

Hong Kong

TAXATION *and* TAX PLANNING

23rd
Edition



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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 185 tables to make the knowledge more easily understandable
- ✿ More than 230 numerical examples to demonstrate the requisite knowledge
- ✿ More than 125 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, 3, 8, 10, 11, 14, 15, 16, 17, 18, 27, 32, 33, 37, 39, 41 and 46 to include materials on tax law updates and cases between May 2024 and April 2025
- ✿ The law discussed in this book was updated up to 30 April 2025

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V Finality of an Assessment under Section 70

23. An assessment is final and conclusive under Section 70 under the following circumstances:
- where no valid objection or appeal has been lodged within the time limit allowed by the IRO;
 - where the amount of assessable income or profits or net assessable value has been agreed to by the taxpayer under Section 64(3); or
 - where the taxpayer has agreed to withdraw the objection or appeal as the case may be.

However, an assessor is allowed to make an assessment or additional assessment for a year of assessment which does not involve re-opening any matter which has been determined on objection or appeal for that year.

VI Correction of Errors

24. Correction of errors under Section 70A

If a taxpayer does not lodge an objection to an assessment within the one-month objection period, the assessment will become final and conclusive under Section 70, and the tax payable cannot be reduced. However, Section 70A provides an additional way to revise such an assessment if there is an error in the return or assessment.

The crux of Section 70A is that there is an error or omission in the return or in a statement supporting the return, and the IRD, based on such an error or omission, to issue an assessment under Section 59(2)

(a). If the assessment is not issued in accordance with that error or omission, the revision under Section 70A does not apply.

25. Grounds for revision of errors

The situations where Section 70A is applicable for correction of errors include the following:

- an error in any return or statement submitted in support of the return (e.g., a wrong figure is put in the taxpayer's return or a wrong figure is put in the employer's return);
- an omission in any return or statement submitted in support of the return (e.g., a taxpayer forgot to claim a charitable donation or a company forgot to claim an offshore income or a selling profit as a capital gain);
- an arithmetical error or omission in the calculation of the amount of the income or profits or tax charged; or
- an error of law (e.g., a partner of a business is charged with salaries tax but he should be charged with profits tax instead).

26. Grounds not accepted for correction of errors under Section 70A

The meaning of errors is restricted to certain situations. The errors must be errors of facts. Errors in estimation are not acceptable under Section 70A. These include:

- if an assessment was issued in the absence of a return under Section 59(3) [As the taxpayer did not complete a return, there would not be any error in a return.];
- if an assessment was an estimated one issued under Section 59(2)(b) [An error in estimation is not an error of fact.];
- if an assessment was issued on the basis of or in accordance with the practice generally prevailing at the time when the return or statement was made; or
- if a taxpayer deliberately made an error in a return in order to achieve certain purposes or advantages, and he or she subsequently changed his or her mind [*Extramoney Limited v CIR* (1997): In that case, the Chairman of the company deliberately inflated the profit of the company to obtain loans from

Back Duty and Investigation

Learning Objectives

After having studied this chapter, you would:

- a. understand the differences between tax avoidance and tax evasion;
- b. understand the meaning of "without reasonable excuse";
- c. understand the direct methods of quantification of understatement of profit;
- d. understand the indirect methods of quantification of understatement of profit;
- e. understand how field audit teams operate; and
- f. understand the Commissioner's power to apply for the issue of a search warrant.

I Introduction

1. Chapters 2 and 3 talk about the duty of a person to complete a return to facilitate the Inland Revenue Department's (IRD's) issue of an assessment. This chapter talks about how the IRD finds out whether a taxpayer is understating their income in the profits tax return. Before doing so, it is first required to clarify the concept of tax avoidance and tax evasion, and the difference between the understatement of income without a reasonable excuse and wilful intent to evade tax.
2. The Inland Revenue Department has made great efforts to combat tax evasion by increasing the number of officers working in its investigation unit. In June 1991, it launched a new concept in the revenue law of Hong Kong, the field audit (also known as tax audit). In-depth examination of taxpayers' records was still performed by officers of the investigation unit (i.e., Unit 4) while officers of field audit teams in Unit 1 would concentrate on cases in which the evasion of tax or understatement of income or profits was not very serious. In order to streamline the investigation work, field audit teams were merged under Unit 4 on 1 April 2000.

II Avoidance and Evasion of Tax

3. In revenue law, there is a clear distinction between avoidance of tax and evasion of tax. The former is legitimate while the latter is illegitimate and may lead to penalties or even imprisonment.
4. Tax avoidance refers to the legitimate minimisation of tax payable within the framework of the Inland Revenue Ordinance. Lawful means are employed by a taxpayer to reduce his or her tax liability by making use of the characteristics of the Hong Kong tax system, e.g., the territorial concept in the assessment of income and profits, and the generous remuneration package such as the reimbursement of rent in salaries tax. Very often, such arrangements for the reduction of tax liability are referred to as tax planning. Normally, tax planning does not involve any penalty in case the tax plans fail, and the taxpayers are required to pay the tax as if no tax plans have been implemented unless the case is regarded as a sham under Section 61.

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.

