

## **LEGISLATIVE COUNCIL BRIEF**

Inland Revenue Ordinance  
(Chapter 112)

### **INLAND REVENUE (AMENDMENT) (NO. 7) BILL 2017**

#### **INTRODUCTION**

At the meeting of the Executive Council on 31 October 2017, the Council ADVISED and the Chief Executive ORDERED that the Inland Revenue (Amendment) (No. 7) Bill 2017 (“Bill”), at Annex, should be introduced into the Legislative Council (“LegCo”) to make necessary amendments to the Inland Revenue Ordinance (“IRO”) to implement a two-tiered profits tax rates regime.

#### **JUSTIFICATIONS**

##### *Policy Objectives*

2. It has become an international trend to reduce corporate tax rates in order to attract more foreign businesses. While Hong Kong’s corporate tax rate of 16.5% is amongst the lowest in the world, we have to give due consideration to the changes in the external environment.

3. It is our objective to adopt a competitive taxation system to promote economic development, while maintaining a simple tax regime and low tax rates. Introducing a two-tiered profits tax rates regime can bring about the following positive impacts –

- (a) The lower tax rate will reduce the tax burden on enterprises, especially small and medium enterprises (“SMEs”) and startup enterprises. This will help foster a favourable business environment, drive economic growth and enhance Hong Kong’s

competitiveness.

- (b) The tax savings by enterprises can be reinvested in upgrading their hardware or software, thereby boosting their overall operation and efficiency which in turn could bring in additional tax revenue in future.
- (c) The lower tax will also benefit the more successful social enterprises by alleviating their tax burden. The tax saved will enable these enterprises to pursue their social objectives, e.g. enhancing the services they provide and creating more employment and training opportunities for the socially disadvantaged.
- (d) The two-tiered regime will gain international publicity mileage in promoting Hong Kong as a preferred investment destination.

### ***Our Proposal***

4. We propose to amend the IRO to introduce two-tiered profits tax rates for corporations and unincorporated businesses (“UBs”) starting from 2018-19 as follows –

<b>Assessable Profits</b>	<b>Tax Rates</b>	
	<b>Corporations</b>	<b>UBs</b>
First \$2 million	8.25%	7.5%
Beyond the first \$2 million	16.5%	15%

5. Given the low tax policy in Hong Kong, we consider it appropriate to set the lower tax rate at 8.25% (i.e. half of the current single rate at 16.5%) for corporations as announced in the 2017 Policy Address. For UBs which are mostly partnerships and sole proprietorships, the lower tax rate will be set at 7.5% (i.e. half of the current single rate at 15%).

6. In order to avoid double benefits, we propose excluding from the two-tiered profits tax rates regime (a) those enterprises electing the preferential half-rate tax regimes (e.g. professional reinsurance companies, captive insurance companies, corporate treasury centres and aircraft leasing companies) and (b) the assessable profits for sums received by or accrued to holders of qualifying debt instruments as interest, gain or profit for

which are already taxed at half-rate. They will continue to be subject to the current applicable tax rates, i.e. 7.5% or 8.25%, as the case may be.

7. The proposed two-tiered regime is designed to benefit all eligible enterprises with assessable profits irrespective of their size. The tax rate for the first tier (8.25%) is lower than that proposed in CE's Manifesto (10%) so as to provide further tax relief to SMEs. To ensure that the tax benefits will target at SMEs, we propose to introduce restrictions to limit the application to only one enterprise nominated from among those which are connected<sup>1</sup>. Under the proposed two-tiered profits tax rates regime, a tax paying corporation or UB may save up to \$165,000 and \$150,000 each year respectively.

## **OTHER OPTIONS**

8. The IRO has to be amended in order to introduce the two-tiered profits tax rates. There is no other viable option.

## **THE BILL**

9. The main provisions of the Bill are as follows –
- (a) **Clause 3** amends section 14 of the IRO (charge of profits tax) to provide that for any year of assessment commencing on or after 1 April 2018, profits tax is to be charged in accordance with the new Schedule 8A or 8B (depending on whether the person is a corporation);
  - (b) **Clause 4** adds the new sections 14AA, 14AAB and 14AAC to the IRO to define “entity” and “connected entities”; and to provide that if two or more entities are connected, the two-tiered profits tax rates may only apply to one of them;
  - (c) **Clause 11** adds the new Schedules 8A and 8B to the IRO to provide for the charging of profits tax under the two-tiered profits tax rates system. The new Schedule 8A applies to a

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<sup>1</sup> Enterprises or entities are “connected” if they are under the control of the same enterprise or entity.

person other than a corporation, while the new Schedule 8B applies to a corporation; and

- (d) **Clause 12** adds the new Schedule 42 to the IRO to provide for the transitional arrangements in relation to the charging of provisional profits tax for the year of assessment commencing on 1 April 2018.

