

**Hong Kong**

# **Taxation and Tax Planning**

**22nd Edition**

**Patrick Kin-wai Ho  
Kelvin Po-lung Mak**



## Features of the Book

- ✿ Written in easily understood English
- ✿ Meeting students' needs by explaining how to study taxation and achieve better examination results
- ✿ “Learning objectives” at the beginning of each chapter assists students in understanding what they are going to learn in each chapter
- ✿ “Questions to test your knowledge” at the end of each chapter reminds students what they have learnt
- ✿ More than 180 tables to make the knowledge more easily understandable
- ✿ More than 230 numerical examples to demonstrate the requisite knowledge
- ✿ More than 120 concept maps to visually present the relationships of key elements or components of particularly difficult tax issues or concepts
- ✿ 47 “examination questions” at the end of Sections B to K and 28 “mock examination questions” testing students' tax knowledge; suggested answers and time allowed are provided for students' reference
- ✿ Major rewrites in Chapters 1, 4, 5, 8, 9, 10, 12, 14, 15, 16, 17, 19, 20, 25, 27, 30, 32, 33, 37, 39, 40, 41 and 46 to include materials on tax law updates and cases between June 2023 and May 2024
- ✿ The law discussed in this book was updated up to 31 May 2024

## About the Authors

**Patrick Kin-wai Ho** LL.B, LL.M, MBA, MCS, PCLL, FCPA, Barrister-at-law

Patrick Ho has over 35 years of experience in professional accounting and tax practice, and in teaching accounting and taxation subjects in universities. He has been a fellow of the HKICPA for more than 35 years, and has been an editorial board member of the Asia-Pacific Journal of Taxation for over 20 years. He was awarded an LL.B from the University of London, an LL.M and MBA from HKU, and a PCLL from CityU. He obtained the qualification of a barrister. He was formerly an associate professor and visiting professor of HKBU, an adjunct professor of CityU and a principal tax lecturer with FTMS Training Systems (HK) Ltd. He was an assessor of the IRD, a senior tax training manager at KPMG and a tax director at Deloitte. He was also an examiner of tax papers for the HKICPA, TIHK and HKICS, and an assessor of tax paper for ACCA.

**Kelvin Po-lung Mak** PhD, FCA, FCCA, FCPA, FTIHK, CTA (Non-practising)

Kelvin Mak is an associate professor of business education at the Department of Accounting, the School of Business & Management of HKUST. He has over 30 years of experience in professional tax practice and in teaching taxation subjects at both undergraduate and postgraduate levels. Before joining the university, he was a senior tax manager at Deloitte. He was a member of the Inland Revenue Board of Review from 2013 to 2018. He serves as a member of the examination board and examination paper moderators for the HKICPA and TIHK. He is a Joint Editor of the Asia-Pacific Journal of Taxation.

**PPC** 導師出版社有限公司  
PILOT PUBLISHING COMPANY LTD.

ISBN 978-988-8652-99-0



9 789888 652990

# Contents

Preface	
Table of Cases	
Table of Statutes	
How to Use This Book	i
How to Study Taxation	iii
<b>Section A Introduction</b>	<b>1</b>
1. Introduction to the Hong Kong Taxation System	2
<b>Section B Tax Administration</b>	<b>23</b>
2. Compliance, Returns and Assessments	24
3. Objections, Holdover Claims and Revision of Errors	43
4. Back Duty and Investigation	57
5. Miscellaneous Items	74
Examination Questions on Tax Administration	84
Answers to Examination Questions on Tax Administration	84
<b>Section C Property Tax</b>	<b>87</b>
6. Scope of Charge and Sources of Income	88
7. Property Tax Computation	99
Examination Questions on Property Tax	107
Answers to Examination Questions on Property Tax	109
<b>Section D Salaries Tax</b>	<b>113</b>
8. Scope of Charge and Sources of Income	114
9. Chargeable Income	138
10. Allowable Deductions	172
11. Personal Allowances	197
12. Salaries Tax Computation	211
13. Salaries Tax Planning	225
Examination Questions on Salaries Tax	232
Answers to Examination Questions on Salaries Tax	236

## **Section E Profits Tax**

14. Scope of Charge	249
15. Source of Profit	250
16. Chargeable Income and Deemed Trading Receipts	274
17. Deductible and Non-deductible Items	313
18. Deduction of Interest under Profits Tax	350
19. Specific Deductions	370
20. Profits Tax Computation	390
21. Unincorporated Business	416
22. Treatment of Loss	423
23. Basis Period	437
24. Profits Tax Planning	447
Examination Questions on Profits Tax	462
Answers to Examination Questions on Profits Tax	473
	478

## **Section F Special Businesses**

25. Insurance Businesses	485
26. Ship Owners, Ship Lessors and Specified Shipping Activities	486
27. Aircraft Owners, Aircraft Lessors and Aircraft Leasing Managers	510
28. Clubs and Trade Associations	532
29. Financial Institutions and Corporate Treasury Centres	544
30. Taxation of Investment Funds	551
Examination Questions on Special Businesses	564
Answers to Examination Questions on Special Businesses	592
	593

## **Section G Depreciation Allowance**

31. Plant and Machinery	597
32. Industrial Building	598
33. Commercial Building	617
Examination Questions on Depreciation Allowance	630
Answers to Examination Questions on Depreciation Allowance	641
	642

## **Section H Personal Assessment**

34. General Principles	645
35. Computation of Personal Assessment Tax Payable	646
Examination Questions on Personal Assessment	662
Answers to Examination Questions on Personal Assessment	670
	671

**Section I Overseas Activities and Anti-Avoidance 675**

36. Non-Residents and Overseas Activities	676
37. Anti-Avoidance	683
Examination Questions on Overseas Activities and Anti-Avoidance	703
Answers to Examination Questions on Overseas Activities and Anti-Avoidance	703

**Section J Stamp Duty 705**

38. Stamp Duty — Scope of Charge	706
39. Immovable Properties Situated in Hong Kong	716
40. Hong Kong Stock	746
41. Relief and Exemption	755
42. Administration of the Stamp Duty Ordinance	764
43. Stamp Duty Planning	769
Examination Questions on Stamp Duty	773
Answers to Examination Questions on Stamp Duty	774

