

## LEGISLATIVE COUNCIL BRIEF

Inland Revenue Ordinance  
(Chapter 112)

### INLAND REVENUE (AMENDMENT) (NO. 7) BILL 2018

#### INTRODUCTION

A At the meeting of the Executive Council on 30 October 2018, the Council ADVISED and the Chief Executive ORDERED that the Inland Revenue (Amendment) (No. 7) Bill 2018 (“Bill”), at **Annex A**, should be introduced into the Legislative Council (“LegCo”). The Bill seeks to –

- (a) align the tax treatment of financial instruments with their accounting treatment;
- (b) allow the deduction of interest expenses payable to overseas export credit agencies;
- (c) refine the provisions that implement the arrangement for automatic exchange of financial account information in tax matters (“AEOI”);
- (d) avoid potential double non-taxation of income of visiting teachers and researchers; and
- (e) revise the meaning of the sibling relationship.

#### JUSTIFICATIONS

##### ***Alignment of Tax Treatment of Financial Instruments with their Accounting Treatment***

2. Since 1 January 2005, enterprises in Hong Kong have been required to account for financial instruments on a fair value basis (i.e. both realised and unrealised profits of the financial instruments have to be accounted for in the financial statements) in accordance with applicable accounting standards. The Inland Revenue Department (“IRD”) uses profits computed in accordance with applicable accounting standards as the basis for computing the profits chargeable to profits tax under the Inland Revenue Ordinance (“IRO”), unless provided otherwise in the IRO.

3. However, in *Nice Cheer Investment Limited v CIR (2013) 16 HKCFAR 813* (“Nice Cheer case”), the Court of Final Appeal (“CFA”) ruled that profits are not chargeable to profits tax on a fair value basis under the existing provisions of the IRO. The contentious issue in the Nice Cheer case is the taxability of the gains resulting

from revaluation of trading securities held at the end of the accounting period as required by the accounting standards. Having regard to the basic principles of tax law<sup>1</sup> and the fact that the prevailing IRO does not expressly allow the use of fair value accounting in tax computation in respect of financial instruments, the CFA held that the revaluation gains in respect of listed securities held by enterprises for trading purposes were not chargeable to tax in Hong Kong. In accordance with this judgment, profits computed on a fair value basis cannot be used for tax reporting, and would have to be recomputed on a realisation basis for the purpose.

4. After the CFA judgment in the Nice Cheer case, financial institutions and securities dealers, which mark their financial instruments to market and account for financial instruments on a fair value basis, have requested the IRD to continue accepting profits computed on a fair value basis for tax computation purpose. Otherwise, they would have to incur substantial costs to re-compute their profits on a realisation basis. In view of the industry's request and the practical difficulties faced by taxpayers, the IRD has been accepting tax returns from enterprises with assessable profits computed on a fair value basis as an interim administrative measure.

5. Accounting on a realisation basis is not an established commercial practice, and indeed departs from the Hong Kong Financial Reporting Standard 9 ("HKFRS 9") which has been implemented since 1 January 2018. Under HKFRS 9, financial instruments are required to be accounted for on a fair value basis in certain circumstances. The Government has also received suggestions from stakeholders to codify the interim administrative measure of accepting assessable profits computed on a fair value basis into the IRO for the sake of clarity and certainty.

6. We propose amending the IRO to allow, on the taxpayer's election, the alignment of tax treatment of financial instruments with their accounting treatment for assessing profits. Specific provisions should also be enacted for making tax adjustments under certain circumstances. Generally, an election for aligning the tax treatment with their accounting treatment, once made, is irrevocable and has effect for the year of assessment for which the election is made and all subsequent years of assessment. However, the election may be revoked with the approval of the Commissioner of Inland Revenue ("Commissioner") if the taxpayer satisfies the Commissioner that there are good commercial reasons for the revocation and tax avoidance is not the main purpose of the revocation. The option to elect for alignment of tax treatment of financial instruments with their accounting treatment is available to a taxpayer only if the taxpayer prepares financial statements in accordance with a specified financial reporting standard. We propose that the new provisions apply to a year of assessment for which the basis period begins on or after 1 January 2018.

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<sup>1</sup> The two basic principles of tax law referred to by the CFA are (i) the word 'profits' connotes actual or realised and not potential or anticipated profits; and (ii) neither profits nor losses may be anticipated. (paragraph 21 of the judgment of the Nice Cheer case)

### ***Deduction of Interest Expenses Payable to Overseas Export Credit Agencies***

7. Pursuant to section 16(1)(a) of the IRO, interest expense incurred in the production of chargeable profits is deductible, provided that at least one of the prescribed conditions under section 16(2) of the IRO is satisfied. Interest expenses payable by a person on money borrowed from an “overseas financial institution” as defined under section 16(3) of the IRO<sup>2</sup> is one of the prescribed conditions under section 16(2) of the IRO.

8. Currently, an overseas export credit agency that is run as a public institution is not recognised as an “overseas financial institution” since it is not carrying on banking or deposit-taking business outside Hong Kong, and is not regulated by an overseas authority as a banking or deposit-taking institution. It follows that Hong Kong borrowers cannot claim tax deduction in respect of interest payments made on loans from an overseas export credit agency.

9. We therefore propose amending the IRO so that, for the purpose of deduction of interest expense under the IRO, an export credit agency which is owned by, or is established and operated by, a governmental entity of a jurisdiction outside Hong Kong for the purposes of supporting and developing international trade by providing financing support to its exporters or investors for export or investment activities outside that jurisdiction can be recognised as an “overseas financial institution”. This would help foster trading activities between Hong Kong and other places.

10. To confine the scope of export credit agencies for which deduction of interest expense is allowed and in line with existing provisions, we also propose that the Commissioner may determine that an export credit agency is not recognised as an overseas financial institution if the business of that agency is not adequately monitored or regulated by the relevant governmental entity by which the agency is owned or is established and operated. We propose that the new provisions relating to overseas export credit agencies apply to interest accrued on or after the date on which the amendment ordinance is published in the Gazette.

### ***Refinements to the Legislative Framework of AEOI***

11. The Organisation for Economic Co-operation and Development (“OECD”) has earlier examined the AEOI legislative framework of Hong Kong which was put in place in June 2016, and made a number of recommendations for better aligning the relevant provisions of the IRO with the requirements of the Common Reporting

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<sup>2</sup> Under section 16(3) of the IRO, overseas financial institution is defined as “a person carrying on the business of banking or deposit-taking outside Hong Kong other than a person whom the Commissioner has, in accordance with the powers vested in him by subsection (4), determined shall not be recognised for the purposes of this section as an overseas financial institution”. Section 16(4) of the IRO further stipulates that “[t]he Commissioner may for the purposes of this section determine that a person shall not be recognised as an overseas financial institution if he is of the opinion that that person’s banking or deposit-taking business is not adequately supervised by a supervisory authority.”

Standard (“CRS”) promulgated by the OECD<sup>3</sup>. While most of the necessary refinements have been incorporated in the Inland Revenue (Amendment) Ordinance 2018<sup>4</sup> approved by the Legislative Council on 24 January 2018, some further legislative amendments are required for Hong Kong to align the AEOI provisions of the IRO with the requirements of the CRS. The objects of the amendments include–

- (a) clarifying that the concept of “controlling person”, in relation to a trust, covers trustees and beneficiaries;
- (b) clarifying that controlling persons will be identified, in relation to any legal person which is functionally equivalent or similar to a trust, in a way similar to the way in which controlling persons are identified in relation to a trust<sup>5</sup>;
- (c) providing that the term “investment entity” is to be interpreted in a manner consistent with the recommendations of the Financial Action Task Force (“FATF”);
- (d) incorporating the residency rules in relation to financial institutions (other than trusts) that do not have a residence for tax purposes;
- (e) providing that the Commissioner may publish non-statutory guidelines on the interpretation of AEOI related provisions; and
- (f) removing Mandatory Provident Fund Schemes (“MPF schemes”), Occupational Retirement Schemes registered under the Occupational Retirement Schemes Ordinance (Cap. 426) (“ORSO registered schemes”), pooling agreements, approved pooled investment funds and credit unions from the list of non-reporting financial institutions (“NRFIs”).

12. While the refinements in paragraph 11(a) to (e) above serve to align the AEOI regime with the CRS without making substantial changes to the systems and operations of reporting financial institutions, we propose that the refinements should apply from the reporting year 2021 (in respect of information covering 1 January to 31 December 2020). The lead time should be adequate and reasonable taking into account the preparatory work of reporting financial institutions.

13. As regards the proposed removal of the NRFIs in paragraph 11(f), the OECD considered that MPF schemes, ORSO registered schemes and credit unions failed to meet the criteria of NRFIs under the CRS and recommended that Hong Kong

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<sup>3</sup> The Common Reporting Standard is contained in the Standard for Automatic Exchange of Financial Account Information in Tax Matters (Second Edition), published by the Organisation for Economic Co-operation and Development on 27 March 2017.

