

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:
- to furnish employer's returns on the details of his or her employees and remuneration paid to each – Section 52(2);
  - 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);
  - to notify the Commissioner of the cessation of employment of employees not later than 1 month before such cessation – Section 52(5);
  - 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);
  - 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)	<i>Notify</i> 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)	<i>Notify</i> 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)	<i>Notify</i> 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)	<i>Not to make any payment</i> 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:
- 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);
  - 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);
  - 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);
  - 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);
  - 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
  - the Commissioner or an officer not below the rank of chief assessor may apply to the magistrate for a search warrant – Section 51B.

**Example 3.2**

M Ltd's assessable profits for the year of assessment is \$700,000, but its estimated assessable profit for 2014/15 provisional profits tax is \$500,000. As the company's profit for the current year of assessment 2014/15 is less than 90% of the previous year (i.e. 2013/14), it may apply for holdover of the 2014/15 provisional profits tax.

The date of issue of the demand note for 2014/15 provisional profits tax is 6 November 2014 while the due date for payment is 31 January 2015.

What is the latest date that M Ltd may apply for holdover of 2014/15 provisional profits tax?

**Answer**

- a. 14-day rule

The date of issue of notice for payment of provisional profits tax is 6 November 2014. 14 days after the date of issue is 20 November 2014.

- b. 28-day rule

The date of payment of provisional profits tax is 31 January 2015. 28 days before the due date is 3 January 2015.

The latest date for application for holdover of provisional profits tax is the later of 20 November 2014 or 3 January 2015. Therefore, the answer is 3 January 2015.

**24. Holdover of provisional salaries tax**

Grounds for holdover of payment of provisional salaries tax (Section 63E) are as follows:

- the taxpayer is entitled to additional personal allowance;
- the net chargeable income is, or is likely to be, less than 90% of the net chargeable income for the preceding year or the estimated amount;
- the taxpayer has ceased, or will cease before the end of the year of assessment, to derive income chargeable to salaries tax; and the assessable income is, or is likely to be, less than the assessable income for the year preceding the year of assessment or the estimated amount; or
- the taxpayer has objected to his salaries tax assessment for the year preceding the year of assessment.

**25. Holdover of provisional profits tax**

Grounds for holdover of payment of provisional profits tax (Section 63J) are as follows:

- the assessable profits are, or are likely to be, less than 90% of the assessable profits for the preceding year or the estimated amount;
- the amount of loss brought forward for set off to that year of assessment under Section 19 or 19C has been omitted or is incorrect;
- the taxpayer has ceased, or will before the end of the year of assessment cease, to carry on his trade, profession or business, and the assessable profits are, or are likely to be, less than the assessable profits for the year preceding the year of assessment or the estimated amount;
- the taxpayer has elected or is deemed to have elected for personal assessment for that year of assessment and the election of personal assessment will reduce his or her tax liability; or
- the taxpayer has objected to his profits tax assessment for the year preceding the year of assessment.

**26. Holdover of provisional property tax**

Grounds for holdover of payment of provisional property tax (Section 63O) are as follows:

- the assessable value is, or is likely to be, less than 90% of the assessable value for the year preceding the year of assessment or the estimated assessable value;
- the taxpayer has ceased, or will before the end of the year of assessment cease, to be an owner of land or building and the assessable value is, or is likely to be, less than the assessable value for the year preceding the year of assessment or the estimated amount;
- the taxpayer has elected or is deemed to have elected for personal assessment for that year of assessment and the election for personal assessment will reduce his tax liability; or
- the taxpayer has objected to his property tax assessment for the year preceding the year of assessment.

**27. Summary of various grounds for holdover of provisional tax**

Grounds for Holdover	Provisional Salaries Tax (Section 63E)	Provisional Profits Tax (Section 63J)	Provisional Property Tax (Section 63O)
The taxpayer is entitled to personal allowance not available in the preceding year of assessment.	Yes	N/A	N/A
Assessable income/ assessable profits/ net assessable value is less than 90% of that of preceding year of assessment.	Yes	Yes	Yes
The taxpayer ceased to derive income in the year of assessment.	Yes	Yes	Yes
Objection was lodged in the preceding year of assessment.	Yes	Yes	Yes
Omission of loss brought forward for set off under Section 19 or 19C.	N/A	Yes	N/A
The taxpayer has elected for personal assessment.	N/A	Yes	Yes

**VIII Refund under Section 79**

28. If a taxpayer can prove that he or she has paid tax in excess of the amount with which he was properly chargeable for the year, he may apply in writing for a refund of tax:
- within 6 years of the end of the year of assessment concerned; or
  - within 6 months after the date on which the relevant notice of assessment was served; whichever is the later.

Year of Assessment 2013/14	
Period spread over is 1.1.2014 – 31.3.2014	$\$720,000 \times \frac{3}{36} = \underline{\underline{\$60,000}}$
Year of Assessment 2014/15	
Period spread over is 1.4.2014 – 31.3.2015	$\$720,000 \times \frac{12}{36} = \underline{\underline{\$240,000}}$
Year of Assessment 2015/16	
Period spread over is 1.4.2015 – 31.3.2016	$\$720,000 \times \frac{12}{36} = \underline{\underline{\$240,000}}$
Year of Assessment 2016/17	
Period spread over is 1.4.2016 – 31.12.2016	$\$720,000 \times \frac{9}{36} = \underline{\underline{\$180,000}}$

#### IV Property Tax Treatment on Rent Receivable

12. Section 5B(2) provides that the assessable value of an immovable property is the consideration payable in a year of assessment. The consideration is taxable on an accrual basis, not on a cash basis. Bad debt may arise if a tenant does not pay the rent as stipulated in the lease.

#### V Property Letting by an Individual Amounting to a Business

13. Generally, it does not matter whether an individual owner lets one immovable property or lets many immovable properties. The owner is chargeable with property tax. Sometimes, property letting by an individual may amount to carrying on a business. In that circumstance, that individual is chargeable with profits tax, not property tax.
14. Whether property letting by an individual amounts to carrying on a business is a question of fact, and it has to be decided according to the merits of each case. The CIR states the IRD's view in paragraph 24 of DIPN 14 that the following situations demonstrate strong indication of business:
- the number of properties let is substantial and the owner has engaged some staff to handle tenancies and deal with the tenants;
  - the properties are of a special class such as ballrooms, cinemas or restaurants, and that additional services are provided by the landlord such as the landlord being the licensee of the ballroom, cinema or restaurant (see *Louis Kwan-nang KWONG & Carol Kwok-nang KWONG v. CIR*, (1989) 2 HKTC 541) [CACV16/1989];
  - letting by a property dealer, and the rents are regarded as income of the property dealing business;
  - the letting is incidental to and is therefore part of the trade or business as would be the situation of a trader who owns a property which he uses partly for his trade and lets that part which is surplus to his immediate requirements.

#### VI Property Letting by a Corporation

##### 15. Charge of property tax

If a corporation owns a property situated in Hong Kong, and receives income from leasing that property, the income is chargeable with property tax as an owner of the property under Section 5 of IRO.

##### 16. Charge of profits tax

Section 2 of IRO defines "business" to include the letting of a property by a corporation. The income derived from a property is reflected as a part of the income of the corporation in its income statement. As result, the income is also chargeable to profits tax.

##### 17. Exemption of a corporation from property tax

In order to avoid the double taxation of the same income derived from a property under property tax and profits tax, Section 5(2)(a) allows a corporation to apply for exemption from property tax if that property income is assessable under profits tax. Such exemption is not applicable to a sole-proprietorship or a partnership.

