

立法會
Legislative Council

LC Paper No. CB(1)704/17-18
(These minutes have been seen
by the Administration)

Ref : CB1/BC/3/17/2

Bills Committee on Inland Revenue (Amendment) (No. 7) Bill 2017

**Minutes of the first meeting
held on Wednesday, 24 January 2018, at 8:30 am
in Conference Room 3 of the Legislative Council Complex**

Members present : Hon Holden CHOW Ho-ding (Chairman)
Hon WONG Ting-kwong, GBS, JP
Hon Starry LEE Wai-king, SBS, JP
Hon Paul TSE Wai-chun, JP
Hon WU Chi-wai, MH
Hon YIU Si-wing, BBS
Hon CHAN Chi-chuen
Hon Kenneth LEUNG
Hon KWOK Wai-keung, JP
Hon Christopher CHEUNG Wah-fung, SBS, JP
Hon CHUNG Kwok-pan
Hon Alvin YEUNG
Hon CHAN Chun-ying

Member absent : Hon Jimmy NG Wing-ka, JP

**Public Officers
attending** : **For item II**

Financial Services and the Treasury Bureau

Mr Andrew LAI, JP
Deputy Secretary (Treasury)²

Ms Pecvin YONG
Principal Assistant Secretary (Treasury) (R1)

Inland Revenue Department

Mr CHIU Kwok-kit, JP
Deputy Commissioner (Technical)

Ms CHAN Shun-mei
Senior Assessor (SD)

Department of Justice

Mr Manuel NG
Senior Government Counsel

Clerk in attendance : Miss Cindy HO
Chief Council Secretary (1)1

Staff in attendance : Mr Cliff IP
Assistant Legal Adviser 8

Mr Jason KONG
Council Secretary (1)1

Miss Mandy POON
Legislative Assistant (1)1

Action

I. Election of Chairman

Election of Chairman

Mr WONG Ting-kwong, the member with the highest precedence among those present at the meeting, presided at the election of Chairman of the Bills Committee. He invited nominations for the chairmanship of the Bills Committee.

2. Mr CHAN Chun-ying nominated Mr Holden CHOW, and the nomination was seconded by Ms Starry LEE and Mr Kenneth LEUNG. Mr CHOW accepted the nomination. There being no other nominations, Mr CHOW was declared Chairman of the Bills Committee.

3. Members agreed that there was no need to elect a Deputy Chairman.

Action

II. Meeting with the Administration

- | | | |
|------------------------------------|---|---|
| (LC Paper No. CB(3)233/17-18 | — | The Bill |
| File Ref: TsyB R 00/765-3-2/1/0(C) | — | Legislative Council Brief |
| LC Paper No. LS20/17-18 | — | Legal Service Division Report |
| LC Paper No. CB(1)507/17-18(01) | | Marked-up copy of the Bill prepared by the Legal Service Division (Restricted to Members) |
| LC Paper No. CB(1)513/17-18(01) | — | Assistant Legal Adviser's letter dated 23 January 2018 to the Administration) |

Declaration of interest

4. Mr YIU Si-wing and Mr CHUNG Kwok-pan declared that their respective companies might benefit from the proposed two-tiered profits tax rates regime ("two-tiered regime"). Mr CHAN Chun-ying declared that the bank(s) and banking association(s) in which he served might benefit from the proposed two-tiered regime. Ms Starry LEE declared that her employer provided tax consultancy services, but she was not involved in the provision of such services. The Chairman declared that the law firm he worked for might benefit from the proposed two-tiered regime.

Discussion

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

Follow-up actions to be taken by the Administration

- Admin 6. The Administration was requested to provide:
- (a) information on the corporate tax/profits tax rates of other jurisdictions, including those which had their corporate tax rates reduced recently;

Action

- (b) the rationale for proposing an upper limit and setting it at the first HK\$2 million of assessable profits for the lower tax rates under the proposed two-tiered regime; and
- (c) written response to Assistant Legal Adviser's letter dated 23 January 2018 to the Administration.

(Post-meeting note: The Administration's response was circulated to members on 1 February 2018, vide LC Paper No. CB(1)549/17-18(02).)