- h. a person who holds land or buildings or land and buildings subject to a ground rent (地租) or other annual charge (年費),
- i. (in so far as common parts are concerned) a corporation registered under Section 8 of the Building Management Ordinance (Cap. 344) or a person who, on the person's own behalf or on behalf of another person, receives any consideration, in money or money's worth, in respect of the right of use of any common parts solely or with another,
- j. an executor of the estate of an owner (遺產的遺囑執行人).

4. **Definition of "land or buildings"**

"Land or buildings or land and buildings" is defined in Section 7A to include piers, wharves and other structures.

5. **Property income earned by a corporation**

Income derived from an immovable property owned by a corporation may be charged with property tax or profits tax. Since the rental income of a corporation is included and reflected in its profit and loss account, as a matter of administrative convenience, a corporation's immovable property income is assessable under profits tax.

6. **Property income earned from sub-letting**

Property tax is only charged on a person who is an owner of an immovable property. As a result, income received from the sub-letting of an immovable property is assessable under profits tax (not property tax).

II **Types of Income Chargeable under Property Tax**

7. **Computation of property tax**

Property tax is charged at the standard rate on the net assessable value of an immovable property situated in Hong Kong.

8. **Assessable value (應評稅值)**

a. **Definition of "assessable value"**

Section 5B(2) provides that the assessable value of an immovable property is the consideration, in money or money's worth, *payable* in a year of assessment, to the order of, or for the benefit of, the owner in respect of the right of use of that immovable property.

b. **Definition of "consideration"**

The word "consideration" (代價) is defined in Section 5B(6) to include any consideration payable in respect of the provision of any services or benefits connected with or related to the right of use.

c. **Elements of assessable value**

DIPN 14 (revised in March 2011) provides, in paragraph 12, examples of sums *received or receivable* to be included in the assessable value as follows:

- i. rent,
- ii. payments for the right of use of premises under licence,
- iii. lump sum premium,
- iv. service charges, management fees, etc. paid to the owner who provides the service, and
- v. owner's expenditure, e.g., repairs, borne by the tenant.

10. **Example 6.1: a lease period of not more than 3 years**

Mr. Lau owns a flat and lets the flat to a person for a period of 2 years commencing on 1 June 2022 at a premium of \$600,000. Compute the premium to be spread over and assessable in each relevant year of assessment.

The premium is spread over 24 months (i.e., from 1 June 2022 to 31 May 2024) and assessable in the following years of assessment:

Year of Assessment 2022/23

$$\text{Period spread over is 1.6.2022} - 31.3.2023 \quad \$600,000 \times \frac{10}{24} = \underline{\underline{\$250,000}}$$

Year of Assessment 2023/24

$$\text{Period spread over is 1.4.2023} - 31.3.2024 \quad \$600,000 \times \frac{12}{24} = \underline{\underline{\$300,000}}$$

Year of Assessment 2024/25

$$\text{Period spread over is 1.4.2024} - 31.5.2024 \quad \$600,000 \times \frac{2}{24} = \underline{\underline{\$50,000}}$$

11. **Example 6.2: a lease period of more than 3 years**

Mr. Hui owns a flat and lets the flat to a person for a period of 5 years commencing on 1 January 2022 at a premium of \$720,000. Compute the premium to be spread over and assessable in each relevant year of assessment.

The premium is spread over 36 months (i.e., from 1 January 2022 to 31 December 2024) and assessable in the following years of assessment:

Year of Assessment 2021/22

$$\text{Period spread over is 1.1.2022} - 31.3.2022 \quad \$720,000 \times \frac{3}{36} = \underline{\underline{\$60,000}}$$

Year of Assessment 2022/23

$$\text{Period spread over is 1.4.2022} - 31.3.2023 \quad \$720,000 \times \frac{12}{36} = \underline{\underline{\$240,000}}$$

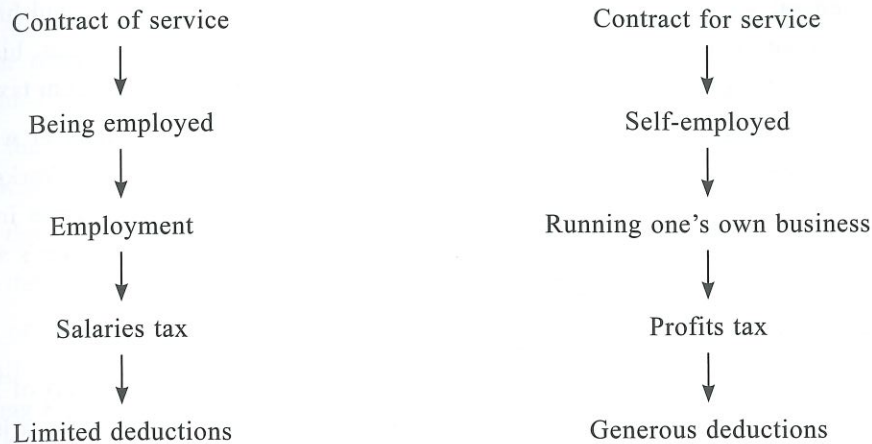
Year of Assessment 2023/24

$$\text{Period spread over is 1.4.2023} - 31.3.2024 \quad \$720,000 \times \frac{12}{36} = \underline{\underline{\$240,000}}$$

Year of Assessment 2024/25

$$\text{Period spread over is 1.4.2024} - 31.12.2024 \quad \$720,000 \times \frac{9}{36} = \underline{\underline{\$180,000}}$$

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.

b. **Facts**

The taxpayer is a certified public accountant. He was engaged by the HKICPA as a Workshop Facilitator and Examination Marker for its Qualification Programme. According to the IR56M filed by the HKICPA, for the period from 1 April 2010 to 31 March 2011, the taxpayer received remuneration in the sum of HK\$50,400 ("the Sum").