## **LEGISLATIVE TIMETABLE**

10. The legislative timetable will be as follows –

Publication in the Gazette	29 December 2017
First Reading and commencement of Second Reading debate	10 January 2018
Resumption of Second Reading debate, committee stage and Third Reading	to be notified

## **IMPLICATIONS OF THE PROPOSAL**

11. The proposal is in conformity with the Basic Law, including the provisions concerning human rights. The proposal will not affect the binding effect of the existing provisions of the IRO and its subsidiary legislation. It has no environmental, gender, family or productivity implications.

### ***Financial and Civil Service Implications***

12. On the assumption that 20% of the tax-paying enterprises are connected enterprises, the tax revenue forgone under the proposal will be about \$5.8 billion per year, or around 4% of the total profits tax received in 2016-17. However, the tax amount saved by enterprises can be reinvested in hardware or software upgrade, thereby boosting the overall scale of operation and efficiency which in turn could bring in additional tax revenue in future.

13. To cope with the implementation work, the Inland Revenue Department will flexibly deploy its existing resources and seek additional financial and manpower resources as necessary in accordance with the established resources allocation mechanism.

### ***Economic and Sustainability Implications***

14. The proposal will reinforce Hong Kong's favourable business environment and enhance our tax competitiveness, which may then foster economic growth and create more job opportunities. Indeed, according to an annual survey by the Census and Statistics Department on non-local companies in Hong Kong, a simple tax system with low tax rates is persistently ranked as the most important factor for choosing Hong Kong as their regional headquarters/regional offices/local offices. As such, the proposal should help enhance Hong Kong's attractiveness to foreign companies. Also, the proposal would reduce the tax burden on SMEs notably, thereby promoting entrepreneurship and adding vibrancy to our economy.

## **PUBLIC CONSULTATION**

15. We briefed the Panel on Financial Affairs of the LegCo at its meeting on 20 October 2017, among other initiatives announced in the 2017 Policy Address. Members had no objection to the proposal.

## **PUBLICITY**

16. We will issue a press release on 27 December 2017. A spokesperson will be available to answer media and public enquiries.

## **BACKGROUND**

17. Profits tax is the largest revenue source in Hong Kong. In 2016-17, it stood at \$139 billion, accounting for 24% of total government

revenue.

18. In 2015-16, about 111 900 enterprises in Hong Kong (comprising 82 500 corporations and 29 400 UBs) had assessable profits of \$2 million or below, and they contributed about 4% of the total profits tax of \$140 billion. 96% of the profits tax were contributed by some 23 900 enterprises (comprising 21 300 corporations and 2 600 UBs) with assessable profits above \$2 million.

## **ENQUIRIES**

19. Enquiries on this Brief can be addressed to Ms Pecvin Yong, Principal Assistant Secretary for Financial Services and the Treasury (Treasury), at 2810 2370.

**Financial Services and the Treasury Bureau  
December 2017**

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

**Contents**

Clause	Page
1. Short title .....	1
2. Inland Revenue Ordinance amended .....	1
3. Section 14 amended (charge of profits tax) .....	1
4. Sections 14AA, 14AAB and 14AAC added .....	2
“14AA. Interpretation .....	3
14AAB. Meaning of <i>connected entity</i> .....	3
14AAC. Charge of profits tax for connected entities .....	6
5. Section 19CA amended (treatment of losses: concessionary trading receipts) .....	7
6. Section 63H amended (amount of provisional profits tax) .....	7
7. Section 63HA added .....	8
“63HA. Amount of provisional profits tax for connected entities .....	8
8. Section 89 amended (transitional provisions) .....	10
9. Schedule 1 amended (standard rate) .....	10
10. Schedule 8 amended (rate of profits tax in respect of a corporation) .....	10
11. Schedules 8A and 8B added .....	11

