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Report of the Bills Committee on
Inland Revenue (Amendment) (No. 7) Bill 2018

Purpose

This paper reports on the deliberations of the Bills Committee on Inland Revenue (Amendment) (No. 7) Bill 2018 ("the Bills Committee").

Background

2. The purpose of the Inland Revenue (Amendment) (No. 7) Bill 2018 ("the Bill") is to make amendments to the Inland Revenue Ordinance (Cap. 112) in five different areas outlined below.

Aligning tax and accounting treatment of financial instruments

3. In *Nice Cheer Investment Limited v Commissioner of Inland Revenue* (2013) 16 HKCFAR 813 ("Nice Cheer case"), the Court of Final Appeal ("CFA") held that "profits" connoted actual or realized (not potential or anticipated) profits, and that on a proper construction of the existing provisions of Cap. 112, unrealized revaluation gains (i.e. increases in the value of a company's trading stock of marketable securities) were ***not*** chargeable to tax under Cap. 112. As a result of the judgment, profits on financial instruments ("FIs") computed on a fair value basis (i.e. accounting for both realized and unrealized profits) in accordance with Hong Kong and international financial reporting standards cannot be used for tax reporting, and must be re-computed on a realization basis for that purpose.

4. According to the Administration, accounting on a realization basis is not an established commercial practice and indeed departs from the Hong Kong Financial Reporting Standard 9 (Financial Instruments)

("HKFRS 9") which has been effective since 1 January 2018. This would cause financial institutions and securities dealers hitherto using the fair value basis to incur substantial costs for re-computation of their profits for tax reporting purpose. In view of the industry's request and the practical difficulties faced by taxpayers, the Inland Revenue Department ("IRD") has been accepting tax returns from relevant enterprises with assessable profits computed on a fair value basis as an interim administrative measure. In response to the stakeholders' request to codify the interim administrative measure, the Administration proposes amending Cap. 112 to allow, on the taxpayer's election, the alignment of tax treatment of FIs with their accounting treatment for assessing profits.

Interest expenses payable to overseas export credit agencies

5. Under sections 16(1)(a) and 16(2)(d) of Cap. 112, interest expenses payable to, among others, an overseas financial institution ("OFI") shall be deducted in ascertaining the profits chargeable to tax. However, an overseas export credit agency ("OECA") that is run as a public institution is currently not recognized as an OFI. With an aim to foster trading activities between Hong Kong and overseas jurisdictions, the Administration proposes amending the definition of OFI in section 16 of Cap. 112 to include OECAs such that interest expenses payable to them would be deductible for profits tax purpose.

Refinements to the legislative framework of the automatic exchange of financial account information in tax matters

6. According to the Administration, the Organisation for Economic Co-operation and Development ("OECD") has earlier examined the legislative framework of the automatic exchange of financial account information in tax matters ("AEOI") of Hong Kong which was put in place in June 2016, and made a number of recommendations for better aligning the relevant provisions of Cap. 112 with the requirements of the Common Reporting Standard ("CRS") promulgated by OECD.[1] While most of the necessary refinements have been incorporated in the Inland Revenue (Amendment) Ordinance 2018 passed by the Legislative Council ("LegCo") on 24 January 2018,[2] some further legislative amendments are required. Also, taking the opportunity of

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[1] The CRS is contained in the Standard for Automatic Exchange of Financial Account Information in Tax Matters (Second Edition), published by OECD on 27 March 2017.

[2] The Inland Revenue (Amendment) Ordinance 2018 ("Amendment Ordinance") was gazetted on 2 February 2018. The technical amendments on AEOI (i.e. clauses 5 to 11) under the Amendment Ordinance came into operation on 1 January 2019, while other provisions took effect on the day of gazettal of the Amendment Ordinance.

this legislative amendment exercise, the Administration proposes to add 51 reportable jurisdictions to Schedule 17E to Cap. 112.[3]

Income of visiting teachers and researchers

7. With a view to fostering exchanges in teaching or research between Hong Kong and other places, Hong Kong may include an Article on Teachers and Researchers ("TRA") providing for tax exemption for visiting teachers and researchers in the jurisdiction visited for a prescribed period of time in the Comprehensive Avoidance of Double Taxation Agreements (or Arrangements) ("CDTAs") concluded with appropriate partners.[4]

8. Pursuant to section 8(1A)(b) of Cap. 112, income derived under a Hong Kong employment from services rendered wholly outside Hong Kong is generally not subject to salaries tax in Hong Kong. By virtue of a TRA in a CDTA, visiting teachers or researchers could enjoy tax exemption during the prescribed period in the visited jurisdiction with which the CDTA was signed. To avoid double non-taxation that might arise from the TRA in a CDTA, the Administration proposes amending section 8 of Cap. 112 so that a Hong Kong resident person's income derived as a visiting teacher or researcher in the visited jurisdiction to which a TRA applies would be exempted from salaries tax in Hong Kong only if tax is paid or payable in the visited jurisdiction.