Invitation of written submissions

7. Members agreed to invite professional organizations and the public to provide written submissions on the Inland Revenue (Amendment) (No. 7) Bill 2017 ("the Bill").

(Post-meeting note: Letters to invite written submissions on the Bill were sent to relevant organizations and District Councils on 24 January 2018; and a general notice was posted on the Legislative Council website on the same day.)

III. Any other business

Date of next meeting

8. The Chairman said that he would work out the date of next meeting with the Clerk and inform members of the date in due course.

(Post-meeting note: With the concurrence of the Chairman, the second meeting was scheduled for Tuesday, 6 February 2018 at 4:30 pm. Members were informed vide LC Paper Nos. CB(1)520/17-18 and CB(1)521/17-18 on 24 January 2018 of the schedule of the next meeting, and the organizations to be invited to provide written submissions on the Bill.)

9. There being no other business, the meeting ended at 10:30 am.

Bills Committee on Inland Revenue (Amendment) (No. 7) Bill 2017

**Proceedings of the first meeting
on Wednesday, 24 January 2018, at 8:30 am
in Conference Room 3 of the Legislative Council Complex**

Time marker	Speaker	Subject(s)	Action required
<i>Agenda Item I - Election of Chairman</i>			
000409 - 000555	Mr WONG Ting- kwong Mr CHAN Chun- ying Ms Starry LEE Mr Kenneth LEUNG Mr Holden CHOW	Election of Chairman	
<i>Agenda Item II - Meeting with the Administration</i>			
000556 - 000717	Chairman	Opening remarks	
000718 - 001450	Administration	Briefing by the Administration on the Inland Revenue (Amendment) (No. 7) Bill 2017 ("the Bill").	
001451 - 002000	Chairman Mr Kenneth LEUNG Administration	<p>Mr LEUNG enquired about:</p> <p>(a) the estimated tax revenue forgone upon implementing the proposed two-tiered profits tax rates regime ("two-tiered regime"); and</p> <p>(b) with reference to the anti-abuse provisions in the proposed new section 14AAB, whether tax deduction would apply to the following scenario: a natural person was a partner of "Company A", "Company B" and "Company C" which were three partnerships engaged in different businesses.</p> <p>The Administration responded that:</p> <p>(a) on the assumption that 20% of the tax-paying enterprises were "connected entities", the tax revenue forgone under the proposal in the Bill would be about HK\$5.8 billion per year, having regard to the fact that in 2015-2016, some 111 000 enterprises in Hong Kong had assessable profits of HK\$2 million or below and about 23 000 enterprises with assessable profits above HK\$2 million; and</p> <p>(b) in line with the objective of the Chief Executive of focusing the tax benefits on small and medium enterprises ("SMEs") and start-ups, it was proposed to</p>	

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		<p>introduce restrictions to limit the application of the proposed two-tiered regime to only one enterprise nominated among those which were connected. Entities would be considered "connected" if one had control over the other or they were under the control of the same entity. "Control" generally referred to holding directly or indirectly more than 50% of the issued share capital, voting rights, capital or profits of another entity as defined under clause 4 of the Bill ("the 50% threshold"). In the scenario mentioned by Mr LEUNG, under the proposed new section 14AAB, if a natural person was carrying on a sole proprietorship business as well as engaging in partnerships, the proprietorship business and partnerships would be regarded as connected entities if the 50% threshold was exceeded for the partnerships.</p>	
002001 - 002234	Chairman Mr YIU Si-wing Administration	<p>Declaration of interest by Mr YIU (paragraph 4 of the minutes refers).</p> <p>Mr YIU expressed support for the implementation of the proposed two-tiered regime so as to reduce the tax burden on enterprises, especially SMEs. He sought clarification on the proposed definition of "connected entity", and enquired whether the tax saved by enterprises would have to be used for specific purposes.</p> <p>The Administration reiterated that two entities would be regarded as "connected entities" if one of them had control over the other or both of them were under control of the same entity where the 50% threshold was exceeded. The Administration clarified that there were no specific conditions for the enterprise electing for the proposed two-tiered regime and there would also be no restriction on how the tax savings should be used by individual enterprises.</p>	
002235 - 002750	Chairman Ms Starry LEE Administration	<p>Ms LEE supported the policy direction of the Bill with a view to assisting SMEs in reducing operating cost.</p> <p>Ms LEE queried whether the proposed two-tiered regime should be applicable to entities which profited from purchase and sale of properties as their sole or primary business. She raised concern about possible abuse of the proposed two-tiered regime through tactics such as carrying on business through natural persons and sole proprietorships, instead of through a group of subsidiaries in order to maximize the benefits arising from the proposed reduced profits tax rate for the first HK\$2 million of assessable profits of each unconnected entity. She sought clarification with the Administration in this regard.</p>	