<sup>4</sup> The Inland Revenue (Amendment) Ordinance 2018 was gazetted on 2 February 2018. It contains technical amendments to certain provisions on AEOI so as to align them with the CRS promulgated by the OECD.

<sup>5</sup> The concept of “legal person” is used in the CRS and is defined in the FATF recommendations to mean “an entity other than a natural person that can establish a permanent customer relationship with a financial institution or otherwise own property”. The Bill now incorporates the contents of that definition into the definition of “entity”. The Bill also defines controlling person, in relation to an entity which is functionally equivalent or similar to a trust, in a way similar to the way in which the concept is defined in relation to a trust.

should remove such entities from the list of NRFIs. MPF schemes and ORSO registered schemes are not meeting NRFI criteria because –

- (a) the voluntary contributions and special voluntary contributions of MPF schemes go beyond the character of providing benefits for retirement, disability or death;
- (b) the flexibility of ORSO registered schemes, in particular the withdrawal grounds, goes beyond the character of providing benefits for retirement, disability or death;
- (c) some ORSO registered schemes do not meet the condition that no single beneficiary should have the right to more than 5% of the fund's assets; and
- (d) information reporting by MPF schemes and ORSO registered schemes to the tax authority is inadequate.

As for credit unions, the following inadequacies are identified by the OECD –

- (a) credit unions render saving services and loan services, rather than merely accepting contributions leading to guaranteed benefits provided for retirement, disability or death as in retirement funds;
- (b) not all credit unions meet the requirement that no individual member holds more than 5% of the credit union's asset; and
- (c) information reporting by credit unions to the tax authority is inadequate.

As for pooling agreements and approved pooled investment funds, there was no need to list them as NRFIs if all the participants of the schemes were financial institutions.

14. The proposed change to the list of NRFIs is essential for ensuring that Hong Kong's AEOI regime is consistent with the requirements of the CRS. To allow sufficient lead time for setting up the systems for AEOI reporting, we propose that the financial institutions concerned be required to report the necessary information to the IRD for the first time in 2021 (in respect of the information covering 1 January to 31 December 2020).

15. We also propose to take the opportunity of this legislative amendment exercise to revise the list of reportable jurisdictions under Schedule 17E to the IRO. With the application of the Convention on Mutual Administrative Assistance in Tax Matters ("Convention") extended to Hong Kong by the Central People's Government, Hong Kong's network for tax information exchange has been significantly expanded. We therefore propose to include all Hong Kong's prospective AEOI partners in the list of reportable jurisdictions so that reporting financial institutions can collect relevant data for future exchanges with the prospective AEOI partners. This would involve the addition of 51 jurisdictions<sup>6</sup>, which are AEOI-committed jurisdictions and signatories/potential signatories to the Convention, to the existing list of 75 reportable

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<sup>6</sup> Among the 51 proposed jurisdictions, 48 are signatories to the Convention and three (namely Dominica, Maldives and Trinidad and Tobago) are non-signatories but have committed to implementing AEOI.

B jurisdictions. A list of these additional jurisdictions is at **Annex B**. We propose that the expanded list should take effect from 1 January 2020.

***Avoidance of Potential Double Non-taxation of Income of Visiting Teachers and Researchers***

16. To foster exchanges in teaching or research between Hong Kong and other places, Hong Kong may include an Article on Teachers and Researchers (“Teachers’ Article”) 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. So far, a Teachers’ Article is already included in our CDTA with Saudi Arabia, and we plan to add a Teachers’ Article in our CDTA with the Mainland.

17. A potential problem of double non-taxation arises with the income of a visiting teacher or researcher from Hong Kong derived from services rendered wholly in a visited jurisdiction with which Hong Kong has adopted a Teachers’ Article in the relevant CDTA. Employment income of the visiting teacher or researcher derived from services rendered wholly outside Hong Kong is generally not subject to Hong Kong’s salaries tax under existing provisions of the IRO, given that Hong Kong adopts a territorial basis of taxation. On the other hand, the visiting teacher or researcher could enjoy tax exemption during the prescribed period in the visited jurisdiction.

18. To avoid double non-taxation, we propose to limit the application of section 8(1A)(b) of the IRO<sup>7</sup>, which provides that income derived from services rendered wholly outside Hong Kong is not subject to salaries tax in Hong Kong. If a Teachers’ Article is in the relevant CDTA with the visited jurisdiction, a Hong Kong resident person’s income derived as a visiting teacher or researcher, even though derived from services wholly rendered in the visited jurisdiction, is exempted from salaries tax in Hong Kong only if tax is paid or payable in the visited jurisdiction. This is in line with OECD’s efforts to combat double non-taxation. We propose that the amendments concerning visiting teachers and researchers should apply in relation to a year of assessment beginning on or after 1 April 2019.

***Revising the meaning of sibling relationship in the IRO***

19. During the scrutiny of the Inland Revenue (Amendment) (No. 4) Bill 2018 which provides for tax concession for premiums paid in respect of certain health insurance plans, it was noted that the definition of “sibling” in the proposed new

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<sup>7</sup> Section 8(1A)(b) of the IRO provides that, for the purpose of salaries tax, income arising in or derived from Hong Kong from any employment **excludes** income derived from services rendered by a person who—

(a) is not employed by the Government or as master or member of the crew of a ship or as commander or member of the crew of an aircraft; and

(b) renders outside Hong Kong all the services in connection with his employment.

section 26J(4)<sup>8</sup> to be added to the IRO does not cover a taxpayer's (or his or her spouse's) adoptive parents' natural children where the taxpayer (or the spouse) is himself or herself an adopted child. This limitation is proposed to be removed through a Committee Stage Amendment for the bill.

20. Since the definition of "siblings" in the proposed new section 26J(4) is modelled on the existing section 30B of the IRO (with the modification that a full or half blood sibling is referred to instead of a natural sibling), we consider it prudent to correspondingly amend the definition of "brother or sister or brother or sister of the spouse" in section 30B<sup>9</sup> to cover, in relation to a taxpayer, both –

- (a) an individual who is adopted by the taxpayer's (or his or her spouse's) parents; and
- (b) the taxpayer's (or his or her spouse's) adoptive parents' natural children where the taxpayer (or the spouse) is himself or herself an adopted child.

21. Further, the definition will refer to a brother or sister of full or half blood. We propose that the amendments concerning the meaning of brother or sister should apply in relation to a year of assessment beginning on or after 1 April 2019.

## OTHER OPTIONS

22. Amending the IRO is the only way to give effect to the above proposals. There is no other option.

## THE BILL

23. The major provisions of the Bill are set out below –

- (a) **Clause 3** adds new sections 18G to 18L to the IRO to provide for the alignment of the treatment of financial instruments for profits tax purpose with their accounting treatment. In particular—
  - (i) under the new section 18J, the amount of profit, gain, loss, income or expense computed for a financial instrument for profits tax purpose for a period is the amount of profit, gain, loss, income or expense recognized for the instrument for accounting purpose for the period;

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<sup>8</sup> According to section 26J(4) proposed to be added under Inland Revenue (Amendment) (No. 4) Bill 2018, *sibling, in relation to a person, means, (a) a full or half blood sibling of the person or of the person's spouse; (b) an adopted sibling of the person or of the person's spouse; (c) a step sibling of the person or of the person's spouse; or (d) if the person's spouse is deceased—an individual who would have been the sibling of the person under paragraph (a), (b) or (c) if the spouse had not died.*

<sup>9</sup> Section 30B of the IRO provides for dependent brother or dependent sister allowance. Section 30B(3)(b) of the IRO defines "brother or sister or brother or sister of the spouse" to include "*an adopted brother or adopted sister of the person or the spouse*", which is rendered in the Chinese text as "該人或配偶的父母的領養子女". The statutory meaning does not include the taxpayer's (or the spouse's) adoptive parents' natural children where the taxpayer (or the spouse) is himself or herself an adopted child.