##### 18. Harley case – Property Income Exempt from Profits Tax Assessable under Property Tax

In *Harley Development Inc and Another v CIR* (1994), the taxpayer granted with a 30-year lease and received a lump sum premium. The taxpayer applied for exemption from property tax under Section 5(2)(a) at the first instance. Then, the taxpayer applied for exemption from profits tax on the ground that the lump income was a capital gain. CIR accepted the taxpayer's claim of capital gain under profits tax, and cancelled the profits tax assessment. Then the CIR issued property tax assessment on the premium received. The taxpayer objected to the property tax assessment on the ground of ultra vires.

The judges at the Court of Appeal dismissed the taxpayer's appeal, and ruled that the property tax assessment was valid as the property income would not be assessed under profits tax. Exemption from property tax would be granted only when the property income was included in the profits tax computation.

#### VII Double Payments of Property Tax and Profits Tax

##### 19. Set-off of property tax against profits tax payable

As explained above, it is possible that a business may pay property tax and profits tax on the same piece of income derived from a property. In such situation, the taxpayer may apply to the property tax paid to set off against the profits tax payable under Section 25 of IRO. The relief of tax set-off applies to all types of business such as a sole-proprietorship, a partnership and a corporation.

#### VIII Taxation of Property Income Derived from Sub-letting (分租)

##### 20. Definition of "business"

Section 2(1) defines "business" 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.

## II Hong Kong and Non-Hong Kong Source Employment

### 7. Significance of a non-Hong Kong source employment

The tax effects of a Hong Kong source employment and a non-Hong Kong source employment are different. Generally, a non-Hong Kong source employment is liable to a less amount of salaries tax liability. Therefore, it is very important to distinguish whether an employment is of a Hong Kong source or a non-Hong Kong source (i.e. a foreign employment).

### 8. Assumption of a Hong Kong source employment

According to the practice of Inland Revenue Department (IRD), an employment is treated as sourced in Hong Kong unless it is proved to the contrary that an employment is sourced outside Hong Kong.

### 9. Two-tier approach

The Commissioner revised DIPN 10 in June 2007, and adopts a two-tier approach to determine the source of employment. He will first apply the three tests in the DIPN 10. If it is found that the source of employment is outside Hong Kong after the application of the three tests, he will apply the totality of facts approach to see whether it is a genuine non-Hong Kong source employment.

### 10. Three conditions in DIPN 10 on the determination of source of employment

Commissioner explained in DIPN 10 (revised in 2007) that source of employment is a practical hard matter of fact. IRD will take all the relevant factors and circumstances into consideration on the determination of source of employment. In particular, IRD places emphasis on the following three factors:

- a. where the contract of employment was negotiated and entered into, and is enforceable, whether in Hong Kong or outside Hong Kong;
- b. where the employer is resident, whether in Hong Kong or outside Hong Kong; and
- c. where the employee's remuneration is paid to him, whether in Hong Kong or outside Hong Kong.

If any one of the three factors is in Hong Kong, the IRD will treat the employment is sourced in Hong Kong. If all the three factors are outside Hong Kong, the IRD may treat the employment is sourced outside Hong Kong subject to the analysis of totality of facts approach.

In DIPN 10 (revised 2007), the Commissioner provided detailed analysis on how to apply the three factors in the determination of source of employment. If readers wish to have a more detailed understanding on this, they may download the DIPN 10 from IRD's web-site: [www.info.gov.hk/ird](http://www.info.gov.hk/ird).

### 11. Totality of facts approach

In some situations, IRD may look beyond the three conditions stated in the DIPN 10. If the IRD finds that all the three conditions mentioned in DIPN 10 are outside Hong Kong, but based on other relevant factors, the IRD may consider that the employment is sourced in Hong Kong. Generally, the IRD looks into whether the employee's remuneration is reimbursed by a Hong Kong company. If so, the employment is considered sourced in Hong Kong.

## III Income from Hong Kong Source Employment

### 12. Tax treatment of income derived from a Hong Kong source employment

#### a. No time-apportionment of taxable income

The income of a Hong Kong source employment is either fully taxable or fully exempt. There is no time-apportionment of taxable income from a Hong Kong source employment.

#### b. When income is fully taxable

If an employment is sourced in Hong Kong, all the income derived from that employment is fully chargeable to salaries tax even though the employee performs some services outside Hong Kong.

#### c. When income is fully exempt

The income of a Hong Kong source employment is exempt from salaries tax if one of the following conditions is satisfied:

- i. the employee renders ALL his services for that employment OUTSIDE Hong Kong [Section 8(1A)(b)]; or
- ii. the employee is a visitor to Hong Kong and stays in Hong Kong for 60 days or less in a year of assessment [Section 8(1B)].

#### d. When income is excluded from the charge of salaries tax

If an employee's income is chargeable to Hong Kong salaries tax and at the same time is also taxed outside Hong Kong, that part of income taxed outside Hong Kong may be excluded from Hong Kong salaries tax [Section 8(1A)(c)].

## IV Taxes Paid outside Hong Kong on Chargeable Employment Income

### 13. Relief available

If a person pays tax chargeable on his employment income outside Hong Kong, he may get relief from the following two ways:

- a. income exclusion rule under Section 8(1A)(c) which applies to income tax paid in all the overseas countries; and
- b. tax credit set-off against Hong Kong salaries tax payable under Section 50, but this relief applies to those places and countries with which Hong Kong has signed a double tax arrangement.

### 14. Exclusion of income already taxed outside Hong Kong

If a person pays tax outside Hong Kong on income from employment which is chargeable to Hong Kong salaries tax, he or she may exclude such income from his salaries tax assessment provided that the following two conditions of Section 8(1A)(c) are satisfied:

- a. the nature of the tax which he or she paid in the territory where he performed services is of substantially the same nature of salaries tax chargeable in Hong Kong; and
- b. there is evidence that the foreign tax has been paid or deducted.

Both conditions must be fulfilled before the income can be excluded from assessment.

## VIII Receipts from a Recognised Occupational Retirement Scheme (RORS) (認可職業退休計劃)

### 24. Taxable amounts

The following amounts received by employees from a RORS are taxable:

- any amount (other than a pension) received by an employee from a RORS other than on termination of service, death, incapacity or retirement, to the extent that it represents his or her employer's contributions to the scheme – Section 9(1)(ab)(i); and
- any amount (other than a pension) received by an employee from a RORS upon termination of service to the extent that it represents his or her employer's contributions to the scheme in excess of the "proportionate benefit" prescribed in Section 8(4)(b) – Section 9(1)(ab)(ii).

### 25. Definitions

"Termination of service" is defined in Section 8(3) as a termination of employment with the employer other than upon retirement, death or incapacity.

"Retirement" is defined in Section 8(3) as:

- a retirement from the service of the employer at some specified age of not less than 45 years; or
- a retirement after some specified period of service with the employer of not less than 10 years; or
- the attainment of the age of 60 years or some specified age of retirement, whichever is the later.

"Accrued benefit" is defined in Section 8(4) as the maximum benefit a person would have been entitled to receive under an occupational retirement scheme in respect of his or her service recognised for the purposes of the scheme if, at the date of termination of the person's employment, retirement has instead taken place.

$$\text{Proportionate benefit} = \frac{\text{Accrued benefit in respect of employer's contributions}}{\text{Completed months of service}} \times \frac{120}{120}$$

### 26. Defined contribution scheme v defined benefit scheme

According to the DIPN 23, there may be two methods to calculate the retirement benefit, namely:

#### a. Defined contribution scheme

The accrued benefit is taken as the aggregate of contributions made by or in respect of the employee.

#### b. Defined benefit scheme

The accrued benefit is calculated in accordance with the method recommended by the scheme's actuaries.