Time marker	Speaker	Subject(s)	Action required
		<p>The Administration's explanations as follows:</p> <ul style="list-style-type: none"> (a) enterprises, whether unincorporated businesses or corporations, would be regarded as connected entities if they were under the control of the same entity, including a natural person; and only one of the connected entities would benefit from the proposed lower tax rates; and (b) how an entity carried on its business or made investments was essentially a commercial decision of the entity concerned. Besides, measures such as the Buyer's Stamp Duty and Special Stamp Duty were in place to cool down investment and speculative activities in the property market, regardless of whether the entities involved in the property transactions were natural persons or companies. 	
002751 - 003628	Chairman Mr CHAN Chi- chuen Administration	<p>Mr CHAN Chi-chuen's views and questions as follows:</p> <ul style="list-style-type: none"> (a) it was the People Power's position that a progressive profits tax rates regime should be adopted instead and, in this respect, he was not inclined to support proposals on reducing the profits tax rates; (b) he expressed doubt on whether the proposal was able to achieve the policy objectives of the Bill which included, among others, gaining international publicity mileage in promoting Hong Kong as a preferred investment destination; (c) enterprises might exploit the gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations (i.e. base erosion and profit shifting ("BEPS")); (d) whether the Administration had plans to further reduce the upper corporate profits tax rate in future; and (e) whether the proposed two-tiered regime would have the effect of narrowing Hong Kong's tax base. <p>The Administration's response as follows:</p> <ul style="list-style-type: none"> (a) while Hong Kong's corporate tax rate of 16.5% was amongst the lowest in the world, it was appropriate to introduce the proposed two-tiered regime in order to remain competitive and attract foreign investments into Hong Kong given the international trend to reduce corporate tax rates; (b) as the proposal only reduced the rates of charging 	

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		<p>assessable profits, it would not change or narrow the tax base;</p> <p>(c) issues relating to BEPS were dealt with in the context of the Inland Revenue (Amendment) (No. 6) Bill 2017, which was introduced to the Legislative Council in January 2018 for implementing a package of measures to counter BEPS and enhance tax transparency; and</p> <p>(d) the Administration had no plan at present to reduce the upper corporate profits tax rate across the board.</p> <p>Mr CHAN requested the Administration to provide supplementary information as follows: (a) the corporate tax/profits tax rates of other jurisdictions, including those which had their corporate tax rates reduced recently; and (b) the rationale for proposing an upper limit and setting it at the first HK\$2 million of assessable profits for the lower profits tax rates under the proposed two-tiered regime.</p>	<p>Admin (paragraphs 6(a) and (b) of the minutes refer)</p>
003629 - 003814	Chairman Administration	<p>The Chairman shared Ms Starry LEE's concern regarding possible abuse of the proposed two-tiered regime through tactics such as segregation of businesses, and asked how the Administration would ensure compliance in administering the proposed two-tiered regime.</p> <p>The Administration's explanations as follows:</p> <p>(a) the taxpayers concerned would be required to indicate in their tax returns whether they elected for the proposed two-tiered regime, and if so, declared that their connected entities, if any, had not elected for the same;</p> <p>(b) penal provisions might be invoked for providing false information in the tax returns; and</p> <p>(c) the Inland Revenue Department ("IRD") would monitor enterprises' compliance with the requirements under the proposed two-tiered regime by conducting desk audits and risk-based thematic reviews.</p> <p>The Chairman enquired whether the Administration might consider additional parameter(s) such as the number of employees engaged by an enterprise as the eligibility criteria for the proposed two-tiered regime as a measure to boost employment.</p> <p>The Administration emphasized that the proposed two-tiered regime was designed to benefit all eligible enterprises with assessable profits irrespective of their size and number of employees, while maintaining a simple tax system.</p>	

