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

5. Summary of major obligations and related penalties for Section 51 (See also XV Concept Map 44.)

With respect to the level of penalty below, it is cross-referenced to Criminal Procedure Ordinance Cap. 221 Schedule 8 Level of Fines for Offences.

• Level 3: \$10,000

• Level 6: \$100,000

Bever o.	ψ100,000		
Section	Obligation	Penalty for Non-compliance	
S.51(1) Complete return within the time limit as requested in the notice from an assessor in writing.		A fine at level 3, and a fine of treble the amount of tax undercharged – S.80(2).	
S.51(2)	Notify Commissioner of the <i>chargeabilit</i> , of tax not later than 4 months after the end of the basis period in which the income was derived.	A fine at level 3, and a fine of treble the amount of tax undercharged – S.80(2).	
S.51(3)	Answer enquiries, i.e. to furnish fuller or further returns, raised by assessor to support the tax returns.	A fine at level 3 and court order for compliance within the time specified in the order – S.80(1)(a).	
S.51(4)(a)	Answer enquiries as a third party.	A fine at level 3 and court order for compliance within the time specified in the order – S.51(4B).	
S.51(6)	Notify Commissioner in writing of the cessation of income within 1 month of such cessation.	A fine at level 3 and court order for compliance within the time specified in the order – S.80(1)(c).	
S.51(7)	Notify Commissioner in writing of the departure from Hong Kong for any period exceeding 1 month not later than 1 month before the expected date of departure.	A fine at level 3 and court order for compliance within the time specified in the order – S.80(1)(c).	
S.51(8)	Notify Commissioner in writing of the change of address within 1 month of such change.	A fine at level 3 and court order for compliance within the time specified in the order – S.80(1)(c).	
S.51C	Keep record of business income and expenditure for a period not less than 7 years.	A fine at level 6 and court order for compliance within the time specified in the order – S.80(1A).	
S.51D	Keep record of property income for a period not less than 7 years.	A fine at level 3 and court order for compliance within the time specified in the order – S.80(1)(c).	

8 Different forms of employer's returns

Form Number	Relevant Section	Situation Required	
BIR56A	Section 52(2)	Covering sheet for employer's return	
IR56B	Section 52(2)	Annual employer's return	
IR56E	Section 52(4)	Commencement of employment	
IR56F	Section 52(5)	Cessation of employment	
IR56G	Section 52(6)	Employee departure from Hong Kong	
IR56M Section 52(2) Employer's return for commission recipients and subcontractors etc. who are not employees		Employer's return for commission recipients and subcontractors etc. who are not employees	

IV Obligations of a Reporting Entity under CbCR Requirement

- 9. Sections 58E, 58H and 58L impose the following obligations on a reporting entity:
 - a. a Hong Kong ultimate parent entity of a reportable entity must file a CbCR in respect of an accounting period (begins on or after 1 January 2018) by the filing deadline specified in the notice served by the assessor Section 58E(1).
 - b. each Hong Kong entity of a reportable group must file a written notice with the Commissioner informing the Commissioner the name, address and business registration number of each of the group's Hong Kong entities; identifying an ong them the Hong Kong ultimate parent entity or the surrogate parent entity that is resident for tax purposes in Hong Kong Section 58H(1)(a).
 - c. to inform the Commissioner within 1 month after the change of the address should a reporting entity has changed it Section 58L(1).
 - d. a reporting entity must keep sufficient records to enable the accuracy and completeness of the CbCR filed Section 58L(2)(a).
 - e. a reporting entity must retain the records for a period of 6 years beginning on the date which the CbCR is filed Section 58L(2)(b).

10. Summary of obligations and penalties for Sections 58E, 58H and 58L (See also XV Concept Map 46.)

With respect to the level of penalty below, it is cross-referenced to Criminal Procedure Ordinance Cap. 221 Schedule 8 Level of Fines for Offences.

• Level 5: \$50,000

• Level 6: \$100,000

Section	Obligation	Penalty for Non-compliance
S.58E(1)	File a CbCR before filing deadline specified.	A fine at level 5 and court may order for compliance within the time specified in the order – Section 80G(3); a further fine of \$500 for every day or part of a day during which the offence continues after conviction – Section 80G(4).

- g. an assessor may enter business premises of reporting financial institutions and service providers and inspect its compliance system and process for the purpose of checking AML/KYC procedures [anti-money laundering requirements or similar requirements (including requirements to know a customer)] Section 51BA.
- h. an assessor may give a written notice to an entity requiring it to file a CbCR for an accounting period specified in the notice.