### 27. Summary of chargeable and exempt income

The taxation of lump sum received under RORS is summarised in the following table:

The Time the Lump Sum is Received	Treatment
a. Not at the time of termination of employment, not upon retirement, not upon death, or not upon incapacity	<ul style="list-style-type: none"> <li>Fully assessable</li> </ul>
b. At the time of termination of employment, but not upon retirement, not upon death, not upon incapacity	<ul style="list-style-type: none"> <li>Assessable on the amount paid in excess over the proportionate benefit</li> </ul>
c. At the time upon retirement, upon death, upon incapacity	<ul style="list-style-type: none"> <li>Fully exempt</li> </ul>
d. For employees having joined an old retirement scheme formerly approved by the repealed Section 87A and such scheme was converted to RORS	<ul style="list-style-type: none"> <li>Fully exempt under Section 8(4)(b) proviso (i.e. grandfathering proviso)</li> </ul>

## IX Gain on Share Option

### 28. Basis of charge

Section 9(1)(d) provides that any gain realised by the exercise of, or by the assignment or release of, a right to acquire shares or stock in a corporation obtained by an employee, by reason of his office or employment, is chargeable to salaries tax.

### 29. Stages of a share option scheme

The different stages of share option scheme from the grant of a share option to the sale of shares obtained through the exercise of the option include the following:

- grant of option,
- exercise of option,
- assignment of option without exercise of the share option (i.e. sale of option to other people who are most likely colleagues in the company),
- release of option without exercise of the share option (i.e. the employer buys back the option and releases itself from the obligation of the issue of shares at a later date when the employee exercises the option), and
- sale of shares or stock.

## V Concessionary Deductions (特惠扣除)

17. The Inland Revenue (Amendment) Ordinance 1998 created a new part IVA (Sections 26B – 26G) in the IRO providing four concessionary deductions under salaries tax and personal assessment. The difference between deductions under Section 12(1) and the concessionary deductions is that those deductions under Section 12(1) apply to salaries tax only while concessionary deductions are deductible under both salaries tax and personal assessment.
18. The four concessionary deductions are:
- charitable donations,
  - elderly residential care expenses,
  - home loan interest,
  - contributions to recognised retirement schemes.

## VI Charitable Donation (認可慈善捐款)

19. Section 26C provides that charitable donations actually paid out by an employee in a year of assessment may be deductible from his or her net assessable income before ascertaining his or her net chargeable income. The donation must be made in cash. Donation made in kind, e.g. gift of books or equipment, or its cash equivalent is not deductible under salaries tax or personal assessment.
20. The donation must be made to a charitable institution approved by the CIR under Section 88, and supported by evidence of payment. The aggregate of approved charitable donations must be not less than \$100.
21. With effect from the years of assessment 2003/04 to 2007/08, the maximum amount of charitable donations deductible from assessable income is increased from 10% to 25% of the assessable income. For year of assessment 2008/09 onwards, the maximum deduction is increased to 35% of the assessable income.

## VII Elderly Residential Care Expenses (長者住宿照顧開支)

### 22. Introduction

Sections 26D was first enacted for the year of assessment 1998/99 via the Inland Revenue (Amendment) Ordinance 1998 to allow the deduction of an expense paid for the nursing home of a parent or a grandparent who is over 60 years old or eligible for an allowance under the Government's Disability Allowance Scheme.

### 23. Conditions for the deduction

#### a. Qualifying person and payment

Section 26D(1) provides that where a person or his or her spouse, not being a spouse living apart from the person, pays during any year of assessment any residential care expenses in respect of a parent or a grandparent of the person who at any time in that year of assessment is:

- aged 60 or more, or
- being under the age of 60, is eligible to claim an allowance under the Government's Disability Allowance Scheme,

a deduction in respect of the residential care expenses shall be allowable to that person for that year of assessment.

#### b. Qualifying payment

The payment must be made to an approved elderly residential care home in Hong Kong.

#### c. Qualifying deduction

The maximum amounts of elderly residential care expenses for recent years of assessment are as follows:

	1998/1999 – 2010/2011	2011/2012	2012/2013 – 2013/2014	From 2014/2015
Amount	\$60,000	\$72,000	\$76,000	\$80,000

### 24. Deduction for each parent or grandparent

Section 26D(2) provides that a deduction of the elderly residential care expenses is allowed to a person in respect of each parent or grandparent of the person. If there are two parents living in a residential care home, the person may claim the elderly residential care expenses for both parents.

### 25. No double claim in respect of the same person

- If more than one person claim the deduction in respect of the same parent or the same grandparent, the CIR will disallow the deduction until a compromise has been reached among the family members who claim for the deduction.
- If a parent or a grandparent has been granted with the deduction of the elderly residential care expenses, no dependent parent allowance nor dependent grandparent allowance will be granted in respect of the same person. Similarly, if a parent or a grandparent has been granted with dependent parent allowance or dependent grandparent allowance, as the case may be, no deduction of elderly residential care expenses will be granted for such person.

## VIII Home Loan Interest (居所貸款利息)

### 26. Introduction

Sections 26E and 26F were first enacted for the year of assessment 1998/1999 via the Inland Revenue (Amendment) Ordinance 1998 to allow deduction of interest expenses incurred for the purchase of a home by a person.

### 27. Qualifying premises

#### a. Dwelling

Section 26E(1) provides that where a person pays during any year of assessment any home loan interest for the purposes of a home loan obtained in respect of a dwelling which is used at any time in that year of assessment by the person exclusively or partly as his place of residence, a deduction in respect of the home loan interest shall be allowable to that person for the year of assessment.

**Answer**

Bases for the calculation of Mr. Wong's salaries tax liabilities:

- Mr. Wong's employment is of Hong Kong source;
- he is not entitled to 60-day rule of visit exemption;
- the income taxed in Mainland China is excluded from chargeable income under Section 8(1A)(c); and
- holiday journey is taxable.

<b>Mr. Wong (Hong Kong Source Employment) Salaries Tax Computation Year of Assessment 2013/14</b>		
	\$	\$
Salary		1,000,000
Holiday journey		62,000
		<u>1,062,000</u>
Less: Income already taxed outside Hong Kong		600,000
		<u>462,000</u>
Less: Contribution to mandatory provident fund		15,000
		<u>447,000</u>
Less: Married person's allowance	240,000	
Child allowance	140,000	380,000
Net chargeable income		<u><u>67,000</u></u>
Salaries tax thereon	\$40,000 @ 2%	800
	\$27,000 @ 7%	1,890
		2,690
Less: Tax rebate (lower of \$2,690 × 75% or \$10,000)		2,018
Salaries tax payable		<u><u>672</u></u>

Standard rate  $\$447,000 \times 15\% = \$67,050$  [which is higher than the tax at progressive rates].

21. **Example 12.2: non-Hong Kong source employment**

The details are the same as Example 12.1 except that Mr. Wong is an employee of an overseas company, and he stayed in Hong Kong for 50 days. He performed services both inside and outside Hong Kong. Mr. Wong remains a Hong Kong resident.

**REQUIRED:**

Compute Mr. Wong's salaries tax liability for the year of assessment 2013/14.

**Answer**

Bases for the calculation of Mr. Wong's salaries tax liabilities:

- Mr. Wong's employment is of non-Hong Kong source and his income is chargeable on time basis;
- Mr. Wong is a Hong Kong resident, and he is not entitled to the exemption of the preferential tax treatment of 60-day rule of visit;
- the income taxed in Mainland China is not relevant as Mr. Wong is taxed on time basis; and
- holiday journey is taxable.