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003815 - 004326	Chairman Mr KWOK Wai-keung Administration	<p>Mr KWOK said that he supported in principle the introduction of the proposed two-tiered regime, and considered that enterprises benefiting from the proposed reduced tax rates should make use of the tax savings to improve their staff salary and welfare.</p> <p>Mr KWOK said that the Hong Kong Federation of Trade Unions had all along advocated adopting a tax system to achieve vertical equity. In this regard, he suggested that the Administration should consider introducing more tax bands in the profits tax regime (including one for assessable profits of HK\$10 million or above with a corporate tax rate at 17.5% for instance) in the long run. The Administration reiterated that in view of the international trend of reducing corporate tax rates, it might not be appropriate at this stage to consider the suggestion lest Hong Kong's competitive edge would be undermined. For instance, the United States had recently announced that it would cut down its corporate tax rates to 21% while the United Kingdom would lower the same to 17% in 2020. Japan had also lowered its corporate tax rate from 23.4% in 2016 to 23.2% in 2018.</p> <p>In response to Mr KWOK's enquiry on how the relevant measure would help improve competitiveness of Hong Kong enterprises, the Administration reckoned that foreign investments in Hong Kong were influenced by a number of factors, and tax concessions including lowering the profits tax rates formed only part of the government measures to promote Hong Kong as a preferred investment destination.</p>	
004327 - 004644	Chairman Mr CHUNG Kwok-pan Administration Mr Kenneth LEUNG	<p>Declaration of interest by Mr CHUNG (paragraph 4 of the minutes refers).</p> <p>Mr CHUNG expressed support for the proposal in the Bill as the proposed lower tax rates would reduce the tax burden on enterprises especially SMEs. He asked whether the proposed two-tiered regime would apply to the following scenario: business restructuring through transfer of shares or re-distribution of profits to alter the control, or conceal the genuine control, of an entity in a group such that the entity would no longer be considered as "connected" with another entity or other entities in the group for the purpose of the proposed two-tiered regime.</p> <p>The Administration advised that business restructuring was a normal commercial activity. Different business set-ups could have diverse risk profiles, return on assets and cost structures. Costs and benefits had to be carefully considered prior to an amalgamation of businesses and that was a business decision. Generally, such commercial activities would not be treated as tax avoidance transactions.</p>	

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		<p>Mr LEUNG sought clarification on the application of the two-tiered regime to enterprises electing for the preferential half-rate tax regimes.</p> <p>The Administration clarified that professional reinsurers/authorized captive insurers, qualifying corporate treasury centres, qualifying aircraft lessors and qualifying aircraft leasing managers would not be eligible for the proposed two-tiered regime if they had elected for the existing preferential half-rate tax regimes so as to avoid having double benefits.</p>	
004645 - 005156	Chairman Ms Starry LEE Administration	<p>Ms LEE opined that the Administration should consider reducing the tax burden on the middle class by lowering the salaries tax rates or introducing more tax-deductible items in respect of salaries tax if financially viable with a view to narrowing the income gap. The Administration stressed that basically the salaries tax regime and the proposed two-tiered regime accorded with the "ability-to-pay" principle. Nevertheless, it agreed to give thought to Ms LEE's suggestion in future reviews.</p> <p>Ms LEE reiterated her concern about the application of the proposed two-tiered regime to entities which profited from purchase and sale of properties as their sole or primary business.</p>	
005157 - 005506	Chairman Mr CHAN Chun-ying Administration	<p>Declaration of interest by Mr CHAN (paragraph 4 of the minutes refers).</p> <p>With a view to targeting the tax benefits at SMEs only, Mr CHAN enquired whether it was possible to simplify the operation of the proposed regime by imposing restrictions on the size of enterprises, thereby excluding multinational enterprises ("MNEs") and larger enterprises from being eligible for the proposed two-tiered profits tax rates.</p> <p>The Administration responded that the proposed eligibility criteria, based on the amount of assessable profits, were meant to simplify the operation of the proposed two-tiered regime. On the other hand, a tax system based on turnover/size of enterprises would complicate the profits tax system and might not be suitable for all kinds of businesses.</p>	
005507 - 005527	Ms Starry LEE	Declaration of interest (paragraph 4 of the minutes refers).	
005528 - 010057	Chairman Mr KWOK Wai-keung Administration	<p>Mr KWOK's concern and enquiry as follows:</p> <p>(a) whether the proposed two-tiered regime would have the effect of narrowing Hong Kong's tax base and would</p>	