- (ii) the new sections 18K and 18L 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 new section 18I states the effect of the new sections 18J, 18K and 18L on the existing provisions on profits tax in the IRO as follows—
    - (A) *profits* are not limited to realized profits and a change in fair value of a financial instrument is to 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 is changed in certain circumstances (for example, interest is calculated in some cases at the effective rate instead of the contractual rate);
  - (iv) the new sections 18I, 18J, 18K and 18L apply to a taxpayer who follows a specified financial reporting standard and elects that those new sections apply to the taxpayer; (See the new sections 18H)
- (b) **Clause 4** amends section 16 of the IRO so that, unless the Commissioner determines otherwise, an overseas export credit agency (definition added to section 16(3) of the IRO) falls within the definition of overseas financial institution and interest expenses payable to the agency is deductible under section 16(1)(a) of the IRO;
- (c) **Clauses 5, 7 and 8** amend section 50A of, and Schedules 17C and 17D to, the IRO and **Clause 6** adds a new section 50L to the IRO, so that—
  - (i) the terms “Common Reporting Standard”, “CRS publications” and “FATF Recommendations” are defined to represent key documents relating to the AEOI arrangement;
  - (ii) the meanings of “entity” and “controlling person” reflect relevant provisions in the CRS and the FATF Recommendations (see paragraph 11(a) and (b) above for details);
  - (iii) the term “investment entity” is to be interpreted in a way consistent with the FATF Recommendations;
  - (iv) the residency rules are 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 cease to be non-reporting financial institutions, and consequential changes are made to the definitions of “pre-existing account”, “reporting year”, “new account”;
  - (vi) provisions are made for the Commissioner to issue guidelines for ensuring that provisions in the IRO implementing the AEOI arrangement are construed in a way consistent with the effect given to



the CRS and in accordance with the CRS publications, and for clarifying the status of the guidelines;

- (d) **Clause 9** amends Schedule 17E to the IRO to substitute an updated list of reportable jurisdictions;
- (e) **Clause 10** amends section 8 of the IRO 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, is no longer exempted from salaries tax in Hong Kong unless tax is paid or payable in respect the income in that territory;
- (f) **Clause 11** revises the meaning of brother or sister in section 30B of the IRO (so as to align with the meaning of sibling in the new section 26J proposed to be added by the Inland Revenue (Amendment) (No. 4) Bill 2018).

## LEGISLATIVE TIMETABLE

24. The legislative timetable is as follows –

|   |                  |
|---|------------------|
| Publication in the Gazette  | 2 November 2018  |
| First Reading and commencement of<br>Second Reading debate                | 14 November 2018 |
| Resumption of Second Reading debate,<br>committee stage and Third Reading | To be notified   |

## IMPLICATIONS OF THE PROPOSAL

25. The proposals are in conformity with the Basic Law, including the provisions concerning human rights. The proposals will not affect the binding effect of the existing provisions of the IRO and its subsidiary legislation. The financial, economic and family implications of the proposals are at **Annex C**. The proposals have no productivity, environmental, gender or civil service implications and no sustainability implications other than those set out in the economic and family implications paragraphs in Annex C.

## PUBLIC CONSULTATION

26. We consulted the LegCo Panel on Financial Affairs on 3 July 2018 regarding the alignment of tax treatment of financial instruments with their accounting treatment, deduction of interest expense payable to overseas export credit agencies and refinements to AEOI regime. Members of the panel did not object to these proposals being introduced into the LegCo.

27. We also conducted a stakeholder consultation from July to August 2018 to gauge views for the alignment of tax treatment of financial instruments with their accounting treatment. Organisations that have responded generally support allowing such an election while proposing suggestions on various technical matters. The Bill has incorporated the suggestions received as appropriate.

28. To prepare for the removal of certain institutions from the list of NRFIs (see paragraphs 11(f) and 13), we have kept MPF trustees, ORSO administrators and credit unions updated of the OECD's assessments and conducted briefings for them to facilitate their understanding of the reporting requirements under AEOI. We have briefed the Heads of Universities for the amendments to avoid possible double non-taxation arising from Teachers' Article.

## **PUBLICITY**

29. We will issue a press release on 31 October 2018. A spokesperson will be available to answer media and public enquiries.

## **ENQUIRIES**

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

**Financial Services and the Treasury Bureau**  
**31 October 2018**

# **Inland Revenue (Amendment) (No. 7) Bill 2018**

## **Contents**

| Clause  | Page |
|---|------|
| <b>Part 1</b>   |      |
| <b>Preliminary</b>  |      |
| 1. Short title and commencement .....   | 1    |
| 2. Inland Revenue Ordinance Amended .....   | 1    |
| <b>Part 2</b>   |      |
| <b>Amendments for Aligning Tax Treatment of Financial Instruments with their Accounting Treatment</b>                         |      |
| 3. Sections 18G to 18L added .....  | 2    |
| 18G. Financial instrument: interpretation of this section and sections 18H, 18I, 18J, 18K and 18L .....                       | 3    |
| 18H. Financial instrument: application of sections 18I, 18J, 18K and 18L .....  | 4    |
| 18I. Financial instrument: effect of sections 18J, 18K and 18L on other Part 4 provisions .....                               | 6    |
| 18J. Financial instrument: generally, profits etc. for accounting purpose taken to be profits etc. for taxation purpose ..... | 7    |
| 18K. Financial instrument: special treatment of impairment loss .....   | 9    |

| Clause  | Page |
|---|------|
| 18L. Financial instrument: special treatment of equity instrument, financial liability, embedded derivative, preference share, non-arm's length loan, etc. .... | 12   |
| <b>Part 3</b>   |      |
| <b>Amendments Relating to Interest Expense Payable to Overseas Export Credit Agency</b>   |      |
| 4. Section 16 amended (ascertainment of chargeable profits) .....   | 15   |
| <b>Part 4</b>   |      |
| <b>Amendments Relating to Automatic Exchange of Financial Account Information in Tax Matters</b>  |      |
| 5. Section 50A amended (interpretation) .....   | 18   |
| 6. Section 50L added .....  | 25   |
| 50L. Guidelines published by Commissioner .....   | 25   |
| 7. Schedule 17C amended (non-reporting financial institutions and excluded accounts) .....  | 27   |
| 8. Schedule 17D amended (due diligence requirements) .....  | 27   |
| 9. Schedule 17E amended (reportable jurisdictions and participating jurisdictions) .....  | 28   |
| <b>Part 5</b>   |      |
| <b>Amendments Relating to Income of Visiting Teacher or Researcher</b>  |      |
| 10. Section 8 amended (charge of salaries tax) .....  | 35   |

| Clause |   | Page |
|--------|---|------|
|        | <b>Part 6</b>   |      |
|        | <b>Amendment Relating to Sibling Relationship</b>   |      |
| 11.    | Section 30B amended (dependent brother or dependent sister allowance).....                      | 37   |
|        | <b>Part 7</b>   |      |
|        | <b>Transitional Provisions</b>  |      |
| 12.    | Section 89 amended (transitional provisions).....   | 38   |
| 13.    | Schedule 48 added .....   | 38   |
|        | Schedule 48 Transitional Provisions for Inland Revenue (Amendment) (No. 7) Ordinance 2018 ..... | 38   |

# A BILL

## To

Amend the Inland Revenue Ordinance to align tax treatment of financial instruments with their accounting treatment in certain circumstances; to provide for deduction of interest expenses payable to overseas export credit agencies; to refine the provisions that implement the arrangement relating to automatic exchange of financial account information in tax matters; to avoid potential double non-taxation of income of visiting teachers and researchers; and to revise the meaning of the sibling relationship.

Enacted by the Legislative Council.

## Part 1

### Preliminary

#### 1. Short title and commencement

- (1) This Ordinance may be cited as the Inland Revenue (Amendment) (No. 7) Ordinance 2018.
- (2) Subject to subsection (3), this Ordinance comes into operation on the day on which it is published in the Gazette.
- (3) Part 4 comes into operation on 1 January 2020.

#### 2. Inland Revenue Ordinance Amended

The Inland Revenue Ordinance (Cap. 112) is amended as set out in Parts 2 to 7.

## Part 2

### Amendments for Aligning Tax Treatment of Financial Instruments with their Accounting Treatment

#### 3. Sections 18G to 18L added

After section 18F—

##### Add

“Note without legislative effect on sections 18G, 18H, 18I, 18J, 18K and 18L—

1. The specified financial reporting standards (as defined in section 18G(1)) require enterprises to account for financial instruments on a fair value basis (that is, both realized and unrealized profits of the instruments have to be accounted for in the financial statements) in certain circumstances. Sections 18G, 18H, 18I, 18J, 18K and 18L provide for the alignment of the treatment of financial instruments for profits tax purpose with their accounting treatment.
2. Sections 18I, 18J, 18K and 18L apply to a taxpayer who follows a specified financial reporting standard and elects that those sections apply to the taxpayer (see section 18H).
3. Section 18I explains the effect of sections 18J, 18K and 18L on the other Part 4 provisions in determining whether any profit, gain, loss, income or expense is chargeable to tax or allowable for deduction. (The other Part 4 provisions are provisions of this Part other than sections 18G, 18H, 18I, 18J, 18K and 18L.) In summary—
  - (a) for the purposes of this Part, profits are not limited to realized profits despite the other Part 4 provisions and a change in fair value of a financial instrument is to be brought into account in assessing profits tax in certain circumstances;
  - (b) also, the way in which a profit, gain, loss, income or expense is computed is changed in certain circumstances (for example, interest is computed in

some cases at the effective rate instead of the contractual rate); and

- (c) apart from the changes described in paragraphs (a) and (b), sections 18J and 18L apply subject to the other Part 4 provisions.
4. Under section 18J, the amount of profit, gain, loss, income or expense computed for a financial instrument for profits tax purpose for a period is the amount of profit, gain, loss, income or expense recognized for the instrument for accounting purpose for the period.
5. Sections 18K and 18L 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.

