Refunds

A claim for a refund of taxes which have been overpaid must be lodged within six years from the end of the relevant tax year or within six months from the date on which the notice of assessment was served (whichever is the later). If the claim is proved to the satisfaction of the Commissioner, the taxpayer is entitled to have the amount of the excess taxes refunded (see ¶10-8700).

Payment and recovery of tax are dealt with in Chapter 10 (¶10-0200ff).

[¶1-3900] Offences and penalties

Failure to comply "without reasonable excuse" (see ¶12-4400) with the various requirements of the Ordinance is an offence, for example:

- failure to furnish a return or furnishing an incorrect return;
- failure to comply with the Commissioner's request for information;
- wilful intention to evade tax through false statements or supplying inaccurate information.

It is also an offence for breaches of official secrecy under the Ordinance.

Evasion

A person who wilfully intends to evade or assists another person in evading tax through, for example, non-disclosure, making false statements, providing false information or maintaining false records, is guilty of an offence (see ¶12-5100). Penalties for wilful evasion range from a set fine, together with a further fine of treble the amount of tax undercharged, to imprisonment for three years. Severe penalties have been handed down by the courts in circumstances involving blatant tax evasion.

Offences and penalties are dealt with in Chapter 12 (¶12-0200ff).

STAMP DUTY ORDINANCE

[¶1-4500] Overview of stamp duty scheme

Stamp duty is levied under the *Stamp Duty Ordinance* (Cap 117). The scheme of the Ordinance is relatively straightforward. Stamp duty applies only to instruments evidencing transactions which involve immovable property, stocks or shares. Some instruments attract a fixed amount of duty per instrument while others are subject to *ad valorem* duty.

Instruments which are chargeable with stamp duty are:

- instruments for the conveyance or lease of immovable property in Hong Kong (see ¶14-0400);
- agreements for the sale of immovable residential property in Hong Kong (see ¶14-1080);
- instruments for the sale, purchase or other transfer of Hong Kong stock (see ¶14-1550);
- Hong Kong bearer instruments (see ¶14-2700); and
- duplicates and counterparts (see ¶14-2900).

The Governmet has adopted several measures for the property market over the past years, for example, the introduction of Special Stamp Duty ("SSD") in November 2010, which is imposed on transactions of residential properties for all values if the residential property

There is no special form of construction required for instruments liable to stamp duty, except that stamp duty must be capable of appearing on the "face of the instrument" and when so affixed shall not be used for, or applied to, any other document (see ¶14-4950). If an instrument contains or relates to several distinct matters, it is charged with duty in respect of each separate subject matter.

All the facts and circumstances affecting the amount and liability to stamp duty of a document are required to be fully set out in the instrument. In determining the liability of a document to stamp duty, the Collector has the power to call for additional material in order to satisfy himself that all the facts and circumstances affecting liability of the document to duty or the amount of duty chargeable on the instrument are fully disclosed therein (see ¶14-6000). Any person who, with intent to defraud the Government, (a) executes any document which does not contain all the relevant details, or (b) is involved in the preparation of any instrument and neglects to include all the facts and circumstances, commits a criminal offence (see ¶14-7700).

Adhesive stamps

Contract notes for the sale or purchase of "Hong Kong stock" may be stamped by means of adhesive stamps in lieu of submitting the document to the Collector for stamping (see ¶14-5030). Adhesive stamps are available for purchase from the Stamp Duty Office.

Where stamp duty is permitted to be denoted by an adhesive stamp, the stamp must be cancelled in such a manner as to render it incapable of being used again. The normal manner in which this is done is by writing the word "cancelled" across the face of the stamp, together with the date and the signature or initials of the person cancelling it. A contract note is not regarded as having been stamped for the purposes of the Ordinance if the adhesive stamp has not been properly cancelled.

[¶1-4900] Time limit for stamping

The period within which an instrument is required to be stamped is set out in the First Schedule (see ¶14-5190). Where a document is required to be stamped before "execution", then it must be stamped prior to signature by any party to the instrument.

Late stamping

A document which is not stamped within the appropriate time period may be stamped by the Collector out of time upon payment of penalties, in addition to normal stamp duty, as follows:

- when the document is stamped within one month of the time limit imposed by the Ordinance, the penalty is double the duty listed in the Schedule;
- when stamped later than one month but within two months of the time limit, the penalty is four times the normal amount of stamp duty; and
- after the expiration of two months from the proper date, the penalty is 10 times the amount of the prescribed duty (see ¶14-5270).

The Collector has an overriding discretion to waive payment of part or all of these penalty rates of duty.

The penalty scheme outlined above does not apply where a request is made to the Collector for an opinion as to (i) whether an instrument is liable for duty and/or (ii) the amount of duty chargeable (see ¶14-6000). The duty only becomes payable after the expiration of one month from the date of the Collector's adjudication, even though the time period in the Schedule may have expired.

person, for example, through material included in trade or professional directories, journals or other publications, the issue of name cards, statements at public functions, information contained in press releases, etc (DIPN No 25 (Revised), para 29).

Since all of the above conditions must be fulfilled in order for a service company or trust arrangement to escape the effect of s 9A(1), it is expected that s 9A(3) exemption will rarely apply. It is unlikely that even a taxpayer who genuinely is not an employee would be able to fulfil the stringent requirements of this provision.

Where the Commissioner is satisfied that no employment exists

An individual performing services will not be deemed to be an employee of a person paying the remuneration for those services to a service company or trust if the individual can establish, to the satisfaction of the Commissioner, that his or her performance of services was not in substance the holding of an office or employment of profit (s 9A(4)).

In exercising his discretion under this provision, the Commissioner will have regard to whether or not the individual's performance of services displays the accepted characteristics of an office or employment of profit as opposed to a contract for services, as set down in case law.

See ¶2-2850 for a discussion of the "control test", the "economic reality test", the "integration test" and the "mutuality of obligations test".

On the surface, this provision appears to provide a less stringent avenue for escaping to application of s 9A(1). However, careful consideration of all of the circumstances of the relevant arrangement will be required to determine whether or not an employment relationship exists. In practice, since the Inland Revenue has repeatedly expressed its intention to curtail the avoidance of tax through service company arrangements, the Commissioner is unlikely to exercise his discretion lightly. In order to escape the effect of s 9A(1) under this provision, an individual may be required to establish many, if not all, of the factors required under s 9A(3) (listed above) in order to satisfy the Commissioner that he or she does not hold an office or employment of profit. Note, in this regard, the information required to be provided and the list of questions required to be answered by an individual who requests an advance ruling under s 9A(4).

In *Case* P19 (2006) HKRC ¶81-171 (*D13/06* IRBRD Vol 21), the taxpayer sought to rely on s 9A(4) after failing to satisfy all the six criteria set down in s 9A(3). The Board noted the following facts of the case:

(i) The taxpayer had only one full time job at all material times, being a deputy director or consultant at the hospital. He had committed himself to work exclusively for the hospital for five years.

(ii) The taxpayer received a steady monthly income from the hospital.

(iii) The taxpayer was under the hospital's control and held himself out as its officer.

(iv) The Board was unable to see any real entrepreneurship on the part of the taxpayer due to the absence of any business decision or managerial function to be made by the taxpayer and risk taken by the taxpayer.

By looking at the whole picture, the Board concluded that the relationship in question was one of employment in substance and s 9A(4) was not satisfied.

Where the individual performing the services and the person paying the remuneration are the same

An employer/employee relationship cannot exist when there is only one party involved: a person cannot employ himself. Therefore, for the avoidance of doubt, it is specifically declared that s 9A(1) does not apply where either:

5. Can the service company or the relevant individual work for others without the approval of the relevant person? Can the service company or the relevant individual refuse the performance of a particular task or job requested by the relevant person?

B. *Integration Test* (to determine whether the relevant individual is holding a position within the organisation of the relevant person).

1. Does the relevant individual represent to third parties that he is a staff member of the relevant person?
2. Does the relevant individual get promotions within the organisation framework of the relevant person?
3. Does the relevant individual have subordinates who are staff of the relevant person?
4. Is the relevant individual part and parcel of the organisation of the relevant person?
5. Is the relationship a continuing one or does it exist only to procure a result?

C. *Economic Reality Test* (to determine whether the income of the relevant individual is in effect derived from the relevant person and whether the relevant individual is at risk with his capital).

1. Does the relevant person provide the equipment or assistants while the relevant individual is performing his duties?
2. Does the relevant individual contribute capital and in what amount? Can the capital be at risk and in what way?
3. How is the remuneration received by the service company from the relevant person computed? How is the remuneration received by the relevant individual from the service company computed?
4. What is the duration of the agreement between the service company and the relevant person? Will the agreement be renewed and on what basis?

The Commissioner in some cases may seek further information from the relevant individual or a third party in order to make an advance ruling.

[¶2-0600] Prevention of double taxation

To prevent the double taxation of income, where an individual becomes chargeable to salaries tax on remuneration deemed to be employment income under s 9A(1):

(i) the corporation or trustee to whom the remuneration was paid or credited is not chargeable to tax on that remuneration; and

(ii) the individual is not chargeable to tax on any remuneration paid or credited to him or her by the corporation or trustee in respect of any office or employment held by the individual with the corporation or trust (to the extent that the remuneration is attributable to services performed under the service company or trust arrangement) (s 9A(5)).

[¶2-0650] Application of general anti-avoidance provisions

The Inland Revenue's view is that, depending upon the facts of the case, an arrangement which falls outside the scope of s 9A may nevertheless be charged to salaries tax by the operation of the general anti-avoidance provisions of the *Inland Revenue Ordinance* (Cap 112) (s 61 and 61A) (DIPN No 25 (Revised), para 58). The Privy Council decision in *CIR v Challenge Corporation Limited* (1987) 2 WLR 24 is cited as authority for the proposition that a general anti-avoidance provision can apply notwithstanding the existence of specific anti-avoidance provisions.

However, if the sum is withdrawn in the case of termination of service and it is attributable to contributions made by the employer, the amount excluded from the relevant employee's income is restricted to the amount that does not exceed the proportionate benefit calculated under s 8(5) (s 8(2)(cc)(i); 8(4)) (see ¶2-2000).

- **Monetary Authority provident fund benefits**. Benefits withdrawn from any provident fund scheme to which the Monetary Authority is a party which are received by any person appointed to be the Monetary Authority under s 5A(1) of the *Exchange Fund Ordinance* (Cap 66) or by any person appointed under s 5A(3) of that Ordinance. The exemption of these benefits is subject to the same conditions and restrictions which apply in relation to the exclusion from tax of sums received from a recognised occupational retirement scheme, see ¶2-2000 (*Exemption from Salaries Tax (Monetary Authority) Order*).
- **Army emoluments**. Emoluments payable by the Central People's Government to members of the Chinese People's Liberation Army, and to persons in the permanent services of that Government in Hong Kong (s 8(2)(d)).
- **Army pensions**. Wound and disability pensions granted to members of the Chinese People's Liberation Army (s 8(2)(e)).
- **Army gratuities**. Gratuities granted to members of the Chinese People's Liberation Army for services rendered during war (s 8(2)(f)).
- **War memorial pensions**. The Hong Kong War Memorial Pensions and any additional benefits paid under the *Hong Kong War Memorial Pensions Ordinance* (Cap 386) (s 8(2)(fa)).
- **Educational endowment**. Any amount arising from a scholarship, exhibition, bursary, or other similar educational endowment held by a person who is receiving full time instruction at an educational establishment (s 8(2)(g)).
- **Central People's government servants temporarily in Hong Kong**. Emoluments payable by the Central People's Government to persons serving temporarily in Hong Kong on the same terms as they are employed in the Mainland China, but who are liable for overseas service or are recruited in the Mainland China specially for Hong Kong service (s 8(2)(h)).
- **Alimony or maintenance**. Any periodical payment of alimony or maintenance received by a person from his or her spouse or former spouse (s 8(2)(i)).
- **Ship or aircraft crew**. Income derived by members of the crew of a ship or aircraft in certain circumstances (s 8(2)(j)) (see ¶2-3900).
- **Salary from another person**. Any salary paid by another person who is chargeable to profits tax which, but for s 17(2), would be deductible in computing the profits of that person (s 8(2)(k)). Section 17(2) renders remuneration of a spouse or, in the case of a partnership, remuneration of a partner or a partner's spouse non-deductible.
- **Discharge of employer's own liability**. Any amount paid by an employer, to the benefit of a taxpayer, where the relevant payment is one for which the employer has the sole liability — provided that the benefit is not convertible into money, not an education benefit for the taxpayer's child, and not in connection with a holiday journey (s 9(1)(a)(iv); 9(2A)) (see ¶2-1500).
- **Rent payments or refunds**. Payments or refunds of rent made to employees by employers (s 9(1A)).

