

Chapter 2

Compliance, Returns and Assessments

Learning Objectives

After having studied this chapter, you would:

- a. understand the obligations of a taxpayer under the Inland Revenue Ordinance (IRO);
- b. understand the obligations of an employer under the IRO;
- c. understand the powers of the Commissioner to obtain information and documents under IRO;
- d. understand the procedures for the issue of assessment and additional assessment;
- e. understand the procedures for the issue of notice for payment of provisional tax; and
- f. understand the importance of notification of change of address.

I Introduction

1. Introduction to tax administration

Tax administration is the rules governing the obligations and rights of a taxpayer under the Inland Revenue Ordinance (IRO). It includes the following:

- a. obligations of a person as a taxpayer for income tax and as an employer,
- b. issue of return and assessment,
- c. taxpayer's right to objection, appeal, correction of error and holdover of provisional tax,
- d. investigation of a taxpayer's affairs, and
- e. offence and penalty.

The above items will be covered in Chapters 2 to 5.

2. It is a rule of law that ignorance of law is not an excuse for not observing the law. There are some conditions set out in the Inland Revenue Ordinance (IRO) that a taxpayer has to observe and comply with. If a taxpayer does not comply with the provisions of the IRO, he or she may be liable to penalty or even imprisonment.
3. Most of the compliance requirements are contained in Sections 51 and 52 of the IRO concerning the reporting responsibilities of a person (including an individual, a partnership, a corporation, a trustee or a body of person). The Commissioner's power of investigation is contained in Sections 51(4)(b), 51A and 51B.

II Obligations of a Taxpayer

4. Section 51 imposes the following major obligations on a taxpayer:
 - a. to complete tax returns issued by an assessor within the time stated in the return – Section 51(1);
 - b. to notify the Commissioner of the chargeability of tax not later than 4 months after the end of the basis period for that year of assessment – Section 51(2);
 - c. to reply to the enquiries raised by an assessor in respect of the returns filed by the taxpayer – Section 51(3);

- d. to reply to the enquiries raised by an assessor in respect of other persons – Section 51(4)(a);
- e. to notify the Commissioner of the cessation of income within 1 month of such cessation – Section 51(6);
- f. to notify the Commissioner of the departure from Hong Kong for more than 1 month not later than 1 month before the expected date of departure – Section 51(7);
- g. to inform the Commissioner in writing of the change of address within 1 month – Section 51(8);
- h. to keep records of business income for 7 years after the completion of the transaction – Section 51C; and
- i. to keep records of income from properties for 7 years after the completion of the transaction – Section 51D.

5. **Keeping business records**

Section 51C requires every person carrying on a trade, profession or business in Hong Kong to keep sufficient business records for a period of not less than 7 years after the completion of the transactions, to which they relate.

The records:

- a. must be in the *English or Chinese language* of his income and expenditure to enable the assessable profits of such trade, profession or business to be readily ascertained; and
- b. may include *books of account* (whether kept in a legible form, or in a non-legible form by means of a computer or otherwise) recording receipts and payments, or income and expenditure; and *vouchers, bank statements, invoices, receipts*, and such other documents as are necessary to verify the entries in the aforesaid books of account.

6. **Summary of major obligations and related penalties for Section 51**

Section	Obligation	Penalty for Non-compliance
S.51(1)	<i>Complete return</i> within the time limit as requested in the notice from an assessor in writing.	A fine at level 3, and a fine of treble the amount of tax undercharged – S.80(2).
S.51(2)	Notify Commissioner of the <i>chargeability</i> of tax not later than 4 months after the end of the basis period in which the income was derived.	A fine at level 3, and a fine of treble the amount of tax undercharged – S.80(2).
S.51(3)	<i>Answer enquiries</i> , i.e. to furnish fuller or further returns, raised by assessor to support the tax returns.	A fine at level 3 and court order for compliance within the time specified in the order – S.80(1)(a).
S.51(4)(a)	Answer enquiries as a third party.	A fine at level 3 and court order for compliance within the time specified in the order – S.51(4B).
S.51(6)	Notify Commissioner in writing of the <i>cessation of income</i> within 1 month of such cessation.	A fine at level 3 and court order for compliance within the time specified in the order – S.80(1)(c).

S.51(7)	Notify Commissioner in writing of the <i>departure</i> from Hong Kong for any period exceeding 1 month not later than 1 month before the expected date of departure.	A fine at level 3 and court order for compliance within the time specified in the order – S.80(1)(c).
S.51(8)	Notify Commissioner in writing of the <i>change of address</i> within 1 month of such change.	A fine at level 3 and court order for compliance within the time specified in the order – S.80(1)(c).
S.51C	<i>Keep record of business income and expenditure</i> for a period not less than 7 years.	A fine at level 6 and court order for compliance within the time specified in the order – S.80(1A).
S.51D	<i>Keep record of property income</i> for a period not less than 7 years.	A fine at level 3 and court order for compliance within the time specified in the order – S.80(1)(c).