**Section K Estate Planning and China Tax 777**

44. Introduction to Trust	778
45. Estate Planning and Succession	784
46. Introduction to PRC Tax	795
47. Double Taxation Arrangement with the Mainland of China	812
48. Transfer Pricing and Double Taxation Relief	832
Examination Questions on Estate Planning and China Tax	850
Answers to Examination Questions on Estate Planning and China Tax	850

**Section L Mock Examination Questions and Answers 853**

49. Mock Examination Questions	854
50. Answers to Mock Examination Questions	866

**Index 885**

# Introduction to the Hong Kong Taxation System



## Learning Objectives

After having studied this chapter, you would generally:

- a. understand the different sources of law and practice affecting the levying of tax in Hong Kong;
- b. understand the characteristics of the Hong Kong taxation system;
- c. understand the tax administration under the Inland Revenue Ordinance including the issue of returns, the issue of assessments, the lodging of an objection to and appeal against the CIR's determination or court decisions;
- d. understand the charge of salaries tax;
- e. understand the charge of profits tax;
- f. understand the charge of property tax;
- g. understand the election for personal assessment,
- h. understand the charge of stamp duty, and
- i. understand the charge of hotel accommodation tax.

## I Law and Practice

### 1. Law

Taxation is a legal subject matter. Studying taxation requires not just the basic knowledge of what the relevant sources of tax law are, but more importantly, the ability to explain the relative authority (i.e., the legal binding power) of each of the sources of tax law.

#### a. Statute

The tax law of Hong Kong is governed by the Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China (the Basic Law), and the statutes and subsidiary legislation passed by the Legislative Council and decisions in precedent cases (known as case law).

Major tax legislation passed by the Legislative Council includes the Inland Revenue Ordinance (IRO), Stamp Duty Ordinance (SDO), and Estate Duty Ordinance (EDO) (Estate Duty had been abolished since 11 February 2006); and the Inland Revenue Ordinance subsidiary legislation which covers Inland Revenue Rules, Exemption from Salaries Tax Order, Double Taxation Relief, Exemption from Profits Tax (Interest Income) Order, the Order of various Comprehensive Double Taxation Agreements that the HKSAR has concluded, etc.

#### b. Case law

Tax legislation possesses the highest legal authority. In the judicial system, court judges are empowered to deal with the questions of law in dispute cases and interpret the legal intendment of the wording of the tax and other relevant legislation. Judges' decisions become precedent and are legally binding to future cases where the facts are sufficiently similar. This process is known as judicial precedent.

Sometimes, case law decisions may be overruled by a subsequent amendment in the tax legislation. For instance, the enactment of Section 15(1)(ba) overruled the decision in the *Emerson Radio Corporation* case (2000).

### c. Board of Review

The Board of Review (Inland Revenue Ordinance) is an independent statutory body constituted in 1947 under Section 65 of the IRO to hear and determine tax appeals. The law provides that the Board shall consist of a chairman and ten deputy chairmen who shall be persons with legal training and experience, and not more than 150 members, all of whom shall be appointed by the Chief Executive.

The functions of the Board include hearing appeals to the CIR's determination and appeals to additional tax imposed under Section 82A of the IRO.

## 2. Inland Revenue Practice

- a. In order to assist the public in understanding the tax law easier and knowing the IRD's practice in the course of administration of the law, the IRD issues Inland Revenue Departmental Interpretation and Practice Notes (DIPNs) and advance rulings to explain the IRD's interpretation in particular situations based on cases forwarded by taxpayers. Neither the contents of the DIPNs nor those of the advance rulings are binding, and taxpayers may object to the tax treatments described in the DIPNs and advance rulings.

### b. Inland Revenue Departmental Interpretation and Practice Notes (DIPNs)

The Commissioner of Inland Revenue (CIR), who is also the Collector of Stamp Revenue (CSR) and the Commissioner of Estate Duty (CED), issues DIPNs to explain how the IRD would interpret the legislation and how the IRD would enforce the law in practice. Up to the time of publishing this edition, the IRD has issued 64, 8 and 1 DIPNs under the IRO, SDO and EDO respectively which are currently effective.

### c. Advance rulings

In 2000, the CIR started publishing advance ruling cases regarding business arrangements of taxpayers under contemplation. The objectives of this practice are to draw the attention of the public and to clarify how the IRD would treat certain scenarios under the IRO. The types of ruling deliberated by the CIR include *specific rulings* and *general rulings*. *Specific rulings* apply to a specific person who is entitled to rely upon such rulings. *Specific rulings* cover advance tax rulings, clearances and advance pricing arrangements. *General rulings* address groups or types of persons provided with a given and defined set of parameters, circumstances or activities, instead of applying to a specific person.

## 3. Summary of authority of different sources of law

The level of authority of the different sources of law may be summarised as follows:

- a. the Basic Law, Inland Revenue Ordinance and Stamp Duty Ordinance,
- b. subsidiary legislation to the Inland Revenue Ordinance, e.g., Inland Revenue Rules, Exemption from Salaries Tax Order, Exemption from Profits Tax (Interest Income) Order and various specifications of arrangements concerning double taxation relief agreements concluded with foreign contracting states, jurisdictions, etc.
- c. case law derived from precedent court cases both in Hong Kong and common law countries,
- d. decisions of the Board of Review,
- e. departmental interpretation and practice notes, and
- f. advance rulings.

(With the statute as the supreme one at the top of the list and advance rulings as the least persuasive at the end of the list) [See also IX Concept Map 59.]