#### 18G. Financial instrument: interpretation of this section and sections 18H, 18I, 18J, 18K and 18L

- (1) In this section and sections 18H, 18I, 18J, 18K and 18L—

*recognized* (確認)—see subsection (2)(a);

*specified financial reporting standard* (指明財務報告準則)—

- (a) unless paragraph (b) applies, means—
  - (i) the Hong Kong Financial Reporting Standard 9 (Financial Instruments) issued by the Hong Kong Institute of Certified Public Accountants, as in force from time to time; or
  - (ii) the International Financial Reporting Standard 9 (Financial Instruments) issued by the International Accounting Standards Board, as in force from time to time; or

- (b) in relation to a person for a year of assessment for which the person prepares financial statements in accordance with a standard referred to in paragraph (a)(i) or (ii), means that standard.
- (2) If a person prepares financial statements for the basis period for a year of assessment in accordance with a specified financial reporting standard—
  - (a) *recognized* in this section or section 18H, 18I, 18J, 18K or 18L (other than section 18L(6)(c)), in relation to the person and the year, means recognized in accordance with the standard; and
  - (b) an expression used in this section or section 18H, 18I, 18J, 18K or 18L has the same meaning in relation to the person and the year as the expression has in the standard if the expression is—
    - (i) defined in the standard; and
    - (ii) not defined in this section or section 18H, 18I, 18J, 18K or 18L.

**18H. Financial instrument: application of sections 18I, 18J, 18K and 18L**

- (1) Sections 18I, 18J, 18K and 18L apply to a person for a year of assessment only if—
  - (a) the person prepares financial statements for the basis period for the year in accordance with a specified financial reporting standard; and
  - (b) the person has elected in writing that those sections apply to the person (*election*) and the election has effect for the year.

- (2) A person may make an election for a year of assessment (*election year*) and, subject to subsections (4), (5), (6) and (7), the election—
  - (a) is irrevocable; and
  - (b) has effect for the election year and all subsequent years of assessment.
- (3) The amount of any profit, gain, loss, income or expense which would have been brought into account for computing the person's assessable profits for the basis period for any year of assessment preceding the election year, had the assessable profits been computed on the basis set out in sections 18I, 18J, 18K and 18L, must be brought into account for computing the person's assessable profits for the election year.
- (4) Despite subsection (2), an election may be revoked with the Commissioner's approval under subsection (5) and, on the revocation, the election ceases to have effect from the year of assessment specified by the Commissioner.
- (5) The Commissioner may, on a person's application in writing, approve the revocation of the person's election if the person proves to the Commissioner's satisfaction—
  - (a) that there are good commercial reasons for the revocation; and
  - (b) that avoidance of tax is not the main purpose, or one of the main purposes, of the revocation.
- (6) If, after a person has made an election, the person ceases to prepare, in accordance with a specified financial reporting standard, financial statements for the basis period for a year of assessment, the election ceases to have effect from the year.

- (7) If an election ceases to have effect from a year of assessment under subsection (4) or (6) (*cessation year*)—
- (a) sections 18I, 18J, 18K and 18L do not apply to the person for the cessation year and all subsequent years of assessment; and
  - (b) every financial instrument held by the person at the end of the basis period for the year of assessment immediately preceding the cessation year is taken to have been disposed of and reacquired, or released and reassumed, at its fair value on the first day of the basis period for the cessation year.

**18I. Financial instrument: effect of sections 18J, 18K and 18L on other Part 4 provisions**

- (1) This section applies in determining whether any profit, gain, loss, income or expense is chargeable to tax or allowable for deduction in relation to a person to whom this section applies under section 18H for a year of assessment.
- (2) Sections 18J, 18K and 18L do not affect the operation of sections 17C and 17D.
- (3) Subject to subsection (2), sections 18J, 18K and 18L apply despite any other Part 4 provisions to the extent that—
  - (a) those other provisions (regardless of how they are expressed) would otherwise limit the profit, gain, loss, income or expense chargeable to tax or allowable for deduction to that which is realized, received, receivable, accrued, paid, payable or incurred; or

- (b) under those other provisions (regardless of how they are expressed), any profit, gain, loss, income or expense would otherwise be computed in a way different from that provided for in any of sections 18J, 18K and 18L (whether or not by having the profit, gain, loss, income or expense wholly or partly brought into account for a different year of assessment).
- (4) Except as provided for in subsection (3), sections 18J and 18L apply subject to the other Part 4 provisions.
- (5) In this section—  
*other Part 4 provisions* (第4部其他條文) means provisions of this Part other than sections 18G, 18H, 18I, 18J, 18K and 18L.

**18J. Financial instrument: generally, profits etc. for accounting purpose taken to be profits etc. for taxation purpose**

- (1) In relation to a person to whom this section applies under section 18H for a year of assessment, the tax-relevant amount in respect of a financial instrument is the accounting-relevant amount in respect of the instrument.
- (2) Subsection (1) applies subject to sections 18K and 18L.
- (3) For subsection (1)—
  - (a) the tax-relevant amount in respect of a financial instrument is the amount of profit, gain, loss, income or expense to be brought into account for computing the person's assessable profits in respect of the instrument for the basis period for the year of assessment; and

- (b) the accounting-relevant amount in respect of a financial instrument is the amount which is recognized in determining any profit, gain, loss, income or expense of the person in respect of the instrument for the basis period for the year of assessment.
- (4) In applying subsection (1) to a financial instrument that is measured at fair value through profit or loss—
  - (a) if the person derives interest from the instrument—the amount of interest chargeable to tax is the amount recognized in profit or loss;
  - (b) if the person incurs interest on any money borrowed by the person for the purpose of producing the person's assessable profits—the amount of interest allowable as a deduction is the amount recognized in profit or loss;
  - (c) if the instrument is a debt security and the person derives a gain from a discount or premium on the debt security—the amount of gain chargeable to tax is the amount recognized in profit or loss; and
  - (d) if the instrument is a debt security that the person issues at a discount or redeems at a premium, and the proceeds of the issue of the debt security are applied for the purpose of producing the person's assessable profits—the amount of discount or premium allowable as a deduction is the amount recognized in profit or loss.
- (5) In applying subsection (1) to a financial instrument that is measured at amortized cost or fair value through other comprehensive income—
  - (a) if the person derives interest from the instrument—the amount of interest chargeable to tax is the

amount recognized in profit or loss at the effective interest rate;

- (b) if the person incurs interest on any money borrowed by the person for the purpose of producing the person's assessable profits—the amount of interest allowable as a deduction is the amount recognized in profit or loss at the effective interest rate;
- (c) if the instrument is a debt security and the person derives a gain from a discount or premium on the debt security—the amount of gain chargeable to tax is the amount recognized in profit or loss at the effective interest rate; and
- (d) if the instrument is a debt security that the person issues at a discount or redeems at a premium, and the proceeds of the issue of the debt security are applied for the purpose of producing the person's assessable profits—the amount of discount or premium allowable as a deduction is the amount recognized in profit or loss at the effective interest rate.

**18K. Financial instrument: special treatment of impairment loss**

- (1) This section applies in relation to a person to whom this section applies under section 18H for a year of assessment.
- (2) Any impairment loss recognized by the person in respect of a financial instrument that is not credit-impaired is not deductible and any subsequent reversal of any amount of the impairment loss is not chargeable to tax.



- (3) If an impairment loss is recognized by the person in respect of a financial instrument that is credit-impaired—
- (a) if the instrument represents a debt that was included as a trading receipt in ascertaining the person's assessable profits for the basis period in which the debt arose—the impairment loss is allowable as a deduction up to the amount of the debt so included;
  - (b) if the instrument represents a debt in respect of money lent, in the ordinary course of the business of lending money in Hong Kong, by the person who carries on that business—the impairment loss is allowable as a deduction up to the amount of the debt; and
  - (c) in any other case—the impairment loss is not deductible.
- (4) If—
- (a) a deduction of an amount was previously allowed to the person for a year of assessment—
    - (i) under section 16(1)(d) in respect of a bad debt or doubtful debt in respect of a financial instrument; or
    - (ii) under subsection (3) in respect of an impairment loss in respect of a financial instrument; and
  - (b) recovery or reversal of an amount of the bad debt, doubtful debt or impairment loss is recognized by the person for a subsequent year of assessment,
- the amount recovered or reversed is chargeable to tax for the subsequent year of assessment.

