

立法會
Legislative Council

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**Paper for the House Committee Meeting
on 26 March 2021**

**Legal Service Division Report on
Inland Revenue (Amendment) (Miscellaneous Provisions) Bill 2021**

I. SUMMARY

- 1. The Bill**

The Bill seeks to amend the Inland Revenue Ordinance (Cap. 112) to:

 - (a) provide for tax treatment in relation to the amalgamation of companies under Division 3 of Part 13 of the Companies Ordinance (Cap. 622) and the transfer or succession of certain capital assets;
 - (b) enhance the mechanism for furnishing tax returns required under Cap. 112;
 - (c) enhance the current provisions for deduction of foreign tax paid in respect of certain income, profits or gains; and
 - (d) provide for related matters.

- 2. Public Consultation**

According to the Administration, the relevant industry representatives were consulted on the legislative proposals through the Joint Liaison Committee on Taxation. Members of the Committee generally welcomed the proposals and supported broadening the scope of foreign tax deduction under Cap. 112.

- 3. Consultation with LegCo Panel**

The Panel on Financial Affairs was consulted on 4 January 2021. Members had no objection to the introduction of the Bill into the Legislative Council.

- 4. Conclusion**

The Legal Service Division is scrutinizing the legal and drafting aspects of the Bill. Since the Bill seeks to codify the Inland Revenue Department's existing administrative practice in making assessment on qualifying amalgamation cases and to enhance the statutory frameworks for furnishing tax returns and foreign tax deduction, Members may wish to form a Bills Committee to study the Bill in detail.

II. REPORT

The date of First Reading of the Bill is 24 March 2021. Members may refer to the Legislative Council ("LegCo") Brief (File Ref.: TsyB R 183/700-6/12/0 (C)) issued by the Financial Services and the Treasury Bureau in March 2021 for further details.

Object of the Bill

2. The Bill seeks to amend the Inland Revenue Ordinance (Cap. 112) to:
 - (a) provide for tax treatment in relation to the amalgamation of companies under Division 3 of Part 13 of the Companies Ordinance (Cap. 622) and the transfer or succession of certain capital assets;
 - (b) enhance the mechanism for furnishing tax returns required under Cap. 112;
 - (c) enhance the current provisions for deduction of foreign tax paid in respect of certain income, profits or gains; and
 - (d) provide for related matters.

Background

3. Division 3 of Part 13 of Cap. 622, which came into effect on 3 March 2014, provides for a set of court-free amalgamation procedures for wholly-owned intra-group companies incorporated in Hong Kong and limited by shares to amalgamate and continue as one company ("qualifying amalgamation"). At present, the Inland Revenue Department ("IRD") makes assessment on qualifying amalgamation cases in accordance with an assessment practice published on IRD's website.¹ According to paragraph 5 of the LegCo Brief, while the interim administrative assessment practice has been implemented smoothly since its publication, it is necessary to introduce legislative amendments to codify the practice into Cap. 112 for clarity and certainty. The Bill is thus introduced into LegCo to provide for tax treatment in relation to qualifying amalgamations and the transfer or succession of certain capital assets. It also seeks to enhance the statutory frameworks for furnishing tax returns and foreign tax deduction.

Provisions of the Bill

4. The Bill consists of six Parts. The key provisions of the Bill are summarized in the ensuing paragraphs.

¹ See https://www.ird.gov.hk/eng/tax/bus_cfa.htm (accessed on 23 March 2021).

Proposed amendments relating to qualifying amalgamations (Part 2 of the Bill)

Tax treatment for qualifying amalgamations (proposed new Part 6C and Schedule 17J)

5. Clause 3 of the Bill proposes to add a new Part 6C (i.e. new sections 40AE to 40AM) to Cap. 112 to provide for tax treatment in relation to qualifying amalgamations² that take effect on or after the commencement date of the enacted Ordinance ("Amendment Ordinance") upon passage of the Bill.

