香港女會計師協會有限公司
*Association of Women Accountants (Hong Kong) Limited*
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Hon. Kenneth Leung, Chairman
Bills Committee on the Inland Revenue (Amendment) (No. 6) Bill 2017
Secretariat, Legislative Council
Hong Kong SAR Government
1 Legislative Council Road
Central, Hong Kong

Via email: bc_02_17@legco.gov.hk

23 February 2018

Dear Hon. Kenneth Leung,

***Comments on Inland Revenue (Amendment) (No. 6) Bill 2017 ("the Bill")***

We refer to the Bill gazetted on 29 December 2017 seeking to implement certain Base Erosion and Profit Shifting ("BEPS") measures, following the *Consultation Paper on Measures to Counter BEPS* and *Consultation Report on Measures to Counter BEPS* issued by the Government in October 2016 and July 2017 respectively.

On behalf of Association of Women Accountants (Hong Kong) Limited, we provide our comments and recommendations in relation to the Bill in the Appendix.

We first of all thank the Government for its effort in drafting this significant Bill to align Hong Kong's tax system with international standards. In providing our comments, we wish to remind the Government that whilst it is important for the Government to fulfil its commitment as an Associate in the Organisation for Economic Co-operation and Development ("OECD") BEPS inclusive framework, it is equally important for Hong Kong to maintain a simple, territorial tax system, and that the relevant measures to be implemented need to be practical and easy to administer. We note that there are various unexpected provisions in the Bill as they were not mentioned during the previous consultation. In addition, some of the provisions may potentially give rise to uncertainty and create additional work and burden to both the Inland Revenue Department and taxpayers without necessarily creating economic benefits to

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Hong Kong. We believe the right balance needs to be struck in order to maintain Hong Kong's competitiveness.

We thank the Bills Committee for considering our comments and recommendations. Should you have any questions, please do not hesitate to contact the undersigned on 2846 9086 or Gwenda Ho, Hon. Treasurer, on 2289 3857.

Yours sincerely,
For and on behalf of
Association of Women Accountants (Hong Kong) Limited

Agnes Tso
President

Enclosures

**Appendix**

***Comments on Inland Revenue (Amendment) (No. 6) Bill 2017 ("the Bill")***
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| | Clause | Part / Section / Schedule under IRO[1] amended / introduced | Concerns | Recommendation |
|---|---|---|---|---|
| 1. | 3, 4 and 8 | Sections 8(1A)(c), 16(1)(c) and 50AA | Under the proposed amendment, the unilateral tax relief provisions under sections 8(1A)(c) and 16(1)(c) will only be available to Hong Kong taxpayers subject to foreign tax in a jurisdiction that does not have a double taxation agreement ("DTA") with Hong Kong. Where the Hong Kong taxpayer is subject to foreign tax in a DTA jurisdiction, he/she can only claim a tax credit under section 50.<br><br>There are situations where the claiming of a unilateral relief is preferred by the taxpayer. For instance, it is common for Hong Kong salaries taxpayers to claim exemption under section 8(1A)(c) in respect of the part of their income that has already been taxed in the foreign jurisdiction in which they perform employment services, regardless of whether the foreign jurisdiction is a DTA jurisdiction. Not only is this approach simpler in terms of administration, but it also generally produces a more favourable result to the taxpayer. Having only the option of a tax credit for taxes paid in a DTA jurisdiction means that the taxpayer is worse off if he/she works in a DTA jurisdiction, which is counter-intuitive. Moreover, there are individuals who are non-Hong Kong tax residents, but work for a Hong Kong employer both in Hong Kong and a DTA jurisdiction. They will be unable to obtain any double tax relief at all, as neither section 8(1A)(c) (applicable with respect to non-DTA jurisdiction taxes) nor section 50 (applicable to a Hong Kong tax resident only) is available to them.<br><br>Similarly, for Hong Kong profits taxpayers that are non-Hong Kong residents (e.g. Hong Kong branches of a foreign corporation), they will be unable to claim a deduction under section 16(1)(c), nor can they claim a foreign tax credit under section 50, in respect of foreign tax paid in a DTA jurisdiction on the same income subject to tax under various subsections in section 15. | Remove the amendment to sections 8(1A)(c) and 16(1)(c), and the corresponding reference in section 50AA. |
| 2. | 8 | Section 50AAB | Section 50AAB(3) states that the Commissioner may request a taxpayer who presents a case for mutual agreement procedure to pay any costs and reasonable expenses incurred by the Commissioner in relation to the mutual agreement procedure (or arbitration if applicable), or reimburse the Commissioner for the costs and expenses. The objective of mutual agreement procedure is for the Inland Revenue Department to help aggrieved taxpayers to resolve international tax disputes. Besides, the Bill requires all | Remove sections 50AAB(3) and (4) |

[1] Inland Revenue Ordinance.

