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By Fax (2527 0790)  
25 January 2016

Mr Jackie LIU  
Prin AS for Financial Services & the Treasury (Financial Services)  
Financial Services and the Treasury Bureau  
24/F, Central Government Offices  
2 Tim Mei Avenue, Tamar  
Hong Kong

Dear Mr LIU,

**Inland Revenue (Amendment) (No. 4) Bill 2015**

I am scrutinizing the legal and drafting aspects of the captioned Bill. Please let me have your clarifications on the following matters –

Long title

It is noted that Part 3 of the Bill deals with "Consequential and Related Amendments Concerning Regulatory Capital Securities" but the long title of the Bill covers "consequential amendments" but not "related amendments". Please consider adding "related and" before "consequential amendments" in the long title as in the respective long titles of the Personal Data (Privacy) (Amendment) Bill 2011 and the Companies (Winding Up and Miscellaneous Provisions) (Amendment) Bill 2015.

Proposed section 14C (qualifying corporate treasury centre: interpretation)

- (a) Under the proposed section 14C(1), please consider adding ", in relation to a corporation," after "(企業財資活動)" in the definition of "corporate treasury activity" as in the definitions of "associated corporation" and "corporate treasury asset" under the same section.
- (b) Under the proposed definition of "associated corporation" in section 14C(2), please consider replacing "subsection (1)" by "subsection (1)(b)" for the sake of accuracy.

Proposed section 14D (profits tax concession)

Under the proposed section 14D(1), the assessable profits of a corporation that is a qualifying corporate treasury centre for a year of assessment are, subject to certain criteria, chargeable to tax under Part 4 of the Inland Revenue Ordinance (Cap. 112) at one-half of the rate specified in Schedule 8 ("the concessionary tax rate"). One of the criteria as set out in the proposed subsection (5)(b) is that the corporation has elected in writing that subsection (1) applies to it. The proposed section 14D(6) further provides that an election under subsection (5)(b), once made, is irrevocable for so long as the corporation remains as a qualifying corporate treasury centre.

- (a) Please clarify the meaning of an "irrevocable" election under subsection (6).
- (b) Please clarify whether the election under subsection (5)(b) is to be made with respect to a year of assessment. For example, in order to be eligible for the concessionary tax rate, is it necessary for a corporation that is a qualifying corporate treasury centre for three years to make an "annual" election to the Commissioner of Inland Revenue ("the Commissioner")?
- (c) What if the corporation's status as a qualifying corporate treasury centre changes in the middle of a year of assessment after an election under subsection (5)(b) has been made? There is nothing in the Bill as drafted requiring the corporation to report any change of status to the Commissioner and its impact on its entitlement to the concessionary tax rate. Please consider whether provisions should be added to the Bill to protect the public purse.
- (d) In the light of the proposed subsection (7), does it mean that once an election is made under subsection (5)(b), the corporation's entitlement to profits tax concession will be valid for the whole year of assessment even if the corporation's status as a qualifying corporate treasury centre changes in the middle of that year. Please clarify the legislative intent in this regard.

Proposed section 14F (qualifying corporate treasury centre: Commissioner's determination)

Under the proposed section 14F(1), the Commissioner may make a determination that the corporation is a qualifying corporate treasury centre for a year of assessment. Subsection (2) provides for the circumstances under which a corporation may apply for the determination. Subsection (3) provides

that the Commissioner may make the determination under subsection (1) only if the Commissioner is of the opinion that the conditions specified in section 14D(3), or the safe harbour rule under section 14E, would, in the ordinary course of business of the corporation, have been satisfied for the year of assessment.

- (a) There is nothing in the LegCo Brief to explain the possible scenario(s) that the proposed section 14F intends to catch. As taxpayer's money is at stake, please advise the legislative intent for this section.
- (b) Please clarify whether there are any other factors that are not currently provided for under the proposed subsection (3) that the Commissioner would take into account when exercising the discretion to make the determination under subsection (3), and consider making express provision of the same in the Bill.

Proposed amendments to section 15 (certain amounts deemed to be trading receipts)

At footnote 5 of the LegCo Brief, reference is made to the Privy Council case of *Orion Caribbean Limited v Commissioner of Inland Revenue* (4 HKTC 432) ("the *Orion Caribbean* case") in support of the proposed amendments to add section 15(ia) and (la) to Cap. 112 to make it clear that the "operations test" applies in the determination of the source of interest income, as well as relevant gains or profits, arising from the carrying on in Hong Kong by a corporation (other than a financial institution) of its intra-group financing business. The said Privy Council's opinion was delivered based on the specific facts of that case. To quote from Lord Nolan at page 931 of the reported case, "the ascertaining of the actual source of income is a 'practical hard matter of fact ... No simple, single, legal test can be employed".

- (a) Please elaborate with appropriate case law and other authorities in support of the Administration's stance that the "operations test" is to be codified as the governing principles applicable to all intra-group financing arrangements.
- (b) Please confirm whether the "provision of credit" test has been applied to similar intra-group financing business after the decision of the *Orion Caribbean* case.
- (c) It seems that the proposed section 15(ia) and (la) applies to a corporation even if it is not a qualifying corporate treasury centre. Please clarify whether this is the legislative intent.

Proposed amendments to section 16 (ascertainment of chargeable profits)

- (a) The proposed section 16(2)(g) seems to apply to a corporation even if it is not a qualifying corporate treasury centre. Please clarify whether this is the legislative intent.
- (b) Under the proposed section 16(2CC), where a deduction under subsection (1)(a) is claimed, by virtue of subsection (2)(g), for a year of assessment in respect of interest payable on money borrowed by a corporation, no deduction is to be allowed in respect of the interest if the Commissioner is satisfied that the main purpose, or one of the main purposes of the borrowing of the money by a corporation is to utilize a loss to avoid, postpone or reduce any liability, whether of the corporation or another person, to profits tax under Cap. 112. It seems that the "main purpose, or one of the main purposes" test proposed in section 16(2CC) is more stringent than the "sole or dominant purpose" test under the existing section 61A. Please clarify whether this is the legislative intent. Please provide case law on the Court's construction of the "main purpose, or one of the main purposes" test and the "sole or dominant purpose" test.

Proposed section 17H (arm's length and separate enterprise principles not prevented from application in other circumstances)

In view of members' concerns over the need for this proposed section and the confusion it may cause to the existing scheme, please review the need for this section. If the Administration considers such section to be necessary, please advise whether any drafting improvements can be made in the light of members' concerns.

I would be grateful if you would let me have the Administration's reply in Chinese and English by 22 February 2016.

Yours sincerely,

(Miss Carrie WONG)  
Assistant Legal Adviser

c.c. Clerk to Bills Committee