12. Summary of the IRD's authority in obtaining information and document

S.51(1)	CIR may issue tax return to a taxpayer for completion	
S.51(3)	Assessor may ask a taxpayer to provide his or her own information	
S.51(4)(a	Assessor may ask a person to provide the information of other persons if that person possesses such information of the third party	
S.51(4)(b	Assistant commissioner may ask a taxpayer to attend an interview	
S.51A	CIR or DCIR may, with consent of BOR, require a taxpayer to furnish a statement of assets and liabilities	
S.51B	Chief assessor may apply to a magistrate for issue of a search warrant for searching and examining the books and records of a taxpayer	
S.51BA	Assessor may enter business premises of reporting financial institutions and service providers and inspect its compliance system and process for the purpose of checking AML / KYC procedures	
S.52(1)	The CIR may ask any officer in the employment of the Government or of any public body to provide the information which may be in the possession or control of such officer.	
S.52(2)	Assessor may issue employer's return to a business for details of its employees	
DIPN 11	IRD staff may carry cut field audits at the taxpayer's premises	

VI Issue of Returns (See also XV Concept Map 47.)

13. A bridge of information between taxpayers and IRD

Hong Kong does not implement the tax collection system of "Pay As You Earn". Tax is not collected by withholding, but by the issue of assessment. Before issuing a tax assessment, the IRD issues a tax return (which is generally referred to as a "return") to ask the taxpayer to declare the income which he or she received in a particular year of assessment. As a matter of practice, a month is allowed for a person to file his or her return.

14. Time for issue of returns

a. Types of returns issued by IRD

Types of Tax Return	BIR Form Number	Date of Issue
Profits tax return (Corporation)	BIR 51	1 st working day in April
Profits tax return (Partnership)	BIR 52	1 st working day in April
Profits tax return (Non-resident)	BIR 54	1 st working day in April
Property tax return – joint owners	BIR 57	1 st working day in April

- 16. An assessor is empowered to issue an assessment of tax in the following circumstances:
 - a. as soon as the time limit expired as stated in the notice requiring him or her to furnish a return under Section 51(1) Section 59(1);
 - b. at any time if the assessor is of the opinion that such a person is about to leave Hong Kong, or that for any other reason it is expedient to do so Section 59(1) proviso.
- 17. An assessor may raise an assessment in the following manners:
 - a. to accept the return and make an assessment in accordance with the return Section 59(2)(a);
 - b. not to accept the returned income but raise an estimated assessment Section 59(2)(b);
 - c. to raise an estimated assessment in the absence-of a return Section 59(3); or
 - d. to raise an estimated assessment based on a percentage of turnover Section 59(4).

18. Assess First Audit Later (AFAL)

With effect from April 2001, the Inland Revenue Department (IRD) effected the policy of AFAL. The system is different from the old "assessor-examining returns" system. Under the AFAL system, assessors issue tax assessments without detailed examination of tax returns. Tax returns are examined after the issue of assessment at a later date. In other words, an assessment issued as per returned figure does not mean that the IRD accepts that the profit or loss as reported in the tax return is correct.

19. DIPN 12 on disclosure of commissions, rebates and discounts in tax returns and computation

DIPN 12 titled "Commissions, Rebates and Discounts" requires taxpayers and tax representatives to disclose details of payments of commissions, rebates and discounts in the profits tax returns and computations.

In order to ascertain the deductibility of commissions, rebates and discounts, DIPN 12 requires the following disclosure in the tax returns and computations:

- a. Return the gross income and clearly distinguish the payment of commissions, rebates and discounts instead of showing the income net of commissions, rebates and discounts.
- b. Disclose each payment and the following details:
 - i. full name, address and identity card number or business registration number of the recipient;
 - ii. whether the recipient has any relationship with the taxpayer;
 - iii. amount of the payment;
 - iv. details of services rendered; and preferably
 - v. evidence of payment.

If the payer does not supply the details of the payment of commissions, rebates and discounts, the payment is disallowed, and added back to the assessable profit. If it is a loss case, the payer is treated as an agent of the recipient, and the payer is required to pay the tax on the commissions, rebates and discounts on behalf of the recipient.

XVII Procedures for Issuing and Appealing against Additional Tax Assessment under Section 82A (See also XIX Concept Map 52.)

41. Steps involved in the issue of additional tax assessment

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- a. The assessment is personally issued by the Commissioner ("CIR") or a Deputy Commissioner ("DCIR").
- b. Before the issue of the assessment, the taxpayer is served with a notice signed by CIR or DCIR under Section 82A(4) notifying the taxpayer that additional tax will be assessed on him or her. He or she is invited to furnish reasonable excuse for the omission or understatement of income or mitigating factors for the amount of additional tax to be charged.
- c. The taxpayer has the right of submitting representations to CIR or DCIR within 21 days from the date of the notice.
- d. After having considered the taxpayer's representations, CIR or DCIR will issue the additional tax assessment on the taxpayer. The additional tax assessment may be issued by a CIR or DCIR different from the one who issued the notice under Section 82A(4) as long as he or she is the person holding the post of CIR or DCIR at that time [CIR v Suresh Babu Loganathan (2000)].
- e. The taxpayer may lodge an appeal against the additional tax assessment within 1 month from the date of the assessment if he or she is of the view that the additional tax (i.e., the penalty) is excessive.