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| | | | corresponding relief claims involving foreign tax to go through mutual agreement procedure. Furthermore, the taxpayer has no control over the mutual agreement procedure process, which is a matter between two competent authorities. It would therefore seem onerous for the aggrieved taxpayer to have to also incur uncertain costs to seek a governmental body's assistance in resolving these matters. | |
| 3. | 9 | Part 8AA Section 50AAD | The proposed section 50AAD states that Part 8AA applies to property tax, salaries tax and profits tax. Extending the application of transfer pricing rules beyond profits tax is inconsistent with common international tax practice. In particular, requiring transactions concerning salaries tax to comply with transfer pricing rules will create unnecessary burden to employers who will be required to justify the arm's length nature of the salaries and staff benefits paid to associated persons. The shareholders of many small businesses or startups (which may still be loss-making) are prepared to sacrifice their salaries in order to facilitate the growth of their businesses. On the other hand, some successful family businesses may reward shareholders for their contributions by paying sizeable bonuses. It is difficult to determine what might be an arm's length remuneration in this kind of situations. | Restrict the application of section 50AAD to profits tax only and remove the application to salaries tax and property tax. |
| 4. | 9 | Part 8AA Section 50AAF and 50AAM | Under section 50AAF, the Rule 1 arm's length principle applies to both domestic and cross-border provisions / transactions between associated persons. Applying transfer pricing rules to domestic provisions / transactions creates additional work and burden to both the Inland Revenue Department and taxpayers while there is no change in net tax revenue to the government in most cases.<br><br>One common arrangement within Hong Kong corporate groups is the usage of one employment company to hire all employees of the group for administrative convenience. The employment company will then recharge the relevant staff costs to group companies for which the staff serve. For the arrangement to be arm's length, the employment company would likely need to charge a mark-up on the costs. However, this would create additional administrative work for corporate groups in having to come up with and support the arm's length nature of such mark-ups, when in most cases the taxation of the mark-up and deduction of it offset each other from a group perspective, creating no net tax advantage or disadvantage to both the taxpayer and the government. | Restrict the application of Rule 1 to provisions / transactions between a Hong Kong person and its non-Hong Kong associated person. |

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| | | | In the case of a non-arm's length domestic transaction, the assessor of the advantaged person would make an adjustment to its tax position. The disadvantaged person would seek corresponding relief from its own assessor. Under section 50AAM, the disadvantaged person may be required to prove to its assessor's satisfaction that its claim is the arm's length amount. The entire arrangement results in extra work for four parties but no net increase in tax revenue to the government. This reduces overall efficiency of the economy.<br><br>In situations where a non-arm's length domestic transaction may result in loss of tax revenue to the government due to different tax attributes of the two Hong Kong taxpayers (e.g. where one of the companies has tax losses), the Inland Revenue Department can make use of anti-avoidance provisions under the IRO to tackle such situations. | |
| 5. | 9 | Part 8AA Sections 50AAF, 50AAK and 50AAM | Sections 50AAF, 50AAK and 50AAM use the term "*the* arm's length amount". This appears to imply that there is only one arm's length amount. According to the OECD guidelines, an arm's length amount normally refers to an amount within an arm's length range, not a specific amount.<br><br>In addition, sections 50AAF and 50AKK empower an assessor to estimate an amount as the arm's length amount, apparently without any need to provide support as to how he/she comes up with that estimate, and the burden is then on the taxpayer to prove that another amount is a *more reliable* measure of the arm's length amount. As mentioned above, an arm's length amount can be any point within an arm's length range. Therefore, any amount within that range can be equally reliable. It would be difficult if not impossible for the taxpayer to prove that another amount is more reliable. | Replace "*the* arm's length amount" with "*an* arm's length amount" or "*an amount within* the arm's length *range*".<br><br>Replace "*a more* reliable" with "*an equally or more* reliable".<br><br>Clarify the power of the assessor in particular whether and how he/she should support his/her |

