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Paper for the House Committee meeting on 15 June 2018

Report of the
Bills Committee on Inland Revenue (Amendment) (No. 6) Bill 2017

Purpose

This paper reports on the deliberations of the Bills Committee on Inland Revenue (Amendment) (No. 6) Bill 2017.

Background

Base Erosion and Profit Shifting

2. Base Erosion and Profit Shifting ("BEPS") refers to the exploitation of the gaps and mismatches in tax rules by multinational enterprises ("MNEs") to artificially shift profits to low or no-tax locations where there is little or no economic activity. To counter BEPS, the Organisation for Economic Co-operation and Development ("OECD") released a package of 15 action plans ("BEPS package") in October 2015. The Group of Twenty ("G20") and OECD have called on all countries and jurisdictions to join an inclusive framework for implementing the BEPS package ("Inclusive Framework"). In June 2016, Hong Kong indicated to OECD its commitment to implementing this initiative.

3. The Administration conducted a consultation exercise in late 2016, which revealed broad support for the proposed implementation strategy that focused on the codification of the transfer pricing principles into the Inland Revenue Ordinance (Cap. 112) ("IRO") and the implementation of the four minimum standards of the BEPS package,[1] i.e. countering harmful tax practices,

[1] Transfer pricing refers to the setting of prices for transactions of goods, services and intangible property between associated enterprises. The internationally agreed standard for setting transfer prices is the arm's length principle.

preventing treaty abuse, imposing country-by-country ("CbC") reporting requirements and improving the cross-border dispute resolution mechanism.

The Inland Revenue (Amendment) (No. 6) Bill 2017

4. The Inland Revenue (Amendment) (No. 6) Bill 2017 ("the Bill") was published in the Gazette on 29 December 2017 to amend IRO to:

(a) codify the rules on transfer pricing to require income or loss from provision between associated persons to be computed, on an arm's length basis, and income or loss to be attributed to a non-resident's permanent establishment ("PE") in Hong Kong in accordance with the separate enterprises principle (as explained in paragraph 33 below);

(b) provide for a statutory advance pricing arrangement ("APA") regime under which the application of the transfer pricing rules may be agreed before the transactions take place;

(c) require transfer pricing documentation, including CbC reporting;

(d) enable effect to be given to the solutions arrived at pursuant to the mutual agreement procedure ("MAP") under a double taxation arrangement ("DTA");

(e) enhance the current provisions for double taxation relief;

(f) adjust fees in respect of an application for advance ruling;

(g) revise the requirements relating to profits tax concessions for particular classes of person so as to meet the international standards promulgated by OECD; and

(h) make related amendments.

The Bill received its First Reading at the Legislative Council ("LegCo") meeting of 10 January 2018. The Bill, if passed, will come into operation on the day the enacted Ordinance is published in the Gazette, subject to the transitional provisions in the proposed Schedule 44.[2]

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[2] All the provisions and schedules mentioned in this report refer to the existing or proposed provisions in or schedules to IRO.

The Bills Committee

5. The House Committee agreed at its meeting on 12 January 2018 to form a Bills Committee to study the Bill. The membership list of the Bills Committee is in **Appendix I**. Under the chairmanship of Hon Kenneth LEUNG, the Bills Committee has held nine meetings to discuss the Bill with the Administration, including one meeting to receive views from deputations. A list of the organizations which have provided views to the Bills Committee is in **Appendix II**.

Deliberations of the Bills Committee

6. The Bills Committee has no objection to the Bill in principle. The Bills Committee has also noted that the deputations in general are supportive of Hong Kong's commitment to honouring its international obligations by implementing the BEPS package. The deliberations of the Bills Committee are set out in the ensuing paragraphs, as follows:

(a) transfer pricing regulatory regime (paragraphs 7 – 35);

(b) advance pricing arrangement (paragraphs 36 – 40);

(c) administrative penalty relating to transfer pricing (paragraph 41);

(d) transfer pricing documentation (paragraphs 42 – 60);

(e) exchange of transfer pricing-related information with other tax jurisdictions (paragraphs 61 – 62);

(f) dispute resolution mechanism (paragraphs 63 – 64);

(g) double taxation relief (paragraphs 65 – 68);

(h) application for advance ruling (paragraph 69);

(i) amendments to preferential tax regimes (paragraphs 70 – 72); and

(j) other issues (paragraphs 73 – 75).

Transfer pricing regulatory regime (proposed Part 8AA)

General

7. The Bill codifies OECD's transfer pricing rules into IRO so that intra-group transactions will be taxed on the basis that they are effected at arm's length. The fundamental transfer pricing rule ("fundamental rule") requires an adjustment of the profits or losses of an enterprise where the actual provision made or imposed between associated persons departs from the provision which would have been made between independent persons and the actual provision has created a potential advantage in relation to Hong Kong tax. The fundamental rule will be applied to cases where the affected persons are associated, including transactions of assets and services as well as financial and business arrangements.

8. Some members have expressed concern about the potential adverse impact arising from implementation of the BEPS package on the simple tax system and the business/investment environment of Hong Kong. As Hong Kong adopts a territorial-based tax regime, these members consider that implementation of the BEPS package will not help bring about significant and direct economic benefits (e.g. recovery of undercharged taxes) apart from fulfilling international obligations. Hon Abraham SHEK, Hon CHUNG Kwok-pan and Hon Holden CHOW have stressed that the Administration should seek to comply with only the minimum international tax standards so as to minimize the compliance burden on the business sector.

9. The Administration has advised that at present, the Inland Revenue Department ("IRD") deals with transfer pricing issues based on the general provisions in IRO and its Departmental Interpretation and Practice Notes ("DIPNs"),[3] and IRD has all along been applying the arm's length principle to transactions between associated persons in accordance with OECD's guidelines, regardless of the size of company and type of transactions and taxes. The transfer pricing rules and the arm's length principle are also provided for under the comprehensive avoidance of double taxation agreements ("CDTAs") signed between Hong Kong and its trading partners.[4] In order to honour Hong Kong's commitment to implementing the BEPS package while minimizing the

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[3] IRD has issued dedicated DIPNs on transfer pricing since 2009. These include DIPN No. 45 on "Relief from double taxation due to transfer pricing or profit reallocation adjustments" and DIPN No. 46 on "Transfer pricing guidelines – Methodologies and related issues", covering the arm's length principle, transfer pricing methodologies and the practice adopted by IRD in dealing with transfer pricing issues. They are consistent with the transfer pricing guidelines promulgated by OECD.

[4] As at end May 2018, Hong Kong signed 40 CDTAs with other jurisdictions.

compliance burden on the business sector, the Bill focuses on the codification of the transfer pricing principles into IRO and the minimum standards of the BEPS package. As far as codification of the transfer pricing rules is concerned, the Administration's objective is to provide greater clarity and certainty for taxpayers. It does not involve introduction of any new policy.

10. The Administration has further advised that the ultimate objective of OECD's BEPS package is to restore public confidence in tax systems and level the playing field for businesses through international tax cooperation. The world's major economies and financial centres (including Hong Kong) have already joined the Inclusive Framework.[5] OECD will conduct comprehensive peer reviews on all participating jurisdictions to assess their compliance with the minimum standards of the BEPS package and the effectiveness of implementation. The Administration has stressed that it is incumbent for Hong Kong to put in place a legislative framework for implementing OECD's requirements as soon as practicable. Otherwise, Hong Kong will risk being labelled as a non-cooperative tax jurisdiction by OECD and/or the European Union ("EU") and could be subject to defensive measures in tax and/or non-tax areas.[6]

11. The Bills Committee has enquired about how arm's length prices can be set on an objective basis. Some members have pointed out that there may be instances where (a) exceptionally high transaction prices are offered by independent third parties in the market; (b) the goods/services are provided by an enterprise free of charge to both associated enterprises and third party enterprises; (c) no reference can be made to the transfer prices of similar transactions in the market; or (d) the transfer price may have been written off as bad debts. There is also a concern whether the transfer pricing regulatory regime will interfere with the business or pricing strategies of enterprises.

12. The Administration has advised that OECD's guidelines have set out a number of methods (such as comparable uncontrolled price method) for determining the arm's length price. In applying these methods, functional analysis and comparability study have to be conducted in respect of the transactions involved where appropriate. IRD will give due regard to a number of factors (e.g. characteristics of assets/services and contractual terms) in considering whether transfer pricing adjustment is necessary, taking into account

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[5] As in May 2018, 116 jurisdictions have joined the Inclusive Framework, including all the member states of G20, OECD and the European Union.

[6] Defensive measures may include reinforced monitoring and documentation requirements, non-deductibility of costs, application of controlled foreign company rules, revocation of exemptions, imposition of withholding tax measures, etc.

the circumstances of each case and a series of comparable transactions (not just one single transaction). The Administration has assured members that it will strengthen publicity and issue guidance by way of DIPN to enhance understanding by the relevant sectors of the transfer pricing regulatory regime.

13. In response to the Bills Committee's enquiry, the Administration has informed members that it has provided resources for IRD in 2017-2018 and beyond to ensure the effective implementation of the BEPS package in Hong Kong and oversee the peer review process. The Administration envisages that the additional workload on IRD arising from the transfer pricing regulatory regime will not be significant since a risk-based approach will be adopted to ensure compliance.

Interaction between transfer pricing rules and territorial source principle of taxation

14. The Bills Committee has sought clarification on the interaction between the transfer pricing rules and the existing rules for determining the source of income or profit under the territorial-based tax regime of Hong Kong. The Administration has emphasized that the long-established territorial source principle of taxation will not be changed as a result of the codification of the transfer pricing rules. The transfer pricing rules require the computation of income or profits from transactions with associated persons on an arm's length basis for tax purposes. After ascertaining the amount of income or profits, IRD will apply the territorial source principle of taxation to determine whether and, if so, the extent to which such income or profits arise in or are derived from Hong Kong. The territorial source principle will continue to determine the chargeability of income or profits to Hong Kong tax. IRD will provide further clarification on this aspect when updating its DIPNs.

Scope of transactions (proposed section 50AAI and 50AAJ)

15. Under the Bill, the proposed transfer pricing rules are intended to be applicable to both cross-border and domestic transactions. As stipulated in the proposed section 50AAI, the scope of transactions includes any operation, scheme, arrangement, understanding and mutual practice. The Bills Committee has explored with the Administration the possibility of exempting domestic transactions conducted between two associated persons who are subject to the same effective tax rate (i.e. tax neutral domestic transactions which will not give rise to any tax revenue loss) from the transfer pricing rules and/or related documentation requirements.[7]

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[7] Please refer to paragraphs 42 to 52 of this report for details of the transfer pricing documentation requirements.

