



By email (mpoon@legco.gov.hk) and by hand

6 February 2018

Our Ref.: C/TXP, M115159

Hon. Holden CHOW Ho-ding
Chairman,
Bills Committee on Inland Revenue (Amendment) (No.7) Bill 2017,
Legislative Council Complex,
1 Legislative Council Road,
Central, Hong Kong

Dear Mr Chow,

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

The Tax Faculty ("TF") of the Hong Kong Institute of Certified Public Accountants ("Institute") has reviewed the Inland Revenue (Amendment) (No.7) Bill 2017 ("the Bill") and has the views explained below on the proposed legislation.

Members of TF support the introduction of the two-tier tax system. Small and medium-sized enterprises and start up companies should benefit under the new system and we hope that they will use the tax savings to reinvest in their businesses by, for example, upgrading existing equipment, improving the working environment, or developing new products.

At the same time, the Administration may wish to consider the following issues relating to the Bill:

1. Definition of connected entity

We note the intention that a group of connected entities may nominate only one entity to enjoy the benefit of taxation on the first HK\$2 million of its assessable profits at half of the current tax rate. We understand that this restriction is meant to forestall abusive use of the two-tier system.

"Connected entity" is defined in the proposed new section 14AAB of the Inland Revenue Ordinance ("IRO") by reference to "control" or to the same person carrying on more than one sole proprietorship business. "Control" is defined in terms of entitlement to, e.g., capital, voting rights, profits, etc., where the 50% threshold is exceeded. The definition seems to be less rigorous than the definition of "associate" in other parts of the IRO. While this will potentially allow more taxpayers to benefit from the two-tier tax system, there may be greater scope for abuse. This may need to be monitored and, if necessary, further action taken to prevent abuses, once the system has been implemented.

2. Connected entity nomination

As explained in the Legislative Council Brief, the intention is to limit the preferential tax treatment under the two-tier regime to only one enterprise nominated from among a group of connected entities. The proposed section 14AAC(5) provides that the nomination, once made, is irrevocable. We take it that this irrevocable nomination should apply only to a particular year of assessment and that the group of entities could nominate another connected entity to enjoy the preferential tax treatment in future years of assessment, should it wish to do so.

The drafting of the provisions on connected entities seem to add significant complexity into the IRO. The relevant provisions appear to prescribe that the amended section 14 of the IRO, which introduces the two-tier regime, will apply to connected entities, but only subject to modifications. Under section 14AAC(3), the modifications disapply the preferential arrangements, but this subsection is itself subject to the proposed subsection (4), under which the Commissioner of Inland Revenue may exempt an entity from the disapplication of the relevant provisions, if it elects to be so exempted. In the interests of retaining the simplicity of the IRO, as far as possible, we would ask whether there is scope to make the approach more straightforward from a drafting point of view.

3. Tax treatment on income from qualified debt instruments

The Legislative Council Brief (paragraph 6) refers to excluding from the two-tier-tax regime, the assessable profits for sums received by or accrued to holders of qualifying debt instruments, as interest, gain or profit (in addition to excluding entities that have elected to be assessed at the preferential half-rate tax regimes for reinsurance business, captive insurance business, corporate treasury centres, aircraft leasing business and aircraft leasing management business). However, it is not clear how the exclusion of qualified debt instruments is stipulated in the Bill. Further clarification in this regard would be helpful.

Should you have any questions on this submission, please contact me at 2287 7084 or peter@hki CPA.org.hk

Yours sincerely,



Peter Tisman
Director, Advocacy & Practice Development

PMT/EKC/pk