III Obligations of an Employer

7. Section 52 imposes the following obligations on an employer.
 - a. to furnish employer's returns on the details of his or her employees and remuneration paid to each – Section 52(2);
 - b. to notify the Commissioner of the commencement of employment of employees not later than 3 months after the date of commencement of such employment – Section 52(4);
 - c. to notify the Commissioner of the cessation of employment of employees not later than 1 month before such cessation – Section 52(5);
 - d. to notify the Commissioner of the departure of employees leaving Hong Kong for a period of more than 1 month; the notice is to be given not later than 1 month before the expected date of departure – Section 52(6);
 - e. to withhold payment of money to the employee who is to leave Hong Kong for more than 1 month and notice under Section 52(6) has been served to the Commissioner – Section 52(7).
8. **Summary of obligations and penalties for Section 52**

Section	Obligation	Penalty for non-compliance
S.52(1)	<i>Furnish</i> information requested in a notice given by the Commissioner within the time specified in the notice.	A fine at level 3 and court order for compliance within the time specified in the order – S.80(1)(a).
S.52(2)	<i>File employer's return</i> within the time specified in the return.	A fine at level 3 and court order for compliance within the time specified in the order – S.80(1)(a).

S.52(4)	Notify Commissioner in writing of the <i>commencement of employment</i> of staff not later than 3 months after the date of commencement of such employment.	A fine at level 3 and court order for compliance within the time specified in the order – S.80(1)(c).
S.52(5)	Notify Commissioner in writing of the <i>cessation of employment</i> of staff not later than 1 month before such individual ceases to be employed in HK.	A fine at level 3 and court order for compliance within the time specified in the order – S.80(1)(c).
S.52(6)	Notify Commissioner in writing of the <i>departure</i> of staff from HK for more than 1 month not later than 1 month before the expected date of departure.	A fine at level 3 and court order for compliance within the time specified in the order – S.80(1)(c).
S.52(7)	Not to make any payment of money to staff who is leaving HK for a period of 1 month from the date the employer serves the notice to Commissioner under S.52(6).	A fine at level 3 and court order for compliance within the time specified in the order – S.80(1)(c).

IV Powers of the Commissioner to Obtain Information and Documents

9. The Commissioner and his staff are empowered to obtain information from a taxpayer under the following provisions:
- a. an assessor may issue a tax return to a person for completion and return within a reasonable time stated on the tax return – Section 51(1);
 - b. an assessor may give notice in writing to a person requiring him or her to furnish fuller or further returns in respect of matters arising from his own information – Section 51(3);
 - c. an assessor or an inspector may give notice in writing to a person or any other person whom he or she considers may be in the possession of information or documents which may affect any liability, responsibility or obligation of the first named person – Section 51(4)(a);
 - d. an assistant commissioner may give notice in writing to a person requiring him to attend and be examined on questions put to him – Section 51(4)(b);
 - e. the Commissioner or a deputy commissioner may, with the consent of the Board of Review, give notice in writing to a person to furnish a statement of assets and liabilities within a period not less than 30 days if he or she is personally of the opinion that such a person has made an incorrect return or supplied false information having the effect of understating his income or profits chargeable to tax without a reasonable excuse – Section 51A; and
 - f. the Commissioner or an officer not below the rank of chief assessor may apply to the magistrate for a search warrant — Section 51B.

Chapter 14

Scope of Charge

Learning Objectives

After having studied this chapter, you would:

- a. understand the scope of charge of profits tax;
- b. understand the meaning of "trade", "profession" and "business";
- c. understand when activities may amount to carrying on a trade in Hong Kong;
- d. understand when a business is carried on in Hong Kong by a non-resident; and
- e. understand when tax is required to be withheld at the time of making payment to a non-resident.

I Introduction

1. The charge of profits tax may involve many different sections under the IRO. The purpose of this chapter is to explain the first two limbs of Section 14, i.e. whether a trade, business or profession is carried on in Hong Kong, and whether the profits made from a sale of an asset amount to a capital gain. The source of profits is to be explained in the following chapter.

II Prerequisites for Profits Tax Liability

2. Statute

The charge of profits tax is governed by Section 14(1) which reads as follows:

"Subject to the provisions of this Ordinance, profits tax shall be charged for each year of assessment at the standard rate on every person carrying on a trade, profession or business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong for that year from such trade, profession or business (excluding profits arising from the sale of capital assets) as ascertained in accordance with this Part."

3. Explanation and interpretation

Profits tax liability is chargeable under Section 14 of IRO when the following conditions are satisfied:

- a. a person carries on a trade, a profession or a business in Hong Kong,
- b. there are profits arising in or derived from such a trade, a profession or a business (excluding profits from the sale of capital assets), and
- c. the profits must be arising in or derived from Hong Kong.