Sibling relationship

9. In the course of scrutinizing the Inland Revenue (Amendment) (No. 4) Bill 2018 ("No. 4 Bill") which sought to introduce a new tax deduction for premiums paid in respect of insurance plans certified under the Government's Voluntary Health Insurance Scheme, the Legal Service Division ("LSD") of the LegCo Secretariat noted that the definition of "sibling" under the proposed section 26J of Cap. 112 (which was modelled on that under section 30B(3)(b)) only covered an adopted brother or sister of the taxpayer or the taxpayer's spouse, i.e. the adopted children of the parents of the taxpayer or the taxpayer's spouse (該人的或其配偶的父母的領養子女), but not the

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[3] Among the 51 proposed reportable jurisdictions, 48 are signatories to the Convention on Mutual Administrative Assistance in Tax Matters ("the Convention") which has been extended to Hong Kong by the Central People's Government, and three (namely Dominica, Maldives and Trinidad and Tobago) are non-signatories to the Convention but have committed to implementing AEOI.

[4] According to the Administration, among the CDTAs signed by Hong Kong with 40 other jurisdictions, only the one with Saudi Arabia included a TRA so far, and a TRA is planned to be added to the CDTA with the Mainland.

natural children of the adoptive parents of the taxpayer (or the taxpayer's spouse) where the taxpayer (or the spouse) is himself or herself adopted.[5] An amendment to the No. 4 Bill to rectify the omission was moved by the Administration and passed. Correspondingly, the Administration considers it prudent to amend the definition of "brother or sister" in section 30B(3)(b) of Cap. 112 so as to align with the meaning of "sibling" under the new section 26J added by the No. 4 Bill.

The Bill

10. The Bill was gazetted on 2 November 2018 and received its First Reading at the Council meeting of 14 November 2018. The Bill seeks to:

(a) align the tax treatment of FIs with their accounting treatment;

(b) allow the deduction of interest expenses payable to OECAs;

(c) refine the provisions that implement the AEOI arrangement;

(d) avoid potential double non-taxation of income of visiting teachers and researchers; and

(e) revise the meaning of the sibling relationship.

11. The major provisions of the Bill are set out in **Appendix I**. If the Bill is passed, the proposed amendments relating to AEOI under the Bill would come into operation on 1 January 2020, while the remaining provisions would come into operation on the date of gazettal of the enacted amendment ordinance.

The Bills Committee

12. At the House Committee meeting on 16 November 2018, Members agreed to form a Bills Committee to study the Bill. The membership list of the Bills Committee is in **Appendix II**. Under the chairmanship of Hon Kenneth LEUNG, the Bills Committee has held three meetings to study the Bill including one meeting to receive views from deputations. A list of the

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[5] A Bills Committee was formed to scrutinize the No. 4 Bill, which was passed by LegCo on 31 October 2018. The above observation of LSD regarding the definition of "sibling" is detailed in paragraphs 20 and 21 of the Bills Committee's report tabled at the Council.

individuals/deputations which have provided views to the Bills Committee is in **Appendix III**.

Deliberations of the Bills Committee

13. The Bills Committee raises no objection to the Bill in general. The main subjects deliberated by the Bills Committee are set out below:

(a) alignment of tax and accounting treatments of FIs (paragraphs 14 - 29);

(b) deduction of interest expenses payable to OECAs (paragraphs 30 - 32);

(c) refinements to the legislative framework of AEOI (paragraphs 33 - 35);

(d) avoidance of potential double non-taxation of income of visiting teachers and researchers (paragraphs 36 - 40); and

(e) miscellaneous issues (paragraphs 41 and 42).

Alignment of tax and accounting treatments of financial instruments

Proposed amendments to address the Court of Final Appeal's decision in the Nice Cheer case

14. The Bills Committee notes that there are two accounting approaches, i.e. fair value accounting (i.e. both realized and unrealized profits of FIs have to be accounted for in the financial statements) and realization accounting. Before the Nice Cheer case, unless provided otherwise in Cap. 112, IRD had been assessing profits in respect of FIs computed in accordance with the applicable accounting standards, including those computed on a fair value basis.