Clause	Page
“Schedule 8A 11	
Two-tiered Rates of Profits Tax—Persons other than Corporations .....	11
Schedule 8B 11	
Two-tiered Rates of Profits Tax—Corporations .....	12
12. Schedule 43 added .....	12
“Schedule 43 13	
Transitional Provisions Relating to Provisional Profits Tax in respect of Year of Assessment 2018/19 .....	13

# A BILL

## To

Amend the Inland Revenue Ordinance to lower the rate of profits tax on assessable profits that are not more than a specified threshold for the years of assessment commencing on or after 1 April 2018.

Enacted by the Legislative Council.

### 1. Short title

This Ordinance may be cited as the Inland Revenue (Amendment) (No. 7) Ordinance 2017.

### 2. Inland Revenue Ordinance amended

The Inland Revenue Ordinance (Cap. 112) is amended as set out in sections 3 to 12.

### 3. Section 14 amended (charge of profits tax)

(1) Section 14(1)—

#### Repeal

“at the standard rate”.

(2) Section 14—

#### Repeal subsection (2)

#### Substitute

“(2) For a person other than a corporation, the tax is to be charged on the assessable profits of the person—

(a) for any year of assessment commencing before 1 April 2018—at the standard rate; or

(b) for any year of assessment commencing on or after 1 April 2018—in accordance with section 1 of Schedule 8A.

(3) For a corporation, the tax is to be charged, subject to subsections (4) and (5), on the assessable profits of the corporation—

(a) for any year of assessment commencing before 1 April 2018—at the rate specified in Schedule 8; or

(b) for any year of assessment commencing on or after 1 April 2018—in accordance with section 2(a) of Schedule 8B.

(4) If a corporation is a partner in a partnership, in relation to any share of assessable profits of the partnership apportioned to the corporation under section 22A, the tax is to be charged—

(a) for any year of assessment commencing before 1 April 2018—at the rate specified in Schedule 8; or

(b) for any year of assessment commencing on or after 1 April 2018—in accordance with section 2(b) of Schedule 8B.

(5) If a corporation has made an election under section 14B(2)(a), 14D(5)(b), 14H(4)(b) or 14J(5)(b) in respect of a portion of its assessable profits, then, in relation to the rest of its assessable profits, the tax is to be charged at the rate specified in Schedule 8.”.

### 4. Sections 14AA, 14AAB and 14AAC added

After section 14—

#### Add



**“14AA. Interpretation**

(1) In this section and sections 14AAB and 14AAC—

*entity* (實體) means—

- (a) a natural person;
- (b) a body of persons; or
- (c) a legal arrangement, including—
  - (i) a corporation;
  - (ii) a partnership; and
  - (iii) a trust;

*sole proprietorship business* (獨資經營業務), in relation to a natural person, means a trade, profession or business carried on by the person as a sole proprietor.

(2) For the purposes of section 14AAB(1)(c), if a natural person carries on more than one sole proprietorship business, the person is taken to be a separate entity in relation to each sole proprietorship business.

**14AAB. Meaning of *connected entity***

(1) For the purposes of section 14AAC, an entity is a connected entity of another entity if—

- (a) one of them has control over the other;
- (b) both of them are under the control of the same entity; or
- (c) in the case of the first entity being a natural person carrying on a sole proprietorship business—the other entity is the same person carrying on another sole proprietorship business.

(2) For the purposes of subsection (1), an entity (*entity A*) has control over another entity (*entity B*) if—

(a) in the case of entity B being a trust—entity A is entitled to a vested interest in more than 50% of the capital of the property of the trust—

- (i) whether the interest is in possession or in remainder or reversion; and
- (ii) whether the interest is defeasible or not; or

(b) in any other case—entity A has a specified interest in entity B.

(3) However, entity A does not have control over entity B if it falls within the description in subsection (2)(a) or (b) in respect of entity B solely by acting in the capacity of a trustee.

(4) For the purposes of subsection (2)(b), entity A has a specified interest in entity B if entity A, whether directly or indirectly through one or more than one other entity (*interposed entity*)—

- (a) owns or controls more than 50% in aggregate of the issued share capital of entity B;
- (b) is entitled to exercise or control the exercise of more than 50% in aggregate of the voting rights in entity B; or
- (c) is entitled to more than 50% in aggregate of the capital or profits of entity B.