<b>Mr. Wong (Non-Hong Kong Source Employment) Salaries Tax Computation Year of Assessment 2013/14</b>		
	\$	\$
Salary		1,000,000
Holiday journey		62,000
		<u>1,062,000</u>
Assessable income ( $\$1,062,000 \times \frac{50}{365}$ )		145,479
Less: Contribution to mandatory provident fund		15,000
		<u>130,479</u>
Less: Married person's allowance	240,000	
Child allowance	140,000	380,000
Net chargeable income		<u><u>nil</u></u>

22. **Example 12.3: joint assessment**

Mr. Kam works for a Hong Kong company and received a monthly salary of \$40,000 for the year ended 31 March 2014.

His wife works as a part-time accountant for a small firm and received a monthly salary of \$8,000 for the year ended 31 March 2014. Mrs. Kam paid charitable donation of \$40,000 to her church for the year ended 31 March 2014.

Mr. and Mrs. Kam have two children at the age of 10 and 15. Mr. Kam's mother, age 65, lives in a registered nursing home in Hong Kong, and he paid \$8,000 each month to support her nursing home fee.

**REQUIRED:**

Compute Mr. and Mrs. Kam's salaries tax liability for the year of assessment 2013/14.

As Mr. Donald's employer is a Hong Kong subsidiary, not the American parent company, the source of his employment is in Hong Kong. All his income is assessable to Hong Kong salaries tax unless his visits in Hong Kong are 60 days or less in a year of assessment. Mr. Donald stayed in Hong Kong for 200 days during the year of assessment 2013/14, he is not entitled to the relief, and all his income is fully assessable in Hong Kong.

**Mr. Donald**  
**Salaries Tax Computation**  
**Year of Assessment 2013/14**

	\$
Salary	2,000,000
Bonus	400,000
Commission	150,000
	<u>2,550,000</u>
Add: Rental value (\$2,550,000 × 10%)	255,000
Assessable income	<u>2,805,000</u>
Less: Basic allowance	120,000
Net chargeable income	<u>2,685,000</u>
Progressive tax \$40,000 @ 2%	800
\$40,000 @ 7%	2,800
\$40,000 @ 12%	4,800
\$2,565,000 @ 17%	436,050
	<u>444,450</u>
Standard rate tax (\$2,805,000 × 15%)	<u>420,750</u>
Salaries tax payable by Mr. Donald	<u>420,750</u>

**Mrs. Donald**  
**Salaries Tax Computation**  
**Year of Assessment 2013/14**

	\$
Salary	250,000
Bonus	30,000
Assessable income	<u>280,000</u>
Less: Basic allowance	120,000
Net chargeable income	<u>160,000</u>

Progressive tax \$40,000 @ 2%	800
\$40,000 @ 7%	2,800
\$40,000 @ 12%	4,800
\$40,000 @ 17%	6,800
	<u>15,200</u>
Standard rate tax (\$280,000 × 15%)	<u>42,000</u>
Salaries tax payable by Mrs. Donald	<u>15,200</u>
The minimum salaries tax payable by Mr. and Mrs. Donald is	
\$420,750 + \$15,200 =	<u>435,950</u>

Notes:

The share option was granted by the overseas company (the former employer), and it was not concerned with Mr. Donald's services rendered in Hong Kong. Thus, the gain on share option is exempt from Hong Kong salaries tax. Joint assessment is not beneficial.

7. According to Inland Revenue Departmental Interpretation and Practice Note No. 10, the Commissioner accepts that an employment is located outside Hong Kong if all of the following three conditions are satisfied.
- The contract of employment is negotiated and entered into, and is enforceable outside Hong Kong.
  - The employer is resident outside Hong Kong.
  - The employee's remuneration is paid to him outside Hong Kong.

Mr. Pan is not a Hong Kong resident, and he was offered the job by an American company. It is very likely that his contract of employment was negotiated and entered into and enforceable outside Hong Kong. Mr. Pan's employer is an American company, and his employer's resident status is outside Hong Kong. Mr. Pan's salary is paid to his bank account in America by his employer. Thus, all the three conditions for an employment located outside Hong Kong are satisfied, Mr. Pan's employment is outside Hong Kong.

If Mr. Pan's employment is outside Hong Kong, his salaries tax liability is determined by the number of days he stays in Hong Kong in the year of assessment concerned. Thus, Mr. Pan is not able to ascertain his Hong Kong salaries tax liability until the basis period for the year of assessment has passed. The longer the time he stays in Hong Kong for a year of assessment, the more salaries tax he has to pay.

Dual employment

In order to avoid such uncertainty, Mr. Pan may negotiate with his employer to divide his duties into two parts, namely one for the Hong Kong office and the other for the head office. When Mr. Pan is present in Hong Kong, he works for the Hong Kong office, and while he is outside Hong Kong, he works for the head office. In this way, Mr. Pan can divide his salaries into two parts, and all the income derived from the employment with the head office is exempt from Hong Kong salaries tax under Section 8(1A) because he performs all services outside Hong Kong.

## IX Royalty Income Received by a Business Carried on in Hong Kong

### 39. Types of royalty income

If a business carried on in Hong Kong receives royalty income, it is chargeable to profits tax under Section 14. There are three different methods of acquisition of an intellectual property. They are:

- a. development of intellectual property in Hong Kong,
- b. purchase of the proprietary right of an intellectual property, and
- c. licence of the right to use an intellectual property.

Intellectual property includes copyright, trademark, patent for a design and patent for a secret process.

### 40. Development of intellectual property

If an intellectual property is developed in Hong Kong, the source of royalty income derived from the use of that intellectual property is governed by development test. The royalty income is wholly chargeable to profits tax no matter where the intellectual property is used. For example, if an author writes a book in Hong Kong, and receives royalty income from a publisher for books sold overseas, that royalty income is fully chargeable to profits tax.

### 41. *CIR v HK-TVB International Ltd. (1992)*

HK-TVB International Ltd. acquired films in Hong Kong, and granted sub-licences to overseas parties for the distribution of films outside Hong Kong. The Privy Council confirmed that the test used in the case for the determination of the source of profit on royalty income received was operations test. The source of profit was the place where the films were acquired, where the rights in the films were exploited, and where the films rights were granted. Where the films were distributed was not relevant.

### 42. Purchase of the proprietary right of an intellectual property

In this situation, the locality of the royalty income is at the place where the intellectual property is used. It is stated in paragraph 74 of DIPN 49 that if a person has purchased the proprietary interest of an intellectual property right (IPR) and licenses that IPR to another party for use outside Hong Kong, the royalties so derived will generally be regarded as non-Hong Kong sourced income and hence will not be subject to Hong Kong tax.

### 43. Licence of the right to use an intellectual property

According to paragraph 45(g) of DIPN 21 (revised in 2012) and paragraph 75 of DIPN 49 (issued in 2012), the locality of source of royalty income other than those deemed chargeable under Section 15(1)(a), (b) or (ba) is at the place of acquisition and granting of the licence or right to use. This applies to a person who merely obtains a licence to use from an owner. The source of profit is governed by operations test.

If a person only obtains a licence to use an IPR from its owner (i.e. the taxpayer has not obtained the proprietary interest of the IPR) and then sub-licenses the IPR to another party for use outside Hong Kong, the IRD will, generally, take the place of acquiring and granting the licence as the source of the income so received. IRD's view is that if either one is in Hong Kong, the royalty income is wholly chargeable to profits tax.

This is in line with the decision of *CIR v HK-TVB International Ltd. (1992)* 3 HKTC 301 and *Lam Soon Trademark Ltd. v CIR (2005)*.

### 44. *Lam Soon Trademark Ltd. v CIR (2005)*

Lam Soon Trademark Ltd. was incorporated in the Cook Islands and was a part of the Lam Soon Group of Companies. Its principal activities were the acquisition of trademarks and the granting of licences to its related companies to use the trademarks in return for royalty income. The assessor raised profits tax assessment on the royalty income so received from the grant of licences for use of trademarks as the contracts took place in Hong Kong.