It is only when all the three conditions are satisfied, the profit is taxable in Hong Kong.

4. The above criteria have the following implications:
- the place where a business is incorporated is irrelevant, and
 - the place where a business is carried on is not necessarily the same place where an income from that business arises.

III Whether a Trade is Carried on in Hong Kong

5. Definition of "trade"

- Section 2 defines "trade" (行業或生意) to include every trade and manufacture, and every adventure and concern in the nature of trade.
- The definition of "trade" is very wide. Any activities not falling within the normal meaning of trade or manufacture may still be treated as a "trade" under the IRO.

6. Badges of trade

In order to decide whether a trade is carried on, it usually relies on the six "badges of trade" as arrived at by the UK Royal Commission on the Taxation of Profits and Income in 1955 as follows:

a. Profit-seeking motive at the time of acquisition

If there is a profit-seeking motive at the time of purchase of the flat, it is interpreted by the IRD that there is a trading business. However, motive is subjective, and it has to be proved by objective evidence as shown below.

b. Subject matter of the commodity disposed

If the subject matter is able to provide enjoyment to the owner, such as accommodation or rental income, it is possible to prove that there is no intention of making a profit at the time of purchase of the property.

c. Length of ownership

Usually the longer the period of ownership, the less likely that the property is acquired for short-term profit.

d. Frequency of similar transactions

Usually the more similar transactions take place, the more likely that the taxpayer carries on a trading business.

e. Supplementary work done on the property

If the owner incurs heavy expenditure to make the property more marketable or exerts effort to promote the sale, it is likely that the property is acquired for sale.

f. Circumstances leading to the disposal

If the sale is due to compelling reasons not expected by the owner at the time of purchase of the property, e.g. sudden need of cash, the owner may be able to prove that the original intention for the purchase of the property does not aim for making a short-term profit.

7. **Balance of probability in the determination of the existence of a trade**

The most important factor is whether the taxpayer has any profit-seeking motive at the time of acquisition of the asset. If there is such a motive, the taxpayer is regarded as carrying on a trade. Since whether a person carries on a trade is a question of fact, none of the above badges is by itself conclusive evidence to arrive at the decision that a person is or is not carrying on a trade. Thus, all the relevant factors have to be considered, and the decision is usually arrived at on a *balance of probability*.

8. Two cases to demonstrate the determination of capital gain or existence of a trade for the sale of property or sale of shares.

a. **Real Estate Investments (N.T.) Ltd. v CIR (2008) – Sale of property**

Issue:

Whether profit on disposal of landed properties should be assessed to tax when the properties were held for more than 16 years.

Facts:

The Taxpayer was a joint venture between the Chinachem group and the Sun Hung Kai group. The Taxpayer was the owner of a new building situated at No. 49 Conduit Road, Mid-Levels, Hong Kong [“the Property”] which it acquired in December 1979. The Taxpayer finished redeveloping in June 1996.

Court of Final Appeal Decision

- i. The stated intention of the Taxpayer was not conclusive and the Board had considered all the surrounding circumstances to come to its conclusion. There is no specifically identifiable error of law on the part of the Board.
- ii. The onus of proof cannot be shifted from the taxpayer to the Commissioner of Inland Revenue where section 68(4) of the Inland Revenue Ordinance places it, namely on a taxpayer who appeals against an assessment to show that it is excessive or incorrect.

Observation by the author

Although the length of ownership is 16 years and the holding period may be regarded as long enough for the characteristics of a capital asset, other factors have to be considered. Since the company is a joint venture and both shareholders are property developers, it is difficult to persuade others that the property was acquired as a long-term investment of producing a steady rental income. Therefore, no one factor is conclusive and all the facts have to be taken into account before coming to a decision of a capital asset or a trading asset.

b. **Lee and Yeung v CIR (2008) – Sale of Hong Kong listed shares**

Issue:

The activities of the taxpayer in the purchases and sales of Hong Kong listed shares amount to the existence of a share-dealing business.

Facts:

- i. From about 1992 Mr. Lee spent much time buying and selling shares and futures. Most of these transactions were in his own name but a significant number were done through a wholly owned company called Y.S. Tide Ltd. ("YST").
- ii. Up to 1997, his losses were greater than his gains but in early 1997 very large profits were made, exceeding his previous losses by \$15 million. Then came the Asian financial crisis and by 1998, he was sustaining substantial overall losses.
- iii. The taxpayer had an office and the necessary equipments and facilities for share dealings, and a secretary to keep those records and accounts, these amenities enjoyed by him were not those of his own. He was able to use them because of his special relationship with Y.S. Tide and Kin Tak Fung.
- iv. The taxpayer operated 18 margin accounts at any one time, invested a quarter of his wealth in his share dealings and sub-underwrote share offerings.