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 (See also XIV Concept Map 66.)

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 under Section 8(1C).)

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
- c. the countries/jurisdictions where he or she derived overseas income from are not having a bilateral double taxation arrangement with Hong Kong, Section 8(1C).

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

17. Tax of substantially the same nature

Tax of substantially the same nature of Hong Kong salaries tax means that the foreign tax is charged and paid as a result of a person carrying out services at that overseas place, and the tax is imposed on income derived from the services rendered.

If the tax is not imposed on services rendered but based on the residence or citizenship of the taxpayer, the overseas tax is not of the same nature of Hong Kong salaries tax. In such circumstances, the income already taxed by an overseas country cannot be excluded from Hong Kong salaries tax.

c. All services were performed outside Hong Kong (i.e., no. of days in Hong Kong is nil)	100% exempt
d. Services were performed in Hong Kong for 60 days or less during visits to Hong Kong	100% exempt
e. Services were performed in Hong Kong for 60 days or less, but the employee's presence in Hong Kong did not constitute visit to Hong Kong	100% assessable
f. Services were performed in Hong Kong for more than 60 days	100% assessable

Taxation Position of Non-Hong Kong Employment	
a. Services were wholly performed in Hong Kong	100% assessable
b. Services were partly performed in Hong Kong, partly outside Hong Kong	Assessable on time basis (i.e., according to the no. of days the taxpayer was present in Hong Kong)
c. Services were performed in Hong Kong for 60 days or less during visits to Hong Kong	100% exempt
d. Services were performed in Hong Kong for 60 days or less, but the employee's presence in Hong Kong did not constitute visit to Hong Kong	Assessable on time basis (i.e., according to the no. of days the taxpayer was present in Hong Kong)

VIII Examples Illustrating Sources of Employment

33. Example 8.4: Hong Kong resident with a Hong Kong employment

Mr. Chan is employed by A Limited which is a company incorporated and carrying on business in Hong Kong. Mr. Chan lives with family in Hong Kong. According to the job description, he has to travel extensively outside Hong Kong. Thus, he carries out his duties both in and outside Hong Kong. He stays in Hong Kong for 50 days in the current year of assessment.

REQUIRED:

How is Mr. Chan's income derived from A Limited chargeable to Hong Kong salaries tax?

Answer

The first issue is whether Mr. Chan's employment is sourced in Hong Kong or sourced outside Hong Kong. A Limited is a company incorporated and carrying on business in Hong Kong, and the IRD will treat A Limited as resident in Hong Kong. Thus, Mr. Chan's employment is sourced in Hong Kong. As a result, Mr. Chan's employment income is either fully taxable or fully exempt from salaries tax.

Since Mr. Chan carries out some services in Hong Kong, he cannot get the exemption from the condition of all services being carried out outside Hong Kong under Section 8(1A)(b).

Mr. Chan stays in Hong Kong for 60 days or less. It is required to consider whether he is entitled to exemption under the 60-day rule of visit under Section 8(1B). Mr. Chan's family is in Hong Kong, and he is not able to satisfy as a visitor. The 60-day rule of visit does not apply to him.

Since he cannot get any exemption under the 60-day rule, all his employment income is chargeable to salaries tax.

and children live in Singapore. According to the job description, he has to travel to Hong Kong to visit his clients here. Thus, he carries out his duties both in and outside Hong Kong. He stays in Hong Kong for 50 days in the current year of assessment.

REQUIRED:

How is Mr. Liang's income derived from D Limited chargeable to Hong Kong salaries tax?

Answer

The first issue is whether Mr. Liang's employment is sourced in Hong Kong or sourced outside Hong Kong. D Limited is a company carrying on business in Singapore, and the IRD will treat D Limited as resident outside Hong Kong. As the employment contract is also signed outside Hong Kong, Mr. Liang's employment is sourced outside Hong Kong. As a result, Mr. Liang's employment income is either taxable on time basis or fully exempt from salaries tax.

Since Mr. Liang carries out some services in Hong Kong, he cannot get the exemption from the condition of all services being carried out outside Hong Kong under Section 8(1A)(b).

Mr. Liang's family lives in Singapore, and he is able to satisfy as a visitor. Moreover, he stays in Hong Kong for not more than 60 days. As a result, he is entitled to exemption under the 60-day rule of visit under Section 8(1B).

37. **Example 8.8: visitor with a non-Hong Kong employment stayed in Hong Kong for more than 60 days**

Mr. Godo is employed by E Limited which is a company carrying on business in Japan. Mr. Godo is a Japanese who signed his employment contract with E Limited in Japan. Mr. Godo's wife and children live in Japan. According to the job description, he has to travel to Hong Kong to visit his clients here. Thus, he carries out his duties both in and outside Hong Kong. He stays in Hong Kong for 70 days in the current year of assessment.