General & specific anti-avoidance provisions		
No.	Inland Revenue DIPNs	Issued Date (or Revised Date)
15	(A) Limitation of loss relief (Section 22B) (B) Leasing arrangements (Section 39E) (C) General anti-avoidance provision (Section 61) (D) General anti-avoidance provision (Section 61A) (E) Loss companies (Section 61B) (F) Ramsay principle (G) Penalty on tax avoidance cases (H) Guidelines on lease financing (I) Advance rulings	(January 2006)
24	Profits tax — Service company “Type II” arrangements	(July 2009)
25	Service company “Type I” arrangements — Salaries tax	(November 2011)

Double taxation relief		
No.	Inland Revenue DIPNs	Issued Date (or Revised Date)
19	The agreement between the United States of America and Hong Kong in respect of the taxation of shipping profits	September 1989
29	Tax relations between the Hong Kong Special Administrative Region and the People’s Republic of China	August 1997
32	Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the avoidance of double taxation on income ( <i>Note: the arrangement explained herein ceases to apply after the year of assessment 2006/07</i> )	(October 2011)
44	Arrangement between the Mainland of China and the Hong Kong Special Administrative Region for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income	(August 2008)
45	Relief from double taxation due to transfer pricing or profit reallocation adjustments	April 2009
47	Exchange of information on request	(July 2020)

Transfer pricing		
No.	Inland Revenue DIPNs	Issued Date (or Revised Date)
46	Transfer pricing guidelines — Methodologies and related issues	December 2009
48	Advance pricing arrangement	(July 2020)
58	Transfer pricing documentation and Country-by-Country reports	July 2019
59	Transfer pricing between associated persons	July 2019
60	Attribution of profits to permanent establishments in Hong Kong	July 2019

## 33. Comparison of offences and penalty under Sections 80(1) and (2)

Section 80 (without Reasonable Excuse) [Criminal Offence]	
Section 80(1)	Section 80(2)
Non-compliance of IRO, e.g.: <ul style="list-style-type: none"> <li>• S.51(3)</li> <li>• S.52(1) / (2)</li> <li>• S.64(2) / 68 (6)</li> <li>• S.51(6) – (8)</li> <li>• S.52(4) – (7)</li> </ul>	5 offences: <ul style="list-style-type: none"> <li>• incorrect return</li> <li>• incorrect statement</li> <li>• incorrect information</li> <li>• S.51(1)</li> <li>• S.51(2)</li> </ul>
<ul style="list-style-type: none"> <li>• Level 3 penalty</li> <li>• Court order of compliance</li> </ul>	<ul style="list-style-type: none"> <li>• Level 3 penalty</li> <li>• 3 times tax undercharged</li> </ul>
Appeal to court of higher level	

**XV Section 82 – Prosecution with Imprisonment Penalty**

34. Section 82 applies when a person who *wilfully with intent to evade* or to assist any other person to evade tax:
- a. omits items from a tax return; or
  - b. makes a false statement or entry in a tax return; or
  - c. makes a false claim of deduction or allowance; or
  - d. signs a statement or tax return without reasonable grounds for believing the same to be true; or
  - e. gives a false answer whether verbally or in writing to officers of the IRD; or
  - f. prepares or maintains or authorises the preparation of false books or accounts or records; or
  - g. makes use or authorises the use of any fraud, art, or contrivances.
35. The penalty may be divided into two classes as follows:
- a. **On summary conviction**
    - i. a fine at level 3 (i.e., \$10,000),
    - ii. a further fine of treble the amount of tax undercharged,
    - iii. an imprisonment of 6 months.
  - b. **On indictment**
    - i. a fine at level 5 (i.e., \$50,000),
    - ii. a further fine of treble the amount of tax undercharged,
    - iii. an imprisonment of 3 years.
36. **Section 82(1)(b) case – omission of income in a return**

**Facts:**

- The two defendants were a couple, and each of them owned four properties (i.e., a total of eight properties). Both defendants declared in their tax returns that they did not have any solely-owned properties which were let during the years.

38. **Section 82(1)(d) case – evading provisional salaries tax and false claims on self-education expenses and charitable donations**

**Facts:**

- The defendant applied for holdover of provisional salaries tax for the years of assessment 2007/08 to 2010/11, but the total amount of income understated in the application for holdover for those periods was \$687,816 and the total provisional salaries tax undercharged was \$146,223.
- In addition, the defendant claimed in his tax returns deductions of expenses of self-education for the years of assessment 2011/12 to 2014/15, and approved charitable donations for the years of assessment 2011/12 to 2016/17. However, the defendant failed to produce sufficient details to support the aforesaid claims. The defendant's total false deduction claims for expenses of self-education and approved charitable donations for the six years of assessment amounted to \$961,598 and the total tax evaded was \$148,419.

**Allegations:**

- Allegations and charges against him were wilfully with intent making false statements in connection with holdover applications for provisional tax and falsely claiming deductions of expenses of self-education and approved charitable donations, contrary to Section 82(1)(d) of the IRO.

**Conviction and penalty:**

- He was convicted of tax evasion on 10 December 2020 at the Tuen Mun Magistrates' Courts, and was sentenced to 12 weeks' imprisonment on 24 December 2020 after being remanded for 14 days.

39. **Sections 82(1)(a), (d) and (f) in one prosecution case**

**Facts:**

- The director and manager of the printing company, aged 64 and 69 respectively, were a couple. They were convicted of a total of 11 counts of wilfully with intent to evade tax.
- The sales incomes of 33 transactions of the printing company were reduced for the four years of assessment 2006/07 to 2009/10. Revised total understated sales incomes were \$12,869,258 and total tax evaded amounted to \$1,968,725.
- The company, its director and manager were defendants.

**Allegations:**

- Six counts for the three defendants of preparing or maintaining false books of accounts or other records, thereby understating the sales of the printing company for the years of assessment 2006/07 to 2008/09, contrary to Section 82(1)(f) of the IRO;
- One count for the printing company of omitting its sales income from the profits tax return for the year of assessment 2009/10, contrary to Section 82(1)(a) of the IRO; and
- Four counts for the director of signing the profits tax returns of the printing company for the aforesaid four years of assessment without reasonable grounds for believing the same to be true, contrary to Section 82(1)(d) of the IRO.

## XVII Procedures for Issuing and Appealing against Additional Tax Assessed under Section 82A (See also XIX Concept Map 55.)

### 43. Steps involved in the issue of additional tax assessment

- 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 the 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 excuses 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 the CIR or DCIR within 21 days from the date of the notice.
- d. After having considered the taxpayer's representations, the 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.

### 44. Appeal against Section 82A additional tax assessed under Section 82B

A taxpayer may lodge an appeal against the additional tax assessed 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 the CIR.
- c. The time limit for the appeal is within 1 month after the notice of the additional tax assessed is given to the taxpayer (i.e. the date of assessment). As a result of the decision of *CIR v Chan Min 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 appeals on the grounds of illness, absence from Hong Kong or other reasonable causes preventing an appellant from lodging an appeal in time.
- d. Documents required to be attached with the notice of appeal:
  - i. a copy of the notice of additional tax;
  - ii. a statement of grounds for appeal;
  - iii. a copy of the CIR's or DCIR's notice of intention to assess additional tax given under Section 82A(4); and
  - iv. a copy of the taxpayer's written representation made under Section 82A(4).