However, in *Case* K31 (2001) HKRC ¶80-762 (*D56/00* IRBRD Vol 15) and *Case* K46 (2001) HKRC ¶80-777 (*D85/00* IRBRD Vol 15), the taxpayers rented properties from their

Example

If Ms A received $500 to be disposed of as she wished then, all else being equal, the amount would have been derived beneficially by Ms A and would be taxable "income". If, however, Ms A was paid $500 on condition that she invest it and pay the proceeds to Mr B then the income would not have been derived beneficially by Ms A. She could not treat the amount as her own and dispose of it as she wished. The amount would not then be "income".

[¶2-1200] Money or money's worth

To constitute "income" at common law there must have been a receipt of money or something capable of being turned into money.

It is not necessary for income to be received in the form of money. It is sufficient if the item is in a form which can be converted into money or money's worth (*Cross v London & Provincial Trust Ltd* (1938) 1 All ER 428).

A taxpayer's right to be reimbursed by his or her employer for dental fees, which he or she had incurred and paid, was a benefit or perquisite which was convertible into money or money's worth, and so deemed to be taxable in *D56/86* IRBRD Vol 2, 323.

[¶2-1250] Reward for services rendered

Receipts which are the product of personal exertion in employment are usually regarded as "income" at common law. Gains which are not linked to employment, such as gifts flowing from personal considerations, or "windfall" gains such as betting or lottery wins, are not.

A gift is only taxable as "income" if it is given for a reason which is connected with the recipient's employment. An example of an assessable gift is a tip paid in appreciation of the quality of services rendered. Such payments have been held to be income in a number of situations, including in the case of:

- a taxi-cab driver (*Calvert v Wainwright* (1947) 27 TC 475);
- a railway dining car waiter (*Penn v Spiers & Pond Ltd* (1908) 1 KB 766); and
- a railway porter (*Great Western Railway Co v Helps* (1918) AC 141).

Money collected by a professional cricket player from appreciative spectators was characterised as "income" in *Moorhouse v Dooland* (1955) 1 All ER 93. In that case, the taxpayer was a professional cricket player entitled under his contract of employment to make public collections from spectators whenever he performed outstanding cricket feats. The money collected on those occasions was held to be "income" as it was directly related to his employment. In contrast, the proceeds of a benefit match for a professional cricket player were regarded as non-assessable in *Seymour v Reed* (1927) AC 554. The proceeds were characterised as a tribute to the taxpayer's personal attributes, rather than income from his or her employment.

A number of basic principles which a Court may consider when deciding whether a voluntary payment qualifies as "income" were set out in the *Moorhouse* case:

(i) The test of liability to tax on a voluntary payment is whether, from the standpoint of the person who receives it, it accrues as a reward for services.

(ii) If the taxpayer's contract of employment entitles him or her to receive the payment, there is a strong ground for holding that the payment accrues by virtue of the employment and is therefore income.

(iii) The fact that a voluntary payment is of a periodic or recurrent character affords a further, though less cogent ground for the same conclusion. (The element of

United Kingdom authority

United Kingdom authority holds that an inducement payment is taxable as an emolument from employment (*Glantre Engineering Ltd* v *Goodhand* 56 TC 165). The Board of Review, citing the *Glantre* case, has stated that "emolument" corresponds with "income" in s 8 and 9 of the *Inland Revenue Ordinance* such that an inducement sum is taxable as income from employment (*Case* D42 (1994) 1 HKRC ¶80-292 (*D3/94* IRBRD Vol 9)).

The Board in *Case D42* also referred to the United Kingdom case of *Shilton* v *Wilmshurst* (1991) STC 88 as authority for the principle that the payment of a sum of money by a third party, who was not the employer, to a taxpayer as an inducement to enter a contract of employment with the employer was taxable as an emolument "from employment" because it was an emolument "from becoming an employee". In the Board's view this principle applies to payments from an employer as well as from a third party. Accordingly, the Board held that the phrase "income from employment" in the *Inland Revenue Ordinance* means "income from being or becoming an employee".

Termination payments

When considering whether a termination payment qualifies as taxable "income" it is essential to determine why it was made. A payment made out of personal esteem, for instance, is not regarded as "income" (*Seymour*). A payment made simply to discharge a personal obligation and not connected with the taxpayer's employment is also non-taxable. A taxpayer who was promised by his employer that his previous employment with another company would be taken into account when his severance pay was calculated was not assessed to salaries tax on the part of his severance payment which apparently related to his former employment (*D24/88* IRBRD Vol 3, 289). According to the Board of Review, the payment was not income from the taxpayer's employment. The payment represented a discharge of the director's personal obligation to the taxpayer and, therefore, was not a payment for services.

A termination payment constitutes taxable "income" only if it relates to the services rendered by the taxpayer during his or her employment. A termination payment which has been pre-arranged as part of the terms of employment may be regarded as a deferred payment for services rendered and, therefore, taxable income (*Henry v Foster* 16 TC 605).

The Court of First Instance in *Fuchs, Walter Alfred Heinz v Commissioner of Inland Revenue* (2008) HKRC ¶90-209 adopted the following approach in determining the taxability of the termination payments:

(i) Look at the contract as a starting point — if a payment had been made upon premature termination which was not a contractual entitlement, it would be *prima facie* not income from employment ie not assessable.

(ii) On the other hand, payment made pursuant to the contract as an entitlement on early termination would be *prima facie* "income arising in or derived from the office…".

(iii) However, if it could be shown that the payment was truly compensation for loss of office or damages for breach of contract, it would not be assessable.

(iv) Damages for breach would logically not be provided for in the contract.

The taxpayer's appeal to the Court of Final Appeal in *Fuchs, Walter Alfred Heinz v Commissioner of Inland Revenue* (2010) HKRC ¶90-234 was dismissed. The Court held that the payments to the taxpayer were paid in satisfaction of the rights which accrued to the taxpayer under a clause in the employment contract and were plainly amounts derived from his employment. They were not sums paid in consideration of the abrogation of the taxpayer's rights under the employment contract.

Separation Agreement. The taxpayer claimed that the discretionary bonus and Share Option Gain under the Separation Agreement should not be taxable. The Board found the discretionary bonus is stemmed from the Service Agreement instead, and therefore it is taxable. Besides, the Taxpayer was granted the Share Option as an Eligible Person under the Company's Share Option Scheme and not from the Separation Agreement. Therefore, the Share Option Gain would be income from office or employment and would be subject to Salaries Tax.

Long service and severance payments

It is the Inland Revenue Department's practice to exempt from salaries tax severance payments and long service payments paid in accordance with the *Employment Ordinance* (Cap 57) (*Case* D25 (*D15/93*)). For a severance payment to qualify, there must have been, among other things, an actual dismissal or lay-off. For long service payments, the statutory requirements are that an employee has been either: dismissed; certified as permanently unfit for the relevant work; or has terminated his or her employment at the age of 65 years. Furthermore, an employee must be employed by the employer for not less than 24 months to be eligible for a severance payment pursuant to s 31B(1) of the *Employment Ordinance* (*Case* O59 (2005) HKRC ¶81-115 (*D17/05* IRBRD Vol 20).

In Case O95 (2005) HKRC ¶81-151 (D68/05 IRBRD Vol 20), the taxpayer was entitled to a gratuity on completion of satisfactory service. He had received a number of payments of gratuity in respect of the periods covered by the earlier letters of engagement, totaling $1,447,383. These payments were offered for assessment and salaries tax was paid on them. On completion of the last year of his employment, the taxpayer received a gratuity of $251,280. The Board found that part of the gratuity received by the taxpayer, in the amount of $103,196, was in the nature of a long service payment under the *Employment Ordinance*. The remaining amount of $148,084 was subject to salaries tax.

The Court of Appeal allowed the Commissioner's appeal by a majority in *Commissioner of Inland Revenue* v *Tsai Ge Wah* (2009) HKRC ¶90-212. The Court held that the Board had misapplied s 31Y and as a result, the Board was wrong to find as a fact that $103,196 out of $251,280 represented a long service payment to the taxpayer. The Court agreed with the submission of the Commissioner's Counsel that no long service pay was in fact payable to the taxpayer having regard to the provisions of s 31Y, given that the taxpayer had previously received well over $103,196 in the form of the earlier gratuities paid to him.

The Court also agreed that the earlier gratuities that had been paid to the taxpayer were clearly "gratuities based on length of service" and as such came within s 31Y. In the present case, the amount of gratuities which had already been paid greatly exceeded the amount of long service pay to which the taxpayer would have been entitled. The effect of s 31Y was that the taxpayer was not entitled to receive any amount of long service pay from the employer on termination of his employment.

If there has been no true dismissal or termination of employment, long service payments will be taxable. It is the true nature of a payment in the relevant circumstances, not the label placed upon the payment, that will determine whether or not it is tax exempt.

In *Case* J41 (2000) HKRC ¶80-709 (*D104/99* IRBRD Vol 14), an employee received a severance payment as the factory in Hong Kong was closed. He was re-employed to work in a China factory. Although the new employment letter was dated immediately after termination of the old employment, the Board held that as the new employment term was only finalised some time after, therefore, there was a technical break as distinguished from *Case* I12 (1999) HKRC ¶80-581 (*D25/98* IRBRD Vol 13). Thus, the payment was a severance payment and not taxable.

The taxpayer's employment was terminated by a letter dated 12 January 2001 ("Termination Letter") and the taxpayer was offered severance payment equal to 12 months base salary ("Sum A"). The Termination Letter required the taxpayer to sign a "Severance Agreement and Release" ("Severance Agreement") agreeing to certain restrictive covenants, including to refrain from recruiting or soliciting any customers and employees of the Company. Any breach of the covenants may result in the cessation of payments to the taxpayer and the recovery of payments made previously by the employer.

The majority of the Board took the view that Sum A under the Employment Letter was only payable if there was termination of the taxpayer's assignment and if there were not any reassignment of the taxpayer within the AC Nielsen Group. Consequently, the majority of the Board held that the taxpayer's entitlement of Sum A was wholly dependent on the cessation of his employment with AC Nielsen. Further, the Severance Agreement did not impose any obligation on the taxpayer to render any service in favour of AC Nielsen.

The Court of First Instance considered that the Board had not expressly dealt with the more pertinent question of whether Sum A was an inducement to the taxpayer entering into employment. Although it was correct that Sum A would not be payable unless the employment was terminated and no reassignment offered, the taxpayer may also be entitled to such payment as *an insurance policy for peace of mind* which may act as an inducement for the taxpayer to enter into employment.

In determining what part of Sum A was income chargeable subject to salaries tax, the Court of First Instance examined more closely the "insurance policy for peace-of-mind" and found that it was the offer of reassignment or Sum A at the option of the employer ("the offer"). Thus, if there was an inducement to enter into employment, it was not Sum A, but rather the offer. Further, the taxable amount was the value of the offer to the taxpayer as an inducement and not Sum A itself. The Court noted that placing a monetary value on the offer was difficult. It was necessary to apportion Sum A and for this purpose, the Court needed to put a value on the offer as the inducement. Taking all circumstances from the Employment Letter to the actual payment of Sum A into consideration, the Court concluded that a reasonable value would be 10% of Sum A as the inducement to enter into employment. It was common ground that this would be subject to further apportionment depending on the number of days of service performed in Hong Kong during the taxpayer's employment.