REQUIRED:

How is Mr. Godo's income derived from E Limited chargeable to Hong Kong salaries tax?

Answer

The first issue is whether Mr. Godo's employment is sourced in Hong Kong or sourced outside Hong Kong. E Limited is a company carrying on business in Japan, and the IRD will treat E Limited as resident outside Hong Kong. As the employment contract is also signed outside Hong Kong, Mr. Godo's employment is sourced outside Hong Kong. As a result, Mr. Godo's employment income is either taxable on time basis or fully exempt from salaries tax.

Since Mr. Godo carries out some services in Hong Kong, he cannot get the exemption from the condition of all services being carried out outside Hong Kong under Section 8(1A)(b).

Mr. Godo's family lives in Japan, and he is able to satisfy as a visitor. However, he stays in Hong Kong for more than 60 days. As a result, he is not entitled to exemption under the 60-day rule of visit under Section 8(1B). Thus, his income is chargeable on a time apportionment basis of 70/365.

38. **Example 8.9: Hong Kong resident with a non-Hong Kong employment stayed in Hong Kong for more than 60 days**

Mr. Cheung is employed by F Limited which is a company carrying on business in Macao. Mr. Cheung is a Hong Kong resident who signed his employment contract with F Limited in Macao. Mr. Cheung's wife and children live in Hong Kong.

According to the job description, he is stationed in Macao's head office, but he has to travel to Hong Kong once a month. He is required to oversee the operations of F Limited's branch in Hong Kong. He stays in Hong Kong for ten days each month, and lives with his family in Hong Kong. Thus, he carries

41. **Example 8.11**

Mr. Wang is a Mainland Chinese who is an employee of a Mainland Chinese company. He has to come to Hong Kong to perform his duties, and he stayed in Hong Kong in a continuous period of 12 months with the following scenarios:

No. of Days Present in Hong Kong	Taxability under Hong Kong Salaries Tax	Reasons
58 days	Exempt	60-day rule of visit, and as a result of DTA signed
70 days	Exempt	As a result of DTA signed
180 days	Exempt	As a result of DTA signed
184 days	Time basis	DTA not cover such situation

42. **Example 8.12**

Mr. Chen is a Mainland Chinese who is an employee of a Hong Kong company. He has to come to Hong Kong to perform his duties, and he stayed in Hong Kong for a continuous period of 12 months in the following scenarios:

No. of Days Present in Hong Kong	Taxability under Hong Kong Salaries Tax	Reasons
58 days	Fully exempt	60-day rule of visit
70 days	Fully taxable	DTA not cover such situation
180 days	Fully taxable	DTA not cover such situation
184 days	Fully taxable	DTA not cover such situation

The DTA signed between the Mainland of China and the Hong Kong SAR does not cover the situation where a Mainland Chinese works for a Hong Kong enterprise. Nevertheless, the Mainland Chinese is still entitled to the beneficial treatment of the 60-day rule of visit, and get an exemption from Hong Kong salaries tax if he is qualified as a visitor during a particular year of assessment.

43. **Tables showing the relationship between the 60-day rule and the 183-day rule**a. **Hong Kong source employment**

	No. of Days Staying in Hong Kong		
	60 Days or Less	61 – 183 Days	More than 183 Days
Mainland Chinese	Exempt	100% taxable	100% taxable
Non-DTA foreign residents	Exempt	100% taxable	100% taxable

The DTA does not apply to Hong Kong source employment, and a Mainland Chinese gets no exemption from salaries tax even though he or she stays in Hong Kong for 183 days or less. He or she can only get exemption under the 60-day rule of visit.

b. **Non-Hong Kong source employment**

	No. of Days Staying in Hong Kong		
	60 Days or Less	61 – 183 Days	More than 183 Days
Mainland Chinese	Exempt	Exempt	Time basis
Non-DTA foreign residents	Exempt	Time basis	Time basis

n. **Sum received due to employer's default to grant rest days or holidays**

Dr. The Honourable Leung Ka-Lau v CIR (2023)

i. **Facts**

According to the Hospital Authority (HA), doctors were entitled to rest days as well as statutory or public holidays. In default of being granted such rest days or holidays, the doctors were entitled to compensation to be assessed in an amount equivalent to a full day's wages in respect of each missed rest day or holiday.

The Taxpayer was awarded a sum of HK\$1,765,821 ("Sum") as compensation for his loss of rest days and statutory holidays from 17 March 1996 to 1 October 2005.

ii. **Issues**

- Whether the Sum received by the Taxpayer from the HA because of its default to grant rest days or holidays is taxable; and
- Whether the Taxpayer was taxed twice on the Sum received as he had paid salaries tax on his employment income reported to the IRD by the HA.

iii. **Taxpayer's argument for the Sum being not chargeable to salaries tax, but taxed twice**

- The Sum of HK\$1,765,821 was paid to the Taxpayer as compensation for the deprivation of rest days and public holidays to him. This was the compensation or damages for the HA's breach of contract for not granting such rest days or holidays, being placed on-call instead. The sum was thus NOT chargeable to salaries tax.
- As the CIR accepted that under his contract of employment, the Taxpayer had earned his day off entitlement and had paid tax on it indirectly because he was taxed on his remuneration package. That being the case, the Taxpayer would have to pay tax again (or twice) on the compensation which was the substitution for his rest days.

