

Bills Committee on Inland Revenue (Amendment) Bill 2000

Follow-up actions arising from the discussion at the meeting on 29 April 2004

Purpose

This paper presents the information enquired after by Members at the meeting on 29 April 2004.

Clause 4 – Adjustments to Assessable Income

2. A total of nine institutions have been approved by the Commissioner of Inland Revenue under the existing section 12(6)(d)(i)(F) of the Inland Revenue Ordinance (Cap. 112) (IRO) as approved institutions since this section came into effect in 1996 (institutions number 1 to 9 in *Annex A* refer). So far, no application as approved institutions under the section has been rejected.

3. In addition to the nine institutions mentioned above, the Commissioner has also approved for the purpose of self-education expense deduction under 12(6)(d)(i)(F) schools which are exempted by the Permanent Secretary for Education and Manpower from registration under section 9(5) of the Education Ordinance¹. Currently, there are 258 such schools.

4. The criteria used in assessing applications are set out at *Annex B*. The intention is to apply the same set of criteria under the proposed section 12(6)(e).

Clause 6 – Ascertainment of Chargeable Profits

5. As explained at the last meeting, subsection 16(2)(f) was introduced in 1986 in response to a call by the industry to relax the

¹ Fees in respect of courses of education undertaken to gain or maintain qualifications for use in any employment and provided by any school registered under section 13(a) or any school exempted from registration under section 9(1) of the Education Ordinance can already be deducted under the existing 12(6)(d)(i)(C) and (D) of the Inland Revenue Ordinance.

interest expense deductibility to cover funds flowing from public issues of debentures and marketable commercial papers even when the ‘tax symmetry’ rule is not met. While no explicit restriction was set out in the provision in respect of borrowings between companies in the same group, it was clear from the provisions of that section that the policy intention was to extend the interest deductibility only to public issues (i.e. to non-associates of the issuer) of debt securities as opposed to private ones (i.e. associates) and only to interest on external borrowings instead of internal ones. Unfortunately, the drafting of the existing 16(2)(f) fails to reflect the full policy intent.

6. A few years after the enactment of section 16(2)(f), aggressive tax avoidance schemes exploiting this loophole and other loopholes to be dealt with under other provisions of this Bill began to emerge. These schemes have grown in both number and size over the last several years. According to statistics of the Inland Revenue Department (IRD), the profits tax liability involved in these questionable transactions which is being investigated by the department (by challenging the interest deduction claims lodged by taxpayers with the use of the general anti-avoidance provision) amounted to \$6 billion in the past 6 years. Out of these, \$1 billion is attributable to schemes involving debenture interests in 7 cases under section 16(2)(f). The bulk of the companies involved are in one particular sector of the economy. Some other cases are still under investigation with the quantity of tax involved yet to be assessed. These figures however only partly reflect the real situation, because there are avoidance plans that are more sophisticated and which IRD is not adequately empowered to tackle under the existing general anti-avoidance provisions.

7. Information on back tax assessed on tax avoidance schemes relating to interest deduction claims showing a breakdown on tax amounts recovered on finalised cases and tax amounts on the not-yet-finalised cases from 1997 up to 31 March 2004 is set out at *Annex C*.

Inland Revenue Department
May 2004

**List of Education Providers Approved by CIR
under section 12(6)(d)(i)(F)**

1. Hong Kong Productivity Council
2. The Arts School of Hong Kong Arts Centre
3. Charmtime Limited – Pang’s Music Therapy Centre
(Note: only teachers enrolled can claim SEE deduction)
4. The Continuous Learning Centre of Vocational Training Council
5. Top Express Consultants Limited – Rigos US CPA Review
6. Hong Kong Trade Development Council
7. Phillip Institute of Financial Learning Co. Limited
8. Physical Fitness Association of Hong Kong, China Limited
9. International Health and Fitness Institute
10. Schools exempted under section 9(3) and (5) of the Education Ordinance (Cap. 297) (total 258 schools)

**Criteria used by the Commissioner in approving “institution”
under section 12(6)(d)(F) and to be used under the proposed section
12(6)(e)**

1. “Institution” is given its dictionary meaning. It means “an establishment, organization or association instituted for the promotion of some object”. For local institutions, it is expected to be either a company incorporated under the Companies Ordinance, a society registered under the Societies Ordinance or a statutory body established under a specific ordinance. If it is an overseas entity, it should be constituted in a similar manner. For purposes of section 12(6), the establishment, organization or association must have been formed with the primary object of promoting education or trade or professional skills and techniques.
2. Being an establishment, organization or association, it should have a stable organizational structure, preferably a physical location or an address at which it offers teaching facilities. It should also have a responsible officer or a team of responsible officers for the day-to-day management of its activities.
3. The institution must be providing courses which are employment related and the teachers be suitably qualified, taking into account the subjects taught.

Annex C

**Back Tax Assessed on Tax Avoidance Schemes Involving Interest Deductions
(as at 31 March 2004)**

	Finalised Cases¹		Cases still in progress		Total	
	No. of cases	Tax amount (\$ million)	No. of cases	Tax amount (\$ million)	No. of cases	Tax amount (\$ million)
Debenture Cases	4	250	3	880	7	1,130
Other Cases	17	400	49	5,150	66	5,550
Total	21	650	52	6,030	73	6,680

¹ Finalised Cases refer to cases that have become final and conclusive under the Inland Revenue Ordinance, i.e. cases that are no longer under objection or appeal.