## X Royalty Income Received by Non-residents

### 45. General principle

If a non-resident not carrying on a business in Hong Kong licenses the use of an intellectual property that it owns to a Hong Kong resident, and in return receives royalty income, the royalty income is not chargeable to profits tax under Section 14. However, the royalty income may be chargeable under the deemed trading receipts – Section 15(1)(a), (b) or (ba).

### 46. Intellectual property used in Hong Kong

If a non-resident owns an intellectual property, and licenses it to a Hong Kong resident to use it in Hong Kong, the royalty income received by the non-resident is chargeable to profits tax under Section 15(1)(a) or (b). Section 15(1)(a) is for the use of film, sound, videos, etc., in Hong Kong. Section 15(1)(b) is for the use of trademark, copyright, patent, etc., in Hong Kong.

### 47. Intellectual property used outside Hong Kong

There are two possibilities about the chargeability of the royalty income for an intellectual property used outside Hong Kong.

#### a. Royalty expense deductible under profits tax

Section 15(1)(ba) was enacted, with effect from 25 June 2004. If a person in Hong Kong pays royalty to a non-resident for the use of an intellectual property outside Hong Kong, and the royalty is a deductible expense of the payer under profits tax, then the non-resident is chargeable to profits tax on the royalty income so received.

#### b. Royalty expense not deductible under profits tax

If a person in Hong Kong pays royalty to a non-resident for the use of an intellectual property outside Hong Kong, and the royalty expense is not a deductible expense of the payer under profits tax, then the non-resident is not chargeable to profits tax on the royalty income so received.

#### c. Application of Section 15(1)(ba)

If the profits derived from the sales of goods bearing the intellectual property (such as trademark) are chargeable to profits tax, the royalty expense will likely be deductible. In such situation, the royalty income received by the non-resident owner is chargeable to profits tax under Section 15(1)(ba). If the selling profit is offshore, and not chargeable to profits tax, the royalty income will not be caught by Section 15(1)(ba), and not chargeable to profits tax.

### 48. Meaning of use of an intellectual property

It was decided in *Emerson Radio Corporation v CIR (1999)* that the place of use of trademark and patent was the place of manufacturing of goods bearing such trademark or using such design or process. Thus, if goods bearing a brand name are produced outside Hong Kong, the intellectual property is used outside Hong Kong. As a result, the royalty income received may be sourced outside Hong Kong.

However, the interest expense may be included in the cost of construction for the claim of initial allowance and annual allowance of industrial building or annual allowance of commercial building allowance. If the interest expense is of capital nature, it is not required to consider Sections 16(2), (2A), (2B) and (2C). Please refer to *Wharf Properties Ltd. v CIR* (1997) and *CIR v Tai On Machinery Works Ltd.* (1969).

b. **After the issue of occupation permit**

A building is treated as ready for use after the issue of occupation permit. If the building is constructed for the purpose of self-use as an office, a factory or a director's residence, the interest is treated as revenue in nature. The interest is generally deductible unless it falls within the restriction of Section 17(1)(f) in respect of expenses in connection with, any premises or part of premises not occupied or used for the purpose of producing such profits.

## V Expenses Deductible under Section 16

16. The expenses deductible under Section 16 may be summarised in the following table.

Section	Description
16(1)	Expense must be, to the extent, incurred in the production of assessable profits
16(1)(a)	Interest expense in connection with borrowing
16(1)(b)	Rent paid for land or building occupied
16(1)(c)	Overseas income tax on interest income etc.
16(1)(d)	Bad debts and provision for doubtful debts
16(1)(e)	Expenditure on repair
16(1)(f)	Expenditure on replacement of implement, utensil or article
16(1)(g)	Expense for registration of trademark or design or patent
16(1)(ga)	Expenditure for Sections 16AA, 16B, 16C, 16E, 16EA, 16F, 16G and 16I
16(2)(a)	Interest paid by a financial institution
16(2)(b)	Interest paid by a public utility company
16(2)(c)	Interest paid to an entity not a financial institution
16(2)(d)	Interest paid to a financial institution
16(2)(e)	Interest paid for the purchase of inventory or machinery
16(2)(f)	Interest paid on listed debentures or marketable instruments
16(2A)	Interest paid on loan secured by a deposit or another loan
16(2B)	Interest paid back to an associate of the borrower
16(2C)	Interest paid back through the purchase-back of listed debentures or marketable instruments

### 17. Additional conditions for interest paid by a business – Section 16(1)(a)

- In addition to satisfying the requirements of deduction of expenses covered in Section 16(1), the deduction of interest has to satisfy the conditions proved in Sections 16(2), (2A), (2B) and (2C). Details of those sections are covered in Chapter 18.
- If the interest is deductible under Sections 16(2), (2A), (2B) and (2C), the legal fees, procuration fees, stamp duties and other expenses in connection with such borrowing are also deductible under profits tax.

### 18. Rent paid for the purpose of producing assessable profits – Section 16(1)(b)

Section 16(1)(b) governs the deduction of rent paid by a taxpayer. If rent is paid to the spouse or partners or the spouses of the partners, the position is summarised as follows:

#### a. Rent paid by a sole-proprietorship business

Rent paid to the proprietor	Not deductible
Rent paid to the spouse of proprietor	Deductible

#### b. Rent paid by a partnership

Rent paid to a partner	Deductible
Rent paid to the spouse of a partner	Deductible

#### c. Rent paid by a corporation

There is no restriction imposed on the amount of rent paid by a corporation to its directors or shareholders. As long as the payment of rent satisfies the conditions provided in Section 16(1), the rent is deductible under profits tax.

### 19. Overseas income tax on interest income etc. – Section 16(1)(c)

In principle, overseas income tax is not an expense incurred in the production of chargeable profit, and it should not be deductible under profits tax. However, Section 16(1)(c) provides that if the overseas income tax is deducted or paid for income derived from interest, bill of exchange or certificate of deposit earned outside Hong Kong but taxable in Hong Kong under Section 15(1)(f), (g), (i), (j), (k) and (l), such overseas tax is deductible unless the taxpayer is eligible for double tax relief under Section 49.

### 20. Bad debts and provision for doubtful debts – Section 16(1)(d)

The deduction of bad debts and provision for doubtful debts is governed by Section 16(1)(d) which may be summarised into the following scenario:

- Only specific trade debts which have been included as trading receipts previously, and proved to be bad to the satisfaction of the assessor are deductible.
- Bad debt derived from a loan is not usually deductible because the loan is not part of trading receipt of the lender unless the lender is a financial institution or carries on a money-lending business.
- Loan made to staff and suppliers written off are not deductible because they are not trading receipts.
- General provision for doubtful debt is not deductible.
- Trade debts which are found becoming bad after cessation of business are not deductible.
- Recovery of bad debt which has been allowed previously is assessable in the year of assessment when the bad debt is collected – Section 16(1)(d)(ii).

24. **Example 18.11**

C Ltd. borrowed \$2,500,000 from Bank D at 9% interest rate p.a. The loan was used to finance:

- onshore activities in the amount of \$1,500,000, and
- offshore activities in the amount of \$1,000,000.

The loan was secured by a deposit of \$4,000,000 earning tax-free interest of 6% p.a. In the year of assessment, C Ltd. earned tax-free interest of \$240,000 from the deposit and paid interest of \$225,000 on the loan to Bank D.

**Answer**

The amount of interest expenses allowable for deduction will be reduced by \$90,000, which is calculated as follows:

$$\begin{aligned} \text{Interest disallowed} &= \text{Tax free interest} \times \frac{\text{Loan}}{\text{Deposit}} \times \frac{\text{Onshore loan}}{\text{Onshore loan} + \text{Offshore loan}} \\ &= \$240,000 \times \frac{\$2,500,000}{\$4,000,000} \times \frac{\$1,500,000}{\$1,500,000 + \$1,000,000} \\ &= \underline{\underline{\$90,000}} \end{aligned}$$

Thus, the interest deductible under profits tax is reduced to \$45,000 (i.e. \$135,000 – \$90,000).