15. The Bills Committee notes that the contentious issue in the Nice Cheer case is the taxability of unrealized gains resulting from revaluation of trading securities held at the end of an accounting period as required by fair value accounting. In the Nice Cheer case, CFA held that unrealized profits, including unrealized revaluation gains, are not chargeable to profits tax under the provisions of Cap. 112. Clause 3 of the Bill seeks to make express provisions by adding new sections 18G to 18L to Cap. 112 to provide an

alternative basis, i.e. fair value basis, for reporting and assessing profits on FIs. The Bills Committee notes that deputations giving views on the Bill are generally supportive of the proposed amendments in the Bill to allow flexibility for taxpayers to compute assessable profits from FIs based on their fair value.

16. The Bills Committee is however concerned whether the proposed amendments in the Bill would result in unrealized profits including revaluation gains being taxed on a fair value basis and in effect reversing CFA's judgment in the Nice Cheer case. Also, having noted the interim administrative measure of IRD to accept tax returns from enterprises with assessable profits computed on a fair value basis, the Bills Committee has sought clarification on whether a saving provision is required to cover any profits tax thus charged on a fair value basis, which might be *ultra vires* the existing provisions of Cap. 112.

17. The Administration advises that the proposed provisions to be added to Cap. 112 by clause 3 of the Bill allow, on the taxpayer's election, profits in respect of FIs to be computed on a fair value basis for tax reporting purpose. For taxpayers choosing to have their assessable profits computed on a fair value basis under the proposed new section 18H(2), tax computation may be based on the profits/losses (including any unrealized gains/losses) recognized in accordance with the specified financial reporting standards; whilst those not making the election would remain entitled to use the realization basis to exclude any unrealized profits from their tax returns and no tax will be charged on such unrealized profits. This is in line with the legal position under CFA's judgment in the Nice Cheer case. Hence, the Administration takes the view that the proposed amendments would not have the effect of reversing CFA's judgment and would provide a statutory basis for IRD to accept fair value accounting for tax reporting.

18. As regards the interim administrative measure, the Administration considers that such measure is compatible with CFA's judgment in the Nice Cheer case and no saving provision is necessary. While accepting that tax paid pursuant to an *ultra vires* demand by a public authority or pursuant to mistake should be recoverable, the Administration has explained that depending on the classification of an FI, changes in fair value (e.g. the increase of the value of trading securities held at the end of the year) may or may not be recognized in the taxpayer's profit and loss account, and it is up to a taxpayer who submits computation of profits on a fair value basis to exclude unrealized profits which as decided by CFA are not taxable. If a taxpayer has included unrealized profits in its tax return but later argues that the profits tax should be re-assessed to exclude any non-taxable profits, the taxpayer can

invoke section 64 or section 70A of Cap. 112 to lodge an objection or make a claim to correct the assessment. The Administration has added that after the passage of the Bill, any unrealized profits not taxed during the interim arrangement period would be brought into account for the election year pursuant to the proposed new section 18H(3).

19. The Bills Committee has looked into the difference in tax assessment if profits are computed on the fair value basis as opposed to the realization basis. According to the Administration, the difference lies mainly in the timing of recognition of realized/unrealized profits/losses in respect of FIs. Simply speaking, under fair value accounting, profits/losses accounted for at the end of an accounting period (denoted as Year 1 for illustration purpose) may include mark-to-market unrealized gains/losses. If assessable profits are computed on the same basis, the profits/losses so recognized will be assessable to tax/allowable for deduction in the relevant year of assessment ("YA"). In other words, the differences in fair value of FIs from one YA to another will be recognized in the company's profit and loss account. Any upward changes will be assessable to tax and similarly, any downward changes will be allowable for deduction. Under realization accounting, unrealized profits/losses in Year 1 will not be accounted for in that year and hence not assessable to tax/allowable for deduction. Any realized gains/losses will be assessable to tax/allowable for deduction upon the sale of the relevant assets in a subsequent year.

