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By Email (dywlo@legco.gov.hk)

3 May 2021

Mr Derek LO
Clerk to Bills Committee
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

Dear Mr LO,

Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021

Thank you for the Secretariat's emails dated 29 April 2021, conveying the five written submissions in relation to the captioned Bill. Please find the summary of the Government's response at **Annex**.

Yours sincerely,

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

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

Annex

Bills Committee on Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021

Summary of Views of Submissions and the Government's Responses

Note: The parties that made the written submissions are hereinafter referred to as: "Deloitte" (Deloitte Advisory (Hong Kong) Limited), "HKICPA" (The Hong Kong Institute of Certified Public Accountants), "JLCT" (The Joint Liaison Committee on Taxation), "PwC" (PricewaterhouseCoopers Limited) and "TIHK" (The Taxation Institute of Hong Kong).

Item	Summary of views	Government's response
1.	The parties generally support the main aims and welcome the introduction of the Bill. *[Deloitte, HKICPA, JLCT, PwC and TIHK]*	The supportive view is welcomed.
(A) Court-free amalgamation of companies		
1.	The one-month deadline for electing the special tax treatment for qualifying amalgamation is too short. *[Deloitte and TIHK]*	Qualifying amalgamation is governed by the relevant provisions of the Companies Ordinance which involves the fulfillment of certain statutory requirements. It is expected that the whole process would be well planned and would not be carried out hastily. Therefore, the proposed one-month period after the date of amalgamation should be sufficient for the amalgamated company to make an election. Further, the proposed section 40AM allows the Commissioner of Inland Revenue a discretion to accept an election for special tax treatment made after the specified time limit of one month.

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2.	Under the proposed special tax treatment, (a) the post-entry and financial resources conditions for the set-off of pre-amalgamation loss are too restrictive. The corresponding legislation in Singapore does not contain such restrictions and is more competitive. *[HKICPA, JLCT, PwC and TIHK]* (b) The same trade test for the set-off of pre-amalgamation loss of amalgamating companies is not necessary and may give rise to uncertainties. *[Deloitte, HKICPA and PwC]*	To prevent the transfer of losses between group companies and the acquisition of loss-making companies to reduce tax liabilities, it is necessary to introduce specific conditions for allowing the setting off of pre-amalgamation losses under the special tax treatment. The post-entry condition aims to prevent an entity from acquiring an unrelated or a non-wholly-owned loss company and making use of the tax losses accumulated in that loss company before the acquisition so as to reduce the tax liabilities of the group through amalgamation. There is also a similar requirement in the relevant legislation in Singapore, namely that loss incurred before the amalgamating company became a subsidiary is not allowed for set-off against the profits of the amalgamated company. The purpose of the financial resources condition is to minimize the risk of achieving group tax loss relief through amalgamation. Under horizontal amalgamation, the group is free to choose any wholly-owned subsidiary as the amalgamated company. If the condition is removed or relaxed, an amalgamated company may make use of its losses to set off the profit of an amalgamating company to avoid tax even if the amalgamated company has no financial ability to carry on business. In applying the financial resources test, the Inland Revenue Department ("IRD") will consider whether

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		the amalgamated company has sufficient capital, liquid assets or cash on the date of amalgamation to carry on business as well as its ability to raise funds from independent third parties having regard to its own credit rating status. Such test has been included in IRD's interim administrative assessment practice since 2015 and it has been operating smoothly without any operational problems. The same trade test is to prevent the transfer of losses between group companies through amalgamation. An amalgamation is the combination of two or more companies into a larger single company, and the amalgamating company's business should be succeeded by the amalgamated company. In the absence of the same trade condition, an amalgamated company may avoid tax simply through making use of the loss of the amalgamating company by closing the business of the amalgamating company after amalgamation. Singapore also applies the same trade test in similar situation. Whether two businesses are the same is a question of fact and reference can be made to the judgment of Walton J in *Rolls-Royce Motors Ltd v Bamford* [1976] STC 162.
3.	There should be an explicit provision to deem an amalgamating company as being dissolved without liquidation. *[TIHK]*	Under the Inland Revenue Ordinance ("IRO"), profits tax is charged on a person carrying on a business in Hong Kong in respect of his assessable profits arising in or derived from Hong Kong from such business. The proposed section 40AG explicitly states that for the purposes of the IRO, an amalgamating company is treated as

