

Study Notes for Hong Kong Taxation Course, including Module D, QP of HKICPA

1	Salaries Tax – Source of income	3
2	Salaries Tax – Taxable items, Deductions, Allowances etc.	9
3	Self-employment – salaries tax or profits tax	20
4	Property Tax	23
5	Personal Assessment	26
6	Profits Tax – Source of profits	29
7	Profits Tax – Business, Trade, Sale of property, etc.	37
8	Profits Tax – Capital Nature and Revenue Nature	43
9	Profits Tax – Chargeable incomes	47
10	Profits Tax – Non-resident, Offshore Fund trading in HK stock	57
11	Profits Tax – Deduction of Expenditures	65
12	Profits Tax – Interest Deduction	75
13	Profits Tax – Depreciation Allowances	79
14	Profits Tax Computation, Basis Period	84
15	Field Audit and Tax Investigation	87
16	Tax Penalty	90
17	Tax Administration, Objection, S70A, Tax Recovery etc.	96
18	Introduction to China Tax	106
19	Double Taxation Agreement with mainland China	115
20	Tax Avoidance	120
21	Transfer Pricing	126
22	Partnership, Joint Venture, Club	129
23	Deceased person	134
24	Tax Planning, Tax Representative's Service	136
25	Stamp Duty	143

The study notes are based on the author's experience as a marker of various taxation examinations for many years. They aim to provide an answer guide for answering case analysis questions, and getting marks, especially for HKICPA QP Module D Hong Kong Taxation and ACCA (HK Taxation) Examination and many public taxation exams. Based on the author's experience in marking exam papers, **Marking Points** ( • ) are highlighted so as to provide hints on how to answer case questions and get marks.



作者 楊輝洪 Raymond Yeung

All copyrights reserved by Raymond Yeung Tax Consultant

<http://www.rytc.com.hk>

## Topic 1: Salaries Tax - **Source of income**

- **S8(1)(a)** states the **basic charge** of salaries tax: The **whole income** from Hong Kong sourced employment is taxable.
- **Dual employment contracts** case: Analyze each contract separately • S8(1)(a) concerns “employment” relation between an employer and an employee which is created by an employment contract • Identify who is employer • Source of employment is a totality of facts: Comment on the facts given and draw conclusion on whether it is a HK sourced employment.
- **DIPN 10** states IRD’s policy on the charge to salaries tax: IRD follows Goefert decision in determining the source of employment income.
- According to **Goefert** case, the general rule for determination of source of employment concerns 3 important facts: (1) whether the employment contract was negotiated, entered into and enforceable in Hong Kong (2) whether the employer was a resident in Hong Kong; and (3) whether the employee’s remuneration was paid in Hong Kong.
- Distinguish between HK employment and non-HK employment with Geofert principles • IRD puts **more weighting on (1) and (2)** because (3) the location of payment can be easily arranged by the taxpayer.
- Case analysis: Is the **employment contract** negotiated and signed outside Hong Kong? Is the **employer** an overseas resident company? Who is the real employer – HK subsidiary/associated company? or the overseas company?
- A HK **branch** of overseas company is not a “real” employer. The real

employer is the overseas company • If the taxpayer's employment is HK sourced, **S8(1)(a)** applies so that all income from the employment is taxable. Otherwise, extension of charge under **S8(1A)** applies so that only income attributable to HK service is taxable.

- Judge's reservation in **Goefert** case: "There can be no doubt therefore that in deciding the crucial issue, the Commissioner may need to look further than the external or **superficial features** of the employment. Appearances may be deceptive. He may need to examine other factors that point to the real locus of the source of income, the employment."

- Case analysis: Does the non-HK employment case has external or superficial features? — Say, A has been working in HK for more than 2 years and he left HK frequently, mostly for holidays. In that case, IRD can challenge that the facts are superficial features and deceptive. IRD can look further into the case and apply the **totality of facts** approach as adopted under Board of Review cases • Besides, IRD can invoke **S61A** to disregard the superficial features and make an assessment to counteract the tax benefit (that is to disallow the time basis claim).