[Note: Interest expense applicable to onshore activities = \$1,500,000 × 9% = \$135,000]

25. **Example 18.12**

C Ltd. borrowed \$2,500,000 from Bank D at 9% interest rate p.a. The loan was used to finance:

- onshore activities in the amount of \$1,500,000, and
- offshore activities in the amount of \$1,000,000.

The loan was secured by a deposit of \$2,800,000 earning tax-free interest of 6% p.a., and listed shares of a value of \$1,200,000. In the year of assessment, C Ltd. earned tax-free interest of \$168,000 from the deposit and paid interest of \$225,000 on the loan to Bank D.

**Answer**

The amount of interest expenses allowable for deduction will be reduced by \$63,000, which is calculated as follows:

$$\begin{aligned} \text{Interest disallowed} &= \text{Tax free interest} \times \frac{\text{Deposit}}{\text{Deposit} + \text{Shares}} \times \frac{\text{Loan}}{\text{Deposit}} \times \frac{\text{Onshore loan}}{\text{Loan}} \\ &= \$168,000 \times \frac{\$2,800,000}{\$4,000,000} \times \frac{\$2,500,000}{\$2,800,000} \times \frac{\$1,500,000}{\$2,500,000} \\ &= \underline{\underline{\$63,000}} \end{aligned}$$

Thus, the interest deductible under profits tax is reduced to \$72,000 (i.e. \$135,000 – \$63,000).

[Note: Interest expense applicable to onshore activities = \$1,500,000 × 9% = \$135,000]

26. **How to avoid being caught by Section 16(2A)**

In order not to fall into the trap of Section 16(2A), when a person borrows money and a security is required for the loan, it is better to secure the loan in the form of a mortgage of property, shares or personal guarantee. If the loan is secured or guaranteed by a deposit or a loan, the deposit or the loan should be in the name of a company carrying on a business in Hong Kong. The deposit and the loan should not be in the name of an individual or an overseas company which does not carry on a business in Hong Kong.

**V Interest Flow-back Test for Sections 16(2)(c), (d) and (e) – Section 16(2B)**27. **Interest flow-back test applicable to cases not involving listed debentures or marketable instruments**a. **Statute**

Section 16(2B) provides that if arrangements are in place whether between the borrower and the lender or otherwise, whereby any sum payable by way of interest on the money borrowed or on any part of the money borrowed is payable whether directly or through any interposed person, to the borrower or to a person (other than the lender) who is connected with the borrower, the amount of interest deduction shall be reduced by an amount calculated in accordance with the following formula:

$$\text{Interest disallowed} = \frac{A}{B} \times C$$

Where:

- means the total number of days during the basis period of the borrower for the year of assessment concerned, at the end of each of which the principal in respect of the money borrowed or in respect of the relevant part of the money borrowed, as the case may be, is outstanding and the arrangement are in place;
- means the total number of days during the basis period of the borrower for the year of assessment concerned, at the end of each of which the principal in respect of the money borrowed or in respect of the relevant part of the money borrowed, as the case may be, is outstanding; and
- means the total amount of sums payable by the borrower by way of interest on the money borrowed or on the relevant part of the money borrowed, as the case may be, which, but for Sections 16(2A) and (2C), would have been deductible under Section 16(1)(a) for the year of assessment concerned.

b. **Explanation and interpretation**

- If the interest received by the lender flows back to the borrower or an associate of the borrower, and the interest so received back by the borrower or its associate is not taxable in Hong Kong, the interest paid by the borrower may only be partially deductible or wholly not deductible under profits tax under Section 16(2B). This section applies to the situations in Sections 16(2)(c), (d) and (e), but does not apply to situations in Section 16(2)(f).

- b. If a corporation carries on a partnership business with others, and that partnership incurs an assessed loss while the corporation's own business has assessable profits in a year of assessment, the corporation's share of assessed loss incurred in that partnership can be used to set off against the corporation's assessable profits of its own business. In this way, the corporation's profits tax liability is reduced, and this results in a less amount of outflow of cash from the corporation. As the corporation's share of assessed loss in that partnership has been utilised to set off against its own corporation's assessable profits, the used loss cannot be carried forward in the partnership.
- c. Election for personal assessment is not mandatory in the case of natural person, and the application has to be made year by year. However, the set-off of loss in the case of corporation is mandatory under Section 19C(5).

10. **Example 22.1**

A Ltd and B Ltd are in a partnership with equal profit and loss sharing ratio. In year 1, the partnership incurred a loss of \$200,000 while A Ltd made a profit of \$70,000 in its main business.

**REQUIRED:**

What is the treatment of loss in the partnership and the profits tax implication to A Ltd's main business profit?

**Solution**

A Ltd's share of loss in the partnership is set off against the profit of A Ltd's main business profit as follows:

<b>Statement of Loss of Partnership</b>			
	A Ltd	B Ltd	Total
Loss for the year	\$100,000	\$100,000	\$200,000
Less: Loss set off against A Ltd's profit	70,000	0	70,000
Loss carried forward	\$30,000	\$100,000	\$130,000
	↓	↓	
	Carried forward to set off against A Ltd's share of future profit in the partnership	Carried forward to set off against B Ltd's share of future profit in the partnership	

The assessable profits of A Ltd's main business in the amount of \$70,000 is fully set off by its share of loss in the partnership with B Ltd. As a result, no profits tax is payable by A Ltd.

11. **Loss brought forward from the same business**

Before arriving at the assessable profits of a partnership business, the profit of that partnership is reduced by partners' share of unrelieved loss brought forward from the previous year. As some partners may elect for personal assessment in the year when the partnership sustains a loss, and they will not have any share of loss to carry forward to set off against the future profit of the business, it is possible that a partnership business has assessable profits, but at the same time the partnership has loss carried forward in the same year of assessment.

**IV Corporation**

12. **Loss for the year without share of current year profit from a partnership**

Assessed loss of a corporation is usually carried forward to set off against assessable profits of the corporation for subsequent years [Section 19C(1)] unless the loss has been set off against individual corporate partner's assessable profits under Section 19C(5). It is not necessary that the loss has to be set off against the future profit of the same type of business conducted by the corporation.

13. **Loss for the year with share of current year profit from a partnership under Section 19C(4)**

If a corporation carries on a partnership business with others, and that partnership has an assessable profit while the corporation's own business incurs an assessed loss in a year of assessment, the corporation's assessed loss can be used to set off against the corporation's share of assessable profits in that partnership business. In this way, the partnership's profits tax liability is reduced, and this results in a less amount of outflow of cash from the partnership. As the corporation's assessed loss has been utilised to set off against its share of partnership profit, the used loss cannot be carried forward by the corporation.

14. **Example 22.2**

In Year 2, X Ltd incurred a loss of \$140,000 in its main business. X Ltd is in a partnership with Y Ltd with an equal profit sharing ratio. That partnership made a profit of \$240,000 in the same year.

**REQUIRED:**

What is the treatment of X Ltd's business loss and the profits tax implication in the partnership?

**Solution**

X Ltd's share of loss in the business is set off against its share of profit in the partnership with Y Ltd as follows:

b. **Challenged by Sections 61 and 61A**

The success of transfer pricing also depends on whether the transactions are artificial under Section 61 or whether there is any commercial justification for establishing those overseas companies, and whether any staff are actually employed in those overseas countries. The arrangement may also be challenged under Section 61A.