16. The Administration has advised that the proposed scope of transactions is meant to cover all relevant transactions between associated enterprises, and it is an international norm that transfer pricing rules should be applicable to both cross-border and domestic transactions. Such application is also consistent with IRD's prevailing practice. In practice, IRD will consider the overall Hong Kong tax position of the transactions involved in the application of transfer pricing rules.

17. To address the stakeholders' concerns over the compliance burden and having regard to the Bills Committee's suggestion for setting out in the relevant provisions of IRO the prevailing practice of IRD in the application of transfer pricing rules, the Administration has proposed to move amendments to clearly reflect the policy intent. Insofar as domestic transactions between associated persons do not give rise to actual tax difference (or domestic transactions involving non-arm's length loans (e.g. interest-free loans) are not carried out in the ordinary course of money lending or intra-group financing business), and provided that such transactions do not have a tax avoidance purpose, then the relevant persons will not be obliged to compute the income or loss arising from these transactions on the basis of the arm's length provision in their tax returns and no corresponding assessment on that basis will be made by IRD. The Administration has provided supplementary information to explain the "no actual tax difference condition" and "non-business loan condition", as given in **Appendix III**. The Administration has also advised that IRD will provide further guidance in its DIPNs after the Bill is passed by LegCo.

Coverage of tax types (proposed section 50AAD)

18. The Bills Committee has noted that the transfer pricing rules will be applied to all tax types in Hong Kong. While it is readily understandable that these rules should be applied to profits tax, some members have doubted the need for applying the rules to salaries tax and property tax as well.

19. As advised by the Administration, IRD has all along been applying transfer pricing rules to all tax types. As Hong Kong adopts a schedular income tax system which is different from the comprehensive income tax regimes of many overseas tax jurisdictions whereby all sources of income are aggregated for assessment purposes, it is necessary to apply transfer pricing rules to all tax types. Besides, for some non-arm's length transactions, tax adjustments across tax types are necessary. The Administration has pointed out that the impact of the transfer pricing regulatory regime on ordinary tax residents of Hong Kong should be minimal given that transfer pricing risks mainly arise from cross-border related party transactions and tax residents of overseas jurisdictions. Besides, an employer and its employees are generally

not regarded as associated in the context of the transfer pricing regulatory regime given that the "participation condition" is not satisfied in most cases.[8]

Definition of associated persons (proposed section 50AAG and 50AAH)

20. Under the transfer pricing regulatory regime, two persons are associated where one person is directly or indirectly participating in the management, control or capital of the other person, or a third person is so participating in the same of both persons. The Bills Committee has noted that the "participation condition" given in the proposed section 50AAG is met if, at the time of the making or imposition of the actual position, (a) one of the affected persons was participating in the management, control or capital of the other affected person; or (b) the same person or persons was or were participating in the management, control or capital of each of the affected persons. The meaning of a person's participation in the management, control or capital of another person is provided under the proposed section 50AAH.

21. In response to the enquiry of the Bills Committee, the Administration has confirmed that, by virtue of the proposed sections 50AAH(2)(a) and 50AAH(3), a person is regarded as participating in the management, control or capital of an affected person under the proposed section 50AAG if that person "controls" the affected person, i.e. that person has the power to secure that the affairs of the affected person are conducted in accordance with that person's wishes by virtue of, among others, that person having more than 50% of the issued share capital, income, value of the trust estate, ownership interest or voting rights of the affected person.

Assessment of the arm's length amount (proposed section 50AAF)

22. The Bills Committee has sought clarification as to whether the taxpayers may object to the arm's length amount estimated by assessors of IRD.

23. The Administration has explained that the proposed section 50AAF(3) to (6) seeks to put in place a due process for determining whether the income or loss as stated in a tax return has been calculated in compliance with the transfer pricing rules. Under the proposed section 50AAF(3), the assessor of IRD may give a notice requiring the advantaged person to prove that the income or loss stated in his/her tax return is the arm's length amount. If the advantaged person fails to prove his/her case to the assessor's satisfaction, the assessor will estimate an amount as the arm's length amount under the proposed section 50AAF(5). If the advantaged person disagrees with the assessor's estimate, he or she may further pursue his/her case under the existing objection and appeal mechanism

8 Please refer to paragraph 20 of this report for details of the "participation condition".

provided in Part 11 of IRO where appropriate. The Commissioner of Inland Revenue ("the Commissioner"), the Board of Review or the court will then decide, on the basis of the facts and evidence available, whether the advantaged person is able to substantiate his/her reported/claimed amount, or else the assessor's estimate will be taken as the arm's length amount by virtue of the proposed section 50AAF(6).[9]

24. The Administration has further advised that the application of transfer pricing methods may produce a range of figures which are equally reliable to establish the arm's length amount ("arm's length range"). In this connection, the Administration has indicated that it will move amendments to the proposed section 50AAF to clarify that (a) a taxpayer will be accepted as having substantiated his/her reported/claimed amount if such amount is within the arm's length range; and (b) the proposed section 50AAF will not apply where the existing section 15C (valuation of trading stock on cessation of business) is applicable. Amendments will also be moved to sections 50AAK(10) and 50AMM(10) along the same line as (a) above.

Treatment for transfer pricing related to intellectual property (proposed section 15F)

25. The Bill adds a new section 15F to IRO to ensure that a person carrying out the functions of development, enhancement, maintenance, protection or exploitation ("DEMPE") for an intellectual property ("IP") in Hong Kong will be taxed on the basis of that person's contribution in carrying out such functions. The Bills Committee has sought explanation on the need to introduce specific provisions to deal with transfer pricing issues relating to IP as the existing general provisions of IRO, the withholding tax arrangements (where applicable) as well as other relevant provisions of the Bill should suffice to deal with the BEPS issues in relation to the revenue from IP.

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[9] In connection with assessment of the arm's length amount, and at the request of the Bills Committee, the Administration has provided information on an assessor's power to make tax assessments and how an assessment is made in general. The Administration has stressed that the assessor will normally explain to the taxpayer the facts and circumstances which have been taken into account in arriving at the assessment, provided that such disclosure will not prejudice any audit or investigation work. However, the burden of proof that the amount of a taxpayer's income or loss as stated in the person's tax return is the arm's length amount will lie on the taxpayer (not the assessor). Likewise, the burden of proof will rest with the taxpayer if the person raises objection or lodges an appeal against a tax assessment. Please refer to paragraphs 3 to 7 of the Administration's paper for the matters raised at the meeting of the Bills Committee held on 23 May 2018 (LC Paper No. CB(1)985/17-18(02)) for the details.

26. The Administration has explained that the proposed section 15F, which seeks to align taxation of IP income with value creation and economic ownership, is in line with OECD's latest transfer pricing standards. Similar provisions are also included in the tax legislation of other jurisdictions (e.g. the Mainland). Where a person has made value creation contributions in relation to an IP in Hong Kong, e.g. by performing any DEMPE functions, and a sum is derived by the person's associate (which is a non-Hong Kong resident person) for the use of or right to use the IP, the part of the sum that is attributable to his/her value creation contributions in Hong Kong will be regarded as a Hong Kong sourced trading receipt. The rationale is that a person who performs any part of DEMPE functions in Hong Kong in relation to an IP can be regarded as the economic owner (in part or in whole) of the IP so created, rather than purely looking at the matter from the legal ownership perspective.[10]

27. The Administration has also advised that the information contained in master files, local files and CbC reports will facilitate IRD or foreign tax authorities to identify the legal ownership of IP as well as the value creation contributions in relation to the IP in Hong Kong or other jurisdictions. The Administration has pointed out that IRD has come across cases where a Hong Kong enterprise is responsible for carrying out DEMPE functions in relation to an IP in Hong Kong but the legal ownership of that IP is taken up by an overseas associated enterprise, which is usually located in a low-tax jurisdiction. While this overseas associated enterprise may not perform any DEMPE functions in relation to that IP, it can earn the subsequent royalty income for that IP but pay only a limited amount of tax in the low-tax jurisdiction. On the other hand, the Hong Kong associated enterprise is not remunerated with a reasonable return on its relevant functions and taxed accordingly.

28. Taking into account the above, the Administration considers it necessary to introduce specific provisions in IRO to deem part or all of the income derived from the subsequent exploitation of the IP as profits of the person chargeable to tax in Hong Kong, and to maintain consistency with OECD's transfer pricing guidance relating to IP.

29. As regards some stakeholders' concern about the possibility of double taxation that may arise from the proposed treatment for transfer pricing related to IP, the Administration has advised that IRD will make sure that a person will

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[10] The Administration has provided references to the relevant parts of the transfer pricing guidelines or other document(s) of OECD based on which the proposed section 15F (sums derived from intellectual property by non-Hong Kong resident associates) is introduced. Please refer to paragraphs 10 to 12 of the Administration's paper for the matters raised at the meeting of the Bills Committee held on 21 March 2018 (LC Paper No. CB(1)774/17-18(02)) for the details.

not be subject to double taxation in respect of the same income from an IP. The non-resident associate will also not be chargeable to profits tax in respect of the relevant sum to the extent that the proposed section 15F applies. IRD will provide further clarifications in DIPN after passage of the Bill. To allow more lead time for taxpayers' preparation, the Administration has indicated that it will move amendments to the transitional provisions to defer the commencement of the proposed section 15F by 12 months, i.e. the provision will apply in relation to a year of assessment beginning on or after 1 April 2019.

Market value principle (proposed section 15BA)

30. The proposed section 15BA seeks to codify the market value principle as reflected in Hong Kong's jurisprudence and the long standing tax treatments for trading of assets. The Administration has explained that when trading stock is appropriated as capital asset and vice versa, it is necessary to account for the market value upon appropriation so that any change (including diminution or increment) in valuation of trading stock can be recognized.[11] IRD will give due regard to a number of factors and the circumstances of each case in considering whether a transaction price was at the open market value. A taxpayer will be accepted as having substantiated his/her reported/claimed amount if such amount is within an acceptable range.

31. The Administration has also clarified that the proposed section 15BA is not intended to affect the application of the existing section 15C(a) in relation to valuation of trading stock on cessation of business. For example, a property developer may purchase old property units through special purpose companies ("Acquiring Companies") in a redevelopment project. After all the old property units are acquired, the Acquiring Companies will cease their business and transfer the property units to a new company set up for the development ("Developer Company"). In such case, the Acquiring Companies can continue to transfer the property units at the cost of acquisition to the Developer Company, and will not be regarded as deriving any gain from the transfers by virtue of section 15C(a). Section 15BA will not be invoked to bring the market value of the property units into the Acquiring Companies' tax computations. The Administration has indicated that it will move amendments to the proposed section 15BA to highlight the above policy intent and to amend the provision so as to cover trading stock of a "trade or business" for the sake of consistency with section 15C.