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		having ceased to carry on its business on the day immediately before the date of amalgamation to provide more certainty with regard to its taxability. On the other hand, whether a company is dissolved or not is largely not relevant in the context of the IRO.
4.	The tax treatment arising from a qualifying amalgamation where no election for special tax treatment is made should be specified. *[PwC]*	If no election for special tax treatment is made, other provisions in the IRO will apply. We consider that it is not necessary to specify the tax treatment in such case.
5.	Stamp duty implications arising from an amalgamation, if any, should be clarified. *[PwC and HKICPA]*	The succession of assets of the amalgamating company by the amalgamated company is by operation of law. There is no stamp duty implication as no instrument is to be executed for the succession of immovable properties or Hong Kong stocks under court-free amalgamations.
(B) Transfer or succession of specified assets without sale		
1.	Deeming the specified assets as having been sold and purchased by the transferor and transferee at market value in all situations is excessive and unnecessary. A case-by-case approach to cater for different specified events is recommended.	Except for provisions dealing with cessation of business without sale of environment-friendly vehicle (section 16J(5B)) and machinery or plant (section 38(4) and section 39D(4)) under the IRO, there is currently no provision under the IRO to deal with the transfer of assets without sale. It is necessary to provide for a unified tax treatment on the occurrence of specified events since a case-by-case approach for

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	[JLCT and TIHK]	different specified events may lead to uncertainty and result in inconsistent treatment. In the absence of specific provisions, the capital expenditures which have been allowed deductions or allowance cannot be clawed back after the underpinning assets were transferred without sale.
2.	The special tax treatment under the proposed new Schedule 17J should cover the merger of Hong Kong branches of two foreign companies under a foreign law (i.e. treating such merging a qualifying amalgamation by default). *[HKICPA, JLCT, PwC and TIHK]*	A branch is part of an entity and is not a separate legal entity. The merger of foreign entities is governed by the laws of the foreign jurisdictions which may be different in different jurisdictions. Some mergers may also involve companies which are not wholly-owned by the same group. Thus, it is not appropriate to cover the merger of Hong Kong branches of two foreign companies under the proposed legislation.
(C) Furnishing of tax returns		
1.	The scope of service providers and e-filing procedures are unclear. It is not certain whether parties performing certain tasks in preparation for the furnishing of a return will be treated as service providers. Service providers should be more clearly defined. *[Deloitte, HKICPA, JLCT, PwC and TIHK]*	Section 51(1) of the IRO imposes on a taxpayer **the obligation to furnish tax returns** within a stipulated time. It is understandable that preparatory work such as preparing profits tax computations and other supporting documents, filling in the return form, etc. is involved before a taxpayer discharges its obligation to furnish tax returns. However, the obligation imposed on a taxpayer by section 51(1) does not concern how and by whom such preparatory work is to be performed. Even when such preparatory work is contracted out by taxpayers to other persons, the

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		obligation to furnish tax returns under section 51(1) remains with the taxpayer. The proposed section 51AAD(1) and (8) makes cross-reference to section 51(1). Specifically, the proposed section 51AAD(8) serves to define "service provider" to mean a person engaged to carry out a taxpayer's obligation **to furnish returns** under section 51(1). By defining the role of service provider as "furnishing returns", it is intended to refer only to the act of signing the return. Therefore, only the person who furnishes the tax return on behalf of the taxpayer (i.e. the one signing the return), irrespective of the way in which a return is furnished (i.e. paper, electronic or mixed), will be treated as the service provider. In other words, a person engaged by a taxpayer for undertaking **only** preparatory work such as preparing profits tax computations and other supporting documents, filling in the return form, etc. is not a service provider for the purpose of proposed section 51AAD(8) unless he also furnishes the tax return on behalf of the taxpayer. Further, the wording used in the definition of "service provider" in the proposed section 51AAD(8) and the proposed section 51AAD(1) for engagement of service provider is in line with the definitions of "service provider" under sections 50A(1) and 58B(2) of the IRO and the provisions for engagement of service provider under sections 50H(1) and 58M(1). Since these