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| | | | | estimate as being arm's length |
| 6. | 9 | Part 8AA Section 50AAH | For purposes of defining the participation condition, apart from the "control" situations involving beneficial interest, voting rights and powers conferred by constitutional document as set out in section 50AAH(2)(a), section 50AAH(2)(b) also states, in summary, that person B is controlled by person A if person B is accustomed or under an obligation to act in accordance with the directions, instructions or wishes of person A. Such definition is too broad and may lead to disputes due to subjectivity. | Remove section 50AAH(2)(b). |
| 7. | 9, 10 and 36 | Part 8AA Section 50AAK<br><br>Schedule 17G<br><br>Inland Revenue Rule 5 | Section 50AAK sets out Rule 2 that deals with the attribution of profits to a Hong Kong permanent establishments of non-resident, with a new definition for permanent establishment being set out in Schedule 17G. The new permanent establishment definition, which follows the latest OECD Model Tax Convention, is fairly complex. While the current permanent establishment definition under Inland Revenue Rule 5 is seems outdated and does need updating, the new definition is too big a move. It is also unexpected especially when Hong Kong opted out of the relevant permanent establishment articles in implementing the Multilateral Instrument.<br><br>Besides, section 50AAK starts with "Without limiting section 14", meaning that the new permanent establishment definition does not prescribe a threshold test for non-residents carrying on a business in Hong Kong, i.e. a non-resident can still carry on a business in Hong Kong without a permanent establishment in Hong Kong. This creates uncertainty to foreign businesses wishing to have dealings with / in Hong Kong.<br><br>Furthermore, section 50AAK effectively requires the non-resident to adopt the Authorised OECD Approach in attributing profits to the Hong Kong permanent establishment. The Authorised OECD Approach is very complex and will create extra burden to taxpayers using branch structures. Many foreign companies chose to use branch structures in Hong Kong due to simplicity in terms of administration and compliance obligations. Going forward, they will face significant challenges in handling their Hong Kong profits tax filing as they could no longer simply use their branch accounts as | Consider redrafting the permanent establishment definition under Schedule 17G without following the latest OECD Model Tax Convention, and making it clear that a non-resident can only carry on a business in Hong Kong through a permanent establishment for purposes of section 14.<br><br>Removing the Authorised OECD Approach requirement. |

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| | | | the basis for the tax return. Moreover, the interaction between profit attribution using the Authorised OECD Approach and the source of profits is unclear. The addition of subsection (1A) to Inland Revenue Rule 5 stating that the rule has effect to the extent to which it is not inconsistent with section 50AAK is also confusing in this regard. | |
| 8. | 10 | Schedule 17H | The fee payable for an Advance Pricing Arrangement application comprises a service charge calculated based on hourly rates, as well as payment or reimbursement of fees paid to any independent expert appointed by the Commissioner and costs and reasonable expenses incurred by the Commissioner in relation to the application. This fee structure gives rise to a lot of uncertainties to taxpayers, who are seeking certainty in terms of their intercompany pricing arrangements. As governmental bodies, it is uncommon for tax authorities to charge service fees to the public based on hourly rates. This may discourage taxpayers from pursuing an Advance Pricing Arrangements, which is not the objective of the Bill.<br><br>Also, taxpayers would generally expect the tax administration to have the expertise in handling the application, and if the tax administration would like to seek external assistance, this should not be done at the expense of the taxpayer. In special circumstances where an independent expert is deemed necessary (for instance, in providing independent expert opinion), the independent expert should be one that is mutually acceptable to the taxpayer and the Inland Revenue Department, with transparency of fees expected to be borne by taxpayer. | Implement a fixed application fee for normal circumstances. Where an independent expert is deemed necessary, both the taxpayer and the Inland Revenue Department should agree to selection of the expert, and fee estimates of the expert should be made known to the taxpayer in advance. |
| 9. | 13 | Section 15BA | Section 15BA deals with changes in trading stock within the same person, and has nothing to do with transfer pricing. Further, it is inconsistent with *Nice Cheer Investment Limited v. CIR* which confirmed that a man cannot trade with himself and unrealised profits should not be taxable. | Consider removing section 15BA, or amend it to the effect that while a change in intention with regard to trading stock should be accounted for, any tax is not due until after |