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[11] As defined in the proposed section 15BA, "trading stock" does not include materials used in the manufacture, preparation or construction of anything which is sold in the ordinary course of trade.

32. At the request of the Bills Committee, the Administration has provided supplementary information on the application of the proposed section 15BA, including (a) the case law in Hong Kong relating to the timing of taxing profits from trading stock where profits have not yet been earned or realized; and (b) interaction between the proposed section 15BA and section 15C, as set out in **Appendix IV**.

Attributing income or loss to permanent establishments of non-Hong Kong resident persons (proposed section 50AAK)

33. The Authorized OECD Approach ("AOA") as reflected in the proposed section 50AAK seeks to attribute income or loss to a PE of a non-resident enterprise in Hong Kong as if the PE is a distinct and separate entity ("separate enterprises principle") having regard to the functions performed, assets used and risks assumed by the PE.[12] It is an international standard incorporated as part of the Model Tax Convention on Income and on Capital ("Model Tax Convention") as approved by OECD. AOA has also been incorporated in Hong Kong's CDTAs. Enterprises resident in the relevant CDTA territories have already been required to adopt AOA for attributing profits to their PEs in Hong Kong. Equally, enterprises resident in Hong Kong are already subject to the same AOA approach in respect of their PEs in the relevant CDTA territories. The Administration considers it appropriate to align the treatment for CDTA and non-CDTA territory residents. The Administration has also confirmed that the separate enterprises principle will not limit or alter the conditions for charge of profits tax under IRO.

34. The Bills Committee has noted that some stakeholders, particularly those from the financial services sectors, are concerned about the corresponding changes to their business operations and financial reporting systems following the implementation of AOA. They would like to have a longer lead time to prepare for the changes and more guidance from IRD to facilitate compliance with AOA. Having regard to the deputations' suggestion, the Administration has indicated that it will move amendments to the transitional provisions to defer the implementation of the proposed section 50AAK by 12 months, i.e. the proposed section 50AAK will apply in relation to a year of assessment beginning on or after 1 April 2019. IRD will also promulgate further guidance on the application of AOA under the proposed section 50AAK.

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[12] The meaning of "permanent establishment in Hong Kong" in relation to DTA territory or non-DTA territory resident person, as given in the proposed Schedule 17G, would apply to new Parts 8AA and 9A of IRO to be added, and Rules 3 and 5 of the Inland Revenue Rules (Cap. 112 sub. Leg. A) to be amended, by the Bill (DTA territory resident person and non-DTA territory resident person being terms defined in the proposed section 50AAC by reference to DTAs).

35. The Bills Committee has further noted that the Administration will move amendments to update the version date of the Model Tax Convention to that approved by OECD on 21 November 2017 (i.e. the latest Model Tax Convention promulgated by OECD) referred to in the interpretation provisions. As a result of other amendments, such interpretation provisions will be relocated from the proposed section 50AAE(3) to the newly proposed section 50AAC(1A).

Advance pricing arrangement (Division 4 of proposed Part 8AA and proposed Schedule 17H)

36. At present, IRD has been implementing APA which seeks to provide enterprises with an opportunity to reach prior agreement with IRD on the application of the arm's length principle to major or material transactions between associated enterprises to be carried out in the specified years of assessment. The objective of APA is to minimize adjustment of profits or losses that may otherwise be required for the years of assessment concerned as a result of IRD or another tax authority's different views on how the transfer prices of the transactions are to be determined based on the arm's length principle. This will provide greater certainty to enterprises on their tax liability and facilitate their business planning. The Bill puts in place a statutory APA regime to cater for unilateral, bilateral and multilateral APAs. As advised by the Administration, APA is a voluntary arrangement and enterprises may choose whether or not to apply for APA before the transactions take place.

Decisions of the Commissioner of Inland Revenue

37. Under the proposed sections 50AAP(3) and 50AAR(1), the Commissioner may refuse to make an APA or revoke, cancel or revise an APA made. The Administration has clarified that the Commissioner's decisions made under the said provisions are not subject to the existing objection or appeal mechanism under Part 11 of IRO which deals with disputes over assessments made under IRO. If an applicant is aggrieved by the Commissioner's decision in relation to an APA application, he or she may apply for judicial review where appropriate. This is in line with the current arrangement for advance rulings made by the Commissioner under section 88A as they do not involve assessments made under IRO.

Fees

38. The Bills Committee has noted that the fees payable for an APA application include a service charge calculated on the basis of each hour spent

by IRD officers at different ranks and other expenses related to the application.[13] However, according to paragraph 4 of DIPN No. 48, the Commissioner does not charge any fee on enterprises for APA applications at present. The Bills Committee has therefore enquired about the justification for charging fees for APA applications as proposed in the Bill, and the exceptional circumstances under which the Commissioner may waive all or part of any fees payable in respect of an APA application. Some deputations have suggested that a fixed fee be prescribed so that taxpayers can estimate the amount of fees in order to decide whether to apply for APA or not.

39. The Administration has advised that while no fee is currently charged for APA applications, it is considered appropriate to introduce such fee following the introduction of the statutory regime. This seeks to ensure that the applicants will pay for the costs of the services rendered by IRD in processing their APA applications. It is also necessary to introduce this fee as the number of APA applications is expected to progressively increase in future following the implementation of the statutory transfer pricing rules. This is in line with the established "user-pay" and "cost recovery" principles of the Government as well as the current arrangement for advance ruling under section 88A and Schedule 10. Nevertheless, the Administration understands that taxpayers would like to have greater certainty over the fees to be charged by IRD for planning purposes. Taking on board the deputations' suggestions, the Administration has indicated that it will move amendments to section 7 of the proposed Schedule 17H to impose a cap (i.e. HK$500,000) on the amount of service charge to be charged by IRD in respect of APA applications. Other costs and expenses related to the applications, such as the fees payable by the Commissioner for independent experts and travelling expenses, will remain to be fully reimbursed by the APA applicants. As regards the appointment of independent expert for inquiring into and reporting on any matters in relation to the application, the Administration has advised that IRD will consult the APA applicant on the matter and take into account the academic qualifications, related work experience, etc. of the potential candidates for making the appointment.

40. The Administration has further advised that there may be situations where an APA cannot be eventually made because of some unforeseen

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[13] As set out in the new Schedule 17H, the fees payable for an application for APA are a service charge calculated on the basis of each hour spent by (a) a Deputy Commissioner of Inland Revenue ($2,650/hour), (b) an Assistant Commissioner of Inland Revenue ($2,240/hour), (c) a Chief Assessor ($1,960/hour) and (d) any other person appointed under IRO ($1,730/hour); payment or reimbursement of any fees paid by the Commissioner to any independent expert appointed to inquire into and report on matters in relation to the application; and any costs and reasonable expenses incurred by the Commissioner in relation to the application.

circumstances beyond the control of the Commissioner and the applicant.[14] In such circumstances, the Commissioner may consider exercising the discretion to waive all or part of the fees payable in respect of the application.

Administrative penalty relating to transfer pricing (section 82A)

41. The Bills Committee has noted that for the purpose of ensuring compliance with the fundamental rule, an administrative penalty relating to transfer pricing is introduced under the Bill, which is set at a level lower than the existing one imposed for incorrect return and other matters under section 82A. Specifically, the taxpayer whose tax return does not accord with the arm's length principle will be liable to an administrative penalty by way of additional tax not exceeding the amount of tax undercharged (vis-à-vis an amount trebling the tax undercharged, as currently imposed for other non-compliances under section 82A).[15] The Administration has advised that it will not rule out the possibilities of imposing more stringent penalty or initiating criminal prosecutions on blatant cases in accordance with the relevant provisions of IRO.

Transfer pricing documentation (including country-by-country reporting)

42. The transfer pricing regulatory regime mandates the relevant enterprises in Hong Kong to prepare transfer pricing documentation, namely master file, local file and CbC report[16]. This three-tiered standardized approach requires an enterprise to articulate and execute a consistent transfer pricing policy and provide the tax administration with useful information for assessing transfer pricing risks.

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[14] For example, the applicant applies for a bilateral APA involving Hong Kong and another jurisdiction, but the competent authority of that jurisdiction does not eventually agree to enter into such arrangement with IRD despite having engaged in discussion and negotiation of the case.

[15] The Administration has advised that the prescribed penalties relating to the transfer pricing regime are based on the existing framework of penalties for incorrect return and other relevant matters under IRO.

[16] A master file gives a high-level overview of the group of enterprises, including the global business operations and transfer pricing policies. A local file provides detailed transactional transfer pricing information specific to the enterprise in each jurisdiction, including details of material related party transactions or arrangements undertaken by the enterprise and associated enterprises involved, amount involved in those transactions or arrangements and transfer pricing analysis with respect to those transactions or arrangements. A CbC report sets out the amounts of revenue, profits and tax paid as well as certain indicators of economic activity such as number of employees, stated capital, retained earnings and tangible assets for each jurisdiction in which an MNE group operates.

Exemption from preparation of master file and local file

43. On the preparation of the master file and the local file, the Bill provides for two types of exemption so as to minimize compliance burden on the business sector. Specifically, an enterprise engaging in transactions with associated enterprises will not be required to prepare master and local files for an accounting period if they can meet either one of the following exemption criteria for the period:

(a) Exemption based on size of business

An enterprise which satisfies any two of the conditions below will not be required to prepare a master file and a local file:

(i) total amount of revenue not more than HK$200 million;

(ii) total value of assets not more than HK$200 million; and

(iii) average number of employees not more than 100.

(b) Exemption based on value of related party transactions[17]

If the amount of a category of related party transactions for the relevant accounting period is below the prescribed threshold, an enterprise will not be required to prepare a local file for that particular category of transactions:

(i) transfers of properties (other than financial assets and intangibles): HK$220 million;

(ii) transactions in respect of financial assets: HK$110 million;

(iii) transfers of intangibles: HK$110 million; and

(iv) other transactions (e.g. service income and royalty income): HK$44 million.

If an enterprise is fully exempted from preparing a local file (i.e. its related party transactions of all categories are below the prescribed thresholds), it will not be required to prepare a master file either.

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[17] The exemption based on related party transaction, which was not included in the proposal for the public consultation conducted in late 2016, has been introduced under the Bill having regard to respondents' views.

44. The Bills Committee has noted that under the proposal put forth in the public consultation conducted in late 2016, the respective threshold on total revenue and total assets was set at HK$100 million. Having regard to respondents' views, both thresholds have been relaxed to HK$200 million under the Bill. The Bills Committee has enquired whether the exemption thresholds of HK$200 million are broadly in line with those adopted by other jurisdictions implementing the BEPS package, and the estimated number of enterprises to be exempted. Some members consider that the thresholds should be further relaxed (say, to HK$500 million) to relieve more enterprises from the burden of preparing master files and local files. Several deputations have called on the Government to exclude domestic transactions altogether from the scope of preparing such files. There are also views that enterprises should be given a longer period to prepare the master file and local file.