42. Appeal against Section 82A additional tax assessment under Section 82B

A taxpayer may lodge an appeal against additional tax assessment under Section 82B as follows:

- a. The appeal must be in writing.
- b. The notice of appeal is addressed to the Board of Review, not CIR.
- c. The time limit for the appeal is within 1 month after the notice of additional tax assessment is given to the taxpayer (i.e. the date of assessment). As a result of the decision of CIR v Chan Ming Ching trading as Chan Siu Wah Herbalist Clinic (1999), Section 82B was amended on 25 June 2004 to allow the Board of Review to grant an extension for late appeal on the grounds of illness, absence from Hong Kong or other reasonable causes preventing an appellant from give an appeal in time.
- d. Documents required to be attached with the notice of appeal:
 - i. a copy of the notice of additional tax assessment;
 - ii. a statement of grounds of appeal;
 - iii. a copy of CIR's or DCIR's notice of intention to assess additional tax given under Section 82A(4); and
 - iv. a copy of taxpayer's written representation made under Section 82A(4).

43. Grounds for lodging appeal against additional tax assessment under Section 82B

If a person being assessed to additional tax under Section 82A is of the view that the additional tax is excessive, he or she may lodge an appeal to the Board of Review against the assessment within 1 month from the date of the assessment under Section 82B on any of the following grounds:

a. He or she has a reasonable excuse and is not liable for additional tax.

Reliance on professional advice on a technical matter was accepted as a reasonable excuse (D80/76).

b. Genuine mistake

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A taxpayer who makes a genuine mistake has a reasonable excuse (D13/85).

48. Examples not accepted as reasonable excuse by Board of Review and court

a. Incompetent staff or lack of staff

That staff are incompetent is not a reasonable excuse (D46/89).

The taxpayer claimed that it was the book-keeper's fault for the incorrect return. The Board decided that it was not a reasonable excuse as it would be the duty of those who file tax returns to ensure that the returns are correct before signing them (D47/90).

b. Ignorance of law

Ignorance of law is not a reasonable excuse (D79/89). Limited education, illiteracy or an inability to read English are also not reasonable excuses (D46/89).

49. Comparison of offences and penalty under Sections 80(2), 82A and 82

Section 80(2) (Without Reasonable Excuse) [Criminal Offence]	Section 82A (Without Reasonable Excuse) [Administrative Penalty]	Section 82 (Wilful Intent to Evade Tax) [Criminal Offence]
5 offences: • incorrect return • incorrect statement • incorrect information • S.51(1) • S.51(2)	5 offences: • incorrect return • incorrect statement • incorrect information • S.51(1) • S.51(2) [Same offences as Section 80(2)]	Poffences: omission of income false return false claim sign but not believe true false answer false records fraudulent acts
mpacis Microba	Penalty in the form of additional tax which	Summary Indictment
Level 3 penalty3 times taxundercharged	equals 3 times tax undercharged • Additional tax assessment is issued by CIR / DCIR	 Level 3 penalty 3 times tax undercharged 6 months' imprisonment Level 5 penalty 3 times tax undercharged 3 years' imprisonment
Appeal to court of higher level	Appeal to the Board of Review under Section 82B	Appeal to court of higher level

b. Facts

- i. The Church Body is the incorporation of the Anglican Church in Hong Kong. The Foundation is the incorporation of the Anglican Bishop of Hong Kong. Both the Church Body and the Foundation are charitable bodies.
- ii. The Church Body and the Foundation owned certain land ("the Old Lots") in Tai Po, New Territories. Part of the Old Lots was occupied by an orphanage known as the St Christopher's Home ("the Home"). The Old Lots had belonged to the Church Body and the Foundation since the 1930s. The Church Body and the Foundation had planned since the 1970s to develop the Old Lots.
- iii. In the early 1990s, architects commissioned by the Church Body and the Foundation submitted various plans to the Government for the purpose of obtaining town planning permission for a substantial residential development in the Old Lots. A set of plans were approved by the Town Planning Board in July 1990.
- iv. In December 1990 architects applied on behalf of the Church Body and the Foundation to the Districts Land Office Tai Po for a land exchange of the Old Lots to permit the building of the residential development as approved.
- v. On 2 July 1993, the Church and the Foundation invited property developers to submit tender offers either to purchase the Land (Option A) or to enter into a joint venture agreement for development of the Land (Option B). On 23 July 1993, Cheung Kong (Holdings) Limited ("Cheung Kong") submitted two tender offers which included Option A, being a sale and purchase offer. On 12 August 1993, the Church and the Foundation accepted Option B of entering a joint venture agreement with Cheung Kong for the development of the Land into private residential development later known as "Deerhill Bay".
- vi. In March 1998 the Church Body, the Foundation and the Developers agreed that 129 residential units and 94 can parking spaces in the development (which had been named "Deerhill Bay") would be allocated to the Church Body and the Foundation.
 - vii. Between 1998 and 2006, the Church Body and the Foundation sold their residential units and car-parking spaces at Deerhill Bay. From the sales, the Church Body derived a profit of some \$452 million, while the Foundation made a profit of some \$667 million.