### 45. Grounds for lodging appeal against additional tax assessed under Section 82B

If a person being assessed for 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.
- b. The additional tax exceeds the amount for which he or she is chargeable.
- c. Although the tax is validly chargeable, it is excessive having regard to the circumstances.

## IV Computation of Property Tax

### 6. Example 7.1: without irrecoverable rent

Mr. Gap owned a house in Sai Kung, and he let it to Mr. Lau for a three-year lease from 1 January 2022 to 31 December 2024 at a monthly rent of \$30,000, and a premium of \$180,000 payable on 1 January 2022. Mr. Gap paid the following expenses in connection with the property for the year ended 31 March 2024:

Government rent	\$10,800
Interest	\$110,000
Rates	\$18,000
Repairs and improvement	\$20,000

#### REQUIRED:

Compute the property tax payable for the year of assessment 2023/24.

#### Solution

<b>Mr. Gap</b>	
<b>Property Tax Computation</b>	
<b>Year of Assessment 2023/24</b>	
	\$
Rent ( $\$30,000 \times 12$ )	360,000
Premium ( $\$180,000 \times \frac{12}{36}$ )	60,000
Assessable value	420,000
Less: Rates (paid by owner)	18,000
	402,000
Less: Statutory deduction ( $\$402,000 \times 20\%$ )	80,400
Net assessable value	321,600
Property tax ( $\$321,600 \times 15\%$ )	48,240

Note: The Government rent, interest and repairs and improvement are not deductible under property tax.

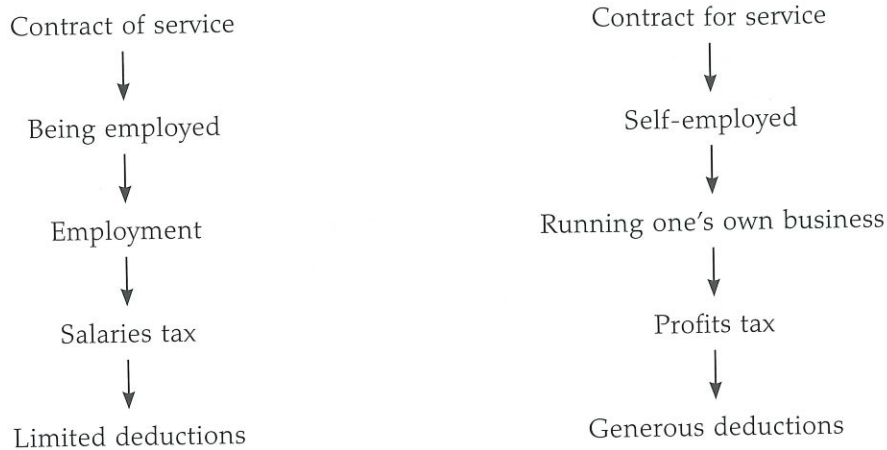
### 7. Example 7.2: with irrecoverable rent fully set off by income in the current year

Mr. Yuet owned a flat in Mongkok, and he let it to Mr. Kwan for a two-year lease from 1 January 2023 to 31 December 2024 at a monthly rent of \$20,000. Mr. Kwan occupied the flat up to 30 June 2023, and disappeared. He did not pay rent for the four months of March to June 2023. Mr. Yuet took back the flat, and let it to Mr. Yan on 1 July 2023 at a monthly rent of \$25,000. Mr. Yuet paid rates of \$3,000 each quarter.

#### REQUIRED:

Compute the property tax payable for the year of assessment 2023/24.

Their differences may be summarised in the following diagram.



In order to determine whether there is a contract of service or a contract for service, the CIR generally applies the following tests:

a. **Control test**

To determine whether the relevant person (i.e. the so-called employer) controls the performance of the relevant individual (i.e. the so-called employee or taxpayer); [evidence includes whether the person to whom the services are rendered can instruct the taxpayer as to what to do, how to do it, and when to do it; whether the taxpayer may work for other persons without the approval of the service recipient, etc.]

b. **Integration test**

To determine whether the relevant individual holds a position within the organisation of the relevant person; [evidence includes whether the taxpayer is "part and parcel" of the organisation, whether he or she represents to third parties that he or she is a staff member of the organisation, etc.]

c. **Economic reality test**

To determine whether the relevant individual is at risk with his or her own capital at the performance of duty for the relevant person; [evidence includes whether the taxpayer provides his or her own equipment or assistants; whether he or she contributes capital; his or her degree of responsibility and any opportunity of profiting, etc.]

d. **Mutuality of obligation test**

To determine whether the relevant individual is obliged to provide his or her work or skill to the payer; is the service recipient (i.e. the relevant person) obliged to provide work and pay a wage or remuneration to the relevant individual; [evidence includes whether either party can terminate the relationship without incurring any liabilities, intention of the parties, terms of the agreement, etc.]

5. **CIR v Pang Fai (2017)**

a. **Issue**

Whether honorarium received by a workshop facilitator and examination marker from a professional body should be assessed under salaries tax or profits tax.

### 9. **Assumption of a Hong Kong source employment**

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

### 10. **Two-tier approach**

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

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

The CIR explained in DIPN 10 that source of employment is a practical hard matter of fact. The IRD takes all the relevant factors and circumstances into consideration in the determination of the source of employment. In particular, the IRD places emphasis on the following three factors:

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

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

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

### 12. **Totality of facts approach**

In some situations, the IRD may look beyond the three conditions stated in DIPN 10. If the IRD finds that all the three conditions mentioned in DIPN 10 are outside Hong Kong, but based on other relevant factors, the IRD may consider that the employment is sourced in Hong Kong.

Generally, the IRD looks into whether the employee's remuneration is reimbursed by a Hong Kong company. If so, the employment is considered sourced in Hong Kong.

### 13. **Randeep S Grewal v CIR (2023)**

#### a. **Facts**

Green Dragon Gas Ltd ("Green Dragon") was incorporated in the Cayman Islands with its shares listed on the Alternative Investment Market ("AIM") of the London Stock Exchange. In 2006, the Taxpayer and Green Dragon entered into an Executive Employment Agreement ("the 2006 Agreement") with which the Taxpayer agreed to serve as Green Dragon's Chairman and Chief Executive Officer ("CEO"). Green Dragon's principal activities were acting as a holding company and providing financing and management services to its subsidiaries.