45. The Administration has stressed that while the preparation of master file and local file will be a new requirement, they are essential for effective implementation of the transfer pricing regulatory regime. It is also an international norm that taxpayers are required to prepare and keep transfer pricing documentation. The transfer pricing documentation will provide IRD with useful information for assessing transfer pricing risks and enterprises' compliance with the transfer pricing rules. Enterprises may use master files and local files as supporting documents to explain their transfer pricing policy and substantiate the arm's length basis of their related party transactions. Hence, the requirement for preparing master file and local file is complementary to the transfer pricing regulatory regime.

46. According to the Administration, the thresholds for exemption from the requirement for preparing master file and local file as proposed in the Bill are generally on par with those of other tax jurisdictions in the region (e.g. the Mainland and Singapore).[18] The detailed exemption thresholds are determined by individual tax jurisdictions having regard to their local economic situations.

47. The Administration has further advised that with the proposed thresholds on total revenue and total assets being raised from HK$100 million to HK$200 million, the estimated number of enterprises which exceed the exemption thresholds on total revenue and staff size will be substantially reduced to around 5 000. Although no data on the total assets held by individual enterprises in Hong Kong are available, it is estimated that the actual number of enterprises required to prepare master files and local files will be

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[18] For details of the exemptions in other jurisdictions, please refer to paragraphs 7 to 8 of the Administration's paper for the matters raised at the meeting of the Bills Committee held on 21 March 2018 (LC Paper No. CB(1)774/17-18(02)).

lower than 5 000 because enterprises will be exempt from preparing these files if they fulfill two of the three exemption thresholds on total asset, total revenue and staff size.

48. Having considered the views of the Bills Committee and the deputations to further relieve the compliance burden on the business sector, the Administration has suggested at the third meeting of the Bills Committee to extend the preparation period for master and local files from six months to nine months after the end of the accounting period of the enterprises concerned so as to tally with the tax return filing deadline. The Administration has further suggested at the fourth meeting of the Bills Committee to:

(a) waive the requirement to prepare master and local files for those domestic transactions between associated persons; and

(b) relax the exemption based on size of business by raising the thresholds on total revenue and total assets respectively from HK$200 million to HK$300 million, while the threshold for the threshold on staff size will stay at 100.[19]

49. On the exemption based on size of business, Hon CHUNG Kwok-pan and Hon CHAN Chun-ying have asked the Administration to consider further relaxing the proposed threshold on total revenue from HK$300 million to HK$500 million, while keeping the threshold on total assets and staff size at HK$300 million and 100 respectively. Hon CHUNG Kwok-pan holds that there should be room for making the suggested adjustment given that OECD has not prescribed the relevant threshold levels, and in the light that the Mainland's exemption threshold on the amount of related party transactions for the purposes of exemption from preparation of master file is RMB 1 billion per year.

50. The Administration has subsequently provided an impact analysis of raising the threshold on total revenue, as set out in **Appendix V**. In gist, the Administration considers that if the threshold on total revenue is further raised to $500 million, only a negligible number of enterprises will need to prepare master files and local files. This may undermine the purpose of putting in place the requirement for preparing master file and local file. The Administration has pointed out that the Mainland's exemption threshold of RMB

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[19] According to IRD's rough estimate, some 2 650 enterprises will be required to prepare master files and local files following the proposed relaxation. The estimate is made on the basis of available data on enterprises' staff size and total revenue. While the Administration does not have data on the total assets held by enterprises, the actual number of enterprises required to prepare master files and local files will be smaller because enterprises will be exempt from the obligation of preparing master files and local files if they fulfill two of the three exemption thresholds on total asset, total revenue and staff size.

1 billion per year based on the amount of related party transactions does not apply when the Mainland enterprise concerned undertakes cross-border related party transactions in the year concerned and the ultimate parent entity of the group to which the enterprise belongs also needs to prepare a master file, whereas Hong Kong's proposed thresholds relating to master file are not subject to such condition.

51. Notwithstanding the above, the Administration has, after further considering the members' views, proposed at the sixth meeting of the Bills Committee to raise the threshold on total revenue to HK$400 million. The Administration has stressed the importance of striking an appropriate balance between maintaining the overall effectiveness of transfer pricing documentation requirements and minimizing the compliance burden on the business sector. It is necessary to ensure that the transfer pricing documentation regime is credible and reasonable in overall terms lest it may draw concerns from the international community on Hong Kong's commitment to putting in place a robust framework for combating BEPS.

52. With the relaxations mentioned in paragraphs 48 and 51 above, the thresholds for exemption from the requirement for preparing master file and local file are summarized in **Appendix VI**. To give effect to the revisions concerned, the Administration will move amendments to the proposed section 58C and Schedule 17I to waive the requirement to prepare master file and local file for domestic transactions between associated persons, and relax the exemption thresholds in question.

53. The Bills Committee has enquired about the mechanism, if any, to verify whether an enterprise meets the prescribed exemption criteria. The Administration has advised that an honour system will be implemented in that if an enterprise can meet the exemption criteria, it will not be required to prepare the master file and the local file. Where there is reasonable doubt to believe that an enterprise has not complied with the relevant documentation requirements, IRD will seek clarification from the enterprise concerned and take further actions if necessary.

Requirement for keeping master file and local file (proposed section 58C(2)(b))

54. The Bills Committee has noted that in line with the prevailing retention requirement for business records under section 51C, enterprises will be required to retain master files and local files for not less than seven years after the end of the relevant accounting period. An enterprise will not be regarded as having failed to meet the record keeping requirement if the failure has been resulted from the occurrence of an extraordinary event beyond the control of the enterprise such as fire or floods.

55. The Bills Committee has enquired whether IRD will conduct random inspection of the master files and local files to ensure compliance. The Administration has advised that IRD will conduct desk audits and risk-based thematic reviews to ensure tax compliance in general, including compliance with transfer pricing rules and documentation requirements. The master files and local files should be kept by enterprises for IRD's inspection when necessary.

Country-by-country reporting (Division 1 and 3 of proposed Part 9A)

56. As mandated by OECD, MNE groups with consolidated group revenue not less than EUR750 million (or HK$6.8 billion) will be required to file CbC reports. The primary obligation of filing CbC reports is to be imposed on the ultimate parent entities of MNE groups that are resident in Hong Kong. Constituent entities of MNE groups in Hong Kong can be subject to secondary filing obligation if the ultimate parent entity is in a jurisdiction that does not require the filing of CbC reports or does not exchange such reports with Hong Kong. In such circumstances, an MNE group may also be allowed, under the surrogate filing arrangement, to authorize a constituent entity in Hong Kong to file CbC reports to IRD on behalf of the group for exchange with other jurisdictions. A reporting entity is also allowed to engage a service provider to furnish CbC reports and give relevant notifications on its behalf.[20]

57. The Bills Committee has noted that OECD's Handbook on Effective Tax Risk Assessment provides guidance on the use of the information contained in CbC reports for the purpose of tax risk assessment. A tax authority can use the information in CbC reports to assess the tax risk and other BEPS-related risks, and the information can serve as a basis for further enquiries in relation to the enterprises concerned if necessary. IRD may request an enterprise in Hong Kong to provide information from its master file and local file for following up areas with high tax risks identified, or in response to requests for exchange of information made by foreign tax authorities.

58. The Bills Committee has further noted that the Administration will move amendments to update the version of the "Guidance on the Implementation of Country-by-Country Reporting – BEPS Action 13" referred to in the definition of "CbCR documents" in the proposed section 58B(2) to that published by OECD in 2018.

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[20] While a reporting entity may engage a service provider to comply with the CbC reporting requirements and the proposed section 80H prescribes the offences of service provider in relation to CbC reporting, the reporting entity will not be relieved from its reporting obligations under the provisions referred to in the proposed 58M(1).

Penalty and offence provisions

59. The Bills Committee has noted that penalty and offence provisions are introduced under the proposed section 80G in respect of matters such as failing to file CbC reports or notifications, providing misleading, false or inaccurate information, or omitting information in CbC reports furnished by the reporting entity. The proposed section 80H provides for similar penalty and offence provisions applicable to the service providers engaged by the reporting entity. Penalty and offence provisions are also prescribed for failing to comply with the requirements in relation to master files and local files. The Administration has pointed out that if a reporting entity commits an offence relating to CbC reporting and the offence is committed with the consent or connivance of the director(s) of the entity or other officer(s) concerned in the management of the entity, the director(s) or officer(s) concerned will be liable on conviction to the penalty provided for that offence.

60. The Administration has stressed that the above penalty and offence provisions are necessary to facilitate enforcement of the transfer pricing documentation requirements, thereby enabling Hong Kong to implement the BEPS package effectively. IRD will consider, having regard to the facts of each case, whether to impose penalties for non-compliances, and will exercise flexibility in handling inadvertent non-compliances.

Exchange of transfer pricing-related information with other tax jurisdictions

61. The Bills Committee has noted that the information collected by IRD from master files and local files may be exchanged with other tax jurisdictions upon request under CDTAs, Tax Information Exchange Agreements or the Convention on Mutual Administrative Assistance in Tax Matters ("international agreements" collectively), whilst CbC reports will be automatically exchanged with relevant jurisdictions under the international agreements. In respect of the information from master files and local files, IRD has stressed that it will only exchange information which is foreseeably relevant to the requests made by the tax jurisdictions and will not entertain requests which are "fishing expeditions". The subject person will also be notified of the information that IRD is prepared to disclose to the tax jurisdiction in question. The subject person can ask IRD to amend any part of the information on the grounds that the information or any part of the information concerned is factually incorrect or is not related to the person. If the subject person is not satisfied with the decision of the Commissioner, the person may refer the case to the Financial Secretary for directions in accordance with the Inland Revenue (Disclosure of Information) Rules (Cap. 112 sub. Leg. BI).

62. The Administration has stressed that IRD will neither conduct tax investigations nor recover undercharged taxes on behalf of foreign tax authorities. Besides, if a reporting entity discovers that the information furnished in its CbC report is inaccurate, it should notify IRD as soon as practicable.

Dispute resolution mechanism (proposed section 50AAB)

63. The Bill prescribes a statutory dispute resolution mechanism to ensure effective and efficient resolution of treaty-related disputes via MAP or arbitration. This statutory dispute resolution mechanism will replace the current mechanism which relies on administrative rules in the DIPN. Under MAP, if a taxpayer considers that the actions of one or both contracting parties result in taxation not in accordance with the relevant CDTA, he or she may present the case to the tax authority of his/her resident jurisdiction. If the case cannot be settled unilaterally by the tax authority of the resident jurisdiction, the tax authorities of both sides will endeavour to resolve the case by mutual agreement. The Administration has assured members that IRD will seek to protect the interests of Hong Kong taxpayers when dealing with such disputes with other tax authorities.