Definitions of "fair value" and "specified financial reporting standard"

20. The Bills Committee has sought clarification on whether it is necessary for the substantive provisions of the Bill to define or explain the concept of "fair value", instead of just including an explanation in the "note without legislative effect" after section 18F of Cap. 112 as proposed in the Bill. The Administration has responded that the term "fair value" refers to the same concept in the relevant accounting standards and financial reporting standards. In Hong Kong Accounting Standard 32 and HKFRS 13, "fair value" is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This meaning is consistently used in HKFRS 9. By virtue of the proposed section 18G(2)(b), if a person prepares financial statements in accordance with a specified financial reporting standard, an undefined expression used in the proposed section 18G, 18H, 18I, 18J, 18K or 18L would have the same meaning as the expression is defined in the standard. As such, it is not necessary to define the term "fair value" in the substantive provisions of the Bill.

21. The Bills Committee notes that in accordance with the proposed new section 18G(1)(a), "specified financial report standard" means, unless paragraph (b) applies, HKFRS 9 issued by the Hong Kong Institute of Certified Public Accountants or the International Financial Report Standard 9 ("IFRS 9") issued by the International Accounting Standards Board, as in force from time to time. In response to a suggestion made in a written submission[6] received by the Bills Committee and with a view to facilitating the preparation of tax returns in Hong Kong by companies (mainly overseas companies) that adopt a financial reporting standard equivalent to IFRS 9, the Administration will propose an amendment to the definition of "specified financial report standard" under the proposed new section 18G(1) to include a financial reporting standard that is adopted by a relevant authority of a jurisdiction other than Hong Kong, as in force from time to time, which is in the opinion of the Commissioner of Inland Revenue ("CIR") equivalent to IFRS 9. Similarly, the Administration will propose an amendment to the proposed new section 18L(6)(c) to reflect the proposed acceptance of accounting standard equivalent to International Accounting Standard 32.

Revocation of a taxpayer's election made under proposed new section 18H(2)

22. According to the Administration, an election of a taxpayer, once made under the proposed new section 18H(2), to align tax treatment of FIs with their accounting treatment for assessing profits is in general irrevocable and has effect for the YA for which the election is made and all subsequent years of assessment. Nonetheless, the proposed new section 18H(5) provides for the revocation of such election with the approval of CIR. The Bills Committee has sought clarification about the criteria for approval for such revocation.

23. The Administration advises that to address the views of stakeholders that flexibility should be allowed for taxpayers to revoke an earlier election in certain justifiable circumstances, the proposed new section 18H(4) provides for the revocation of the election with the approval of CIR under the proposed new section 18H(5) if the taxpayer proves to CIR's satisfaction that (a) there are good commercial reasons for the revocation; and (b) tax avoidance is not the main purpose, or one of the main purposes, of the revocation. According to the Administration, examples of good commercial reasons include a business merger/acquisition/disposal/restructuring where the taxpayer is taken over by a group of companies that adopt a different tax reporting basis. In assessing the taxpayer's purpose of revocation, CIR will consider each case on its own facts and merits. Mere reduction in the amount of tax is not

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[6] The relevant written submission was received from the PricewaterhouseCoopers Limited (LC Paper No. CB(1)321/18-19(03)).

considered equivalent to tax avoidance, which generally refers to the use of provisions in tax legislation in ways that are unintended by governments to reduce a person's tax liability. Moreover, the proposed new section 18H does not prohibit a taxpayer whose application of revocation is approved by CIR from subsequently making a fresh election under the proposed section 18H(2).

24. Further, the Bills Committee notes the Administration's clarification that operationally, in order to avoid possible "drop-outs" of profits as a result of the change in the tax reporting basis upon an approved revocation, it is provided under the proposed new section 18H(7) that if an election ceases to have effect from a YA ("the cessation year"), every FI held by the person at the end of the basis period for the YA immediately preceding the cessation year is taken to have been disposed of at its fair value on the first day of the basis period for the cessation year.

Special treatment of impairment loss

25. The Bills Committee notes that the proposed new section 18K provides for the special treatment of impairment loss. In gist, the proposed new section stipulates that any impairment loss recognized in respect of an FI is not tax deductible unless it is credit-impaired and satisfies the prescribed conditions (proposed new section 18K(2) to (5)). It also sets out the scenarios under which the tax deduction previously granted would be "clawed-back" in case of a transfer of a credit-impaired loan (proposed new section 18K(6) to (8)).

26. The Bills Committee notes the various suggestions of the deputations on the tax deductibility of impairment loss proposed in the Bill. The major suggestions include allowing tax deduction for non-credit-impaired expected credit loss ("ECL"), amending the proposed new section 18K(3) to (5) to allow tax deduction for credit-impaired ECL in respect of FIs valued at amortized cost or fair value through other comprehensive income ("FVOCI") acquired for trading purposes by a taxpayer, and reconsidering whether the proposed "claw-back" arrangement of tax deduction previously granted is necessary and justified, etc.

