

**立法會**  
**Legislative Council**

LC Paper No. CB(1)793/17-18  
(These minutes have been seen  
by the Administration)

Ref : CB1/BC/2/17/2

**Bills Committee on Inland Revenue (Amendment) (No. 6) Bill 2017**

**Minutes of the third meeting**  
**held on Tuesday, 6 March 2018, at 4:30 pm**  
**in Conference Room 3 of the Legislative Council Complex**

- Members present** : Hon Kenneth LEUNG (Chairman)  
Hon James TO Kun-sun  
Hon WONG Ting-kwong, GBS, JP  
Hon Charles Peter MOK, JP  
Hon CHAN Chi-chuen  
Hon Dennis KWOK Wing-hang  
Hon CHUNG Kwok-pan  
Hon Alvin YEUNG  
Hon Holden CHOW Ho-ding  
Hon CHAN Chun-ying
- Members absent** : Hon Abraham SHEK Lai-him, GBS, JP  
Hon WU Chi-wai, MH  
Hon Christopher CHEUNG Wah-fung, SBS, JP  
Hon CHU Hoi-dick
- Public Officers attending** : **For item III**  
Financial Services and the Treasury Bureau  
  
Mr Andrew LAI, JP  
Deputy Secretary (Treasury)<sup>2</sup>

Mr Stephen LO  
Principal Assistant Secretary (Treasury)(R2)

Inland Revenue Department

Mr Brian CHIU, JP  
Deputy Commissioner (Technical)

Mr Benjamin CHAN  
Senior Assessor (Research)3

Ms Vivian NG  
Senior Assessor (Tax Treaty)6

Department of Justice

Miss Betty CHEUNG  
Senior Assistant Law Draftsman

Miss Bonita WONG  
Government Counsel

**Clerk in attendance :** Ms Angel SHEK  
Chief Council Secretary (1)1

**Staff in attendance :** Miss Rachel DAI  
Assistant Legal Adviser 2

Mr Joey LO  
Senior Council Secretary (1)8

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Action

**I. Application for late membership**

(LC Paper No. CB(1)661/17-18(01) — Letter dated 5 March 2018 from Hon Abraham SHEK Lai-him (English version only))

Members agreed to accept the late application for membership from Mr Abraham SHEK.

Action

**II. Confirmation of minutes**

(LC Paper No. CB(1)623/17-18 — Minutes of the meeting held on 23 January 2018)

2. The minutes of the meeting held on 23 January 2018 were confirmed.

**III. Meeting with the Administration**

Matters arising from previous meeting

(LC Paper No. CB(1)657/17-18(01) — List of follow-up actions arising from the discussion at meeting on 13 February 2018

LC Paper No. CB(1)657/17-18(02) — Administration's response to the issues arising from the meeting held on 13 February 2018 and to the submissions received from organizations

LC Paper No. CB(1)584/17-18(01) — Assistant Legal Adviser's letter dated 8 February 2018 to the Administration

LC Paper No. CB(1)657/17-18(03) — Administration's reply to Assistant Legal Adviser's letter dated 8 February 2018

Relevant papers

(LC Paper No. CB(3)232/17-18 — The Bill

File Ref: TsyB R2 00/800/1/0 (C) — Legislative Council Brief

LC Paper No. LS19/17-18 — Legal Service Division Report

LC Paper No. CB(1)506/17-18(01) — Marked-up copy of the Bill prepared by the Legal Service Division (Restricted to Members)

Action

LC Paper No. CB(1)509/17-18(01) — Background brief prepared by the Legislative Council Secretariat)

3. The Bills Committee deliberated (index of proceedings attached at the **Annex**).

Follow-up actions to be taken by the Administration

- Admin 4. The Administration was requested to consider:
- (a) setting out in the relevant provisions of the Inland Revenue Ordinance (Cap. 112), instead of in a Departmental Interpretation and Practice Note of the Inland Revenue Department as proposed in paragraph 10 of the Administration's paper (LC Paper No. CB(1)657/17-18(02)), that transfer pricing rules would generally not be applied to domestic transactions between associated persons which did not give rise to actual tax difference; and
  - (b) further relaxing the proposed thresholds of \$200 million for total annual revenue/total assets for the purpose of exemption from the transfer pricing documentation requirements (i.e. master file and local file) based on the size of business, so as to relieve more enterprises from the burden to prepare such documentation, and taking into account that the Organisation for Economic Co-operation and Development had not prescribed the threshold levels in this regard.