- (5) If—
- (a) a financial instrument purchased or originated by the person is credit-impaired on initial recognition; and
  - (b) the instrument is on revenue account,
- any impairment gain recognized by the person in respect of the instrument for a year of assessment is treated as the person's trading receipt for the year.
- (6) Subsection (7) or (8) applies if—
- (a) the person (*transferor*), being a financial institution, transfers to another person (*transferee*)—
    - (i) a credit-impaired loan; with
    - (ii) a loss allowance, for an expected credit loss arising from that loan, that is made in accordance with the specified financial reporting standard;
  - (b) the transfer is not by way of a sale in the ordinary course of the transferor's business; and
  - (c) in respect of the loss allowance made, a deduction of an amount was previously allowed to the transferor under section 16(1)(d) in respect of a bad debt or doubtful debt or under subsection (3) in respect of an impairment loss.
- (7) If, on the date of the transfer referred to in subsection (6), both the transferor and the transferee are in the business of lending money in Hong Kong, the deduction referred to in subsection (6)(c) is treated as having been allowed to the transferee, despite any provision of this Part.

- (8) If, on the date of the transfer referred to in subsection (6), the transferor or the transferee is, or both are, not in the business of lending money in Hong Kong, the amount of deduction referred to in subsection (6)(c) is treated as the transferor's trading receipt arising in or derived from Hong Kong from a trade, profession or business carried on by the transferor in Hong Kong and accruing on the date of the transfer.

**18L. Financial instrument: special treatment of equity instrument, financial liability, embedded derivative, preference share, non-arm's length loan, etc.**

- (1) This section applies in relation to a person to whom this section applies under section 18H for a year of assessment.
- (2) If an equity instrument on revenue account of the person that is measured at fair value through other comprehensive income is disposed of during the basis period for a year of assessment (*year of disposal*)—
- a gain to the person that is derived from the disposal, including any cumulative gain recognized in other comprehensive income, is chargeable to tax for the year of disposal; and
  - a loss to the person that is derived from the disposal, including any cumulative loss recognized in other comprehensive income, is allowable as a deduction for the year of disposal.
- (3) Subsections (4) and (5) apply if a financial instrument—
- is on revenue account of the person and is a financial liability measured at fair value through profit or loss; and

- matures or is sold, bought back or redeemed (each an *event*) during the basis period for a year of assessment (*event year*).
- (4) A gain to the person that is derived from the event, including any cumulative gain recognized in other comprehensive income, is chargeable to tax for the event year.
- (5) A loss to the person that is derived from the event, including any cumulative loss recognized in other comprehensive income, is allowable as a deduction for the event year.
- (6) If—
- the person issues a debt security;
  - the debt security is issued with an embedded derivative to acquire shares or units in the person; and
  - the embedded derivative is recognized as an equity component in accordance with—
- the Hong Kong Accounting Standard 32 (Financial Instruments: Presentation) issued by the Hong Kong Institute of Certified Public Accountants, as in force from time to time; or
  - the International Accounting Standard 32 (Financial Instruments: Presentation) issued by the International Accounting Standards Board, as in force from time to time,
- the part of the interest, discount, premium or expense recognized by the person in respect of the debt security that is attributable to the embedded derivative is not deductible.

- (7) Any interest, discount, premium or expense recognized by the person in respect of a preference share issued by the person is not deductible.
- (8) Subsection (9) has effect without affecting the operation of sections 50AAF and 50AAK.
- (9) If—
- the person is the lender or borrower of a loan or is the issuer or holder of a debt security; and
  - the loan is made, or the debt security is issued, otherwise than at arm's length to or by another person,
- the amount of profit, gain, loss, income or expense in respect of the loan or debt security that is chargeable to tax, or allowable as a deduction, is the amount computed in accordance with the contractual terms of the loan or debt security.
- (10) An amount of profit, gain, loss, income or expense recognized by the person in respect of a hedging instrument must be disregarded if—
- the hedging instrument is designated, under a hedging arrangement made in good faith, for the purpose of hedging against any risk associated with a hedged item; and
  - the hedged item is on capital account.”.

### Part 3

#### Amendments Relating to Interest Expense Payable to Overseas Export Credit Agency

##### 4. Section 16 amended (ascertainment of chargeable profits)

###### (1) Section 16(3)—

**Repeal the definition of *overseas financial institution***

**Substitute**

**“*overseas financial institution* (海外財務機構)—**

(a) means—

- a person carrying on the business of banking or deposit-taking outside Hong Kong; or
- an overseas export credit agency; but

(b) excludes a person or organization that the Commissioner has, under subsection (4), determined is not recognized as an overseas financial institution;”.

###### (2) Section 16(3)—

**Add in alphabetical order**

**“*controlled entity* (受控制實體) has the meaning given by section 50A;**

***export credit business* (出口信貸業務), in relation to a jurisdiction, means the business of supporting and developing international trade by providing financing support to exporters or investors of that jurisdiction for export or investment activities outside that jurisdiction;**

***governmental entity* (政府實體), in relation to a jurisdiction, means—**

- (a) the government of the jurisdiction;
- (b) the political subdivision of the jurisdiction, including a state, a province, a county and a municipality of the jurisdiction;
- (c) a wholly owned agency or instrumentality of the jurisdiction, or of any entity mentioned in paragraph (a) or (b); or
- (d) an integral part, controlled entity or political subdivision of the jurisdiction;

*integral part* (組成部分) has the meaning given by section 50A;

*overseas export credit agency* (海外出口信貸機構) means an organization that is owned by, or was established and is operated by, a governmental entity of a jurisdiction outside Hong Kong for the purposes of carrying on export credit business;”.

(3) Section 16—

**Repeal subsection (4)**

**Substitute**

- “(4) The Commissioner may, for the purposes of this section, determine that any person or organization is not recognized as an overseas financial institution if the Commissioner is of the opinion that—
- (a) in the case of a person carrying on the business of banking or deposit-taking outside Hong Kong—the business is not adequately supervised by a supervisory authority; or
  - (b) in the case of an organization that is an overseas export credit agency—the organization’s export credit business is not adequately monitored or

regulated by the governmental entity by which the organization—

- (i) is owned; or
- (ii) was established and is operated.”.

**Part 4****Amendments Relating to Automatic Exchange of  
Financial Account Information in Tax Matters****5. Section 50A amended (interpretation)****(1) Section 50A(1)—****Repeal the definition of *controlling person*****Substitute****“*controlling person* (控權人), in relation to an entity—**

- (a) subject to paragraphs (b) and (c), means an individual who exercises control over the entity;
- (b) if the entity is a trust—
  - (i) means an individual who is the settlor, trustee, protector (if any), enforcer (if any), or a beneficiary or a member of a class of beneficiaries, of the trust; or
  - (ii) if the settlor, trustee, protector, enforcer, or the beneficiary or the member of the class of beneficiaries, of the trust is another entity, means an individual who exercises control over that other entity; or
- (c) if the entity is equivalent or similar to a trust (regardless of how the entity is described)—
  - (i) means an individual who, in relation to the entity, is in a position similar to the settlor, trustee, protector (if any), enforcer (if any), or a beneficiary or a member of a class of beneficiaries, of a trust; or

- (ii) if, in relation to the entity, another entity is in a position similar to the settlor, trustee, protector (if any), enforcer (if any), or a beneficiary or a member of a class of beneficiaries, of a trust—means an individual who exercises control over that other entity;”.

**(2) Section 50A(1)—****Repeal the definition of *entity*****Substitute****“*entity* (實體)—****(a) means—**

- (i) an entity, other than a natural person, that can establish a permanent customer relationship with a financial institution or otherwise own property; or
- (ii) a legal arrangement; and

- (b) includes a corporation, partnership and any other body of persons (incorporated or unincorporated) and a trust;

**Note without legislative effect—**The definition of *entity* reflects the following—

- (a) under the Common Reporting Standard and the CRS publications (both expressions are defined in section 50L(4)), *entity* covers a legal person and a legal arrangement; and
- (b) under the FATF Recommendations (as defined in this section), *legal person* means an entity other than a natural person that can establish a permanent customer relationship with a financial institution or otherwise own property.”.

**(3) Section 50A(1)—**

**Repeal the definition of *pre-existing account*****Substitute**

*“pre-existing account* (先前帳戶) means—

- (a) a financial account of an account holder maintained by a reporting financial institution as at the following applicable date (*old account*)—
  - (i) if the institution is not a 2020-covered institution—31 December 2016;
  - (ii) if the institution is a 2020-covered institution—31 December 2019; or
- (b) a financial account—
  - (i) that is a financial account of an account holder opened and maintained by a reporting financial institution on or after the following applicable date (*subsequent account*)—
    - (A) if the institution is not a 2020-covered institution—1 January 2017;
    - (B) if the institution is a 2020-covered institution—1 January 2020; and
  - (ii) in respect of which all of the following conditions are met—
    - (A) the account holder holds with the institution, or its related entity within Hong Kong, any old account;
    - (B) on the opening of the subsequent account, the institution (and, as applicable, its related entity within Hong Kong) treats the subsequent account and the following financial accounts as a single financial account—

- (I) one or more old accounts of the account holder maintained by the institution or its related entity within Hong Kong; and
  - (II) if there exist one or more subsequent accounts that are treated as pre-existing accounts because all of the conditions in this sub-subparagraph and sub-subparagraphs (C), (D) and (E) are met—all of the subsequent accounts that are so treated;
- (C) the institution (and, as applicable, its related entity within Hong Kong) acts in the way described in sub-subparagraph (B) for the purposes of—
- (I) satisfying the requirement set out in section 2 of Part 7 of Schedule 17D; and
  - (II) calculating the balance or value of any of the accounts mentioned in that sub-subparagraph to determine any of the account thresholds;
- (D) the subsequent account is subject to AML/KYC procedures and the institution is permitted to carry out such AML/KYC procedures for the subsequent account by relying on the AML/KYC procedures carried out for the old account mentioned in sub-subparagraph (B)(I);

- (E) on the opening of the subsequent account, no new, additional or amended customer information is required to be provided by the account holder other than for the purpose of complying with sections 50B, 50C, 50F and 50G;”.

