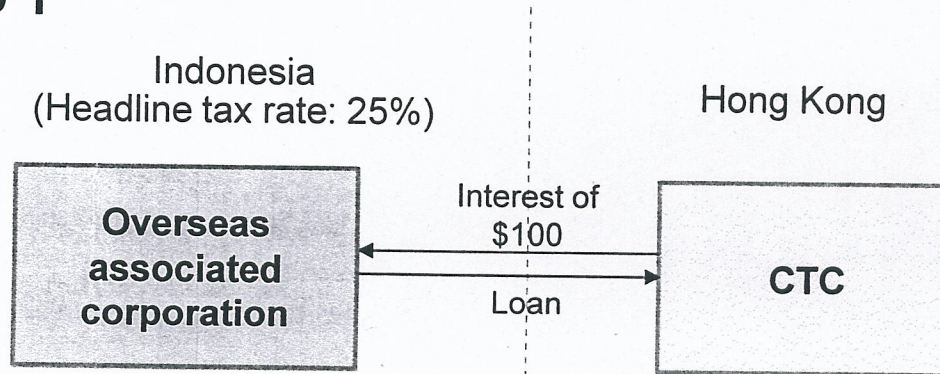


Application of the “subject to tax” condition

Scenario 1

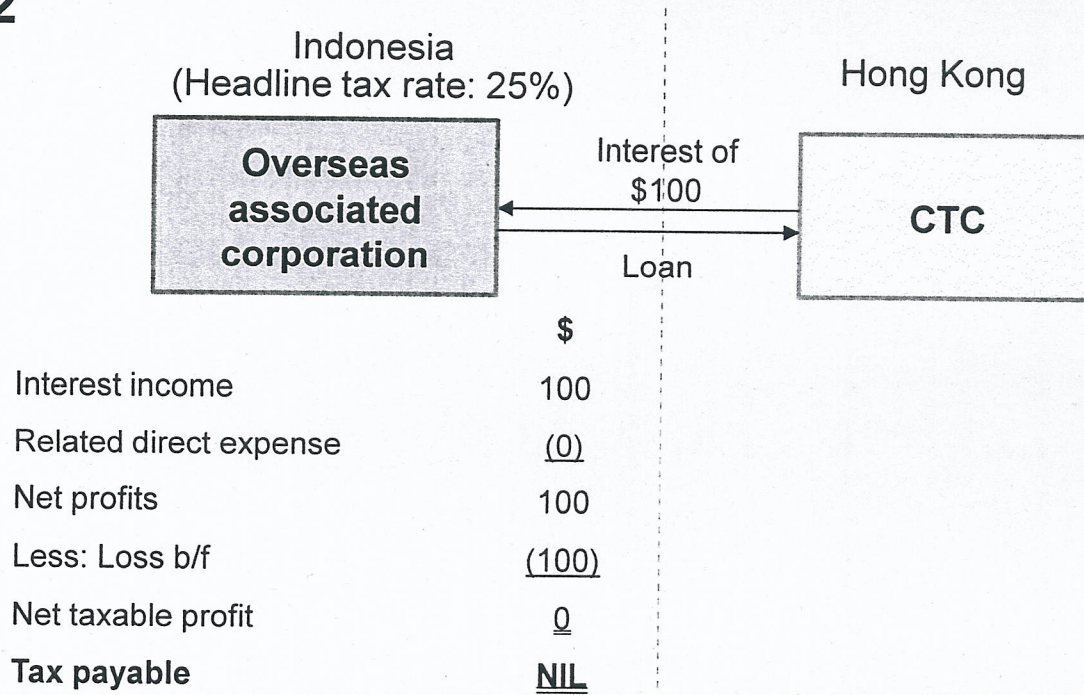


| | |
|------------------|-------------|
| | \$ |
| Interest income | 100 |
| Interest expense | <u>(60)</u> |
| Net profit | <u>40</u> |
| Tax payable | <u>10</u> |

| Possible interpretations | | Deductibility of interest paid by the CTC |
|---|--|---|
| 1. Tax rate paid in respect of gross interest income (ignoring the deduction of direct expense so long as tax has been paid on the net profit): | 25% | Deductible |
| 2. Tax rate paid in respect of net profits derived from the gross interest income: | 10%, which is lower than the reference rate of say 16.5% | Not deductible |

Application of the “subject to tax” condition

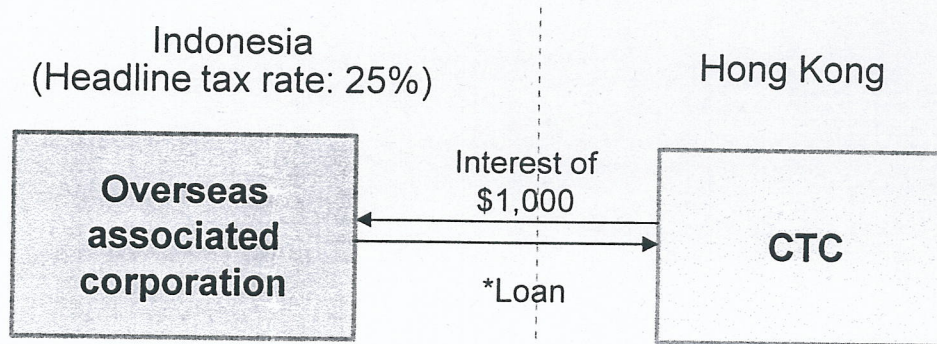
Scenario 2



| Possible interpretations | | Deductibility of interest paid by the CTC |
|---|-----|---|
| 1. Tax rate paid in respect of the interest income (ignoring the utilization of the tax loss, as such utilization would result in higher taxes being paid in subsequent years): | 25% | Deductible |
| 2. Tax rate paid in respect of the interest income after tax losses: | Nil | Not deductible |

Application of the “subject to tax” condition

Scenario 3



| | Year 1 | | Year 2 |
|---|----------------|--|--------------|
| | \$ | | \$ |
| Interest income | 1,000 | | -- |
| Operating (loss) from other business transactions | <u>(1,000)</u> | Operating profits from other business transactions | <u>2,000</u> |
| Tax payable | <u>NIL</u> | Tax payable | <u>500</u> |

| Possible interpretations | Deductibility of interest paid by the CTC |
|--|---|
| 1. The tax rate of 25% paid in Year 2 is in a way attributable to the interest income of HK\$1,000 received in Year 1. | Deductible |
| 2. No tax is paid when the interest income is received in Year 1. The tax paid in Year 2 is in respect of other business transactions in Year 2. | Not deductible |