Greka Gas China Limited ("GGCL") was an investment holding company incorporated in the Cayman Islands and a wholly owned subsidiary of Green Dragon. GGCL was registered in Hong Kong as a non-Hong Kong company with its principal place of address at a suite at The Exchange Square ("the HK Address"). The Taxpayer was the sole director of GGCL.

On 1 January 2007, Green Dragon and GGCL entered into agreements, with the Taxpayer's consent, for the Taxpayer's secondment to perform services for GGCL for a term of 5 years. The secondment was extended to a term of 10 years on 1 January 2012.

b. **When income is fully taxable**

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

c. **When income is fully exempt**

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

- i. the employee renders ALL his services for that employment OUTSIDE Hong Kong [Section 8(1A)(b)]; or
- ii. the employee is a visitor to Hong Kong and stays in Hong Kong for 60 days or less in a year of assessment [Section 8(1B)].
- iii. If a Hong Kong resident derives income from services rendered as a *visiting teacher or researcher* in an overseas territory which provides exemption under its double taxation arrangements with Hong Kong, exemption from Hong Kong salaries tax applies only if the person proves to the CIR's satisfaction that, despite the exemption provision, tax is paid or payable in that territory in respect of the income [Section 8(1AB)]. (*It has been effective from the year of assessment 2019/20.*)

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

In case an employee's income is chargeable to Hong Kong salaries tax and at the same time is also taxed in a territory outside Hong Kong, that part of income taxed outside Hong Kong may be excluded from Hong Kong salaries tax if the income is derived from a territory which has not made any double taxation arrangement with Hong Kong [Sections 8(1A)(c) and 8(1C)].

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

### 15. Relief available

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

- a. If the individual derives income from overseas countries/jurisdictions that do *not* have a signed double taxation agreement/arrangement with Hong Kong, he or she is entitled to the income exclusion rule under Section 8(1A)(c), and the income taxed overseas is excluded from his or her income assessable in Hong Kong; or
- b. If the individual derives income from an overseas country/jurisdiction that has a signed double taxation agreement/arrangement with Hong Kong, a tax credit is set off against Hong Kong salaries tax payable under Section 50. (He or she is not entitled to the income exclusion rule as the above exclusion rule does not apply to income derived from a territory having double taxation agreement/arrangement in place.)

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

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

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

Calculate the assessable income of Mr. Yuen for the year of assessment 2023/24.

Salaries			\$800,000
Bonus			250,000
Commission			150,000
			<u>1,200,000</u>
Less: Annual subscription			3,000
			<u>1,197,000</u>
Rental value (\$1,197,000 × 10%)		\$119,700	
Less: Rent paid by employee	444,000*		
Less: Rent refunded	<u>400,000</u>	<u>44,000</u>	<u>75,700</u>
Assessable income			<u>\$1,272,700</u>

\*\$(35,000 + 2,000) × 12 = \$37,000 × 12 = \$444,000

## VII Receipts from a Non-Recognised Occupational Retirement Scheme (Non-RORS)

27. Any amount (other than a pension) received by an employee from a retirement scheme or provident fund, other than a RORS, is taxable to the extent that it represents the employer's contributions to the scheme – Section 9(1)(aa).

## VIII Receipts from a Recognised Occupational Retirement Scheme (RORS) (認可職業退休計劃) (See also XV Concept Map 60.)

### 28. Taxable amounts

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

- any amount (other than a pension) received by an employee from a RORS other than on termination of service, death, incapacity, terminal illness or retirement, to the extent that it represents his or her employer's contributions to the scheme – Section 9(1)(ab)(i); and
- any amount (other than a pension) received by an employee from a RORS upon termination of service to the extent that it represents his or her employer's contributions to the scheme in excess of the "proportionate benefit" prescribed in Section 8(5) – Section 9(1)(ab)(ii).

### 29. Definitions

- "Termination of service" is defined in Section 8(3) as a termination of employment with the employer other than upon retirement, death, incapacity or terminal illness.
- "Retirement" is defined in Section 8(3) as:
  - a retirement from the service of the employer at some specified age of not less than 45 years; or
  - a retirement after some specified period of service with the employer of not less than 10 years; or
  - the attainment of the age of 60 years or some specified age of retirement, whichever is the later.

36. **Assignment of an option**a. **Time for assessment of assignment of a share option**

If a person does not exercise the share option, but sells the option to a colleague, the time of charge is in the year of assessment in which the share option is assigned or sold.

b. **Calculation of taxable gain**

The taxable gain is the excess of the sales proceeds or money received from the assignee over the total consideration that the employee paid for the grant of the option – Section 9(4)(b).

c. **Formula**

Taxable gain = Money received from assignee – Option cost

d. **Example 9.12**

On 1 June 2023, Mr. Wood's employer granted him the right to acquire 20,000 shares in the employer-company at \$40 per share. Mr. Wood paid \$1,000 to his employer as a consideration for accepting this option when the share price was \$12 per share. Three months later, Mr. Wood did not wish to take up the shares, and his employer permitted him to sell the right to his colleagues. Mr. Wood sold the right to his colleague at a price of \$2,500 when the market value of the share rose to \$15 per share.

**REQUIRED:**

Advise Mr. Wood on the assessable income arising from the above events.

**Solution**

The time of chargeability is at the time of assignment of option in September 2023.

The year of assessment chargeable is year of assessment 2023/24.

Consideration for the assignment of share option	\$2,500
Less: Cost of share option	1,000
Assessable income on the assignment of share option	<u>\$1,500</u>

37. **Release of an option**a. **Time for assessment of release of share option**

Before a person exercises the share option, his employer may wish to buy back the share option. This usually happens when an employee is going to leave the company, but he has been granted with an option to purchase the shares in his employer-company. In order to avoid the share option being held by an outsider or ex-employee, the company will buy back the share option from the employee.

b. **Calculation of taxable gain**

The taxable gain is the excess of the money received by the employee from his employer for the release of the share option over the total consideration that the employee paid for the grant of the option – Section 9(4)(b).

c. **Formula**

Taxable gain = Money received from employer – Option cost

### 57. Notification to the IRD for refund of qualifying premiums

The taxpayer must inform the CIR in writing within 3 months after the date of refund. An assessor will make an additional assessment regarding the reduction amount claimed. For this purpose, the statutory time limit of within 6 or 10 years after the expiration of the year of assessment for making an additional assessment is not applied.

