avoidance purposes, it would be further challenged by the IRD.

(b) Salaries tax borne

(i) Hong Kong salaries tax for Mr Moore

Under s.8, salaries tax is imposed on any income arising in or derived from Hong Kong from an office, employment or pension. The definition of income from employment is elaborated under s.9 which states that income from office or employment includes 'any wages, salary, leave pay, fee, commission, bonus, gratuity, perquisite or allowance'. Amongst all, the term 'perquisite' has a wide meaning to include any emolument or reward of value to an employee in addition to salary and wages. It also comprises benefits that are convertible into cash and payment in discharge of employee's liability.

In relation to Hong Kong salaries tax liability, the legal obligation to pay is Mr Moore's. If Uni-HK agrees to pay on his behalf, Uni-HK is regarded as providing a benefit to Mr Moore by way of discharging Mr Moore's liability to pay his tax. As a result, the value of the benefit, i.e. the amount of tax paid, also becomes assessable income to Hong Kong salaries tax. In practice, the tax amount needs to be grossed up in arriving at the assessable figure in the computation.

(ii) Hong Kong profits tax for Uni-HK

For profits tax purposes, an expense or outgoing is deductible to the extent it is incurred in the production of assessable profits (s.16), as long as it is not precluded from deduction under s.17. In general, costs incurred by an employer to compensate employees for providing services with a view to producing assessable profits for the employer are deductible. If Uni-HK agrees to pay the salaries tax on behalf of its employee, Mr Moore, and this is contractually bound by the employment contract, the salaries tax payment becomes part and parcel of the remuneration to compensate for Mr Moore's services. The fact that the payment is in the nature of salaries tax does not affect its eligibility for tax deduction. Although s.17(1)(g) specifically disallows any tax payment to be deductible, this specific preclusion is limited to the taxes imposed by the Inland Revenue Ordinance on the taxpayer company. Payment of salaries tax which is the employee's liability is not precluded from deduction under s.17(1)(g).

		<i>Available</i>	<i>Maximum</i>
1 (a) Waiver of inter-company balance			
Waiver means a discharge of obligation to pay debt, a taxable credit		0.5	
S.14 basic scope of charge: business purpose		0.5	
– unless offshore		0.5	
or capital in nature		0.5	
Further information is required to prove loan principal of capital nature		0.5	
Loan principal waived arguably taxable if deemed as grant or subsidy		0.5	
Loan interest waived was deductible debt subsequently released, s.15(2)		0.5	
Loan interest taxable in year of release		0.5	4
(b) Deductibility of inter-company loan interest			
S.16(1) – general deductibility rule		0.5	
S.16(1)(a) – usage of loan money for producing assessable profits		0.5	
S.16(1)(a) is met given the purpose of inter-co loan		0.5	
S.16(2) – any condition to be met		0.5	
Either s.16(2)(c) or s.16(2)(e) is relevant to this case		0.5	
S.16(2)(c) – recipient taxable in HK re interest income		0.5	
Interest to O/S-Sub not taxable in HK, thus not satisfied s.16(2)(c)		1.0	
S.16(2)(e) – usage of loan, and not from associate		1.0	
O/S-Sub is associate, not satisfied s.16(2)(e)		0.5	
Potential risk of post-acquisition tax due to interest disallowance		1.0	
Quantify amount and potential costs to be reflected in the acquisition price		1.0	
Or tax indemnity obtained from Vendor Group (as an alternative)		0.5	
		<u>8.0</u>	7
(c) HK-Sub as Intra-group financing centre			
Interest income			
Interest deemed as assessable profits if HK-sourced (s.15(1)(f))		0.5	
Provision of credit test		1.0	
If money lending business, operations test applies		1.0	
If intra-group financing business in HK, interest is HK-sourced		0.5	
HK-Sub earns spread from loans in HK, satisfied, taxable		0.5	
If a Qualifying Corporate Treasury Centre (QCTC), half tax rate or 8.25%		0.5	
Conditions for QCTC		2.0	
Corporate treasury activity includes intra-group financing		0.5	
Other factors per DIPN 52		1.0	
Conclusion		0.5	
Interest expense			
Conditions: s.16(1), (1)(a), (2)		1.5	
Interest received from HK-Holding taxable- s.16(1) and (1)(a) fulfilled		0.5	
Interest payable to O/S-Sub not satisfied s.16(2)(c)		1.0	
Conditions for deduction under s.16(2)(g)		1.5	
Loan from non-HK associate is satisfied		0.5	
Lender is taxed at a rate not lower than 16.5% (or 8.25%) not satisfied		1.0	
Lender is beneficial owner likely satisfied		0.5	
Risk under anti-avoidance rule		0.5	
Effectiveness			
If interest income taxable and interest expense deductible, effective		0.5	
Risk of non-deductible interest expense, not effective		1.0	
		<u>16.5</u>	15