27. In response to the deputations' suggestions, the Administration has reiterated that the current legislative exercise aims to provide a legal basis for election of tax assessment on a fair value basis in accordance with the prevailing accounting standards. The Administration considers it prudent to maintain the status quo, i.e. no tax deduction for non-credit-impaired debts. The Administration has explained that, under HKFRS 9, ECL is recognized in

three stages,[7] but only at Stage 3 the loan's credit risk has increased to the point where it is considered credit-impaired and tax deduction can be allowed. Currently, only a few jurisdictions allow tax deduction for all three stages of ECL with different approaches, and hence it is not an international norm and not a must for jurisdictions to have tax treatment to tally entirely with accounting treatment.

28. The Administration has further explained that in general, FIs acquired for trading purposes would be measured at fair value through profit or loss. Any ECL would be reflected in the fair value changes and charged to the profit and loss account and therefore, no separate allowance for ECL would be made. If a taxpayer classifies an FI as measured at amortized cost or FVOCI but claims that it is acquired for trading purpose and the assessor is satisfied that it is for trading purposes, adjustment can be made in tax computation. As such, no amendments should be required for the proposed new section 18K(3) to (5). As regards the "claw-back" arrangement, the Administration has clarified that the relevant provisions in the proposed new section 18K(6) to (8) would be invoked only if the loss allowance in respect of the credit-impaired loan is transferred to the transferee together with the loan where a "claw-back" arrangement is necessary.

Provision of guidance and information for taxpayers preparing their tax returns

29. The Bills Committee has requested the Administration to provide clear and adequate guidance and information in relation to the proposed amendments under the Bill to facilitate the preparation of tax returns by taxpayers. IRD has advised that the Department will update the Departmental Interpretation and Practice Notes ("DIPN") after the passage of the Bill to provide its interpretation and practices in relation to the relevant enacted amendments. Meanwhile, following CFA's decision in the Nice Cheer case, information regarding the interim administrative measure for profits tax returns on a fair value basis is available at IRD's website.[8] The Bills Committee notes that the webpage currently translates "fair value" as "公允價值", as opposed to "公平價值" as used in the Chinese text of the Bill. IRD has undertaken to amend the relevant webpage to ensure the consistent use of the correct Chinese expression.

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[7] HKFRS 9 categorizes financial assets into three stages in the determination of credit impairment: Stage 1 – not credit-impaired (credit risk has not increased significantly since initial recognition); Stage 2 – not credit-impaired (credit risk has increased significantly since initial recognition); and Stage 3 – credit-impaired.

[8] Please refer to https://www.ird.gov.hk/eng/tax/bus_fva.htm.

Deduction of interest expenses payable to overseas export credit agencies

30. While the Bills Committee expresses agreement in principle with the proposal in Part 3 of the Bill to allow tax deduction of interest payments made on loans from OECAs that are run as public institutions, members have expressed concerns about the uncertainty faced by borrowers concerned as CIR may, pursuant to the proposed amended section 16(4), determine that an OECA is not recognized as an OFI if the export credit business of that agency is not adequately monitored or regulated by the relevant governmental entity. To avoid such uncertainty, Bills Committee members have suggested IRD to consider, for example, making advance announcement to set a future cut-off date after which the OECA concerned would no longer be recognized as an OFI, or circumscribing the discretion of CIR under the proposed amended section 16(4).

31. The Administration has advised that the existing provision under Cap. 112 also provides CIR with the discretion to determine that a person should not be recognized as an OFI if CIR is of the opinion that the person's banking or deposit-taking business is not adequately supervised by a supervisory authority. Moreover, taxpayers can apply to CIR for an advance ruling on whether the interest payments made on loans from the OECAs concerned are tax deductible or not, and the ruling, which would be binding on CIR, will be made within the time specified under DIPN.

32. Clause 4(2) of the Bill proposes to add a definition for "governmental entity" under the proposed amended section 16(3). The Bills Committee notes that "political subdivision of the jurisdiction" appears twice in paragraphs (b) and (d) in that definition. In response to an enquiry made by the Legal Adviser to the Bills Committee, the Administration will propose an amendment to remove "political subdivision" from paragraph (d) to avoid duplication with paragraph (b) in that definition. Also, the Administration will propose a similar amendment to the definition of the same term in section 50A(1) of Cap. 112 for consistency.