- Case analysis: The overseas employer has a subsidiary company in Hong Kong and the employee has been working with it for more than 2 years. IRD may challenge the time apportionment claim and ask Immigration Department for the employer's declaration filed with Immigration Department and the employment agreement relating to the work visa, in order to find out who is the real employer: the HK subsidiary or the overseas company?

- **DIPN 10**: Time apportionment is applicable for employees who hold overseas employment, assigned to HK temporarily, **required to work overseas** and he will be relocated back to his home country later • If the employee is not required to work outside HK, time basis is not allowed.

- **S8(1A)** states the **extension of charge** for non-HK employment cases: Assess the income in respect of the services rendered in HK only • It is called time-apportionment / **time-basis** assessment • Assessable income = Total **employment income** x no. of day in HK / no. of day of employment period in the year of assessment • If the taxpayer took annual leave, first compute the annual leave attributable to HK service: no. of annual leave day x no. of working day in HK / total no. of working day in the year of assessment. Then, add the “no. of annual leave day attributable to HK service” to “no. of working day in HK” to get the “**no. of day in HK**” • Day of arrival in HK and day of departure from HK are each counted as 0.5 day respectively • Total employment income includes share option gain • **Hardship allowance** for overseas work is not included in assessable income, see D56/91 • **Salaries tax paid by employer** is wholly taxable and it is not subject to time apportionment.

- **S8(1A)(b)(ii)** exempts an employee from salaries tax if he renders **all services outside HK** in the year of assessment • This exemption does not apply to seamen and aircrew • From case law, “services” rendered by employee in HK include: supervise junior staff, attend **business meetings**, report duties to supervisors, take part in training of staff, etc. • Case analysis: A reported duties in HK every Friday – that constitutes services rendered in HK in case law. Therefore, A is not entitled to full exemption of salaries tax under S8(1A)(b)(ii).

- **S8(1B)** states the 60-day visit rule: **Exempt** an employee who renders services in HK during **visits** not exceeding 60 days in the year of assessment.
- Exemption is applicable to “visit HK” only
- According to Shorter Oxford Dictionary, “visit” means a short and temporary stay
- In **So Chak Kwong Jack** case, all days in HK are counted, irrespective of whether they are service day or not. Part of a day is counted as one whole day
- From Board of Review cases, if the employee's **permanent base** (or work base) is in HK, his stay in HK cannot qualify as visit
- Case analysis: As Chan’s permanent base (his home) has been moved to mainland China, his stay in HK can qualify as “visits” even he holds a HK Permanent Resident Identity Card
- A HK resident emigrates overseas in May cannot get the exemption even though his total number of stay in HK in that year of assessment does not exceed 60.
- A HK resident who has moved his **work base** (the fixed place of work) to mainland China can apply for the exemption
- The 60-day rule does not apply to an office holder, a seafarer or an aircrew.

- **Company director** appointed under Companies Ordinance is an **office holder**
- Office is a permanent position which has an existence independent from the person filling it, see **Great Western Railway** case
- According to **McMillan v Guest** case, location of director office depends on the management and control of the company
- According to **D123/02**, director office of a company **incorporated in HK** is treated as locating in HK unless the contrary is proved. The board considers the following facts for management and control in HK: carrying on business in HK, having a fixed place of business in HK, recruiting staff in HK, maintaining bank account in HK, incorporation in HK, registered office in HK, **registers of members** in HK, accounts audited in HK. On a **totality of facts**, the director office is held as locating in HK
- Case analysis: As Co. X is **incorporated in HK**, the IRD will

regard the director office locating in HK based on D123/02 • Case analysis: Co. Y is **incorporated in BVI**. As the company director B is a **HK resident** and he ordinarily resides in HK, IRD can regard the **management and control** of the company in HK. The director fee is apparently sourced in HK and taxable.

