

Published in 2012 by
Pearson Education Asia Limited
18th Floor, Cornwall House
Taikoo Place
979 King's Road
Quarry Bay
Hong Kong

Publishing Director: *Mark Cohen*
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Pearson Asia Pacific offices: Bangkok, Beijing, Ho Chi Minh, Hong Kong, Jakarta, Kuala Lumpur, Manila, Seoul, Singapore, Taipei, Tokyo

Printed in China (SWTC/01)

4 3 2 1
15 14 13 12

ISBN 978-988-224-396-5

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Preface to the First Edition

The purpose of this book is to provide materials for students to prepare for Paper 11(H) of Tax Planning (Module E of Professional Stage) of the HKSA/ACCA Joint Scheme Examination (now Paper P6 (HKG) Advanced Taxation (Hong Kong) of the ACCA Examination). This book covers in full Paper 11(H) (now Paper P6 (HKG) Advanced Taxation (Hong Kong)) and Paper 7(H) of Tax Framework (now Paper F6 (HKG) Taxation (Hong Kong)).

At the end of each chapter, there are past ACCA/HKSA examination questions with suggested answers. In addition, there are a number of discussion questions; answers are not provided for these questions. The purpose of these questions is to enable course tutors to use them as exercises or for class discussion.

The materials in this book are based on those prepared for revision courses for Paper 11(H) (now Paper P6 (HKG) Advanced Taxation (Hong Kong)) which have been taught by the authors for a number of years. The authors are grateful to the students of these courses for their helpful suggestions and support.

This book includes relevant legislation and cases up to 1 May 1994.

Acknowledgements are due to the Hong Kong Society of Accountants for permission to reproduce the examination questions from their past papers. The answers to some of these questions are reproduced from the answers published by the Society. Finally, the families of the authors are acknowledged for their moral support and forbearance.

Dora Lee

C M Ho

Hong Kong

August 1994

Preface to the Fifteenth Edition

Since the publication of the Fourteenth edition, there have been some changes in tax law and practice. Some of the significant developments are summarised below for ease of reference:

Court Cases

The Court of Appeal has decided the following case:

- *CIR v C G Lighting Ltd* (2011) CACV 119/2010 — the Court of Appeal upheld the decision of the Court of First Instance that the taxpayer's profits arising from the sale of goods manufactured in the Mainland were chargeable to profits tax. The taxpayer's applications for leave to appeal to the Court of Final Appeal were rejected by the Court of Appeal and the Court of Final Appeal.
- *Chan Chun Chuen v CIR* (2012) CACV 113/2011 — the Court of Appeal overturned the decision of the Court of First Instance that the CIR had acted unreasonably in refusing to grant an extension of time for the taxpayer to lodge his objections.

The Court of First Instance has decided the following cases:

- *Aviation Fuel Supply Company v CIR* (2011) HCIA 6/2009 — the lump sum received by the taxpayer was held not taxable.
- *CIR v Li & Fung (Trading) Ltd* (2011) HCIA 3/2010 and *Li & Fung (Trading) Ltd v CIR* (2011) HCIA 1/2010 — the commission received by the taxpayer was held not taxable.
- *Nice Cheer Investment Ltd v CIR* (2011) HCIA 8/2007 — the unrealised gain in respect of shares held for trading was held not taxable.
- *Kong Tai Shoes Manufacturing Co Ltd v CIR* (2011) HCAL 34/2011 — the taxpayer's application to quash the relevant assessments and the CIR's holdover decision was refused. The CIR was ordered to determine the relevant objections by a certain date.

The above cases are under appeal.

Departmental Interpretation and Practice Notes

The IRD has updated:

- *DIPN 25* Service company "Type I" arrangements — Salaries Tax
- *DIPN 31* Advance rulings
- *DIPN 32* Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the avoidance of double taxation on income

Stamp Office Interpretation and Practice Notes

The IRD issued *SOIPN 5* Special Stamp Duty in July 2011 and revised it in October 2011.