Another case where the termination payment was not accepted as fully non-taxable was *Commissioner of Inland Revenue* v *Elliot* (2005) HKRC ¶90-170). In this case, the taxpayer was entitled to an Incentive Compensation Plan ("ICP") under an employment agreement where he was to be awarded 5,000,000 ICP units following to the effective date of the employment agreement. He would also be entitled up to 3,000,000 ICP units two years after the effective date of the employment agreement.

On 12 June 1997, the taxpayer was requested to resign and a termination agreement dated 12 June 1997 ("the Termination Agreement") was signed. Under the Termination Agreement, the taxpayer agreed, among other things, to the cancellation of his ICP units for a payment of US$11 million ("the Sum") to be paid no later than 12 July 1997.

The Court of First Instance found that the 5M Units formed part and parcel of the taxpayer's remuneration package under the employment agreement. The 5M Units would entitle the taxpayer to annual payments or a lump sum payment in lieu and as such, the 5M Units were an inducement to the taxpayer to enter into the employment agreement. The Court agreed with the Board's finding that one portion of the Sum was attributed to the cancellation of the 5M Units and the other was for the abrogation of his rights to the Future Units.

The Court, however, further found that the sum which was attributable to the cancellation of the 5M Units included a sum representing the value of the inducement, which was

In *Case* N63 (2004) HKRC ¶81-039 *D80/03* (IRBRD vol 18, 820), the employer notified the employee that her employment would be terminated two months from the date of the notice and she was not required to report to work during the two-months' notice period. The issue is whether the salaries she received during these two months were payment in lieu of notice and therefore not taxable. The Board held that the employee was given a notice period of 2 months and her last date of employment was two months after she received the notice. Therefore, the sum received was not payment in lieu of notice, but taxable.

[¶2-1300] Periodicity, recurrence and regularity

The characteristics of periodicity, recurrence and regularity are often seen as important indicators that a payment is "income" at common law. This is simply a reflection of common experience. Non-contentious examples of common law income, such as salary and wages, have periodicity, regularity and repetition as key characteristics. It is logical that a Court will attach considerable weight to these factors (see *Prendergast v Cameron* (1940) 23 TC 122; *Melkman v FC of T* 87 ATC 4855).

TAXATION OF FRINGE BENEFITS

[¶2-1500] Payments to third parties

If an employer makes a payment to a third party which discharges an employee's debt, the benefiting employee is chargeable to tax on that payment. Payments made to discharge an employee's utility or telephone charges, for instance, constitute taxable income of that employee (*D5/87* IRBRD Vol 2, 332). A taxpayer's chargeable income also includes any payments made by an employer which discharge the taxpayer's tax liability (*Hartland v Diggines* (1926) 10 TC 247).

If, on the other hand, an employer makes a payment to a third party for which the employer itself was solely and primarily liable, then the benefiting employee is not taxed on the benefit, unless:

- the benefit is not in connection with a holiday journey and can be converted into money;
- the payment was paid to the third party for the education of a child of the employee; or
- the payment was made by the employer in connection with a holiday journey (s 9(1)(a)(iv) and 9(2A)(a) to (c)).

This "liability test" and its exceptions were introduced to the Ordinance in response to the Privy Council's decision in *Glynn v The Commissioner of Inland Revenue* (1990) 1 HKRC ¶90-032.

The Glynn case

In the *Glynn* case, the Privy Council effectively rejected the "liability test" as a determinant of chargeability, a step that was inconsistent with the standard practice of the Inland Revenue Department. It was found that the taxpayer had been correctly assessed to salaries tax on payments made by his employer to his daughter's school for which, under his employment contract, the employer was solely liable. The Privy Council decided that there was nothing in the salaries tax provisions of the Ordinance to suggest that the expressions "salary" and "perquisite" did not include any sums contracted to be paid by an employer for the benefit of an employee.

Consideration can be in the form of money or money's worth and needs only to be "payable" to (or to the order of or for the benefit of) an owner to be taken into account in determining a property's assessable value. An amount which is payable but which has not actually been received by the owner, or an amount payable to a third party on the owner's direction, is included in the calculation. Consideration may be included in a property's assessable value for a year of assessment even though it is not actually paid until a subsequent year.

A special spreading arrangement is applied when consideration is received as a lump sum payment (see ¶5-3400).

However, the taxpayer in *Case* M35 (2003) HKRC ¶80-900 (*D151/01* IRBRD Vol 17) successfully objected to property tax assessments on the rental which she alleged that she did not receive. She rented the property to her daughter and during this period received no rental from her daughter because of her daughter's financial difficulties. Her daughter gave evidence in support, citing her divorce, her financial difficulties and that she had moved out to reside elsewhere. The Commissioner argued that regardless of whether rental had been paid, rental was still payable by the daughter and relevant to the calculation of the assessable value of the property. The Board accepted the evidence of the daughter. The Board found that the mother–daughter relationship existed on top of the landlord–tenant relationship and by their conduct the parties had agreed to the surrender, cancellation or suspension of the tenancy agreement. Accordingly, rent had ceased to be payable during the relevant period, and the property tax assessments were ordered to be revised.

Consideration for furnished property

Generally, the rental received for furnished property is regarded as consideration which should be fully included in that property's assessable value. A claim that the rent paid for a furnished property can be divided into two parts, and that the rental relating to the furniture is not assessable to property tax, will usually fail unless the person or company providing the furniture or equipment is not the owner of the property.

[¶5-3400] Spreading arrangement for lump sum payments

Consideration may take the form, in full or in part, of a lump sum payment (eg a premium on a lease). Any consideration payable as a lump sum for the right of use of a property for more than one year is spread, on an equal monthly basis, over three years or over the period of the right of use if it is less than three years (s 5B(4)). Any property tax paid on lease premium charged under s 5B(4) will be available for set-off against the profits tax payable by the owner of the property under s 25. Any excess property tax paid will be refunded (DIPN Notes No 4 (Revised)).

Example — Spread of lease premium payable

Assume that Mr D leased out a property on 1 April 2017 for a period of four years. Mr D received a monthly rent of $5,000, payable on the first day of each month, and a lease premium of $21,000, payable on the conclusion of the lease agreement on 1 April 2017.

The lump-sum premium can be spread over a maximum period of three years (36 months). Accordingly, the assessable value of the property during the period of the four year lease will be as follows (spanning four assessment years):

2017/18 Year of Assessment	$
Rent ($5,000 × 12 months)	60,000
Premium ($21,000 × 12 months/36 months)	7,000
Assessable value	67,000

A claim for the deduction of irrecoverable consideration should be supported by documentary evidence (DIPN No 14 (Revised), para 18).

In some cases the assessable value of the taxpayer's property for the year in which the consideration becomes irrecoverable may be insufficient to allow a full deduction, for example, when consideration relating to several earlier years becomes irrecoverable at the same time. In such a case, the excess can be carried back and deducted from the assessable value for the latest preceding year in which the assessable value is sufficient to cover the deduction (s 7C(3)). A revised assessment would be issued to take account of any deduction carried back to an earlier year.

An amount deducted as a bad debt and subsequently recovered must be included in the assessable value of the taxpayer's property in the recovery year (s 7C(2)).

Example — Bad debt deduction

Assume that Mr D leased out a property on 1 April 2017 for a period of four years at a monthly rent of $15,000. His tenant paid rent during 2017 but defaulted on his rent payments from January 2018 onwards.

If the tenant was declared bankrupt before 31 March 2018 (proving the irrecoverability of the unpaid rent), the Inland Revenue Department would likely allow Mr D a deduction for the bad debt. The assessable value of his property would be calculated as follows for 2017/18:

2017/18 Year of Assessment	$
Rent received or receivable ($15,000 × 12 months)	180,000
Less: Irrecoverable bad debt ($15,000 × 3 months unpaid rent)	(45,000)
Assessable value	135,000

If the tenant was declared bankrupt and the debt proved to be bad after 31 March 2018, no deduction would be allowed for the 2017/18 assessment year. The deduction would be made in the year in which the debt was proved bad and, if necessary, could be carried back and a revised assessment issued for an earlier assessment year.

Assume, for example, that the tenant moved out on 1 April 2018 but the debt was only proved to have become bad in June 2018. The property was re-let on the same term starting from 1 February 2019:

2017/18 Year of Assessment	$
Rent received or receivable ($15,000 × 12 months)	180,000
Less: Irrecoverable bad debt (nil since debt not proved bad during 2017/18 year of assessment)	—
Assessable value	180,000
2018/19 Year of Assessment	
Rent received or receivable ($15,000 × 2 months, assuming property not re-let until Feb 2019)	30,000
Less: Irrecoverable bad debt ($15,000 × 3 months defaulted rent for Jan to Mar 2018)	(45,000)
Assessable value	Nil
Bad debt to be carried back	(15,000)
2017/18 Year of Assessment – Revised Assessment	
Rent received or receivable ($15,000 × 12 months)	180,000
Less: Bad debt carried back from 2018/19 assessment year	(15,000)
Assessable value	165,000

- the property is occupied or used by the corporation for the purpose of producing profits (s 5(2)(a) and 25).

The Hong Kong High Court has stated that, looking at the relevant provisions as a whole, "the purpose of s 5(2)(a) and s 25 when read together is to prevent a situation arising whereby a company could be subjected to the double jeopardy of having to pay profits tax and property tax in what amounted to the same situation" (Mayo J in *Harley Development Inc & Anor* v *Commissioner of Inland Revenue* (1993) 1 HKRC ¶90-069 (HC)).

The property tax exemption applies only to a "corporation", which means any company incorporated or registered in Hong Kong or elsewhere. "Corporation" does not include a co-operative society or trade union (s 2(1)).

In *Case* N11 (2004) HKRC ¶80-987 (*D122/02* IRBRD Vol 18), the taxpayers applied for a business registration certificate for an alleged properties investment business. They objected to the assessments raised on rental income derived from properties claiming that the rental income should have been subject to profits tax instead of property tax. They claimed that they had formed a "corporation" registered under the *Business Registration Ordinance* to carry on a business in properties investment and they had habitually sought and added new properties on to their portfolio. See also *Case* T12 (2010) HKRC ¶81-281 (*D14/09* IRBRD Vol 24).

The Board held that the business registration certificate was not a proof that the taxpayers had been carrying on a business in properties investment. The Board pointed out that it had been stated on the back of the certificate that the issue of a business registration certificate would not be deemed to imply that the requirements in relation to the business or to the persons carrying on the same or employed therein had been complied with.

Obtaining the exemption

In order to obtain an exemption, the corporation must make a written application to the Commissioner of Inland Revenue (s 5(2)(a)). The application may take the form of a statement by the corporation that the property is occupied or used by it for the purpose of producing assessable profits.

An exemption remains in force for all subsequent years in which the relevant circumstances remain the same. A separate application should be made for each property owned, and the owner must notify the Commissioner of any change in the relevant circumstances within 30 days after such change (s 5(2)(c)).

The property tax exemption available to corporations under s 5(2) was the subject of an application for judicial review in the *Harley Development Inc* case. Harley, which had acquired premises and simultaneously leased them to another company, had objected to a property tax assessment which was raised upon it. The letter of objection was treated by Harley as a formal application for exemption from property tax, but no reply to the letter/application was ever received from the Commissioner. Notwithstanding this, Harley thereafter submitted profits tax returns on the basis that it was exempt from property tax.

After several years, the Commissioner wrote to Harley requesting property tax returns and sought to charge Harley to property tax on the lease premium it received for its premises. Proceedings for judicial review of the Commissioner's decision to raise property tax assessments were instituted by Harley, which argued that it was entitled to a property tax exemption under s 5(2)(a) and that the Commissioner was by his actions stopped from claiming that no exemption had been granted.

Harley attached much significance to the fact that it had been required to lodge profits tax returns, and submitted that the Commissioner's acceptance of the forms, which were

(2) Rent free period from 1 April 2018 to 30 April 2018.

(3) Rates and management fees were payable by the tenant.

Miss Wan failed to pay any rent from October 2018 onwards. She declared bankrupt on 30 June 2019.

The amount of net assessable value for Mr Sung for the year of assessment 2018/19 is:

(a) $160,000

(b) $192,000

(c) $352,000

(d) $384,000.

