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Hon Holden Chow Ho-ding
The Chairman
Bills Committee on Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021
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Submission on the Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021

Dear Hon Holden Chow,

We refer to the Bills Committee's invitation for submission on the Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021 (the Bill), which seeks to amend the Inland Revenue Ordinance (IRO) to deal with the following matters:

1. to codify the profits tax treatments for corporate amalgamations under the court-free procedures of the Companies Ordinance (Cap. 622);
2. to specify the profits tax treatments for transfer or succession of "specified assets" without sale in "specified events";
3. to update the current statutory framework for furnishing of tax returns to facilitate electronic filing (e-filing) of profits tax returns; and
4. to enhance the deduction of foreign taxes for profits tax purposes.

We set out below our comments and suggestions on the Bill in respect of the above four areas for the consideration of the Bills Committee.

1. Profits tax treatments for corporate amalgamations

Generally speaking, we welcome the government's attempt to codify the interim assessing practice / tax treatments of corporate amalgamations in the IRO as it will provide greater clarity and certainty to taxpayers. However, we have the following comments on the tax treatments proposed in the Bill as set out below:

(a) Utilisation of pre-amalgamation losses

The Bill introduces various conditions that need to be met for the amalgamated company to use the pre-amalgamation losses of itself and the amalgamating companies for setting off the assessable profits of the amalgamated company after the amalgamation. We understand that the main reason for introducing those conditions is to prevent the abusive use of corporate amalgamation as a means to achieve group loss relief, which is not allowed under the current profits tax regime in Hong Kong.

Given that the Bill has already introduced a specific "good commercial reasons and main purposes" test (for pre-amalgamation losses of amalgamating companies) and the Commissioner's satisfaction condition (for pre-amalgamating losses of amalgamated companies) plus there is already a general anti-avoidance provision (i.e. section 61A) in the existing IRO, we consider that the various other

conditions imposed by the Bill are unduly restrictive / harsh for taxpayers which undergo a corporate amalgamation for genuine or good commercial reasons.

For example, under the "financial resources condition", the amalgamated company has to demonstrate that it has adequate financial resources (excluding any loan from an associated corporation) immediately before the amalgamation to purchase the trade or business carried on by the amalgamating company. We understand that the purpose of such condition is to minimise the risk of achieving group loss relief through a horizontal amalgamation (i.e. a group chooses the wholly-owned subsidiary with accumulated tax losses as the amalgamated company to succeed the profitable business of the other wholly-owned subsidiary even though the first mentioned subsidiary has no financial ability to carry on the trade or business succeeded after the amalgamation). However, given that currently there is no equivalent specific anti-avoidance provision preventing a loss company to borrow a loan from its parent to acquire a profitable business, we consider that the financial resources condition which applies in the context of corporate amalgamation is unduly restrictive.

On the other hand, there are various practical issues in applying the "same trade condition" for utilising the pre-amalgamating losses of the amalgamating companies. For example, there are considerable uncertainties on what is regarded as "the same trade or business carried on by the amalgamating company" immediately before the amalgamation. Also, as a result of this condition, the amalgamated company will need to keep track of and account for the profits or losses of the trade or business succeeded from the amalgamating company separately after the amalgamation. Further guidance and examples on the application of the same trade condition from the Inland Revenue Department (IRD) will be welcomed.

(b) Tax treatments where no Schedule 17J election is made

Under section 40AG proposed in the Bill, an amalgamating company in a qualifying amalgamation is treated, for the purpose of the IRO, as having ceased to carry on its trade or business on the day immediately before the date of amalgamation. Section 40AG applies regardless of whether a section 17J election is made to apply the special tax treatments.

Other than the above and the tax treatments for succession of specified assets, the Bill does not specify the tax treatments for other issues arising from a qualifying amalgamation (e.g. utilisation of pre-amalgamating losses and succession of trade debts) in case no election is made under Schedule 17J of the IRO. For the sake of clarity and completeness, we suggest that the Bill also clarify the tax treatments of various items arising from a qualifying amalgamation where no Schedule 17J is made.

This is particularly relevant given that under the court-free amalgamation regime in the CO, the amalgamating company only ceases to exist *as an entity separate from the amalgamated company* (as opposed to being dissolved and ceasing to exist at all) but on the other hand, the shares of the amalgamating company will be cancelled upon the amalgamation. These have given rise to uncertainties as to whether the amalgamating company should be treated as continuing to exist as the same person before and after the amalgamation for tax purposes, which would in turn affect the tax treatments of pre-amalgamating losses and the trade debts succeeded, etc.