	<i>Available</i>	<i>Maximum</i>
(d) Eligibility to carry forward tax loss in HK-Holding and HK-Sub		
Losses continue to be carried forward even shareholding change	0·5	
S.61B risk – tax loss offset may be denied	0·5	
Change in shareholding leading to profits arising in company	1·0	
Sole or dominant purpose to obtain tax benefit	1·0	
HK-Holding: risk as shareholding is changed	0·5	
Transfer of shipping agency business into HK-Holding	0·5	
Unless proved to have no intention to take tax benefit	0·5	
HK-Sub: low risk under s.61B as shareholding has not changed	0·5	
General anti-avoidance risk (s.61, s.61A)	0·5	
	<hr/> 5·5	5
Presentation		
Appropriate format and presentation	2·0	
Logical development	1·0	
Effectiveness of communication	1·0	4
	<hr/> 35	

(a) Liability to Hong Kong salaries tax		
Hong Kong employment taxable in full	0.5	
Unless no services rendered in Hong Kong	0.5	
Or visits to Hong Kong does not exceed 60 days	0.5	
Or foreign tax paid	0.5	
Foreign employment and time basis	1.0	
<i>Goefert's principle</i>	1.5	
Employment is likely HK-sourced, with reason	1.0	
No time apportionment	0.5	
Exemption for services rendered outside HK under s.8(1A)(b) not available	1.0	
If foreign employment, assessed on a time-basis and s.8(1A)(b) exemption not needed	1.0	
	<u>8</u>	7
(b) Relief from double taxation		
Exclusion of income on which foreign tax has been paid (s.8(1)(A)(c))	2.0	
If foreign employment, cannot rely on s.8(1A)(c) and has to seek foreign tax relief under the US domestic tax law	1.5	
	<u>3.5</u>	3
(c) Structuring of remuneration package to minimise salaries tax		
General principles		1
Accommodation benefit		
Provision of quarter or reimbursement of rent not taxable	1.0	
Taxed on rental value	0.5	
Meaning of rent	0.5	
Benefit set out in employment contract	1.0	3
Other benefits		
Employer discharges liability, not employee	1.0	
Benefits not convertible into cash	1.0	2
Car and private transport		
Provision of company car tax free	1.0	
Steven not allowed to take cash instead	0.5	
Benefit specified in employment contract	0.5	
Or simply make car available	0.5	2.5
Utilities		
Gold Ltd contracts with utilities companies	1.0	
Steven not allowed to take cash instead	0.5	
Benefit specified in employment contract	0.5	2
Club membership benefit		
Corporate membership not taxable	1.0	
Taxable if individual membership or employee personally liable	1.0	2
Medical expense		
Gold Ltd maintains an insurance policy	1.0	
Payments under the policy are tax free	0.5	
Gold Ltd contracts with doctors and takes up liability	1.0	2.5
	<u>15</u>	
	<u>25</u>	

