

THE ADVANCED DIPLOMA IN INTERNATIONAL TAXATION

June 2026

MODULE 2.04 – HONG KONG OPTION

SUGGESTED SOLUTIONS

PART A

Question 1

Royalty income and related expenses

Whether the royalty income received by BOL from GRT is taxable depends on whether the income is arising in or derived from Hong Kong.

Under DIPN No. 21, in determining the source of profits, the broad guiding principle is that one looks to see what the person has done to earn the profits in question and where the person has done it (Hang Seng Bank case). In other words, the proper approach is to identify the operations that produced the relevant profits and ascertain where those operations took place. The source of profits must be attributed to the operations of the person that produces them and not to the operations of other members of the person's group.

Under DIPN 22, if a person only obtains a license to use an intellectual property from its owner (i.e. the person has not obtained the proprietary interest of the intellectual property) and then sub-licenses the intellectual property to another person for use outside Hong Kong, the Commissioner will, in ascertaining whether the royalty income so derived is sourced in Hong Kong, take the place of acquiring and granting the license as the location of income. As such, if the person acquires in Hong Kong the license for use of the intellectual property and grants a sub-license in Hong Kong, the royalty income derived from sublicensing the intellectual property will be regarded as having been derived from Hong Kong. Such an approach is derived from the TVBI case. In the TVBI case, the taxpayer acquired rights to show films by contracts negotiated and entered into in Hong Kong. It then licensed such rights to its clients outside Hong Kong. The Privy Council held that the royalties paid by the overseas licensees were derived from Hong Kong and were therefore chargeable to Profits Tax under Section 14.

DIPN No. 21 and No. 22 state the source of the royalty income from Golden River Trading Ltd ("GRT") would be determined by looking at the place where the AGH-BOL license contract and BOL-GRT sub-license contract were effected. If both contracts were effected in Hong Kong, i.e., BOL acquired the right and granted the right in Hong Kong, the royalty would be regarded as sourced from Hong Kong. If either one contract is effected in Hong Kong, it is likely that the IRD takes the initial presumption that the entire royalties were derived from Hong Kong, subject to review of the totality of the facts of where the operation, which is more immediately responsible for the generation of the profits were carried out (Magna case refers). It is the IRD's practice that there will be no apportionment of profits, except for the cases of service income and manufacturing profits. However, the practice of non-apportionment is rejected by the Court of Appeal decision of the Patrick Cox case.

The ING Baring case states that, in determining the source of profits, one should identify the critical operation responsible for generating them. Accordingly, if either of the contracts is effected outside Hong Kong, and BOL can substantiate that the contract effected outside Hong Kong is more critical to generating the royalty income, the royalty income may be considered sourced outside Hong Kong. Alternatively, BOL may argue that at least a portion of the royalty income was derived outside Hong Kong.

The sub-license contract with GRL was negotiated and concluded in Hong Kong. BOL signed the contract in Hong Kong. There is no evidence indicating that any operation by BOL in relation to effecting the license contract with AGH outside Hong Kong. In the circumstances, BOL's royalty income received from GRT is likely to be regarded by the IRD as arising in and derived from Hong Kong and hence taxable.

If the royalty income derived from GRT is assessable, the corresponding annual royalty fee paid was incurred in the production of chargeable profits and hence is deductible under s.16(1).

BOL has incurred value-added tax (VAT) in the Mainland of HK\$300,000 (HK\$ 5 million x 6%) in the production of the royalty income from GRT. BOL has also paid income tax in the Mainland of HK\$350,000 (HK\$5 million x 7%). As the royalty income would be taxable in Hong Kong, income tax paid the Mainland would be creditable against the relevant profits tax payable in Hong Kong, subject to the credit limit of Hong Kong tax payable, under s.50. The VAT was incurred in the production of the chargeable royalty income and would be deductible under s.16(1).

Trading income and related expenses

The trading income from Hong Kong retail stores was derived from Hong Kong and is chargeable to profits tax. Whereas the operating expenses for the Hong Kong market and the annual royalty expense for the Hong Kong market were incurred in the production of chargeable trading income and are deductible under s.16(1).