c. Assessment

CIR issued assessment to tax the respective gains of the taxpayers from the sales of units and car parking spaces in their Deerhill Bay project in the years of assessment 1998/99 – 2004/05 are liable to profits tax.

d. Grounds of appeal

The Church and the Foundation objected and later appealed against the assessment on the ground that they were exempt from profits tax under Sections 14 and 88 of the IRO.

e. Decision and reasons

i. Court of First Instance (judgment issued on 27 January 2010)

The Board of Review upheld the determinations by the CIR assessing the Church and the Foundation. Upon appeal by the Church and the Foundation two questions were raised for the Court of First Instance to answer:

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The following valuation figures (as agreed by the Church, the Foundation and CIR) demonstrate the significance of the date agreed to be the date of change of intention:

Valuation date	Land value (\$)

If the date of change of intention is accepted as 12 August 1993, the assessable profits would be reduced by around \$900 million (i.e. \$1,110 million – \$192 million)

iii. Court of Final Appeal (judgment issued on 4 February 2016)

The CIR lodged an appeal to the Court of Final Appeal on the application of "enhancement for realisation principle", and the date of the change of intention.

The judges explained the "enhancement for realisation principle" as the 7th badge of trade which may be expressed as "Has expended time, money, or effort in selling the asset or commodity that goes beyond what might be expected of a non-trader seeking to sell an asset of that class?" (para. 24 of CFA judgment)

The CFA dismissed the CIR's appeal and the decision was as follows:

- (1) "Where, on the facts of the case, the steps and activities taken have gone beyond the mere realisation of capital, they would be regarded as evidence pointing towards the conclusion that there was a change of intention on the part of the person to embark on an adventure in the nature of trade." (para. 73 of judgment)
- (2) Since there is every reason to think that, although there was no change of intention by September 1989 or December 1990, there may have been such a change subsequent to those dates, that the Court of Appeal was right to remit the matter to the Board of Review to ascertain when that change of intention occurred. (para. 66 of judgment)

f. Summary of the decision by the Court of Final Appeal

There was a change of intention from capital asset to trading activities, and it is likely that the profit on sale would be chargeable to profits tax. However, the date of change of intention has to be ascertained by the Board of Review.

Regarding the exemption of trading profit from the sales of the units, the courts have not considered this issue. The courts would consider this issue when the date for the change of intention is ascertained.



Paragraph 3 of the revised DIPN 31 enlists six categories of specific rulings which in the absence of compulsory spontaneous exchange of information could give rise to BEPS concerns. They are:

- (a) rulings relating to preferential regimes;
- (b) unilateral APAs or other cross-border unilateral rulings in respect of transfer pricing;
- (c) cross-border rulings providing for a downward adjustment of taxable profits;
- (d) permanent establishment rulings;
- (e) related party conduit rulings; and
- (f) any other type of ruling agreed by the Forum on Harmful Tax Practices ("FHTP") that in the absence of spontaneous information exchange gives rise to BEPS concerns.

Currently, the CIR does not give rulings under category (c) while the exact scope for category (f) has yet to be resolved by FHTP. The IRD would only exchange rulings information falling in (a), (b), (d) and (e) above.

In general, the revised DIPN 31 explains the operation of the advance rulings. In paragraph 22, it states that (apart from the discussions concerning BEPS) the service of advance rulings cover, in particular, the source of profit (Section 14), Type I service company (Section 9A), stock borrowing (Section 15E), general anti-avoidance (Section 61A) and sale of loss companies (Section 61B). Since the enactment of Section 88A in 1998, source of profits (20 published advance rulings) and change of accounting date (14 published advance rulings) are the two of the more popular topics for advance rulings over the last 22 years. (See also "List of advance ruling cases" in Chapter 1 para. 6)

14. Details of fees

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Details of application fees payable under the time specified (in brackets below) contained in Part 2 of Schedule 10 of the IRO are as follows:

- a. for a ruling on source of profits under Section 14 (23 hours) \$45,000
- b. for a ruling of service company under Section 9A (11 hours) \$15,000
- c. for any other ruling (7 hours) \$15,000

In the event that the time spent in consideration of the advance ruling applications exceeds the time specified (in brackets above), an additional fee calculated based on the following hourly rate of different levels of officer at the IRD would be applied:

a.	a Deputy Commissioner	\$2,650
b.	an Assistant Commissioner	\$2,240
c.	any other person appointed under the IRO	\$1.730

VII Notice for Deregistration of a Private Company - Section 88B

15. Notice of no objection in respect of an application to deregister a private company

Section 88B provides that on a request made by a person who is entitled to apply for the deregistration of a private company under Section 750 of the Companies Ordinance (Cap. 622), the CIR may issue a written notice stating that he has no objection to the company being deregistered. Generally, such notice is issued when there is no outstanding tax liability due from the company.



in the course of providing professional tax service -

- he is entitled to put forward the best position in favour of his client, provided he can render the service with professional competence,
- it does not in any way impair his standard of integrity and objectivity,
- it is in his opinion consistent with the law,
- he should not hold out to clients the assurance that the tax return he prepares and the tax advice he offers are beyond challenge.

b. in the preparation of a tax return -

- a member should advise his client that the responsibility for the content of the return rests primarily with the client.
- the member should take the necessary steps to ensure that the tax return is properly prepared based on the information received from the client.

c. in the provision of tax advice or opinions -

• such advice or opinion should be recorded either in the form of a letter to the client or in a memorandum for the files.