(4) Section 50A(1)—

**Repeal the definition of *reporting year***

**Substitute**

“*reporting year* (申報年), in relation to a reportable jurisdiction—

- (a) in relation to a reporting financial institution that is not a 2020-covered institution—means the year specified in column 2 of Part 1 of Schedule 17E opposite that jurisdiction; or
- (b) in relation to a reporting financial institution that is a 2020-covered institution—means the later of the following—
  - (i) the year specified in column 2 of Part 1 of Schedule 17E opposite that jurisdiction;
  - (ii) 2021;”.

(5) Section 50A(1), before the definition of *account holder*—

**Add**

“*2020-covered institution* (2020 年涵蓋機構) means a reporting financial institution that is—

- (a) a mandatory provident fund scheme registered under the Mandatory Provident Fund Schemes Ordinance (Cap. 485) (*MPF scheme*);

- (b) an occupational retirement scheme registered under the Occupational Retirement Schemes Ordinance (Cap. 426) (*ORSO scheme*);
- (c) a pooling agreement as defined by section 2(4) of the Occupational Retirement Schemes Ordinance (Cap. 426) that only applies to 2 or more participating ORSO schemes;
- (d) an approved pooled investment fund as defined by section 2 of the Mandatory Provident Fund Schemes (General) Regulation (Cap. 485 sub. leg. A), in which only either or both of the following schemes are invested—
  - (i) MPF schemes;
  - (ii) ORSO schemes; or
- (e) a credit union registered under the Credit Unions Ordinance (Cap. 119);”.

(6) Section 50A(1)—

**Add in alphabetical order**

“*FATF Recommendations* (《財務行動特別組織的建議》) means the International Standards on Combating Money Laundering and the Financing of Terrorism & Proliferation—the FATF Recommendations, as adopted by the Financial Action Task Force Plenary in February 2012 incorporating updates made up to February 2018;”.

(7) Section 50A(6)(c)(iii)—

**Repeal**

“; or”

**Substitute a semicolon.**

(8) Section 50A(6)(c)—

**Repeal subparagraph (iv)**

**Substitute**

- “(iv) is the trustee of the entity;
- (v) is a beneficiary or a member of a class of beneficiaries of the entity; or
- (vi) has ultimate control over the entity; or”.

(9) Section 50A—

**Repeal subsection (8).**

(10) Before section 50A(13)(a)—

**Add**

- “(aa) subject to paragraphs (a) and (b), paragraphs (d) and (e) of the definition must be interpreted in a way consistent with the way in which similar provisions in the definition of *financial institution* in the FATF Recommendations are interpreted;”.

(11) Section 50A(15)(a), before “where”—

**Add**

“subject to paragraph (d) and”.

(12) Section 50A(15)(b)(iii)—

**Repeal**

“; or”

**Substitute a semicolon.**

(13) Section 50A(15)(c), before “where”—

**Add**

“subject to paragraph (d) and”.

(14) Section 50A(15)(c)—

**Repeal the full stop****Substitute**

“; or”.

(15) After section 50A(15)(c)—

**Add**

- “(d) where the financial institution (other than a trust) is not subject to taxation as a resident in any territory—
  - (i) it is incorporated in Hong Kong or constituted under the laws of Hong Kong;
  - (ii) it has its place of management (including effective management) in Hong Kong; or
  - (iii) it is subject to financial supervision in Hong Kong.”.

(16) After section 50A(16)—

**Add**

- “(16A) The Secretary for Financial Services and the Treasury may, by notice published in the Gazette, amend any of the following—
  - (a) the definition of *FATF Recommendations* in subsection (1);
  - (b) the percentage in subsection (7).”.

**6. Section 50L added**

Part 8A, after section 50K—

**Add****“50L. Guidelines published by Commissioner**

- (1) The Commissioner may publish, in the Gazette or in any way the Commissioner considers appropriate, guidelines that the Commissioner considers necessary for providing guidance on the interpretation of the Part 8A-related provisions to best secure consistency between—



- (a) the effect given to the Part 8A-related provisions; and
  - (b) the effect that, in accordance with the CRS publications, is to be given to the Common Reporting Standard.
- (2) A failure on the part of a person to comply with the provisions of any guideline published under this section does not by itself render the person liable to any proceedings, whether before a court or otherwise, but in any proceedings under this Ordinance before a court—
- (a) the guideline is admissible in evidence; and
  - (b) if any provision of the guideline appears to the court to be relevant to the interpretation of any Part 8A-related provisions or relevant to any question arising in the proceedings, the provision of the guideline must be taken into account in interpreting the Part 8A-related provisions or in determining that question.
- (3) A guideline published under this section is not subsidiary legislation.
- (4) In this section—

**Common Reporting Standard** (共同匯報標準) means the Common Reporting Standard contained in the Standard for Automatic Exchange of Financial Account Information in Tax Matters (Second Edition), published by the Organisation for Economic Co-operation and Development on 27 March 2017;

**CRS publications** (共同匯報標準刊物) means—

- (a) the Commentaries on the Common Reporting Standard contained in the Standard for Automatic Exchange of Financial Account Information in Tax

Matters (Second Edition), published by the Organisation for Economic Co-operation and Development on 27 March 2017; and

- (b) the Standard for Automatic Exchange of Financial Information in Tax Matters—Implementation Handbook (Second Edition), published by the Organisation for Economic Co-operation and Development in April 2018;

**Part 8A-related provisions** (第 8A 部相關條文) means any provisions of Part 8A and Schedules 17C, 17D and 17E.

- (5) The Secretary for Financial Services and the Treasury may, by notice published in the Gazette, amend the definitions of **Common Reporting Standard** and **CRS publications** in subsection (4).”.

#### 7. **Schedule 17C amended (non-reporting financial institutions and excluded accounts)**

- (1) Schedule 17C—

**Repeal**

“& 50J”

**Substitute**

“, 50J & 50L(4)]”.

- (2) Schedule 17C, Part 2—

**Repeal sections 12 and 13.**

#### 8. **Schedule 17D amended (due diligence requirements)**

- (1) Schedule 17D—

**Repeal**

“[ss. 2(1), 50A(1) & (2), 50B(1), 50J”

**Substitute**

“[ss. 2(1), 50A(1) & (2), 50B(1), 50J, 50L(4)].”

- (2) Schedule 17D, Part 1, section 1—

**Repeal the definition of *new account***

**Substitute**

“*new account* (新帳戶) means a financial account opened and maintained by a reporting financial institution on or after—

- (a) if the institution is not a 2020-covered institution—1 January 2017; or
- (b) if the institution is a 2020-covered institution—1 January 2020;”.

- (3) Schedule 17D, Part 1, section 1, before the definition of *account holder*—

**Add**

“*2020-covered institution* (2020 年涵蓋機構) has the meaning given by section 50A;”.

**9. Schedule 17E amended (reportable jurisdictions and participating jurisdictions)**

- (1) Schedule 17E—

**Repeal**

“[ss. 50A(1) & 50J]”

**Substitute**

“[ss. 50A(1), 50J & 50L(4)].”

