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19 April 2021

Legal Service Division  
Legislative Council Secretariat  
1 Legislative Council Road  
Central, Hong Kong  
(Attn: Miss Rachel DAI)

Dear Miss DAI,

**Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021**

The Administration was requested to provide clarifications on matters detailed in your letter dated 15 April 2021 regarding the Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021. Our clarifications are set out at Annex.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Helen Chung'.

(Miss Helen CHUNG)  
for Secretary for Financial Services  
and the Treasury

c.c. Commissioner of Inland Revenue (Attn: Mr Leung Kin-wa)

**Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021**

Clause 3 - proposed new section 40AM (election for Schedule 17J)

*Examples of the circumstances in which the Commissioner of Inland Revenue (“the Commissioner”) would allow the extension of the one-month period for making the election for Schedule 17J to the Inland Revenue Ordinance (“IRO”)*

The proposed section 40AM provides the Commissioner with the discretion to accept an election for special tax treatment under the proposed Schedule 17J notwithstanding that the specified time limit of one month after the date of amalgamation has expired. In deciding whether to exercise the discretion, the Commissioner will consider on a case-by-case basis taking into account the special circumstances of each case. Examples of justifiable reasons may include the amalgamated company’s principal officer who acts on behalf of the company having fallen sick, the amalgamated company’s principal officer being subject to quarantine, and other unforeseen circumstances such as fire, flood or other accident, etc. which prevents the amalgamated company from making the election within the specified one-month time limit.

Clause 4 – proposed new Schedule 17J

*Examples of factors that the Commissioner would take into account when determining whether the reasons for carrying out the qualifying amalgamation are good commercial reasons and whether avoidance of tax is the main or one of the main purposes of carrying out the qualifying amalgamation under the proposed sections 24(5) and 26(3) of Schedule 17J*

2. An arrangement can have more than one main purpose and avoidance of tax can be a main object of an arrangement amongst a number of main purposes. The reference to “one of the main purposes” in the proposed sections 24(5) and 26(3) of Schedule 17J means that a particular

arrangement will not be qualified for the special tax treatment as set out in sections 24 and 25 of Schedule 17J even if avoidance of tax is not the sole or dominant purpose of a particular arrangement but only a main purpose amongst other main purposes. In determining whether there are good commercial reasons for carrying out the qualifying amalgamation and whether there exists a main purpose for avoidance of tax, all relevant facts and circumstances have to be considered, including but not limited to the following –

- (a) the reasons for carrying out the amalgamation;
- (b) the reasons for selecting the amalgamated company as the amalgamated company (if under horizontal amalgamation);
- (c) what result is intended to be achieved, or achieved, by the amalgamation;
- (d) the non-tax purposes of the amalgamation and any alternative way that the non-tax purposes could be achieved; and
- (e) the functions, assets and risks of each entity involved in the amalgamation.

*Examples illustrating the application of the proposed new section 27(3) of Schedule 17J*

3. The proposed section 27 of Schedule 17J provides that if an amalgamating company in a qualifying amalgamation has made an irrevocable election under a provision of the IRO for the purpose of ascertaining the assessable profits, applying to have its profits or part of the assessable profits to be charged at concessionary tax rates, or furnishing a return under section 50C as a reporting financial institution, the amalgamated company is treated as if it had made the same irrevocable election.

4. The proposed section 27(3) of Schedule 17J provides that the election ceases to have effect if the conditions for the election in the relevant provisions are not met by the amalgamated company at any time

after the amalgamation. Two examples illustrating the application of the proposed section 27(3) of Schedule 17J are set out below –

- (a) An amalgamating company has accounted for its financial instruments on a fair value basis in accordance with the specified financial reporting standard and elected under section 18H of the IRO the alignment of the treatment of financial instruments for profits tax purpose with their accounting treatment. Subsequently, the amalgamated company ceases to prepare financial statements in accordance with a specified financial reporting standard for a year of assessment. The election under section 18H ceases to have effect from that year of assessment.
- (b) In some concession provisions (i.e. sections 14B(1), 14D(1), 14H(1), 14J(1), 14P(1) and 14T(1) of the IRO), the relevant assessable profits can be chargeable to tax at the concessionary tax rate upon election if the prescribed conditions (for example, the core income generating activities are carried out in Hong Kong, and the full time employees and operating expenditures in Hong Kong for a year of assessment are not less than the number and amount prescribed by the Commissioner) are satisfied. If any of the prescribed conditions is not satisfied, the assessable profits of the amalgamated company cannot be charged at concessionary tax rate and the election ceases to have effect.