Legislative Changes

2010/11 Budget Proposals Enacted into Law

Affecting the assessments for 2010/11 only

75% of the final tax payable in respect of salaries tax and tax payable under personal assessment would be waived, subject to a ceiling of \$6,000 per case.

Affecting the assessments for 2011/12 and thereafter

The changes to personal allowances and deduction for elderly residential care expenses have been incorporated in the table "Summary of Deductions, Tax Rates and Personal Allowances" on page xvi.

Others

The major legislative changes brought about by the:

- *Inland Revenue (Amendment) Ordinance 2011* — concessions for short-term debt instruments;
- *Inland Revenue (Amendment) (No. 3) Ordinance 2011* — taxation for intellectual property rights; and
- *Stamp Duty (Amendment) Ordinance 2011* — imposition of special stamp duty

have been incorporated in the relevant chapters.

Proposed Legislative Changes

The changes to personal allowances, and deduction for home loan interest, elderly residential care expenses and contributions to recognized retirement schemes as proposed by the Financial Secretary in his Budget Speech for 2012/13 have been incorporated in the table "Summary of Deductions, Tax Rates and Personal Allowances" on pages xvi-xviii.

Comprehensive Double Taxation Agreements (CDTAs)

Hong Kong has signed new CDTAs with Portugal, Spain, Czech Republic, Malta and Jersey. These CDTAs have incorporated the 2004 version of Exchange of Information Article of the Organisation for Economic Cooperation and Development. Hong Kong has signed another CDTA with Switzerland to replace the previous CDTA.

monthly salary of \$40,000. In addition, he was entitled to quarters and moved to a flat owned by his employer at Cloud View Road. Mr Yu had to pay a monthly rent of \$1,000 to his employer.

In October 2010, Mr Yu was given an option to purchase shares in Universal Electronic Incorporation, which is an American company. This option was granted by Citipacific Ltd. without consideration. Under the option, he was allowed to purchase 2,000 shares in Universal Electronic Incorporation at the price of US\$4 each. He exercised the option on 15 October 2010. The price quoted on the New York Stock Exchange for Universal Electronic Incorporation at that date was US\$7.50. The exchange rate on 15 October 2010 was US\$1 = HK\$7.80.

Mr Yu has a widowed mother, aged 55, who was claiming disability allowance from the Social Welfare Department and who lived with him from the time Mr Yu returned from Canada. Mr Yu left his mother when he moved into the quarters, and he has contributed \$3,000 per month to her since then. During the YA 2010/11, he donated \$5,000 to the Hong Kong Community Chest and contributed \$12,000 to a mandatory provident fund scheme.

Mr Yu's wife, Mrs Yu, made the following approved charitable donations in cash:

5 March 2010	\$6,000
1 June 2010	\$4,000
1 October 2010	\$1,000
2 January 2011	\$1,000

Mrs Yu contributed \$4,800 to a mandatory provident fund scheme during the year ended 31 March 2011.

Required:

Compute the salaries tax liabilities of Mr and Mrs Yu for the YA 2010/11 to their best advantage. Advise if it is advantageous for them to elect for joint assessment.

Further Reading

- *Departmental Interpretation and Practice Notes*, No. 18, January 2005.

Chapter

6

Property Tax

Key Points

These are:

- scope of charge
- assessable value
- net assessable value
- calculation of property tax
- provisional property tax

Objectives

After studying this chapter, you should be able to:

- identify the persons chargeable to property tax
- identify the properties chargeable to property tax
- explain the scope of charge of property tax
- explain the assessable value
- explain the net assessable value
- compute the property tax liability
- explain the relief available to an owner of property whose rental income is chargeable to both property tax and profits tax
- explain the statutory requirements for keeping rent records
- explain how the provisional property tax is ascertained
- explain the procedures to claim holding-over of payment of provisional property tax

Scope of Charge

1. Property tax is charged for each YA on every person being the owner (擁有人) of any land and/or buildings situated in Hong Kong. The amount of property tax is computed at the standard rate on the net assessable value (應評稅淨值) of the chargeable property (s 5(1)).

