Specimen Exam

Exam Name: Taxation Advisory Professional (STA HKG)
Time Allowed: 3 hours 15 minutes
Pass Mark: 50%

This examination contains 2 sections:

Section A:
1 question, worth 50 marks

Section B:
2 questions, each worth 25 marks

Total 100 marks

Note: This specimen examination has been prepared based on legislation passed by 30 September 2025 (to be updated).

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Section A

Question 1

You should assume that today's date is 1 December 2026.

You are an ACCA student working for a firm of tax consultants. Your tax manager, Jenny Ko, has had a virtual meeting with the chief executive officer (CEO) of Summer (HK) Ltd (the Company), a client of your firm.

During the meeting, the CEO advised that he is reviewing different cash-generating measures suggested by senior management with the aim of resolving the Company's cashflow difficulties. Jenny has asked for your assistance in preparing a report for the Company advising on the related tax issues on these suggested measures.

The following **exhibits** provide information relevant to the question:

1. Summer (HK) Ltd – note of meeting between the Company's CEO and your tax manager regarding additional funding requirements to be met by either debt or equity financing and/or the disposal of a warehouse
2. Accounting date proposal – email from the Company's finance director to the CEO regarding a proposed change of accounting date
3. Staff termination proposal – memorandum from the Company's human resource director regarding a proposed termination of a senior manager of the Company and associated termination payment
4. Work to be carried out – email from manager on the work to be carried out

1 Summer HK Ltd

Note of meeting between the Company's CEO and Jenny (tax manager) on 28 November 2026

Cashflow difficulties

Summer (HK) Ltd (the Company) was incorporated in Hong Kong on 1 January 2002 by Mr and Mrs Chao, who are both permanent residents in Hong Kong. The Company carries on business in Hong Kong in buying and selling cleaning products. The Company's business has been declining in recent years and is currently suffering a shortage of cash. The Company's chief executive officer has held an urgent meeting with the senior management to discuss effective cash-generating measures, to resolve the cash flow difficulties.

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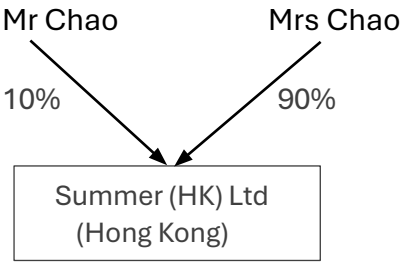
Ideas stemming from the meeting are:

- Additional funding from shareholder
- Disposal of warehouse complex
- Change of accounting date
- Termination of senior manager

Additional funding from shareholder

Mrs Chao, the major shareholder (90% shareholding) of the Company, proposed that she would be prepared to make a cash injection into the Company of $5 million. She is, however, not certain whether the injection should take the form of a loan or equity. Mrs Chao will be financing the cash injection by way of a personal bank loan. If the loan route is to be chosen, she would be seeking an interest rate which is comparable to market rate.

The current holding structure is shown below:



Disposal of warehouse complex

The Company currently owns a warehouse complex in Tuen Mun, Hong Kong, which has been used for storing its inventory, before delivering to customers. The complex was acquired in 2008.

The chief operating officer reported that the usage of the complex in recent years has been declining. The Company may consider disposing of the complex and moving the storage function into another leased warehouse. He believes that the current saleable value of the complex (land and building) is around $22 million. However, given the deteriorating condition of the complex, he proposed that the complex be demolished and only the piece of land be offered for sale. This should attract more attention from developers and could increase its saleable value.

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2 Accounting date proposal

Extract of email received from the Company's finance director, dated 28 November 2026

I'm particularly concerned about the forthcoming due date for making a tax payment for the year of assessment 2025/26 and provisional tax payment for 2026/27.

The Company currently closes its accounts on 31 March. In the projected income statement for the year ending 31 March 2027 made in September 2026, the Company will have incurred a tax loss of $1·8 million for the year 2026/27.

However, in the recent November projection, the Company shows an unexpected estimated annual profit of $2·2 million, which is due to a special profitable project that is scheduled to be signed in January 2027 and take effect a month later.

The special project means the Company will make a profit, resulting in the Company being required to pay both final tax for 2025/26 and provisional tax for 2026/27, which is to be due in the coming month.

If the Company maintains a tax loss position for 2026/27, the Company will be able to hold over the provisional tax payment for 2026/27, thereby easing the cash flow burden.

There is one solution to this. The Company may change its financial year-end date from 31 March to 31 December, effective in 2026. The Company will then close its current year's accounts on 31 December 2026 covering a period of nine months (1 April 2026– 31 December 2026). This nine-month period will be the basis period for the year of assessment 2026/27, reporting a tax loss of around $2 million. The profit arising from the special project will fall within the subsequent year ending 31 December 2027, i.e. year of assessment 2027/28.

As long as documentation is available to support the change, I do not anticipate any challenge from the Inland Revenue Department (IRD).

