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By Email (holdenchow@hotmail.com.hk)

17 May 2021

Hon Holden CHOW
Hon Starry LEE
Room 610, Legislative Council Complex
1 Legislative Council Road
Central, Hong Kong

Dear Hon CHOW and Hon LEE,

Follow-up on Issues Discussed on
Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021

Thank you for your letter dated 12 May 2021 regarding the Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021. The Administration's response is set out at **Annex**.

Yours sincerely,

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

c.c.
Bills Committee on Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021 (Attn: Mr Derek LO)
Commissioner of Inland Revenue (Attn: Mr LEUNG Kin-wa)

Annex

Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021

Commissioner's satisfaction condition

The proposed sections 24(5) and 26(3) of Schedule 17J to the Inland Revenue Ordinance ("IRO") provide that unless the Commissioner of Inland Revenue ("Commissioner") is satisfied that there are good commercial reasons for carrying out the qualifying amalgamation, and avoidance of tax is not the main purpose or one of the main purposes of carrying out the qualifying amalgamation, set-off of pre-amalgamation losses will be disallowed.

2. We understand that there may be various commercial reasons for companies within a group to carry out amalgamation. The Inland Revenue Department ("IRD") would not determine that avoidance of tax is the main purpose of the amalgamation and hence disallow the set-off of pre-amalgamation loss merely because tax benefit would be obtained in qualifying amalgamation. As explained in the reply letter of 3 May 2021 to the Chairman of the Bills Committee, when determining whether the relevant companies have good commercial reasons for carrying out a qualifying amalgamation, the Commissioner will consider all relevant facts and circumstances. If tax benefit is only an incidental consequence of the qualifying amalgamation, the obtaining of tax benefit will not be considered a main purpose. The pre-amalgamation loss would be allowed for set-off subject to the satisfaction of other conditions. Only in the case where the tax benefit is achieved through deliberate arrangement such that avoidance of tax becomes the main purpose or one of the main purposes of the amalgamation that set-off of pre-amalgamation loss would be disallowed.

3. If the Bill is passed, the IRD will issue Departmental Interpretation and Practice Notes setting out examples where set-off of pre-amalgamation can be and cannot be allowed, as well as factors that will be considered.

Same trade test

4. Commercially, an amalgamation should be the combination of two or more companies into a larger single company to carry on the business of each amalgamating company, but not to close the

amalgamating company's business and utilize the amalgamating company's pre-amalgamation loss to set off against the assessable profits of other company within the group with a view to reducing tax liability. Therefore, to avoid the use of qualifying amalgamation as a means for tax avoidance, we consider that it is necessary to enact the same trade test. As a matter of fact, Singapore also applies the same trade test in similar situation to prevent tax abuse.

5. According to the judgment of Walton J in *Rolls-Royce Motors Ltd v Bamford* [1976] STC 162, whether two businesses are the same is a matter of fact. Thus, in determining whether two companies comply with the same trade test, the IRD must consider all facts, such as the companies' business model, operating style, and registered brand, etc.. In respect of the example mentioned in your letter concerning catering businesses, the IRD would not regard the businesses operated by two companies as different merely because of differences in their cuisines; it would consider other factors such as their business models before reaching a conclusion.

Definition of "service provider"

6. While the proposed section 51AAD(8) defines "service provider" to mean a person engaged to carry out a taxpayer's obligation under section 51(1) of the IRO, a taxpayer's obligation under section 51(1) is 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, as the obligation imposed on a taxpayer by section 51(1) does not concern how and by whom such preparatory work is to be performed, such preparatory work is not a taxpayer's obligation under section 51(1).

7. To avoid doubt, the Government would like to make it clear that only the person who furnishes the tax return on behalf of the taxpayer, i.e. the one signing the return, irrespective of the mode in which a return is furnished (i.e. paper, electronic or mixed), will be treated as the service provider. In other words, if a person is 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., that person is not a service provider for the purpose of the proposed section 51AAD(8) and the penalty provisions under section 80K is not applicable, unless the person also furnishes the tax return on behalf of the taxpayer.