64. The Administration has also advised that if a taxpayer has lodged an objection or appeal against an assessment to Hong Kong tax in respect of which a case has been presented for MAP, or an issue has been referred for arbitration under a CDTA, the taxpayer may apply for holding over of the tax in dispute under IRO. In respect of the foreign tax assessment in dispute, it will be dealt with by the competent authority of the foreign jurisdiction concerned in accordance with the tax legislation of that jurisdiction.

Double taxation relief (sections 8, 16, 49, 50 and proposed sections 48A and 50AA)

65. The Bill proposes miscellaneous amendments relating to existing unilateral double taxation relief and tax credit allowed under CDTAs. The Administration has explained that with the implementation of statutory transfer pricing rules and continued expansion of the CDTA network, it is envisaged that more claims for relief from double taxation by way of tax credit will be lodged in the future. The Administration has therefore proposed in the Bill to enhance the current tax credit system by (a) extending the period for claiming tax credit from two years to six years;[21] (b) requiring a taxpayer to minimize its foreign

[21] According to the Administration, this relaxation is proposed in response to stakeholders' call and is meant to tally with the normal limitation period for civil action under the laws of Hong Kong.

tax liability by making full use of all other available relief under CDTAs and the local legislation of foreign jurisdictions before resorting to tax credits; and (c) mandating taxpayers to notify IRD of any adjustment to their foreign tax payments which may result in tax credit granted by IRD being excessive.

66. The Bills Committee has noted that the proposed section 50AA stipulates that taxpayers can only apply for tax credit under section 50 if the double taxation relief involves CDTA territories, while the income exclusion or deduction approach under section 8(1A)(c) or 16(1)(c) will be limited to cases involving non-CDTA territories. Some deputations consider that the Bill deprives taxpayers of the option to choose the income exclusion or deduction approach, which is currently available to taxpayers irrespective of whether CDTA territories are involved. There are also comments that the proposed section 50AA will deny double taxation relief to an individual who works or an entity which operates in a CDTA territory but is not a resident of either that territory or Hong Kong.

67. The Administration has advised that a CDTA is intended to provide a comprehensive solution to all tax matters which are within its scope. The international practice is that where a CDTA is in place, relief for foreign tax should be allowed under the CDTA only to the extent contemplated by it. As the tax credit approach is adopted in all of Hong Kong's existing CDTAs, it is important for Hong Kong to adopt the same approach consistently in the domestic legislation as far as cases involving CDTA territories are concerned. This seeks to ensure that the CDTAs will prevail in case of any conflicts between the provisions in IRO and those in the CDTAs. Indeed, Hong Kong's CDTA partners expect Hong Kong to provide double taxation relief by way of the tax credit approach as agreed under the CDTAs. While a resident of a third jurisdiction is not covered by the CDTA between Hong Kong and the source jurisdiction, the resident may still resort to (a) any unilateral relief available from the resident jurisdiction; or (b) bilateral relief under the CDTA between the resident jurisdiction and the source jurisdiction or Hong Kong.

68. The Bills Committee has further noted that the Administration will move amendments to clarify the scope of the term "double taxation agreement territory" under different sections of the Bill.[22] Generally speaking, the term "double taxation arrangements" in the Bill does not cover the air services income and shipping income agreements in the context of provisions relating to transfer pricing adjustment, tax credit and unilateral double taxation relief.

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[22] Sections 8(1A)(c), 16(1)(c), 48A, 49(1C), 50 and 50AA, 50AAB, 50AAC, 50AAD, 50AAN, 50AAO and 50AAU and Schedule 17G.

Application for advance ruling (Schedule 10)

69. The Bills Committee has noted that the Administration has taken the opportunity of the Bill to adjust upward the fees for an application for advance ruling under section 88A. The Administration has explained that the proposed increase is meant to achieve full cost recovery and takes into account factors such as the salary increase of IRD officers since the existing fees has taken effect. The Administration has further advised that the proposed fee adjustment has been reviewed and accepted by the Treasury Branch of the Financial Services and the Treasury Bureau. The Bills Committee has raised no objection to the said fee increase.

Amendments to preferential tax regimes (sections 14B, 14C, 14D, 14H, 14J, 16, 23A, 23B and 26AB)

70. OECD has all along reviewed preferential tax regimes relating to income from geographically mobile activities (such as financial and other service activities) of all participating jurisdictions. In determining whether a preferential tax regime fails to meet the international standards on countering BEPS, OECD will take into account a number of factors, including whether the regime is ring-fenced from the domestic economy and whether it meets the substantial activities requirement.[23]

71. To meet Hong Kong's commitments made to OECD and EU, the Bill has incorporated amendments to the three tax regimes in Hong Kong which were introduced to promote the development of corporate treasury centres ("CTC"), professional reinsurance and captive insurance. At present, only profits derived from foreign transactions are entitled to the half-rate concessions under these regimes. With the amendments under the Bill, the half-rate concessions will be extended to profits derived from domestic transactions. Subject to passage of the Bill, the revised tax regimes will become effective from the year of assessment 2018-2019 onwards.

72. In line with OECD's expectation that qualifying taxpayers should employ an appropriate number of full-time qualified employees and at least incur a specified amount of operating expenditure in the jurisdiction that offers the tax concessions, the Bill has included the substantial activities requirement in the tax regimes for CTC, professional reinsurers, captive insurers, ship owners, aircraft lessors and aircraft leasing managers. According to the

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[23] Ring-fencing occurs when the applicability of a preferential regime is limited to foreign transactions. In such circumstances, the tax base of the jurisdictions from which the geographically mobile activities are attracted will be eroded, whilst the domestic tax base of the jurisdiction providing the regime will not be affected.

Administration, after the relevant bureaux have consulted their stakeholders on the detailed arrangements, the Commissioner will specify the detailed thresholds (i.e. minimum number of full-time qualified employees and minimum amount of operating expenditure), which are applicable to all taxpayers who enjoy the tax concessions, in a notice to be published in the Gazette. Such notice is a piece of subsidiary legislation, which will be subject to negative vetting by LegCo.

Other issues

73. In response to the enquiries raised by the Legal Adviser to the Bills Committee,[24] the Administration has provided supplementary information to clarify:

(a) the definitions of "recognized pension fund" and "resident for tax purposes" in the proposed section 50AAC(1), including the factors to be considered in determining whether a company incorporated outside Hong Kong is normally managed or controlled in Hong Kong;

(b) the nature of the notices that can be made by the Secretary for Financial Services and the Treasury under the proposed new sections 50AAC(5) and 50AAE(4) to amend Schedule 17G and the definitions in sections 50AAE(2) and 50AAE(3) respectively;

(c) the application of the principle of consistency with the OECD rules in the proposed section 50AAE;

(d) how the proposed section 50AAI(3) applies regarding the interpretation of "series of transactions";

(e) in relation to the proposed section 50AAL, the meaning and application of "for the purposes of a different part of person A's business", and the factors to be considered in determining whether the activities to be excluded from the relevant activities are carried on for the purposes of a different part of person A's business;

(f) the proposed sections 50AAN(3) and 50AAO(3) concerning corresponding relief involving foreign tax, including what will constitute "reasonable steps" for the purposes of those proposed sections;

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[24] For details, please refer to the letter from the Legal Adviser to the Bills Committee issued on 8 February 2018 vide LC Paper No. CB(1)584/17-18(01), and the Administration's written response issued on 2 March 2018 vide LC Paper No. CB(1)657/17-18(03).

(g) the issues that IRD will make reference to when formulating the critical assumptions on which the methodology of an APA is based under the proposed section 50AAP(2)(e); and

(h) the scope of IP under the proposed section 15F.

74. The Bills Committee has noted the written responses provided by the Administration on the above issues and raised no further enquiries.

75. At the request of the Bills Committee, the Administration advised that it will provide the draft or updated DIPNs relating to the transfer pricing regulatory regime to the Panel on Financial Affairs for reference when available.

Proposed amendments

76. Apart from the amendments mentioned in paragraphs 17, 24, 29, 31, 34, 35, 39, 52, 58 and 68 above, the Administration will move other amendments relating to the textual/technical aspects or which are consequential in nature. The major ones are as follows:

(a) to amend the phrase "This Division" to "This Part" in the proposed section 50AAE;

(b) to repeal section 20 as it is no longer necessary following the introduction of section 50AAF;

(c) to amend the proposed sections 58B(2), 58D(4), 58(D)5, 58H(1)(b)(iv) and (c)(iii) and 58I(3)(b) in response to OECD's suggestions for better alignment with the requirements of the CbC reporting regime;

(d) to amend the provisions in the proposed section 26AB(1) and (2) to the effect that the threshold requirements under section 26AB are relevant only for the purpose of determining whether profits producing activities are carried out in Hong Kong in the context of granting profits tax concessions;

(e) to re-number "Schedule 42" as "Schedule 44" to reflect the actual number of the Schedule after passage of the Bill; and

(f) to amend the definition of IP under the proposed section 15F(5), having regard to the proposed amendments under the Inland Revenue (Amendment) (No. 2) Bill 2018 ("No. 2 Bill 2018)" to expand the scope of section 15(1)(b) and (ba) to cover certain

additional IP rights which are being considered by LegCo, and subject to the passage of the No. 2 Bill 2018 before this Bill.

The Bills Committee has examined and agreed to the amendments proposed to be moved by the Administration. A full set of the amendments is in **Appendix VII**. The Bills Committee will not propose any amendments to the Bill.

Resumption of Second Reading debate on the Bill

77. The Bills Committee supports the resumption of the Second Reading debate on the Bill at the Council meeting of 4 July 2018.

Advice sought

78. Members are invited to note the Bills Committee's deliberations set out above.

Council Business Division 1
Legislative Council Secretariat
14 June 2018

Appendix I

Bills Committee on Inland Revenue (Amendment) (No. 6) Bill 2017

Membership list*

Chairman	Hon Kenneth LEUNG
Members	Hon James TO Kun-sun Hon Abraham SHEK Lai-him, GBS, JP Hon WONG Ting-kwong, GBS, JP Hon WU Chi-wai, MH Hon Charles Peter MOK, JP Hon CHAN Chi-chuen Hon Dennis KWOK Wing-hang Hon Christopher CHEUNG Wah-fung, SBS, JP Hon CHUNG Kwok-pan Hon Alvin YEUNG Hon CHU Hoi-dick Hon Holden CHOW Ho-ding Hon CHAN Chun-ying (Total: 14 members)
Clerk	Ms Angel SHEK
Legal Adviser	Miss Rachel DAI

* Changes in membership are shown in Annex to Appendix I.

