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URGENT

By Fax (2179 5848)

23 January 2018

Ms Pecvin YONG  
Principal Assistant Secretary for Financial  
Services & the Treasury (Treasury)(R1)  
Financial Services and the Treasury Bureau  
24/F, Central Government Offices  
2 Tim Mei Avenue  
Tamar  
Hong Kong

Dear Ms YONG,

**Inland Revenue (Amendment) (No. 7) Bill 2017**

We are scrutinizing the legal and drafting aspects of the Inland Revenue (Amendment) (No. 7) Bill 2017 ("Bill"). We should be grateful if you could clarify the following matters:

Qualifying debt instruments – avoidance of double benefits

(1) It is stated in paragraph 6 of the Legislative Council ("LegCo") Brief (File Ref.: TsyB R 00/765-3-2/1/0(C)) that in order to avoid double benefits, the assessable profits for sums received by or accrued to holders of qualifying debt instruments as interest, gain or profit would be excluded from the proposed two-tiered profits tax rates regime because those profits are already taxed at half-rate.

- (a) Please clarify how the above policy intent could be reflected in the provisions of the Bill.
- (b) In the case of a corporation having HK\$3 million assessable profits from his qualifying debt instruments as well as HK\$1 million assessable profits from operating a business in Hong Kong ("HK") in the same year of assessment commencing on 1 April 2018, how do the existing section 14A of the Inland Revenue Ordinance (Cap. 112) and the proposed two-tiered profits tax rates regime under the Bill apply to that corporation? In particular, would section 14A continue to apply to the entire sum of assessable profits of HK\$3 million in respect of the qualifying debt instruments? Would the assessable profits of HK\$1 million from the business be taxed at 8.25% or 16.5% under the proposed two-tiered profits tax rates regime?

Clause 4 – connected entities

(2) In the case of a natural person A ("A") who solely owns only one corporation B ("B"), please clarify whether:

- (a) A and B are considered as "connected entities" pursuant to the proposed section 14AAB(1)(a) of Cap. 112 under clause 4; and
- (b) B would not benefit from the proposed lower profits tax rate if it does not proactively make an election in writing for the proposed lower profits tax rate to apply to it, pursuant to the proposed section 14AAC(4) of Cap. 112. Please also explain how that written election is to be made in practice.

(3) Please clarify if it is the legislative intent to allow only one of two corporations which are connected entities defined under the proposed section 14AAB of Cap. 112 to benefit from the proposed lower profits tax rate even if their combined profits are less than HK\$2 million.

(4) In particular, please let us have your clarifications in respect of the following scenario in the year of assessment commencing on 1 April 2018:

	<b>HK resident X ("X")</b>	<b>HK resident Y ("Y")</b>
<b>Corporation(s)</b>	X solely owns: (i) corporation F (only business is to sell flowers in HK); and  (ii) corporation N (only business is to sell noodles in HK).	Y solely owns only one corporation T (only business is to sell toys in HK).
<b>Net profits (HK\$)</b>	F: 800,000 and N: 800,000 (i.e. X's overall profits are 1,600,000)	T: 2,000,000

- (a) Is X allowed to elect in writing only one of his corporations (either F or N) for the proposed lower profits tax rate pursuant to the proposed section 14AAC(4) of Cap. 112?
- (b) Please confirm whether X would have to pay more profits tax than Y, even if X has less overall profits than Y. If so, please also explain to members the rationale behind this policy intent.

(5) Suppose X restructures his businesses, so that N's business selling noodles is completely transferred on 1 March 2019 to F. N ceases its business and is wound up/de-registered on 1 March 2019. If the only reason that X restructures his businesses is to benefit from the lower profits tax rate in the year of assessment commencing on 1 April 2018 and the subsequent years (if the Bill is passed), would F and/or N be entitled to the proposed lower profits tax rate in the year of assessment commencing on 1 April 2018 and the subsequent years, and would not be treated as avoiding liability for tax?

(6) It is noted that the concept of "relative" is not used in the proposed definition of "connected entity" in the Bill. This is in contrast with the use of the term in other parts of the existing Cap. 112 (e.g. sections 14A(4) and 14G(1) in relation to the definition of "associate"). Please explain the rationale for the proposed definition of "connected entity".

We look forward to receiving your reply in both English and Chinese as soon as possible, preferably before the second meeting of the Bills Committee.

Yours sincerely,

A handwritten signature in black ink, consisting of a large, stylized 'C' followed by a horizontal line.

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