Refinements to the legislative framework of the automatic exchange of financial account information in tax matters

33. Clause 6 of the Bill proposes to add a new section 50L to provide that CIR may publish non-statutory guidelines on the interpretation of any provisions of Part 8A (Returns by Reporting Financial Institutions) of, and Schedules 17C (Non-reporting Financial Institutions and Excluded Accounts), 17D (Due Diligence Requirements) and 17E (Reportable Jurisdictions and

Participating Jurisdictions) to, Cap. 112 (collectively "Part 8A-related provisions"). Bills Committee members have queried about the need for including the proposed new section 50L, and have sought clarifications regarding the consequences, including any criminal consequences, of the failure on the part of a person to comply with: (a) any Part 8A-related provisions; and (b) the provisions of any such guideline published under the proposed new section 50L, in particular in the light of the proposed new section 50L(2)(b) which stipulates that "… the provision of the guideline ***must*** be taken into account in interpreting the Part 8A-related provisions…" (***emphasis added***) in any proceedings under Cap. 112 before a court.

34. The Administration has explained that in reviewing and assessing the implementation of the CRS in Hong Kong, OECD has examined Cap. 112 and the Guidance for Financial Institutions ("Guidance") published administratively by IRD which provides elaboration on and interpretation of Part 8A-related provisions. OECD has recommended that, amongst others, the publishing of the Guidance should be backed up by legal provision so as to ensure that the CRS is effectively complied with in practice. As such, the proposed new section 50L is necessary to meet OECD's recommendation.

35. The Administration has also clarified that while any guideline to be published under the proposed new section 50L is admissible in evidence in proceedings before a court, if relevant, and must be taken into account by the court when interpreting any Part 8A-related provisions or in determining a question arising in the proceedings, the guideline does not bind the court. Besides, while sections 80B and 80D of Cap. 112 stipulate that a failure to comply with the Part 8A-related provisions in Cap. 112 constitutes an offence, the proposed section 50L(2) clearly stipulates that a failure on the part of a person to comply with the provisions of any guideline published under the proposed new section 50L does not by itself render the person liable to any proceedings, whether before a court or otherwise.

<u>Avoidance of potential double non-taxation of income of visiting teachers and researchers</u>

36. The Bills Committee notes that under an existing CDTA between Hong Kong and another jurisdiction, a Hong Kong resident person's income from employment will be taxable in the other jurisdiction if the person concerned is present in the other jurisdiction for more than 183 days a year in general, or his/her income is paid by an employer who is a resident of the other jurisdiction or is borne by a permanent establishment which the employer has in the other jurisdiction. In accordance with the proposed new section 8(1AB), if a CDTA with a territory provides for exemption from tax in the

territory for income of a visiting teacher or researcher in the territory (i.e. the CDTA contains a TRA), a Hong Kong resident person's income derived as a visiting teacher or researcher, even though derived from services wholly rendered in that territory, is no longer exempted from salaries tax in Hong Kong unless tax is paid or payable in respect the income in that territory.

37. Bills Committee members are concerned whether the proposed amendments would in effect change the territorial basis of taxation adopted in Hong Kong. They have sought clarifications on the definition of "visiting teacher or researcher" in the context of a CDTA containing a TRA, as well as the operation of the proposed new section 8(1AB), including whether assessable income derived from services rendered by a Hong Kong resident person as a visiting teacher or researcher in the visited territory would be subject to salaries tax in Hong Kong if tax is exempted or assessed to be nil in that territory.

38. The Administration has responded that the proposed amendments in Part 5 of the Bill seek to avoid double non-taxation of Hong Kong sourced income that may arise from the TRA in a CDTA, and this proposal is in line with the international effort to combat base erosion. The amendments only concern the Hong Kong sourced income of a person visiting another jurisdiction for the purpose of teaching or research where the CDTA between Hong Kong and that other jurisdiction contains a TRA providing for a tax exemption in that other jurisdiction on the income of a visiting teacher or researcher in that other jurisdiction.