Annex to Appendix I

Bills Committee on Inland Revenue (Amendment) (No. 6) Bill 2017

Changes in membership

Member	**Relevant date**
Prof Hon Joseph LEE Kok-long, SBS, JP	Up to 25 January 2018
Hon SHIU Ka-chun	Up to 26 January 2018
Hon Abraham SHEK Lai-him, GBS, JP	Since 6 March 2018

Appendix II

Bills Committee on Inland Revenue (Amendment) (No. 6) Bill 2017

List of organizations/individuals who have given views to the Bills Committee

*1. ACCA Hong Kong
*2. Asia Securities Industry & Financial Markets Association
3. Association of Chartered Certified Accountants Hong Kong
*4. Association of Women Accountants (Hong Kong) Limited
*5. Capital Markets Tax Committee of Asia
6. Certified Practising Accountants Australia Limited
7. Deloitte
8. Ernst & Young Tax Services Limited
*9. Federation of Hong Kong Industries
*10. Hong Kong General Chamber of Commerce
11. Hong Kong Institute of Certified Public Accountants
*12. Hong Kong Investment Funds Association
*13. Joint Liaison Committee of Taxation
14. KPMG
15. Liberal Party
16. Mr LEUNG Kwok-hung
17. PricewaterhouseCoopers Limited
*18. Some members of the public
*19. The Alternative Investment Management Association Limited
20. The American Chamber of Commerce in Hong Kong
21. The British Chamber of Commerce in Hong Kong
*22. The Hong Kong Association of Banks
*23. The Real Estate Developers Association of Hong Kong
24. The Taxation Institute of Hong Kong

* submitted written views only

Appendix III

No actual tax difference condition and non-business loan condition

No actual tax difference condition (proposed section 50AAJ(5))

Under the proposed section 50AAJ(5), the no actual tax difference condition is met if –

(a) each affected person's income arising from the relevant activities is chargeable to Hong Kong tax or each affected person's loss so arising is allowable for the purposes of Hong Kong tax; and

(b) no concession or exemption for Hong Kong tax applies to any affected person's income or loss arising from the relevant activities.

2. The proposed section 50AAJ(5)(a) seeks to ensure that the income or loss of the affected persons from the relevant activities is to be brought into account for the purposes of Hong Kong tax. A person is regarded as having a "loss allowable" for the purposes of Hong Kong tax if he/she sustains a loss (i.e. taxable income is less than allowable deductions) from the relevant activities. Having such a loss brought forward from previous years of assessment is not a pre-requisite for meeting the condition.

3. Furthermore, if the actual provision does not confer a potential advantage in relation to Hong Kong tax within the meaning of the proposed section 50AAJ(1), the transfer pricing rules will not come into play and it is therefore not necessary to consider whether the no actual tax difference condition under the proposed section 50AAJ(5) is met. Internal transfer of investment property between two affected persons is a relevant example. Where the relevant provision involves non-taxable capital gain and non-deductible capital expenditure and hence does not result in a smaller amount of taxable income or a larger amount of tax loss for either of the affected persons, there is no need to consider transfer pricing adjustment.

4. In the case of property development, a person will be regarded as having an income arising from the relevant activities chargeable to Hong Kong tax or a loss so arising allowable for the purposes of Hong Kong tax if he/she borrows a sum of money from an associated person to acquire land and construct a property thereon for sale or business purposes. In such situation, the interest expenses incurred are usually capitalized and deductible as part of the cost of trading stock or by way of

commercial building allowance ("CBA") or industrial building allowance ("IBA")[1]. Provided that no concession or exemption for Hong Kong tax applies to the income or loss of the lender and the borrower arising from the relevant activities, the no actual tax difference condition is met.

Non-business Loan Condition (proposed section 50AAJ(6))

5. Under the proposed section 50AAJ(6), the non-business loan condition is met if the actual provision relates to lending money otherwise than in the ordinary course of a business of lending money or an intra-group financing business.

6. The following factors will be considered when determining whether a company is carrying on an intra-group financing business, which is a question of fact:

(a) the frequency, repetitiveness and the amount of the borrowing from and lending to the associated corporations of money;

(b) whether there is borrowing from and lending to associated corporations of money at commercial rates of interest;

(c) whether there is a degree of system and continuity of laying out and getting back of the loan of money by way of interest and repayment of principal;

(d) the regularity and frequency of the payment of interest and repayment of principal;

(e) whether a profit is earned out of the interest differential between the borrowing and lending; and

(f) whether the interest charged on the borrowing and lending is on an arm's length basis.

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[1] If the property is used for sale, the capitalized interest relating to the acquisition of the land and the construction of the property will form part of the cost of trading stock and be deductible upon the sale of the property. If the property is for self-use or letting purposes, depending on whether the property is used by the borrower or the lessee for qualifying trades (e.g. manufacture or storage of goods, farming, scientific research, etc.), the borrower is entitled to claim CBA (annual allowance at 4%) or IBA (initial allowance at 20% and annual allowance at 4%) in respect of the capital expenditures (including the capitalized interest) incurred for the construction of the property.

7. Having regard to the above factors, the Administration considers that a company merely engaging in providing interest-free loans with interest-free funds to associated enterprises without any motive to earn a profit from interest spread may not be regarded as carrying on an intra-group financing business. In any event, the no actual tax difference condition and the locality of interest should not be disregarded before deciding whether arm's length interest is to be imputed on the relevant company and whether such interest is chargeable to Hong Kong tax.

[Source: Adapted from paragraphs 6 to 12 of the Administration's paper for the meeting of the Bills Committee held on 28 May 2018 (LC Paper No. CB(1)1008/17-18(02)).]

Appendix IV

Application of the proposed section 15BA of the Inland Revenue Ordinance (Cap. 112)

The Administration has advised that it is a well-accepted principle that tax computation needs to be adjusted to reflect the market value of an asset with respect to which a change of intention occurs ("market value principle"): see *Sharkey v Wernher* [1956] AC 58 and *Simmons v IRC* [1980] 1 WLR 1196[1]. This principle also applies where a trading stock is appropriated for non-trade purpose or acquired/disposed of other than in the course of trade. In Hong Kong, the market value principle has all along been applied in determining profits or loss from trading of assets for profits tax purposes. The application of this principle is accepted by the Board of Review and the courts. The decision of the Court of Final Appeal in *Church Body of the Hong Kong Sheng Kung Hui & Anor v CIR* (2016) 19 HKCFAR 54 is a recent example.[2]

2. The proposed section 15BA seeks to codify the market value principle as reflected in Hong Kong's jurisprudence and the long standing tax treatments for trading of assets. No new policy is being introduced.

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[1] In *Sharkey v Wernher* [1956] AC 58, the taxpayer transferred five horses from stud farm to racing stables. The House of Lords held that where a person carrying on a trade disposes of part of his stock in trade not by way of sale in the course of trade but for his own use, enjoyment, or recreation, he must bring into his trading account for income tax purposes the market value of that stock in trade at the time of such disposition. Hence, the amount to be credited to the stud farm accounts on the transfer of the horses was their market value and not the cost of breeding them. In *Simmons v IRC* [1980] 1 WLR 1196, a group of property development companies sold various properties at profits. The House of Lords held that trading required an intention to trade and such intention might be changed. A shift of an asset from investment to trading would involve changes in the company's accounts and possibly a liability to tax. In that case, there was no evidence of a trading intention on the part of the group at any stage of the transactions. The profits arising from the transactions were not assessable to income tax.

[2] In *Church Body of the Hong Kong Sheng Kung Hui & Anor v CIR* (2016) 19 HKCFAR 54, the taxpayer, a religious institution, had acquired certain lots of land on which it had run an orphanage. The taxpayer subsequently decided to redevelop the lots and sell these at a profit. The Court of Final Appeal held that the taxpayer had changed its intention from holding the lots as capital assets to embarking upon a trade when it decided to redevelop the lots into a residential development for resale. The taxpayer was therefore chargeable to tax in respect of the profits derived from the disposal of the lots, taking into account the value of the lots at the time of change of intention.

3. If there is a change of intention of an asset, the proposed section 15BA follows the case law to require the application of the market value principle when the change occurs. This is because when a capital asset is converted into a trading stock, the market value at the time of change needs to be taken into account for computing any balancing adjustment on the capital allowance of the asset and will serve as the cost for determining the profits or loss of the trading stock upon disposal. Likewise, when trading stock is appropriated as a capital asset, it is necessary to account for the market value upon appropriation so that any change (including diminution) in valuation of the trading stock can be recognized and the adjusted value can be adopted for computing the capital allowance of the asset afterwards.

4. The situations to which the proposed section 15BA applies may be distinguished from that in *Nice Cheer Investment Ltd v CIR* (2013) 16 HKCFAR 813. In the *Nice Cheer* case, the issue in dispute is whether the gains resulting from revaluation of trading securities held at the end of the accounting period as required by fair value accounting should be included in the tax computation. The Court of Final Appeal held that such revaluation gains are not chargeable to profits tax but the case does not involve any change of intention of the asset concerned. Section 15BA only deals with change of intention towards assets and acquisition or disposal of assets other than in the course of trade. It has no application where there is neither change of intention nor non-trade acquisition or disposal. In other words, even with the introduction of the proposed section 15BA, any gains arising from year-end revaluation of a landed property (classified as "investment property") will remain not taxable in accordance with the *Nice Cheer* case.

[Source: Adapted from paragraphs 13 to 16 of the Administration's paper for the meeting of the Bills Committee held on 11 April 2018 (LC Paper No. CB(1)774/17-18(02)).]

Appendix V

Impact analysis of raising the threshold on total annual revenue

The impact analysis of raising the threshold on total annual revenue is shown in the table below:

Total revenue exceeding ($ million)	Number of enterprises required to prepare master file and local file	Average amount of profits tax charged for each enterprise ($ million)
300	2 650	25
400	1 390	39
500	540	68

Remarks:

(1) The analysis is based on figures for the year of assessment 2015/2016.

(2) The exemption thresholds on total assets and average number of employees remain at $300 million and 100 respectively.

(3) IRD does not have data on the value of assets held by enterprises. The actual number of enterprises required to prepare master file and local file will be **smaller** because enterprises will be exempt from the obligation of preparing master file and local file if they fulfill two of the three exemption thresholds on asset, revenue and average number of employees.

[Source: Paragraph 4 of the Administration's paper for the meeting of the Bills Committee held on 11 April 2018 (LC Paper No. CB(1)774/17-18(02)).]