- D1/81: **dual capacity** of director and employee may be accepted on facts and evidence. Duties of director are statutorily laid down by the Companies Ordinance and the company's Articles of Association; whereas duties of an employee are laid down from day to day by his employer • No exemption for director fee if the director office is in HK • Location of director office is determined by the company's **central management and control**, see **McMillan v Guest** • Director office of a HK incorporated company is in HK, see D123/02 • Employee's remuneration may get the following exemptions: (i) Exemption under S8(1A)(b)(ii) is allowed if all services outside HK (ii) Exemption under S8(1B) is granted for visiting HK not exceeding 60 days, or (iii) Exemption for the overseas service income is allowed under S8(1A)(c) if overseas income tax is paid in respect of the overseas services income. These exemptions do not apply to an office holder.

- **S8(1A)(c)** exempts income attributable to **services rendered outside HK** if such overseas service is chargeable to tax of a substantially the same nature as salaries tax (e.g. China's IIT) and the overseas tax has already been paid.
- S8(1A)(c) is not applicable if time apportionment under S8(1A) is allowed.
- In general, IRD does not simply exclude the income as assessed in the foreign tax bill from assessable income because foreign income tax may be on world wide basis • In general, IRD uses time apportionment to determine the income attributable to services outside HK, see DIPN 10 • No exemption is granted if the taxpayer does not pay overseas tax even though the overseas

income is chargeable to overseas tax • A taxpayer who did not provide services outside HK cannot get S8(1A)(c) exemption even though he paid foreign income tax • As stipulated in **DIPN 10**, a taxpayer must supply foreign tax bill to get S8(1A)(c) exemption. If foreign tax bill is not yet available, the taxpayer should object to assessment and the tax involved will be held-over pending submission of the foreign tax bill by the taxpayer.

• **Double Taxation Arrangement** with mainland China says : • A mainland resident gets **exemption** from salaries tax if he stays in Hong Kong for not exceeding 183 days in any 12-months period commencing or ending in the year of assessment; his income is not paid by Hong Kong resident employer; and the cost of his salaries is not borne by Hong Kong resident employer.

• Similar exemption of IIT is granted for Hong Kong residents working in mainland – see Topic 19. • A mainland resident gets exemption of salaries tax if he visits HK for not exceeding 60 days in the year of assessment. • A mainland resident cannot apply for tax credit in Hong Kong. If he wishes to apply for tax credit, he should make the claim to China tax authority. • A HK resident who has paid IIT on the China-sourced income doubly assessed in Hong Kong can apply to HK Inland Revenue Department for a **tax credit** to set off his HK salaries tax payable. The maximum tax set off is computed on the assumption that the China-sourced income is taxed under HK Salaries Tax. The time limit for application of tax credit is within two years after the end of the year of assessment. • In general, the taxpayer should apply for S8(1A)(c) exemption first instead of tax credit because of greater tax reduction and easier to get exemption under S8(1A)(c) – see Topic 19 for more on tax credit.

## Topic 2: Salaries Tax – **Taxable items, Deductions, Allowances etc.**

- **S8(1): 3 types of incomes** taxable in salaries tax: **employment, office, pension** • Case analysis: Refund of course fee under a government scheme is not taxable because it is not derived from employment, office or pension.
- **S9(1)(a):** Taxable employment income includes: salary, wage, leave pay, fee, commission, bonus, gratuity, **perquisite**, and **allowance**, whether or not they are derived from employer. • Case analysis: A cash allowance 現金津貼(eg. transportation allowance) or a perquisite 非現金的福利(eg. a gift of gold bar on meeting performance target ) are taxable under S9(1)(a).
- UK tax cases are applicable to tax employment benefits (**perquisite**), see **Glynn case** • A benefit having **money worth** is taxable • A benefit has money worth if it is **convertible into money** (e.g. it is saleable) or if it is involved in the **discharge of the employee's personal liability** (e.g. payment of the employee's credit card liabilities).
- Examples of **non-taxable** employment benefit — **inconvertible into money** (the liability to pay is on the employer) — include: • Corporate membership of a club allowing employees to use club facilities • Employer employs a domestic helper for employee • Employer makes contract with utility company for supply of electricity, gas and telephone to employee • Employer takes group life insurance scheme for employees • Employer provides free medical / free lunch / free transportation etc. to employees • Employer hires a car and allow employees to use it.
- If employer gives the employee a **gift in recognition of work performance**,

the **second-hand value** of the gift (i.e. the open market value at the time of giving) is taxable, see **Wilkins v Rogerson** • Case analysis: Employer gives employee ParknShop **cash coupons** —they are taxable on face value.