*(Post-meeting note: The Administration's written response was issued vide LC Paper No. CB(1)702/17-18(02) on 19 March 2018.)*

**IV. Any other business**

Date of next meeting

5. The Chairman reminded members that the next meeting of the Bills Committee had been scheduled for Wednesday, 21 March 2018, at 8:30 am.
6. There being no other business, the meeting ended at 6:31 pm.

**Bills Committee on Inland Revenue (Amendment) (No. 6) Bill 2017**

**Proceedings of the third meeting  
on Tuesday, 6 March 2018, at 4:30 pm  
in Conference Room 3 of the Legislative Council Complex**

<b>Time marker</b>	<b>Speaker</b>	<b>Subject(s)</b>	<b>Action required</b>
<b><i>Agenda Item I – Application for late membership</i></b>			
000708 – 000845	Chairman Mr James TO Mr CHUNG Kwok-pan Mr CHAN Chun-ying	Members agreed to accept the late application from Mr Abraham SHEK to join the Bills Committee.	
<b><i>Agenda Item II – Confirmation of minutes</i></b>			
000846 – 000920	Chairman	The minutes of the meeting held on 23 January 2018 (LC Paper No. CB(1)623/17-18) were confirmed.	
<b><i>Agenda Item III - Meeting with the Administration</i></b>			
000921 – 003130	Chairman Administration	<p>The Administration briefed members on its written response to the issues arising from the meeting held on 13 February 2018 and to the submissions received from organizations [LC Paper No. CB(1)657/17-18(02)].</p> <p>The Chairman said that the Administration's written response to Assistant Legal Adviser's letter dated 8 February 2018 [LC Paper No. CB(1)657/17-18(03)], which concerned details of the relevant provisions of the Bill, would be dealt with during clause by clause examination of the Bill.</p>	
003131 – 004150	Chairman Mr Holden CHOW Administration	<p>Noting the Administration's proposal to make it clear in a Departmental Interpretation and Practice Note ("DIPN") of the Inland Revenue Department ("IRD") that transfer pricing ("TP") rules would generally not be applied to domestic transactions between associated persons which did not give rise to actual tax difference, Mr CHOW doubted whether the proposal would suffice to alleviate the compliance burden of enterprises in meeting the TP documentation (i.e. master file and local file) requirements.</p> <p>The Administration responded that:</p> <p>(a) the Bill primarily sought to codify into the Inland Revenue Ordinance (Cap. 112) ("IRO") the existing practice of IRD in dealing with TP issues which were promulgated in its DIPN. The established territorial source principle of taxation would remain unchanged; and</p>	Admin (paragraph 4(a) of the minutes refers)

Time marker	Speaker	Subject(s)	Action required
		<p>(b) in addition to the proposed TP documentation exemptions based on the size of business as well as the nature and value of related party transactions as provided for under the Bill, the Administration had proposed to move an amendment to the Bill to waive the requirement to prepare master file and local file in respect of the domestic transactions between associated persons, with a view to further reducing the compliance burden on the business sector.</p>	
004151 – 005410	Chairman Mr CHAN Chun-ying Administration	<p>Mr CHAN asked whether the Administration would consider setting a threshold on the value of cross-border related party transactions for the purpose of exemption from the TP documentation requirements.</p> <p>As far as the preparation of master file and local file was concerned, the Administration explained that the Bill provided for an exemption based on the nature and value of related party transactions and that the proposed exemption thresholds followed those adopted by the Mainland given the close economic relationship between Hong Kong and the Mainland.</p> <p>Mr CHAN sought clarification why TP rules should be applied to salaries tax and property tax as proposed under the Bill.</p> <p>The Administration responded that:</p> <p>(a) IRD had all along been applying TP rules to all tax types;</p> <p>(b) Hong Kong adopted a schedular income tax system, which was different from the comprehensive income tax regimes adopted by many overseas tax jurisdictions whereby all sources of income were aggregated for assessment purposes. It was therefore necessary for Hong Kong to apply TP rules to all tax types. Also, for some non-arm's length transactions, tax adjustments across tax types were necessary; and</p> <p>(c) an employer and its employees were not associated in the context of the TP regulatory regime.</p>	
005411 – 010052	Chairman Mr CHUNG Kwok-pan Administration	<p>Mr CHUNG expressed the following views:</p> <p>(a) codification of TP rules into IRO would complicate Hong Kong's simple tax system; and</p>	