- (2) Schedule 17E, Part 1—

**Repeal everything after the heading and before the Note**

**Substitute**

| “Column 1<br>Reportable jurisdiction | Column 2<br>Reporting year |
|--------------------------------------|----------------------------|
| Albania, Republic of                 | 2021                       |
| Andorra, Principality of             | 2021                       |
| Anguilla                             | 2021                       |
| Antigua and Barbuda                  | 2018                       |
| Argentina, Republic of               | 2018                       |
| Armenia, Republic of                 | 2021                       |
| Aruba                                | 2021                       |
| Australia, Commonwealth of           | 2018                       |
| Austria, Republic of                 | 2018                       |
| Azerbaijan, Republic of              | 2021                       |
| Bahamas, Commonwealth of the         | 2018                       |
| Bahrain, Kingdom of                  | 2021                       |
| Barbados                             | 2021                       |
| Belgium, Kingdom of                  | 2018                       |
| Belize                               | 2021                       |
| Bermuda                              | 2021                       |
| Brazil, Federative Republic of       | 2018                       |
| British Virgin Islands               | 2021                       |
| Brunei Darussalam                    | 2018                       |
| Bulgaria, Republic of                | 2018                       |
| Burkina Faso                         | 2021                       |
| Cameroon, Republic of                | 2021                       |
| Canada                               | 2018                       |
| Cayman Islands                       | 2018                       |

| Column 1<br>Reportable jurisdiction | Column 2<br>Reporting year |
|-------------------------------------|----------------------------|
| Chile, Republic of                  | 2018                       |
| China, Mainland of                  | 2018                       |
| Colombia, Republic of               | 2018                       |
| Cook Islands                        | 2021                       |
| Costa Rica, Republic of             | 2018                       |
| Croatia, Republic of                | 2018                       |
| Curacao, Country of                 | 2018                       |
| Cyprus, Republic of                 | 2018                       |
| Czech Republic                      | 2018                       |
| Denmark, Kingdom of                 | 2018                       |
| Dominica, Commonwealth of           | 2021                       |
| Dominican Republic                  | 2021                       |
| El Salvador, Republic of            | 2021                       |
| Estonia, Republic of                | 2018                       |
| Faroese                             | 2018                       |
| Finland, Republic of                | 2018                       |
| French Republic                     | 2018                       |
| Gabonese Republic                   | 2021                       |
| Georgia                             | 2021                       |
| Germany, Federal Republic of        | 2018                       |
| Ghana, Republic of                  | 2021                       |
| Gibraltar                           | 2018                       |
| Greenland                           | 2018                       |
| Grenada                             | 2018                       |

| Column 1<br>Reportable jurisdiction | Column 2<br>Reporting year |
|-------------------------------------|----------------------------|
| Guatemala, Republic of              | 2021                       |
| Guernsey                            | 2018                       |
| Hellenic Republic (Greece)          | 2018                       |
| Hungary, Republic of                | 2018                       |
| Iceland, Republic of                | 2018                       |
| India, Republic of                  | 2018                       |
| Indonesia, Republic of              | 2018                       |
| Ireland                             | 2018                       |
| Isle of Man                         | 2018                       |
| Israel, State of                    | 2018                       |
| Italian Republic                    | 2018                       |
| Jamaica                             | 2021                       |
| Japan                               | 2018                       |
| Jersey                              | 2018                       |
| Kazakhstan, Republic of             | 2021                       |
| Kenya, Republic of                  | 2021                       |
| Korea, Republic of                  | 2019                       |
| Kuwait, State of                    | 2018                       |
| Latvia, Republic of                 | 2018                       |
| Lebanon, Republic of                | 2018                       |
| Liberia, Republic of                | 2021                       |
| Liechtenstein, Principality of      | 2018                       |
| Lithuania, Republic of              | 2018                       |
| Luxembourg, Grand Duchy of          | 2018                       |

| Column 1<br>Reportable jurisdiction | Column 2<br>Reporting year |
|-------------------------------------|----------------------------|
| Macao Special Administrative Region | 2021                       |
| Macedonia, Republic of              | 2021                       |
| Malaysia                            | 2018                       |
| Maldives, Republic of               | 2021                       |
| Malta                               | 2018                       |
| Marshall Islands, Republic of the   | 2021                       |
| Mauritius, Republic of              | 2018                       |
| Moldova, Republic of                | 2021                       |
| Monaco, Principality of             | 2021                       |
| Montserrat                          | 2018                       |
| Morocco, Kingdom of                 | 2021                       |
| Nauru, Republic of                  | 2021                       |
| Netherlands, Kingdom of the         | 2018                       |
| New Zealand                         | 2018                       |
| Nigeria, Federal Republic of        | 2021                       |
| Niue                                | 2021                       |
| Norway, Kingdom of                  | 2018                       |
| Pakistan, Islamic Republic of       | 2021                       |
| Panama, Republic of                 | 2021                       |
| Paraguay, Republic of               | 2021                       |
| Peru, Republic of                   | 2021                       |
| Philippines, Republic of the        | 2021                       |
| Poland, Republic of                 | 2018                       |

| Column 1<br>Reportable jurisdiction  | Column 2<br>Reporting year |
|--------------------------------------|----------------------------|
| Portuguese Republic                  | 2018                       |
| Qatar, State of                      | 2018                       |
| Romania                              | 2018                       |
| Russian Federation                   | 2018                       |
| Saint Kitts and Nevis, Federation of | 2021                       |
| Saint Lucia                          | 2021                       |
| Saint Vincent and the Grenadines     | 2018                       |
| Samoa, Independent State of          | 2021                       |
| San Marino, Republic of              | 2021                       |
| Saudi Arabia, Kingdom of             | 2018                       |
| Senegal, Republic of                 | 2021                       |
| Seychelles, Republic of              | 2018                       |
| Singapore, Republic of               | 2018                       |
| Sint Maarten                         | 2021                       |
| Slovak Republic                      | 2018                       |
| Slovenia, Republic of                | 2018                       |
| South Africa, Republic of            | 2018                       |
| Spain, Kingdom of                    | 2018                       |
| Sweden, Kingdom of                   | 2018                       |
| Swiss Confederation                  | 2018                       |
| Trinidad and Tobago, Republic of     | 2021                       |
| Tunisia, Republic of                 | 2021                       |
| Turkey, Republic of                  | 2018                       |
| Turks and Caicos Islands             | 2021                       |

| Column 1<br>Reportable jurisdiction                     | Column 2<br>Reporting year |
|---|----------------------------|
| Uganda, Republic of                                     | 2021                       |
| Ukraine   | 2021                       |
| United Arab Emirates                                    | 2018                       |
| United Kingdom of Great Britain<br>and Northern Ireland | 2018                       |
| United Mexican States                                   | 2018                       |
| Uruguay, Oriental Republic of                           | 2018                       |
| Vanuatu, Republic of                                    | 2018".                     |

## Part 5

### Amendments Relating to Income of Visiting Teacher or Researcher

#### 10. Section 8 amended (charge of salaries tax)

- (1) Section 8(1A)(b), before “excludes”—

**Add**

“subject to subsection (1AB),”.

- (2) After section 8(1A)—

**Add**

“(1AB) If—

- (a) a person’s income is derived from services rendered by the person as a visiting teacher or researcher in a territory outside Hong Kong (*territory*);
- (b) the double taxation arrangements made with that territory provide for exemption from tax in that territory on income derived from services rendered as a visiting teacher or researcher in that territory (the provision is referred to as *exemption provision*); and
- (c) the person is or, immediately before visiting that territory as a visiting teacher or researcher, was a Hong Kong resident person,

subsection (1A)(b) applies to the income referred to in paragraph (a) only if the person proves to the Commissioner’s satisfaction that, despite the exemption provision, tax is paid or payable in that territory in respect of the income.”.

(3) After section 8(1C)—

**Add**

“(1D) In subsections (1AB) and (1C)—

*double taxation arrangements* (雙重課稅安排) has the meaning given by section 48A;

*Hong Kong resident person* (香港居民人士) has the meaning given by section 48A;

*visiting teacher or researcher* (外訪教師或研究人員), in relation to a territory outside Hong Kong, means 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.”.

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## Part 6

### Amendment Relating to Sibling Relationship

#### 11. Section 30B amended (dependent brother or dependent sister allowance)

Section 30B(3)—

##### Repeal paragraph (b)

##### Substitute

“(b) *brother or sister or brother or sister of the spouse* (兄弟姊妹或配偶的兄弟姊妹), in relation to a person, means—

- (i) a brother of full or half blood or sister of full or half blood of the person or the spouse of the person;
  - (ii) an adopted brother or adopted sister of the person or the spouse;
  - (iii) a step brother or step sister of the person or the spouse;
  - (iv) if the person or the spouse is adopted—a natural child of an adoptive parent of the person or the spouse; or
  - (v) if the spouse is deceased—a person who would have been the brother or sister of the spouse under subparagraph (i), (ii), (iii) or (iv) if the spouse had not died.”.
-

**Part 7****Transitional Provisions****12. Section 89 amended (transitional provisions)**

Section 89—

**Add**

“(24) Schedule 48 sets out transitional provisions that have effect for the purposes of amendments to this Ordinance made by the Inland Revenue (Amendment) (No. 7) Ordinance 2018 ( of 2018).”.

**13. Schedule 48 added**

The Ordinance—

**Add****“Schedule 48**

[s. 89(24)]

**Transitional Provisions for Inland Revenue  
(Amendment) (No. 7) Ordinance 2018****1. Interpretation**

In this Schedule—

*Amendment Ordinance* (《修訂條例》) means the Inland Revenue (Amendment) (No. 7) Ordinance 2018 ( of 2018);

*commencement date* (生效日期) means the day on which the Amendment Ordinance is published in the Gazette.

**2. Tax treatment of financial instruments**

Sections 18G, 18H, 18I, 18J, 18K and 18L apply in relation to a year of assessment for which the basis period begins on or after 1 January 2018.

**3. Interest expense payable to overseas export credit agency**

The amendments made to section 16 by the Amendment Ordinance apply to interest accruing on or after the commencement date.