6. Clause 4 of the Bill proposes to add a new Schedule 17J to Cap. 112 to provide for special tax treatment for the amalgamating companies (i.e. the companies whose shares are cancelled on the amalgamation) and amalgamated company (i.e. the company whose shares are not cancelled on the amalgamation) in a qualifying amalgamation for the purpose of calculating profits tax payable by those companies as a result of the amalgamation. Under the proposed new section 40AM, the amalgamated company could elect irrevocably for the proposed new Schedule 17J to apply to the amalgamated company and each amalgamating company in the qualifying amalgamation. Special tax treatment under the proposed new Schedule 17J would include, among others, the following:

- (a) if the amalgamated company succeeds to any asset (excluding trading stock) of an amalgamating company, the amalgamated company would be treated as if it were the continuation of and the same person as the amalgamating company and be allowed to claim deductions and annual allowance in respect of the asset (section 3 of the proposed new Schedule 17J); and
- (b) if the amalgamated company succeeds to any trading stock of a trade or business carried on by an amalgamating company in Hong Kong on the amalgamation and the amalgamated company uses the trading stock as its trading stock for carrying on a trade or business in Hong Kong from the date of amalgamation, the trading stock would be accounted for in the financial account of the amalgamated company at a value equal to the carrying amount of the trading stock of the amalgamating company immediately before the date of amalgamation (section 6 of the proposed new Schedule 17J).

Proposed amendments relating to specified assets (Part 3 of the Bill)

7. Currently, except for limited circumstances³, there is no provision under Cap. 112 to deal with the transfer of assets without sale, such as in the case of a qualifying amalgamation. In the absence of specific provisions, the capital expenditures which have been allowed deductions or allowance cannot be clawed back in assessing profits tax.

² "Qualifying amalgamation" is proposed to be defined in the new section 40AE to mean an amalgamation of companies under section 680 or 681 of Cap. 622 and for which a certificate of amalgamation has been issued by the Registrar of Companies under section 684(3) of Cap. 622.

³ For example, under section 16J(5B) and (5C) of Cap. 112 which deals with cessation of business without sale of an environment-friendly vehicle, the Commissioner of Inland Revenue is empowered to use the open market value of the asset at the time of cessation as the deemed proceeds of sale.

8. Clause 5 of the Bill proposes to add a new Part 6D (i.e. new sections 40AN to 40AU) to Cap. 112 to provide for tax treatment in relation to the transfer of specified assets without sale or the succession to specified assets through a qualifying amalgamation (in relation to which no election has been made under the proposed new section 40AM as stated above) that occurs on or after the commencement date of the Amendment Ordinance.

9. In gist, "specified asset" is proposed to be defined in the new section 40AO to include certain things (e.g. machinery or plant, commercial or industrial building or structure) or rights (e.g. patent rights or intellectual property rights) for which a deduction for the relevant capital expenditure or an annual allowance has been allowed or made to the person who incurred the capital expenditure.

10. Under the proposed new sections 40AS to 40AU:

- (a) the transfer of specified asset without sale or the succession to specified asset through a qualifying amalgamation would be deemed as a sale; and
- (b) for the purposes of computing the chargeable profits, the transferor would be deemed to have received proceeds of sale of the specified asset at the lower of the open market value of the asset and the capital expenditure (or the total amount of deductions allowed for the expenditure) incurred by the person, and the transferee would be deemed to have incurred expenditure on the purchase of the specified asset in the same amount.

Proposed amendments relating to furnishing of tax returns (Part 4 of the Bill)

Furnishing tax returns

11. Clauses 6 to 8 of the Bill mainly seek to enhance the mechanism for furnishing tax returns required under Cap. 112 by:

- (a) amending section 51AA of Cap. 112 to provide for the alternative way of mixed filing (i.e. using a printed paper form, or furnishing the relevant particulars in a form other than paper form as specified by the Board of Inland Revenue (e.g. e-filing)) (clause 7);
- (b) adding a new section 51AAB to empower the Commissioner of Inland Revenue, by notice published in the Gazette, to require any class or description of persons to furnish a return in the form of an electronic record (clause 8);⁴ and
- (c) adding a new section 51AAD to provide for the engagement of service providers for furnishing returns for or on behalf of the taxpayers (clause 8).

⁴ Such notice would be subsidiary legislation subject to scrutiny of LegCo pursuant to the negative vetting procedure.