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		<p>(b) the Administration should consider making reference to the Mainland to further relax the proposed threshold of \$200 million for total annual revenue/total assets for the purpose of exemption from the TP documentation requirements based on the size of business.</p> <p>The Administration responded that:</p> <p>(a) it was the Administration's objective to implement the minimum standards of the Base Erosion and Profit Shifting ("BEPS") package promulgated by the Organisation for Economic Co-operation and Development ("OECD") whilst maintaining the existing simple and low tax system of Hong Kong;</p> <p>(b) the detailed conditions of exemption thresholds, if any, were determined by individual jurisdictions having regard to their own needs and circumstances; and</p> <p>(c) the exemptions already provided for under the Bill in relation to the preparation of master file and local file as well as the latest proposal to waive the requirement to prepare such files in respect of the domestic transactions between associated persons would help reduce the compliance burden on the business sector.</p>	Admin (paragraph 4(b) of the minutes refers)
010053 – 010250	Chairman Administration	In response to the Chairman's enquiries, the Administration responded that if an enterprise could meet the exemption criteria based on the size of business, it would not be required to prepare both master file and local file even if the amount of a category of its related party transactions for the relevant accounting period exceeded the prescribed threshold for the value of related party transactions.	
010251 – 011149	Chairman Mr CHAN Chun-ying Administration	<p>Mr CHAN urged the Administration to consider further relaxing the proposed thresholds of \$200 million for total annual revenue/total assets, taking into account that OECD had not prescribed the threshold levels in this regard. This would reduce the number of enterprises subject to TP documentation requirements, and might obviate the need for IRD to increase manpower to cope with additional workload arising therefrom.</p> <p>Mr CHAN also asked if the Administration would consider providing an option for Hong Kong tax</p>	Admin (paragraph 4(b) of the minutes refers)

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		<p>residents working in the Mainland to choose income exclusion or deduction approach, in addition to the tax credit approach, when seeking double taxation relief.</p> <p>The Administration advised that:</p> <p>(a) with the exemption thresholds for total revenue for the accounting period and total assets at the end of the accounting period being raised respectively from \$100 million to \$200 million following the public consultation, the number of enterprises which could not meet the exemption thresholds for total revenue for the accounting period and average number of employees had been substantially reduced to around 5 000. As no data on the value of assets held by individual enterprises in Hong Kong was available, it was estimated that the actual number of enterprises required to prepare master file and local file would be lower than 5 000 because enterprises would be exempt from preparing master file and local file if they fulfilled two of the three exemption thresholds on asset, revenue and staff size;</p> <p>(b) as the tax credit approach was adopted in all of Hong Kong's existing Comprehensive Avoidance of Double Taxation Agreements ("CDTAs"), it was necessary for Hong Kong to implement the same approach consistently in the domestic legislation as far as cases involving CDTA territories (including the Mainland) were concerned; and</p> <p>(c) it was anticipated that additional workload on IRD arising from TP documentation requirements would be limited as a risk-based approach would be adopted to ensure compliance.</p>	
011150 – 011440	Chairman Mr CHUNG Kwok-pan Administration	In reply to Mr CHUNG, the Administration advised that a new DIPN would be issued by IRD on the detailed TP documentation requirements, which would also set out the relevant exemption criteria and thresholds.	
011441 – 012135	Chairman Administration	The Chairman reiterated the concerns expressed by some deputations about introducing specific provisions (i.e. section 15F) to deal with TP issues relating to intellectual property ("IP"), as the existing general provisions of IRO, the withholding tax arrangements (where applicable) as well as other	