39. Further, in determining a person's salaries tax liability in Hong Kong, IRD will consider whether the person falls within the scope of "visiting teacher or researcher" as defined under the proposed new section 8(1D), i.e. a person who visits that territory and is present in that territory for the sole or primary purpose of teaching or conducting research at an educational institution or scientific research institution (including a university, college or school) in that territory. The scope so defined is modelled on the common coverage of TRA in other CDTAs worldwide that contain such an article. For terms that are not defined in the CDTA (e.g. "education institutions"), reference shall be made to the meaning under the law of the visited jurisdiction in accordance with the provisions of the CDTA.[9] Upon enquiry

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[9] According to the Administration, a CDTA generally contains a rule of interpretation regarding the application of the CDTA by a Contracting Party that, unless the context otherwise requires, a term not defined in the CDTA has the meaning that it has under the law of that Party for the purposes of the taxes to which the CDTA applies and any meaning under the applicable tax laws of that Party prevails over a meaning given to the term under other laws of that Party.

by the Legal Adviser to the Bills Committee, the Administration has clarified that a person's "sole or primary purpose" for visiting a territory is a question of fact to be determined by CIR having regard to all relevant circumstances, including the period and length of stay in the territory, any conditions imposed for the person's entry and stay in the territory, whether usual employment terms and conditions for a teacher or researcher apply to the person, and the type and extent of the person's activities in the territory. In case of dispute about the tax exemption status in the visited jurisdiction, the person concerned might resort to the mutual agreement procedure under the relevant CDTAs.

40. Having noted that Hong Kong plans to add a TRA in the CDTA with the Mainland, Bills Committee members have enquired about the latest progress of the negotiation with the Mainland authorities. The Administration has advised that the two parties have agreed in principle on the inclusion of a TRA in the CDTA and have been discussing the operational details. The relevant amendment to the CDTA with the Mainland will have to be given effect to by a piece of subsidiary legislation subject to negative vetting by LegCo.

Miscellaneous issues

Short title

41. The Bills Committee has suggested that, in addition to assigning a serial number to the various amendment bills to Cap. 112 in their short titles, the Administration should consider including also a short description in the short titles in future to specify the subject matter of the proposed amendments of the bills so as to avoid confusion among various amendment bills being concurrently scrutinized by LegCo. The Administration has undertaken to consider including a short description in the short titles of the amendment bills to Cap. 112 in future,[10] but has advised that no serial number will be included alongside or otherwise the short titles will become too long unnecessarily.

Chinese text

42. The Bills Committee notes that a tag-definition "(有關條文)" is added after "本條或第18H、18I、18J、18K或18L條" in the Chinese text of the proposed new section 18G(2)(b) to be added by clause 3 of the Bill. In response to an enquiry made by the Legal Adviser to the Bills Committee, the

[10] See, for example, the Inland Revenue and MPF Schemes Legislation (Tax Deductions for Annuity Premiums and MPF Voluntary Contributions) (Amendment) Bill 2018, and the Inland Revenue (Profits Tax Exemption for Funds) (Amendment) Bill 2018.

Administration will propose an amendment to clause 3 of the Bill to remove the tag-definition "(有關條文)" in the Chinese text of the proposed new section 18G(2)(b) to avoid ambiguities as to whether it refers to "本條或第18H、18I、18J、18K或18L條" or only "第18H、18I、18J、18K或18L條".

Proposed amendments to the Bill

43. The Administration will propose amendments to the Bill as explained in paragraphs 21, 32 and 42 above. The Bills Committee has examined the draft amendments proposed by the Administration to the Bill and has no objection to them.

44. The Bills Committee will not propose any amendments to the Bill.

Resumption of Second Reading debate on the Bill

45. The Bills Committee raises no objection to the resumption of the Second Reading debate on the Bill at the Council meeting of 20 February 2019.

Consultation with the House Committee

46. The Bills Committee reported its deliberations to the House Committee on 25 January 2019.

Council Business Division 1
Legislative Council Secretariat
12 February 2019

Appendix I

Major provisions of the Inland Revenue (Amendment) (No. 7) Bill 2018

(a) **Clause 3** proposes adding new sections 18G to 18L to the Inland Revenue Ordinance (Cap. 112) to provide for the alignment of the treatment of financial instruments for profits tax purpose with their accounting treatment. In particular —

(i) under the proposed section 18J, the amount of profit, gain, loss, income or expense computed for a financial instrument for profits tax purpose for a period would be the amount of profit, gain, loss, income or expense recognized for the instrument for accounting purpose for the period;

(ii) the proposed sections 18K and 18L would provide for special treatment of an impairment loss, an equity instrument or financial liability on revenue account, an embedded derivative, a preference share, a loan made or debt security issued otherwise than on an arm's length basis and a hedging instrument;

(iii) the proposed section 18I states the effect of the proposed new sections 18J, 18K and 18L on the existing provisions on profits tax in Cap. 112 as follows —