Chargeable Property

2. All land (土地) and buildings (建築物) situated in Hong Kong, including the New Territories, are chargeable to property tax.
3. Land and buildings include piers, wharves and other structures. Buildings include any part of a building (s 7A). Thus, letting of part of a flat (e.g., a room) will create a property tax liability. Structures include walls, dams, car parks, bridges, roads, ponds, sewers, etc.

Owners of Land and/or Buildings

4. Owners of land and/or buildings include (s 2(1)):
 - a person holding land and/or buildings directly from the HKSAR Government;
 - a person who acquires ownership of the land and/or building from the person mentioned above by an assignment or conveyance;
 - a beneficial owner;
 - a mortgagor;
 - a mortgagee in possession;
 - a person with adverse title to land who is receiving rent from buildings or other structures erected on the land;
 - a person who is making payments to a co-operative society registered under the *Co-operative Societies Ordinance* for the purpose of the purchase thereof;
 - a person who holds land and/or buildings subject to a ground rent or other annual charge;
 - (in so far as common parts (公用部分) are concerned) –
 - a corporation registered under s 8 of the *Building Management Ordinance* (Cap 344) or
 - a person who,
 - (i) on the person's own behalf, or
 - (ii) on behalf of another person,

receives any consideration, in money or money's worth, in respect of the right of use of any common parts solely or with another; and

- an executor of the estate of an owner.

➤➤ Example 1

Mr Chan rents a piece of land from the HKSAR Government and uses the land as a car park for rental income. He is an owner for property tax purposes because he is a lessee of the HKSAR Government. The rental income which he derives from the letting of the land is subjected to property tax.

➤➤ Example 2

Mr A Wong sets up a trust whereby he appoints Mr Luk as a trustee to hold his flat at South Horizons for the benefit of his son, Mr B Wong, for Mr B Wong's life. Though Luk's name appears in the Land Office as the registered owner of the flat at South Horizons, the declaration of trust executed by Mr Luk will show that he is only holding the property for the benefit of the life tenant, Mr B Wong. Mr B Wong, the person holding the equitable interest in the flat, will be regarded as the owner for property tax purposes.

➤➤ Example 3

By his last will made in 2009, Mr S Cheung appointed Mr Ho to be the executor of his estate and gifted all his properties, including a flat in Kowloon, to his son Mr T Cheung. The flat has been let for rental income since 1 April 2007. Mr S Cheung died on 15 February 2010. The flat was distributed by Mr Ho to Mr T Cheung on 1 May 2012.

Mr S Cheung was an owner for property tax purposes in respect of the rental income for the period from 1 April 2008 to 15 February 2010 (the date of death). Mr Ho, as the executor of the deceased's estate, was chargeable to property tax in respect of the rental income for the period from 16 February 2010 to 30 April 2012. Mr T Cheung has been the beneficial owner of the flat since 16 February 2010. As the flat was distributed to Mr T Cheung on 1 May 2012, Mr T Cheung is liable to property tax in respect of rental income derived from 1 May 2012.

5. In *D 27/98*, the incorporated owners of a building objected to a property tax assessment relating to rental income or licence fee derived from car parking spaces, which formed part of the common areas to which all owners of the building had the right to use. The income was deposited into the management fund of the building. The BoR held that the incorporated owners were liable to property tax because:

- the definition of 'owner' for the purpose of property tax should include an incorporated owner; and

- the incorporated owners should be considered the owners because they have the right to let out commonly-owned car parks.

OWNERS EXEMPT FROM PROPERTY TAX

6. The following owners of land and/or buildings are exempt from property tax:
- the Hong Kong SAR Government;
 - consular — for property used for consular purposes or residence of consular employees; and
 - approved charitable institutions or trusts of a public character (s 88).