- **Reward for service rendered**, whether it is for **past service** or **future service** is taxable, see **Hochstrasser v Mayes** • Case analysis: Money received by employee on signing of the employment contract is taxable. **Ex gratia** (ie. non-contractual) payment is taxable if it is a service reward.

- Payment for **acting as an employee, inducement to enter into an employment** contract, and **payment in lieu of notice** for termination of employment are taxable, see **Fuchs** Walter Alfred Heinz case. • Case analysis: The **bribes** received by an employee concerning his duties are taxable because they are payment for acting as employee • Payment which is **arising out of employment contract** and forms **part and parcel of remuneration package** is taxable, see **Murad** case.

- Payment made as a **gift on a special occasion** or based on **personal relationship** is not taxable • Examples include: gifts made on birthday, New Year, marriage, death, passing examination, retirement, annual dinner etc.

- **S9(2A)(b): School fee** paid by employer for education of employee's child is taxable even though the employer is liable to pay it.

- **S9(2A)(c)** concerns **holiday benefit**. The assessable amount of holiday benefit is the **actual expense paid** by employer in connection with the holiday journey of employee even though such benefit is not convertible into cash • If an overseas trip is substantially for business purpose, the whole journey is

exempt even part of the trip contains private portion • **DIPN 41**: If the private portion is significant and clearly identified, the expenses attributable to the private portion should be ascertained and taxable.

- **DIPN 41**: Payment for **relocation** of an employee to HK on commencement of employment and payment for the relocation of an employee out of HK are not taxable. These payments are **not reward for service**.

- **Compensation for loss of office** is not taxable • Case analysis: Is there **redundancy** due to **downsizing / closure / restructuring** of employer's business and **sudden termination** of the post/office **by employer**? • If the termination of office is initiated by employee or if the office is filled by a successor, there is no loss of office/employment, the compensation is taxable.

- Based on **Fuchs** principle, compensation for **work injuries** or for **damages in legal disputes / wrongful dismissal** of employee / **breach of employment contract / termination of contractual rights / remainder salaries** in employment contract for **unperformed services** — these payments are not taxable.

- According to **Pritchard** case, payment by a new employer for inducement of a person to **leave existing employment** is not taxable • Such payment is taxable if it is made to the person who has signed an employment contract with the new employer, see Fuch case.

- According to **Yung Tze Kwong** case, compensation for a leaving employee **not to compete with employer** is not taxable.

以上只是 qp module d taxation course 的部份筆記，給你作為參考。全部筆記及答題精要共 150 頁，會給與參加補習的學生。這些 taxation course notes 稅務課程筆記及 examination answer key 考試答題精要是基於本人 Raymond Yeung 多年的稅務工作，包括稅務教學及評卷經驗，以常考及可能考的題目，按評分準則 marking scheme，為了快速取分而編寫：筆記列出稅務考試內可能考的題目及其內容，與及能取分的要點 points。

同學請注意，對課題有全面及深入的認識是十分重要，最好是由我講解如何運用這些答題精要，及其餘未列入筆記的稅務知識。課題筆記及答題精要，會在補習有關題目時免費給與學生。想要齊我的答題筆記，就請你參加由我親自教授的補習班了，或直接購買全套筆記。詳情請到 [rytc.com.hk](http://rytc.com.hk)。

Click [here](#) for a Mock Exam Paper to test your ability in passing qp taxation.

Click [here](#) for examination skill in passing hkicpa qp module d taxation.

Copyright reserved by Raymond Yeung Tax Consultant

<http://www.rytc.com.hk/>