

立法會
Legislative Council

LC Paper No. CB(1)980/17-18
(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 fifth meeting
held on Wednesday, 11 April 2018, at 8:30 am
in Conference Room 2 of the Legislative Council Complex

Members present : Hon Kenneth LEUNG (Chairman)
Hon James TO Kun-sun
Hon Abraham SHEK Lai-him, GBS, JP
Hon WONG Ting-kwong, GBS, JP
Hon WU Chi-wai, MH
Hon Charles Peter MOK, JP
Hon CHAN Chi-chuen
Hon Christopher CHEUNG Wah-fung, SBS, JP
Hon CHUNG Kwok-pan
Hon Alvin YEUNG
Hon CHU Hoi-dick
Hon Holden CHOW Ho-ding
Hon CHAN Chun-ying

Member absent : Hon Dennis KWOK Wing-hang

Public Officers : **For item I**
attending

Financial Services and the Treasury Bureau

Mr Andrew LAI, JP
Deputy Secretary (Treasury)²

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

Action

I. Meeting with the Administration

Matters arising from previous meeting

(LC Paper No. CB(1)774/17-18(01) — List of follow-up actions arising from the discussion at meeting on 21 March 2018

LC Paper No. CB(1)774/17-18(02) — Administration's response to the issues raised at the meeting on 21 March 2018 and summary of the draft amendments proposed by the Administration)

Action

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

The Bills Committee deliberated (index of proceedings attached at the **Annex**) and commenced clause-by-clause examination of the Bill.

II. Any other business

Date of next meeting

2. The Chairman reminded members that the next meeting of the Bills Committee would be held on Wednesday, 25 April 2018, at 8:30 am.
3. There being no other business, the meeting ended at 10:37 am.

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

**Proceedings of the fifth meeting
on Wednesday, 11 April 2018, at 8:30 am
in Conference Room 2 of the Legislative Council Complex**

Time marker	Speaker	Subject(s)	Action required
<i>Agenda Item I - Meeting with the Administration</i>			
000429 – 000622	Chairman	Introductory remarks	
000623 – 002044	Chairman Administration	The Administration briefed members on its response to the issues raised at the meeting on 21 March 2018 (LC Paper No. CB(1)774/17-18(02)).	
002045 – 004215	Chairman Mr CHUNG Kwok-pan Administration	<p>Mr CHUNG asked whether there were indeed only some 540 enterprises with total annual revenue exceeding \$500 million as stated in the Administration's impact analysis of raising the threshold on total annual revenue for the purpose of exemption from transfer pricing ("TP") documentation requirements ("threshold on total annual revenue") (paragraph 4 of LC Paper No. CB(1)774/17-18(02)), in the light of the number of companies listed in Hong Kong.</p> <p>The Chairman remarked that it was common for a listed company to be a holding company of its subsidiaries, with minimal annual business turnover and few employees.</p> <p>The Administration explained that the impact analysis focused on the annual turnover of individual companies in a group rather than that of the group as a whole. The analysis was based on the information held by the Inland Revenue Department ("IRD"), for tax assessment purposes, on those companies carrying on business in Hong Kong, including the Hong Kong branches/subsidiaries of overseas incorporated companies.</p> <p>In response to Mr CHUNG's enquiry about the possible consequences of being labelled by the Organisation for Economic Co-operation and Development ("OECD") and/or the European Union ("EU") as a non-cooperative tax jurisdiction, the Administration advised that:</p> <p>(a) EU's list of non-cooperative tax jurisdictions was formulated based on three criteria: (i) tax transparency, i.e. complying with the international</p>	