Appendix VI

Revised conditions for exemption from requirement for preparing master file and local file[1]

(a) Exemption based on size of business

An enterprise which satisfies any two of the conditions below will not be required to prepare a master file and a local file:

(i) total amount of revenue not more than HK$400 million;

(ii) total value of assets not more than HK$300 million; and

(iii) average number of employees not more than 100.

(b) Exemption based on value of related party transactions

If the amount of a category of related party transactions (excluding domestic transactions) for the relevant accounting period is below the prescribed threshold, an enterprise will not be required to prepare a local file for that particular category of transactions:

(i) transfers of properties (other than financial assets and intangibles): $220 million;

(ii) transactions in respect of financial assets: $110 million;

(iii) transfers of intangibles: $110 million; and

(iv) any other transactions (e.g. service income and royalty income): $44 million.

If an enterprise is fully exempted from preparing a local file (i.e. its related party transactions of all categories are below the prescribed thresholds), it will not be required to prepare a master file either.

(c) Exemption in respect of domestic transactions

Master and local files need not be prepared for the domestic transactions between associated persons.

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[1] Please refer to paragraphs 42 to 52 of this report for background information on transfer pricing documentation requirements, the proposed exemption criteria/thresholds under the Bill, and the Administration's proposed amendments to the Bill to further relax the exemption criteria/thresholds.

Appendix VII

Inland Revenue (Amendment) (No. 6) Bill 2017

Committee Stage

Amendments to be moved by the Secretary for Financial Services and the Treasury

Clause	Amendment Proposed
3	By deleting the clause and substituting—

"**3. Section 8 amended (charge of salaries tax)**

(1) Section 8(1A)(c), before "excludes"—

Add

"subject to subsection (1C) and section 50AA,".

(2) After section 8(1B)—

Add

"(1C) Subsection (1A)(c) does not apply in relation to income derived by a person from services rendered by the person in a territory if—

(a) the territory is a DTA territory (as defined by section 48A); and

(b) under section 50, tax payable in the territory by a Hong Kong resident person in respect of income derived from services rendered by him or her in the territory is to be allowed as a credit against tax payable in Hong Kong by the Hong Kong resident person in respect of that income.".".

4 By deleting the clause and substituting—

"**4. Section 16 amended (ascertainment of chargeable profits)**

(1) Section 16(1)(c), before "tax of"—

Add

"subject to subsection (2J) and section 50AA,".

(2) Section 16(1)(c)—

Repeal the colon

Substitute a semicolon.

(3) Section 16(1)(c)—

Repeal the proviso.

(4) After section 16(2I)—

Add

"(2J) Subsection (1)(c) does not apply in relation to any tax paid in a territory by a person in respect of profits referred to in that subsection if—

(a) the territory is a DTA territory (as defined by section 48A); and

(b) under section 50, tax payable in the territory by a Hong Kong resident person in respect of the profits is to be allowed as a credit against tax payable in Hong Kong by the Hong Kong resident person in respect of the profits.".".

5 In the proposed section 48A, by deleting the definition of ***non-DTA territory.***

6 In the heading, by deleting "**arrangements for relief from double taxation and exchange of information**" and substituting "**arrangements: relief from double taxation, exchange of information and other international tax cooperation**".

8 By deleting the proposed section 50AA(1)(a) and (b) and substituting—

"(a) relief under section 8(1A)(c) by way of exclusion of any amount of the relevant income;

(b) relief under section 16(1)(c) by way of deduction of any amount of the foreign tax;

(c) relief under section 50 by way of credit and deduction of any amount of the foreign tax.".

8 By deleting the proposed section 50AA(3)(a)(ii) and substituting—

"(ii) if subsection (1)(c) applies—the double taxation arrangements made with the foreign territory,".

9 In the proposed Part 8AA, in the Note under the Part heading, by deleting item 2 and substituting—

"2. Division 2 incorporates the international transfer pricing rules and has the following effect—

(a) in relation to a year of assessment beginning on or after 1 April 2018—

(i) a person's tax liability under this Ordinance is to be determined on the basis that a provision made or imposed between the person and the person's associated person is made or imposed on an arm's length basis;

(ii) in other words, a person who would have a Hong Kong tax advantage if taxed on the basis of a non-arm's length provision (***advantaged person***) will have income adjusted upwards or loss adjusted downwards;

(b) similarly, in relation to a year of assessment beginning on or after 1 April 2019, the income or loss of a non-Hong Kong resident person attributable to the person's permanent establishment in Hong Kong is to be determined as if the permanent establishment were a distinct and separate enterprise.".

9 In the proposed Part 8AA, in the Note under the Part heading, by adding—

"2A. The arm's length provision is to be determined in accordance with the OECD rules (as defined by section 50AAC(1)). It is possible that application of the OECD rules may not produce a single provision (such as an exact figure as the price) but may produce a range of provisions where each provision constitutes an arm's length provision.".

9 In the proposed section 50AAC(1), by deleting the definition of ***double taxation arrangements*** and substituting—

"***double taxation arrangements*** (雙重課稅安排)—

(a) in relation to the computation of income or loss with respect to a provision made or imposed between 2 persons by means of a transaction or series of transactions—means double taxation arrangements (as defined by section 48A) that incorporate—

(i) the associated enterprises article and the mutual agreement procedure article; or

(ii) any rules in the same or equivalent terms as those articles;

(b) in relation to the attribution of a person's income or loss to the person's permanent establishment in Hong Kong—means double taxation arrangements (as defined by section 48A) that incorporate—

(i) the business profits article and the mutual agreement procedure article; or

(ii) any rules in the same or equivalent terms as those articles; or

(c) in relation to the determination of the question whether a person has a permanent establishment in Hong Kong—means double taxation arrangements (as defined by section 48A) that incorporate—

(i) the permanent establishment article; or

(ii) any rules in the same or equivalent terms as the article;".

9 In the proposed section 50AAC(1), by deleting the definition of ***DTA territory*** and substituting—

"DTA territory (*有安排地區*) means a territory outside Hong Kong with which double taxation arrangements have been made;".

9 In the proposed section 50AAC(1), by deleting the definition of ***non-DTA territory*** and substituting—

"non-DTA territory (*無安排地區*) means a territory outside Hong Kong that is not a DTA territory;".

9 In the proposed section 50AAC(1), by adding in alphabetical order—

"***associated enterprises article*** (相聯企業條文) means the rules contained in Article 9 of the Model Tax Convention;

business profits article (營業利潤條文) means the rules contained in Article 7 of the Model Tax Convention;

mutual agreement procedure article (相互協商程序條文) means the rules contained in Article 25 of the Model Tax Convention;

OECD rules (《經合組織規則》) means—

(a) the commentary on the associated enterprises article or the business profits article (as the case requires); and

(b) the Transfer Pricing Guidelines for Multinational

Enterprises and Tax Administrations published by the Organisation for Economic Co-operation and Development on 10 July 2017;

permanent establishment article (常設機構條文) means the rules contained in Article 5 of the Model Tax Convention;".

9 In the proposed section 50AAC, by adding—

"(1A) For the purposes of the definitions of ***associated enterprises article***, ***business profits article***, ***mutual agreement procedure article***, ***OECD rules*** and ***permanent establishment article*** in subsection (1)—

(a) a reference to an article of the Model Tax Convention means the article of the Model Tax Convention on Income and on Capital as approved by the Organisation for Economic Co-operation and Development on 21 November 2017; and

(b) a reference to the commentary on the associated enterprises article or the business profits article means the commentary on the article so approved on that date.".

9 By deleting the proposed section 50AAC(5) and substituting—

"(5) The Secretary for Financial Services and the Treasury may, by notice published in the Gazette, amend—

(a) the definitions of the following expressions in subsection (1)—

associated enterprises article (相聯企業條文);

business profits article (營業利潤條文);

mutual *agreement* ***procedure article*** (相互協商程序條文);

OECD rules (《經合組織規則》);

permanent establishment article (常設機構條文);

(b) subsection (1A); and

(c) Schedule 17G.".

9 In the proposed section 50AAE—

(a) in subsection (1), by deleting "Division" and substituting "Part";

(b) by deleting subsections (2), (3) and (4).

9 In the proposed section 50AAF(6), by deleting "a more reliable measure" and substituting "an equally reliable measure, or a more reliable measure,".

9 In the proposed section 50AAF, by adding—

"(7) Subsections (1) to (6) do not apply in relation to a provision made or imposed in relation to any disposal or acquisition of trading stock if section 15BA(4) or (5) applies in relation to the disposal or acquisition.

(8) Subsections (1) to (6) do not apply in relation to a provision made or imposed in relation to any trading stock if section 15C applies in relation to the trading stock.".

9 In the proposed section 50AAJ—

(a) by renumbering the section as section 50AAJ(1);

(b) by adding—

"(2) Despite subsection (1), an actual provision made or imposed as between 2 persons is not taken to confer a potential advantage in relation to Hong Kong tax on either of the affected persons if—

(a) the domestic nature condition is met as provided for in subsection (3);

(b) either the no actual tax difference condition is met as provided for in subsection (5), or the non-business loan condition is met as provided for in subsection (6); and

(c) the actual provision does not, under subsection (7), have a tax avoidance purpose.

(3) The domestic nature condition is met—

(a) if the actual provision is made or imposed in connection with each affected person's trade, profession or business carried on in Hong Kong; or

(b) if—

(i) the actual provision is made or imposed in connection with either affected person's trade, profession or business carried on in Hong Kong; and

(ii) the other affected person is resident for tax purposes

in Hong Kong and the provision is not made or imposed in connection with that other person's trade, profession or business.

(4) For the purposes of subsection (3), a trade, profession or business is not regarded as being carried on in Hong Kong by an affected person only because a sum received or receivable by or accrued to the person is deemed under section 15(1) to be a receipt arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong.

(5) The no actual tax difference condition is met if—

(a) each affected person's income arising from the relevant activities is chargeable to Hong Kong tax or each affected person's loss so arising is allowable for the purposes of Hong Kong tax; and

(b) no concession or exemption for Hong Kong tax applies to any affected person's income or loss arising from the relevant activities.

(6) The non-business loan condition is met if the actual provision relates to lending money otherwise than in the ordinary course of a business of lending money or an intra-group financing business (as defined by section 16(3)).

(7) For the purposes of this section, an actual provision has a tax avoidance purpose if the Commissioner is satisfied that the main purpose, or one of the main purposes, of the provision is to utilize a loss sustained by an affected person to avoid, postpone or reduce any liability, whether of the other affected person or any other person, to Hong Kong tax.

(8) In this section—

relevant activities (有關活動) has the meaning given by section 50AAL.".

9 In the proposed section 50AAK(10), by deleting "a more reliable measure" and substituting "an equally reliable measure, or a more reliable measure,".

9 In the proposed section 50AAM(10), by deleting "a more reliable measure" and substituting "an equally reliable measure, or a more reliable measure,".