Upfront royalty payment

The upfront royalty payment, both the portion for the Hong Kong market and the overseas market outside Hong Kong, was incurred to obtain rights for 10 years. It was paid for bringing into existence an advantage with enduring benefits for BOL. It also secures or enhances the profit-yielding structure of BOL. Hence, it would be capital in nature and non-deductible under s.17(1)(c) (British Insulated & Helsby Cables Ltd case and Aviation Fuel Supply Company Ltd case refer). S.16EA, which allows deduction of acquisition costs over 5 years or the remaining protection period of the specified intellectual property right (SIPR), does not apply to BOL's upfront payment. Per DIPN 49, para 46, the Inland Revenue Department (IRD) states that "deduction (under ss.16E and EA) would only be applicable to an outright purchase of a patent right, right to know-how or an SIPR and not to an upfront fee paid for acquiring the right to use for a specified period."

Calculation of BOL's Hong Kong profits tax payable on the royalty income after tax credit

	<u>HK\$</u>
Royalty income from GRT	5,000,000
Less:	
- Annual royalty expense to AGH – for the right to sub-license "Aqua" to GRT	-300,000
- Mainland China VAT on royalty income from GRT (6% of HK\$5,000,000)	-300,000
Net chargeable income re the royalty income	4,400,000
Tax payable before allowance of tax credit @16.5% (assuming two-tiered tax rate does not apply)	726,000
Less: tax credit	
Income tax paid in China	350,000
Tax payable after tax credit	376,000

Question 2

ACL, as a Mainland enterprise, is still likely to have Hong Kong profits tax exposure if a fixed place PE is found at the Client's premises, and the profits attributable to the PE are arising in or derived from Hong Kong. The source of the Hong Kong PE profits will be determined under Hong Kong's territorial rules (DIPN 21 and case law).

Fixed place PE in Hong Kong, source of profits, and profits tax exposure

Fixed place PE tests

Place of business / fixed / disposal: The Client's project rooms in Hong Kong are used as the base from which the consultancy project is executed, with a two year duration and ACL's contractual right to access, control entry and direct activities, so they are a specific, fixed place at ACL's disposal through which ACL's business is carried on, even though owned by the Client.

Unrelated subcontractor and ACL staff: OECD Commentary recognises that a PE can exist where subcontractors perform most activities from a place at the disposal of the enterprise bearing contractual responsibility; BAL's presence does not prevent the rooms being a PE of ACL, especially given ACL's project director's control and the regular two day every fortnight visits of ACL's consultants, which demonstrate that ACL's own business is conducted from that place.

Source of the profits – DIPN 21 and case law

Hong Kong taxes only profits "arising in or derived from" Hong Kong; locality is a practical hard matter of fact, determined by what the taxpayer has done to earn the profit and where those profit producing operations take place (Hang Seng Bank case, HK TVBI case, and DIPN 21 refer).

For service fee income, DIPN 21 para. 20(e) states that the source is generally the place where the services that give rise directly to the fees are performed; other supporting functions are ancillary. In cases like Board of Review D55/00, it was held that for a service provider, profits arose where the substantive services (e.g., processing/operational work) were performed, not where ancillary administration was performed.

Applied here

The consultancy fees from the Hong Kong Client are earned by providing strategic and operational consultancy services largely executed at the Client's premises in Hong Kong (by BAL under ACL's responsibility and by ACL's visiting staff). The core profit producing activities for this engagement are therefore performed in Hong Kong.

Even if some management, planning, and contract conclusion take place in the Mainland, those are likely to be viewed by the IRD as ancillary to the on site consultancy work in Hong Kong for this project. Under the DIPN 21/service income line of authorities, the profits from the Hong Kong project are prima facie Hong Kong sourced to the extent they arise from services performed in Hong Kong. However, if it can substantiate that the work at ACL's head office in the Mainland is also responsible for producing the consultancy fees, there may be an argument that a portion of the consultancy fee attributable to the services rendered outside Hong Kong was derived offshore and is non-taxable.

PE and profits tax exposure

Once a fixed place PE exists, Hong Kong is entitled under the China–Hong Kong DTA business profits article 7 to tax the profits attributable to that PE, but only to the extent those profits are Hong Kong sourced under the IRO.

Given the above locality analysis, a substantial portion of ACL's project profit – corresponding to services performed in Hong Kong via BAL and ACL's visiting staff – will both be attributable to the PE and have a Hong Kong source, therefore subject to Hong Kong profits tax.

Attribution of profits to the Hong Kong PE (including source and deductions)

Attribution and source combined

Under the China–Hong Kong DTA and Hong Kong's DIPN 60, profits attributable to a PE are those it would earn if it were a separate enterprise, based on a functional and factual analysis (functions, assets, risks) and arm's length pricing for dealings between the head office and PE.