Court of Final Appeal Decision

- (a) whether a person is carrying on a trade or business is a matter of fact and degree, to be decided on all the circumstances of each case. For trading in securities or futures, there has to be a habitual and systematic course of dealing.
- (b) As the taxpayer could not show on the evidence that there had been a trade, the only conclusion the Board could reasonably have come to was that the taxpayer was not carrying on a trade, the appeal must fail.

Observation by the author

Although the taxpayer appeared to be trading in the layman's view, all the conditions have to be considered. Therefore, no one factor is conclusive, and all the facts have to be taken into account before coming to a decision of a capital asset or a trading asset. This is also true for speculation in shares. Whether a share dealing business exists is a matter of degree. What the judges consider is whether there is a habitual and systematic course of dealing.

9. Other relevant evidence or factors in the determination of the existence of a trade:

- a. **Method of acquisition of the asset**

If the asset is not acquired through purchase, but involuntary acquisition such as inheritance from family members or group restructuring, it is likely that the profit made from such transactions is exempt from profits tax.

- b. **Method of financing the acquisition of the asset**

If the asset is acquired with short-term finance such as bank overdraft, it is likely that the purchase is acquired with the purpose of quick disposal, and the profit so made will be treated as a trading profit.

It was held in many Board of Review cases that if the purchase of a property was financed by a loan obtained from a deposit taking company (not a licensed bank), the profit-seeking motive would be obvious. It was due to the reason that the interest rate of a deposit taking company is generally higher than that of a licensed bank.

c. **Usage put to the asset**

If a property is left vacant throughout the ownership period, or it is sold during the construction period, it will be likely that the property is acquired for trading purpose.

d. **Minutes supporting the intention for the purchase (if the taxpayer is a corporation)**

A corporation is an artificial person, and its intention for the purchase of a property may be documented in the minutes of a directors' meeting.

e. **How the asset is shown in the accounts or balance of a company (if the taxpayer is a corporation)**

If the asset is shown as a current asset or trading stock in the balance sheet, it will be very likely that the property is acquired for trading purposes.

IV Whether There is a Business Carried on in Hong Kong

10. **Statutory definition of "business"**

Section 2 of IRO defines "business" (業務) to include agricultural undertaking, poultry and pig rearing and the letting or sub-letting by any corporation to any person of any premises or portion thereof, and the sub-letting by any other person, of any premises or portion of any premises held by him under a lease or tenancy other than from the Government.

11. **Explanation and interpretation**

a. The definition of "business" is very wide. Any activities not falling within the definition of trade and profession may be treated as a "business" under the IRO.

b. Section 2 specifically includes the following activities as carrying on a business:

- i. agricultural undertaking,
- ii. poultry and pig rearing,
- iii. the letting of an immovable property by a corporation who is an owner of the property,
- iv. the sub-letting of an immovable property by a corporation, and
- v. the sub-letting of an immovable property by an individual or a partnership.

c. Section 2 does not include the letting of an immovable property by an individual sole owner or a joint owner of a property as carrying on a business.

12. **Placing deposits may constitute carrying on a business**

One of the contentious issues in the taxation is whether the mere placing of deposits by a company would constitute a business. If the answer is yes, the interest income is taxable under Section 15(1)(f) if its source is in Hong Kong. If the answer is no, the interest income will be not taxable even though the interest is sourced in Hong Kong.

13. **CIR v Bartica Investment Ltd. (1996)**

- a. In the case *CIR v Bartica Investment Ltd.* (1996) 4 HKTC 129, the taxpayer transferred money to the taxpayer's bank accounts in Hong Kong, and the deposits were pledged as security for bank loans made to a foreign company. The Board of Review decided that the taxpayer carried on a business at the place where the negotiations took place and the decisions were made. Since all these activities took place outside Hong Kong, and the taxpayer did not take an active role in borrowing money in Hong Kong, the mere depositing money in a bank in Hong Kong did not constitute a business carried on in Hong Kong. The interest income was not taxable.
- b. The CIR appealed to High Court which ruled that the taxpayer carried on a business as it did not merely place a deposit but also used the deposit as a security for the loan of its group companies. As the taxpayer's directors were based in Hong Kong where board meetings were held, the business was treated as being carried on in Hong Kong.

V Whether a Trade or Business is Carried on in Hong Kong by a Non-resident

14. **Trading with Hong Kong or trading within Hong Kong**

- a. When an overseas company sells goods directly to its customers in Hong Kong from overseas, it is treated as "trading with Hong Kong". In this situation, the overseas company is not treated as carrying on a business in Hong Kong. It does not fall within the charge of profits tax under Section 14 of the IRO.
- b. When an overseas company establishes an office in Hong Kong to sell goods to its customers in Hong Kong, it is treated as "trading within Hong Kong". In this situation, the overseas company is treated as carrying on a business in Hong Kong, and this satisfies the requirement of Section 14 of the IRO. The profit of the overseas company derived from Hong Kong is chargeable with profits tax.