(a) (i) Tax implications if property is acquired		
Rental income subject to property tax under s.5(1)	0.5	
On owner at standard rate on net assessable value (NAV)	0.5	
Definition of NAV	0.5	
Actual expenses not deductible	0.5	
Interest not deductible unless personal assessment is elected	1.0	
But interest limited to NAV	0.5	
Eligibility to elect for PA – ordinarily resident or temporary resident	0.5	
Whether Simon and his wife are eligible	1.0	
Conveyance on sale subject to stamp duty	0.5	
Agreement for sale liable to ad valorem duty	0.5	
Application of Scale 1 and Scale 2	0.5	
Dutiable value based on higher of transaction price and market value	0.5	
Scale 2 applies if property acquired in Simon's name	0.5	
Stamp duty payable is \$675,000	0.5	
Part 1 Scale 1 applies if property acquired in joint names	0.5	
Stamp duty payable is \$2.7m	0.5	
Formal assignment liable to a fixed duty of \$100	0.5	
Both parties liable	0.5	
SSD payable if property sold by seller within 36 months	0.5	
Even if seller is an incorporated company	0.5	
Seller and buyer jointly and severally liable	0.5	
Check with seller whether SSD is payable	0.5	
Agree with seller who will bear the SSD	0.5	
BSD not applicable	0.5	
	<u>13</u>	10
(ii) Tax implications if shares are acquired		
Rental income subject to both property tax and profits tax	0.5	
Property tax calculated in the same way as an individual	0.5	
Business includes letting or sub-letting by a corporation	0.5	
The company is carrying on a business of property letting	0.5	
Exempt from property tax under s.5(2)(a)	0.5	
Or property tax set off against profits tax under s.25	0.5	
Revenue expenses and commercial building allowance deductible	0.5	
Loss carried forward under profits tax	0.5	
Two-tiered profits tax rate	0.5	
Shares in the company are Hong Kong stock	0.5	
Prepare and stamp contracts notes and instrument of transfer	1.0	
Stamp duty also payable on the transfer of shareholder's loan	0.5	
Stamp duty payable is \$36,000	0.5	
\$18,000 payable by Simon much lower than \$1.5m or \$2.7m	0.5	
Requirement for all facts to be in the instrument of transfer	1.0	
Potential consequences of having two separate documents	1.0	
	<u>9.5</u>	8
(b) Reporting obligations		
Inform cessation of source of income within one month	1.0	
Inform within one month of departure for a period of more than one month	1.0	
Except vacation or business trips	0.5	
	<u>2.5</u>	<u>2</u>
		20

(a) (i) Share option – taxability for salaries tax		
General assessability rule	1·0	
Benefit is HK-sourced	0·5	
Specific rule for share option under s.9(1)(d)	1·0	
Taxable gain calculation basis upon exercise	1·0	
Taxable gain calculation basis upon assignment/release	1·0	
Disposal gain disregarded	0·5	
HK-sourced if HK employment when granted	1·0	
Unless all services rendered outside HK	0·5	
Vesting period irrelevant unless change of source of employment	0·5	
Moore is likely taxable upon exercise/assignment/release	0·5	
	<u>7·5</u>	7
(ii) Share option – deductibility for profits tax		
General deduction rule under s.16(1)	1·0	
Staff cost deductible if in the production of assessable profits	0·5	
If whole of Moore's services for Uni-HK, fully deductible	0·5	
If only partly for Uni-HK, partly deductible unless recharge	1·0	
Holding's recharge: whether actual expense and incurred	1·0	
Holding's recharge deductible upon exercise of option	0·5	
Holding's recharge must not be excessive	0·5	
Holding's recharge before exercise is provision and not deductible	1·0	
Subsequent write-back is taxable	0·5	
Written recharge agreement	0·5	
Anti-avoidance challenge	0·5	
	<u>7·5</u>	7
(b) (i) Salaries tax – taxability for salaries tax		
General scope of charge under s.8	0·5	
Definition under s.9 to include perquisite	0·5	
Convertible into cash and discharge of employee's liability	1·0	
Obligation to pay falls on Moore	0·5	
Discharge of Moore's personal liability	0·5	
Taxable	0·5	
	<u>3·5</u>	3
(ii) Salaries tax – deductibility for profits tax		
General deduction rule under s.16(1)	0·5	
Not precluded under s.17	0·5	
Staff cost to produce assessable profits are deductible	0·5	
Contractually bound by employment contract	0·5	
S.17(1)(g) refers to company's tax, not employee's salaries tax	1·0	
	<u>20</u>	