Legal obligations and liabilities of taxpayers and service providers

12. Sections 51A, 51B, 80 and 82A of Cap. 112 provide for the legal obligations and liabilities of a taxpayer to make a return and supply information required under Cap. 112. Clauses 9 to 11 and 13 of the Bill propose to amend those sections to the effect that engaging a service provider under the proposed new section 51AAD(1) would not in itself constitute a reasonable excuse for making an incorrect return or supplying false information that has the effect of understating the taxpayer's income or profits chargeable to tax.

13. Clause 12 of the Bill proposes to add new sections 80K to 80N to Cap. 112 to provide for the offences of service provider in relation to furnishing of returns under section 51(1) of Cap. 112. Under the proposed new section 80K, the service provider would commit an offence, punishable by a fine at level 3 (i.e. \$10,000), if the service provider, without reasonable excuse:

- (a) fails to furnish the return for or on behalf of the taxpayer (proposed new section 80K(2));
- (b) fails to obtain or retain a confirmation from the taxpayer stating that the information contained in the return is correct and complete to the best of the taxpayer's knowledge and belief (proposed new section 80K(3)); or
- (c) furnishes the return for or on behalf of the taxpayer but not in accordance with the information provided, or instructions given, by the taxpayer to the service provider, and the return so furnished is incorrect in a material particular (proposed new section 80K(4)).

14. The proposed new section 80L seeks to empower the court to order a service provider who commits an offence under the proposed new section 80K(2) or (3) to do the act that the service provider has failed to do. It would be an offence punishable by a fine at level 6 (i.e. \$100,000) if the service provider fails to comply with the court order.

Proposed amendments relating to deduction of foreign tax (Part 5 of the Bill)

15. Currently, under section 16(1)(c) of Cap. 112, in ascertaining the profits in respect of which a person is chargeable to tax in Hong Kong, limited relief is provided by way of deduction for foreign tax paid to address double taxation arising from charging profits tax on certain specified interest, gains and profits. However, pursuant to section 16(2J) of Cap. 112, such deduction does not apply to foreign tax paid in a territory with a double taxation agreement in force with Hong Kong ("DTA territory").

16. Clauses 14 and 15 of the Bill propose to amend sections 16 and 50AA of Cap. 112 to (a) extend the deduction available for foreign tax paid in respect of specified interest, gains and profits by Hong Kong resident persons and non-Hong Kong resident persons in non-DTA territories to non-Hong Kong resident persons who paid such tax in DTA territories, and (b) provide for the extent of foreign tax deduction allowable to non-Hong Kong resident persons. The Bill proposes that the amendments relating to deduction of foreign tax would apply only in relation to a year of assessment beginning on or after 1 April 2021.

Other related amendments (Part 6 of the Bill)

17. The Bill also proposes certain related amendments, including provisions relating to balancing allowances and charges under certain circumstances (clauses 16 and 17).

Commencement

18. The Bill, if passed, would come into operation on the day on which the Amendment Ordinance is published in the Gazette.

Public Consultation

19. According to paragraph 24 of the LegCo Brief, the Administration consulted relevant industry representatives on the legislative proposals through the Joint Liaison Committee on Taxation. Members of the Committee generally welcomed the proposals and supported broadening the scope of foreign tax deduction under Cap. 112. According to the Administration, the industry's feedback has been taken into account when preparing the Bill.

Consultation with LegCo Panel

20. As advised by the Clerk to the Panel on Financial Affairs, on 4 January 2021, the Administration briefed the Panel on the proposals to amend Cap. 112. Members had no objection to the introduction of the Bill into LegCo and discussed various issues, including the benefits to be brought by the proposals, the Administration's measures to prevent possible abuses of the proposed tax treatments and to promote the use of e-filing.

Conclusion

21. The Legal Service Division is scrutinizing the legal and drafting aspects of the Bill. Since the Bill seeks to codify IRD's existing administrative practice in making assessment on qualifying amalgamation cases and to enhance the statutory frameworks for furnishing tax returns and foreign tax deduction, Members may wish to form a Bills Committee to study the Bill in detail.

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