15. **The existence of a permanent establishment in Hong Kong**

Inland Revenue Rule 5 (IRR 5) governs the charge of profits tax in respect of a non-resident carrying on a business in Hong Kong. If a non-resident has a permanent establishment in Hong Kong, it is treated as carrying on a business in Hong Kong.

16. **Definition of a permanent establishment**

a. **Statute**

IRR 5(1) provides the definition of a "permanent establishment" which reads as follows:

"Permanent establishment" (永久機構或常設機構) means a branch, management or other place of business, but does not include an agency unless the agent has, and habitually exercises, a general authority to negotiate and conclude contracts on behalf of his principal or has a stock of merchandise from which he regularly fills orders on his behalf.

Chapter 26

Owners of Ships and Aircraft

Learning Objectives

After having studied this chapter, you would:

- a. understand when a ship owner is deemed to carry on a shipping business in Hong Kong;
- b. understand how the assessable profit of a shipping business is computed;
- c. understand how the double tax relief with USA on shipping profits is operated;
- d. understand when an aircraft owner is deemed to carry on an aircraft business in Hong Kong;
- e. understand how the assessable profit of a Hong Kong aircraft owner business is computed; and
- f. understand how the assessable profit of a non-Hong Kong aircraft owner business is computed.

I Introduction

1. Shipping business and aircraft business involving the incoming and outgoing of vessels, and the rules governing the taxation and exemption of such income are different from other types of business. In this chapter, students are required to understand when an owner of ships or aircraft is treated as carrying on a business in Hong Kong, and what types of income are included as relevant sum and what are excluded for the purpose of computation of assessable profit.

II Ship Owner Carrying on Business in Hong Kong

2. Section 23B imposes profits tax liability on a ship owner who may be the owner or the charterer of a ship, carrying on a business of chartering or operating ships in Hong Kong. The shipping profit from the chartering or operating ships business does not include the agency income and the ship-dealing income of the owner or the charterer, as the case may be. Section 23B(12) defines the owner of a ship to include a charterer of the ship under a charter-party.
3. Section 23B(1) provides that a ship owner is deemed to carry on a shipping business in Hong Kong in the following situations:
 - a. the ship-owning business is normally controlled or managed in Hong Kong – Section 23B(1)(a); or
 - b. the ship owner is a company incorporated in Hong Kong – Section 23B(1)(b).
4. Section 23B(2) provides that if the conditions of Section 23B(1) is not applicable, but any ship owner has its ships calling at any location within the waters of Hong Kong, that person is deemed to carry on shipping business in Hong Kong. For such ship owners, it is provided in Section 23B(6) that if the call of ship in Hong Kong is casual, and further calls are improbable,

the Commissioner may direct that the ship owner shall not be deemed to carry on a business of chartering or operating ships in Hong Kong by reason of casual call. (This treatment was usually applied to non-resident ship owner, but today the term of non-resident ship-owner is not used.)

5. Section 23B(4A) was enacted by the Inland Revenue (Amendment)(No.2) Ordinance 1998 to provide an exemption of shipping income for a non-resident ship owner. Section 23B(4A) provides that where a person who is deemed to be carrying on a business as an owner of ships in Hong Kong is resident in any territory outside Hong Kong, he shall be regarded as having a reciprocity status, if the Commissioner is satisfied that any profits earned by or accrued to a person from a business carried on in the territory as an owner of ships are, under the laws of that territory, exempt from a tax which is of substantially the same nature as the tax chargeable under profits tax.

III Computation of Shipping Profits

6. Under Section 23B(3), the assessable shipping profit of a ship owner is computed according to the following formula:

$$\text{Assessable profits for ship owner} = \text{Total shipping profit} \times \frac{\text{Relevant sum}}{\text{Total shipping income}}$$

In order to find out the total shipping profit of a ship owner, all the other types of income, such as interest income, agency income, or ship-dealing income, have to be excluded. After the assessable shipping profit has been ascertained, the aforesaid Hong Kong sourced interest income, agency income and ship-dealing income (after deducting the relevant expenses) have to be added back to the assessable shipping profit so as to arrive at the assessable profit for the whole shipping company.

7. The following terms are defined in Section 23B(12) and students are required to understand them which may be broken up into small parts and asked in the examination.

“Relevant sums” means:

- a. any sums derived from, attributable to, or in respect of:
 - i. any relevant carriage shipped in Hong Kong;
 - ii. any towage operation undertaken by a ship within the waters of Hong Kong, or any towage operation undertaken by that ship commencing from any location within those waters, as the case may be;
 - iii. any dredging operation undertaken by a ship within the waters of Hong Kong;
 - iv. any charter hire in respect of:
 - the operation of a ship navigating solely or mainly within the waters of Hong Kong; or
 - a charter-party where one of the parties thereto is a relevant limited partnership;
- b. one half of any sums derived from, attributable to, or in respect of, any charter hire in respect of the operation of a ship navigating between any location within river trade waters, but does not include exempt sums.