19. Misbehaviour of clients

If a member of HKICPA has reason to believe a return or communication:

- · contains a false or misleading statement;
- contains statements or information furnished by the client recklessly or without any real knowledge of whether they are true or false; or
- omits or obscures information required to be submitted and such omission or obscurity would mislead the Inland Revenue Department,

he may take the following actions:

- he must not associate himself with such return or client's misbehaviour,
- his responsibility is to resign from acting as the client's tax representative, and
- he has to inform the Inland Revenue Department that he has withdrawn his services.

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Questions to test your knowledge

- a. Explain, in general, the structure of the Board of Inland Revenue and its functions.
- b. Explain, in general, how the official secrecy within Inland Revenue Department operates.
- c. Explain how the Chief Executive may exempt a person from payment of tax under Inland Revenue Ordinance.
- d. Explain when a charitable body may be exempt from tax chargeable under Inland Revenue Ordinance.
- e. Explain how advance ruling operates.
- f. Explain how the application of a notice from Inland Revenue Department for the deregistration of a private company operates.

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Mrs. Donald
Salaries Tax Computation
Year of Assessment 2020/21

I I I PAYOU		\$
Salaries		250,000
Bonus		30,000
Assessable income		280,000
Less: Contribution to	MPF	12,500
and from Hone		267,500
Less: Basic allowance		132,000
Net chargeable income	e	135,500
Progressive rates tax	\$50,000 @ 2%	1,000
ine Sent days	\$50,000 @ 6%	3,000
n order to has	\$35,500 @ 10%	3,550
deng Kot 600	COL	7,550
Standard rate tax (\$26	7,500 × 15%)	40,125
Salaries tax payable by	Mrs. Donald (lower of \$7,550 and \$40,125)	7,550
The minimum salaries	tax payable by Mr. and Mrs. Donald is	
(\$418,	050 + \$7,550)	425,600

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

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

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



ii. Facts

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

iii. Court of Final Appeal Decision

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

iv. Observation by the author

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

Whether There is a Business Carried on

Statutory definition of "business"

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

Explanation and interpretation

- a. The definition of "business" is very wide. Any activities not falling within the definition of trade and profession may be treated as a "business" under the IRO.
- Section 2 specifically includes the following activities as carrying on a business:
 - agricultural undertaking,
 - poultry and pig rearing,

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Money borrowed from a financial institution - Section 16(2)(d)

a. Section 16(2)(d) applies to borrowings from both Hong Kong financial institutions and overseas financial institutions. There is no similar requirement as that of Section 16(2)(c) that the interest paid to a financial institution is deductible only when the interest received by a financial institution is taxable. Thus, it does not matter whether the interest income received by the financial institution is taxable or not taxable in Hong Kong.

- b. In short, the deduction of interest paid to a financial institution is merely subject to the satisfaction of:
 - i. secured loan test under Section 16(2A), and

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ii. interest flow-back test under Section 16(2B).

[These are explained in the later paragraphs of this chapter.]

11. Money borrowed for the purchase of inventory or machinery, etc. - Section 16(2)(e)

- a. Section 16(2)(e) applies only when the conditions for Section 16(2)(c) are not satisfied. This means that even if the loan is borrowed from an individual or an overseas company, the interest may still be deductible if the conditions of Section 16(2)(e) apply.
- b. Under Section 16(2)(e), the interest on loan is deductible ender profits tax if both of the following conditions are satisfied:
 - i. the money is borrowed wholly and exclusively to finance the purchase of:
 - machinery or plant that qualifies for Fart 6 Depreciation of the IRO; or
 - machinery or plant for R&D activities within the meaning of Section 2 of Schedule 45 of the IRO; or
 - a prescribed fixed asset under Section 16G; or
 - any environmental protection machinery or environment-friendly vehicle under Sections 16H and 16I; or
 - trading stock for the production of profits subject to Hong Kong profits tax; and
 - ii. the lender is not a partner, shareholder, director or associated corporation of the borrower.
- c. If the loan is borrowed to finance the general operation or working capital of the borrower, the condition of Section 16(2)(e) is not satisfied. In that situation, the interest is not deductible.
- d The deduction of interest under Section 16(2)(e) is subject to the conditions of Sections 16(2A) and (2B) being satisfied too.