iv. **Decision of the Court of First Instance and Court of Appeal**

The award of damages granted to the taxpayer for his loss of rest days, statutory and public holidays (i.e., the Sum) was *not chargeable* to salaries tax as this was compensation for the deprivation of the Taxpayer's right under his employment contract with the HA.

v. **Decision of the Court of Final Appeal**

The Sum was not paid for abrogation of right, but for services rendered under employment, and there was no double taxation on the Sum. The Court decided in favour of the CIR's appeal that the Sum should be chargeable to salaries tax.

vi. **Reasons for decision of the Court of Final Appeal**

• **Compensation for deprivation of right**

The deprivation of rest days and public holidays was not abrogation of rights. Abrogation of rights usually involves prematurely terminated contract of employment or wrongful dismissal, but it was NOT the situation in this case.

On the other hand, the Sum was received by the Taxpayer in the capacity of acting as or being an employee. It was a payment for past services as the HA had a responsibility to properly staff its hospitals on holidays and statutory rest days, and the Taxpayer had to stand by on call on those days. Compensation was viewed as an inducement to prospective employees to enter into a contract for services with the HA.

15. **Definitions**

- a. A “**place of residence**” is defined in Section 9(6) as a residence provided by an employer or an associated corporation notwithstanding that the employee is required to occupy that place of residence by or under his or her terms of employment and whether or not by doing so he or she can better perform his or her duties.
- b. An “**associated corporation**” is defined in Section 9(6) as:
- i. a corporation over which the employer has control;
 - ii. if the employer is a corporation:
 - (1) a corporation which has control over the employer; or
 - (2) a corporation which is under the control of the same person as is the employer.
- c. “**Control**”, in relation to a corporation, is defined in Section 9(6) as the power of a person to secure:
- i. by means of the holding of shares or the possession of voting power in or in relation to that or any other corporation; or
 - ii. by virtue of any powers conferred by the articles of association or other document regulating that or any other corporation,
- that the affairs of the first-mentioned corporation are conducted in accordance with the wishes of that person.

VI Refund of Rent to the Employee by the Employer16. **Tax treatment for the rent refunded or reimbursed by the employer**

The amount of rent refunded or reimbursed to the employee by the employer is not taxed in the form of cash allowance under Section 9(1A)(a). Instead, the aforesaid benefit is taxed in the form of notional rental value which is calculated in accordance with Section 9(2) as follows:

Taxable income		A
Less: Lump sum payment at end of employment	B	
Gratuity on retirement or termination of employment	C	
Gain from share option	D	
Allowable outgoing & expenses	E	
Depreciation allowances	F	<u>G</u>
Income subject to rental value		<u>H</u>
Rental value before deduction of rent suffered ($H \times 10\%$)		I
Less: Rent suffered		
i.e., Rent paid by employee to landlord	J	
Less: Rent refunded by employer of an amount smaller than J	K	<u>L*</u>
Rental value		<u>M</u>

* If L is larger than I, M becomes zero. (M cannot be negative.)

In case the notional rental value exceeds the rateable value of the accommodation provided, the taxpayer may elect the rateable value for the computation of taxable income.

The rent paid by an employee includes not merely the actual rent payable but also the rates and building management fee paid by the tenant.

- c. "Accrued benefit" is defined in Section 8(6) as the maximum benefit a person would have been entitled to receive under an occupational retirement scheme in respect of his or her service recognised for the purposes of the scheme if, at the date of termination of the person's employment, retirement has instead taken place.

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

30. Defined contribution scheme v defined benefit scheme

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

a. Defined contribution scheme

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

b. Defined benefit scheme

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

31. Summary of chargeable and exempt income

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

The Time the Lump Sum is Received	Treatment
a. Not at the time of termination of employment, not upon retirement, not upon death, or not upon incapacity	Fully assessable
b. At the time of termination of employment, but not upon retirement, not upon death, not upon incapacity	Assessable on the amount paid in excess over the proportionate benefit
c. At the time upon retirement, upon death, upon incapacity	Fully exempt
d. For employees having joined an old retirement scheme formerly approved by the repealed Section 87A and such scheme was converted to RORS	Fully exempt under Section 8(4)(b) proviso (i.e., grandfathering proviso)

IX Gains from Share Options (See also XV Concept Map 61.)

32. Basis of charge

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

33. Stages of a share option scheme

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

- grant of option,
- exercise of option,
- assignment of option without exercise of the share option (i.e., sale of option to other people who are most likely colleagues in the company),

- a. interest income received by an individual,
 b. interest income received by a company which is not a money lender,
 c. interest income received by a money lender which is not a financial institution,
 d. interest income received by a financial institution, and
 e. interest income received by a qualifying corporate treasury centre (QCTC).

27. **Interest income received on a loan by an individual**

In order to be chargeable with profits tax, a person must carry on a business in Hong Kong. An individual is generally not regarded as carrying on a business in Hong Kong unless he carries on repetitive activities in earning interest income through lending money to others. Thus, if an individual lends money to his friends not on a frequent basis, he will not be treated as carrying on a business, and the interest income is not chargeable to profits tax.