Computation of Property Tax

7. Property tax is computed at the standard rate on the net assessable value of land and/or buildings for the YA concerned (s 5(1)).
The property tax on a property is computed as follows:

Assessable value (s 5B and s 7C(2))	A
Less: Irrecoverable consideration (bad debt) (s 7C)	B
Assessable value after deduction of bad debt	C
Less: Rates paid by owner (s 5(1A)(b)(i)) where the owner agreed to pay the rates	D
Assessable value after deduction of rates	E
Less: Statutory deduction at 20% (s 5(1A)(b)(ii))	F
Net assessable value (s 5(1A))	G
Property tax thereon at the standard rate (s 5(1))	H

Assessable Value

8. The assessable value of a property for a YA is the consideration (代價), in money or money's worth, payable in that year to, to the order of or for the benefit of the owner in respect of the right of use of that land or buildings or land and buildings (s 5B(2)).

In *D 55/01*, T, an owner of a property allowed his mother to let the property out and keep the rent received for her maintenance. The Board held that T, as owner, was chargeable to property tax.

9. Consideration in money's worth is subject to property tax. The assessable amount of a non-monetary consideration is its convertible value or open market value.
10. Consideration includes any consideration payable in respect of the provision of any services or benefits connected with, or related to, the right of use of the land and/or buildings. For example, if the landlord provides management services such as a watchman, cleaning, etc., and charges the tenant a management fee, this fee is subject to property tax.
11. The assessable value therefore includes the following:
- rent;
 - payments for the right of use of premises under licence (e.g., car park fee, advertisements on the wall or roof of a building);
 - payment for the right of use of furniture in the premises;
 - service charges, management fee, etc., paid to the owner; and
 - lump sum premium (*DIPN 14* (Revised), para 9).
12. Premiums on leases are frequently referred to as non-returnable deposits, key or tea money, construction fees, tenancy rights or other terms (*DIPN 4* (Revised), para 1). In a property-letting or dealing business, a lease premium is part of a payment for the use of the property and therefore is an income of a revenue nature (*DIPN 4* (Revised), para 4) and so chargeable to profits tax also (see Chapter 11).
13. If the management fee is the liability of the tenant, the fee will not be included in the assessable value. However, if the management fee is the liability of the landlord and the tenant pays the fee to the landlord, the fee will form part of the assessable value. The landlord will only be entitled to the statutory deduction of 20% and cannot receive deductions for actual expenses incurred by him for management, repairs and maintenance.
14. In *D 48/07*, licence fees for allowing telecom companies to install equipment and antennae at the common areas of the residential blocks of a building were held to be within the definition of assessable values.

SPREADING OVER OF LUMP SUM PREMIUMS

15. Any consideration payable for a period of more than one YA is deemed to be payable in equal monthly instalments during the period for which it is paid up to a maximum of three years (s 5B).

Chapter

14

*Profits Tax: Basis Period,
Provisional Profits Tax and Losses*

Key Points

These are:

- basis period
- provisional profits tax
- losses

Objectives

After studying this chapter, you should be able to:

- determine the basis period for the YA of a continuing business
- determine the basis period for the year of commencement of a business
- determine the basis period for the year of cessation of a business
- explain how provisional profits tax is computed
- explain how provisional profits tax is used
- explain the procedures for claiming holding-over the payment of provisional profits tax
- explain the treatment of losses for different types of business

Normal Basis Period

1. The normal basis period for computing assessable profits for a YA is the actual profits of the accounting period ending in the YA (s 18B(2)). Where the accounts are made up to 31 March, the basis period is the YA (s 18B(1)).

➤ Example 1

A Ltd. has been carrying on business for a number of years and prepares its accounts up to 31 March each year. Its basis period for the YA 2011/12 is from 1 April 2011 to 31 March 2012 (s 18B(1)).

If A Ltd. prepares its accounts up to 31 December each year, its basis period for the YA 2011/12 is from 1 January 2011 to 31 December 2011 (s 18B(2)).