Question 5

Which of the followings is/are the condition(s) required for the exemption from property tax under section 5(2)(a) of the Inland Revenue Ordinnace?

(I) The taxpayer is a corporation.

(II) Rental income from the property forms part of the profits of the corporation.

(III) The property is used or occupied for producing chargeable profit.

(a) II only

(b) I and III only

(c) I, II and III

(d) None of the above.

Question 6

Jason leased out an office unit to Titian Ltd for 4 years staring from 1 August 2018. Titian Ltd paid Jason a lease premium of $150,000 on 1 July 2018. The amount of lease premium assessable in the year of assessment 2018/19 is:

(a) $25,000

(b) $33,333

(c) $37,500

(d) $50,000.

Question 7

Michael let a property in North Point to Winnie for 2 years commencing from 1 January 2017. Winnie was seriously hurt in a traffic accident and she failed to pay the rent from February 2018 onwards. Micheal engaged a lawyer to send Winnie a final reminder on the outstanding rent in October 2018 but in vain. Winnie moved out from the property upon the expiry of the lease on 31 Decmeber 2018 with 11 months' rent oustanding. Winnie promised Michael that she would pay the outsanding rent after she received the insurance compensation by mid 2019. In June 2019, Winnie sent Michael a SMS telling him that she has emigrated to Taiwan already and she would never come back to Hong Kong and pay the outstanding debt. Winnie also stopped her phone service and Micheal could no longer contact her since then.

In which year of assessment would the irrecoverable rent be deductible under property tax?

(a) 2016/17

[¶5-9100] Case study

Question 1

Mathew Sun emigrated to Australia five years ago. During a recent visit back to Hong Kong, he acquired a residential property for investment purposes. The property was leased to Mr Lam through a property agent. The following information relating to the year of assessment 2018/19 is available:

(1) Term of lease: three years from 1 July 2018.

(2) Monthly rental: $20,000, payable on the first day of each month.

(3) Rent free period: one month from 1 July 2018.

(4) Rental deposit: $40,000, payable on signing the lease agreement.

(5) Management fee: $1,250 per month, payable by Mr Lam directly to the building management office.

(6) Rates: $1,500 per quarter, payable by Mathew.

(7) Mortgage interest: $15,000 per month, incurred by Mathew on a bank loan obtained to acquire the property.

(8) Renovation expense: $85,000, incurred by Mathew.

(9) Repair to windows: $1,500, incurred by Mr Lam who has not recovered the same from Mathew.

(10) Property agency fee: 5% of the monthly rental payable by Mathew.

Mathew believed that he is not subject to any tax in Hong Kong because he is no longer a resident in Hong Kong and all rentals were deposited into his bank account in Australia by his agent.

Required:

Compute the Hong Kong property tax liability of Mathew Sun, if any, in respect of the year of assessment 2018/19. Ignore provisional tax. Briefly explain the tax treatments you have accorded to the various items.

Question 2

Simon Cheung bought a residential flat in Tai Po on 5 August 2018 for long-term investment. The flat was let to Ms Leung on 1 September 2018 on the following terms:

(1) Term of lease: four years from 1 September 2018.

(2) Monthly rental: $25,000, payable on the first day of each month.

(3) Initial premium: $90,000, payable on signing the lease agreement.

(4) Rates: $3,750 per quarter, payable by Simon.

(5) Government rent: $2,250 per quarter, payable by Simon.

(6) Furniture fee: $1,000 per month, payable by Ms Leung to Simon starting from the commencement of the lease agreement.

(7) Management fee: $1,600 per month, payable by Ms Leung directly to the property management company.

(8) Mortgage interest: $7,000 per month, incurred by Simon on a bank loan obtained to acquire the property

Required:

Compute Felix's Hong Kong property tax liability for the years of assessment 2017/18 and 2018/19. Ignore provisional tax.

Question 5

Mr Ching bought a residential flat in Happy Valley in May 2017. The flat was let to Ms Suen on the following terms:

(1) Term of lease: 2 years from 1 July 2017.

(2) Rent free period: One month from the start of the tenancy agreement.

(3) Rental deposit: $100,000 payable on signing of the tenancy agreement. Rental deposit will be used to compensate any loss of revenue if the tenant defaults payment.

(4) Monthly rent: $45,000 for the first year and $50,000 for the second year, payable in advance.

(5) Rates: $6,600 per quarter, payable by Ms Suen.

(6) Management fee: $3,500 per month, payable by Ms Suen directly to the building management office.

In November 2017, Ms Suen paid $2,000 to replace the water tap. She did not claim this repair expense from Mr Ching.

Starting from 1 March 2018, Ms Suen failed to pay any rent to Mr Ching. She also failed to pay management fees to the management office. On 1 August 2018, Ms Suen died in a traffic accident and the lease was deemed to have been terminated on that date. Mr Ching had to pay the outstanding management fee of $17,500 to the management office for the period from March to July. He also found that Ms Suen has paid the rates up to 30 June 2018 only. He paid the rates for the quarter starting from 1 July 2018.

Mr Ching engaged a property agent to let out the property and a new tenant, Mr Sze, was being introduced to rent the flat on the following terms:

(1) Term of lease: 4 years from 1 September 2018.

(2) Monthly rent: $28,000 per month payable in advance.

(3) Initial premium: $360,000 payable on signing the tenancy agreement

(4) Furniture fee: $2,000 per month payable to Mr Ching starting from the commencement of the lease.

(5) Property agency fee: $28,000 payable by Mr. Ching.

(6) Rates: $6,600 per quarter payable by Mr Ching.

(7) Management fee: $3,500 per month payable by Mr Sze to Mr Ching, who collects it as agent for the building management office.

Mr Sze paid all rent and management fee on time.

Required:

Compute Mr Ching's property tax liabilities for the years of assessment 2017/18 and 2018/19.

[¶7-0800] Purchaser's entitlement to annual allowance

When the "relevant interest" (see ¶7-0700) in a building or structure which has been used at any time before the sale as an industrial building or structure or otherwise is sold, the purchaser is entitled to an annual allowance for wear and tear based on the residue of expenditure immediately after the sale (s 34(2)(b)). The "residue of expenditure" consists of the amount of the capital expenditure incurred in the construction of the building or structure reduced by any initial, annual or balancing allowances that have already been granted, or any notional amounts written off (see below) and increased by any balancing charges made when the building or structure was used previously as an industrial or commercial building or structure (see ¶7-5100).

ALLOWANCES FOR COMMERCIAL BUILDINGS OR STRUCTURES

[¶7-1200] Annual allowance

A person who is entitled to an interest in a commercial building or structure at the end of the basis period of a year of assessment is eligible for an annual allowance for depreciation of the building or structure by wear and tear (s 33A). This annual allowance for commercial buildings and structures was introduced with effect from the 1998/99 year of assessment, replacing the rebuilding allowance.

A "commercial building or structure" is any building or structure used by a person for the purposes of his or her trade, profession or business which is not an "industrial building or structure" (see ¶7-0300 for definition of "industrial building or structure") (s 40(1)).

The amount of the annual allowance for a commercial building or structure is equal to 4% of the capital expenditure incurred on the construction of the building (s 33A(1)). Each year, the amount of the annual allowance is subtracted from the amount of the original capital expenditure until the residue of expenditure is nil.

The annual allowance granted to a taxpayer in a year of assessment must never exceed the residue of expenditure at the end of the basis period for that year. If, when the final annual allowance is to be made and exceeds the residue, only an amount equal to the residue will be allowed (see 33A(3)).

Qualifying taxpayers — the meaning of "relevant interest"

A taxpayer may qualify for an annual allowance for a commercial building or structure even though he or she did not personally incur any capital expenditure on its construction. To qualify for the allowance, however, the taxpayer must have a "relevant interest" in the building or structure at the end of the basis period for the relevant year of assessment. This means that the taxpayer must have the same legal interest in the building or structure as the person who incurred the original capital expenditure in constructing the building (s 40(1)).

A person who purchases the relevant interest in a building or structure is entitled to annual depreciation allowances for the property. The amount of the allowances granted to the purchaser is determined by the application of special formulae.

See further ¶7-1400.

Where rebuilding allowance was claimed before 1 April 1998

The annual allowance for commercial buildings and structures was introduced with effect from 1998/99 year of assessment, replacing the former rebuilding allowance provided under s 36. In cases where rebuilding allowances have been claimed for years prior to

(iii) with inflation and a buoyant property market, the acquisition cost would be substantially higher than the original construction cost over the years. The appreciation in turn comprises the upsurge in the land value and the profits of the subsequent sellers. Over time, the third element would far exceed the other two elements but only the first element would qualify for rebuilding allowance or commercial building allowance. Taking half of the acquisition cost incurred by the taxpayer in the 1990s as the cost of construction of the properties would be a gross over-estimate of the cost of construction by merging the big appreciation in value of the properties over time with it.

[¶7-1400] Purchaser's entitlement to annual allowance

When the "relevant interest" (see ¶7-1200) in a building or structure which has been used at any time before the sale as a commercial building structure or otherwise is sold, the purchaser is entitled to an annual allowance for wear and tear based on the residue of expenditure immediately after the sale (s 33A(2)). The "residue of expenditure" consists of the amount of the capital expenditure incurred in the construction of the building or structure reduced by any initial, annual or balancing allowances that have already been granted, or any notional amounts written off (see below), and increased by any balancing charges made when the building or structure was used previously as an industrial or commercial building or structure (see ¶7-5100) (s 40(1)).

For the purpose of determining the residue of expenditure which a purchaser inherits when buying the relevant interest in a building, a notional amount is written off for any year in which no annual allowance was made (s 40(1)). The notional amount equals 4% of the capital expenditure.

The rate of the annual allowance available to a purchaser is determined using the following formula:

$$\text{Residue of expenditure} \times \frac{1}{\text{Number of years of assessment from the basis period in which the sale takes place, to the 25th year after first use.}}$$

In cases where rebuilding allowances had been claimed for the relevant commercial building or structure prior to the introduction of the annual allowance in the 1998/99 year of assessment, the rate of annual allowance allowed would be determined by the following formula:

$$\text{Residue of expenditure} \times \frac{1}{\text{Number of years of assessment from the basis period in which the sale takes place, to the 25th year after the 1998/99 year of assessment (in which the annual allowance scheme commenced).}}$$

[¶7-1500] Rebuilding allowance (pre-1998/99)

In the years of assessment preceding the 1998/99 year of assessment, commercial buildings or structures were not eligible for the same annual allowance as industrial buildings for capital expenditure incurred on their construction.

Instead, up to the basis period for the year of assessment 1997/98, where a taxpayer was entitled to a "relevant interest" (see ¶7-1200) in a commercial building or structure at the end of the basis period of a year of assessment, he or she was entitled to a rebuilding allowance for that year. The amount of the rebuilding allowance granted to a taxpayer

Although the Board accepted that the Paintings were decorative items that embellished the interior of the taxpayer's chambers, the taxpayer had failed to prove that in his practice as a barrister, the Paintings were purchased to provide an atmosphere or ambience for the purposes of producing profit or promotion of the taxpayer's practice. In addition, the Board was not convinced of the existence of a convention for senior barristers to spend on paintings and decorations in order to promote their practice and to generate greater profits. As such, the Board dismissed the taxpayer's appeal and held that the taxpayer had not discharged the burden of showing that the Paintings were plant for the purposes of promoting his practice as a barrister and/or for the purposes of generating profits.