## XI Use of Loss Companies within a Group

27. **Basic principle**

If there are companies within a group incurring losses, it is possible to transfer profitable assets or projects to those loss companies. The profit made from such assets or projects will be used to set off against the loss of the transferee company and at the same time the transferor companies will be able to reduce their profits tax liability. As a result, the profits tax liability for the whole group is reduced.

28. **Planning techniques and caution**

If the arrangement is merely a transfer of profit in the form of management fee without any substance, such activities are not acceptable by the CIR. The arrangement may be attacked under Sections 61 and 61A.

## XII Selection of Accounting Date at the Commencement of Business

29. **Basic principle**

The basis for the calculation of assessable profits depends on the existence of the basis period for a year of assessment. If there is no basis period for a year of assessment, there is no assessable profits for that year of assessment. It is possible that there is no basis period in the year of commencement of a business.

30. **Planning techniques**

It is possible for a new business to choose an appropriate account closing date so as to defer its tax liability. If a company commences business and chooses to close its first account at a date that is in the second year, and the first account is not more than 12 months, there will not be any basis period in the year of commencement. (Please refer to Part III of Chapter 23 for the detailed arrangement.)

## XIII Year End Tax Planning

31. **Basic principle**

The principle is to increase the amount of deduction and to reduce the amount of taxable income before the close of the accounting year.

32. **Planning techniques for purchase of machinery**

If a company wishes to purchase equipment or machinery at the beginning of the following year, it may purchase the equipment or machinery before the close of the current account year. In this way, company will get depreciation allowance on those assets in the year of purchase, and this can reduce the assessable profits of the current year.

33. **Planning techniques for delaying issuing invoices**

If a company wishes to reduce its revenue for the current year, it may withhold from sending invoices to its customers before the year end or wait until the work has been completed. In this way, the income is reflected in the following year, and the profits tax liability may be delayed for one year.

34. **Planning techniques for doubtful debts**

A company may adopt a more stringent debt control policy by shortening the period of collection and recognising doubtful debts at an earlier stage. As long as the policy is consistently carried out in a reasonable manner, the practice is accepted by IRD. A more stringent policy on the provision of doubtful debts will reduce the net profit of a company.

35. **Planning techniques for obsolete stock**

Similar to the provision of doubtful debts, a more stringent stock policy will recognise slow-moving stock at an earlier stage, and provides a larger provision deductible from assessable profits. If the policy is consistently carried out in a reasonable manner, the IRD will not challenge the practice. A more stringent policy on the provision of obsolete stock will reduce the net profit of a company.

## XIV Caution for Profits Tax Planning

36. A profits tax plan requires a lot of follow-up actions after the implementation so as to maintain its effectiveness. These include:

a. **Properly documented**

The plan must be properly documented, and all the transactions have to be supported by documents. These may demonstrate that the transactions are not artificial or fictitious. When the plan is challenged by IRD, and comes to the court, the court will look for the relevant documents to make its decision on the validity of the plan.

b. **Continuous monitoring**

It is common that clients are willing to keep proper records and everything is tidy at the initial or implementation stage of the plan. As time goes by, clients become relaxed at keeping the proper records and following up the steps required for the tax plan. Thus, many tax plans become not effective after some years have passed as a result of lacking continuous supervision.

c. **Real transactions**

The transactions must be real, and should not be artificial. If not, the plan can be overturned by Section 61 or the client may be chargeable with fine or imprisonment.

d. **Anti-avoidance transactions**

Although the transactions are real, there are a lot of specific anti-avoidance provisions and the general anti-avoidance provisions of Sections 61 and 61A to fight back the tax plans. Tax professionals have to be very alert and careful of those anti-avoidance provisions.

- b. the nature of the trade carried on in the property – Section 40, and
- c. the amount of cost of construction incurred.

### III Building Qualified for Industrial Building Allowance

#### 5. Definition of industrial building

Section 40(1) defines an industrial building as any building or structure or part of it used:

- a. for the purposes of a trade carried on in a mill, factory or other similar premises; or
- b. for the purposes of a transport, tunnel, dock, water, gas or electricity undertaking or a public telephonic or public telegraphic service; or
- c. for the purposes of a trade which consists of the manufacture of goods or materials or the subjection of goods or materials to any process;
- d. for the purposes of a trade which consists in the storage –
  - i. of goods or materials which are to be used in the manufacture of other goods or materials; or
  - ii. of goods or materials which are to be subjected in the course of a trade to any process; or
  - iii. of goods or materials on their arrival into Hong Kong; or
- e. for the purposes of the business of farming; or
- f. for the purposes of research and development related to any trade, profession or business.

#### 6. Definition of structure

IRO does not define the meaning of "structure", but "structure" usually includes the following:

- a. walls,
- b. bridges,
- c. dams,
- d. fish-ponds,
- e. banks around paddy fields,
- f. constructed parking grounds,
- g. roads,
- h. boreholes and wells,
- i. sewers,
- j. water mains and tunnel linings,
- k. wharves,
- l. acoustic tile ceiling (installed as an integral part of a building),
- m. ceiling light points,
- n. cocklofts,
- o. formica wall panelling (installed as an integral part of a building),
- p. telephone cable and wiring (installed as an integral part of a building),
- q. wiring and electrical fixtures and fittings (installed as an integral part of a building).

#### 7. Structure not qualified for industrial building allowance

Section 40(1) provides that "industrial building or structure" does not include any building or structure or part of any building or structure used for the following purposes:

- a. dwelling house (other than as a dwelling house for the housing of manual workers),
- b. retail shops,
- c. showroom,
- d. hotel, or
- e. office.

#### 8. 10% rule on non-qualifying part of industrial building

- a. If the non-qualifying part for the use as an industrial building does not exceed one-tenth of the industrial building, the expenditure incurred on the non-qualifying part is still entitled to industrial building allowance.
- b. If the non-qualifying part exceeds one-tenth of the industrial building, the cost of construction will be divided into two parts. One part is granted with industrial building allowance while the remaining non-qualifying part is granted with commercial building allowance.

### IV Determination of Cost of Construction and Initial Allowance

#### 9. Initial allowance (首年折舊免稅額 或 初期折舊免稅額)

- a. Where a person incurs capital expenditure on the construction of a building or structure which is to be an industrial building (i.e. within the definition of "industrial building" as defined in Section 40), he or she is entitled to an initial allowance of 20% on the cost of construction for the year of assessment in the basis period in which the expenditure was incurred – Section 34(1).
- b. Initial allowance is granted no matter whether the building is in use or not in use during the basis period of that year of assessment.

#### 10. Definition of cost of construction (建築成本)

- a. Capital expenditure does not only mean the actual construction cost, but interest expense etc. incurred before the completion of the building. Section 40(1) defines capital expenditure to:
  - i. *include* interest paid and commitment fees incurred in respect of a loan made for the sole purpose of financing the provision of an industrial building or structure or commercial building or structure or machinery or plant; but
  - ii. *not include* expenditure which is reimbursed by way of or attributable to any grant, subsidy or similar financial assistance.

16. **Tax rebate for personal assessment**

There is a one-off tax rebate (or reduction of tax) for all taxpayers for some years of assessment as follows:

	2008/09	2009/10 – 2010/11	2011/12	2012/13 – 2013/14	2014/15
Tax rebate	100%	75%	75%	75%	75%
Ceiling	\$8,000	\$6,000	\$12,000	\$10,000	\$20,000

A single person will get a tax rebate of \$10,000 for year of assessment 2013/2014. If married couples make the election for personal assessment together, the ceiling for each couple is the same figure as shown above for a single person, and not double of the above amount. A married couple gets tax rebate of \$10,000 in total for year of assessment 2013/2014.

