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Clerk to Bills Committee on Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021
Legislative Council Secretariat
Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

Dear Sir,

Submission of views on Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021

We are pleased to submit comments on behalf of Deloitte Advisory (Hong Kong) Limited in response to the public invitation for submissions on the captioned Bill, which seeks to amend the Inland Revenue Ordinance (IRO) to address matters relating to:

(a) the tax treatment for the amalgamation of companies under court-free procedures as provided for under the Companies Ordinance (Cap. 622) and the tax treatment for transfer or succession of specified assets under certain circumstances;
(b) the furnishing of tax returns; and
(c) the deduction of foreign tax under specified circumstances.

There has been no previous legislation addressing the tax treatment of court-free amalgamations, although the Inland Revenue Department (IRD) issued non-binding guidance in December 2015 and subsequently published relevant advance ruling cases. The Bill, which proposes to codify current taxation practice into the IRO, can provide clarity and improve certainty for taxpayers and is therefore welcome.

The Bill also seeks to amend the IRO to provide the statutory framework for the filing of tax returns electronically. In addition, it proposes to allow a taxpayer to engage a service provider to furnish a tax return for or on behalf of the taxpayer. We welcome the introduction of this new mechanism for the filing of tax returns, which aligns with information technology trends.

The Bill also seeks to rectify the foreign tax deduction issues of certain taxpayers, particularly the banking sector, which primarily operates in Hong Kong through branch structures and therefore cannot benefit from double tax relief under Hong Kong's treaties. We welcome the Bill, which proposes changes broadly consistent with the IRD's previous position, i.e. that withholding tax on payments are generally deductible.

We generally welcome the government's introduction of the Bill, and have some comments on possible fine-tuning for your consideration.

(a) Tax treatment for court-free amalgamation of companies (Part 2)

(i) Same trade test for offsetting pre-amalgamation losses (Schedule 17J Sections 24 to 26)

The Bill proposes "same trade" conditions for the utilization of pre-amalgamation tax losses. This means the tax loss of the amalgamating company can only be used to set off against profits of the amalgamated company that are derived from the same trade or business succeeded from the amalgamating company. The Bill does not provide any definition of "same trade".

According to the IRD's current guidelines on court-free amalgamation on its website (https://www.ird.gov.hk/eng/tax/bus_cfa.htm), "same trade or business" means an identical trade or business, not a similar trade or business. If the same trade condition is adopted and implemented according to the IRD's current interpretation, it would be too restrictive and commercially impractical for utilizing tax loss upon amalgamation.

For example, a company operating a Japanese restaurant (Business A) is making a loss before amalgamation. It amalgamates with another group company carrying on a catering business in order to improve synergy. From a commercial perspective, Business A may not be able to turn into a profitable business by remaining as it was prior to the amalgamation. If some changes are made after amalgamation, e.g. conversion into an Italian restaurant, changing the mode of operation, or adding some value-added services, Business A would not be considered as the "same business" according to the IRD's current guidelines. In other words, were such a restrictive "same trade" condition imposed, the pre-amalgamation tax loss of Business A is unlikely to be able to be utilized upon the change of business model after amalgamation.

In contrast, if the company does not undergo amalgamation, it can always modify its business model, or even add a new business line, and utilize its tax loss without any restriction. Under the existing section 19C(4) of the IRO, a corporation carrying on a business that sustains a loss in that business can set off the amount of the loss against the corporation's assessable profits for that year of assessment and, to the extent that this is not so set off, the loss shall be carried forward and set off against the corporation's assessable profits for the subsequent year of assessment. This means the tax loss of one business of a company can set off against the assessable profits of its other businesses. There is no same trade condition for tax loss set-off within the same entity under the existing law.

We understand that the government's intention to impose various conditions on pre-amalgamation tax loss utilization is to avoid transfer of tax losses between group companies. In addition, the government is seeking to prevent an entity from acquiring an unrelated company with an un-utilized tax loss and amalgamating them to make use of that tax loss to reduce the acquirer group's tax liabilities. These purposes can already be addressed in the existing anti-avoidance provision section 61B[1] of the IRO and even the "post-entry condition" and other anti-avoidance measures (e.g. good commercial reasons, main purposes test) under amalgamation. Therefore, the "same trade" condition is not necessary to achieve the purpose of preventing group tax loss relief. It is unduly restrictive and hinders commercial practicality, as explained above. If the conditions for tax loss utilization are so restrictive, taxpayers could be worse off by undergoing amalgamation as compared to a traditional business transfer in a restructuring exercise. We therefore suggest the "same trade" condition be removed from the Bill.

[1] Section 61B of the IRO disallows the set off of tax loss where there is any change in the shareholding of the loss company and the sole or dominant purpose of the change was for the purpose of utilizing the tax loss in order to reduce tax liability.

(ii) Timing for election (Section 40AM(5))

The Bill proposes that the amalgamated company be able to make an irrecoverable election for special tax treatment, which covers the offsetting of pre-amalgamation losses as discussed above, in writing to the Commissioner within 1 month after the date of amalgamation. Any notice later than the prescribed 1-month deadline can be considered invalid and the benefits of lodging an election could thus be denied. From a practical perspective, the 1-month period would be quite tight in certain circumstances, especially where an amalgamation is part of a broader group restructuring. We would therefore recommend that a longer period of time, say 4 months, be allowed for the lodging of an election.

(b) Penal provisions on service providers for furnishing tax returns (Part 4 - Sections 80K to 80N)

The Bill proposes new penal provisions against service providers for certain acts without reasonable excuse, e.g. failure to furnish returns and filing incorrect returns. According to the Bill, a "service provider" means a person engaged to carry out a taxpayer's obligation to furnish a tax return. The extent to which services would fall under the scope is unclear. For example, would a person engaged in part of the tax return preparation work (e.g. tagging of information for electronic filing) be regarded as a "service provider" and subject to the penal provisions? Or, would a "service provider" be limited to a person who submits the tax return on behalf of the taxpayer?

We understand that the IRD is working on the regime for the electronic filing of profits tax returns. However, the details of the regime and the exact requirements for the taxpayers and service providers remain subject to discussion and have not been released. Without knowing the procedures and hence the roles of a service provider, or a clear definition of "service provider", it is hard to discuss or comment on the penal provisions for service providers in the Bill.

Given the IRD's plan is to enable more businesses to voluntarily e-file profits tax returns and financial statements in 2023, with the ultimate goal of implementing e-filing of profits tax returns through the newly developed Business Tax Portal in 2025, there is still plenty of time, compared to the other amendments in the Bill, for this issue to be addressed. To avoid delay to the more pressing matters in the Bill, e.g. the tax treatment of court-free amalgamation of companies and the foreign tax regime, we suggest putting aside the penal provisions for service providers in the Bill and proceeding with the other amendments first. The penal provisions can be discussed and introduced at a later stage when more details of e-filing procedures are released by the IRD.

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We thank you again for the opportunity to put forward our comments. If you would like to discuss any of the above comments, please do not hesitate to contact me at 2852 6661, or our Tax Director Doris Chik at 2852 6608.

Yours faithfully,
For and on behalf of Deloitte Advisory (Hong Kong) Limited

Raymond Tang
Deputy Managing Tax Partner

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