28. **Interest income received on a loan by a company (not a money lender)**

A company is established to make money. Thus, interest income earned by a company carrying on a business in Hong Kong is chargeable to profits tax on its interest income derived from Hong Kong under Section 15(1)(f). The source of interest income is determined by the provision of credit test.

29. **Interest income received by a money lender (not a financial institution)**

In the case of a money lending business, the taxpayer's business would normally encompass a broader range of activities, including the borrowing and/or lending of money. For this type of business, the IRD will apply the operations test instead of the provision of credit test in determining the source of the interest income. After the decision of the *Orion* case and the issue of DIPN 13, this becomes a two-tier approach for the determination of the source of interest income for money-lenders which are not financial institutions.

a. **The initial step – provision of credit test**

If the provision of credit is in Hong Kong, the loan interest income is wholly chargeable to profits tax, and the IRD will not take any further action but charge profits tax on the interest income. If the provision of credit is outside Hong Kong, the IRD may apply the operations test to determine the source of interest income.

b. **The second step – operations test**

The IRD will look at activities such as the evaluation of the loan and the decision of approval for the application of the loan. If any one of such activities is carried out in Hong Kong, the interest is sourced in Hong Kong, and the interest income will be fully chargeable to profits tax.

30. ***CIR v Orion Caribbean Limited (In Voluntary Liquidation) (1997)***

a. **Facts**

The taxpayer was a Cayman Islands company, and it was a wholly owned subsidiary of a Hong Kong company called Orion Royal Pacific Ltd. The taxpayer's main business was to consider and approve the loan participations recommended by its parent company. The taxpayer borrowed money in foreign currencies from the parent company and on-lent the money to borrowers outside Hong Kong. The parent company negotiated and serviced the loan for the taxpayer's approval, and raised funds for the loans approved by the taxpayer. The parent company also provided management, administrative and accounting services for the loans approved by the taxpayer.

b. **Board of Review decision**

The Board of Review found that based on the "provision of credit test", the source of interest income was derived outside Hong Kong. However, the Board treated the taxpayer as a financial institution, thus all the interest income was subject to Hong Kong profits tax under Section 15(1)(i).

40. **Summary of taxation of interest income earned from a deposit**

Recipient	Place of Deposit and Use of Deposit		Chargeability
Not a financial institution	In Hong Kong	Deposit pledged for a loan	Taxable
		Deposit NOT pledged for a loan	Exempt from payment of profits tax
	Outside Hong Kong		Exempt from profits tax
Financial institution	In Hong Kong		Taxable
	Outside Hong Kong		Taxable

X Royalty Income Received by a Business Carried on in Hong Kong

41. Types of royalty income

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

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

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

42. Development of intellectual property

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

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

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

44. Purchase of the proprietary right of an intellectual property

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

45. Licence of the right to use an intellectual property

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

e. **Decision of Court of First Instance**

- i. The licence fees received by Muse for the grant of licence (i.e., the exhibition of TV programme falling within copyright), and they are chargeable under Section 15(1)(ba).
- ii. The technical fees received by Muse for the provision of dubbing and subtitling do not fall within the scope of Section 15(1)(a), (b) or (ba), and are not chargeable to profits tax.

f. **Judge's reasons for the decision**

- i. The Copyright Ordinance Cap. 528 itself identifies that copyright is a property right which may subsist in, amongst other things, sound recording, films, broadcasts or cable programmes. (See Section 2(1)(b) and 6 and 9) (para. 66 of judgment)
- ii. Section 15(1) is a deeming provision introduced to deal with an individual tax issue, and there is no "central theme" to the section. Because the various paragraphs were intended to deal with different situations, they need not necessarily be mutually exclusive. (para. 69 of judgment)
- iii. That they may overlap does not mean that they are inconsistent. (para. 70 of judgment)

g. **Decision of Court of Appeal**

The Taxpayer lodged an appeal to The Court of Appeal. The Taxpayer's appeal to The Court of Appeal was heard on 10 December 2013 and a judgment was delivered in May 2015 confirming the decision at the Court of First Instance.

XII Commission Arising from Provision of Guarantee Services

60. Different types of guarantee commission income

There are two types of guarantee commission income:

- a. Passive guarantee commission income
- b. Active guarantee commission income

61. Passive guarantee commission income — assumption of risk test

In such a situation, the guarantor is not required to take any physical activity to earn the income. The mere promise of providing a guarantee, such as a repayment of money on loan through an undertaking, belongs to such category. If the guarantor receives a commission on the provision of such guarantee service, the source of the commission income is governed by the assumption of risk test.

If the loan being guaranteed arises in Hong Kong or the undertaking for repayment of loan is signed or enforceable in Hong Kong, the assumption of risk is in Hong Kong. Thus, the guarantee commission so received is chargeable to Hong Kong profits tax.

62. Active guarantee commission income — operations test

If the situation is that the guarantor has to do something to ensure that the success of the guarantee, the source of the commission income is governed by operations test. The source of guarantee commission is at the place where the guarantor provides activities to make the guarantee successful as in the *Kwong Mile* case.