[¶7-2700] Items which qualify as "machinery or plant"

The expression "machinery or plant" is deemed to include the following items:

- air-conditioning plant;
- bank safe deposit boxes, doors and grills;
- broadcasting transmitters;
- cables (electric);
- lamp standards (street) — gas or electric;
- lifts and escalators (electric);
- mains (gas and water);
- oil tanks;
- shipping — ships, junks, sampans, lighters, tugs, launches, ferry vessels, hydrofoils and outboard motors;
- sprinklers;
- domestic appliances;
- furniture (excluding soft furnishings);
- room air-conditioning units;
- taxi meters;
- type and blocks (if not dealt with on renewals basis);
- aircraft (including engines);
- bar syphon apparatus;
- bicycles;
- bleaching and finishing machinery and plant;
- concrete pipe moulds;
- electric cookers and kettles;
- electronic data processing equipment;
- electronics manufacturing machinery and plant;
- motor vehicles;
- plastic manufacturing machinery and plant including moulds;
- silk manufacturing machinery and plant;
- sulphuric and nitric acid plant;

- acoustic tile ceilings (installed as an integral part of a building);
- ceiling lighting points;
- cocklofts;
- fish ponds and fish storage barge;
- shop fronts, fixed wall and floor coverings, suspended ceilings, raised floors, balustrades and stair;
- telephone cable and wiring (installed as an integral part of a building);
- wiring and electrical fixtures and fittings (installed as an integral part of a building);
- car parks and piers;
- canopies over petrol-filling stations; and
- car-wash halls (ie buildings housing washing and control equipment).

The following articles are prescribed by the Board of Inland Revenue *(Inland Revenue Rules*, r 2), to be "implements, utensils and articles" and are excluded from the expression "machinery or plant":

- belting;
- crockery and cutlery;
- kitchen utensils;
- linen;
- loose tools; soft furnishings (including curtains and carpets);
- surgical and dental instruments; and
- tubes for X-ray and infra-red machines (*Inland Revenue Rules*, r 2(1)).

Although no depreciation allowance is available for these items and any initial expenditure is disallowed as capital expenditure, the cost of replacing the items is fully deductible from a taxpayer's profits under s 16 (see ¶6-5220).

Wharves are also specifically excluded from machinery or plant (*Inland Revenue Rules*, r 2(3)) and therefore can only qualify for allowances as industrial structures (see ¶7-0300ff).

Assets which have not qualified as machinery or plant include the following:

- A **new concrete stand at a football club**, because it was not part of the apparatus with which the club carried on its trade (*Brown (Inspector of Taxes)* v *Burnley Football and Athletic Co Ltd* (1980) 53 TC 357).
- A **ship** bought and adapted as a restaurant, because it constituted premises (*Benson (Inspector of Taxes)* v *Yard Arm Club Ltd* (1979) 53 TC 67).
- The **roof or shelter** over the service area of a garage, because it merely gave protection from the weather and was not functional in supplying petrol (*Dixon (Inspector of Taxes)* v *Fitch's Garage Ltd* (1975) 50 TC 509). (Note, however, that this decision was criticised in subsequent cases: see *IRC* v *Scottish and Newcastle Breweries Ltd* (1982) BTC 187; *Coles Bros Ltd* v *Phillips (Inspector of Taxes)* (1982) BTC 208).
- A **false ceiling** installed by caterers to conceal pipes and wiring, because it was characterised as part of the premises (*Hampton (Inspector of Taxes)* v *Fortes Autogrill Ltd* (1980) 53 TC 691).

An allowance can be claimed for a contribution to the cost of an asset, provided that the taxpayer has the use of it.

However, the taxpayer is not entitled to initial allowance for those assets that were brought into the business after non-business use (DIPN No 7 (Revised), para 26).

Timing of allowance

As initial allowance is allowed for capital expenditure "incurred", it is not limited to sums actually paid. Where a contractual obligation exists, the due date for payment of deposits, instalments, etc, will be regarded as the date when the expenditure is incurred, even if actual payment occurs at a later date. However, unless the deposit or advance payment is non-refundable in respect of a binding purchase contract, it may still be regarded as merely a contingent liability and no allowance can be made.

If no written contract is available, the date of delivery of the plant or machinery is normally taken to be the date on which the expenditure is incurred (DIPN No 7 (Revised), para 17).

[¶7-3100] Qualifying capital expenditure

"Capital expenditure" for which an initial allowance may be granted includes any interest paid and any commitment fees incurred in connection with a loan made for the purpose of financing the provision of machinery or plant (s 40(1)). Specifically excluded from the definition of "capital expenditure" are grants, subsidies or any other financial assistance paid to the taxpayer who incurred the expenditure, and any amount deductible under the profits tax provisions of the Ordinance (s 40(1)).

The definition of capital expenditure which is provided in s 40(1) is not exhaustive. Attention must also be paid to general principles (see ¶6-6120 for more on identifying capital expenditure).

The expression "capital expenditure on the provision of machinery or plant" includes any capital expenditure incurred on alterations made to an existing building incidental to the installation of machinery or plant for the purposes of the taxpayer's trade, profession or business (s 40(1)).

In this regard, the qualifying capital expenditure is the net cost of acquisition of the asset, which is represented by the supplier's price, plus any charges relating to freight, insurance, delivery, import duties, etc, and less any discounts, rebates, subsidies, etc, accorded to the purchaser (DIPN No 7 (Revised), para 6).

Capital expenditure incurred prior to commencement of business

Where a person carries on a trade and incurs capital expenditure on the provision of assets for a new trade about to be commenced, the expenditure is regarded as if it were incurred on the day that the new trade commences (s 40(2)). Accordingly, capital allowances are deductible against the profits of the new trade once it has commenced, but not against those of the taxpayer's existing trade (DIPN No 7 (Revised), para 11).

Where a person ceases to carry on a particular trade and transfers machinery or plant previously used in it to another trade which he or she carries on, it is not considered that the person is entitled to claim more than one annual allowance in respect of that machinery or plant for any one year of assessment. This is because the allowance is granted to the "person"; and not to the "trade" (DIPN No 7 (Revised), para 12).

Basis period

The basis period for the purpose of calculating capital allowances is generally the same as that of computing assessable profits , other than these two specified exceptions (sec 40(1)):

Example

X Ltd acquired a machine in 2014 for a cost of $500,000. Its accounts are made up to 31 December. The machine was not used in the production of assessable profits until mid-2017. The depreciation rate applicable to the machine is 20%. The capital expenditure incurred on its provision would be determined as follows:

		$
Original cost		500,000
LESS		
2014/15 notional annual allowance ($500,000 × 20%)	–	(100,000)
		400,000
LESS		
2015/16 notional annual allowance ($400,000 × 20%)	–	(80,000)
		320,000
LESS		
2016/17 notional annual allowance ($320,000 × 20%)	–	(64,000)
		256,000
EQUALS		
Adjusted capital expenditure	=	256,000

[¶7-3300] Rates of depreciation

Rates of depreciation for various types of plant and machinery are specified in the *Inland Revenue Rules* (r 2) as follows:

Plant or machinery	Rate of depreciation
10% Class (or Pool)	
Air-conditioning plant (excluding room air-conditioning units)	10%
Bank safe deposit boxes, doors and grills	10%
Broadcasting transmitters	10%
Cables (electric)	10%
Lamp standards (street) — gas or electric	10%
Lifts and escalators (electric)	10%
Mains (gas and water)	10%
Oil tanks	10%
Shipping — ships, junks, sampans, lighters, tugs	10%
Sprinklers	10%
Machinery used for purposes of a transport, tunnel, dock, water, gas or electric undertaking or a public telephone or public telephone service	10%
20% Class (or Pool)	
Domestic appliances	20%
Furniture (excluding soft furnishings)	20%
Room air-conditioning units	20%
Shipping — launches, ferry vessels, hydrofoils	20%

- a director or principal officer of such a corporation; or
- a corporation of which any partner is a director or principal officer.

The scope of the term "associate" was expanded to include associates of persons deemed to be holding rights as lessees with effect from 13 March 1992.

An "associated corporation" is either a corporation over which the lessee has control; a corporation which has control over the lessee; or a corporation under the same control as the lessee (sec 39E(5)). From 13 March 1992, the definition of "associated corporation" was also expanded to include corporations controlled by, controlling, or under the same control as a person deemed to be holding rights as a lessee. "Control" in relation to a corporation means the power of a person to ensure that the affairs of the corporation are conducted in accordance with their wishes. This may be achieved by holding shares, or possessing voting power in the corporation or any other corporation; or by virtue of powers conferred by the articles of association or other documents regulating the corporation or any other corporation (sec 39E(5)).

Trust arrangements

Provision has been made to prevent taxpayers from avoiding the effect of s 39E through the use of a trust. When a trustee owns machinery or plant, or holds rights as a lessee of machinery or plant, the trustee, the corporation and the beneficiary under the trust are each deemed to be the owner or holder of lessee rights (s 39E(4)).

[¶7-4300] Exception to restriction rule

When there has been a sale and leaseback of plant or machinery as outlined in s 39E(1)(a), initial and annual allowances may nevertheless be granted if:

(i) the plant or machinery was acquired by the taxpayer from the lessee at a price which did not exceed the price paid by the lessee to the supplier (who is not a lessee); and

(ii) no initial or annual allowances were made to the lessee before he or she sold the machinery or plant to the taxpayer (s 39E(2)).

Disclaiming initial allowance

Section 39B provides that an initial allowance "shall be" made when a person incurs capital expenditure on machinery or plant to produce assessable profits. The entitlement to the allowance in the Department's view is mandatory (DIPN No 15 (Revised), para 14). However, if the lessee disclaims the allowance within three months of having made the relevant capital expenditure, the allowance is deemed not to have been made (s 39E(3)). The lessee must disclaim the allowance in writing to the Commissioner. The Inland Revenue Department requires the following information to be provided:

(a) the description of the relevant asset;

(b) the name and address of the supplier;

(c) the date of purchase from and price paid to the supplier;

(d) the date of sale to and price paid by the lessor; and

(e) the name and address of the lessor.

Copies of purchase and sale agreements, invoices and the lease agreement should support the information provided (DIPN No 15 (Revised), para 14).

When a leased asset is used both within and outside Hong Kong, the Department will look at the use of the asset for each year of assessment separately. If in a particular year the asset is not used wholly or principally within Hong Kong, no allowances will be granted. However, for the purpose of determining the written down value of the item to be carried forward, the notional amount of allowances which could have been granted will be deducted from the written down value brought forward (DIPN No 15 (Revised), para 18). Any balancing adjustments on the sale of the item will be calculated on a pro-rata basis.

Contract processing arrangements with a Mainland enterprise, where a Hong Kong company is required to provide machinery or plant for the use of the Mainland enterprise, is a lease defined in s 2. The Inland Revenue Department as a concession is prepared to allow 50% of the depreciation allowances on the leased machinery or plant on the condition that the profits from manufacturing activities of the Hong Kong company are assessed on a 50:50 basis. This concession will not apply where the Hong Kong company has ceased to be the owner of the machinery or plant, eg machinery or plant injected as a share of equity into a foreign investment enterprise in the Mainland (DIPN No 15 (Revised), para 19). The concession also does not apply to import processing arrangements even if the profits earned by the Hong Kong company from the arrangement is wholly chargeable to Hong Kong profits tax.

Ships or aircraft

Neither an initial allowance nor annual allowances are available for a ship or aircraft acquired under a transaction entered into on or after 15 November 1990 if the relevant asset is subsequently leased and one of the following conditions applies:

(i) the person holding rights as lessee of the asset is not an operator of a Hong Kong ship or aircraft; or

(ii) the asset's acquisition or construction was financed wholly or predominantly by a non-recourse debt (see ¶7-4500) (s 39E(1)(c)).

Allowances will not be denied if an advance clearance of the relevant transaction by the Commissioner was applied for and granted before 15 November 1990, or if the Commissioner believes that an advance clearance would have been granted if applied for before that date (s 39E(6)).

[¶7-4500] "Non-recourse debt"

A "non-recourse debt" is a debt where the creditor only has recourse to the asset being purchased, or any income arising from that asset: the borrower has no absolute liability in respect of the borrowing (DIPN No 15 (Revised), para 23). Specifically, the rights of the creditor, in the event of a default in the repayment of principal or interest, are limited to:

- rights to the machinery or plant, or the use of the machinery or plant;
- rights to goods produced, supplied, carried or delivered, or services provided, by means of the machinery or plant;
- rights in relation to the loss or disposal of the whole, or part, of the machinery or plant, or the taxpayer's interest in it;
- rights in relation to a mortgage, or other security, over the machinery or plant; or
- rights in relation to the financial obligations of the lessee to the lessor in relation to the machinery or plant (s 39E(5)).