(5) For the purposes of subsection (4), the extent of any indirect interest of entity A in entity B is—

- (a) if there is 1 interposed entity—the percentage arrived at by multiplying the percentage representing the extent of the direct interest of entity A in the interposed entity by the percentage representing the extent of the direct interest of the interposed entity in entity B; or

- (b) if there is a series of 2 or more interposed entities—the percentage arrived at by multiplying the percentage representing the extent of the direct interest of entity A in the first interposed entity in the series by—
  - (i) the percentage representing the extent of the direct interest of each interposed entity (other than the last interposed entity) in the next interposed entity in the series; and
  - (ii) the percentage representing the extent of the direct interest of the last interposed entity in entity B.
- (6) For the purposes of subsection (5), the extent of the direct interest of an entity in another entity is—
  - (a) in relation to issued share capital—the percentage of the issued share capital of the other entity directly owned or directly controlled by the first entity;
  - (b) in relation to voting rights—the percentage of the voting rights in the other entity that the first entity is directly entitled to exercise, or over which the first entity is directly entitled to control the exercise; or
  - (c) in relation to capital or profits—the percentage of the capital or profits of the other entity that the first entity is directly entitled to.
- (7) For the purposes of this section, if an entity is a corporation, a reference to the exercise of the voting rights in the entity is to be construed as a reference to the exercise of the voting rights at general meetings of the entity.

#### 14AAC. Charge of profits tax for connected entities

- (1) This section applies to an entity in relation to any year of assessment commencing on or after 1 April 2018 (*specified year of assessment*) if, at the end of the basis period of the entity for that year of assessment, the entity has any connected entity.
- (2) Section 14 applies to the entity subject to any applicable modifications specified in subsection (3).
- (3) The modifications are—
  - (a) for an entity other than a corporation—the reference in section 14(2)(b) to “in accordance with section 1 of Schedule 8A” is taken to be a reference to “at the standard rate”;
  - (b) for a corporation—the reference in section 14(3)(b) to “in accordance with section 2(a) of Schedule 8B” is taken to be a reference to “at the rate specified in Schedule 8”; and
  - (c) for a corporation that is a partner in a partnership—the reference in section 14(4)(b) to “in accordance with section 2(b) of Schedule 8B” is taken to be a reference to “at the rate specified in Schedule 8”.
- (4) However, the Commissioner may exempt an entity from subsection (2) for a specified year of assessment if the entity has elected in writing to be so exempted.
- (5) The election, once made, is irrevocable.
- (6) Subsection (4) does not apply to an entity (*entity A*) for a specified year of assessment if—
  - (a) entity A is a connected entity of another entity (*entity B*) at the end of the basis period of entity A for that year of assessment; and

(b) entity B has been exempted under that subsection for that year of assessment.”.

**5. Section 19CA amended (treatment of losses: concessionary trading receipts)**

Section 19CA(5)—

**Repeal the definition of *normal trading receipts***

**Substitute**

“*normal trading receipts* (一般營業收入) means any trading receipts and other sums, other than concessionary trading receipts;”.

**6. Section 63H amended (amount of provisional profits tax)**

(1) Section 63H(1)—

**Repeal**

“(1A),”.

(2) Section 63H(1)—

**Repeal**

“at the standard rate”.

(3) Section 63H—

**Repeal subsection (1A)**

**Substitute**

“(1A) For a person other than a corporation, the tax is to be charged on the assessable profits of the person—

(a) for any year of assessment commencing before 1 April 2018—at the standard rate; or

(b) for any year of assessment commencing on or after 1 April 2018—in accordance with section 1 of Schedule 8A.

(1B) For a corporation, the tax is to be charged, subject to subsections (1C) and (1D), on the assessable profits of the corporation—

(a) for any year of assessment commencing before 1 April 2018—at the rate specified in Schedule 8; or

(b) for any year of assessment commencing on or after 1 April 2018—in accordance with section 2(a) of Schedule 8B.