“Exempt sums” means any sums derived from, attributable to, or in respect of:

- a. any relevant carriage shipped aboard by a registered ship at any location and proceeding to sea from that or any other location within those waters; or
- b. any towage operation undertaken by a registered ship proceeding to sea from any location within the waters of Hong Kong.

(Author’s note: exempt sums apply to international operations only.)

“Registered ship” means a ship registered under the Merchant Shipping (Registration) Ordinance (Cap. 415).

“Relevant carriage”, in relation to a ship, means the carriage by sea of passengers or goods, or both passengers and goods, as the case may, but does not include the carriage of goods in transit.

“Sea”, except in relation to relevant carriage, means the waters of the sea other than those contained within river trade limits.

“River trade waters” means the waters contained within river trade limits other than the waters of Hong Kong contained within those limits. (In substance, river trade limits refer to the ports within the Pearl River Delta, including Macau.)

8. In short, the treatment of various types of shipping income may be summarised in the following table:

Types of Shipping Income	Income Treatment
a. Income received by a registered ship (i.e., registered in Hong Kong) departing from Hong Kong	<ul style="list-style-type: none"> • Exempt sum
b. Income received by a ship arrived at Hong Kong from waters outside Hong Kong	<ul style="list-style-type: none"> • Exempt sum
c. Income received in respect of passengers and goods in transit	<ul style="list-style-type: none"> • Exempt sum
d. Charter hire relating to the whole of a ship where the operation of the ship navigating between Hong Kong and river trade waters	<ul style="list-style-type: none"> • 50% included as relevant sum
e. Charter hire of a ship navigating solely or mainly in Hong Kong	<ul style="list-style-type: none"> • 100% included as relevant sum
f. Income received by a ship, not registered in Hong Kong, departing from Hong Kong	<ul style="list-style-type: none"> • 100% included as relevant sum
g. Income received by a ship, whether carriage, towage, dredging, navigating within Hong Kong	<ul style="list-style-type: none"> • 100% included as relevant sum

9. Depreciation allowance is not available to a Hong Kong registered ship, (i.e., the ship is on the Hong Kong Shipping Register) because the income of the ship when registered with the Hong Kong Shipping Register is exempt from Hong Kong profits tax. Depreciation allowance is apportioned and disallowed if the ship is on the Hong Kong Shipping Register for part of the basis period.

IV Double Taxation Relief with USA on Shipping Profits

10. On 28 September 1989, the Hong Kong Commissioner of Inland Revenue signed a double taxation relief order called "Double Taxation Relief (Income from Shipping Operations) (United States of America) Order 1989" made by the Governor in Council under Section 49 of the Inland Revenue Ordinance with USA on shipping profits in the terms summarized as follows:

The exemption granted to Hong Kong corporations by the United States only applies when either:

- a. the corporation's stock is primarily and regularly traded in the Hong Kong Stock Exchange, or
- b. more than 50% of the value of the corporation's stock is owned, directly or indirectly, by individuals who are residents of Hong Kong.

The exemption provided by Hong Kong to US corporations is based upon identical criteria.

11. The shipping income exempt under the Order is restricted to the gross income arising from the international operation of ships. The Agreement has effect with respect to taxable years on or after 1 January 1987.
12. Since 1998, double tax relief has been available to Hong Kong ship-owners having shipping income in Mainland China after signing the Avoidance of Double Taxation Arrangement with Mainland China. In recent years, Hong Kong Government also signed double taxation relief agreements on shipping income with other countries such as UK and Netherlands.

V Hong Kong Aircraft Owners (i.e. Resident Aircraft Owners)

13. Section 23C imposes profits tax liability on an aircraft owner, who may be the owner or the charterer of an aircraft, carrying on a business of chartering or operating aircraft in Hong Kong. The aircraft profit from the chartering or operating aircraft business does not include the agency income and the aircraft-dealing income of the owner or the charterer, as the case may be. Section 23C(5) defines the owner of an aircraft to include a charterer of the aircraft under a charter-party.
14. Section 23C(1) provides that an aircraft owner is deemed carrying on a business of chartering or operating aircraft in Hong Kong if:
- a. the aircraft owning business is normally controlled or managed in Hong Kong – Section 23C(1)(a); or
 - b. the aircraft owner is a company incorporated in Hong Kong – Section 23C(1)(b).