12. Differences in Sections 16(2)(c), (d) and (e)

The differences of payment interest on loan in Sections 16(2)(c), (d) and (e) may be summarised as follows:

	Requirement	Condition(s) for Deduction
Section 16(2)(c)	Interest paid to non-financial institution	Recipient taxable
Section 16(2)(d)	Interest paid to financial institution	Not required recipient taxable
Section 16(2)(e)	Interest paid to : • individual or • overseas company	Not associated, andloan wholly and exclusively used for purchase of machine or stock

Example 18.7

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ee 00 C Ltd. borrowed \$1,000,000 from Bank D at 9% interest rate p.a. The loan was secured by a fixed deposit in the amount of \$1,200,000 placed outside Hong Kong. The interest rate is 6% p.a. There was no other security. In the year of assessment, C Ltd. earned tax-free interest of \$72,000 from the deposit and paid interest of \$90,000 on the loan to Bank D.

Answer

The amount of interest expenses allowable for deduction will be reduced by \$60,000 calculated as follows:

Interest disallowed = Tax free interest
$$\times \frac{\text{Loan}}{\text{Deposit}}$$

$$= \$72,000 \times \frac{\$1,000,000}{\$1,200,000}$$

$$= \$60,000$$

Thus, the interest deductible under profits tax is reduced to \$30,000 (i.e. \$90,000 - \$60,000).

Example 18.8

C Ltd. borrowed \$1,000,000 from Bank D at 9% interest rate p. The loan was secured by a fixed deposit of \$800,000 earning tax-free interest of 6% p.a. and listed shares valued at \$400,000. In the year of assessment, C Ltd. earned tax-free interest of \$48,000 from the deposit and paid interest of \$90,000 on the loan to Bank D.

Answer

The amount of interest expenses allowable for deduction will be reduced by \$32,000, which is calculated as follows:

Interest disallowed = Tax free interest
$$\times$$
 Deposit Deposit + Shares = $$48,000 \times \frac{$800,000}{$1,200,000}$ = $$32,000$

Thus, the interest deductible under profits tax is reduced to \$58,000 (i.e. \$90,000 - \$32,000).

Example 18.9

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

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

The loan was secured by a deposit of \$2,000,000 earning tax-free interest of 6% p.a. In the year of assessment, C Ltd. earned tax-free interest of \$120,000 from the deposit and paid interest of \$225,000 on the loan to Bank D.

Answer

The amount of interest expenses allowable for deduction will be reduced by \$72,000, which is calculated as follows:



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- i. The taxpayer lost the case at Court of First Instance and Court of Appeal. (October 2008)
- ii. The Court of Final Appeal decided in July 2009 that the Commissioner's basis of assessment was not substantiated. The assessments for all the five years were annulled and the case was remitted to the Commissioner through the Board of Review to make fresh assessments for the years of assessment 1993/94, 1994/95 and 1995/96.

d. Observation and comment

Generally, the Commissioner is able to apply Section 61A successfully in almost all cases. However, in this case, the judges of the Court of Final Appeal found that although the Commissioner is empowered to disregard certain transactions if the sole or dominant purpose of such transactions is to obtain a tax benefit, the Commissioner cannot abuse such authority.

The judges summarised the approach of Section 61A as follows:

- i. Section 61A requires a particular transaction or a particular series of transactions through which the Commissioner has to demonstrate that there is a tax benefit obtained by the taxpayer.
- ii. The Commissioner has to ascertain the amount of tax that may be undercharged through such transactions when issuing a Section 61A assessment.
- iii. The Commissioner cannot rely on a broad brush approach when applying Section 61A to raise an estimated assessment.

In Ngai Lik case, the Commissioner used 50% of the total group profit of the taxpayer as the assessable profits under Section 61A. The judges ruled that the broad brush approach was not appropriate, and the case was remitted back to the Board of Review for the Commissioner to find out the particular transactions giving rise to a tax benefit, and quantify the tax benefit so obtained.

XV Advance Rulings

- 62. Following the enactment of the Inland Revenue (Amendment) (No. 2) Ordinance 1998, the practice of advance rulings has now become part of the statute, not merely as a practice as demonstrated in the past. Section 88A and Schedule 10 were inserted into the Inland Revenue Ordinance. Section 88A provides an opportunity to a taxpayer for an advance ruling on his or her tax affairs. The main objectives of the service of advance rulings are to:
 - a. provide taxpayers with a degree of certainty,
 - b. promote consistency in the application of the IRO, and
 - c. minimise disputes between the IRD and taxpayers.
- 63. Schedule 10 outlines the procedures for applying for advance rulings, on what matters which the Commissioner would or would not make a ruling, the follow-up steps after a ruling has been made, and the fees payable for a ruling.
- 64. In April 2020, the CIR revised DIPN 31 to align with international practice in terms of advance pricing arrangement (APA), i.e. how the tax rules are applied and may be agreed before transactions take place. (Please refer to paragraph 13 of Chapter 5 Miscellaneous Items for details.)