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3 Termination payment

Extract from a memorandum from the Company's human resource director, dated 27 November 2026

Brian, one of the senior managers of the Company, has been serving Summer (HK) Ltd since 1 January 2002. Brian is receiving the highest pay amongst those at the same grade, but he is approaching his retirement age with declining productivity. It is proposed that Brian's employment be terminated in January 2027 upon serving sufficient notice, and the following final payment be paid in addition to the last month's salary:

1. Payment for leave not taken amounting to $50,000, including some leave days brought forward from 2025; and
2. An estimated amount of $150,000 representing his bonus entitlement in respect of the financial year 2026. This amount is estimated based on last year's payment. The final figure will be available in April 2027. Should the final figure exceed the payment of $150,000, the top-up will be paid to Brian in mid-April 2027. If, however, the final figure is lower than $150,000, the difference will not be pursued as a usual practice of the Company.

In an earlier casual discussion with Brian, he was ready to accept early retirement but indicated that he would like his termination payment to be packaged as one lump sum 'compensation for loss of office' paid in pursuance to a termination agreement without showing the details of the components of the compensation. Brian believes that this will enable him to claim the total payment as not assessable to tax in Hong Kong.

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4 Work to be carried out

Email from your manager

To: Tax assistant
From: Jenny Ko, Tax manager
Date: 1 December 2026
Subject: Summer (HK) Ltd

Hi

Please prepare a report for the Company addressing each of the following issues:

(a) Mrs Chao's proposal to provide additional funding to the Company

Evaluate the tax implications for both the Company and Mrs Chao, arising from the two different forms of additional funding under consideration (interest-bearing loan and equity funding) and recommend the best course of action, from the Company's perspective, in view of its cash flow difficulties.

(8 marks)

(b) Disposal of warehouse complex

Evaluate the tax implications for the Company arising from the disposal of the warehouse complex as proposed by the chief operating officer.

(8 marks)

(c) In relation to the finance director's proposal that the Company should change its accounting date from 31 March 2027 to 31 December 2026:

- **Advise on the position which will be taken by the Inland Revenue Department (IRD) when assessing the Company for the year of assessment 2026/27 and its preceding year; and**

- **Evaluate the appropriateness of the proposal by the finance director and his opinion that no challenge from the IRD would be expected and recommend any alternative action(s) the Company could take.**

Note: A computation of the Company's assessable/adjusted profits as a result of the change of accounting date is NOT required.

(12 marks)

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(d) Termination of senior manager

In respect of the human resource director's proposal that the Company should terminate a senior manager, Brian, evaluate:

- **The tax deductibility of the final payments to be made to Brian from the Company's perspective;**
- **The assessability of each item of the final payments to be received by Brian; and**
- **The effectiveness of Brian's suggestion to package the final payments as a lump sum payment for 'compensation for loss of office.'**

(12 marks)

I look forward to receiving your report.

Jenny

Requirement:

You should assume that today's date is 1 December 2026.

Prepare a report which addresses the instructions in the email from your tax manager.

Note: the split of the mark allocation is shown in Exhibit 4 – Work to be carried out.

(40 marks)

Professional marks will be awarded for the demonstration of skill in communication, analysis and evaluation, scepticism, and commercial acumen in your answer.

(10 marks)

(50 marks)

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Section B

Question 2

You should assume that today's date is 1 December 2026.

Eddie is soon to retire and is seeking advice in respect of the exercise of share options and the receipt of consultancy fees and gratuities from a consultancy agreement. He is also seeking advice in respect of stamp duty on the acquisition of assets or shares in a company, Anara Ltd.

The following **exhibits** provide information relevant to the question:

1. Eddie – details of the exercise of a share option and consultancy agreement.
2. Anara Ltd – details regarding Eddie's potential acquisition of assets or shares in the company

1 Eddie

Eddie has been working in Hong Kong for a company resident in Hong Kong, Brilliant Ltd (Brilliant), at an annual salary of $840,000, and he contributes 5% of his salary to the mandatory provident fund. He will retire on 1 January 2027. Eddie is married to Susan, who is a housewife.

Eddie was granted an option to acquire 10,000 shares in Brilliant at $5 each, out of which 5,000 shares had been acquired during 2024/25. He plans to acquire the balance of the shares either before his retirement on 1 January 2027, or after Brilliant's announcement of its results in April 2027. The market value of the shares on 1 December 2026 is $12, and it is expected that the share price will remain the same following the announcement of results.

Upon his retirement, Eddie will sign a two-year consultancy agreement with Brilliant commencing on 1 April 2027 and will receive consultancy fees on an ad hoc basis.

The estimated fee income per annum from the consultancy agreement is $200,000, and Eddie will incur allowable expenses of $30,000. At the expiry of the consultancy agreement, subject to Brilliant's satisfaction with his service, Eddie may be entitled to a gratuity of $40,000.