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		enacted provisions have been operating smoothly for some years without any problem, the same wording should be adopted in the proposed section 51AAD(1) and (8) for the sake of consistency in the administration of the IRO.
2.	Certain penalty provisions on service providers are considered unnecessary, or the penalty provisions should be considered only if the role of service providers is well defined. *[Deloitte, HKICPA, JLCT and TIHK]*	The Administration fully agrees that the taxpayer should have the primary responsibility for furnishing the tax return. Under normal circumstances, penal action would be taken against the taxpayer for failure to furnish the return or furnishing an incorrect return. Unlike the situation where a taxpayer secures the service of a professional to undertake preparatory work such as preparing profits tax computations and other supporting documents, filling in the return form, etc., a service provider under the proposed section 51AAD(8) is engaged by the taxpayer to perform a statutory act, i.e. to furnish the tax return for or on behalf of the taxpayer. If the service provider so engaged, without reasonable excuse, fails to do so, or does not do so in accordance with the information provided or instructions given by the taxpayer and the return so furnished is incorrect in a material particular, it is reasonable to impose penalty on the service provider to protect the interest of the taxpayer.
3.	The provision that provides for the court to order service providers to rectify	The proposed section 80L empowers the court to order service providers to rectify their failure to discharge their obligations

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	irregularities is unnecessary. The responsibility should rest on taxpayers. *[HKICPA, JLCT and TIHK]*	under the IRO. Whether it is appropriate to make such an order is to be considered by the court based on the facts of each case. Sections 80D(9)(a) and 80H(7) also provided the court with similar powers in respect of service providers engaged by financial institutions or reporting entities in the context of the Common Reporting Standard and country-by-country reporting.
4.	Whether a taxpayer has a reasonable excuse for failure to comply with any requirements is to be determined based on the specific circumstances of each taxpayer's case. It would be inappropriate to ignore any relevant factor such as the engagement of a service provider by way of a statutory provision that specifies that engaging a service provider "does not in itself constitute a reasonable excuse". *[HKICPA and JLCT]*	The wording "does not in itself constitute a reasonable excuse" in the proposed sections 51A(1A), 51B(1AAAA), 80(2AA) and 82A(1AA) only serves to clarify that the mere fact of a taxpayer having engaged a service provider under section 51AAD(1) does not, in itself alone, "automatically" constitute a reasonable excuse for the taxpayer concerned. It does not pre-empt the decision of the Board of Review or the court to take into consideration the engagement of a service provider by a taxpayer, together with the particular facts of the case, when deciding whether the taxpayer has failed to comply with any relevant requirements. It should be noted that sections 80B(2) and 80G(2) of the IRO also provide that "engaging a service provider … does not in itself constitute a reasonable excuse" in relation to the carrying out of the obligations of the financial institutions or reporting entities in the context of the Common Reporting Standard and country-by-country reporting, and these requirements are similar to the engagement of service providers

Item	Summary of views	Government's response
		under the proposed section 51AAD(1).
(D) Foreign tax deduction under specified circumstances		
1.	The additional restriction imposed on non-Hong Kong resident persons poses conceptual and practical issues, and may result in some of them not being able to benefit from the proposed amendments. *[TIHK]*	The policy intent is that a non-Hong Kong resident person should not be allowed to claim tax relief in both Hong Kong and its jurisdiction of residence in respect of the same portion of foreign tax paid, and that the non-Hong Kong resident person should first approach his jurisdiction of residence for tax relief as a matter of principle. If a non-Hong Kong resident person is not entitled to utilise any portion of foreign tax paid for claiming tax relief (whether by tax credit or deduction) against tax payable in the person's jurisdiction of residence (say because tax relief is not allowed under the laws of the jurisdiction of residence or the person is not required to pay any tax in the jurisdiction of residence), the person will be allowed to claim tax deduction in respect of such portion of foreign tax paid in Hong Kong.
2.	The Government may consider offering a concessionary tax treatment for foreign tax paid on interest derived from loans made by the Hong Kong branch of a foreign bank to overseas borrowers. *[TIHK]*	The proposed deduction of tax has already provided appropriate relief to the branches of foreign banks operating in Hong Kong. Further deduction of tax based on concession is not recommended.
3.	Clarification is needed as to whether the definition of	Whether foreign taxes charged on deemed profit is deductible would depend on the

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	"specified tax" covers foreign taxes charged on deemed profit. *[HKICPA, PwC and TIHK]*	basis of computation. Subject to other conditions, foreign taxes on deemed profit should be deductible if they are charged based on turnover.
4.	As the legislative amendments will only take effect from the year of assessment 2021/22, some taxpayers might have been exposed to double taxation in prior years. IRD should allow deduction of foreign tax paid by taxpayers during the transition period and/or limit enforcement in relation to deduction cases during that period. *[HKICPA and PwC]*	The IRD must administer the law as it is and cannot allow deduction of foreign tax which is not provided in the law applicable to the period prior to the year of assessment beginning on or after 1 April 2021.