Clause 8 – proposed new section 51AAD (service provider to be engaged to furnish return)

*Circumstances under which the Commissioner would specify by a gazette notice that a taxpayer may engage a service provider to furnish a return*

5. Under the proposed section 51AAD, the Commissioner may specify by notice published in the Gazette and by reference to a class or description of persons or returns that a taxpayer may engage a service provider to furnish a return for or on behalf of the taxpayer.

6. The Administration's current plan is to allow taxpayers to engage service providers to furnish profits tax returns for or on their behalf

irrespective of the mode in which a return is furnished (i.e. paper, electronic or mixed). As system enhancement is required, the gazette notice will be published as and when the enhanced system is ready for operation.

*Reason why the Commissioner's notice is not proposed to be subsidiary legislation*

7. Under the existing section 51AA(5) and (6) of the IRO, the Commissioner may specify by notice in the Gazette the types of tax returns which can be furnished electronically or using a telefiling system, the form and manner of furnishing electronic returns, and technical requirements in relation to an electronic record. Such notice is not subsidiary legislation under the existing section 51AA(8) given that these are operational matters and do not carry any significant policy implications.

8. The notice to be made by the Commissioner under the proposed section 51AAD regarding the optional engagement of a service provider to furnish a tax return for or on behalf of a taxpayer is similar in nature to the notice to be made under the existing section 51AA(5) and (6) of the IRO in that it is operational matter and does not carry any significant policy implications. Therefore, the Administration proposes that such notice to be made by the Commissioner is similarly not subsidiary legislation.

Clause 12 – proposed new section 80N (Commissioner may compound offences)

*The rationale for making an offence under the proposed section 80K(2), (3) or (4) a compoundable offence*

9. The IRO imposes requirements in relation to the filing of returns (including reportable account information returns and country-by-country returns); keeping and retention of records; and establishing, maintaining and applying due diligence procedures for reportable account information. If such requirements under the IRO are not complied with, the penalty provisions under sections 80, 80B, 80C, 80D, 80E, 80G, 80H, 80I and 82 empower the Commissioner to institute prosecution against the person concerned. Sections 80(5), 80F(2), 80J(2) and 82(2) provide that the Commissioner may compound the offence in lieu of prosecution.

10. As the nature of the offences under the proposed section 80K(2), (3) and (4) are similar to those under sections 80 and 82, etc., the Administration considers that it is appropriate to make those new offences compoundable offences.

*Circumstances in which the Commissioner would compound an offence or stay or compound the proceedings for an offence*

11. Given that the resources of the court are limited and legal proceedings for an offence may be time-consuming, the Commissioner would consider compounding an offence under the proposed section 80K(2), (3) or (4) as far as possible and in particular for simple and straight forward cases. The procedure for compounding an offence is relatively simple and could give the person concerned more certainty with regard to the penalty at an earlier time.

12. After deciding to compound an offence, the Commissioner will serve a notice on the person who is in breach of the specified offence to offer him an opportunity to rectify the default within a specified period and pay a specified amount as a compound penalty. If the person accepts the offer and complies with the terms of the notice, no prosecution will be instituted for that offence. In case of non-compliance, the Commissioner may proceed to institute prosecution.

*Factors determining whether an offence or the relevant proceedings should be compounded*

13. In determining whether an offence under the proposed section 80K(2), (3) or (4) or the relevant proceedings should be compounded, the Commissioner would take into account various factors such as whether the offender has committed similar offence, level of sophistication of the case, the period of time over which the offence was committed, the strength of evidence and the amount of tax undercharged or would have been undercharged, etc.