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2 Anara Ltd

Eddie is negotiating to acquire the business of a company incorporated in Hong Kong, Anara Ltd (Anara). The consideration will be based on the agreed market value of the net assets ($55 million) of Anara:

	$
Assets:	
Shop premises in Hong Kong	50,000,000
Plant and machinery	6,500,000
Inventory	4,500,000
Trade receivables	2,500,000
	63,500,000
Liabilities:	
Trade creditors	(3,500,000)
Shareholder's loan	(5,000,000)
Net assets	**55,000,000**

Eddie has been offered two different options for acquiring the business:

Option 1
To acquire all the assets of Anara for $63.5 million.

Option 2
To acquire all the shares in Anara for $55 million, comprising cash of $50 million and assignment of the shareholder's loan of $5 million. A separate assignment deed will be executed for the assignment of the shareholder's loan.

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Requirements:

You should assume that today's date is 1 December 2026.

(a) Evaluate whether it would be beneficial from a tax perspective for Eddie to exercise the balance of his share options on 1 January 2027, instead of April 2027.

(4 marks)

(b) Advise Eddie on his Hong Kong tax position, as a consequence of any consultancy fees and gratuity received after his retirement, including any recommendations which would improve the tax effectiveness of this arrangement.

(8 marks)

(c) Advise Eddie on the stamp duty cost of Option 1 and Option 2 in relation to the acquisition of Anara Ltd.

(8 marks)

Professional marks will be awarded for the demonstration of skill in analysis and evaluation, and commercial acumen in your answer.

(5 marks)

(25 marks)

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Question 3

You should assume that today's date is 1 December 2026.

You have been asked to provide advice to the group, comprising Pearl (HK) Ltd (PHK) and Pearl (China) Ltd (PCL), in relation to the transfer pricing risk to PHK and the double tax position of the group including relief for PHK.
The following **exhibits** provide information relevant to the question:

1. Background - the group's operations and transactions between PHK and PCL
2. Tax investigation – details of the tax investigation on PCL by the China tax authority, including adjustments made
3. PHK 2024 – income statement extract

1 Background

Pearl (HK) Ltd (PHK) was incorporated in Hong Kong and is carrying on business in Hong Kong as a trader of recycled paper.

PHK has a wholly owned subsidiary in China, Pearl (China) Ltd (PCL), which was incorporated in China and is carrying on business in China as a manufacturer.

PHK buys the recycled paper from Hong Kong and sells the paper to PCL and other Asian countries.

According to the group's internal policy, the sale of recycled paper from PHK to PCL is invoiced at 20% above market price.

All income earned by PHK and PCL are assessed to tax in Hong Kong and China respectively.

2 Tax investigation

In recent months, PCL was notified by the China tax authority that a tax investigation is to be conducted on its 2024 position, alleging that its reported profits were understated due to excessive pricing for raw materials imported from PHK.

As a consequence, a transfer pricing adjustment will be made by the China tax authority leading to additional China corporate tax payable by PCL. A penalty will also be imposed.

An extract from the income statement of PCL for 2024, together with associated tax adjustments to be made by the China tax authority are shown below:

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Income statement (extract) for 2024 (Pearl (China) Ltd)

	In HK$ million	Tax adjustments by China Tax Authority In HK$ million	Note
Sales in China	200		
Purchases from Hong Kong	(120)	-20	Cost base is revised downward to a level comparable to market
Purchases from other sources	(30)		
Gross profit	**50**	+20	
Net income per accounts	15	+20	
Taxable income	15	+20	
Additional taxable income		20	
Additional tax payable in China		5	

3 PHK 2024

Income statement (extract) for 2024 (Pearl (HK) Ltd)

	In HK$ million
Sale to Pearl (China) Ltd	120
Sales to other countries	50
Purchases in Hong Kong	(130)
Gross profit	**40**
Net income per accounts	40
Assessable profit for Hong Kong tax	40

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Requirements:

You should assume that today's date is 1 December 2026.

(a) Making reference to the transfer pricing rules and regulations, evaluate whether Pearl (HK) Ltd (PHK) is at risk of being challenged by the Hong Kong Inland Revenue Department (IRD) on the sales made to Pearl (China) Ltd (PCL), leading to a tax adjustment to PHK's assessable profits.

Notes:

1. For this part only, you should ignore the tax adjustment made by the China Tax Authority to PCL as shown in Exhibit 2.
2. You may make reference to PHK's income statement for 2024 for illustration purposes.

(9 marks)

(b) In view of the tax adjustment made to PCL for 2024, assess the overall tax position of the group (PHK and PCL) and recommend any possible actions which may be taken by PHK to release the group's double taxation burden.

Note:

You should make reference to the relevant content under the PRC-HK double taxation arrangement (DTA) and relevant Departmental Interpretation and Practice Notes issued by the IRD.

(11 marks)

Professional marks will be awarded for the demonstration of skill in analysis and evaluation, and commercial acumen in your answer.

(5 marks)

(25 marks)

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