COMMENCEMENT

2. The basis period of the YA in which a business commences depends on whether the first accounting date ends in the year of commencement or the following YA.
3. If the first accounting date ends in the year of commencement, the basis period is the period from the date of commencement to the first accounting date (s 18C(1)(a)).

➤ Example 2

B Ltd. commenced business on 1 May 2011 and its first accounting date ended on 31 January 2012. Its basis period for the YA 2011/12 is from 1 May 2011 to 31 January 2012. In this case, both the commencement date and first accounting date fall within the YA 2011/12.

4. Where the first accounting date ends in the following YA and the first accounting period is not more than 12 months, then:

- there shall be no assessment for the year of commencement; and
- the basis period for the following YA is from the date of commencement to the first accounting date (s 18C(2)).

➤ Example 3

C Ltd. commenced business on 1 January 2011 and its first accounting date was 31 December 2011. There would be no assessment for the YA 2010/11. The basis period for the YA 2011/12 is from 1 January 2011 to 31 December 2011.

5. Where the first accounting date ends in the following YA and the first accounting period is more than 12 months, the assessable profits shall be computed for the first YA on such basis as the CIR thinks fit (s 18C(1)(b)). Normally, for the year of commencement, the IRD will choose the period from the date of commencement to the corresponding accounting date in the year of commencement.

➤➤ *Example 4*

D Ltd. commenced business on 1 January 2011 and its first accounting date was 31 March 2012. Its adjusted assessable profit for the 15 months from 1 January 2011 to 31 March 2012 was \$15,000. As the first accounting period was over 12 months, it is likely that its first YA is 2010/11 and the corresponding basis period is from 1 January 2011 to 31 March 2011, while its second YA is 2011/12 and the corresponding basis period is from 1 April 2011 to 31 March 2012.

D Ltd.
Year of assessment 2010/11
Basis period: 1 January 2011 to 31 March 2011

$$\text{Assessable profit } \$15,000 \times \frac{3 \text{ months}}{15 \text{ months}} = \$3,000$$

Year of assessment 2011/12
Basis period: 1 April 2011 to 31 March 2012

$$\text{Assessable profit } \$15,000 \times \frac{12 \text{ months}}{15 \text{ months}} = \$12,000$$

CESSATION

6. The basis period for the YA in which the business ceases depends on whether the business commenced on or after 1 April 1974.

New businesses

7. For businesses which commenced on or after 1 April 1974, the basis period is the period from the day following the basis period for the preceding YA to the date of cessation (s 18D(1)). (Note: Over 12 months' profit may be assessed.)

➤➤ *Example 5*

F Ltd. commenced business on 1 May 1989 and prepared its accounts to 31 December each year. It ceased business on 30 November 2011. Its last YA was 2011/12 and the basis period was from 1 January 2011 to 30 November 2011. Its preceding YA was 2010/11 with the corresponding basis period of 1 January 2010 to 31 December 2010.

➤➤ *Example 6*

F Ltd. commenced business on 1 January 1994 and prepared its accounts to 31 December each year. It ceased business on 31 March 2012. Its last YA was 2011/12 and the basis period was 15 months from 1 January 2011 to 31 March 2012. Its preceding YA was 2010/11 with the corresponding basis period of 1 January 2010 to 31 December 2010.

Old businesses

8. For businesses which commenced before 1 April 1974, there are two sets of rules for determining the last basis period on cessation of business.

Businesses which ceased before 1 April 1979

9. The basis period is 1 April in the YA to the date of cessation (s 18D(2)) if:
- there is no successor to the business; or
 - there is a successor to the business, but the cause of cessation was the death of the proprietor (s 18D(2) proviso).

➤➤ *Example 7*

G Ltd. commenced business on 1 January 1972 and made up its accounts to 31 December each year. It ceased business on 30 November 1978 and had no successor. Its adjusted profit for the period from 1 January 1978 to 30 November 1978 was \$121,000. It ceased business during the YA 1978/79 and the corresponding basis period was eight months from 1 April 1978 to 30 November 1978.