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| | | | | the relevant asset has been finally disposed of to another person. |
| 10. | 14 | Section 15F | Section 15F seeks to attribute royalty income to a Hong Kong person that contributes to the value creation of intellectual property owned by a non-resident associate (and "associate" has the meaning given by section 20AC(6), not section 50AAG). A similar result could have been achieved by just applying section 50AAF to make a transfer pricing adjustment to the Hong Kong person, and thus section 15F is not necessary. Section 15F also potentially gives rise to various uncertain ramifications, which may not be intended. For instance, where a Hong Kong subsidiary of a foreign multinational group performs marketing functions in relation to the group's brands, the Hong Kong subsidiary could potentially be regarded as having contributed to the value creation of the brands, in which case section 15F can be invoked to attribute a part of the worldwide royalty income derived by the non-resident associate to the Hong Kong subsidiary. There is also uncertainty as to whether attribution of royalty income is still required if the Hong Kong subsidiary already received an arm's length remuneration for its value creation activities.<br><br>Besides, where the non-resident associate already paid tax on the royalty income in its home country (as well as withholding tax in the royalty payers' countries), the group will not be able to obtain double tax relief in respect of the additional Hong Kong profits tax imposed under section 15F, as the taxpayer for purposes of section 15F is the Hong Kong subsidiary not the non-resident associate.<br><br>The complexity potentially created by this section may discourage R&D activities in Hong Kong, which is inconsistent with the Chief Executive's wish to boost innovation and technological development in Hong Kong. | Remove section 15F. |
| 11. | 16 | Part 9A<br>Section 58C | Section 58C(3)(b) states that the local file and master file must cover the items of information, and reflect the format (including terminology and order of presentation), set out in Schedule 17I. This is a very stringent requirement and creates unnecessary burden to taxpayers, particularly those that are part of | Remove "(including terminology and order |

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| | | | a multinational group whose parent has already prepared the master file in accordance with OECD guidelines but not following the exact terminology and order of presentation as in Schedule 17I. | of presentation)" from section 58C(3)(b) |
| 12. | 17 | Part 9A Schedule 17I | With respect to the thresholds for controlled transactions, "other transactions" is not defined, and it is unclear whether the HK$44 million threshold applies to each type of other transactions (e.g. HK$44 million for interest, HK$44 million for services, etc), or whether the threshold is for all types of other transactions combined. If the latter, it could mean that a taxpayer having a small amount of interest income, but having service fee income that exceeds the threshold, will have to prepare transfer pricing documentation covering the interest arrangement, which is impractical and cost ineffective.<br><br>Echoing point 4 above where we suggest the removal of domestic provisions / transactions from the coverage of Rule 1, we also suggest that only cross-border transactions be required to be covered by transfer pricing documentation. | Include additional separate categories for interest, services and royalties to the list of thresholds.<br><br>Limiting the coverage of transfer pricing documentation to cover only cross-border transactions between associated persons. |
| 13. | 20 | Sections 80G, 80H and 80I | Sections 80G and 80H impose penalties to a reporting entity and a service provider, respectively, in relation to country-by-country reporting, including in situations where the reporting entity or its service provider has knowledge, is reckless, has no reasonable grounds, or has wilful intent to defraud, etc, with respect to misleading, false or inaccurate information in a material particular in relation to the compilation of a country-by-country report. Section 80I imposes penalties on a director, officer or specified person of a corporation that commits an offence under section 80G or 80H.<br><br>Filing of tax returns is always the obligation of taxpayers. Service providers can only assist with the cooperation of the taxpayers. It would be too onerous to service providers to have to face potential penalties in respect of their clients' failure to meet the obligations, especially as service providers do not normally have full control of the information and preparation process. | Remove sections 80H and 80I. |

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| | | | Section 80I also imposes significant burden on the directors, officers or specified persons of reporting entities or service providers. The preparation of a country-by-country report is an extremely tedious exercise, requiring in most cases the concerted efforts of many teams of many different individual entities within a multinational group. Therefore, it is practically difficult for the directors, officers or specified persons to personally ensure the accuracy of the country-by-country report / return. Judging whether a person is reckless or acts without reasonable excuse can sometimes be subjective.<br><br>It therefore seems inappropriate to extend the penalty provisions to cover service providers as well as directors, officers and specified persons. | |
| 14. | 22 | Section 82A | Section 82A(1G) absolves a person from additional tax under subsection (1D) or (1F) if the person proves that he has made reasonable efforts to determine the arm's length amount according to sections 50AAF(1) or 50AAK(2). It is unclear what "reasonable efforts" mean – for instance, whether the preparation of contemporaneous transfer pricing documentation amounts to reasonable efforts. In many jurisdictions, preparation of contemporaneous transfer pricing documentation provides penalty protection. | Consider including penalty protection for taxpayers that have prepared contemporaneous transfer pricing documentation |