63. *Kwong Mile Services Limited v CIR (2004)*

In this case, the taxpayer provided a guarantee service to a development project in Guangzhou. It guaranteed the sales proceeds of the flats to a certain amount. Although the project was in Guangzhou, all the purchasers were Hong Kong residents, and the advertisement was done in Hong Kong to promote the sale.

XVI Profits of a Qualifying Corporate Treasury Centre (QCTC) – Section 14D

75. Profits of a QCTC subject to half of the profits tax rate

Section 14D(1) provides that the assessable profits of a qualifying corporate treasury centre (QCTC) are chargeable to profits tax at one-half to the extent to which those profits are —

- a. assessable profits derived from its intra-group lending transaction;
- b. assessable profits derived from its intra-group corporate treasury service; or
- c. assessable profits derived from its intra-group corporate treasury transaction,

received by or accrued to the corporation on or after 1 April 2016 (Schedule 36 of the IRO).

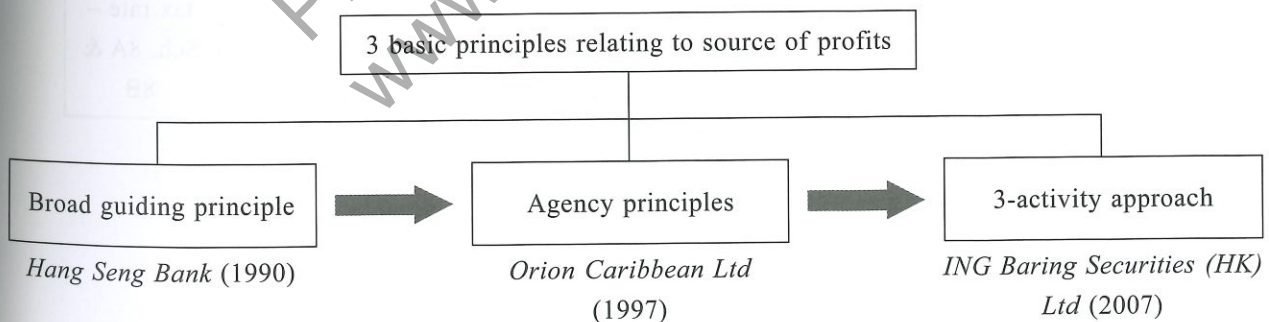
76. Prerequisite conditions for a QCTC subject to half of the profits tax rate

Section 14D(5) provides that the half rate concession applies to a QCTC for a year of assessment only if:

- a. in that year of assessment —
 - i. the central management and control of the corporation is exercised in Hong Kong (*the central management and control requirement*); and
 - ii. the activities that produce its qualifying profits in that year are carried out in Hong Kong by the corporation; or arranged by the corporation to be carried out in Hong Kong (*the substantial activity requirement*); and
- b. the corporation has made an election in writing, which is irrevocable, that the half rate concession applies to it. The election, once made, is irrevocable.
- c. Part C of Chapter 29 “Financial Institutions and Corporate Treasury Centres” contains the profits tax position of a QCTC.

XVII Concept Map

77. Historical development of rules for the source of profits



NE means the non-eligible expenditure incurred in respect of the subject intellectual property, i.e.,

- interest payments;
- payments for acquisition; alteration, addition or extension to any land or building;
- any expenditure (including capital expenditure) incurred by the eligible person to obtain the subject IP or any right regarding the property from another person, regardless by means of acquisition, licensing or amalgamating with another company or otherwise.

The meaning (constituents) of EE and NE (incurred) are shown in the following table:

R&D expenditures incurred during the specified period	HK	Overseas
For an R&D activity carried out		
• By an eligible person	EE	EE
• By a non-associated person on behalf of the eligible person	EE	EE
• By an associated person who is a Hong Kong resident person on behalf of the eligible person	EE	NE
• By an associated person who is a non-Hong Kong resident person on behalf of the eligible person	NE	NE

Section 12(2) of Schedule 17FD provides that an R&D fraction is to be regarded as 100% if the percentage ascertained from the formula above is more than 100%.

91. **Transitional arrangement**

a. **The objective of such a transitional arrangement**

- i. To allow sufficient time for taxpayers to acquaint themselves with the tracking and tracing requirements.
- ii. If an eligible person has insufficient records to track and trace the R&D expenditure to calculate the R&D fraction (F), he/she may adopt such a transitional arrangement.
- iii. After the transitional period, the eligible person must transit from using the 3-year average to the R&D fraction (F).

b. **The transitional period**

It refers to the eligible person's basis periods for the years of assessment from 2023/24 to 2025/26.

92. **Tax treatment under certain circumstances — Sections 16 and 17 of Schedule 17FD**

a. **Tax concessions will be withdrawn — Section 16 of Schedule 17FD**

- i. The tax concessions provided above will be withdrawn while any one of the circumstances specified in Section 17 of Schedule 17FD occurs regarding the eligible IP.
- ii. All concessionary portions of the assessable profits from the eligible IP income subject to the concessionary tax rate (5%) for the years of assessment preceding the relevant year are to be regarded as trading receipts of the eligible person for the relevant year.

b. **Specific circumstances for the purposes of Section 16 — Section 17 of Schedule 17FD**

The specified circumstances for withdrawal of tax concession under Section 17 of the Schedule are:

- i. The eligible patent is unconditionally revoked.
- ii. The patent application is abandoned, refused or withdrawn.