Different Stamp Duty Rates Applicable to Exchange of Property

When Scale 1 or Scale 2 stamp duty rates applies to exchange of property

a. Scale 1 stamp duty rates

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For an exchange of *non-residential property* for another *non-residential property*, the deed of exchange is chargeable with ad valorem stamp duty at the progressive rates of Scale 1 on the equality money.

For an exchange of residential property for another residential property, or an exchange of residential property for a non-residential property, the deed of exchange is chargeable with:

- i. ad valorem stamp duty at the new flat rate of 15% of Scale 1 on the equality money if the payment of equality money is made by the purchaser / transferee of the residential property;
- ii. ad valorem stamp duty at the progressive rates of Scale 1 on the equality money if the payment of equality money is made by the vendor / transferor of the residential property.

b. Scale 2 stamp duty rates

i. Close relatives

If the transferor and transferee are close relatives, the deed of exchange is chargeable with stamp duty rates at Scale 2 no matter whether it is an exchange of residential property for another residential property, an exchange of non-residential property for another non-residential property, or an exchange of residential property for a non-residential property.

ii. Hong Kong Permanent Resident (HKPR) without residential property

Each party to the instrument is a FKPR acting on his or her own behalf, and is not a beneficial owner of any other residential property in Hong Kong at the time of execution of the deed of exchange.

86. Special stamp duty (SSD) and buyer's stamp duty (BSD)

SSD and BSD are payable on the equality money for the deed of exchange.

XVII Lease

87. Charge of stamp duty

A lease for immovable property situated in Hong Kong is chargeable with ad valorem stamp duty under Head 1(2) of the First Schedule to the SDO.

88. How consideration is payable for a lease

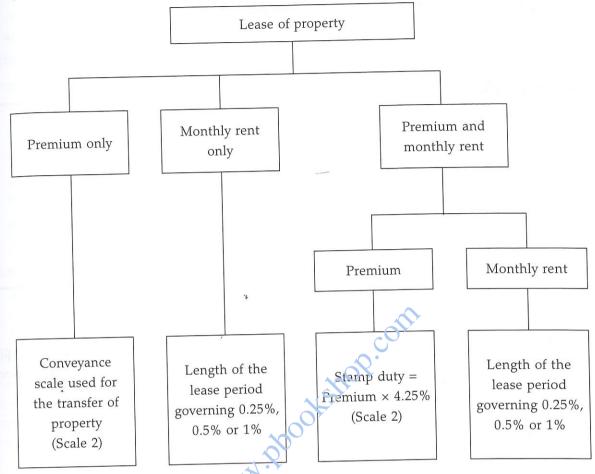
Monetary consideration for a lease may take three different scenarios as follows:

- a. premium only,
- b. rent only, and
- c. premium and rent.

89. Premium only

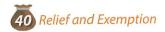
If the consideration for the use of a property under a lease is a premium only, Head 1(2)(a) provides that ad valorem stamp duty is chargeable on the lease at the same progressive Scale 2 applicable to the transfer of immovable property under Head 1(1).

111. Stamp duty on lease of an immovable property



Questions to test your knowledge

- a. Explain the procedures involved in the sale and purchase of immovable property.
- b. Explain the procedures involved in the stamping of the conveyance on sale of non-residential immovable property.
- c. Explain the procedures involved in the stamping of the conveyance on sale of residential immovable property.
- d. Explain the procedures involved in the stamping of a gift of immovable property.
- e. Explain how to calculate the amount of stamp duty chargeable on the transfer of immovable property.
- f. Explain how a lease of immovable property and an agreement for a lease of immovable property are stamped.



12. Situations where Section 45 group stamp duty relief is not granted

Section 45(4) provides that the group stamp duty relief is not available unless it is also shown to the satisfaction of the Collector that the instrument was not executed, or the sale or purchase of the Hong Kong stock was not made, in pursuance of or in connection with an arrangement in the following situations:

a. An arrangement under Section 45

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An arrangement under Section 45 for the purpose of avoidance of payment of stamp duty in effecting a transfer of beneficial interest of Hong Kong immovable property or Hong Kong stock to an outsider.

b. Consideration provided by an outsider

The consideration is provided by a party (i.e. an outsider) which is not an associate corporation as defined in Section 45(2) (i.e. 90% or more relationship) unless the consideration is provided by a financial institution during its course of carrying on its normal business – Section 45(4)(a).

c. Parting with the sales proceeds received to an outsider

For the purpose of Section 45(4)(a), after the receipt of the consideration (i.e. sales proceeds) the seller (which is an associated corporation) does not pass the sales proceeds to an outsider – Section 45(5). [The Stamp Duty Ordinance uses the words "was to part with any of it (the sales proceeds)" in Section 45(5).]

d. Property or stock conveyed by the transferee before

For the purpose of Section 45, the said interest in the property or stock was not previously conveyed, transferred, purchased or sold directly or indirectly, by such a person – Section 45(4)(b).

e. Cessation of associated relationship

The transferor and the transferor cease their associated relationship by reason of a change in the percentage of the issued share capital of the transferor in the beneficial ownership of the transferor or a third body corporate – Section 45(4)(c).

f. 2-year rule in Section 45(5A)

For the purpose of Section 45(4)(c) about the cessation of associated relationship, Section 45(5A) provides that if the cessation occurs within 2 years after the date of execution of the instrument, the relief from stamp duty that has been granted under Section 45 is automatically withdrawn as if no such exemption has been granted.