For Hong Kong tax, after determining the PE's notional profits under this separate enterprise approach, the IRD still applies the locality test: only the portion of those attributed profits arising from services performed in Hong Kong will

be chargeable. In a project specific PE like this, the attributed PE profits will largely align with Hong Kong sourced consultancy profits.

Subcontracting fees to BAL

Economically, the Hong Kong PE is the contracting party earning Hong Kong sourced consultancy income and, in turn, purchasing subcontracting services from BAL. On a separate enterprise basis, the PE should deduct arm's length subcontracting charges as business expenses.

DIPN 21 confirms that for service providers, the source of the PE's fee income is where the services are performed; the subcontracting fee is an expense incurred in the production of the Hong Kong sourced fee income and hence is deductible under s.16(1).

Head office expenses

The China-Hong Kong DTA and OECD authorized approach, as reflected in DIPN 60, allows a reasonable allocation of head office management, administration, and support expenses to the PE, based on appropriate keys (e.g., time spent, project revenues or costs), so that the PE's profits reflect an arm's length return after bearing its share of global overheads.

For Hong Kong profits tax purposes, these allocated expenses are deductible to the extent they are incurred in the production of the PE's Hong Kong sourced profits and are not capital, excessive, or unsubstantiated. DIPN 21 stresses that what matters for the source is what is done to earn the profit and where; the fact that some overhead is incurred outside Hong Kong does not prevent deduction where it supports profit producing services in Hong Kong.

So, in practice, the Hong Kong PE's assessable profits would be broadly calculated as follows:

- Hong Kong sourced consultancy income from the Client attributable to the PE
- minus arm's length subcontracting fees to BAL (for Hong Kong work)
- minus an appropriate allocation of head office management and administration supporting this Hong Kong project
- adjusted for any other arm's length internal dealings and source refinements (e.g., excluding profits clearly arising from services performed wholly outside Hong Kong).

PART B

Question 3

To BHH

Taxability of the lease rental under s.15(1)(d)

Section 15(1)(d) deems as taxable trading receipts “sums received by way of hire, rental or similar charges for the use of movable property in Hong Kong or the right to use movable property in Hong Kong”.

The weaving machines are movable property, and AML physically used them in Hong Kong; the payments from AML to BHH are lease rentals for the right to use that movable property in Hong Kong.

Section 15(1)(d) applies even where the recipient does not carry on a trade or business in Hong Kong; it is designed to bring such lease rentals into the Hong Kong tax net as deemed trading receipts.

Therefore, the gross rentals (subject to any allowable deductions where applicable) received by BHH from leasing the machines to AML for use in Hong Kong will be deemed Hong Kong sourced profits chargeable to profits tax under s.15(1)(d).

Deduction of the machine acquisition costs and application of s16G

The machine cost is capital in nature and not deductible under s17(1)(c).

S.16G allows an outright deduction for capital expenditure on prescribed manufacturing plant and machinery, but it excludes assets that are “subject to a lease” from being treated as prescribed fixed assets.

After the sale-and-leaseback, the machines will be subject to a lease; therefore, AML cannot claim a 16G deduction for expenditure on these leased machines.

Deduction of depreciation allowances (DA)

S.39E(1)(a) denies initial and annual depreciation allowances to a lessor on machinery or plant where a person holds rights as a lessee, and that lessee (or an associate) previously owned the asset or uses it outside Hong Kong.

Here, after the sale to BHH, BHH will be the legal owner-lessor, and AML will hold rights as lessee under the three-year leaseback. And AML previously owned and used the machines.

This fits squarely within the mischief targeted by s.39E, which was enacted specifically to limit tax avoidance through sale-and-leaseback arrangements.

BHH will be denied DA on the weaving machines under s.39E(1)(a).

AML

General anti-avoidance provisions

S.61 empowers an assessor to disregard any transaction or disposition if the assessor is of the opinion that the transaction reduces or would reduce a taxpayer's liability and the transaction is artificial or fictitious or is not given effect to.

No definition was given in the IRO of the meaning of “artificial” or “fictitious”. One has to look at the literal meaning and cases.

In *Seramco Trustees v Income Tax Commissioner* (1977): A fictitious transaction is one which the parties to it never intended should be carried out. An “artificial” transaction means a commercially unrealistic transaction in D44/92. A transaction cannot be said to be artificial or fictitious if it was in fact carried out (*CIR v Douglas Henry Howe* (1977)). Given these case-law principles, it is not easy to conclude that a transaction is artificial or fictitious, and hence to apply s.61.