(c) Stamp duty implications of corporate amalgamations

The Bill only deals with the tax treatments of corporate amalgamations from a profits tax perspective. There is no Stamp Duty (Amendment) Bill that deals with the stamp duty implications, if any, arising from an amalgamation. While we consider that technically, the succession of any Hong Kong immovable properties or stocks of the amalgamating company by the amalgamated company in an amalgamation is by operation of law and therefore, there is no chargeable instrument involved for

stamp duty purposes and thus no stamp duty is payable, the IRD's confirmation that it takes the same view will be welcomed.

2. Transfer or succession of specified assets without sale

A merger of two foreign companies (e.g. two foreign banks) under the merger law of a foreign country is not a "qualifying amalgamation" as defined in the Bill and as a result, the transfer or succession of assets between the Hong Kong branches of these two foreign companies pursuant to the merger will not qualify for the special tax treatments. On the other hand, based on the current definition of "specified event" in the Bill, the above transfer or succession of assets between the two Hong Kong branches will fall within the scope of specified events.

As proposed in the Bill, for any transfer or succession of "specified asset" without sale in a "specified event", the transferor is deemed to have sold the specified asset and received sale proceeds for an amount equal to the lower of (i) the open market value of the asset and (ii) the total tax deductions allowed or the capital expenditure incurred on the asset (depending on the type of asset transferred). On the other hand, the transferee of the specified asset is deemed to have incurred expenditure on the purchase of the asset of the same amount.

Based on the above, the provisions of deemed disposal and purchase of specified assets in a specified event will apply to a foreign merger but not a qualifying amalgamation in Hong Kong. We consider that from the tax policy perspective, there should not be any differences between the tax treatments of a qualifying amalgamation under the Companies Ordinance in Hong Kong and a merger under the merger law of a foreign country if the latter is of substantially the same nature of the former. We therefore suggest that the government consider allowing qualifying mergers under the merger laws of foreign countries to apply the special tax treatments as well upon election.

3. The revised statutory framework for furnishing of tax returns

We welcome the government's initiative of upgrading the IRD's existing information technology infrastructure and facilitating the electronic filing of profits tax returns by more businesses. As for the proposed revisions to the current statutory framework for furnishing of tax returns to facilitate e-filing of profits tax returns, we have the following comments on the definition of "service provider".

The term "service provider" is defined in the Bill to mean "a person engaged to carry out a taxpayer's obligation under section 51(1) of the IRO". Section 51(1) of the IRO deals with a person's obligation to furnish a property tax, salaries tax or profits tax return within a reasonable time when a written notice is given by an assessor requiring the person to do so. While the government's legislative intent may be to refer to only those who will e-sign and e-file a return for or on behalf of taxpayers through the future e-filing mechanism as "service provider", it is not absolutely clear that it is the case based on the current definition. For example, it is not absolutely clear whether those who only assist the taxpayers in filling in a profits tax return (and preparing a profits tax computation) without signing and submitting the same for the taxpayers will be regarded as a "service provider". Given the new penal provisions against "service providers" proposed in the Bill, it will be helpful to refine the definition to avoid any doubts.

In this regard, we suggest that the government consider modifying the current definition of "service provider" so that it refers to only those who will e-sign and e-file a return for or on behalf of taxpayers.

4. Deduction of foreign taxes for profits tax purposes

Again, we welcome the government's initiative of relaxing the deduction of foreign taxes for profits tax purposes to help address the double taxation issues currently faced by some Hong Kong companies and Hong Kong branches of foreign companies.

In connection with the revised rules, we would like to seek clarification on whether the proposed definition of "specified tax" will cover the foreign taxes paid in both of the following examples:

- an income tax imposed on 100% of the gross amount of income received without deduction of any actual outgoings and expenses

  Example 1:
  A 5% income tax charged on the gross amount of $10,000 of royalty income received, resulting in a foreign tax paid of $500.

- an income tax imposed on the deemed profit amount (based on a deemed profit rate) of income received without deduction of any actual outgoings and expenses

  Example 2:
  A deemed profit rate of 20% of the gross amount of $10,000 of service fee income received and a 25% income tax charged on the deemed profit amount of $2,000, resulting in a foreign tax paid of $500.

We consider that the foreign taxes paid in both Examples 1 and 2 should qualify as "specified tax".

Separately, as the revised rules will only take effect from the year of assessment 2021/22 but not retrospectively, there would be cases where Hong Kong taxpayers may have been exposed to double taxation as a result of the revision of the IRD's assessing practice specified in the revised DIPN 28 in prior years. We urge the IRD to consider taking a pragmatic approach and allowing a deduction of foreign taxes paid by these taxpayers during the transition period where appropriate as an interim measure before the revised rules come into effect.

If you have any questions on our submission, please feel free to contact me (charles.lee@cn.pwc.com) or Anita Tsang (anita.wn.tsang@hk.pwc.com).

Yours sincerely,
For and on behalf of PricewaterhouseCoopers Limited

Charles Lee
PwC South China (including Hong Kong SAR) Tax Leader