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		<p>have a long-term negative impact on tax revenue; and</p> <p>(b) whether the Administration would consider a mechanism to provide for termination of the proposed two-tiered regime after a fixed period.</p> <p>The Administration's response as follows:</p> <p>(a) given that profits tax was the largest source of government revenue, the Administration had exercised prudence when formulating the current proposal. Having taken into account relevant factors, the Administration considered it appropriate to set the proposed threshold for the lower tax rates at HK\$2 million of assessable profits;</p> <p>(b) the Tax Policy Unit of the Financial Services and the Treasury Bureau would review Hong Kong's tax regime, including how to broaden the tax base and increase government revenue in the long run; and</p> <p>(c) the proposed two-tiered regime would be a long-term measure, but the Administration would consider reviewing the regime in future if necessary.</p>	
010058 - 010934	Chairman Assistant Legal Adviser ("ALA") Administration	<p>Declaration of interest by the Chairman (paragraph 4 of the minutes refers).</p> <p>Referring to the scenario as set out in paragraphs (3) and (4) of ALA's letter of 23 January 2018 to the Administration, ALA and the Chairman sought clarification on whether it was the policy intent to (i) allow only one of two corporations which were connected entities to benefit from the proposed lower profits tax rate even if their combined profits were less than HK\$2 million, and (ii) charge someone (X) who had two corporations more profits tax than another (Y) who had one corporation under the proposed two-tiered regime even though X's overall profits were less than Y's.</p> <p>The Administration replied in the affirmative and supplemented that:</p> <p>(a) the proposed restrictions regarding connected entities would prevent possible abuse of the proposed two-tiered regime through tactics such as artificial shift of profits among a group of entities under the control of the same entity;</p> <p>(b) there was a need to strike a balance between maintaining a simple tax regime and achieving the policy objectives</p>	

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		<p>of the proposed two-tiered regime, which included reducing the tax burden on SMEs and start-up enterprises; and</p> <p>(c) the scenario set out in ALA's letter was worth careful consideration. When formulating the current proposal, the Administration had taken into account the tax treatments in a number of scenarios including those suggested in ALA's letter. In real-life situations, the accounting periods of connected entities might be different and the profits of each entity varied from year to year, and hence aggregating their profits for taxation purposes might not be feasible from the tax administration angle.</p> <p>The Chairman requested the Administration to provide a written response to ALA's letter.</p>	Admin (paragraph 6(c) of the minutes refers)
010935 - 011201	Chairman Mr Kenneth LEUNG Administration	<p>Mr LEUNG asked whether the proposed two-tiered regime would apply to the scenario which involved artificial shift of profits/losses of an enterprise across different years of assessment.</p> <p>The Administration explained that as loss carried forward from the previous year of assessment had to be set off against the profits in the immediate year that followed, it was not possible to artificially shift the loss across subsequent years of assessment with a view to lowering the assessable profits to HK\$2 million or less to yield the maximum savings under the proposed lower profits tax rate.</p>	
011202 - 012236	Chairman Mr WU Chi-wai Administration	<p>To better achieve the "ability-to-pay" principle and help recoup tax revenue forgone in connection with the current proposal, Mr WU opined that the Administration should explore introducing more tax bands in the profits tax regime and increasing the tax rates applicable to higher tax bands.</p> <p>The Administration took note of Mr WU's view and pointed out that enterprises might reinvest their tax savings from the proposed two-tiered regime and boost their business scales, which in turn might bring in additional tax revenue in future.</p>	
012237 - 015711	Chairman Mr Paul TSE Administration Mr Kenneth LEUNG Mr WU Chi-wai ALA	<p>Discussion on the public consultation on the legislative proposal and the need for the Bills Committee to invite public views.</p> <p>Regarding public consultation, the Administration remarked that it had briefed the Panel on Financial Affairs on the</p>	