## XI Qualifying Annuity Premiums (See also XVI Concept Map 93.)

### 58. Introduction

#### a. Law and years of assessment applicable

From the year of assessment 2019/20 onwards, Sections 26N to 26R are enacted via the Inland Revenue and MPF Schemes Legislation (Tax Deductions for Annuity Premiums and MPF Voluntary Contributions) (Amendment) Ordinance 2019 to allow deductions of qualifying annuity premiums paid to qualifying deferred annuity policy (or policies) (合資格延期年金保單) during a year of assessment for an annuitant (年金領取人).

#### b. Deduction available

Section 26O(1) allows a deduction in respect of qualifying annuity premiums (合資格年金保費), paid by a taxpayer or a taxpayer's spouse, for annuity payment receivable by an annuitant.

#### c. Key terms

The keywords in this new law are:

- i. deduction of qualifying annuity premiums,
- ii. qualifying deferred annuity policy (QDAP), and
- iii. annuitant.

### 59. Parties involved in deductions of qualifying annuity premiums

These include:

- a. the insurance policy called "qualifying deferred annuity policy",
- b. the policy holder,
- c. the taxpayer, and
- d. the annuitant (or annuitants).

### 60. Qualifying deferred annuity policy

#### a. Definition of "qualifying deferred annuity policy"

The term "qualifying deferred annuity policy" (QDAP) is defined in Section 26N(1) as an insurance policy under which a regular payment is receivable by an annuitant during an annuity period, and that insurance policy is certified by the Insurance Authority (IA) to be in compliance with the criteria specified in the guidelines published by the IA under Section 133 of the Insurance Ordinance.

#### b. Features of a qualifying deferred annuity policy

The features of a qualifying deferred annuity policy include:

- i. minimum total qualifying annuity premium payable of \$180,000,
- ii. minimum premium payment period of 5 years,
- iii. minimum annuity period of 10 years, and
- iv. annuitisation at the age of 50 or beyond (i.e. the annuity period only starts when the annuitant has reached the age of 50 or beyond).

**REQUIRED:**

Calculate the amount of annuity premiums deductible for Mr. R and Mrs. R for the year of assessment 2023/24.

**Solution**

- Mr. R — Deduction allowable but capped at \$60,000.
- Mrs. R — No deduction is allowed since Mrs. R did not have any salary income, property income or profits chargeable to tax under the IRO.

66. **Example 10.11**

Mr. Q and Mrs. Q were a married couple. Mr. Q, as the sole policy holder, purchased a QDAP for the benefit of himself as the sole annuitant. Qualifying annuity premiums of \$110,000 were paid during the year of assessment 2023/24 and no TVC was made. Both Mr. Q and Mrs. Q had income chargeable to tax.

**REQUIRED:**

Calculate the amount of annuity premiums deductible for Mr. Q and Mrs. Q for the year of assessment 2023/24.

**Solution**

- Mr. Q — Deduction allowable but capped at \$60,000.
- Mrs. Q — Deduction allowable with \$50,000 (did not reach the cap of \$60,000)
- Total deduction for Mr. and Mrs. Q is \$110,000 (i.e., \$60,000 + \$50,000).

67. **Refund of qualifying annuity premiums**

If any of the qualifying annuity premiums paid during the year of assessment under a qualifying deferred annuity policy is refunded, and a deduction had been claimed, the refund amount is used to reduce the amount of qualifying annuity premiums claimed.

68. **Notification to the IRD for refund of qualifying annuity premiums**

The taxpayer must inform the CIR in writing within 3 months after the date of refund. An assessor will make an additional assessment regarding the reduction amount claimed. For this purpose, the statutory time limit of within 6 or 10 years after the expiration of the year of assessment for making an additional assessment is not applied.

69. **Illustrations in DIPN 57**

The CIR issued a new DIPN called DIPN 57 to explain the law and practice on the deductions of annuity premiums and MPF voluntary contributions. The DIPN provides 13 examples to illustrate the practical treatment on the deductions of the qualifying annuity premiums in various situations. Readers are recommended to study DIPN 57 to get a better understanding of this deduction.

**XII MPF Voluntary Contributions**70. **Law and years of assessment applicable**

From the year of assessment 2019/20 onwards, Sections 26S to 26U are enacted via the Inland Revenue and MPF Schemes Legislation (Tax Deductions for Annuity Premiums and MPF Voluntary Contributions) (Amendment) Ordinance 2019 to allow deductions of MPF voluntary contributions paid by a taxpayer into a TVC account (可扣稅自願性供款帳戶) during a year of assessment under Section 26U(1).

### XIII Domestic Rents (See also XVI Concept Maps 94 and 95.)

#### 74. Law and years of assessment applicable

From the year of assessment 2022/23 onwards, a new Division 8 – Domestic Rents and Sections 26V to 26ZC are enacted via the Inland Revenue (Amendment) (Tax Deductions for Domestic Rents) Ordinance 2022 to allow deductions for domestic rents paid by a taxpayer during a year of assessment.

#### 75. Deductions allowable under Sections 26X and 26Y

- a. A taxpayer may deduct the rent paid by himself or herself or his or her spouse for the taxpayer's residence if the conditions required are satisfied.
- b. For the purpose of deductions of domestic rents in Division 8, "rent" does not include any Government rent, rates, management fee, utility charge or charge on any service provided under or in connection with the tenancy concerned (*incidental charge*) unless –
  - i. the incidental charge is included as rent under the tenancy; and
  - ii. the tenant concerned has no obligation under the tenancy to pay the incidental charge.
- c. The ceiling is \$100,000 each year subject to the following restrictions:
  - i. The amount deductible is the *smaller* of \$100,000 or the actual rent paid for the year of assessment.
  - ii. If the number of tenants is *more than one*, the rent deduction is reduced on a *pro rata basis*.
  - iii. If the property is not exclusively used for residence, the rent deduction is reduced on a *pro rata basis*.
  - iv. If the lease period is *less than 12 months* in the year, the ceiling of \$100,000 is reduced on a *pro rata basis*.
- d. Formula for the calculation of deduction ceiling:

$$\text{Deduction ceiling} = \$100,000 \times \frac{\text{Number of months (and pro rata for an incomplete month)}}{12} \div \text{Number of tenants}$$

#### 76. Qualifying conditions for deduction

Conditions required to be satisfied for a deduction of domestic rents include:

- a. The taxpayer and their spouse do not own any residential property in Hong Kong.
- b. The property must be used as the principal residence of the taxpayer.
- c. The lease agreement has been stamped.
- d. If the rent includes a car parking space which is not separately leased, the car parking space is treated as a part of the residence.