(A) ***profits*** would not be limited to realized profits and a change in fair value of a financial instrument would be taken into account in assessing profits tax in certain circumstances; and

(B) also, the way in which a profit, gain, loss, income or expense is calculated would be changed in certain circumstances (for example, interest would be calculated in some cases at the effective rate instead of the contractual rate);

(iv) the proposed sections 18I, 18J, 18K and 18L would apply to a taxpayer who follows a specified financial reporting standard and elects that those new sections apply to the taxpayer (see the new section 18H);

(b) **Clause 4** seeks to amend section 16 of Cap. 112 so that, unless the Commissioner of Inland Revenue ("CIR") determines otherwise, an overseas export credit agency (definition proposed to be added to section 16(3) of Cap. 112) would fall within the definition of overseas financial institution and interest expenses payable to the agency would be deductible under section 16(1)(a) of Cap. 112;

(c) **Clauses 5, 7 and 8** seek to amend section 50A of, and Schedules 17C and 17D to, Cap. 112 and **Clause 6** seeks to add a new section 50L to Cap. 112, so that —

(i) the terms "Common Reporting Standard" ("CRS"), "CRS publications" and "FATF Recommendations"[1] would be defined to represent key documents relating to the arrangement of automatic exchange of financial account information in tax matters ("AEOI");

(ii) the meanings of "entity" and "controlling person" would reflect relevant provisions in the CRS and FATF Recommendations;

(iii) the term "investment entity" would be interpreted in a way consistent with FATF Recommendations;

(iv) the residency rules would be incorporated in relation to financial institutions (other than trusts) that do not have a residence for tax purposes;

(v) certain schemes and pooling agreements and approved pooled investment funds under the Mandatory Provident Fund Schemes Ordinance (Cap. 485) or the Occupational Retirement Schemes Ordinance (Cap. 426) and credit unions registered under the Credit Unions Ordinance (Cap. 119) would cease to be non-reporting financial institutions, and consequential changes would be made to the definitions of "pre-existing account", "reporting year" and "new account";

(vi) provisions would be made for CIR to issue guidelines for ensuring that provisions in Cap. 112 implementing the AEOI arrangement would be construed in a way consistent with the effect given to the CRS in accordance with the CRS publications, and for clarifying the status of the guidelines;

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[1] FATF refers to the Financial Action Task Force.

(d) **Clause 9** seeks to amend Schedule 17E to Cap. 112 to substitute an updated list of reportable jurisdictions;

(e) **Clause 10** proposes amending section 8 of Cap. 112 to avoid double non-taxation. If a double taxation arrangement with a territory outside Hong Kong provides for exemption from tax in the territory for income of a visiting teacher or researcher in the territory, a Hong Kong resident person's income derived as a visiting teacher or researcher, even though derived from services wholly rendered in that territory, would no longer be exempted from salaries tax in Hong Kong unless tax is paid or payable in respect the income in that territory;

(f) **Clause 11** seeks to revise the meaning of brother or sister in section 30B of Cap. 112 (so as to align with the meaning of sibling in the new section 26J added by the Inland Revenue (Amendment) (No. 4) Bill 2018 passed by LegCo and published in the Gazette as the Inland Revenue (Amendment) (No. 8) Ordinance 2018).

Appendix II

Bills Committee on Inland Revenue (Amendment) (No. 7) Bill 2018

Membership list

Chairman	Hon Kenneth LEUNG
Members	Hon James TO Kun-sun Hon Charles Peter MOK, JP Hon Christopher CHEUNG Wah-fung, SBS, JP Hon CHUNG Kwok-pan (Total：5 members)
Clerk	Ms Doris LO
Legal Adviser	Mr Bonny LOO

Appendix III

Bills Committee on Inland Revenue (Amendment) (No. 7) Bill 2018

List of organizations from which the Bills Committee has received views

Deputations that attended the meeting on 17 December 2018 to give views

1. Association of Chartered Certified Accountants Hong Kong
2. Hong Kong Securities Professionals Association
3. Hong Kong Venture Capital and Private Equity Association
4. The Institute of Securities Dealers
5. The Taxation Institute of Hong Kong

Individuals/deputations that provided written submissions only

6. Dr Agnes W Y LO and Dr Raymond M K WONG
7. Hong Kong Baptist University
8. Hong Kong Bar Association
9. Hong Kong Institute of Certified Public Accountants
10. PricewaterhouseCoopers Limited
11. Stephen YIP
12. The Hong Kong Association of Banks