17. **Tax set-off under personal assessment**

If an individual has paid salaries tax, profits tax and / or property tax, the tax so paid is used to set off against the personal assessment tax payable – Section 43(2). If the aggregate of the tax paid is more than the personal assessment tax payable, a refund of tax is made under personal assessment – Section 43(3).

18. **Format of personal assessment tax computation**

Net assessable value		A	
Net assessable income (after deduction of self-education expenses)		B	
Assessable profits (after deduction of charitable donation)		C	
		D	
Less: Interest (not exceeding the net assessable value)		E	
		F	
Less: Business loss		G	
		H	
Less: Concessionary deductions:			
Charitable donation #	J		
Elderly residential care expenses	K		
Home loan interest	L		
Contribution to recognised retirement fund	M	N	
Net personal assessment income		O	
Less: Personal assessment loss brought forward from previous year		P	
Net personal assessment income (after loss set-off)		Q	
Less: Personal allowances		R	
Net chargeable income under personal assessment		S	
# Maximum amount of charitable donation deductible under personal assessment is calculated as follows:			
J = [35% × (F + Donation already allowed under profits tax + Self-education expense allowed under salaries tax)] – Donation already allowed under profits tax			

**VI Payment of Personal Assessment Tax**

19. **No provisional tax for personal assessment**

Readers may remember that there is a provisional payment for current year of assessment for profits tax, property tax and salaries tax. However, there is no provisional tax payable for personal assessment.

20. **Split payment of personal assessment tax between spouse**

For married couples, the personal assessment tax is calculated on a joint basis. However, the liability for payment of tax is apportioned between the husband and the wife based on to their respective proportion of income after deduction of concessionary deductions – Section 42(2B).

**Example 32.7**

Mr. Black owns a property and received rental income of \$450,000 for year of assessment 2013/2014, and the tenant is responsible for the payment of rates. For year of assessment 2013/2014, Mr. Black received salaries of \$280,000 from his employer, and contributed \$14,000 to his mandatory provident fund. Mrs. Black's sole proprietorship business's assessable profits was \$160,000. Mrs. Black paid \$100,000 to a Hong Kong registered nursing home for her 65-year-old mother's resident fee. They do not have any children below the age of 18.

**REQUIRED:**

Calculate Mr. and Mrs. Black's personal assessment tax liability for the year of assessment 2013/2014.

**Solution**

	Mr. Black	Mrs. Black
	\$	\$
Net assessable value (\$450,000 × 80%)	360,000	0
Net assessable income	280,000	0
Assessable profits	0	160,000
	<u>640,000</u>	<u>160,000</u>
Less: Elderly residential care expenses (max. \$76,000)	0	76,000
Contribution to mandatory provident fund (max. \$15,000)	14,000	0
	<u>626,000</u>	<u>84,000</u>
Total joint income		710,000
Less: Married person's allowance		<u>240,000</u>
Net chargeable income		<u>470,000</u>
Tax at progressive rate \$40,000 @2%		800
\$40,000 @7%		2,800
\$40,000 @12%		4,800
\$350,000 @17%		59,500
		<u>67,900</u>
Less: Tax rebate (max. \$10,000)		<u>10,000</u>
Joint personal assessment tax payable		<u>57,900</u>

39. **How to demonstrate not owning any other residential property**

When presenting an agreement for sale/conveyance on sale in respect of a residential property transaction to the Stamp Office for stamping, for which a claim is made that the Scale 1 applies, the purchaser will be required to furnish a statutory declaration to declare whether he owns any other residential property in Hong Kong. The Stamp Office will verify the correctness of the information deposed from its available information, including a check with the Land Registry records.

40. **Provisional Agreement for Sale and Purchase (PASP) signed before 23 February 2013 and signed a Formal Agreement for Sale and Purchase (FASP) on or after that date**

For stamp duty purposes, a PASP is a chargeable agreement for sale. The parties who entered into a PASP for acquisition of a property before 23 February 2013 is regarded as having "acquired" the property before that date. Hence the Scale 1 will NOT apply to the acquisition of the property, and no new double stamp duty rate is paid for the FASP.

41. **Property acquired on or after 23 February 2013 by a company whose shareholders and directors are all HKPRs**

If a limited company, regardless of the residency status of its shareholders and directors, acquires a residential property or non-residential property on or after 23 February 2013, Scale 1 will apply unless the transaction is specifically exempted from the new double stamp duty rate.

42. **Section 29 certificate**

In order to enjoy the lower rate of ad valorem stamp duty below 8.5%, a certificate (which is actually a paragraph) under Section 29 is required to be put in the agreement for sale, the conveyance on sale or deed of gift declaring that the transaction is not part of a series of transactions, the value of which will exceed the lower block of stamp duty. In the absence of such Section 29 certificate, the top rate of 8.5% will be applied to the value of the agreement for sale, the conveyance on sale or deed of gift (as the case may be) even though the stamping value does not exceed \$21,739,121.

43. **Marginal relief**

As the ad valorem stamp duty rate is applied to the whole value of the property, the stamp duty payable rises sharply when the stamping value is emerging to the next higher block of stamp duty. In order to avoid the aforesaid hardship, Heads 1(1) and 1(1A) provide a marginal relief of ad valorem stamp duty when the stamping value just exceeds the lower block of stamping value as demonstrated in the example below.

**Example 37.1**

Mr. Chan sells an immovable property to Mr. Dick for a consideration of \$3,100,000. The ad valorem stamp duty is calculated twice by using the following methods:

a. \$3,100,000 × 4.5%	<u>\$139,500</u>
b. \$3,000,000 × 3%	\$90,000
Add: \$(3,100,000 – 3,000,000) × 10%	<u>\$10,000</u>
	<u>\$100,000</u>

Stamp duty on the transaction is payable on the lower amount, i.e., \$100,000.

44. **Fraction of \$1**

Under Section 18A, any fraction of \$1 included as stamp duty, penalty or interest payable under the SDO is reckoned as \$1.

## VII Special Stamp Duty on Residential Property

45. **Definition of stamp duty and special stamp duty**

Section 2 defines stamp duty and special stamp duty as follows:

"Stamp duty" (印花稅) means stamp duty chargeable under the Stamp Duty Ordinance and includes additional stamp duty chargeable under Section 13(10), buyer's stamp duty and special stamp duty.

"Special stamp duty" (額外印花稅) means special stamp duty chargeable under Head 1(1AA) or (1B) in the First Schedule.

46. **Original special stamp duty effective from 20 November 2010**

Sections 29CA and 29DA were enacted to cool down the speculation of the property market with the introduction of special stamp duty under Heads 1(1AA) and 1(1B) in the First Schedule on residential property acquired on or after 20 November 2010.

If the property is disposed within 2 years after the date of purchase, a special stamp duty (in addition to the normal stamp duty under Head 1(1) or 1(1A) as the case may be) is payable on the transaction as shown in the following table.

Disposal within a period after purchase	Rate of special stamp duty
6 months	15%
12 months	10%
24 months	5%

47. **New special stamp duty effective from 27 October 2012**

Sections 29CA and 29DA were proposed to amend to further cool down the uprising speculation of the property market with the amendment of special stamp duty under Heads 1(1AA) and 1(1B) in the First Schedule on residential property acquired on or after 27 October 2012.

Section 29CA and Head 1(1B) relate to the charge of special stamp duty on agreement for sale for the purchase of residential property. Section 29DA and Head 1(1AA) relate to the charge of special stamp duty on conveyance on sale for the purchase of residential property.

If the property is disposed within 3 years after the date of purchase, a special stamp duty (in addition to the normal stamp duty under Head 1(1) or 1(1A) as the case may be) is payable on the transaction as shown in the following table.

Disposal within a period after purchase	Rate of special stamp duty
6 months	20%
12 months	15%
36 months	10%