9 In the proposed section 50AAO(3)(b)(ii), in the Chinese text, by deleting "虧損定" and substituting "虧損".

9 In the proposed section 50AAP(3)(a)(i)(A), in the Chinese text, by deleting "評計算" and substituting "計算".

10 In the proposed Schedule 17G, by deleting "Sch. 42]" and substituting "Sch. 44]".

10 In the proposed Schedule 17H, by deleting "Sch. 42]" and substituting "Sch. 44]".

10 In the proposed Schedule 17H, in section 7(9)(a), by adding "subject to subsection (10)," before "a service".

10 In the proposed Schedule 17H, in section 7, by adding—

"(10) The service charge payable under subsection (9)(a) in respect of an application must not exceed $500,000.".

13 In the proposed section 15BA(1), by adding in alphabetical order—

"***trade*** (行業) means a trade or business;".

13 In the proposed section 15BA, by adding—

"(6) Subsection (4) does not apply in relation to a disposal, and subsection (5) does not apply in relation to an acquisition, of any trading stock if section 15C applies in relation to the trading stock.".

14 In the proposed section 15F(5)—

(a) in the definition of ***intellectual property***, in paragraph (b), by deleting everything after "material," and substituting "layout-design (topography) of an integrated circuit, performer's right, plant variety right, secret process or formula, or other property or right of a similar nature;";

(b) in the English text, in the definition of ***non-Hong Kong resident person***, by deleting the full stop and substituting a semicolon;

(c) by adding in alphabetical order—

"***performer*** (表演者) has the meaning given by section 200(2) of the Copyright Ordinance (Cap. 528).".

New — By adding—

"**14A. Section 20 repealed (liability of certain non-resident persons)**

Section 20—

Repeal the section.".

16 — In the proposed section 58B(2), in the definition of ***CbCR documents***, in paragraph (b), by deleting "2017" and substituting "2018".

16 — In the proposed section 58B(2), by deleting the definition of ***filing deadline*** and substituting—

"***filing deadline*** (*提交期限*) has the meaning given by subsections (2A) and (2B);".

16 — In the proposed section 58B(2), in the Chinese text, in the definition of *國別標準文件*, ***in paragraphs (a), (b) and (c)***—

(a) by deleting "(《" and substituting "("《";

(b) by deleting "》是" and substituting "》"是".

16 — In the proposed section 58B, by adding—

"(2A) In this Part—

filing deadline (*提交期限*), in relation to a country-by-country return for an accounting period, means, subject to subsection (2B), the earlier of the following dates—

(a) the date on which a period of 12 months after the end of the accounting period expires;

(b) the date specified in a notice given under section 58G.

(2B) If—

(a) a Hong Kong entity (not being a HK ultimate parent entity) required under section 58F to file a country-by-country return for an accounting period notifies the Commissioner in accordance with section 58H that the SPE-filing-elsewhere exception is to apply within the meaning of section 58I(2)(a); and

(b) the date by which a country-by-country report for the accounting period is required to be filed by the laws or regulations of the jurisdiction of tax residence of the

surrogate parent entity concerned (***foreign filing date***) is later than the filing deadline under subsection (2A),

the filing deadline, in relation to the country-by-country return for the accounting period, is the foreign filing date.".

16 In the proposed section 58B(3)—

(a) in paragraph (a)(ii), by deleting "; and" and substituting a semicolon;

(b) in paragraph (b), by deleting the full stop and substituting "; and";

(c) by adding—

"(c) for the purposes of applying Schedule 17G to determine whether a business unit of a multinational enterprise group has a permanent establishment in Hong Kong, a reference to a person or to an enterprise—

(i) in paragraph (c) of the definition of ***double taxation arrangements*** in section 50AAC(1); or

(ii) in Schedule 17G,

is to be construed as including such a business unit.".

16 In the proposed section 58C(2)(a), by deleting "6" and substituting "9".

16 By adding before the proposed section 58C(4)(a)—

"(aa) a local file of the Hong Kong entity in respect of an accounting period of the entity is not required to cover specified domestic transactions;".

16 In the proposed section 58C, by adding—

"(4A) Specified domestic transactions are to be disregarded in computing, for the purposes of subsection (4)(a) or (b), the total amount of a type of controlled transaction specified in section 4 of Schedule 17I.".

16 In the proposed section 58C(5)—

(a) in the English text, by deleting the full stop and substituting a semicolon;

(b) by adding in alphabetical order—

"***specified domestic transaction*** (指明本地交易).".

16 In the proposed section 58D(4)—

(a) in paragraph (a), by adding "and" after the semicolon;

(b) in paragraph (b), by deleting "; and" and substituting a comma;

(c) by deleting paragraph (c).

16 In the proposed section 58D(5), by deleting the definition of ***jurisdiction U's threshold amount*** and substituting—

"***jurisdiction U's threshold amount*** (終區門檻款額) means—

(a) if jurisdiction U requires the filing of a country-by-country report in respect of period P by a multinational enterprise group that has a total consolidated group revenue for period P-1 of at least a threshold amount and that amount is specified under the laws or regulations of jurisdiction U—the threshold amount specified; or

(b) in any other case—an amount, in currency U, that is equivalent to EUR 750 million as at January 2015;".

16 In the proposed section 58H(1)(b)(iv) and (c)(iii), by deleting "the date on which" and substituting "whether".

16 In the proposed section 58I(3)(b), by deleting everything after "in jurisdiction S" and substituting "on behalf of the group.".

17 In the proposed Schedule 17I, by deleting "Sch. 42]" and substituting "Sch. 44]".

17 In the proposed Schedule 17I, in the Chinese text, in section 1, by deleting "本部" and substituting "本附表".

17 In the proposed Schedule 17I, in section 2, by adding in alphabetical order—

"***specified domestic transaction*** (指明本地交易) means a controlled transaction between a Hong Kong entity of a group in the extended sense and an associated entity of that Hong Kong entity if, in relation to the transaction—

(a) subject to section 2A of this Schedule, either of the following conditions is met—

(i) the transaction is undertaken in connection with

each entity's trade, profession or business carried on in Hong Kong; or

(ii) both—

(A) the transaction is undertaken in connection with either entity's trade, profession or business carried on in Hong Kong; and

(B) the other entity is resident for tax purposes in Hong Kong and the transaction is not undertaken in connection with that other entity's trade, profession or business; and

(b) either of the following conditions is also met—

(i) each entity's income arising from the transaction is chargeable to Hong Kong tax or each entity's loss so arising is allowable for the purposes of Hong Kong tax; or

(ii) the transaction relates to lending money otherwise than in the ordinary course of a business of lending money or an intra-group financing business (as defined by section 16(3));".

17 In the proposed Schedule 17I, in Part 1, by adding—

"2A. For the purposes of paragraph (a) of the definition of ***specified domestic transaction*** in section 2 of this Schedule, a trade, profession or business is not regarded as being carried on in Hong Kong by an entity only because a sum received or receivable by or accrued to the entity is deemed under section 15(1) to be a receipt arising in or derived from Hong Kong from a trade, profession or business carried on in Hong Kong.".

17 In the proposed Schedule 17I, in section 3(a), by deleting "$200" and substituting "$400".

17 In the proposed Schedule 17I, in section 3(b), by deleting "$200" and substituting "$300".

32 In the proposed section 26AB—

(a) in the heading, by deleting "**for determining whether profits producing activities are carried out in Hong Kong etc.**" and

substituting "**relating to concession condition provisions**";

(b) in subsection (1), by adding ", for the purposes of a concession condition provision," after "whether";

(c) by deleting the Note after subsection (1);

(d) in subsection (2), by adding ", for the purposes of a concession condition provision," after "not";

(e) by adding—

"(2A) To avoid doubt, the fact that the threshold requirement is not met for the purposes of subsection (2) does not imply that the assessable profits or the exempt sums under subsection (1)(a) or (b) do not arise in or are not derived from Hong Kong.";

(f) in subsection (3), in the definition of ***threshold requirement***, in paragraph (a), by deleting "engaged in the activity" and substituting "who carry out the activity and have the qualifications necessary for doing so";

(g) in subsection (3), in the definition of ***threshold requirement***, in paragraph (b), by adding "operating" before "expenditure";

(h) in subsection (3), by adding in alphabetical order—

"***concession condition provision*** (寬免條件條文) means section 14B(2)(a), 14D(5)(a)(ii), 14H(4)(a)(ii), 14J(5)(a)(ii) or 23B(4AA);

Note (with no legislative effect)—

Section 14B(2)(a), 14D(5)(a)(ii), 14H(4)(a)(ii), 14J(5)(a)(ii) or 23B(4AA) imposes a condition for activities producing the assessable profits or the exempt sums concerned to be carried out in Hong Kong or arranged to be carried out in Hong Kong. The condition must be met in order for the tax concession under section 14B(1), 14D(1), 14H(1), 14J(1) or 23B(4AA) to apply.".

33 By renumbering the proposed subsection (20) as subsection (21).

33 In the proposed subsection (21), by deleting "42" and substituting "44".

34 By deleting "**Schedule 42**" (wherever appearing) and substituting "**Schedule 44**".

34 In the proposed Schedule 44, by deleting "89(20)]" and substituting "89(21)]".

34 In the proposed Schedule 44, by deleting section 4(1) and substituting—

"(1) Subject to subsections (2), (3) and (4), the following provisions apply in relation to a year of assessment beginning on or after 1 April 2018—

(a) Divisions 2 and 3 of Part 8AA (except section 50AAK) and Schedule 17G;

(b) Division 4 of Part 8AA and Schedule 17H;

(c) section 15BA;

(d) the amendments made to sections 80, 82 and 82A by the Amendment Ordinance (except to the extent that the amendments relate to section 50AAK).

(1A) Subject to subsections (2A), (5) and (6), the following provisions apply in relation to a year of assessment beginning on or after 1 April 2019—

(a) section 50AAK;

(b) section 15F;

(c) the amendments made to sections 80, 82 and 82A by the Amendment Ordinance (to the extent that the amendments relate to section 50AAK);

(d) the amendments made to rules 3(1A) and 5(1) of the Inland Revenue Rules (Cap. 112 sub. leg. A) by the Amendment Ordinance;

(e) rule 5(1A) of those Rules.".

34 In the proposed Schedule 44, in section 4(2), by deleting "(1)(a), (d) and (e)" and substituting "(1)(a) and (d)".

34 In the proposed Schedule 44, in section 4, by adding—

"(2A) The provisions referred to in subsection (1A)(a), (c), (d) and (e) do not apply in relation to a transaction entered into or effected before 1 April 2019.".

34 In the proposed Schedule 44, in section 4(5) and (6), by deleting "the commencement date" (wherever appearing) and substituting "1 April 2019".