**4. Income of visiting teacher or researcher**

The amendments made to section 8 by the Amendment Ordinance apply in relation to a year of assessment beginning on or after 1 April 2019.

**5. Sibling relationship**

The amendment made to section 30B by the Amendment Ordinance applies in relation to a year of assessment beginning on or after 1 April 2019.”.

### Explanatory Memorandum

The object of this Bill is to amend the Inland Revenue Ordinance (Cap. 112) (*Ordinance*)—

- (a) to align tax treatment of financial instruments with their accounting treatment in certain circumstances;
- (b) to provide for deduction of interest expenses payable to overseas export credit agencies;
- (c) to refine the provisions that implement the arrangement relating to automatic exchange of financial account information in tax matters (*AEOI arrangement*);
- (d) to avoid potential double non-taxation of income of visiting teachers and researchers; and
- (e) to revise the meaning of the sibling relationship.

#### Aligning tax treatment of financial instruments with their accounting treatment

2. Hong Kong and international financial reporting standards require enterprises to account for financial instruments on a fair value basis (that is, both realized and unrealized profits of the instruments have to be accounted for in the financial statements) in certain circumstances. Clause 3 adds new sections 18G to 18L to the Ordinance to provide for the alignment of the treatment of financial instruments for profits tax purpose with their accounting treatment.
3. The new sections 18I to 18L 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).
4. The new section 18I explains the effect of the new sections 18J, 18K and 18L on the other Part 4 provisions in determining whether any profit, gain, loss, income or expense is chargeable to tax or

allowable for deduction. (The other Part 4 provisions are provisions of Part 4 of the Ordinance other than the new sections 18G to 18L.) In summary—

- (a) for the purposes of Part 4 of the Ordinance, profits are not limited to realized profits despite the other Part 4 provisions and a change in fair value of a financial instrument is to be brought into account in assessing profits tax in certain circumstances;
- (b) also, the way in which a profit, gain, loss, income or expense is computed is changed in certain circumstances (for example, interest is computed in some cases at the effective rate instead of the contractual rate); and
- (c) apart from the changes described in paragraphs (a) and (b), sections 18J and 18L apply subject to the other Part 4 provisions.

5. Under the new section 18J, the amount of profit, gain, loss, income or expense computed for a financial instrument for profits tax purpose for a period is the amount of profit, gain, loss, income or expense recognized for the instrument for accounting purpose for the period.
6. The new sections 18K and 18L 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.

#### Interest expenses payable to overseas export credit agencies

7. Clause 4 amends section 16 of the Ordinance so that, unless the Commissioner of Inland Revenue (*Commissioner*) determines otherwise, an overseas export credit agency falls within the definition of *overseas financial institution* and interest expenses payable to the agency is deductible under section 16(1)(a) of the



Ordinance. A definition of *overseas export credit agency* is added to section 16(3) of the Ordinance.

#### **AEOI arrangement**

8. Clauses 5 to 9 refine the provisions of the Ordinance that implement the AEOI arrangement.
9. Clauses 5, 7 and 8 amend section 50A of, and Schedules 17C and 17D to, the Ordinance. Clause 6 adds a new section 50L to the Ordinance. With these amendments—
  - (a) the terms *Common Reporting Standard*, *CRS publications* and *FATF Recommendations* are defined to represent the key documents relating to the AEOI arrangement;
  - (b) the concept of *controlling person*, in relation to a trust, covers (among others) trustees and beneficiaries of the trust;
  - (c) controlling persons will be identified, in relation to any legal person which is functionally equivalent or similar to a trust, in a way similar to the way in which controlling persons are identified in relation to a trust (The concept of *legal person* is used in the Common Reporting Standard and is defined in the FATF Recommendations to mean “an entity other than a natural person that can establish a permanent customer relationship with a financial institution or otherwise own property”. The Bill incorporates the contents of that definition into the definition of *entity*. The Bill also defines *controlling person*, in relation to an entity which is functionally equivalent or similar to a trust, in a way similar to the way in which the concept is defined in relation to a trust.);

- (d) the term *investment entity* is to be interpreted in a way consistent with the FATF Recommendations;
  - (e) residency rules are incorporated in relation to financial institutions (other than trusts) that do not have a residence for tax purposes;
  - (f) certain schemes, 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) cease to be non-reporting financial institutions, and consequential changes are made to the definitions of *pre-existing account*, *reporting year* and *new account*; and
  - (g) provisions are made for the Commissioner to publish guidelines for ensuring that provisions of the Ordinance implementing the AEOI arrangement are construed in a way consistent with the effect given to the Common Reporting Standard, in accordance with the CRS publications, and for clarifying the status of the guidelines.
10. Clause 9 amends Schedule 17E to the Ordinance to substitute an updated list of reportable jurisdictions.

#### **Income of visiting teachers and researchers**

11. Clause 10 amends section 8 of the Ordinance to avoid double non-taxation. If the double taxation arrangement with a territory outside Hong Kong provides for exemption from tax in that territory on income of a visiting teacher or researcher in that 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, is no longer exempted from salaries tax in Hong Kong

unless tax is paid or payable in respect of the income in that territory.

**Sibling relationship**

12. Clause 11 revises the meaning of *brother or sister* in section 30B of the Ordinance (so as to align with the meaning of *sibling* in the new section 26J proposed to be added to the Ordinance by the Inland Revenue (Amendment) (No. 4) Bill 2018).

**Jurisdictions to be Included in  
the List of Reportable Jurisdictions  
under Schedule 17E of the Inland Revenue Ordinance**

|    |                                     |    |                          |
|----|-------------------------------------|----|--------------------------|
| 1  | Albania                             | 31 | Monaco                   |
| 2  | Andorra                             | 32 | Morocco                  |
| 3  | Anguilla                            | 33 | Nauru                    |
| 4  | Armenia                             | 34 | Nigeria                  |
| 5  | Aruba                               | 35 | Niue                     |
| 6  | Azerbaijan                          | 36 | Pakistan                 |
| 7  | Bahrain                             | 37 | Panama                   |
| 8  | Barbados                            | 38 | Paraguay                 |
| 9  | Belize                              | 39 | Peru                     |
| 10 | Bermuda                             | 40 | Philippines              |
| 11 | British Virgin Islands              | 41 | Saint Kitts and Nevis    |
| 12 | Burkina Faso                        | 42 | Saint Lucia              |
| 13 | Cameroon                            | 43 | Samoa                    |
| 14 | Cook Islands                        | 44 | San Marino               |
| 15 | Dominica                            | 45 | Senegal                  |
| 16 | Dominican Republic                  | 46 | Sint Maarten             |
| 17 | El Salvador                         | 47 | Trinidad and Tobago      |
| 18 | Gabon                               | 48 | Tunisia                  |
| 19 | Georgia                             | 49 | Turks and Caicos Islands |
| 20 | Ghana                               | 50 | Uganda                   |
| 21 | Guatemala                           | 51 | Ukraine                  |
| 22 | Jamaica                             |    |                          |
| 23 | Kazakhstan                          |    |                          |
| 24 | Kenya                               |    |                          |
| 25 | Liberia                             |    |                          |
| 26 | Macao Special Administrative Region |    |                          |
| 27 | Macedonia                           |    |                          |
| 28 | Maldives                            |    |                          |
| 29 | Marshall Islands                    |    |                          |
| 30 | Moldova                             |    |                          |

## **Financial, Economic and Family Implications of the Proposal**

### *Financial Implications*

By electing the alignment of tax treatment of financial instruments with accounting treatment, subject to certain specific provisions, profits or loss on financial instruments due to fair value changes will be taxed or allowed as the case may be. Therefore, depending on the individual circumstances of a taxpayer, the tax liability may be increased or decreased as compared to that computed on realisation basis. While the impact to revenue in individual year of assessments is difficult to estimate, the overall impact over time should not be significant given the difference in the amount of taxable gain or loss between taxation of financial instruments on a fair value basis or on a realisation basis is only a timing difference.

2. While allowing the deduction of interest expenses payable to overseas export credit agencies may reduce revenue from profits tax, the initiative would foster the development of the import and export industry, hence generating more profits tax revenue. The quantum of revenue impact is difficult to estimate.

3. The amendments to prevent potential double non-taxation of visiting teachers and researchers should help safeguard salaries tax revenue.

### *Economic Implications*

4. Providing the option for aligning tax treatment of financial instruments with accounting treatment have positive economic implications by easing taxpayers' efforts in preparing tax returns, while maintaining Hong Kong's simple tax regime.

5. The refinements to AEOI regime will demonstrate Hong Kong's commitment to international tax cooperation. This is particularly crucial for Hong Kong to preserve our competitiveness and reputation as an international financial and business centre, and to avoid being listed as a "non-cooperative" tax jurisdiction.

### *Family Implications*

6. The amendment to the meaning of "brother or sister" under the IRO may help promote family support.