- ii. whether the asset can be readily used after having been purchased without incurring the so-called "repairing" expenditure.
- c. For example, if a person purchases an office and incurs expenditure to decorate that office, such expenditure is for improvement. Another example is that a business has been using its office for some years, and incurs expenditure to redecorate the office, such expenditure is for repair which is a deductible expense under profits tax.

24. **Replacement – Section 16(1)(f)**

- a. There are different tax treatment for expenditure incurred in the replacement of the aforesaid items. Section 16(1)(f) provides that expenditure incurred in the replacement of any implement, utensil or article employed is fully deductible under profits tax, but replacement for other assets is treated as acquisition of plant and machinery and the owner is entitled to depreciation allowances only.
- b. Inland Revenue Rule 2 (IRR 2) defines implement, utensil or article to include the following items:
 - i. belting,
 - ii. crockery and cutlery,
 - iii. kitchen utensils,
 - iv. linen,
 - v. loose tools,
 - vi. soft furnishings (including curtains and carpets),
 - vii. surgical and dental instruments, and
 - viii. tubes for X-ray and infra-red machines.
- c. If an item falls into the category of IRR 2 above, the tax treatment is as follows:
 - i. the cost incurred in the initial purchase of such items is not entitled to any deduction and no depreciation allowance is granted on such expenditure, and
 - ii. the cost incurred for the subsequent purchases of those items is fully deductible in the year in which the expenditure was incurred.

25. **Expense for registration of trademark or design or patent – Section 16(1)(g)**

The expense incurred for the registration of a trademark or design, or the registration or grant of a patent or plant variety right, used in the trade, profession or business is of capital nature, and it should not be deductible under Section 17(1)(c). However, Section 16(1)(g) allows such payment deductible under profits tax if the expense produces assessable profits for the business concerned.

26. **Expenses deductible under Sub-divisions in Division 4 of Part 4 (Profits Tax) of the IRO**

- a. The payments and expenditure specified in Sections 16AA, 16C, 16E, 16EA, 16F, 16G, 16I and 16N, as provided in those Sections – Section 16(1)(ga);
- b. any deduction allowed under Section 16B – Section 16(1)(gb).

27. **Reinstatement costs incurred deductible for any premises under a lease — Section 16(1)(gc)**

a. **Introduction**

The Inland Revenue (Amendment) (Tax Deductions for Leased Premises Reinstatement and Allowances for Buildings and Structures) Ordinance 2024 was enacted on 18 December 2024. Section 16(1)(gc) provides that, despite Section 17, reinstatement costs incurred for any premises under a lease are deductible, but only if all of the conditions specified in Section 16(2K) are met.

b. **Annual contribution**

No deduction is allowed for payment or provision made to a non-RORS under profits tax after the expiration of the transitional period under the Occupational Retirement Scheme Ordinance on 15 October 1995 – Sections 17(1)(j) and (l).

X Deductions Not Allowable under Section 17

51. The following is a summary of deductions *not* allowed under Section 17:

Section	Description
17(1)(a)	Domestic or private expenses
17(1)(b)	Expenses not for the purpose of producing chargeable profits
17(1)(c)	Expenditure of a capital nature
17(1)(d)	Expenditure on improvement
17(1)(e)	Sums recoverable under an insurance contract
17(1)(f)	Rent of premises not occupied for the purpose of producing chargeable profits
17(1)(g)	Any tax paid or payable under the IRO other than salaries tax paid in respect of employees' remuneration
17(1)(h)	Ordinary or annual contributions made for the payment in respect of a recognised occupational retirement scheme which exceed 15% of the total emoluments of an employee
17(1)(i)	Provision made for the ordinary or annual contributions in respect of a recognised occupational retirement scheme which exceed 15% of the total emoluments of an employee
17(1)(j)	Provision made in respect of an unrecognised occupational retirement scheme
17(1)(k)	Sum paid by an employer being either a contribution under an occupational retirement scheme or a premium in respect of a contract of insurance under an occupational retirement scheme, where – (i) provision for the payment of such sum has been made in any prior year of assessment; and (ii) a deduction has been allowed for such provision in any prior year of assessment
17(1)(l)	(i) Contribution made by an employer to the funds of; or (ii) Payment made by an employer for the purposes of the operation of, an occupational retirement scheme other than a recognised occupational scheme
17(2)	Payment made to a sole proprietor, partners and their spouses

52. **Domestic or private expenses – Section 17(1)(a)**

- Domestic or private expenses include the cost of travelling between the person's residence and place of business and excess of the statutory limit of monthly contribution to the mandatory provident fund.
- Section 17(1)(a) applies to sole proprietor and partnership businesses. As a corporation is not a human being, Section 17(1)(a) does not apply to a corporation. The private or domestic expense of a director does not mean that it is a private or domestic expense of a corporation. Although the private or domestic expense of a director satisfies Section 17(1)(a), an assessor may disallow such expense under Section 16(1) if he or she is of the opinion that the expense is not incurred in the production of assessable profits.