Contents

Preface	
Table of Cases	
Table of Statutes	
How to Use This Book	i
How to Study Taxation	iii
Section A Introduction	1
1. Introduction to the Hong Kong Taxation System	2
Section B Tax Administration	17
2. Compliance, Returns and Assessments	18
3. Objections, Holdover Claims and Revision of Errors	32
4. Back Duty and Investigation	43
5. Offences, Penalty and Recovery of Tax	50
Examination Questions on Tax Administration	59
Answers to Examination Questions on Tax Administration	59
Section C Property Tax	63
6. Scope of Charge and Sources of Income	64
7. Property Tax Computation	73
Examination Questions on Property Tax	82
Answers to Examination Questions on Property Tax	83
Section D Salaries Tax	85
8. Scope of Charge and Sources of Income	86
9. Chargeable Income	105
10. Allowable Deductions	127
11. Personal Allowances	136
12. Salaries Tax Computation	147
13. Salaries Tax Planning	157
Examination Questions on Salaries Tax	162
Answers to Examination Questions on Salaries Tax	165

Section E Profits Tax	175
14. Scope of Charge	176
15. Source of Profit	186
16. Chargeable Income and Deemed Trading Receipts	213
17. Deductible and Non-deductible Items	226
18. Deduction of Interest under Profits Tax	244
19. Specific Deductions	264
20. Profits Tax Computation	290
21. Unincorporated Business	297
22. Treatment of Loss	302
23. Basis Period	311
24. Profits Tax Planning	325
Examination Questions on Profits Tax	333
Answers to Examination Questions on Profits Tax	338
Section F Special Businesses	345
25. Insurance Businesses	346
26. Owners of Ships and Aircraft	351
27. Clubs and Trade Associations	359
28. Financial Institutions	364
Examination Questions on Special Businesses	371
Answers to Examination Questions on Special Businesses	372
Section G Depreciation Allowance	375
29. Plant and Machinery	376
30. Industrial Building	388
31. Commercial Building	400
Examination Questions on Depreciation Allowance	410
Answers to Examination Questions on Depreciation Allowance	411
Section H Personal Assessment	413
32. General Principles	414
33. Computation of Personal Assessment Tax	430
Examination Questions on Personal Assessment	436
Answers to Examination Questions on Personal Assessment	437



Section I	Overseas Activities and Anti-Avoidance	441
34.	Non-Residents and Overseas Activities	442
35.	Anti-Avoidance	456
	Examination Questions on Overseas Activities and Anti-Avoidance	469
	Answers to Examination Questions on Overseas Activities and Anti-Avoidance	469
Section J	Stamp Duty	471
36.	Stamp Duty – Scope of Charge	472
37.	Immovable Properties Situated in Hong Kong	481
38.	Hong Kong Stock	499
39.	Relief and Exemption	508
40.	Administration of the Stamp Duty Ordinance	514
41.	Stamp Duty Planning	520
	Examination Questions on Stamp Duty	525
	Answers to Examination Questions on Stamp Duty	526
Section K	Estate Planning and China Tax	529
42.	Introduction to Trust	530
43.	Estate Planning and Succession	536
44.	Introduction to PRC Tax	547
45.	Anti-Avoidance of Double Tax Arrangement with Mainland China	561
46.	Transfer Pricing and Double Taxation Relief	581
	Examination Questions on Estate Planning and China Tax	598
	Answers to Examination Questions on Estate Planning and China Tax	598
Section L	Mock Examination Questions and Answers.....	601
47.	Mock Examination Questions	602
48.	Answers to Mock Examination Questions	614
Index	634

How to Use This Book

I Introduction

1. This book is applicable to all the examination papers with the syllabus of Hong Kong Taxation and Tax Planning. As each accountancy professional body and company secretary institution has different emphasis in its own tax syllabus, this book covers all the possible aspects of each level of tax examinations. This book starts from the basics of different types of Hong Kong income tax and tax administration to the advanced level of stamp duty, estate duty and tax planning.
2. In the past, professional bodies prefer close-book examination. The trend starts to change. For some accountancy bodies, advanced level of tax examination is conducted in an open-book environment. The requirements of open-book examination are different from those of the conventional close-book examinations. This book also provides a chapter on how to write in close-book and open-book examinations. The purpose is to assist students to pass different types of examination.

II Objectives of Each Chapter

3. At the beginning of each chapter, there is a list of objectives to be achieved after having studied the chapter. Before starting each chapter, students may have a clear picture of what they have to know after finishing each chapter. If they want to revise a particular topic, they will know where they should go to.

III Text of Each Chapter

4. The contents of each chapter are written in such a way that students may easily understand. They are written in numbered paragraphs, and students can easily make cross-reference to relevant topics in other parts of the book. Most of each chapter are divided into different parts with sub-topics for each important area to draw the attention of students. For computation questions such as property tax computation, salaries tax computation, profits tax computation and basis period, there are many worked examples that students can work through so as to have a better understanding of those topics.

