

Answer-to-Question-_1_

1)

Taxability of the royalty income

BOL carried on business in Hong Kong and the royalty income earned from sublicensing Aqua to GRT is likely to be chargeable to Hong Kong profits tax according to Section 14 of the Inland Revenue Ordinance (IRO). As outlined in the Departmental Interpretation and Practice Notes (DIPN) 21, for royalty income derived from licensing/sublicensing an acquired right, the source of such income is the place where the license/sublicense agreement was effected. In BOL's case, all the negotiations, approvals and contractual execution of the sublicensing contract were handled by BOL's Hong Kong staff in Hong Kong. Based on such, it is considered that the royalty income is likely to be regarded as arising in or derived from Hong Kong, hence chargeable to Hong Kong profits tax.

Deductibility of related expenses

The following expenses are considered as being related to the royalty income:

The \$300,000 annual royalty expense to AGH, for the right to sublicense Aqua to GRT - this expense is considered as directly associated with the royalty income received from GRT and is likely deductible under Section 16 (1) of the IRO, considering that such expense was incurred in producing the royalty income received from GRT, which is likely chargeable to Hong Kong profits tax.

The \$300,000 Mainland China withholding VAT on royalty income from GRT is also likely deductible as such tax expense was charged on the gross royalty income, therefore could be considered as being incurred in the production of the royalty income received from GRT.

The \$350,000 withholding income tax on royalty income from GRT should not be treated as an ordinary expense deduction similar to the treatment of the \$300,000 Mainland China withholding VAT. A more appropriate treatment of such withholding income tax in Hong Kong is a tax credit relief under Section 50 of the IRO as well as the Arrangement between the Mainland China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation, given that the royalty income is likely taxable in both Hong Kong and Mainland China.

2)

Taxability of the trading income from Hong Kong retail stores

BOL operates retail stores in Hong Kong, therefore, it is clear that both the business operations and the source of the trading profits of BOL are in Hong Kong. BOL is considered carrying on business in Hong Kong. Under Section 14 of the IRO, the trading income of BOL from Hong Kong retail stores should be fully taxable in Hong Kong as such income from the trading business is considered arising in or derived from Hong Kong.

Deductibility of related expenses

The following expenses are considered as being related to the trading income:

The \$600,000 annual royalty expense to AGH, for using in Hong Kong stores is likely deductible under Section 16(1) of the IRO, as the payment is an annual recurring payment for the use of the brand in the Hong Kong retail stores and considered being incurred in generating taxable trading income in Hong Kong. Based on such, such royalty expense is considered revenue in nature.

The \$200,000 operating expenses for Hong Kong market appears to be expenses incurred for carrying on the trading operations in Hong Kong as it is labeled as for Hong Kong market. In that case, they are also likely deductible under Section 16(1) of the IRO, as they are considered ordinary expenses incurred in operating the Hong Kong taxable retail store trade.

3)

The upfront royalty payment was made for the initial assignment of the rights for ten years. This may indicate that the payment was not a recurring payment for current use but for acquiring a profit-making asset. A lump-sum payment for obtaining certain rights for an extended period of time is typically considered as having the characters of an acquisition costs. On this basis, there is a possibility that the Inland Revenue Department (IRD) deem such upfront royalty payment as capital in nature and non-deductible.

To conclude, under Section 16(1) and Section 17(1)(c), it is likely that the IRD denies the deduction of the upfront royalty payment considering its capital nature.

4)

The tax payable in relation to the royalty income from GRT is calculated below:

Item	\$		
Royalty income from GRT	5,000,000		
Less:royalty expense to AGH	300,000		
Less: Mainland withholding VAT	300,000		
Assessable profits	4,400,000		
Profits tax at 16.5%	726,000		
Less:Mainland tax credit	350,000		
Net Hong Kong profits tax payable	376,000		

Answer-to-Question-_2__

1)Based on the existing tax rules in Hong Kong and the OECD, a fixed place PE exists if there is a fixed place of business in Hong Kong that is at the disposal of the company and through which the business of the company is carried on.

Based on the facts that 1)the project rooms at the Client's office in Hong Kong appear to be at the disposal of ACL; and 2)the project rooms/facilities are for the exclusive use of the project team, including ACL, on an as-needed basis; 3)ACL controls who may enter the project rooms and directs the project schedule; 4)ACL's senior consultants use the project rooms on a regular basis, these facts suggest that ACL may create a fixed place PE in Hong Kong.

The IRD could be of the view that ACL carries part of its consulting service business through a fixed place of business in Hong Kong that is at its disposal, while ACL is the sole contracting party to the Client in Hong Kong and retains overall responsibility of the project. The fact that ACL subcontracts a substantial part of its on-site work to BAL does not shield ACL from its PE risk exposure in Hong Kong.

To sum up, under the IRO and the OECD principles, it is likely that ACL has established a fixed place PE in Hong Kong.

2)Assuming ACL has established a fixed PE in Hong Kong, the profits attributable to the PE should be determined as it was a separate legal entity based on the PE rules in Hong Kong (e.g., DIPN 60) as well as the OECD guidance (e.g., the Authorised OECD Approach) in accordance with the functions performed. risks assumed as well as assets employed by the Hong Kong PE.

For the subcontracting fees paid by ACL to BAL, it is likely that they are deductible in calculating the assessable profits of the PE in Hong Kong, under the conditions that 1)such subcontracting fees are incurred

in generating chargeable Hong Kong income; and 2) the fees are priced at arm's length.

For the appropriate share of ACL's overall expenses (e.g., management, administration and support functions), it is likely that these expenses are deductible under the conditions that 1) such expenses are incurred in generating chargeable Hong Kong income; and 2) the expenses are attributable to the Hong Kong PE assuming that the basis for allocating the expenses to the Hong Kong PE is supportable and reasonable according to the PE provisions in Hong Kong.