When the creditor's rights are not specifically limited in any of the ways described above, the debt is nevertheless regarded as a non-recourse debt, and s 39E will apply if the

- *Premature termination of lease* — If the lessee has the right to terminate the lease on payment of an amount of money to the lessor, the amount paid is treated as an assessable profit of the partnership.
- *Interest* — Transactions under which more than what would normally be a year's interest on money borrowed to produce assessable profits is sought to be deducted in one year are not acceptable.
- *Non-recourse debt* — Financing on a recourse basis should be for at least 51% of the cost of the machinery or plant throughout the term of the lease.
- *Equity* — When no limited partnerships are involved in the transaction, lessors should themselves contribute capital for at least 35% of the cost of the machinery or plant. Interest-free and interest-bearing loans, even with recourse, will not be accepted.
- *Profit motive* — The lessors must demonstrate a profit motive apart from gaining tax benefits. This will normally be satisfied if the aggregate taxable income of the lessors over the term of the lease is no less than 1% of the cost of the machinery or plant.

The Department indicates in DIPN No 15 (Revised), para 82, that the requirements it has set out will be subject to review from time to time and amended where necessary.

Taxpayers may request advance rulings from the Department for proposed leverage lease transactions which are likely to be considered under the anti-avoidance provision. A favourable advance ruling in relation to s 61A will only be given if the guidelines outlined above are complied with. Even then, the Department still may not accept the transaction if it is believed that the dominant purpose of the transaction is to obtain a tax benefit.

See ¶13-7600 for more on advance rulings.

BALANCING ALLOWANCES AND CHARGES

[¶7-5000] Balancing allowances and charges

The aim of the capital allowances scheme set out in Pt VI of the Ordinance is to spread tax relief for capital expenditure incurred on the construction of an industrial or commercial building, or the provision of machinery or plant, over the life of the relevant asset until the residue of the capital expenditure originally incurred is exhausted.

To ensure that the depreciation allowances granted to a taxpayer in each year of assessment are related to a realistic residue of expenditure, balancing allowances are granted and balancing charges made. The former make up for shortfalls in allowances should a building, structure, plant or machinery be disposed of for an amount less than the residue. The latter adjusts the position when an asset is disposed of for an amount which exceeds the residue.

[¶7-5100] Balancing allowances and charges for commercial or industrial buildings and structures

A balancing allowance or charge arises in relation to a commercial building or structure, or an industrial building or structure (see ¶7-0300 and ¶7-1200) when one of the following occurs:

- the relevant interest (see ¶7-0800 and ¶7-1200) in the building or structure is sold;
- the relevant interest is a leasehold interest which has come to an end otherwise than by the leaseholder acquiring the reversionary interest; or
- the building or structure is demolished or destroyed, or ceases to be used (s 35(1)).

		$
EQUALS		
Residue of expenditure	=	48,000
Insurance payment		60,000
LESS		
Residue	–	(48,000)
EQUALS		
Amount of assessable balancing charge	=	12,000

If the excess of the insurance above the residue had been more than $52,000, a balancing charge of only $52,000 would be granted as the charge must not exceed the total value of the allowances already granted (s 35(3)(b)).

[¶7-5200] Balancing allowances and charges for machinery or plant under the pooling system

Balancing allowances and charges rarely arise under the pooling system (see ¶7-2900) since under that system moneys received in the form of sale, insurance, salvage or compensation payments for plant or machinery are simply deducted from the reducing pool value of the relevant items (see example at ¶7-3300).

Balancing allowance

A balancing allowance arises when, on the cessation of the taxpayer's business, the aggregate of all proceeds from the disposal of machinery or plant amounts to less than the reducing pool value (see ¶7-3200). The amount of the balancing allowance granted is equal to either the reducing value or the excess of the reducing value above the sale, insurance, salvage and/or compensation proceeds received by the taxpayer for the plant or machinery (s 39D(2)(a)). It is important to note that a balancing allowance for plant or machinery can only arise when the taxpayer's trade, profession or business has ceased.

Balancing charge

A balancing charge for plant and machinery arises under the pooling system in two situations:

- If at the end of a basis period for a year of assessment the reducing value (see ¶7-3200) of a class of plant or machinery is negative, because deductions from the pool in that year exceed the reducing value brought forward plus any additions, a balancing charge is imposed (s 39D(1)(a)). The balancing charge is equal to the excess, and the reducing value is deemed to be nil; and
- If on the cessation of a trade, profession or business the aggregate of any sale, insurance, salvage or compensation moneys received exceeds the reducing value of the relevant class of plant or machinery, a balancing charge is imposed (s 39D(2)(b)). The balancing charge is equal to the excess, or if the reducing value is nil, to the aggregate of the moneys from the disposal.

	$	$	$
EQUALS			
Balancing charges		= (8,000)	= (10,000)
Balancing allowance	= 20,000		

Subtracting balancing charges from balancing allowance, Y Ltd is entitled to a net allowance of $2,000 for 2016/17.

[¶7-5300] Calculation of balancing allowances and charges for unsold machinery and plant when business has ceased

When a taxpayer has ceased to carry on a trade, profession or business and no sale, insurance or compensation moneys have been received for the plant or machinery, the taxpayer is deemed to have received the amount of money that the Commissioner considers the plant and machinery would have realised if sold on the open market at the time of cessation (s 38(4), 39D(4)). If the taxpayer subsequently sells the relevant plant and machinery within 12 months of the business' cessation, an adjustment may be claimed for any balancing allowance or charge which would have been made if the sale had taken place immediately before the cessation (s 38(4), 39D(5)).

When a person transfers his or her business to another, without actually selling the plant or machinery to the new owner, no balancing allowance or charge arises. The new owner simply inherits the reducing value of the plant or machinery transferred (s 39D(3)).

[¶7-5400] Balancing allowances and charges for plant and machinery under non-pooled system

For plant and machinery to which the pooling system does not apply (see ¶7-3400), a balancing allowance or charge arises if, while the taxpayer is carrying on his or her trade, or at the time the trade ceases, any machinery or plant for which an initial or annual allowance has been granted is:

- sold (whether still in use or not);
- destroyed; or
- put out of use (as being worn out, obsolete, or otherwise useless or no longer required) (s 38(1)).

The allowance or charge is calculated on the amount of capital expenditure incurred on the provision of the machinery or plant which is "still unallowed". That is, the capital cost of the asset less any allowances already granted: the residual value of the asset.

If the "expenditure still unallowed" exceeds the sale, insurance, salvage or compensation proceeds accruing to the taxpayer from the disposal of the asset, a balancing allowance is made (s 38(2)). The allowance made is equal to the excess of the expenditure still unallowed above the disposal proceeds.

A balancing charge arises if the proceeds accruing from the disposal of the asset exceeds the amount of capital expenditure still unallowed (s 38(3)). The amount of the charge is equal to the excess of the proceeds above the expenditure still unallowed. Any balancing charge made is restricted, however, to the aggregate of any initial and annual allowances already made in respect of machinery or plant in question (s 38(5)).

(3) On 5 February 2018, Mr Cheung took one of the cars which had previously been used exclusively for business purposes for his own private use and replaced it with his own private car which was thereafter used wholly for business purposes. The open market value of the business car at 5 February 2018 was $64,000 (original cost $100,000). Mr Cheung's private car was acquired at a cost of $120,000 on 1 September 2015.

(4) On 1 November 2017, Mr Cheung purchased for business use office equipment at a cost of $68,000 on hire-purchase terms. He paid $20,000 deposit and the balance was to be paid by 12 monthly installments of $5,000 each. The first instalment was due on 1 December 2017.

(5) On 5 June 2018, a fire broke out in the business premises. On 31 August 2018, the company received $500,000 insurance compensation of which a quarter was for damage to the furniture whereas the balance was for damage to the old air-conditioning plant.

(6) Mr Cheung's son completed his studies abroad and returned to Hong Kong on 15 March 2019. Mr Cheung allowed him to use one of the business cars whenever he wished. The Assessor agreed that the market value of the car as at 15 March 2019 was $80,000 (original cost $100,000) and that on average one third of the use in the year was for private purposes by Mr Cheung's son.

(7) Monthly installment for the computer bought under hire purchase was $50,000 (including interest portion of $10,000). The tax written down value of the computer as at 31 March 2017 was $900,000. The last installment was paid on 31 March 2018. The title of the computer was then transferred to the business on the same day.

Required:

Compute the depreciation allowances to which Mr Cheung's business was entitled for the years of assessment 2017/18 and 2018/19 respectively.

Question 3

Sunny Ltd contracted for an industrial building to be built in Tai Po in January 2009 at a construction cost of $4 million. Initial payment of $2.5 million was made upon the signing of contract. The building was completed in August 2010 when the balance payment was made. Sunny Ltd immediately used the building in its manufacturing process. Sunny Ltd closes its annual accounts on 31 December.

As from September 2016, this building was put out of use because the company had moved to Shatin. In March 2018, the building was put into qualifying use again. In November 2018, it was sold to Flower Ltd for $18 million which included the land value of $13 million.

Required:

Calculate the depreciation allowances available to Sunny Ltd for all relevant years of assessment.

Question 4

In February 2013, Energetic Ltd purchased a piece of land in Kwun Tong and contracted for an industrial building to be built at the site for its handbag manufacturing business. Details of the costs incurred by the company are as follows:

to that which would be charged on an agreement for sale for the consideration only. Stamp duty is not calculated upon the value of the partitioned or exchanged land.

Voluntary agreements inter vivos

Any chargeable agreement for sale which operates as a voluntary agreement *inter vivos* is chargeable with stamp duty. In calculating the duty payable, the value of the immovable property which is the subject of the agreement is taken into account in place of the amount or value of consideration (s 29F(1)).

An agreement is deemed to be a voluntary agreement *inter vivos* where:

- the amount of consideration is not ascertained at the time of the agreement; or
- the Collector believes that the agreement confers a substantial benefit on the purchaser by virtue of the inadequacy of the consideration to be paid (s 29F(3)).

The Commissioner of Rating and Valuation may be requested to give expert advice as to the adequacy of consideration.

A chargeable agreement made for nominal consideration for the purpose of securing the repayment of an advance or loan is not regarded as a voluntary disposition *inter vivos* (s 29F(4)).

[¶14-1240] Amount of duty, time for stamping, etc

The amount of duty payable on an agreement for the sale of immovable residential property is set down in the First Schedule of the Ordinance (see ¶14-3500).

See ¶14-5190 for the time limits applicable to the stamping of the sale agreements.

[¶14-1320] Duty charged on conveyance on sale when agreement for sale stamped

When a conveyance on the sale of immovable residential property is executed in conformity with, or pursuant to, a chargeable agreement for sale, the amount of duty payable on the conveyance is determined according to whether the agreement has been duly stamped. This is discussed at ¶14-3340 under the sub-heading "Duty payable on conveyance on sale of residential property".

TRANSFER OF HONG KONG STOCK

[¶14-1550] Instruments relating to Hong Kong stock

Stamp duty is chargeable on any contract note for the transfer of Hong Kong stock by way of sale and purchase (First Schedule, Head 2(1) and (2)).

Any person who effects a sale or purchase of Hong Kong stock as either a principal or agent must make, execute, and have stamped, a contract note evidencing the sale or purchase (s 19(1)). However, if any sale or purchase of Hong Kong stock is effected by a broker (whether as the principal or agent), the contract note will be regarded as having been so executed, whether or not it has actually been executed by the broker (s 19(1F)).

The instrument of transfer of the stock must be endorsed or a stamp certificate in respect of the instrument must be issued to the effect either that the required stamp duty has been paid on the contract note, or that the note is exempt from duty because stock has been transferred between associated corporations (see ¶14-7320) (s 19(1)(d)). Endorsement is not required, however, if at the time of the sale or purchase the instrument of transfer was

- loan capital;
- bills of exchange, promissory notes or certificates of deposit;
- Exchange Fund debt instruments or Hong Kong dollar denominated multilateral agency debt instruments (as defined in the *Inland Revenue Ordinance* (Cap 112), see ¶6-3400); or
- debentures, loan stocks, funds, bonds or notes which are not denominated in Hong Kong currency, except to the extent that they are redeemable in that currency (s 2(1)).