IV Questions to Test Knowledge

5. At the end of each chapter, there is a list of questions called "Questions to test your knowledge" to remind students of what they have learned in that chapter. This can serve as a checklist. Students may go through the questions without referring back to the contents of the chapter. Then they can write out what is still stored in their memory and check how far they have understood what they have studied from that chapter.

V Examination Questions at the End of Each Section

6. In order to make sure that students can integrate what they have learned, there are some examination questions at the end of each section (which cover more than one chapter) that students can do by themselves. There are altogether forty questions and suggested answers are also provided. The questions are marked with time allowed. Students can try and write as much as possible to see how far they can match with the standard of the suggested answer to each question.

VI Mock Examination Questions at the End of this Book

7. At the end of this book (i.e., in Chapters 47 and 48), the author has designed 28 questions to cater for the needs of different students who attend different levels of tax examination. The questions are divided into five parts.
8. Parts A and C of those two chapters cater for students attending all types of tax examination, including tax paper of Association of Accounting Technicians (AAT), Papers F6H and P6H of The Association of Chartered Certified Accountants (ACCA), tax paper of The Institute of Chartered Secretaries and Administrators (ICSA), and tax papers of Qualified Programme (QP) and Practising Certificate (PC) of Hong Kong Institute of Certified Public Accountants (HKICPA). Part A is for short questions and Part C is for long questions. The time allowed for each question is stated, and students can make better use of the time and allocate their time in attempting the questions.
9. Parts B and D of those two chapters cater for students attending tax planning papers including Paper P6H of ACCA, tax paper of ICSA, and tax papers of QP and PC of HKICPA. Part B is for short questions which cover specific topics, and Part D is for long questions that cover more than one type of taxes in each question.
10. Part E caters solely for QP and PC of HKICPA examinations. Two essay questions are designed for the purpose of open-book examinations. Each question covers a lot of issues. Students are required to dig out as many issues as possible. These two questions demand students' awareness of different tax implications. If students are patient enough and attempt the questions in an examination environment (for example, forcing themselves to write out the answers to the questions within the time allowed), they will get benefit over those who do not try in this way. Practice makes perfect.

How to Study Taxation

I Introduction

1. Taxation is something almost every person cannot avoid, but many people have little knowledge about it. Taxation subject is one of the most difficult subjects in an accountancy or company secretary examinations. Mere memorisation is not sufficient for this subject. Although working through examples and problems does not guarantee that you will get a good result in your examination, at least it assists you to get a pass. Taxation examination demands students not only to have an in-depth knowledge of the subject matters, but also requires students to be alert of the circumstances of each person, business or taxpayer given in the question as if it is in a real daily working environment. The author will try, in this chapter, to offer some guidelines on how to learn taxation in an easier way.

II Methods of Learning

2. In order to get a good result in a tax examination or be a good tax accountant, piecemeal knowledge on taxation knowledge is not sufficient. You must get a very broad knowledge on various tax topics, and also have an in-depth knowledge on individual topics.
3. A possible way is to glance through the syllabus of the tax examination you are going to attend, and the topics in this book, especially the learning objectives of each chapter. After having got some ideas about the contents, you can choose individual topic starting from easier ones to the more difficult ones. When you carry out your study on this book, you must work through the questions and examples. They can help you understand the knowledge better and keep the knowledge in your mind longer.

III Easier and More Difficult Topics

4. The easier topics include tax administration, property tax, salaries tax and depreciation allowances for plant and machinery. The more difficult topics include profits tax, non-resident, tax planning, anti-avoidance, stamp duty and estate duty. If students concentrate their effort on easier topics first, they can grasp the knowledge of those topics faster, and form a basis for the more difficult topics. This can arouse their interest and let them have more enthusiasm in the more difficult topics.

IV Examination Writing Techniques

5. The reason why students cannot get a passing mark in their examination is mainly a result of a lack of examination writing techniques. This may be divided into three parts as follows:

- a. General
 - i. Time management and time allocation to each question
 - ii. Never leaving a question or part of a question unanswered
 - iii. Doing computation question first, then essay questions
 - iv. Writing tidily
 - v. Using a dark ballpoint pen
- b. Computation
 - i. Workings and steps, not the figures, in earning the marks
 - ii. Format of presentation
- c. Essay questions
 - i. Reading the question twice to fully understand what is being asked
 - ii. Covering all the alternatives
 - iii. Answering questions comprehensively in depth

V Conclusion

6. The recommendations for students taking tax examination papers may be summarised as follows:
 - a. a good review of all the topics of the subject,
 - b. not to study merely some particular topics,
 - c. having two to three topics better familiarised with and preparing them for scoring higher marks in the examination,
 - d. good time management in the examination,
 - e. practising more for computation questions such as profits tax computation, salaries tax computation, property tax computation and personal assessment computation, and
 - f. answering essay type or analytical questions in greater depth and avoiding superficial answers.