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LEGAL SERVICE DIVISION
LEGISLATIVE COUNCIL SECRETARIAT

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By Fax (2523 0642)

8 February 2018

Mr LO Yip-kwong, Stephen
Prin AS for Financial Services & the Treasury
(Treasury)(R2)
Financial Services and the Treasury Bureau
24/F, Central Government Offices
2 Tim Mei Avenue
Tamar, Hong Kong

Dear Mr LO,

Re: Inland Revenue (Amendment) (No. 6) Bill 2017

We are scrutinizing the legal and drafting aspects of the captioned Bill and should be grateful if you could clarify the following matters:

General

(1) According to the long title of the Bill and paragraph 1(g) of the Explanatory Memorandum to the Bill, the Bill seeks to revise the requirements relating to profits tax concessions for particular classes of person so as to meet the international standards promulgated by the Organization for Economic Co-operation and Development ("OECD"). Please identify the international standards concerned, and explain how the proposed amendments to the relevant requirements relating to profits tax concessions in the Inland Revenue Ordinance (Cap. 112) would align with the international standards concerned.

Clause 9 – proposed section 50AAC(1)

(2) In paragraphs (b)(i) and (ii) of the definition of "recognized pension fund" under the proposed section 50AAC(1), the term "almost exclusively" is used in both paragraphs. Please explain the meaning of "almost

exclusively" and provide examples of the circumstances under which a pension fund would be considered as established and operated "almost exclusively" to administer or provide retirement benefits or to invest funds as described in paragraphs (b)(i) and (ii) of the definition. Please consider whether it is desirable to provide, under that definition, the criteria used in determining the extent of the "almost exclusively" condition for a recognized pension fund.

(3) Please clarify the meaning of "normally managed or controlled in Hong Kong" in the definition of "resident for tax purposes" under the proposed section 50AAC(1). Please provide the factors to be considered in determining whether a company incorporated outside Hong Kong is normally managed or controlled in Hong Kong.

Clause 9 – proposed sections 50AAC(5) and 50AAE(4)

(4) The proposed new sections 50AAC(5) and 50AAE(4) provide that the Secretary for Financial Services and the Treasury may, by notice published in the Gazette, amend Schedule 17G and the definitions in sections 50AAE(2) and 50AAE(3) respectively. Please clarify whether the notices made are subsidiary legislation subject to amendment by the Legislative Council under section 34 of the Interpretation and General Clauses Ordinance (Cap. 1).

Clause 9 – proposed section 50AAE

(5) The proposed section 50AAE under Division 1 of Part 8AA of the Bill provides that that Division is to be read in the way that best secures consistency between the effect given to the proposed sections 50AAF, 50AAG, 50AAM, 50AAN, 50AAK and 50AAO and the effect given to the respective Articles 7 and 9 of the Model Tax Convention on Income and on Capital approved by OECD. However, it is noted that Division 1 of Part 8AA only contains preliminary provisions in respect of the interpretation and application of Part 8AA. Please clarify whether the principle of consistency with OECD rules in the proposed section 50AAE is intended only to apply to Division 1 or the whole Part 8AA. If it is the latter case, should "This Division" in the proposed section 50AAE be changed to "This Part"?

Clause 9 – proposed section 50AAF(6)

(6) The proposed section 50AAF(5) provides that if the advantaged person fails to prove to the assessor's satisfaction that the amount of the person's income or loss as stated in the person's tax return is the arm's length amount, the assessor must estimate an amount as the arm's length amount. However, under the proposed section 50AAF(6), the estimated amount under proposed section 50AAF(5) is taken to be the arm's length amount **unless the advantaged**

person proves that the another amount is a more reliable measure of the arm's length amount. Please clarify whether it is intended that under the proposed section 50AAF(6) the advantaged person may object the arm's length amount estimated by the assessor and by further proving that another amount is a more reliable measure of the arm's length amount after the assessor has estimated an amount as the arm's length amount under the proposed section 50AAF(5). Please explain how the subsections (5) and (6) of the proposed section 50AAF interact with each other.