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		<p>proposed introduction of the proposed two-tiered regime and Panel members had not raised objection to the proposal. In addition, during its meetings and contacts with representatives of chambers of commerce and the business sector, the Administration also received positive feedback on the proposal in general.</p> <p>Mr TSE queried whether the proposal in the Bill was able to bring about the intended positive impacts as set out in paragraph 3 of the Legislative Council Brief. In particular, it might not be appealing enough to attract MNEs by reducing the profits tax rates only for the first HK\$2 million of assessable profits. Mr TSE's concerns and suggestions as follows:</p> <ul style="list-style-type: none"> (a) the restrictions imposed in relation to "connected entities" might have the effect of lifting the corporate veil and complicating the profits tax system; and (b) for the purposes of maintaining a simple profits tax regime and minimizing administrative cost, the proposed two-tiered regime should be applied to all enterprises with assessable profits. <p>Mr WU and the Chairman considered that IRD should seek additional manpower resources as appropriate if necessary to ensure compliance and combat tax evasion after introducing the proposed two-tiered regime.</p> <p>The Administration's response as follows:</p> <ul style="list-style-type: none"> (a) the proposed eligibility criteria, based on amount of assessable profits and a simple definition of "connected entity" prescribed by the Bill, were meant to simplify the operation of the proposed regime and minimize both administrative and compliance burden; (b) in respect of profits tax returns to be filed by enterprises, the Administration explained that the taxpayers concerned would be required to indicate in their tax returns whether they elected for the proposed two-tiered regime, and if so, declared that their connected entities, if any, had not elected for the same; (c) the tax reporting system in Hong Kong was an "honour system" and audit was conducted by IRD after the filing of tax returns by taxpayers. IRD would conduct desk audits and risk-based thematic reviews to ensure tax compliance, and penal provisions like section 82A of the Inland Revenue Ordinance (Cap.112) ("IRO") might be invoked for incorrect returns. If the tax returns filed by 	

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		<p>taxpayers contained errors or omissions, IRD would seek additional information from the taxpayers concerned, and take appropriate measures, including raising additional tax and instituting legal actions, to rectify the errors and to enforce compliance; and</p> <p>(d) while it was necessary to enhance the relevant computer system of IRD, it was envisaged that the existing manpower resources could cope with the additional administrative and enforcement workload arising from the operation of the proposed two-tiered regime.</p> <p>Mr WU enquired whether a group of companies jointly owned by relatives like brother and sister, each of which owning or controlling no more than 50% of the issued share capital, interest or profits in each of the companies in question, would be regarded as "connected entities".</p> <p>ALA supplemented that he had raised a similar question in paragraph (6) of his letter to the Administration. It was noted that the concept of "relative" was not used in the proposed definition of "connected entity" in the Bill, and this was in contrast with the use of the term in other existing parts of IRO (e.g. section 14A(4) and 14G(1) in relation to the definition of "associate"). He had requested the Administration to explain the rationale for the proposed definition of "connected entity".</p> <p>The Administration responded that many SMEs in Hong Kong were family businesses. Given that members of the same family might run different businesses independently, it was reasonable to apply the proposed lower rates to each of them. Therefore, the concept of "relative" was not included in the proposed definition of "connected entity" under the proposed two-tiered regime.</p>	
015712 - 020349	Chairman Mr Kenneth LEUNG Mr Paul TSE Administration	Concluding remarks	
<i>Agenda Item III — Any other business</i>			
020350 - 020448	Chairman	Date of next meeting	