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		<p>standards on automatic exchange of financial account information in tax matters and exchange of information on request as well as participating in the Multilateral Convention on Mutual Administrative Assistance in Tax Matters; (ii) commitment to implementing OECD's minimum requirements to counter Base Erosion and Profit Shifting ("BEPS"); and (iii) fair taxation, i.e. amending or abolishing the identified harmful tax regimes; and</p> <p>(b) jurisdictions listed by OECD and/or EU could be subject to defensive measures such as reinforced monitoring and documentation requirements, non-deductibility of costs, application of controlled foreign company rules, denial of exemptions, imposition of withholding tax, etc.</p>	
004216 – 010554	Chairman Mr Abraham SHEK Administration	<p>Mr SHEK considered that Hong Kong should not go beyond the minimum standards in the implementation of international requirements in tax matters lest it would jeopardize the simple tax system and competitiveness of Hong Kong, as well as the viability of local enterprises. He urged the Administration to consider the proposals submitted by The Real Estate Developers Association of Hong Kong ("REDA")(LC Paper No. CB(1)614/17-18(02)) and Mr CHUNG's suggestion of further relaxing the threshold on total annual revenue to \$500 million.</p> <p>The Administration responded that:</p> <p>(a) it had strived to strike a balance between meeting international requirements in tax matters and minimizing the compliance burden on the business sector. A pragmatic approach was adopted by implementing the four minimum standards out of the 15 action plans of OECD's BEPS package; and</p> <p>(b) if the exemption threshold on total annual revenue was further raised to \$500 million, only a negligible number of enterprises would need to prepare the master file and local file. This would undermine the effectiveness of the TP documentation requirements.</p> <p>On REDA's concerns about the proposed section 15BA (changes in trading stock), the Administration advised that the requirement for adjusting the value of trading stock to market value upon changes of</p>	

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		<p>intention or acquisition/disposal other than in the course of trade had been well established by case law and followed in many court judgments. The proposed section 15BA only sought to codify such existing requirements in the Inland Revenue Ordinance (Cap. 112) ("IRO"). No new policy was being introduced.</p> <p>The Administration briefed members on the comparison of the proposed exemptions for TP documentation requirements with those of the Mainland, as detailed in paragraph 7 of LC Paper No. CB(1)774/17-18(02).</p>	
010555 – 011904	Chairman Mr CHAN Chun-ying Mr CHUNG Kwok-pan Mr Abraham SHEK Administration	In response to Mr CHAN's observation that the definition of "intangibles" adopted by the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Guidelines") was not limited to intellectual property ("IP"), whereas the proposed section 15F of IRO seemed to equate "intangibles" with IP, the Administration advised that the definition of "intangible" in the OECD Guidelines had a wider meaning than "IP", whereas the application of the proposed section 15F was confined to "IP" as defined therein.	
011905 – 012202	Chairman Mr CHUNG Kwok-pan Administration	<p>Referring to paragraph 7 of the Administration's paper (LC Paper No. CB(1)774/17-18(02)), Mr CHUNG enquired why Hong Kong's proposed thresholds based on the nature and value of related party transactions for the purpose of exemption from preparation of master file could not be raised on par with that of the Mainland.</p> <p>The Administration responded that:</p> <p>(a) given the close economic relationship between Hong Kong and the Mainland, it was advisable for Hong Kong to adopt similar exemption thresholds for local file based on the nature and value of related party transactions as set by the Mainland so as to facilitate the handling of cross-border transactions; and</p> <p>(b) as regards the exemption for preparation of master file, the Mainland's exemption threshold of RMB 1 billion per year based on the value of related party transactions would not apply if the Mainland enterprise concerned undertook cross-border related party transactions and the ultimate parent</p>	