#### 77. When domestic rents paid NOT qualified for deduction

- a. The landlord is an associate of the taxpayer or the taxpayer's spouse, e.g., the taxpayer's spouse, a relative, a partner or a corporation controlled by the taxpayer or the spouse.
- b. The taxpayer or the taxpayer's spouse holds a public housing unit.
- c. The taxpayer has already been provided with accommodation by his or her employer.
- d. The rented place is not for residential purposes.
- e. The taxpayer signed a lease and purchase agreement with the landlord.

**Example 14.5**

- g. Based on the facts of Example 14.4, Saiyan Limited found that the net profit made from the consignment sale was only \$900,000. The profits tax based on \$900,000 is \$74,250 (i.e. \$900,000 × 8.25%).

In this circumstance, Saiyan Limited may write to the IRD for a refund of profits tax withheld and paid to the IRD by the Hong Kong agent.

The amount of tax refund = \$25,750 (i.e. \$100,000 – \$74,250)

(assuming Saiyan Limited has no connected entity or none of its connected entities elect to be chargeable using the two-tier tax rates)

45. **Non-resident entertainers performing in Hong Kong**

a. **Chargeability of profits tax for a non-resident entertainer or sportsman**

Section 20B(1)(b) provides that if a non-resident receives money directly or indirectly derived from the performance in Hong Kong by a non-resident entertainer or sportsman of an activity in his character as entertainer or sportsman on or in connection with a commercial occasion or event, he is chargeable with profits tax. Non-resident barristers employed in Hong Kong for litigation purposes fall within this category.

b. **Collection of tax for a non-resident's performance from a Hong Kong payer**

Section 20B(2) provides that the non-resident person is chargeable to tax *in the name of any person in Hong Kong* who paid or credited those sums to that or any other non-resident person, and the tax so charged shall be recoverable by all means provided in IRO from that person in Hong Kong.

c. **Obligation of the Hong Kong payer in connection with the non-resident**

Section 20B(3) provides that when a Hong Kong payer pays or credits to a non-resident person in respect of activities in Hong Kong described in Section 20B(1), he has to deduct from those sums so much thereof as is sufficient to settle the amount of such tax.

d. **Amount of tax to be withheld by the Hong Kong payer**

Section 21 provides that assessable profits of a non-resident may be computed on a fair percentage of turnover. According to DIPN 17, the IRD has the practice of advising Hong Kong promoters to withhold tax on the basis that assessable profits represent two-thirds of the gross receipts payable to the entertainer or sportsman. In other words, IRD automatically allows one-third of the income as deductible expenses without the need for the provision of documentary evidence.

e. **Example 14.6**

A Hong Kong company employs a non-resident artist to perform in Hong Kong with a contract sum of \$3,000,000. The non-resident incurred expenses of \$500,000 for his performance in Hong Kong.

**REQUIRED:**

Calculate the amount to be withheld by the Hong Kong company.

**Answer**

Deemed assessable profit:  $(\$3,000,000 \times 2/3) = \$2,000,000$

Profits tax liabilities under two-tier tax regime:  $\$2,000,000 \times 7.25\% = \$145,000$

(assuming the non-resident artist has no connected entity or none of its connected entities elect to be chargeable using the two-tier tax rates)

to purchase Japanese Yen worth HK\$99.8m in more than 10 occasions. Unfortunately, the taxpayer took an exchange loss on these purchases. The court held that what is important is the intention at the time of acquisition. If that question is posed in the context of the present case, it is clear that the taxpayer's intention at the time of acquisition of Yen was to dispose of it quickly for a profit, not to acquire a permanent investment. This is also supported by the number of purchase of Yen within a short period of three months. As a result, they were trading activities, and the exchange loss was of revenue nature and deductible under profits tax.

g. **Exchange differences derived from a loan**

i. **Introduction**

In determining whether the loan is on capital or revenue account, relevant facts include the length of borrowing and the use to which the funds are put in the company's business.

ii. **Length of loan**

Loans having a term of more than one year (such as in this case) are more likely to be on capital account than loans for a shorter period, particularly if the interest rate is fixed.

iii. **Temporary or fluctuating**

The issue is whether the taxpayer's borrowings were 'temporary and fluctuating' in the course of transacting its business of trading (in which case the currency loss would be deductible) or 'a fixed amount for a definite period'. If it is temporary or fluctuating, it is more likely a business of money lender (*Beauchamp v FW Woolworth plc.*).

iv. **Money lending business**

If the taxpayer is a money lender or a financial institution, the loan is a tool for earning its general revenue. The exchange difference derived from the conversion of such loan at the year-end or at the time of settlement is of revenue nature. Gain is taxable and loss is deductible. This is supported by *CIR v Chinachem Finance Co. Ltd.* (1992) (3 HKTC 529). This treatment is in line with the treatment of bad debts of a money lender under Section 16(1)(d).

## VII Share-based Payments (See also XI Concept Map 55.)

33. **Introduction**

When a company grants share option or share award to its employees, the company has to give shares to its employees when they exercise the option. Thus, at the end of the day, the company has to get shares through the purchase of shares from the market or the issue of its shares. These two different methods are referred as cash-settled share-based payment and equity-settled share-based payment respectively.

34. **Cash-settled share-based payment**

It is the company to purchase shares from the market with cash. As the company incurs an expense for the production of its assessable profits, the amount paid is a deductible expense under Section 16(1).

35. **Equity-settled share-based payment**

This may be done in three different ways as follows:

- a. shares issued by the company (i.e. the employer),

### 63. **Hotel not defined as domestic building or structure**

Section 16F(5) defines domestic building or structure to mean any building or structure used for habitation, but does not include any building or structure used as a hotel or guesthouse, or any part of a hotel or guesthouse. Thus, hotel operators are entitled to Section 16F relief.