Payments of excessive management fees have been disallowed in various Board of Review cases, such as D61/91, D110/98, and D32/94, under s.16(1). If the assets are sold to the finance company, BHH, at an inflated price (the taxable balancing charge is restricted to the previously granted allowance) and leased back at an inflated rental fee,

s.16(1) may disallow the deduction of the excessive lease fee payment. However, if the lease fee payment is at arm's length, ss. 16(1) and 61 may not apply.

Under s.61A, an Assistant Commissioner (AC) is empowered to raise an assessment on a taxpayer if the AC, having regard to the seven factors (form, substance, timing, participation of associates, changes in financial position, etc.) stipulated in the section, concludes that a transaction has been entered into which has the effect of conferring a tax benefit upon a taxpayer, and the transaction was entered into for the sole or dominant purpose of obtaining that benefit. The assessment can be raised (i) as if the whole transaction or part of it had not been entered into or carried out; or (ii) in any other manner considered appropriate to counteract the tax benefit.

To apply s.61A, there must be a tax benefit, and the sole or dominant purpose of the transaction is to obtain such tax benefit.

“Tax benefit” is regarded as being obtained if a tax liability is being “avoided,” a tax liability is being “postponed,” or a tax liability is being reduced.

In this situation, the financing arrangement would lead to the deduction of the inflated lease rental to AML if the anti-avoidance rule were not in place. The lease rental is taxable to BHH but would be offset by its tax loss. Consequently, a tax benefit would occur. Regardless of the lease rental level, there would be no impact on the group's overall financial position since AML is fully owned by BHH. Having reviewed the seven factors, especially the change in financial position, the Assistant Commissioner would likely conclude that obtaining the tax benefit is the primary or main purpose of the transaction and invoke s.61A. The possible outcome might be a purposive interpretation of s.16(1), permitting only the deduction of the lease rental up to the market level, meaning the 10% premium would be disallowed.

Question 4Profits Tax computation for the year of assessment 2024/25

Basis Period: Year ended 31 March 2025

HK\$

Net profit before tax	16,900,000
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Add:

- Legal fees for the initial office tenancy agreement	60,000
- Legal fees for appealing against the profits tax assessment	40,000
- Write off a staff loan (principal)	19,000
- General provision for bad debts	10,000
	17,029,000

Less:

- Interest from RMB sovereign bonds	-300,000
- Refurbishment cost of the warehouse (20% x \$2,500,000)	-500,000
- Additional deduction for Type B research and development expenses	-1,000,000
- Registered trademark acquisition cost (20% x 5,000,000)	-1,000,000

Assessable profits	14,229,000
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Treatment of product research expenses and legal fees

Under s.16B, Type B qualifying research and development expenses are eligible for enhanced deduction, i.e. 300% deduction for the first \$2,000,000, and 200% deduction for the amount exceeding \$2,000,000. Type A qualifying research and development expenses are 100% deductible, but not eligible for an enhanced deduction. Staff salaries and payments to the local research institute are Type B, whereas the research director's remuneration is Type A. The additional deduction for Type B expenses is $\$500,000 \times 300\% - \$500,000 = \$1,000,000$.

The legal fees for preparing the initial tenancy agreement were incurred to bring into existence an advantage for the enduring of the company, and hence are capital in nature and non-deductible under s.17(1)(c) (British Insulated & Helsby Cables Ltd case). The legal fees on appealing against the profits tax assessment were incurred "after" the production of assessable profits, rather than "in" the production of assessable profits, and hence were not deductible under s.16(1).

PART CQuestion 5Property Tax Computation for the year of assessment 2024/25

	\$
Rent (\$17,000 x 12)	204,000
Lease premium (\$60,000 x 12/24)	30,000
Recovery of irrecoverable rent	20,000
Assessable value	254,000
Less:	
- Rates (\$2,500 x 4)	-10,000
- 20% statutory deduction	-48,800
Net assessable value	195,200
Property tax at 15%	29,280

Lodging an objection under the Inland Revenue Ordinance

Under s.64(1), a valid objection should be made in writing, stating precisely the grounds of objection, received by the CIR, submitted within 1 month after the date of the notice of assessment, and accompanied by a valid return if the objection is made against an estimated assessment raised under section 59(3) due to non-submission of tax return.

Late objection is accepted if the CIR is satisfied that the taxpayer is prevented from giving notice of objection due to absence from Hong Kong, sickness, or other reasonable causes.