(1C) If a corporation is a partner in a partnership, in relation to any share of assessable profits of the partnership apportioned to the corporation under section 22A, the tax is to be charged—

(a) for any year of assessment commencing before 1 April 2018—at the rate specified in Schedule 8; or

(b) for any year of assessment commencing on or after 1 April 2018—in accordance with section 2(b) of Schedule 8B.

(1D) If a corporation has made an election under section 14B(2)(a), 14D(5)(b), 14H(4)(b) or 14J(5)(b) in respect of a portion of its assessable profits, then, in relation to the rest of its assessable profits, the tax is to be charged at the rate specified in Schedule 8.”.

**7. Section 63HA added**

After section 63H—

**Add**

**“63HA. Amount of provisional profits tax for connected entities**

(1) This section applies to an entity in relation to any year of assessment commencing on or after 1 April 2018 (*specified year of assessment*) if, at the end of the basis

- period of the entity for the year preceding that year of assessment, the entity has any connected entity.
- (2) Section 63H applies to the entity subject to any applicable modifications specified in subsection (3).
- (3) The modifications are—
- (a) for an entity other than a corporation—the reference in section 63H(1A)(b) to “in accordance with section 1 of Schedule 8A” is taken to be a reference to “at the standard rate”;
- (b) for a corporation—the reference in section 63H(1B)(b) to “in accordance with section 2(a) of Schedule 8B” is taken to be a reference to “at the rate specified in Schedule 8”; and
- (c) for a corporation that is a partner in a partnership—the reference in section 63H(1C)(b) to “in accordance with section 2(b) of Schedule 8B” is taken to be a reference to “at the rate specified in Schedule 8”.
- (4) However, the Commissioner may exempt an entity from subsection (2) for a specified year of assessment if the entity has elected in writing to be exempted from section 14AAC(2) for the year preceding that year of assessment.
- (5) Also, the Commissioner may exempt an entity from subsection (2) for the year of assessment commencing on 1 April 2018 if the entity has elected in writing to be so exempted.
- (6) Subsection (5) does not apply to an entity (*entity A*) if—
- (a) entity A is a connected entity of another entity (*entity B*) at the end of the basis period of entity A

- for the year of assessment commencing on 1 April 2017; and
- (b) entity B has been exempted under that subsection for the year of assessment commencing on 1 April 2018.
- (7) Sections 14AA and 14AAB apply for the interpretation of this section as they apply for the interpretation of section 14AAC.”.
- 8. Section 89 amended (transitional provisions)**
- Section 89—
- Add**
- “(21) Schedule 43 has effect in relation to a person liable to pay provisional profits tax in respect of the year of assessment commencing on 1 April 2018.”.
- 9. Schedule 1 amended (standard rate)**
- Schedule 1—
- Repeal**
- “& (5)”.
- 10. Schedule 8 amended (rate of profits tax in respect of a corporation)**
- Schedule 8—
- Repeal**
- “[ss. 14(2), 14A(1), 14B(1), 14D(1), 14H(1), 14J(1), 16(2), 19CA(4) & (5) & 63H(1A)]”
- Substitute**
- “[ss. 14, 14AAC, 14A, 14B, 14D, 14H, 14J, 16, 19CA, 63H & 63HA]”.

**11. Schedules 8A and 8B added**

After Schedule 8—

**Add**

**“Schedule 8A**

[ss. 14, 14AAC, 63H  
& 63HA & Sch. 43]

**Two-tiered Rates of Profits Tax—Persons other than Corporations**

1. For a year of assessment commencing on or after 1 April 2018, profits tax is chargeable in respect of each trade, profession or business—
  - (a) at the rate of 7.5% on the assessable profits from the trade, profession or business up to \$2,000,000; and
  - (b) at the rate of 15% on any part of the assessable profits over \$2,000,000 from the trade, profession or business.

**Schedule 8B**

[ss. 14, 14AAC, 63H  
& 63HA & Sch. 43]

**Two-tiered Rates of Profits Tax—Corporations**

1. In this Schedule—

*threshold* (限額), for a corporation that is a partner in a partnership, means \$2,000,000 multiplied by the ratio at which the corporation shares the profits or losses of the partnership during the basis period for the year of assessment concerned.