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		<p>entity of the group to which the enterprise belonged also needed to prepare a master file, whereas Hong Kong's proposed thresholds relating to master file were not subject to such a condition and could in that sense be regarded as more relaxed than the Mainland's threshold.</p>	
012203 – 013409	Chairman Administration	<p>Referring to paragraph 4 of the Administration's paper (LC Paper No. CB(1)774/17-18(02)), the Chairman enquired whether the impact analysis of raising the threshold on total annual revenue was based solely on the impact of the change in total annual revenue of the enterprises concerned, without taking into account their total value of assets and average number of employees.</p> <p>The Administration replied in the affirmative and advised that:</p> <ul style="list-style-type: none"> (a) IRD did not have any data on the value of assets held by enterprises; and (b) the actual number of enterprises required to prepare master and local files would be smaller than the estimated number in the impact analysis because enterprises would be exempt from the obligation of preparing the master file and local file if they fulfilled two of the three exemption thresholds on asset, revenue and average number of employees. <p>In response to the Chairman's enquiries, the Administration advised that:</p> <ul style="list-style-type: none"> (a) it planned to move amendments to clarify the policy intent that section 15C (valuation of trading stock on cessation of business) of IRO would prevail over section 15BA (changes in trading stock). Moreover, when trading stock was appropriated as capital asset and vice versa, it was necessary to account for the market value upon appropriation so that any change (including diminution or increment) in valuation of the trading stock could be recognized. This market value principle was also recognized by the Court of Final Appeal ("CFA") in <i>Church Body of the Hong Kong Sheng Kung Hui & Anor v CIR</i> (2016) 19 HKCFAR 54. The proposed section 15BA followed the case law and sought to codify the market value principle as reflected in Hong Kong's jurisprudence and the long-standing tax treatments 	

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		<p>for trading of assets. No new policy was being introduced;</p> <p>(b) <i>Nice Cheer Investment Ltd v CIR</i> (2013) 16 HKCFAR 813 concerned the taxability of the gains resulting from revaluation of trading securities held at the end of the accounting period as required by fair value accounting. As the existing IRO did not expressly allow the use of fair value accounting in tax computation in respect of financial instruments, CFA held in the <i>Nice Cheer</i> case that the unrealized revaluation gains in respect of listed securities held for trading purposes were not chargeable to tax in Hong Kong. However, in response to strong call from the financial sector, the Administration intended to submit another legislative proposal in late 2018 to codify the existing interim administrative measure of accepting the computation of assessable profits on a fair value basis in respect of financial instruments, which had been introduced subsequent to the CFA ruling on <i>Nice Cheer</i> case; and</p> <p>(c) the Administration had no plan at this stage to extend the scope of the application of fair value accounting for tax purposes to investment property.</p>	
013410 – 013834	Chairman Mr CHUNG Kwok-pan Administration	<p>In response to Mr CHUNG's enquiry about whether the definition of trading stock under the Bill covered raw materials used by different industries in the production process, the Administration advised that as defined in the proposed section 15BA, "trading stock" did not include materials used in the manufacture, preparation or construction of anything which was sold in the ordinary course of trade.</p> <p>The Chairman pointed out that revaluation gains were not chargeable to profits tax unless there was change of intention of the asset concerned.</p>	
013835 – 014302	Chairman Administration	The Administration briefed members on the summary of its proposed amendments (Annex B to LC Paper No. CB(1)774/17-18(02)).	
014303 – 020054	Chairman Mr James TO Administration	<p>Discussion on the Administration's proposed textual amendments to the Bill in response to OECD's suggestions.</p> <p>The Chairman extended the meeting by 15 minutes.</p>	

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020055 – 020727	Chairman Mr CHUNG Kwok-pan Administration	Discussion on OECD's review of Hong Kong's TP documentation regime.	
<p>Clause-by-clause examination of the Bill [The Bill (LC Paper No. CB(3)232/17-18)] [Marked-up copy of the Bill prepared by the Legal Service Division (LC Paper No. CB(1)506/17-18(01))]</p>			
020728 – 021007	Chairman Administration	<p>Part 1 – Preliminary</p> <p><u>Clause 1 – Short title</u></p> <p><u>Clause 2 – Enactments amended</u></p> <p>Members raised no query.</p>	
<p><i>Agenda Item II – Any other business</i></p>			
021008 – 021115	Chairman Administration	Date of next meeting	