Instruments for the transfer of these investments are therefore not chargeable with stamp duty.

Contract note requirements

A contract note for the sale or purchase of stock must set out the following particulars (s 19(2)):

- whether the person effecting the transaction is acting as a principal or agent. In the latter case the name of the principal must be disclosed;
- the date of the transaction and the date the contract note was made;
- the quantity and description of the Hong Kong stock which was the subject of the transaction;
- the price per unit of the stock transacted and the amount of the consideration. In the case of an exchange, the particulars of the property for which the stock was exchanged must be included; and
- the date of settlement.

Contract notes for jobbing business

Contract notes for sales and purchases of Hong Kong stock which are made in respect of "jobbing business" are liable for only nominal stamp duty. See further ¶14-1790.

Deemed sale and purchase

Instruments which transfer Hong Kong stock other than on sale and purchase are also chargeable with stamp duty (First Schedule, Head 2(3) and (4)). Duty must be paid on any instrument of transfer which operates as a voluntary disposition *inter vivos* or is made for the purpose of effecting a transaction whereby the beneficial interest in the stock passes without any sale being made.

Stamp Office Interpretation and Practice Notes No 4 deals with the deemed sale and purchase of Hong Kong stock. Where a transaction passes the beneficial interest in Hong Kong stock otherwise than by way of sale and purchase, the transaction is deemed to be a sale and purchase for the purposes of levying stamp duty. Practice Note No 4 provides examples of deemed sale and purchases of Hong Kong stock.

Amount of duty, time for stamping

The amount of stamp duty payable on instruments which effect the sale, purchase or other transfer of Hong Kong stock is set down in the First Schedule of the Ordinance: see ¶14-3900 and ¶14-4140. For the time limits applicable to the stamping of the various instruments see ¶14-5190.

Requirement for due stamping

Any instrument effecting a transfer of Hong Kong stock is duly stamped only if it bears an endorsement by the Collector to the effect that the duty has been paid or that the instrument

(b) the sale or purchase of Hong Kong stock by an options market maker through a recognised stock market in the ordinary course of acting as an options market maker in the options market where the sale or purchase directly arises out of a transaction in an options contract entered into by the options market maker.

An "options market maker" is defined as an exchange participant who has been granted a permit by a recognised exchange company to make a market in options contracts. A "sale or purchase" includes any disposal or acquisition (other than an allotment) for valuable consideration, any exchange, or any transaction in respect of unit trusts which is deemed to be a transfer by way of sale under s 30(3)-(5) (see ¶14-4750).

The transactions indicated above are specified as "jobbing business" under the *Stamp Duty (Jobbing Business) (Options Market Makers) Regulation*.

[¶14-1870] Exemption for specified derivative transactions

Relief from stamp duty is provided for the sale or purchase of any specified derivative which is effected by a broker through the Unified Exchange in the course of his or her business as a broker, whether as a principal or agent (s 19(1D) and the Fourth Schedule). Contract note obligations prescribed under s 19(1) do not apply to such exempted transactions and any transfer made to effectuate the sale or purchase of stock which qualifies as an exempted transaction is exempted from the stamp duty which would normally be imposed under Head 2(4) of the First Schedule.

[¶14-1950] "Specified derivatives"

"Specified derivatives" qualifying for stamp duty exemption under s 19(1D) are (Fourth Schedule, para 3):

(i) options which give their holders the right (without obligation) to acquire or dispose of a pre-determined number of approved regional stocks or approved basket stocks at a pre-determined price, or to receive a cash payment in lieu thereof, on a pre-determined date; and

(ii) convertible bonds or notes which give their holders the right (without obligation) to convert them into stocks of their issuer, which are either approved regional stocks or approved basket stocks, on or before a pre-determined date.

"Approved regional stocks" are any stocks listed on an approved regional stock exchange (ie a regional stock exchange which has been specified as approved by the Unified Exchange by notice in the *Gazette*). "Approved basket stocks" are stocks which form part of a basket of stocks where:

(i) the basket comprises stocks listed on one or more approved regional stock exchanges and stocks listed on the Unified Exchange; and

(ii) the aggregate value of the stocks listed on the Unified Exchange does not exceed 40% of the aggregate value of the total basket.

In this regard, the value of stocks listed on either an approved regional stock exchange or the Unified Exchange is the closing price of the stock quoted in the relevant exchange on the launch date of the specified derivative to which the stock relates or, if there is no such closing price, the previous closing price of the stock by reference to the launch date.

[¶14-2030] Relief for stock borrowing and lending transactions

Stock borrowing and lending transactions are relieved from stamp duty if the following conditions are fulfilled:

- the borrowed stock must have been used for one or more *specified purposes*;

The borrower may now register either the executed agreement *or a true copy* of the agreement at any time after the stock borrowing is executed *but before the expiry of 30 days after the stock borrowing is effected.*

Stock return

A stock return is a transaction by which a borrower returns any stock which is of the same description as the borrowed stock or delivers any reasonable equivalent of the borrowed stock, whether or not the return or delivery is made (s 19(16)).

To qualify for relief, the borrowed stock may be returned either directly to the lender of the stock, or indirectly under or through a recognised clearing house in accordance with its rules.

Reasonable equivalent

In relation to the definition of a stock borrowing and lending agreement, a reasonable equivalent means any stock or monies which, in the opinion of the Collector, can, as a result of the occurrence of a relevant event, be reasonably and fairly regarded as such (s 19(16)). Paragraph 30 of the Stamp Office Interpretation and Practice Note No 2 (Revised) has given certain examples of reasonable equivalent.

Relevant event

Relevant events are those which, in the opinion of the Collector, make it either impracticable or inappropriate to return stock of the same quantity and description (s 19(16)).

Specified payment

A specified payment is an amount equivalent to any dividend, interest or other distribution payable by the issuer or any other person to the holder of the stock or its reasonable equivalent during the stock borrowing and lending period.

A "specified payment" is described as a payment equivalent to the economic benefits which the lender of stock would have received during the loan period as being the owner of the stocks had the stocks not been parted with him or her.

[¶14-2190] Registration of stock borrowing and lending agreement

In order for relief from stamp duty to be granted in relation to a stock borrowing and lending agreement, the stock borrower is required to deliver to the Collector:

(i) an executed copy of, or a true copy (certified as true by the borrower, or by the company secretary or a director of the borrower, or by a counsel of the borrower) the stock borrowing and lending agreement;

(ii) any other documents, particulars and information requested by the Collector; and

(iii) the prescribed registration fee (currently $270) (s 19(12A)).

The agreement is required to be provided at any time after the agreement is executed but within 30 days of the day the stock borrowing is effected.

Stock Borrowing and Lending Registration Forms are available from the Stamp Office.

Records and returns

A stock borrower who has effected any stock borrowings under a stock borrowing and lending agreement, an executed copy of which has been provided to the Collector in accordance with s 19(12A), is also required to keep a stock borrowing ledger and to furnish the Collector with a return of stock borrowings and returns (s 19(13)).

The ledger should contain the following particulars:

If these conditions are satisfied, the Collector will treat a repurchase agreement as equivalent to a stock borrowing and lending agreement. Stock sales and corresponding stock repurchases effected under qualifying repurchase agreements are regarded as "stock borrowings" and "stock returns" and the sellers and buyers of the stock are regarded as "lenders" and "borrowers" for the purposes of the relevant provisions of the *Stamp Duty Ordinance* (Cap 117).

[¶14-2350] Treatment of stock collateral

Under certain stock borrowing and lending transactions or repurchase agreements, stocks or other securities may be provided by the borrower or buyer as collateral. According to Stamp Office Practice Note No 2 (Revised), para 44, in such cases, where Hong Kong stock is involved, the initial transfer of the collateral and the transfer upon its return are both exempt from *ad valorem* stamp duty in accordance with s 27(5).

Section 27(5) excludes from *ad valorem* stamp duty any "conveyance or transfer made for nominal consideration for the purpose of securing the repayment of an advance or loan". According to the Stamp Office Practice Note No 2 (Revised), para 44, the ordinary meaning of "loan" includes a stock loan and it is accepted that stock borrowing and lending transactions and repurchase agreements are in respect of stock loans. The fact that the title to the collateral is actually transferred from the borrower to the lender, or from the buyer to the seller, and then back again when the borrowed stock is returned does not make any difference; s 27(5) is intended to provide relief for outright transfers of stock used as security.

Where collateral is involved, the parties to a stock borrowing and lending agreement or repurchase agreement should produce the transfer documents in respect of the stock collateral for stamping, together with supporting evidence such as the related stock borrowing and lending agreement or repurchase agreement. Each transfer document will be stamped with a fixed duty of $5 (as per Head 2(4) of the First Schedule) and denoted with a "No Ad Valorem Duty Payable" stamp (Stamp Office Practice Note No 2 (Revised), para 45).

[¶14-2430] Agency stock loan agreements

Agency stock loans involve the lending of stock by custodians who act as agents for clients who have deposited stock with them. The clients are the principals in the stock loan transactions. However, in most cases, custodians act as agents for "undisclosed" principals so that the identities of their clients are not revealed. A custodian also may lend on behalf of a "pooled investor" (eg a mutual fund) in which case it may be impossible to identify the beneficial owners of the stock. And even if a loan can be allocated to specific clients, the composition of the underlying lenders may change over the duration of the loan. It is a typical practice for custodians, acting as agents, to execute one agency stock loan agreement with each borrower. Borrowers, in turn, treat the custodian as a single counterparty for booking and reporting purposes (Stamp Office Practice Note No 2 (Revised), para 46).

Recognising the difficulties involved in identifying the principals involved in agency stock loan agreements, the Collector of Stamp Duty allows certain concessions in complying with the requirements of the stock borrowing and lending stamp duty relief scheme. The Collector accepts that:

- a custodian may enter into an agency stock loan agreement with a borrower or borrowers on behalf of undisclosed or disclosed principals in its capacity as an agent;
- a custodian who has entered into an agency stock loan agreement can discharge its obligations under the stock borrowing and lending regime by informing the Stamp Office in writing as soon as an agreement is entered into, including particulars of the

For the duty payable on duplicates and counterparts, see ¶14-4460. For the time limit for stamping a duplicate or counterpart, see ¶14-5190.

DUTY PAYABLE AND PERSONS LIABLE

[¶14-3100] Stamp duty payable and persons liable

The tables which appear in the following paragraphs are derived from the First Schedule of the Ordinance. They show the stamp duty payable on various instruments. The persons who are liable for that duty and the factors affecting the calculation of the duty payable on certain instruments in special circumstances are also set out.

Note that the stamp duty payable on any chargeable instrument, as prescribed in the First Schedule, may be remitted, wholly or in part, under s 52.

Conveyance on sale of immovable property (Head 1(1))

[¶14-3180] Ad Volarem Stamp Duty payable (AVD)

For sale of immovable property, in general a sale and purchase agreement is executed before the execution of the conveyance on sale (i.e. the deed of assignment). If a deed of assignment is executed in conformity with the sale and purchase agreement, which has been properly stamped, the AVD payable on the conveyance on sale is $100. However, if there is no sale and purchase agreement being executed beforehand, the conveyance will be chargeable to AVD at either Scale 1 or Scale 2 rates.

With effect from 5 November 2016, Scale 1 AVD rates are divided into Part 1 and Part 2. Part 1 of Scale 1 applies to instruments of residential property and Part 2 of Scale 1 applies to instruments of non-residential property and certain instruments of residential property executed on or after 23 February 2013 but before 5 November 2016. Part 2 of Scale 1 is in essence the prevailing AVD at Scale 1 rates before 5 November 2016. The rates at Scale 1 are as follows:

Scale 1

Part 1 of Scale 1: (Applicable to instruments of residential property executed on or after 5 November 2016):	
A flat rate of 15% of the consideration or value of the property (whichever is the higher)*	
Part 2 of Scale 1: (Applicable to instruments of residential property executed on or after 23 February 2013 but before 5 November 2016 and instruments of non-residential property executed on or after 23 February 2013)	
Consideration (round up to nearest $1)	Rates of Scale 1 (Part 2)
Up to $2,000,000	1.5%
$2,000,001 - $2,176,470	$30,000 + 20% of excess over $2,000,000
$2,176,571 - $3,000,000	3%
$3,000,001 - 3,290,330	$90,000 + 20% of excess over $3,000,000
$3,290,331 - $4,000,000	4.5%
$4,000,001 - $4,428,580	$180,000 + 20% of excess over $4,000,000
$4,428,581 - $6,000,000	6%
$6,000,001 - $6,720,000	$360,000 + 20% of excess over $6,000,000

who acquires more than a single residential property under an instrument will be liable to pay AVD at a flat rate of 15%, irrespective of whether or not he/she is a beneficial owner of any other residential property in Hong Kong on the date of acquisition of the subject properties.