2. For a year of assessment commencing on or after 1 April 2018, profits tax is chargeable—
  - (a) for a corporation—
    - (i) at the rate of 8.25% on assessable profits up to \$2,000,000; and
    - (ii) at the rate of 16.5% on any part of assessable profits over \$2,000,000; and
  - (b) for a corporation that is a partner in a partnership—
    - (i) at the rate of 8.25% on the net share of assessable profits concerned up to the threshold; and
    - (ii) at the rate of 16.5% on any part of the net share of assessable profits over the threshold.”.

**12. Schedule 43 added**

The Ordinance—

**Add**

**“Schedule 43**

[s. 89(21)]

**Transitional Provisions Relating to Provisional Profits Tax in respect of Year of Assessment 2018/19****1. Interpretation**

In this Schedule—

*year of assessment 2018/19* (2018/19 課稅年度) means the year of assessment commencing on 1 April 2018.**2. Application for holding over payment of provisional profits tax on additional ground**

(1) A person who is liable to pay provisional profits tax in respect of the year of assessment 2018/19 may apply to the Commissioner to have the payment of the whole or part of the tax held over until the person is required to pay profits tax for the year.

(2) An application may be made under subsection (1) if, for the year of assessment 2018/19, the person is, or is likely to be, chargeable to profits tax in accordance with section 1 of Schedule 8A, or section 2 of Schedule 8B, under section 14.

(3) This section does not affect the operation of section 63J.

**3. Provisions supplementary to section 2 of this Schedule**

(1) This section applies to an application under section 2 of this Schedule.

(2) The application must be made in writing.

(3) The application must be made not later than—

(a) the 28th day before the day by which the provisional profits tax is to be paid; or

(b) the 14th day after the date of the notice for payment of provisional profits tax under section 63H(7),

whichever is the later.

(4) However, the Commissioner may, if satisfied that it is appropriate, either generally or in a particular case, postpone the deadline.

(5) On receipt of the application, the Commissioner—

(a) must consider the application; and

(b) may hold over the payment of the whole or part of the provisional profits tax.

(6) The Commissioner must, by notice in writing, inform the applicant of the Commissioner’s decision.”

**Explanatory Memorandum**

The object of this Bill is to amend the Inland Revenue Ordinance (Cap. 112) (*Ordinance*) to implement a two-tiered profits tax rates system for the years of assessment commencing on or after 1 April 2018.

2. Clause 1 sets out the short title.
3. Clause 3 amends section 14 of the Ordinance (charge of profits tax) to provide that for any year of assessment commencing on or after 1 April 2018, profits tax is to be charged in accordance with the new Schedule 8A or 8B to the Ordinance (depending on whether the person is a corporation).
4. Clause 4 adds the new sections 14AA, 14AAB and 14AAC to the Ordinance—
  - (a) the new section 14AA defines *entity* and *sole proprietorship business*;
  - (b) the new section 14AAB defines *connected entity*; and
  - (c) the new section 14AAC provides that if 2 or more entities are connected, the two-tiered profits tax rates may only apply to one of them.
5. Clauses 5, 6, 7, 9 and 10 make the following consequential amendments to the Ordinance—
  - (a) amending section 19CA (treatment of losses: concessionary trading receipts);
  - (b) amending section 63H (amount of provisional profits tax);
  - (c) adding the new section 63HA (amount of provisional profits tax for connected entities);
  - (d) amending Schedule 1 (standard rate); and

- (e) amending Schedule 8 (rate of profits tax in respect of a corporation).
6. Clause 11 adds the new Schedules 8A and 8B to the Ordinance to provide for the charging of profits tax under the two-tiered profits tax rates system.
7. The new Schedule 8A to the Ordinance applies for a person other than a corporation. The Schedule specifies 2 tax bands and the rates of profits tax applicable to them, and provides for how profits tax is to be charged.
8. The new Schedule 8B to the Ordinance applies for a corporation. The Schedule specifies 2 tax bands and the rates of profits tax applicable to them, and provides for how profits tax is to be charged—
  - (a) in general cases; and
  - (b) in respect of any share of assessable profits of a partnership apportioned to the corporation under section 22A of the Ordinance.
9. Clause 8 amends section 89 of the Ordinance (transitional provisions), and clause 12 adds the new Schedule 43 to the Ordinance to provide for the transitional arrangements in relation to the charging of provisional profits tax for the year of assessment commencing on 1 April 2018.