### 64. **History of enactment and the development of Section 16F**

In order to promote the tourism industry in Hong Kong, the Legislative Council passed the Inland Revenue (Amendment) (No. 2) Ordinance 1996 and inserted a new section, namely, Section 16F into the Inland Revenue Ordinance. With effect from the year of assessment 1996/97, capital expenditure incurred by a hotel owner or operator on hotel renovation or refurbishment for the production of taxable profit is an allowable deduction under profits tax although it is of capital nature. The expenditure is deducted in five equal annual instalments starting from the year in which the expenditure was incurred. The Inland Revenue (Amendment) (No. 2) Ordinance 1998 extends the application of Section 16F to include renovation or refurbishment of a building or structure other than a domestic building or structure.

## **XII Section 16G – Capital Expenditure on the Provision of a Prescribed Fixed Asset (See also XXI Concept Map 98.)**

65. With effect from the year of assessment 1998/99, capital expenditure incurred for prescribed fixed assets are fully deductible from the assessable profits in the year the expenditure was incurred – Section 16G(1). In other words, a full deduction of capital expenditure is allowed in the year of acquisition.

### 66. **Definition of “prescribed fixed asset”**

Section 16G(6) defines “prescribed fixed asset” to mean:

- a. machinery or plant specified in items 16, 20, 24, 26, 28, 29, 31, 33 and 35 of the First Part of the Table annexed to Rule 2 of the Inland Revenue Rules as is used specifically and directly for any manufacturing process;
- b. computer hardware, other than that which is an integral part of any machinery or plant; or
- c. computer software and computer systems;

but does not include an excluded fixed asset.

### 67. **Definition of “excluded fixed asset”**

Section 16G(6) defines “excluded fixed asset” to mean a fixed asset in which any person holds rights as a lessee under a lease.

### 68. **Conditions when a prescribed fixed asset is not treated as a deductible expense:**

- a. an asset leased out by the owner,
- b. an asset acquired via hire-purchase terms, or
- c. the expenditure may be deducted under any other section under profits tax.

If an asset does not fall within the definition of a prescribed fixed asset, and the cost of such asset is not deductible under Section 16G, the owner is entitled to depreciation allowance in respect of such asset.

g. **Qualifying ship manager – Sections 14ZL to 14ZT**

The profits of a qualifying ship manager are chargeable to profits tax under Section 14, and the profits are subject to a tax rate of 0% (under Schedule 8C) or half of the profits tax rate of a corporation under Section 14ZM(1).

h. **Qualifying ship broker – Sections 14ZU to 14ZZC**

The profits of a qualifying ship broker are chargeable to profits tax under Section 14, and the profits are subject to a tax rate of 0% (under Schedule 8C) or half of the profits tax rate of a corporation under Section 14ZZC(1).

## Part B Ship Owners

### II Shipping Business and Ship-owner Business

#### 2. Elements of shipping business

A shipping company may carry on the following shipping business:

- a. construction and dealing in ships;
- b. shipping agency; and
- c. ship-owner business.

#### 3. Profits tax treatment of different types of shipping income

Generally, assessable profits are arrived at by making adjustments based on the tax law to accounting profits in the income statement of a company, but the assessable profits of a ship-owner business are determined according to Section 23B of the IRO. In other words, the charge of profits tax is as shown below:

- a. construction and dealing in ships – Section 14;
- b. shipping agency – Section 14; and
- c. ship-owner business – Section 23B.

### III Ship Owners Carrying on a Business in Hong Kong

#### 4. Scope of charge

##### a. Profits tax liability of a ship owner

Section 23B imposes profits tax liability on a ship owner carrying on a business chartering or operating ships in Hong Kong.

##### b. Who is a ship owner under Section 23B

Section 23B(12) defines “ship owner” to include a charterer of the ship under a charter-party. A charterer of a ship is a lessee of the ship.

##### c. Business as an owner of ships

Section 23B(12) defines the “business as an owner of ships” to mean “a business of chartering or operating ships, but does not include dealing in ships or agency business in connection with shipping”.

### Types of leases of ships as defined in Section 14O(1)

#### a. Lease (租約)

A "lease" means an operating lease or a funding lease.

#### b. Operating lease (營運租約)

It means –

- i. an arrangement under which a right to use a ship is granted by an owner of the ship to another person for a term exceeding 1 year (*specified head lease*); or
- ii. an arrangement under which a right to use a ship is granted by a lessee under a specified head lease (or by a sub-lessee or any other person deriving the right under the lessee) to another person; and
- iii. does not include a funding lease.

#### c. Funding lease (融購租約)

It means an arrangement –

- i. under which a right to use a ship is granted by a person (*lessor*) to another person (*lessee*) for a term exceeding 1 year;
- ii. that satisfies one of the following conditions at its inception –
  - A. the arrangement is accounted for as a finance lease or loan by the lessor in accordance with the financial reporting standards issued by the Hong Kong Institute of Certified Public Accountants or International Accounting Standards Board, as in force from time to time;
  - B. the present value of the aggregate minimum lease payments (whether or not they are periodic payments and including any sum payable under a residual value guarantee) during the term of the arrangement is equal to or more than 80% of the fair market value of the ship;
  - C. the term of the arrangement is equal to or more than 65% of the remaining useful economic life of the ship; and
- iii. under which the property in the ship will or may pass to the lessee, or an associate of the lessee, at the end of its term,

and includes an agreement or another arrangement in connection with such an arrangement.

### 29. Calculation of assessable profits under an operating lease – Section 14R(2)

- a. The net lease payments received by a qualifying ship lessor from an operating lease are chargeable to profits tax as determined in Section 14R(2) and Part 2 of Schedule 17FA (which is currently 20%).
- b. Assessable profits = (Gross lease payments – Allowable deductions) × 20%
- c. No depreciation allowance is granted to the ship lessor (i.e., also the ship owner) even if it has incurred capital expenditure.

### 30. Calculation of assessable profits under an operating lease – Section 14R(3)

If no capital expenditure has been incurred by the qualifying ship operator, the assessable profits will be calculated under Section 14R(3) with the following formula:

Assessable profits = Gross lease payments – Allowable deductions