13. Anti-Avoidance under Section 45(5A)

- a. Where a transferor and transferee to the transaction cease to be associated within two years after the date of execution of the instrument as required under Section 45(4), the already claimed stamp duty group relief is withdrawn. This means that the stamp duty relief will not be affected if the transferor (not the transferee) leaves the group.
- b. The transferor and transferee are required to notify the Collector of that fact and the date of the cessation within 30 days after date of such cessation.



- b. VAT payable by Company B = Output VAT Input VAT = RMB910 RMB390 = RMB520
- c. VAT payable by Company C = Input VAT paid= RMB910

35. Example 45.5

Facts are same as Example 45.4 except that Company C is not the ultimate consumer, but an exporter who exports all the goods to overseas customers.

REQUIRED:

Calculate the VAT liability for each party if Co. C is an exporter.

Solution

- a. The VAT payable by Company A remains the same as RMB390.
- b. The VAT payable by Company B remains the same as RMB520.
- c. If Company C is the exporter, and all the goods are exported to overseas, the VAT rate for export is zero. Company C is not required to pay any VAT. Thus, Company C may apply a refund of VAT of RMB910 from the PRC tax bureau with the following formula:

VAT payable = Sales value x 0% - Input VAT = - Input VAT = -RMB910

VIII VAT Reform (營改增) completed on 1 May 2016

36. Replacement of business tax with VAT

In the past when there was business tax, business tax and VAT were mutually exclusive for the purpose of the charge of turnover tax. The major distinction between business tax and VAT is that there is no set-off in business tax while there is a set-off of input VAT against output VAT payable. Thus, business tax was an expense and a burden for businesses. VAT is not a burden for a business in that the business may get a set-off of input VAT with the output VAT received from the customers. The intention of replacing business tax with VAT is to reduce the running cost of businesses. The replacement process started in 2012, and was completed on 1 May 2016. After that date, there is no more business tax in China.

IX Consumption Tax

37. Scope of charge

Consumption tax is levied on the manufacturing, processing or importation of various luxury or environmentally unfriendly (i.e. hazardous), or non-essential goods.

38. Commodities subject to consumption tax

- a. cigarettes,
- b. alcoholic beverages,
- c. cosmetics,
- d. jewellery,

ii. Definition of "ordinarily resides"

An individual is regarded as "ordinarily resides" in Hong Kong if he or she has a permanent home in Hong Kong where the individual or the individual's family lives.

Other relevant factors in considering the status of "ordinarily resides":

- (1) duration of his or her stay in Hong Kong,
- (2) whether he or she has a permanent place of residence in Hong Kong,
- (3) whether he or she owns any property overseas for residential purposes, and
- (4) whether he or she is primarily resident in Hong Kong or overseas.

If an individual has a permanent home in both Sides (i.e. Hong Kong and the Mainland) concurrently, it is necessary to ascertain with which of the two Sides his or her personal and economic relations are closer. Consideration will be taken into account of his or her family and social relations; his or her occupations; political, cultural and other activities; his or her place of business; and the place from which he or she administers his or her property, etc.

b. Resident company

i Definition of "resident company"

In Hong Kong, a resident company is:

- (1) a company incorporated in Hong Kong, or
- (2) if incorporated outside Hong Kong, a company normally managed or controlled in Hong Kong.

ii. Definition of "management"

"Management" refers to management of daily business operations, or implementation of the decisions made by top management, etc.

iii. Definition of "control"

"Control" refers to control of the whole business at the top level, including formulating the central policy of the business, making strategic policies of the company, choosing business financing, evaluating business performance, etc. The board of directors usually exercises "control".

Where by reasons of the definitions adopted by both Sides, a company is a resident of both Sides, the company resident status will be determined according to its place of effective management.

iv. Definition of "effective management"

"Effective management" refers to the place where key management and strategic decisions that are necessary for the conduct of the company's business are in substance made. Under normal circumstances, it is the place where the most senior persons of the company formulate the directions and work plans of the company. A company can have only one place of effective management at any one time.

c. Certification of resident status

If a person is not able to produce evidence that he or she is a resident of One Side, he or she may apply to his or her domestic government for a certification of his or her resident status. For example, the tax authority of the Mainland may require an individual, a company or a body of person to produce a certificate from the Hong Kong Inland Revenue Department certifying that the person is a "resident" of Hong Kong.