In this case, as the notice of assessment was issued more than 3 months ago, the assessment could have been regarded as final and conclusive. There is no reasonable excuse for a late objection.

S.70A provides that an assessment that has become final and conclusive can be reopened if it is:

- established to the satisfaction of an assessor that the tax charged is excessive by reason of:
- error or omission in any return or statement submitted, or
- arithmetical error or omission in the calculation of income or profit or tax charged

There is a time limit, of 6 years after the end of the year of assessment concerned or 6 months after the date of notice of assessment issued (whichever is the later).

Since Antonia has omitted to put down information about the rates deduction in the tax return, she could lodge a claim under s.70A to open the assessment and deduct the rates within 6 years after the end of that year, i.e., not later than 31 March 2031.

Question 6P Co.

For a business commenced on or after 1 April 1974 that changes its accounting date:

- The year of assessment in which the change occurs:
 - The Commissioner selects a basis period “as he thinks fit” under s.18E(1), typically using the accounts made up to the new accounting date (which may produce a basis period shorter or longer than 12 months).
- The preceding year of assessment:
 - The Commissioner may, but need not, recompute the basis period under s.18E(2); IRD practice is not to recompute if the existing assessment already gives a fair result and total lifetime profits will still be fully brought into charge.
- Over the life of the business, the IRD ensures that the aggregate assessable profits are not less than the total commercial profits, using the discretion under s18E(2)(b) to adopt a basis period exceeding 12 months if necessary.
- Where the change of accounting date is made for a compelling commercial reason, such as aligning the subsidiary’s year-end with that of a new parent following a change in shareholding, the IRD generally accepts the new year-end and applies section 18E on the above basis, without invoking anti-avoidance provisions

Based on the above rules, the basis period for P Co. Ltd. for the year of assessment 2023/24 would be less than 12 months because there is a compelling reason for the change of accounting year-end date, as follows:

1 April 2023 to 31 December 2023, a 9-month period.

Computation of the profits tax payable for the year of assessment 2024/25

Basis period: 1 January 2024 to 31 December 2024

	<u>HK\$</u>
Losses b/f *	-1,400,000
Assessable profits	2,000,000
Net assessable profits (after setting off tax loss b/f)	600,000
Profits tax payable before tax reduction@8.25%	49,500
Tax reduction (100% of the tax payable, limited to \$1,500)	-1,500
Profits tax payable after tax reduction	48,000

*Assuming the IRD adopts 1 April 2023 to 31 December 2023 (i.e., a 9-month period) as the basis period for 2023/24, and allows the entire amount of the tax loss to be carried forward, given there is a compelling reason for the change of accounting date.

Chan & Co**Depreciation allowance for wastewater treatment machine (30%) for the year of assessment 2024/25**

	\$	\$
Cost (400,000 + 44,000 + 10,000)	454,000	
Less:		
- Initial allowance (44,000 + 10,000 + 100,000 + 20,000* x 6) x 60%	-164,400	164,400
- Annual allowance	-86,880	86,880
WDV carried forward (2024/25)	202,720	251,280

*Being cash price less down-payment, then spread over 15 instalments = $(\$400,000 - \$100,000) / 15 = \$20,000$

The hire-purchase interest of $(\$24,000 - \$20,000) \times 6 = \$24,000$ was deductible under ss. 16(1)(a) and (2)(e).

Question 7

S.8(1)(a) imposes a charge to salaries tax on income arising in or derived from Hong Kong from any office or employment of profit. If the location or source of a person's office or employment is in Hong Kong, any income arising from that office or employment is chargeable to salaries tax, except those specifically exempt. If the source of a taxpayer's income from employment is outside Hong Kong, he is chargeable to salaries tax only on income derived by him from services rendered in Hong Kong (s.8(1A)(a)).

Before Mr Lee's claims are addressed, the sources of his employment have to be examined. For the source of employment, DIPN No. 10 states that the IRD will take into account all the relevant facts, with particular emphasis on the following factors:

- The place where the contract of employment was negotiated, entered into and enforceable.

Mr Lee signed the employment contract when he arrived here. It should be regarded that the place where the contract was entered into is Hong Kong.

- The place of residence of the employer.

Since a separate employment contract was signed with the Hong Kong subsidiary, the new employer is the Hong Kong subsidiary, not the Canadian company.

- The place where the employee's remuneration is paid.