Clause 9 – proposed sections 50AAG and 50AAH

(7) Please confirm whether, by virtue of the proposed sections 50AAH(2)(a) and 50AAH(3), a person is regarded as participating in the management, control or capital of an affected person under the proposed section 50AAG if that person has more than fifty percent of the issued share capital, income, ownership interest or voting rights of the affected person.

Clause 9 – proposed section 50AAI(3)

(8) The proposed section 50AAI(3) sets out the situations where a series of transactions is not prevented from being regarded as a series of transaction by means of which a provision has been made or imposed as between two persons, even if one or more of the three scenarios set out in sub-paragraphs (a) to (c) under that section applies. Please provided examples to illustrate how the proposed section 50AAI(3) applies.

Clause 9 – proposed section 50AAL

(9) By virtue of the proposed section 50AAL(3), relevant activities, in relation to a person (person A) who is one of the persons as between whom any provision is made or imposed, means activities that are not carried on for the purposes of a different part of person A's business. Please explain the meaning and the application of "for the purposes of a different part of person A's business" and clarify the factors to be considered in determining whether the activities to be excluded from the relevant activities under the proposed section 50AAL are carried on for the purposes of a different part of person A's business.

Clause 9 – proposed sections 50AAN and 50AAO

(10) Under the proposed section 50AAN(3), if a disadvantaged person's income or loss has been assessed or computed upon a claim by it under the proposed section 50AAN(2), the disadvantaged person must take reasonable steps to ensure that it has knowledge about the advantaged person's foreign tax-related adjustment. Similarly, under the proposed section 50AAO(3), if a

non-Hong Kong resident person's income or loss has been assessed or computed upon a claim by it under the proposed section 50AAO(2), the non-Hong Kong resident person must take reasonable steps to ensure that it has knowledge about the foreign tax-related adjustment. Please clarify what would constitute "reasonable steps" for the purpose of the proposed sections 50AAN(3) and 50AAO(3).

Clause 9 – proposed section 50AAP(2)

(11) The proposed section 50AAP(2) provides that the advance pricing arrangement ("APA") must specify, among others, the critical assumptions on which the agreed methodology is based. Please provide examples to illustrate what would constitute "critical assumptions" under the proposed section 50AAP(2)(e).

Clause 9 – proposed sections 50AAP(3) and 50AAR(1)

(12) Under the proposed sections 50AAP(3) and 50AAR, the Commissioner may refuse to make an APA or revoke, cancel or revise an APA made. Please clarify whether the Commissioner's decisions made under sections 50AAP(3) and 50AAR(1) are subject to review or appeal under Cap. 112; if not, please provide the reasons.

Clause 9 – proposed section 50AAV and Schedule 17H

(13) According to paragraph 4 of the current Departmental Interpretation and Practice Notes No. 48 issued by the Inland Revenue Department, the Commissioner does not charge any fee on enterprises during the APA process. Please provide justification for charging fees for application for APA under the proposed section 50AAV and Schedule 17H.

Clause 10 – proposed Schedule 17H, section 7(6)

(14) Under the proposed section 7(6) of Schedule 17H, in exceptional circumstances, the Commissioner may, at the Commissioner's discretion, waive all or part of any fees payable in respect of an application. Please provide examples to illustrate what would be considered as exceptional circumstances for the purpose of the proposed section 7(6) of Schedule 17H.

Clause 14 – proposed section 15F

(15) Please clarify whether the classes of intellectual property set out in the definition of "intellectual property" under the proposed section 15F are meant to be exhaustive.

As scrutiny of the Bill is continuing, further letter(s) may be issued to seek clarifications of the legal or drafting issues of other parts of the Bill, if necessary.

We look forward to receiving your reply in both English and Chinese as soon as possible.

Yours sincerely,



(Rachel DAI)
Assistant Legal Adviser

cc. Department of Justice (Attn: Miss Betty CHEUNG, SALD & Miss Bonita WONG, GC) (By Fax: 3918 4613)
Legal Adviser
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