In addition to acquisition of a residential by a HKPR, Scale 2 rates apply to other situations as well. There are also situations where AVD is exempt. The relevant situations are listed below:

Part 1 or Part 2 of Scale 1 will not be applicable under the following circumstances with effect from 23 February 2013 –

(A) Where Scale 2 is applicable:

(i) acquisition of a residential property (whether or not together with a car parking space) by a HKPR who is acting on his/her own behalf and does not own any other residential property (and car parking space, if applicable) in Hong Kong at the time of acquisition. However, if the instrument is executed on or after 12 April 2017 for acquisition of more than 1 residential property, it will be subject to AVD at Part 1 of Scale 1;

(ii) acquisition of a residential property (whether or not together with a car parking space) by two or more HKPRs jointly as co-owners or joint owners and each of the purchasers is acting on his/her own behalf and does not own any other residential property (and car parking space, if applicable) in Hong Kong at the time of acquisition. However, if the instrument is executed on or after 12 April 2017 for acquisition of more than 1 residential property, it will be subject to AVD at Part 1 of Scale 1;

(iii) acquisition of a residential property by a HKPR jointly as a co-owner or joint owner with a close relative or close relatives (i.e. spouse, parents, children, brothers and sisters) who is/are not HKPR and each of the purchasers is acting on his/her own behalf and does not own any other residential property in Hong Kong at the time of acquisition. However, if the instrument is executed on or after 12 April 2017 for acquisition of more than 1 residential property, it will be subject to AVD at Part 1 of Scale 1;

(iv) acquisition or transfer of residential properties between close relatives, irrespective of whether they are HKPRs and whether they are beneficial owners of any other residential property in Hong Kong at the time of the acquisition or transfer;

(v) nomination of a close relative(s) (be they HKPRs or not) who is/are owner(s) of other residential property in Hong Kong at the time of nomination, to take up the assignment of a residential property;

(vi) acquisition or transfer of a property by a court order or pursuant to a court order, which includes a foreclosure order obtained by a mortgagee whether or not it falls under the definition of a financial institution within the meaning of section 2 of the Inland Revenue Ordinance;

(vii) transfer/vesting of a mortgaged property under a conveyance to/in its mortgagee that is a financial institution within the meaning of section 2 of the Inland Revenue Ordinance, or a receiver appointed by the mortgagee;

(viii) acquisition of a property by a person acting on his/her own behalf to replace another property which was owned by that person and that has been:

- purchased or acquired pursuant to redevelopment projects pursued by the Urban Renewal Authority; or

Conveyance executed in conformity with chargeable agreement for sale

When a conveyance on sale of residential property has been executed in conformity with a chargeable agreement for sale (see ¶14-1080ff), which has been stamped in accordance with the Ordinance, the stamp duty payable on the conveyance is $100 (s 29D(2)(a)). The phrase "in conformity with" means that the conveyance on sale is in favour of exactly the same person/s named in the agreement for sale as the purchaser/s and the conveyance is of the whole or part of the immovable property which is the subject matter of the agreement for sale (s 29D(6)(c), Stamp Office Practice Note No 1, para 60).

A conveyance on sale is regarded as being made between the same parties as a previous agreement for sale only if:

(i) the names of both the vendor and the purchaser, or the vendors and the purchasers if there are multiple parties, are the same in both the conveyance and the agreement; and

(ii) where there is more than one purchaser, the property or interest to be acquired by each purchaser is the same in both the conveyance and the agreement (s 29A(3A)).

If the agreement has not been stamped, the conveyance on sale is chargeable with a stamp duty in the same amount as any other conveyance for the sale of immovable property under Head 1(1) of the First Schedule (see above) and the agreement for sale is chargeable with a stamp duty of $100 (s 29D(2)(b)).

To determine the time for stamping the conveyance, it is deemed to have been executed on the date that the agreement for sale was made.

Conveyance executed in conformity with two or more agreements

When a conveyance on sale of residential property is executed *in conformity* with two or more agreements for sale, and each of the agreements has been stamped under the Ordinance, the conveyance is chargeable with the stamp duty prescribed under Head 1(1) of the First Schedule less the total amount of stamp duty paid for the agreements (s 29D(3)(a)). Any penalty which has been paid cannot be set off against the duty payable on the conveyance on sale.

If any of the agreements for sale have not been stamped, the conveyance on sale will not be stamped by the Collector unless the stamp duty payable on the conveyance under Head 1(1) is paid together with any penalty imposed for late stamping (see further ¶14-5270) (s 29D(3)(b)). The amount of duty paid on the other agreements may be deducted from the amount payable.

If the conveyance is stamped before each of the agreements is stamped, any unstamped agreements are chargeable with a $100 stamp duty (s 29D(3)(c)). Any agreement which has been assessed, remains chargeable with the assessed duty.

Conveyance in favour of purchaser and another

When a conveyance on sale for residential property is executed in pursuance of a chargeable agreement for sale (see ¶14-1080), in favour of a person named as the purchaser in the relevant agreement for sale, but also in favour of a person not named as the purchaser, the stamp duty payable is adjusted accordingly. If the agreement for sale has been stamped, the conveyance is chargeable with the duty prescribed under Head 1(1) of the First Schedule, less an amount which represents the proportion of the property vested in the person named as purchaser (s 29D(4)(a)). (Joint tenants are treated as having equal shares in property.)

If the agreement has not been stamped, the conveyance is chargeable with a duty according to Head 1(1) and, provided that the conveyance is stamped before the agreement, the agreement is chargeable with a $100 stamp duty.

within two years after the agreement has been cancelled or otherwise not performed (s 29C(5B)).

Refund of stamp duty under s 29DF of the Stamp Duty Ordinance

A HKPR who is acting on his own behalf acquiring a residential Property B to replace his only other residential Property A can apply for partial refund of AVD. He will be subject to AVD at Scale 1 as usual in the first instance, but he may seek a refund of the stamp duty paid in excess of that computed under Scale 2 upon proof that Property A has been disposed of within six months (if Property B was acquired before 5 November 2016) or 12 months (if Property B was acquired on or after 5 November 2016) from the date Property B was assigned to him. There is a general time limit for claiming refunds, which is within 2 years after the date of the chargeable instrument for acquisition of Property B (in this case, the agreement for purchase of Property B) or not later than 2 months after the date of the assignment for the disposal of Property A, whichever is the later.

In *Ho Kwok Tai v Collector of Stamp Revenue* (2015) HKRC ¶90-266, a judicial review case has been brought out by a taxpayer concerning the application for partial refund of ad valorem stamp duty under s 29DF of the Stamp Duty Ordinance. Mr. Ho, who purchased a new flat, disposed of two old flats within six months of his purchase of the new flat.

The completion of the sale of two old flats of Mr. Ho took place on 15 August 2013 and 23 September 2013 respectively, and the completion of his purchase of the new flat took place on 7 October 2013. Mr. Ho believed that he would be entitled to a refund of the difference between the new rate and the old one under s 29DF of the Stamp Duty Ordinance and therefore applied a refund of the difference of $273,750 through his solicitors.

The Collector of Stamp Revenue rejected the application based on the ground that the Mr. Ho would only have been eligible for a refund if the property he has disposed of had been his only residential property. Since Mr. Ho had disposed of two of his old flats, the provision did not apply to him. Mr. Ho argues otherwise and submitted an application for judicial review.

The Court of First Instance held that s 29DF of the Stamp Duty Ordinance applied to the situation where the purchaser owned more than one original residential property and the Collector of Stamp Revenue should refund the stamp duty difference to Mr. Ho. Further to the court judgement, the Collector of Stamp Revenue has lodged an appeal against the judgement of Court of First Instance.

Followed by the appeal lodged against the judgement of the Court of First Instance HCAL 49/2015, on 31 October 2016, in *Ho Kwok Tai* v *Collector of Stamp Revenue* (2016) CACV 52/2016 HKRC ¶90-267, the Court of Appeal ruled that the "Original Property" in s29DF was not intended to refer to more than one property. In English, that expression was defined to mean "another residential property… of which the person was a beneficial owner on the date of that acquisition", and in Chinese, the expression "原物業 (original property)" was defined to mean

"就根據適用文書取得某標的物業的人而言，指符合以下說明的另一住宅物業…：該 人於其取得該標的物業的日期，是該另一物業的實益擁有人".

The Chinese word "另一" in the Chinese definition of the expression "原物業 (original property)" clearly indicate that the expression cannot refer to more than one property. It is not intended that a purchaser would be entitled to a partial refund of the enhanced ADV paid in relation to the acquisition of a new property where the beneficial owner of two or more residential properties which he disposed of within the specified statutory period.

There could not be more than one date of the conveyance on sale under which the "Original Property" was transferred of divested as prescribed in s 29DF(3)(c), it indicates a clear

Agreement for sale of immovable residential property (Head 1(1A))

[¶14-3500] AVD payable

For sale of immovable property, in general sale and purchase agreement is executed before the execution of the conveyance on sale (i.e. the deed of assignment). The sale and purchase agreement is chargeable to AVD. The subsequent deed of assignment executed in conformity with the sale and purchase agreement, which has been properly stamped, the AVD payable on the conveyance on sale is $100. The sale and purchase agreement is chargeable to AVD on either Scale 1 or Scale 2 rates as explained in the following paragraphs.

With effect from 5 November 2016, Scale 1 AVD rates are divided into Part 1 and Part 2. Part 1 of Scale 1 applies to instruments of residential property and Part 2 of Scale 1 applies to instruments of non-residential property and certain instruments of residential property executed on or after 23 February 2013 but before 5 November 2016. The rates at Scale 1 are as follows:

Scale 1

Part 1 of Scale 1: (Applicable to instruments of residential property executed on or after 5 November 2016):	
A flat rate of 15% of the consideration or value of the property (whichever is the higher)*	
Part 2 of Scale 1: (Applicable to instruments of residential property executed on or after 23 February 2013 but before 5 November 2016 and instruments of non-residential property executed on or after 23 February 2013)	
Consideration (round up to nearest $1)	Rates of Scale 1 (Part 2)
Up to $2,000,000	1.5%
$2,000,001 - $2,176,470	$30,000 + 20% of excess over $2,000,000
$2,176,571 - $3,000,000	3%
$3,000,001 - 3,290,330	$90,000 + 20% of excess over $3,000,000
$3,290,331 - $4,000,000	4.5%
$4,000,001 - $4,428,580	$180,000 + 20% of excess over $4,000,000
$4,428,581 - $6,000,000	6%
$6,000,001 - $6,720,000	$360,000 + 20% of excess over $6,000,000
$6,720,001 - $20,000,000	7.5%
$20,000,001 - $21,739,130	$1,500,000 + 20% of excess over $20,000,000
Over $21,739,130	8.5%

- *Effective 5 November 2016, all residential property is chargeable to AVD at 15% in general. However, if exemption or relief applies, Scale 2 rates (which is lower than Scale 1 rates) will apply.
- As an anti-avoidance measure, where Scale 1 rates apply, if AVD is not payable at the maximum rate of 8.5%, a statement certifying that the transaction does not form part of a larger transaction or a series of transactions of which the aggregate amount is more than the amount of that subject transaction needs to be made; otherwise, the maximum rate of 8.5% will be applied.
- Scale 2 rates – For residential property, where the buyer is a HKPR who is acting on his behalf and did not own any other residential property at time of acquisition