Although the monthly salary was paid partly in Canada and partly in Hong Kong, the IRD may regard the location where the larger amount is paid as the relevant place of payment. In this case, it is Hong Kong. However, it should also be noted that "remuneration" is not restricted to the monthly salary; it includes all perquisites and benefits in kind that are included in the definition of income in s.9(1)(a).

Under s.9(1)(b), for the reimbursement of rental payments, the taxable amount is the rental value, which is calculated as 10% of the income from the employer described in s.9(1)(a) after deducting allowable outgoings, expenses (s.12(1)(a)), and depreciation allowances (s.12(1)(b)). The income used to determine the rental value excludes termination lump sum payments. If the rent paid exceeds the rental reimbursement, the excess may be deducted from the rental value.

The reimbursement of personal travel expenses was derived from employment, for services provided, and in money's worth (i.e., discharging his personal liability). Therefore, it would be taxable (s.9(1)(a) and DIPN 41 refer).

Based on the above analysis, Mr Lee's employment should be in Hong Kong.

Mr Lee's claims

Mr Lee claimed that during the year of assessment 2023/24, he should not be subject to salaries tax since he did not work in Hong Kong for more than 60 days. Although he had stayed in Hong Kong for only 46 days (15 February to 31 March 2024), the stay marked the beginning of a long period of residence in Hong Kong and is neither short nor temporary. It therefore does not come within the ordinary meaning of the word "visit" and cannot be ignored. Hence, his claim for exemption under ss.8(1A)(b) and 8(1B) fails.

For the year of assessment 2024/25, his claim that his income attributable to services rendered in the Mainland of China should be exempt from tax fails because his employment is a Hong Kong-sourced employment and the "day-in-day-out" apportionment of income is not applicable.

With respect to the 60-day visit rule exemption, it applies only if the taxpayer is treated as making a "visit" while staying in Hong Kong. In Mr Lee's case, he returned to Hong Kong with his whole family. In practice, the IRD would consider his social and economic ties to determine whether his intention to stay in Hong Kong is short-term/temporary or permanent. It seems his work and family are primarily located in Hong Kong. Even though he worked in Hong Kong for 55 days in 2024/25, the IRD would not regard him as a visitor under the 60-day visit rule for 2024/25. On this basis, he will be subject to salaries tax on the whole of his employment income.

Regarding the China tax paid, he may claim a tax credit under s.50 pursuant to the double taxation arrangement concluded between Hong Kong SAR and the Mainland of China to set off the China tax paid against the Hong Kong tax payable. S.8(1A)(c) exemption does not apply to the case as the Mainland of China and Hong Kong SAR have signed a tax arrangement.

Question 8Cheung Kee Ltd

	<u>\$</u>	<u>Y/A</u>
Qualifying expenditure	5,000,000	
Less:		
- Initial allowance at 20%	-1,000,000	
- Annual allowance (ind. building) at 4%	-200,000	2020/21
- Annual allowance (com. building) at 4%	-160,000	2021/22
- Annual allowance (ind. building) at 4%	-200,000	2022/23
Residue before sale	3,440,000	

Notes:

- For the year of assessment 2021/22, as the building was not used as an industrial building, no annual allowance as an industrial building would be available to the company. Instead, the company may claim a deduction of the annual allowance for a commercial building. Commercial building allowance shall be based on the cost of construction of \$4 million, i.e., annual allowance (commercial building allowance) is 4% x \$4,000,000 = \$160,000.
- Proviso to s.35(2) provides that no balancing allowance shall be made where the industrial building is demolished for purposes unconnected with or not in the ordinary course of conduct of the trade or business for the purposes of which the building was used in circumstances qualifying for industrial building allowances. Cheung Kee Ltd is a garment manufacturer. The redevelopment of the property for resale to the public is clearly outside the normal scope of its business. Consequently, the aforesaid proviso would apply, and no balancing allowance shall be made to it.

Keen Tai Ltd

	<u>\$</u>
Qualifying expenditure	20,000,000
Less:	
- Initial allowance at 20%	-4,000,000
- Annual allowance at 4% (Y/A 2024/25)	-800,000
WDV c/f	15,200,000

Note: S.35B (b)(ii) provides that if the industrial building is not purchased from a person whose business is the development and sale of properties, the allowances are based on the lesser of the purchase price for the building (excluding the value of the land) or the actual cost of construction to the vendor. Therefore, the allowances to Cheung Kee Ltd are based on \$20 million. However, if it is successfully argued that Cheung Kee Ltd has changed its main business into the development and sale of properties, then \$30 million could be used instead.