To conclude, assuming that there is a fixed place PE in Hong Kong for ACL, the profits attributable to such PE should be determined as it is a separate entity based on the prevailing PE rules in Hong Kong and the OECD principles. Deduction for the subcontracting fees paid to BAL as well as a fair share of ACL's overall expenses may be deductible under the conditions set out above.

Answer-to-Question-3__

1)

Taxability of the lease rental for BHH

Since BHH has been leasing machines in Hong Kong for several years, it is considered carrying on a leasing business in Hong Kong. Based on Section 14 of the IRO, rental income from movable properties is sourced from where the movable properties are used. As the weaving machines are used by BHH in Hong Kong, the lease rental for BHH is chargeable to Hong Kong profits tax.

Deductibility of the weaving machines' acquisition cost

The weaving machines were acquired by BHH for leasing instead of trading. Hence, the acquisition cost incurred by BHH is likely considered capital in nature instead of revenue in nature. According to Section 16(1), the acquisition cost is likely not deductible for Hong Kong profits tax purposes.

Entitlement to depreciation allowance for the weaving machines

As mentioned above, in general, the weaving machines are likely considered as capital assets which are entitled to depreciation allowance.

Having said that, BHH may not be able to obtain allowances based on Section 39E of the IRO. The reason being that the weaving machines were already owned and used by AML before being sold to BHH. After the sale, AML would then lease the machines from BHH, which is considered an associate to AML. Since AML purchased the machines at \$1 million each and proposed to sell the same to BHH at \$1,100,000 each, which is higher than the original purchase costs of the machine, the genuine lease-financing exception may not be applicable here. As such, BHH may not be entitled to depreciation allowances for the weaving machines.

2) There are multiple anti-avoidance provisions that may be applicable to the deduction of the lease rentals of AML, namely Sections 61A as well as 16(1).

Under Section 61A, multiple statutory factors need to be considered when looking at an arrangement, such as the form and the substance of the arrangement, the financial results produced by the arrangement, the transfer pricing, etc. Under the arrangement involving AML, there appears to be a tax benefit for the lease paid by AML, which is 10% higher than the market leasing rate, inflating the lease expense deduction to be made by AML. The IRD could be of the view that the set-up of the lease arrangement involving AML is for obtaining a tax benefit in Hong Kong.

Under Section 16(1), there is a possibility that the IRD disallows deduction of the inflated portion of the lease expenses to be paid by AML (e.g., the 10% increment on the prevailing market leasing rate) and only allows deduction of expenses incurred in producing chargeable profits.

Answer-to-Question-5__

1) Under Section 5 of the IRO, Antonia is chargeable to property tax on the assessable value of the property and the assessable receipts for the year of assessment 2024/25, which is the year ended 31 March 2025.

The property tax liability of Antonia is calculated as follows:

	Working	\$	
Rent from Apple	17,000x12	204,000	
Lease premium	60,000x12/24	30,000	
Recovered rent from Winnie		20,000	
Total assessable value		<u>254,000</u>	
Less:			
Rates		10,000	
Net assessable value		<u>244,000</u>	
Less: statutory allowance	244,000x20%	48,800	
Net assessable value		<u>195,200</u>	
Property tax at 15%	195,200x15%	<u>29,280</u>	

2) Under Section 64 of the IRO, a valid objection must be made in writing to the IRD and the grounds of objection should be clearly stated. The objection should be lodged within one month after the date of the notice of assessment. In Antonia's case, the notice was issued on 10 July 2025. Assuming today is 1 November 2025, the deadline for lodging an objection has already lapsed.

Having said that, Antonia could still lodge a late objection where an explanation about the late objection needs to be made but it is likely that such a late objection may not be accepted by the IRD.

Alternatively, Antonia could make an application for correcting an omission/error, of which her case (e.g., forgetting to claim the rates deduction) may fall under the definition, under Section 70A of the IRO. Typically, the application under Section 70A has a longer timeline of within 6 years after the end of the year of assessment, or within 6 months after the assessment becomes final and conclusive, whichever is the later.

Answer-to-Question- _7__

For YA 2023/2024

It is very unlikely that Mr Lee will be successful in his claims for YA 2023/2024 just because he worked in Hong Kong for fewer than 60 days.

Mr Lee moved to Hong Kong to take up a position for three years as the CEO of the subsidiary in Hong Kong. He came to Hong Kong with his wife and children and terminated his employment with the Canadian company. All these facts above indicate that the move by Mr Lee is a relocation instead of a visit for fewer than 60 days. As such, the 60-day exemption would likely not stand.

Additionally, as Mr Lee entered into an employment contract with the Hong Kong subsidiary. The employment contract was effected in Hong Kong and the salary was paid by the Hong Kong subsidiary. All these facts entail that the employment of Mr Lee is a Hong Kong employment.

For YA 2024/2025

It is very unlikely that Mr Lee will be successful in his claims for YA 2024/2025 as well. Exemption under Section 8(1A)(c) is not applicable to income derived from services rendered in a DTA territory. Since Mainland China is a DTA territory, exemption cannot be claimed.

As mentioned above, as the employment of Mr Lee is a Hong Kong employment, his employment income is taxable in Hong Kong. In that case, he should instead obtain a relief through tax credit on his Mainland portion of income under Section 50 of the IRO as well as the Arrangement between the Mainland China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation.

Taxability of reimbursements for rental payments and personal travel expenses

For the rental payments, it shall be treated as a housing benefit

instead of salaries as part of the employment income, meaning that the salaries tax is based on rental value with any rent paid by the employee himself/herself qualifying for deduction.

For the reimbursement for personal travel expenses, they may be considered as a personal benefit from his employment and being taxable.