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		<p>proposed provisions under the Bill should be sufficient to prevent BEPS associated with revenue from IP.</p> <p>The Administration responded that:</p> <p>(a) section 15F, which sought to align taxation of IP income with value creation and economic ownership, was in line with OECD's latest TP standards. Similar provisions were also included in the Mainland's tax legislation; and</p> <p>(b) IRD would make sure that a person would not be subject to double taxation in respect of the same income from an IP. IRD would provide further clarifications in DIPN after the Bill had been passed by the Legislative Council.</p>	
012136 – 014800	Chairman Mr Holden CHOW Mr CHUNG Kwok-pan Administration	<p>Reiterating his view that Hong Kong should not go beyond the minimum standards for implementing the BEPS package, Mr CHOW queried the need for TP rules to cover all tax types. Mr CHUNG shared similar views.</p> <p>Noting that the Administration proposed to extend the period for enterprises to prepare TP documentation ("the preparation period") from six months to nine months after the end of the accounting period of the enterprises concerned, Mr CHOW urged the Administration to consider further extending the preparation period to 12 months.</p> <p>The Administration responded that:</p> <p>(a) it was necessary for Hong Kong to apply TP rules to all tax types given the need to align the TP adjustment made by Hong Kong with that made by other jurisdictions which adopted comprehensive income tax regimes. Otherwise, IRD would have no legal basis to make TP adjustment where necessary and Hong Kong could be considered as failing to fulfil its treaty obligations under the relevant CDTAs. This would in turn dampen other jurisdictions' incentives to conclude CDTAs with Hong Kong;</p> <p>(b) as TP rules would generally not be applied to the domestic transactions between associated persons which did not give rise to actual tax difference, they had little impact on the ordinary Hong Kong tax residents; and</p>	

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		<p>(c) the proposed extension of the preparation period for master file and local file from six months to nine months would tally with the tax return filing deadline for enterprises. The preparation period for individual enterprises could be extended upon request with justified grounds.</p> <p>In reply to Mr CHOW, the Administration clarified that IRD would not be obliged to recover undercharged taxes arising from TP adjustment on behalf of overseas tax jurisdictions.</p>	
014801 – 015451	Chairman Mr Holden CHOW Administration	<p>Mr CHOW enquired whether the Administration would consider introducing a cap on the fee payable to IRD in respect of application for advance pricing arrangement ("APA").</p> <p>The Administration responded that:</p> <p>(a) having regard to deputations' suggestion, it had proposed to move an amendment to the Bill to impose a cap on the amount of fee to be charged by IRD in respect of APA applications, excluding the costs of engaging external advisors and travelling expenses which would be fully reimbursed by APA applicants;</p> <p>(b) reference would be drawn from the current average costs of conducting an APA in pitching the cap; and</p> <p>(c) if the jurisdictions concerned could not arrive at a solution on TP adjustments in a multilateral or bilateral APA, the APA would be unsuccessful and the Commissioner of Inland Revenue could, having regard to the facts of each case, consider waiving all or part of the fees payable by the enterprise in question for the APA application.</p> <p>The Chairman extended the meeting by 15 minutes.</p>	
015452 – 020300	Chairman Mr CHUNG Kwok-pan Mr Holden CHOW Mr CHAN Chun-ying Administration	<p>Mr CHOW and Mr CHAN considered that implementation of the BEPS package would not help bring about significant and direct economic benefits (such as recovering undercharged taxes) since Hong Kong adopted a territorial-based tax regime, not global tax system.</p> <p>The Administration stressed the need for Hong Kong to honour its international tax obligations by implementing the BEPS package.</p>	

<b>Time marker</b>	<b>Speaker</b>	<b>Subject(s)</b>	<b>Action required</b>
020301 – 020451	Chairman Administration	Summing up members' views and suggestions, the Chairman requested the Administration to consider:  (a) setting out in the relevant provisions of IRO, instead of in a DIPN, that TP rules would generally not be applied to domestic transactions between associated persons which did not give rise to actual tax difference; and  (b) further relaxing the proposed thresholds of \$200 million for total annual revenue/total assets for the purpose of exemption from the transfer pricing documentation requirements (i.e. master file and local file) based on the size of business.	Admin (paragraph 4(a) and (b) of the minutes refers)
<b><i>Agenda Item IV – Any other business</i></b>			
020452 – 020557	Chairman	Date of next meeting	

Council Business Division 1  
Legislative Council Secretariat  
12 April 2018